Below are all non-confidential responses to the FCA's 'Payment Systems Regulation: Call for Inputs' (5 March 2014)

PSR – Call for inputs

The responses below are from Ian Brown, Abaci Payments Ltd. Abaci Payments is a specialist consulting firm focussed on card payments primarily. The responses below should be read in that light and primarily relate to the card payments space rather than the entire spectrum of industry payments.

Q1 – Do you have any views on which payments systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

- The list of systems seems complete at the present time. There would, however, be benefit in complete clarity in the PSRs objectives and what/whom it intends to regulate for what purpose. For example, will the PSR only regulate these systems or will it also regulate the players in the market who use these systems.
- Similarly, there should be clarity over how the PSRs role relate to and integrates with the various European and global regulations and standards e.g. SEPA, PCI DSS etc.

Q2 – Where do you believe competition is effective and ineffective within UK payments systems?

- There is a general perception that the banks operate a bank dominated infrastructure which has a limited exposure to completion. To an extent, there appears to be some truth in this. Payments is a challenging area in that it is a natural monopoly business which is transaction volume based and volume brings economies of scale and monopoly advantages.
- The PSR should, I believe, recognise this and organise its activities to support the industry in achieving scale advantages, and hence cost effective processing, whilst ensuring that these scale advantages are made available on an open market, fair, basis to all players (easier said than done).

Q3 - At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

- Cost benefits (and some quality benefits) are most easily driven at levels 2 and 3
- Innovation will almost certainly come from the higher levels e.g. 7, 8

Q4 – What are the main factors impeding more effective competition at each level?

- Monopoly incumbents and high barriers to entry

- Price transparency

Q5 – What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

- To be somewhat provocative, in an industry which demonstrates scale benefits and significant barriers to entry, I am not sure "collaboration" is a good thing at all.
- There should be a focus on:
    - Lowering barriers to entry – where arguably a strong promotion of industry standards would be a key contributor
    - Ensuring equitable access to scale benefits – which could be achieved by ensuring the creation of one or more (probably at least two) scale advantaged utilities which provide open access to all

Q6 – Do you think the current ownership structures create problems? If so, please explain your concerns with the current structure.

- The current ownership structures (of infrastructure providers) are dominated by the banks and from, admittedly an outsiders perspective, there is a natural tendency for these organisations to serve the banks in priority to other parties e.g. consumers or non-traditional competitors

Q7 – How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternative model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

- Consider changing it to make it independent of the banks
- Ensure access rules are independently monitored and regulated
- Ensure pricing is independently monitored/regulated
- Ensure that the steering bodies which control the future development plans of these infrastructure providers are representative of all stakeholders

Q8 – Do you have any concerns about the current governance of UK payment systems?

- See previous comments

Q9 – What do you believe is the appropriate governance structure for UK payment systems?

- It would make sense to define a set of clear, key objectives for the PSR and then agree what controls/processes are needed to achieve these objectives first. The governance structure should then be developed to meet these objectives. At the present time, the objectives and priorities for the PSR are not clearly enough defined to make the best governance structure clear.

Q10 – How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or restraints you have in this regard.

- Abaci Payments is a consulting organisation and as such does not have direct or indirect access.

Q11 – For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

- See above

Q12 – Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

- See above

Q13 – If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

- See above

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?

- See above

Q15 – What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

- From a cards perspective the "honour all cards" rule operated by the major schemes is hard to justify from a competitive perspective when the charges for accepting some cards e.g. commercial cards is significantly higher than others.

Q16 – Do you have any other comments regarding access?

Q17 – What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payment systems?

- Access to infrastructure should be open and openly priced
- Whether there is justification in ensuring there is always at least two suppliers of any infrastructure service would require more detailed study. In the short term at least, the answer is most likely no but even then consideration should be given to ensuring dual supply for any future infrastructure
- It may be worth considering the lessons from Network Rail, the National Grid and even BT (and its exchange unbundling) before taking decisions in this area

Q18 – What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

- There would be a strong benefit, we believe, in the PSR becoming a strong advocate and promoter of industry standards and in alignment with EU (or broader) initiatives where appropriate
- At the same time, this activity should be considered as a long term objective. It is unlikely that promoting the rapid adoption of new standards could be cost justified in the short term given the level of investment in current infrastructure and the high cost of changing it.

Q20 – Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

- The background to this question is not clear. The market should provide incentives to innovate based on where customers are willing to pay more for innovative services. The proposed reduction in interchange will provide a challenge to the card schemes but arguably will promote innovation not prevent it.
- It is clear the PSR should avoid stifling that market but this should be achieved if the PSR focusses on open equitable access without undue regulation except where it is justified for this reason or to ensure the stability of the market.
- It is not clear that the PSR should concern itself overly with innovation, in the sense of trying to promote it. It should leave this responsibility to the market and simply ensure its regulation does not prevent it.

Q21 – Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

- The main challenge is that anything new typically does not fit well with the current arrangements whether these be process based or fee based (for example, mobile payment using a card attracts higher card not present fees rather than card present fees which is probably not an accurate reflection of the risk associated with the transaction).
- It is hard to see what can be done about this as anything new is likely to present these sorts of challenges. The PSR could of course monitor the market for these sorts of obstacles but for it to have any effect, the PSR would then need to impose rulings on infrastructure providers to require them to address these obstacles. This would not necessarily be appropriate or easy to justify. If the infrastructure providers were regulated utilities it might, only might, be possible to define rules to allow this to work effectively.

Q22 – What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

- As mentioned earlier, the PSR should ensure open equitable access to utility services. Apart from this, I believe the PSR should leave innovation to the market

Q23 – What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

- I think that almost by definition, innovation cannot be driven collectively.
- It would be appropriate for the PSR to drive the use of standards and to adjudicate when a party or third parties made a justified claim that another party (most likely an infrastructure provider) was providing an artificial barrier to innovation.

Q24 – Do you have any other comments or concerns you would like to highlight?

- I would emphasise the importance of the PSR having a very clear set of objectives and then set itself up to achieve these objectives and nothing else.
- For example, if the objective of the PSR was the stability of the market it would naturally focus on the largest players. If on the other hand, it was to focus on consumer protection, it would probably need to focus more on the smaller players as these are more likely to have immature processes, weak security etc etc. If its objectives are clear it will be easier for all stakeholders to understand what is required and what needs to be done.

Q25 – What, if any, are the significant benefits you see regulation bringing?

- This is not clear. Hopefully this will come out of the current consultations

Q26 – What, if any, are the risks arising from regulation of payment systems?

- The key risk is of adding more administrative overhead without a commensurate addition of value. At this stage, a minimalist approach to regulation would seem preferable.

Q27 – How do you think regulation might affect your business and your participation in UK payment systems?

- As a consultant it will simply add an additional consideration to all the others required when advising clients

Payment Systems Regulation – Response from ACI Worldwide

About ACI

ACI contributed to a response to the previous HM Treasury Consultations through our membership of Vendorcom, and as an Associate Member of the Payments Council we input to their response through their Business Forum. However, as a major UK payments software vendor, on this occasion we have decided to respond directly to this consultation so you are clearly aware of our views. We would also be delighted to participate in the Summer and Autumn sessions you highlighted at last week's meeting.

ACI solutions are positioned at the heart of the growing electronic payments market. Our software is highly differentiated in large-scale, complex technology environments and has been proven in the world's most demanding environments. We license our solutions based on product features, transaction volume and term, and also sell complementary services.

ACI combines a global perspective with local presence to tailor solutions for each customer. We have a UK presence in both Watford and Leeds. Our proven products, domain expertise and nearly 40 years of experience have earned us a position as trusted provider of gold standard payments solutions.

With more than 4,200 employees worldwide and offices in principal cities around the globe, ACI now has one of the most diverse and robust product portfolios in the industry, with application software spanning the length of the payments value chain.

Today's ACI builds on nearly 40 years of experience of delivering systems to process payments for banks, processors, payment schemes and retailers around the world. ACI's reputation is based upon the success of products that have consistently provided stability, scalability and reliability. Customers have come to trust ACI because of these products and because of ACI's expertise and dedication.

Today, ACI has more than 5,000 customers including 21 of the top 25 banks and 14 of the leading retailers globally. ACI also has more than 170 processors as customers including leading global processors such as Euronet, First Data, Global Payments and Worldpay.

General Comments

Whilst ACI will respond fully to the specific questions asked in this document, we would like to begin by making a number of key comments about the overall document and the establishment of the new Payments System Regulator (PSR).

- ACI believe there is still a need for substantive evidence as to the requirement for another regulator in payments. This has yet to be provided by the Treasury or any other Government department. This was our premise when we contributed to the Vendorcom and Payments Council's responses to the previous consultation exercise in 2013. Rather we see the use of terms such as 'many people feel…' and 'it has been expressed that…', which at best reflect hearsay and opinion of those in Government rather than the Payment Industry's views. It appears that the need for regulation is being tied closely to the failures of the UK banks and the Payments Council's handling of the proposed withdrawal of cheques in 2018 (subsequently amended and now the subject of a consultation on the use of image to make processing more efficient to which ACI has also responded). This linkage is at best unhelpful and confusing and in our view actually considerably flawed. Whilst, we fully support the PSR's objectives of 'promoting effective competition', promoting '…the development of, and innovation in, payment systems…' and ensuring '…that payment systems are operated… in the interest of service-users…' to encourage payment inclusion we don't feel that, at any stage, substantive evidence has been produced that there are currently failures in these areas. As a member of the Payments Council's Business Forum ACI has the opportunity to input to the discussions that must necessarily occur in the UK Payments Industry for certain projects and the Regulator must be aware of the need for and should encourage, collaboration as well as creating regulation.

- The main role of the new Regulator once we have more substantive evidence of the need for it should be to identify and remove barriers to competition, and overly burdensome regulation. To be an effective organisation it needs a clear statement of its objectives.

- The use of the term 'UK payment systems' is confusing because many of the payment systems in operation in the UK are not restricted to UK borders but global with the purchase of goods and services from outside the UK using a variety of different payment types. The payments industry is a global industry and many of the providers who operate within the UK do so as part of much wider pan-European and global businesses. Indeed, ACI EMEA who are crafting this response are part of a US company headquartered in Naples Florida and with operations across the globe. Our view is that any Payment Systems Regulation must operate with constant reference to the global nature of the payments industry and in particular must work closely with Europe and the established International Payment Schemes (Visa and MasterCard and American Express), but also evolving Schemes e.g. China Union Pay to ensure that there is no mismatch in UK regulation which could lead to the UK being viewed less favourably or being disadvantaged compared to other geographies.

- Interoperability is key such that payments need to work anywhere in the world.

- What must be avoided is a situation where organisations seek to relocate out of UK jurisdiction because of the legislative overhead, which would not be good for competition, innovation or service-users from a UK perspective.
- In reviewing the various payment systems to be governed by the PSR, a 'one size fits all' approach must be avoided. For example, whilst CHAPS, Bacs, ACH and Faster Payments can be seen as largely domestic systems (today) and as such suitable for domestic regulation, this is not the case of the three and four party card schemes and many of the emerging, non-card based merchant payment systems . These operate on a global basis and, therefore, are already subject to significant global regulation, such as the PSD and proposed PSD2, which already provide rules relating to access to the schemes due to the coverage of the Directive and are applicable in the UK even though they do not actually utilise the euro as a currency. ACI are concerned that the PSD/PSD2 are largely excluded from the remit of the PSR, which, given their impact upon the three and four party card schemes (and their participants/associated service providers) would appear to leave potential for confusion and misunderstanding in the UK market. An early example of this is the definition of 'payment service provider', which does not correspond with that included in the PSD/PSD2.
- As a major software provider in Europe, ACI would like clarification on whether the PSR will have responsibility for the implementation of the PSD2 and other SEPA driven European legislation within the UK? There are significant pieces of legislation regarding interchange and fees within Europe which must be taken into account in any future UK regulation and which the UK must seek to influence to a greater capability than has been evident to date so UK based organisations are not disadvantaged in either the European of Global markets. The PSR must ensure that it is working with the regulators in other jurisdictions to ensure that any regulation it develops does not have the effect of making the UK a less attractive market in which to do business. Should this be the case, this could lead to organisations avoiding designation in the UK by basing themselves in another European jurisdiction and using the provision for 'passporting' within the PSD/PSDII to provide services into the UK market. What role, if any, will the PSR will have in representing the interests of UK payment systems (including the three and four party card schemes) at a European level as Brussels seeks to implement further regulation.

- As mobile payments will be a major development in the near future, how will the PSR work with regulators in e.g. the TelComs industry to ensure new and changes to existing legislation in these currently diverse industries allows the market to develop fully and does not disadvantage payments providers by having them more heavily regulated than the Mobile Network Operators (MNO's) with regard to mobile payments?

- ACI believe that ensuring the security of payment systems should also be an objective of the PSR. As a direct provider of risk software for banks and building societies in the UK and also a partnership with Experian, it is of huge concern to us that there is no reference to the security of the system in this document.

- What influence will the PSR have with other regulating bodies responsible for payments in the UK? The Treasury, the Office of Fair Trading (OFT) and the Bank of England should be agreeing the boundaries of responsibility with regard to their oversight presence today with the PSR so providers and Financial Institutions know clearly who is responsible for each area of payments. The PSR must not operate in isolation from these other regulators and should also attend the Payments Council's Business Forum to hear the views of major organisations (including ACI) operating in the UK Payments market.
- The PSR should also liaise with the Financial Action Task Force (FATF) who provide guidance and recommendations to help prevent money laundering and terrorist financing. FATF also undertake mutual evaluations of individual countries jurisdictions to encourage the adoption of recommendations. They provide a more uniform and global approach to the payment system regulation, as a Universal body that provides guidance and recommendations. Their aim is to provide polices and encourage cooperation and adherence to recommendations through mutual evaluations between different jurisdictions.
- If creating a level playing field in order to encourage competition and innovation is at the heart of the PSR, ACI's concern is that, at present, we believe the risk is that things will actually be less fair, with requirements around designation meaning that new, unproven entrants to the market will not be subject to the same level of regulation as existing, proven providers. This has been an effect of legislation emerging from the European Commission and European Central Bank. A view that has been expressed at a number of payments industry meetings is that part of the remit of the regulator appears to be to reduce the position of the incumbent players and whilst we applaud any efforts to improve competition and increase service-user choice, care should be taken not to undermine the systems and organisations already in operation in the UK. The new Regulator should also not stifle the UK recovery from recession by further legislation that impacts business cases for new developments.

Question Responses

Q1 – Do you have any views on which payments systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

- The integrity of the payments systems is essential for consumer and business confidence
- There needs to be clear definition of what is and what is not included in the PSR's remit. For example do they only regulate the traditional four party model of the International Card Schemes or does the three party model also come under their remit? Are Corporate Cards in or out of scope? Does it have a SEPA focus? ? Is cash included? Is underground banking and payment systems included such as Hawala banking? Or is the focus only on electronic payment types.
- There needs to be a considerable level of detail around how designation is going to be managed: Who will make the decisions regarding the UK organisations mentioned in the Call for Inputs document as currently the Treasury, the Office of Fair Trading (OFT) and Bank of England also have regulatory roles? What criteria will be used (e.g. consumer protection, protection of the integrity of the payment systems, interpretation of European Legislation, competition - who will judge whether a SEPA requirement should be implemented in the same way in the UK as in a country issuing the euro? It's essential that a clear framework is set, which applies to everyone, but acknowledges different stages of development and grows with the organisations. For example, with PCI, ACI see different levels of requirement dependent upon the size of an organisation; we would suggest reviewing whether similar criteria should be applied in other areas of payments. Providing such a framework, with all players requiring a level of designation, also protects new entrants to the market from establishing a business, which then grows and has to be reengineered at a point in time in order to achieve designation, so it should encourage them to work with the designation criteria from day one.
- There is a very strong risk in not applying designation to smaller, less systemic payment systems/services – for example, mobile payments operators. These organisations may lack experience and make mistakes, causing vulnerabilities in existing payment systems, etc through insufficient testing or risk controls. Not designating smaller players may also play to organisations remaining small, niche players and thus not delivering the level of competition that the regulator is seeking to create.
    - Returning to the earlier theme of integrating with SEPA, will the PSR be responsible for undertaking how the passporting provisions of the PSD2 may enable organisations to get around designation.

Q2 – Where do you believe competition is effective and ineffective within UK payments systems?

- ACI has the concern that National standards such as the APACs standards in the UK, provide some difficulty for new market entrants, especially given the time taken for certifications/accreditation. Organisations from other European markets are often used working to very different standards. A more universal approach to standard setting, such as that advocated by SEPA would allow for greater competition.
- ACI also believes that the vertical expansion that is currently being seen in the market may lead to lack of effective competition. For example, where the schemes are buying payment processors and taking shares in new providers (such as iZettle, Square etc) but then imposing some restrictions because of the interest of the other scheme (this was initially the case for Visa and iZettle because MasterCard had a stake in it). Areas such as this should be reviewed by the divestment board within the PSR to ensure competition remains effective.
- The payments systems operators are not solely responsible for ineffective competition around payments, for example in the merchant payments space, the ISOs have a significant part to play in whether competition can be effective or ineffective and its level of security. Will the PSR have the power to regulate wider players in the payments space like Retailers (e.g. the Supermarkets and other retailers with banking licences or also Retailers that issue wallets etc like Starbucks, Mobile Network Operators, Google, Paypal, Amazon, Apple etc?
- VocaLink are developing a number of new pieces of payments infrastructure e.g. Zapp and Paym and they are increasingly obtaining projects in non-UK markets for replica Faster Payments systems. Will the PSR being reviewing that payments development is limited to only a few players like VocaLink and that they are resourced sufficiently to ensure UK developments do not have extended lead times because of their foreign commitments?
- There is a need to review existing legislation such as the Consumer Credit Act 1975 (revised 2005) to ensure that it is still fit for purpose and is not having a negative impact on the ability for new players to enter the market because of the significant burden of risk that it places on the payment systems operators.
- There need to be a concerted effort to move away from batch processing to single message payments. This is restricting the reporting of a customer's available balance. Shadow balancing is now a common practice. But payment processing needs to move towards becoming a more real time process and which includes the update of the customer's available balance-removing the necessity of overnight batch processing. There is a huge

reliance on overnight processing. Real time, intra-day posting and settlement need careful scrutiny not just the payment types themselves.

- Competition could be driven through transparency in respect of payment plans. How much it costs to process a particular payment type by a Bank. Comparative analysis or benchmarks (named or unnamed) of banks pricing should be considered in the same way the consumer can compare the purchase of a can of beans between the supermarkets.

- There is a general problem with payments where the card details are stored securely in the cloud. If the card details are securely stored (and the cardholder has been verified) then the merchant service charge on these transactions should be lower than other CNP transactions. These types of transactions are the basis for many wallets and 'alternative' payments. High Merchant Service Charges (MSC) which should only be associated with high risk will stifle innovation in payments, and eventually lead to banks being excluded from new payment methods.

- The development of applications such as Paym, Pingit, and Zapp etc. in the mobile space provides the opportunity for faster payments to compete with the three and four party card schemes in the merchant payments space. This evolution of faster payments as a competitor to cards has taken time because of the necessity firstly for the infrastructure to achieve realistic transaction limits and to achieve a sufficient level of customer adoption and secondly for the smartphone market to reach an appropriate level of maturity as the development of Near Field Communication (NFC) stalled because of prolonged negotiation between the banks and Mobile Network Operators (MNO's) over the secure element to be used in the phone. ACI, as a provider of mobile solutions for payments would like clear direction on the role of the PSR in this developing market area vs., the existing TelCom Regulators.

Q3 - At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

- It depends what 'levels' are being referred to here. Please clarify. If these are the 'levels' in the diagram on page 7 of the Call for Inputs ACI believe this is not truly representative of the complexity of the marketplace. However, we think competition or competitive pricing at Level 2 and 3 will help the market.

- Innovation is currently coming from both within and without the payments systems, with MNOs, tech start-ups, opportunities created by Bluetooth, Beacon, wifi, NFC, Payment Schemes, retailers and infrastructure providers all driving change.

- Ultimately competition should benefit the consumer – but we have seen examples in other markets e.g. Australia where an interchange limit was created by the Regulator and the savings were not passed on by Retailers to the consumer, In fact the consumer lost out as loyalty benefits were reduced in value and fees were increased. ACI are assuming the PSR will have reviewed these developments and construct any legislation accordingly after appraising the arguments of the banks and acquirers and the British Retail Consortium (BRC).
- ACI believe there is a need to measure the internal unit cost of payment processing by Banks. There may be differentiation in costs due to technology, processing plans and infrastructure and if the PSR have documented payment plans they have the platform to provide comparative analysis. Board members, consumers, shareholders are going to quickly take notice if they have the higher unit cost against their peers.

Q4 – What are the main factors impeding more effective competition at each level?

- Level 2 and level 3 are effectively monopolies, but this might be necessary to achieve UK wide interoperability. This is a difficult one, if you had multiple providers at these levels you aid competition but then it is harder to get UK wide interoperable systems. Perhaps the payments industry could learn from the UK energy industry or TelCos/broadband, where common infrastructure is used in a competitive way.
- We must ensure that where action is being taken to secure the infrastructure, there is transparency such that these actions are not regarded as anti-competitive.
- Existing regulations impede both competition and innovation as the costs in terms of time and money to bring new solutions to market are prohibitive. As a result, much of today's innovation is taking place outside of the regulations by smaller companies unaware of the strict risk and testing requirements of payments leading them to deliver solutions outside of the current rules.
- Some recent European regulation e.g. PSD2 is creating a mentality that cheapest is best (e.g. by demonising the interchange fees) when it should be focusing on the delivery of value added services. That is why the PSR must provide a more effective voice in Europe either directly or through more overt sponsorship of e.g. The UK Cards Association who have demonstrated the impact of changes to interchange rates as being not beneficial to competition in the UK market.

- Where does the PSR view that competition is being impeded at the moment? As Visa Debit is the predominant debit player at present we need clarification as to whether the PSR will be supporting the European Commission view that e.g. a third debit scheme is required alongside the International Schemes?

- The continued use of cash with its excessive costs is still a competition delimiter.

- The plans of the GAFA (Google, Amazon, Facebook and Amazon) players are as yet unclear but their impact could be very disruptive as they have access to huge customer bases. ACI see part of the PSR's role is to ensure these organisations do not make UK Payment systems unstable and offer similar levels of service in key business areas like disputes. It will complicate things significantly for the customers if they offer completely different solutions and or payment networks.

- Reliance on batch and overnight processing is a continued delimiter to payments development. Updating of available balance in real time or near real time is required.

- Inability and restrictions within the existing payment systems to help facilitate person to person payments or direct payments continue to limit payments development

- Regulation and compliance. This places burdens on banks and restricts the ability to innovate. New entrants do not have the same constraints. They are faster and more agile.

- Impact of a bank collapse also need to be assessed. Transaction has been processed by bank A, but settlement has not yet taken place between bank A and Bank b. Bank b collapses before settlement. Does bank A unwind the transaction. How does this work in practice?

- ACI would also like to highlight the ineffective and costly security burden that the card issuers are imposing on retailers (via the card schemes, and the acquiring banks). PCI regulations are becoming increasingly costly (millions of Pounds each year are spent by each of the large retailers in order to comply with PCI-DSS), and it is demonstrably ineffective - in the case of Target in the US for example - who were PCI compliant and yet were still breached. The focus should shift to removing the treasure from the system - currently the 6 "secret" of the card number need to be encrypted and securely handled throughout the payment chain, whereas they are visible to the naked eye as they are embossed on the front of the card (the first 6 and the last 4 are shown on the receipt, leaving the remaining 6 digits of the 16-digit card number as a secret. Issuers should not rely on these digits remaining secret, instead they should more appropriate security checks such requiring the CVV, out-of-band authorisation for untrusted merchants, etc.I ACI believe that if the regulator forced issuers to offer alternative approaches to retailers it would open up the market and reduce costs to consumers. For example if all cards issued in the UK contained a card number in the chip which is different to the card number on the magstripe or embossed on the front, and if a retailer opted to accept only chip-based transactions in store, then this could reduce or eliminate the need for the retailer to comply with PCI-DSS (the retailer may choose to keep some PCI-DSS compliant terminals, or perhaps rent a small number of PDQ terminals, to take care of exceptional cases such as technical fallback, or tourists from abroad).

Q5 – What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

- We have seen significant success and benefit to all stakeholders where the payments industry has worked together i.e. Banks, Retailers and Vendors plus Regulators. For example, the Chip & PIN rollout in the UK was a strongly collaborative effort and continues to be held up as a shining example of how working together delivers benefit for all. By contrast, the rollout of contactless payments in the UK was seen as a purely competitive opportunity and thus we have seen a fragmented, confused merchant and consumer message and a very slow level of adoption. Larger retailers e.g. Supermarkets, Petrol Stations and department stores refused to participate without a reduction in interchange and were really required to promote regular usage which meant cardholders often could not find a retailer offering the contactless option. The leader in the market place for contactless was McDonalds in the UK as it fitted their business model.
- Similarly, Switch, which was a commercially led innovation, was a collaborative project which broke up some of the pre-existing schemes.
- The Current Account Switching Service (CASS) is an example of a successful collaborative industry project.
- Another example of a successful collaborative industry project is the directory for mobile payments e.g. linking mobile numbers to bank accounts that has been built by VocaLink for the Payments Council and named Paym.
- In essence, open collaboration should be allowed and encouraged wherever possible as it will lead to faster, more robust innovation. There is a significant difference between collaboration and collusion and what constitutes the latter should be clearly defined. It is ACI’s view as an Associate Member of the Payments Council and a contributor to its Business

Forum that the Payments Council should oversee collaborative activity and have its membership extended to include more Retailers, TelCos and Third Party Processors to promote this collaboration,

- The view that collaboration should be legislated out of the payments market is ludicrous as it ensures the failure of the stated intent of the regulator! There needs to be a clearly defined distinction between collaboration and collusion

Q6 – Do you think the current ownership structures create problems? If so, please explain your concerns with the current structure.

- The predominantly US ownership of the International Card Schemes means their rules etc can be US centric and these can take considerable time to change for the UK and other European markets particularly as EMV is not yet fully rolled out in the US.
- The International schemes are also issuer centric organisations and there is a need to increase the promotion of Acquirers requirements. Things are changing, the acquirers are working to have a collective voice, but the current structure does lead to various players being disadvantaged. For example, there are costs attached for vendors to access the Visa website or for Merchants to be listed on the Visa Merchant Agent List.
- The schemes have bought companies recently who compete with their member banks – this does bring more competition but surely it's a conflict of interest? Will this be something that the PSR seeks to review even though it is not UK specific?
- When looking at the current ownership and how it might potentially need to change, we must do this whilst looking at the impact on the players. In particular, if we're putting in rules that are UK specific, the PSR must keep in mind that these are global businesses and give due consideration to how any changes impact globally.
- ACI are aware that some other organisations in the payments industry have some concern over VocaLink's ownership of LINK/Faster Payments/Paym networks. As VocaLink are a customer of ACI we would like to understand whether the PSR is aiming to make these networks more open and available to others (via licence) to ensure a more level playing field?

Q7 – How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternative model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

    - In addition to the comments above, there are still a number of barriers to entry in certain European markets for UK Payments companies. Does the PSR plan to review this as part of its remit to allow UK firms greater competitiveness in Europe (and particularly some SEPA countries)

- The PSR need to encourage greater use of measuring and benchmarking. There needs to be evidence of transparency between banks. How much does it cost for Bank A to process this payment type verse it’s peers.

Q8 – Do you have any concerns about the current governance of UK payment systems?

    - Control of the Boards of the UK Payments systems outside of the International Schemes is currently very bank centric and relatively closed (UK Cards/UK Payments Council) and achieving compliance/accreditation can be slow and burdensome, resulting in significant barriers to both new entrants and innovations from existing providers. A governance system which allows for greater representation from the Retailer, Vendor and Processor communities and collaboration in the development of frameworks/standards and facilitates greater openness would be beneficial and also pave the way for e.g. MNO’s etc to join as mobile payments develop.
    - We must not focus on governing payments systems as ‘UK payments systems’ because they are pan European and global systems and must continue to operate as such. Care should also be taken to ensure that any governance works alongside existing governance structures, such as those coming out of Europe, for example, to ensure that we are not creating ‘Fortress UK’ and thus preventing competition from organisations coming in from outside the UK and also causing interoperability issues for UK organisations seeking to expand their businesses beyond UK shores.

- The PSR will, of necessity be policing global organisations. Inappropriate fresh governance could see payment processing services driven off shore to circumnavigate legislation. The UK Regulator must not force organisations offshore, who then use the PSD2 provisions to passport their solutions into the UK. So I open a UK bank account, but my payment services are supplied through an outsourced service operating from Luxembourg. How would or indeed could the PSR police this?

Q9 – What do you believe is the appropriate governance structure for UK payment systems?

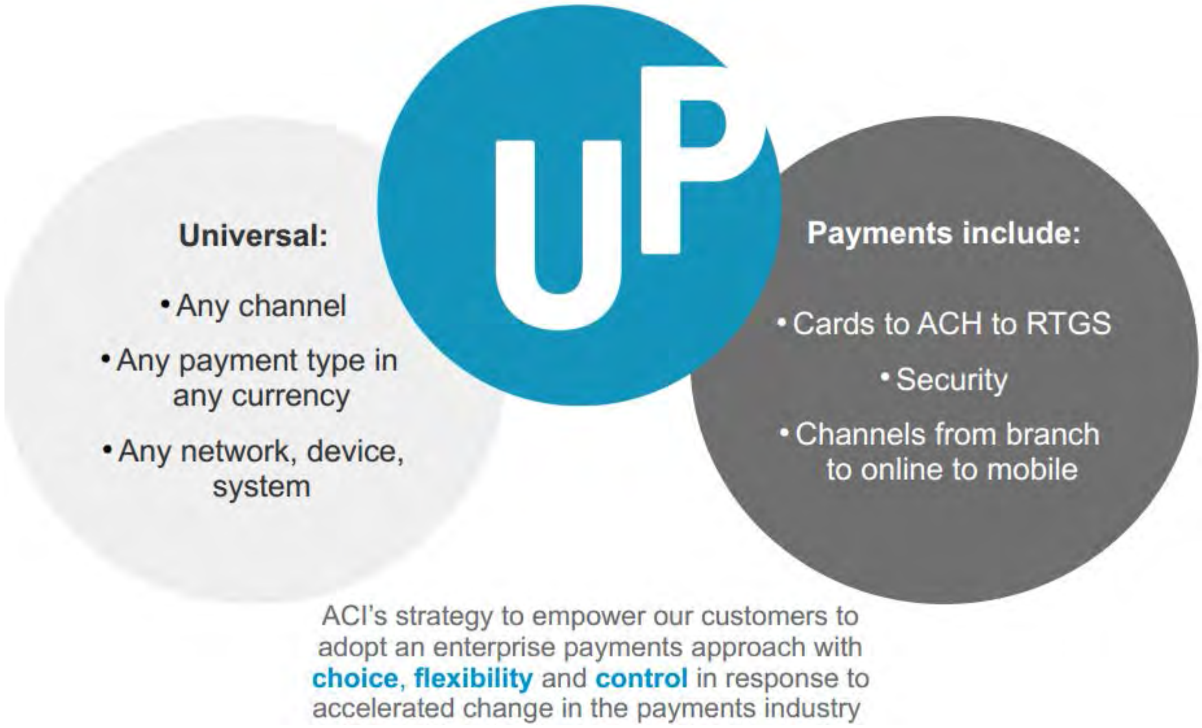
    - An objectives-based governance structure, which sets a framework but which leaves organisations free to compete around how they achieve those objectives is the most appropriate governance structure.

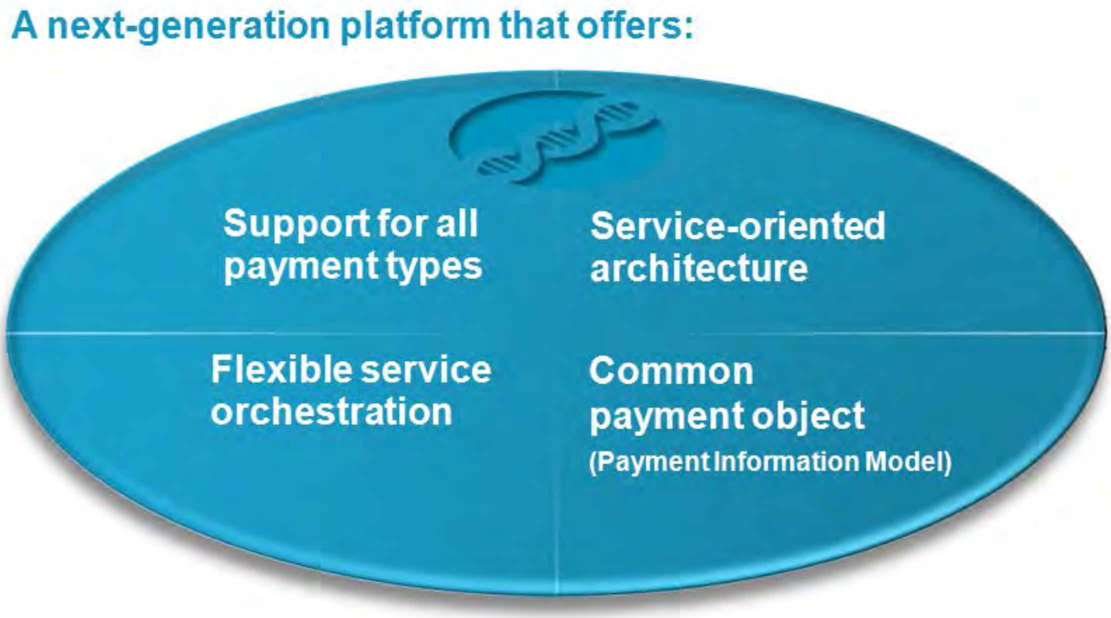
- Any governance structure must take account of, reference and interact with existing governance structures. For example, PSD2, PCI DSS… It is essential that we do not view the 'UK payments system' with an island mentality.
- Perhaps industry bodies should be involved more in governance (as well as traditional players) to represent smaller organisations as a group. This would allow them to understand the complex testing and security elements required at an early stage.
- The Payments Council should continue to oversee collaboration in the UK market with an expanded membership as it has proven the benefits of collaboration with the Account Switching and Paym projects.

Q10 – How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or restraints you have in this regard.

- ACI is a software provider and we are providing some information on our products in this section for the PSR's information. ACI connects Banks and Retailers to UK Payments systems via a number of its products which are used for:
- device driving
- switching
- authorisation
- scheme connectivity
- transaction processing
- Risk
- **ACI Universal Payments Platform will:**
- Harmonise and transform payments types making processing quicker and more efficient
- Deliver real time, anytime, anywhere payment processing
- Accelerate time-to-market when addressing new market initiatives and regulations

- Enable new combinations of services to allow innovative payments processing
- Leverage existing payments infrastructure with modern SOA-based approach
- Eliminate processing silos reduce costs, increase efficiency





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- **Base24-eps**
- The most widely deployed retail payments engine, in the UK, with the most functionality in the market featuring open product architecture and multi

channel enterprise deployment driving lower customisation costs and faster time to market.

- The only software solution that provides integration with ACI’s card management, fraud management, settlement, and merchant acquiring products
- High volume, tier one scalable system proven in production in all major geographies with a blue chip customer base
- A gateway to the International Card schemes and the UK Faster Payments System
- **Money Transfer System (MTS)**
- A standard product implemented globally providing a single, consolidated global payment processing, messaging system and payments hub
- A multi-bank, multi-branch, multi-currency product that provides the most resiliency for continuous processing capabilities 24 hours a day, 7 days a week
- Only one MTS is required to support different bank business units with the most highly configurable workflows, and configuration options without changes to core code
- Supports all payment types and channels, and all business requirements, routing and workflows by standard configuration versus customisation
- Rich functionality exposed as business services to operations or can consume other business services elsewhere in the bank, e.g. foreign exchange rates facilitating cost savings and revenue generation
- MTS can operate as a SWIFT gateway and low and high value transaction processing engine. This is achieved using MTS as a payments engine for multiple wholesale payment types along with support for SWIFT MT and MX financial messaging. Ideal for high-volume, mission-critical payments handling, it is the proven choice of the world’s leading banks. MTS is continuously updated to address changes related to regulatory updates. These updates are delivered in a timely, coordinated manner in order to assure that financial institutions remain compliant with as little impact to the operation.
- Examples of recent regulatory updates addressed are:
    - SEPA EPC Rulebook and EBA STEP2 specification compliance for CORE and B2B

- Annual SWIFT Standards
- Dodd-Frank payments processing

- The latest version of Money Transfer System, 5.3 offers an open, interoperable architecture for streamlined integration. The system provides service-based access to its core functions and payment processing capabilities – offering service interfaces to enable robust and relevant integration to financial institutions' payment operations. This supports interfaces to back-end bank systems and communication networks for SWIFT, clearing houses and central banks.
- Money Transfer System has standard inter-operability with ACI Proactive Risk Manager™ to check transactions for fraud or money laundering, and with BASE24-eps® for Faster Payments gateway services. It interoperates with ACI Universal Online Banker™ and ACI Global Trade Manager™ for corporate treasury and supply chain finance services.
- **ACI Issuer**
- ACI Issuer is a modern card and account management system. It has been developed to support national, international and global financial institutions. The system has full multi-currency, multi-product, multi-institution and multi-language capabilities. It manages card portfolios in different countries and for different issuers on a single platform. Finally, ACI Issuer has been built to fully comply with EMV standards.
- Customer service focus is essential to the success of the payments industry. At the heart of ACI Issuer is a powerful relational database, giving a consolidated, near-real-time view of the customer and the customer's transactions. Issuers can view their complete relationship with individual customers, and Visa, MasterCard, American Express, JCB clearing and settlement customer data is readily available for customer profiling and segmentation operations.
- ACI Issuer supports three main types of products:
  - Credit cards, including charge, revolving, business, purchasing and family cards
  - Debit cards, with a standard interface for delivering monetary transactions to core banking (or host) systems
  - Prepaid cards, including support for personalised and anonymous cards, multi-channel card activation, load and reload parameters, and dormancy tracking tools

- **ACI Acquirer**

- ACI Acquirer is a comprehensive multi-currency merchant management system. Merchant accounts and their histories are stored and managed in ACI Acquirer giving acquiring banks complete control of the merchant accounting and settlement processes.

- The multi-currency capabilities of ACI Acquirer make it ideally suited to managing cross-border acquiring operations. Multi-level merchant hierarchies are supported, and a different currency can be used at each point in the hierarchy.

- Merchant service charges and transaction fees are calculated and managed through ACI Acquirer, which also facilitates the collection of fees and charges from the merchants. Transactions that are submitted to ACI Acquirer are automatically settled with the merchant based on extensive merchant reserve and settlement parameters. Numerous merchant statement options are also available.

- ACI Acquirer provides comprehensive merchant service inquiry and maintenance facilities. Fraud monitoring against pre-defined limits is a standard feature.

- **ACI Interchange**

- ACI Interchange is the central monetary transaction manager, processing all incoming customer transactions and maintaining a central transactions database.

- ACI Interchange also manages the clearing and settlement communication with the major international payment schemes, ensuring compliance with Visa, MasterCard, American Express, JCB and Discover. The module can easily be adapted to manage clearing and settlement with additional networks such as domestic payment schemes.

- Based on ISO 8583-93 specifications, ACI Interchange contains separate processes for passing clearing and settlement data to and from each of the international networks. Transaction routing is achieved using a combined BIN table, which is built using automated routines to incorporate the Visa ARDEF and MasterCard MPE files.

- ACI Interchange offers ongoing compliance with EMV standards, with support for the data requirements of EMV clearing and settlement transactions, and storage of EMV data on the transactions database.

- The receipt and entry of dispute and other special interchange transactions are also managed in the solution, with a range of screens supporting the capture and inquiry of the special interchange transactions of each card scheme.
- **ACI Token Manager**
- Powered by Bell IDACI Token Manager provides for central lifecycle
- management of smart cards and other tokens as well as the management of the applications activated within the scheme. Furthermore, Token Manager provides management from cardholder registration through personalisation and production processes until revocation or withdrawal of the card. In short, Token Manager manages all processes related to the entire lifecycle of cards and applications.
- Token Manager hardware/software requirements include Oracle® database server. Token Manager is available for several hardware and OS platforms (Windows®, Sun Solaris, HP-UX, AIX®, and Linux®).
- **ACI Automated Dispute Manager – partnership with Lean Industries**
- Automated Dispute Manager integrates all of a banks exception handling and dispute processing needs into one cohesive system, reducing the cost of processing and improving customer service through a single system interface. It is a solution used by a growing number of financial institutions and payment processors.
- The solution has been proven to immediately introduce benefits in productivity and efficiency as well as reduce long-term financial risks. The product receives an active and steady stream of investment in R&D to ensure the solution remains the top choice for automated exception and dispute case handling.
- Finally, the strategic partnership between ACI Worldwide and Lean Industries ensures that users will receive 24x7x365 support.
- React with agility to changing market dynamics Automated Dispute Manager offers highly parameterised business rules that allow users to modify case management procedures quickly, or create new processes based on changes in dispute transaction patterns. Examples of some of the key areas of product agility include flexible case management workflows, unique queuing options to allocate cases as business needs dictate, scalability to manage growing numbers of claims without having to increase resources in parallel, and finally, integration with major electronic payment systems in use by banks all over the world today.

- Optimal architecture and design The exceptions and disputes management process is integral with other aspects of an overall payment operation and, thus, any dispute management system must integrate with other payment systems and customer service applications. Additionally, the system must leverage business applications commonly used by banks and processors. Automated Dispute Manager meets these requirements by integrating with document management systems, email systems and network gateways. The solution can also create cases from internet or LAN browser workstations, files or through web services.
- **ACI Global Trade Manager**
- ACI Global Trade Manager automates the documentation utilised in Global Trade Finance, saving time and enabling Banks to start to do business sooner. Global Trade Manager is designed as a system that processes all trade transaction types, both traditional trade and open account transactions regardless if they are for the domestic or international markets. Corporate clients of the bank can access, enter and track their entire trade portfolio of traditional trade and open account transactions over the internet.
- ACI Global Trade Manager enables the buyer and bank to receive the invoice electronically and start business now
- With the goods ready, ACI Universal Online Banker automates the payment, getting the supplier paid faster and ensuring smooth supplier cash flow.
- **ACI Universal OnLine Banker**
- A single platform that provides financial institutions with leading edge features and functionality to enable their customers, from small business to middle market to large corporate customers, the online cash management tools to easily manage the daily collections, disbursements and liquidity needs of their business, whether around the corner or on the other side of the globe.
- ACI Universal Online Banker is a single platform developed to offer leading edge features and functionality that support customers from small business to large corporates. The platform delivers clients with control, choice and flexibility with online tools to easily manage the daily collections, disbursements and liquidity needs of their business whether around the corner or on the other side of the globe.

- ACI Universal Online Banker offers the flexibility, configurability and control that financial institutions require, as well as the self-service functionality, security and usability that financial institution customer esxpect.

- The breadth of features and depth of configurability allow financial institutions to support the varying needs and expectations of a wide range of customer segments.

- **Postilion**

- A payments engine for retailers who operate integrated POS terminals and switch transactions out to (and settle with) potentially more than one acquirer. **6** of the top 10 retailers in the UK use Postilion. The solution allows retailers to operate their businesses independently of any individual hardware vendors, PED suppliers, or acquiring banks in that they can select different suppliers over time and thereby not become locked-in.

- **Pro-Active Risk Manager**

- Fulfil compliance (AML) and fraud monitoring

- Real time. Cross channel and payment type monitoring.

- Open, scalable solution designed to detect, prevent and minimize fraud for a sing le, multi, or enterprise channel approach

- Case management system facilitates managing complex, cross-channel fraud and money laundering cases

- Unique ACI Analytics offering real or near real-time fraud detection along with flexible rules and scoring options to identify trends earlier and decrease losses

- Proven scalable solution capable of monitoring millions of accounts and transactions with high processing throughput on a single platform

- **ACI Asset**

- ACI Simulation Services for Enterprise Testing (ASSET) is a Windows PC-based testing application that can mimic all external elements of a of a payment application system e.g. ATM devices, POS devices, host systems, switch networks and fraud detection applications

- ASSET scripting language allows users to customize, or create new test packs to simulate any message based interface beyond the scope of ACI's payment engines

- As part of product support, we are the only vendor to provide ASSET testing updates in parallel with BASE24-eps and BASE24 interchange interface mandates

- Only software vendor to provide a PRM testing solution

- Only software vendor to provide an MTS testing solution

- **ACI Token Manager**

- Addresses compliance requirements for EMV with full functionality for chip card issuance and management while addressing risk reduction

- This product is a partnership between ACI and Bell ID and is used for implementing chip and application management solutions. It offers the widest breadth of product available in the market today and is pre-integrated with the ACI Issuer and ACI Interchange products. It is also the only off-the-shelf solution where product integration is ready to be deployed and supported as customers require EMV scripting interfaces between Token Manager and ACI payment engines.

Q11 – For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

- The fees to access the systems are the responsibility of ACI's customers therefore we cannot comment for them on their views of the fees. ACI merely processes these through its products.

- ACI is a payment solution provider. ACI provides payment solutions to the financial services sector, processors and retailers. ACI is paid a license fee for these solutions. ACI does not influence or direct how our customers charge their customers for the delivery of payment services administered through these solutions

Q12 – Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

- ACI does not impose or limit the service provided through the deployment of our solutions. Our solutions are fully configurable. Our customers are free to select the features and service they wish to expose and supply to their customers. ACI has a strong user and advisory board community who discuss and prioritise future enhancements.

- ACI previously supplied a full solution to access the UK Faster Payments System using Base24-eps as the gateway to the system, Money Transfer System as the processing engine for transactions and Proactive Risk Manager as a risk checking system. This is a true payments hub. However, many customers have taken only one or two parts of this solution preferring to use other vendor supplied solutions of in-house built systems to provide a solution. Our Universal Payments Hub has replaced this as our solution for Faster Payments in the UK.

- ACI's concerns with regard to the Faster Payments system in the UK are as follows:

  - There have been no additional full members established since the launch, despite phenomenal increases in transaction volume and value processed

  - Many banks still prefer and agency arrangement with the original members of the scheme despite these volume increases and have used this to fulfil the processing timescale requirements of the original Payment Services Directive.

  - Only one member of the scheme offers direct corporate access to the Faster Payments system

Q13 – If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

- ACI are aware that a large number of banks use Agency arrangements for access to the Faster Payments system and have been told that none of these have joined as full members of the scheme because the costs are prohibitive, although we understand a number are reviewing the business case to join currently. We are also aware that only Barclays offer direct Corporate access to the Faster Payments Scheme and see this as a limitation

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

To whom do you provide indirect access?

What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

Are there any barriers to becoming a sponsoring bank?

- ACI do not operate as a sponsoring bank. We are a software provider

Q15 – What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you

believe should be developed (e.g. a second tier membership to payment system operators)?

- There is currently a problem with the Account Updater System, with acquirers only providing access to people using their gateway and not providing access to third party PSPs. If you don't use the Acquirer Updater Systems, then different fees are charged, creating an uneven playing field.
- ACI believe the industry should be looking at having interoperable global standards rather than punitive fine systems.
- ACI are aware of changes to attempt to increase the number of full members of CHAPS
- The rules should limit the use of batch processing. Real time and intra-day posting should be encouraged as should the ability to provide the current available balance

Q16 – Do you have any other comments regarding access?

- Wider access should be encouraged to promote competition, e.g. via service providers that provide a gateway to the payment scheme on behalf of smaller organisations. ACI have developed the Universal Payments Platform that will reduce the number of silos in the UK payments network. The platform can provide Banks with choices in respect of how they renovate their payments infrastructure, innovate and deliver new payment services to their customers. The solution provides the ability and foundations for banks to process payments in real time, anywhere, anytime, including support for direct payments.

Q17 – What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payment systems?

- There is a need for global rather than national standards, in order to ensure greater competition; attracting new players to the UK market and enabling UK organisations to compete more effectively across international borders. Common platforms and common standards ensure greater interoperability. Any consideration of a national standard which differs in any way from the common standard should be given the upmost thought prior to agreement.
- Standards/regulations need to be developed in a more 'agile' manner, to enable them to better keep up with market developments, ensure they

don’t delay/discourage innovation and that they remain relevant rather than quickly becoming obsolete.

- Adoption of a common framework for mobile payments.Interoperability between regulators and regulation/legislation/standards is key, especially with the various pieces of legislation emerging from SEPA. There must be an alignment between regulations and it must be clear which standards/regulations/legislation take precedence in any given environment. For example, what will be the impact of the Network and Internet Services Directive when it comes into force later this year? What will be the outcome of the current European Data Protection Regulation discussions? – can we achieve harmonisation across Europe in any meaningful way?

- Move away from batch and overnight processing to real time single message payments.

Q18 – What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

- ACI has already embraced the ISO20022 standards in its products as part of its SEPA readiness but also supports the APACS standards and a number of the domestic standards used in Europe and other parts of the globe.

- It is important that the infrastructure has the flexibility to provide and accommodate message transformation. The ability to take any message and reformat it for processing will influence the speed of adoption and help minimise costs – keep good parts of the infrastructure without throwing away everything.

- A shift from ISO8583 to ISO20022 for Faster Payments makes sense over a longer period. Adoption of EPAS over time in place of the APACS standards should also be looked at.

Q19 – What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems?

- The technical solutions that exist today are sufficient for banks needs. What is needed is viable costs and membership fees to allow wider access.

- One area where competition could be increased is in the area of Faster Payments. At present the cost is an effective barrier to entry and this is why we have seen take up from only 10/12 players and nobody joining within the last 5 years despite huge increases in the volume and value of payments. Transparency around cost is difficult to achieve.

- The development of Host Card Emulation (HCE) , Near Field Communications (NFC) and increased use of real time payments will all support the technical and operational functions of agency banks
- ACI would suggest a more formal discussion and presentation on the capabilities of the UP Hub framework and other solution to help articulate the extent to which our solution could support the delivery of new services and functions for agency banks participating in the UK payment systems.
- Need to focus on the payment information. The added value payment information can provide to a customer or consumer i.e. notification of payment made or received, invoicing or reconciliation services etc.

Q20 – Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

- There is a risk that with the change in the interchange fees, organisations will be actively discouraged from innovating, and that continued investment in the existing payment infrastructure will reduce. Concern should also be raised that from a UK perspective, the change to the debit card fees (change from fixed price per transaction to 0.2% per transaction will increase merchants' debit card charges, thus disadvantaging service-users. Unfortunately, it is likely that the changes to interchange fees will already be in force by the time the PSR becomes effective.
- Part of the difficulty today is that organisations (current players) are so busy trying to keep up with regulatory change (for example the proposed changes to interchange fees) that there is not time to innovate. The inherent complexity in current standards/regulation/legislation is stifling innovation. 75% of bank spending is currently association with compliance (e.g. having to replace PinPads/Payment Terminals)

Q21 – Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

- ACI is a payment solution provider. ACI provides payment solutions to the financial services sector, processors and retailers. ACI is paid a license fee for these solutions. ACI does not influence or direct how our customers charge their customers for the delivery of payment services administered through these solutions

- Cost of compliance restricts investment available for innovation, so regulation should not increase the compliance burden. Some customers have told us over 80% of their IT budget is spent on compliance.

Q22 – What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

- Providing good access to new market entrants is needed, but don't penalise proven players to achieve this. Adopt global standards. Don't erode margins excessively and stifle investment. Common framework for mobile payments.

- ACI believe that a greater pace of innovation can be achieved if Vendors and e.g. Third Party Processors are given more access to the decision making forums of UK payments. ACI's membership of the Payments Council Business Forum has allowed us access to e.g. The National Payments plan and given us an awareness of planned developments which we can feed into our strategic planning for our Region that covers the UK and Ireland. There is also a greater need for the Payments Council and the UK Cards Association to work together more closely.

- The Regulator needs to benchmark or measure payment processes. The last industry benchmark study that looked at comparative peer-to-peer payment processing focused on cheque unpaids and was in the mid to late 1990's. There has not been a similar study since. Once you have documented payment types and process together with associated unit costs for can then start to influence and drive direction and innovation. This exercise will need to be undertaken independently.

Q23 – What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

- Collectively driven innovation has proved to be beneficial to UK Payments with the collaborative approach leading to the Faster Payments system, the Current Account Switching Service and the mobile payments database to be launched later this month.
- Collective innovation is likely to achieve wider adoption and interoperability but at the expense of slower innovation.
- Benefits: cost reduction, focused technology spend, prioritization and the speed at which change and innovation deliver or barriers to change removed.

Q24 – Do you have any other comments or concerns you would like to highlight?

- We do have a concern as specified above that the amount of Regulation emerging from the European Commission and European Central Bank is not co-ordinated and would see part of the role of the new PSR to ensure the UK Payments Industry is not disadvantaged by this. The UK Cards Association have identified the issues here and the PSR needs to work with them to protect the UK market.

Q25 – What, if any, are the significant benefits you see regulation bringing?

- ACI's view is that there are few benefits from additional regulation and another Regulator because the huge IT cost of compliance with the domestic, European and International Regulatory requirements stifles innovation for major players. Smaller players sometimes remain blissfully unaware of this overhead until they reach a certain size and the amount involved usually means they are forced to be bought by a larger player, merge with other smaller players or fold.

- However, we recognise that benefits of regulation can also include stability, reliability and security of critical systems

- Regulation may also help focus board members minds and shareholders. May bring payment renovation higher up the agenda.

- ACI welcome the open approach being taken by the PSR to date and look forward to hearing more about the development of its strategic aims, vision and values and the approaches it will be taking to deliver these.

Q26 – What, if any, are the risks arising from regulation of payment systems?

- As mentioned in the general comments at the beginning of this document, the varying payment systems (particularly those which are domestic versus those which have a global reach) cannot be regulated with a one size fits all approach. Where payments systems such as the card schemes are already subject to governance from Europe and more widely, little, if any, additional regulation should be considered.

- The main risks are increased higher costs for compliance, further restricts innovation / investment, increased time to market, decreased revenues. Drives delivery of the services and regulation across jurisdictions where PSR cannot influence.

- A mix of domestic, European and International regulations makes it hard for a true pan European of Global solution. As a Global payments software provider, nirvana for ACI would be universal standards so our software could be used in any market without customisation. We are a long way from this situation at present.

- We have identified in our submission that ACI spend time, funds and resource tracking the regulation of payments systems of all types to ensure compliance for our products and we provide this comfort to our customer base, However, smaller companies do not have the resources to undertake this and often find out the requirements only as they grow in their marketplace.
- ACI would like to highlight that any documentation that the new PSR produces should refer to already-existing documentation where possible, e.g. ISO20022. The main role of the PSR should be to clarify interpretation where existing documentation is silent or ambiguous -- and in this case they should take action to ensure that the original documentation is updated (especially if it originates from an international body such as SEPA, or the international card schemes). Over time this will keep the PSR's documents smaller in size and ensure interoperability / parity between the UK and payment rules outside of the UK.

Q27 – How do you think regulation might affect your business and your participation in UK payment systems?

- ACI is a payment solution provider. ACI provides payment solutions to the financial services sector, processors and retailers. We anticipate a strong degree of interest and adoption of our UP Hub solution as the FCA focuses on the antiquated aspects of the UK payment systems.
- Regulation often requires system changes which impact vendor software, so ACI may need to make changes to existing functionality or add new modules for bigger changes, to allow our customers (e.g. banks) to comply with regulation.
- Through its membership of the UK Payments Council and its interaction with the UK Cards Association ACI have input to the decision making in the UK market. However, as indicated above we have concerns that regulation emerging from SEPA could damage the UK market.
- We also input to SEPA Vendor groups for European legislation.
- Finally we interface with the International Payment Schemes

Annex 3: Questions

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

The current list at this time seems exhaustive and fairly represents the current payment ecosystem.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Access through direct providers does allow participation and competition among a wider group of indirect participants although the model is not as open as it was once intended. Numerous UK banks (e.g. direct participants) are withdrawing this service and / or making access for those who have the capability to operate as an indirect participant virtually impossible. From a bank's viewpoint the risk/revenue opportunity is too great. As an indirect participant we understand this challenge for the direct members. Services, especially a full range of Agency Banking services, is not necessary a primary, nor significant revenue driver for a bank. It also represents a significant risk to give a 3rd party access to the payment schemes without corresponding governance, oversight and the representative controls in place.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

The cost base for alternative (currently indirect) providers is much lower than that for traditional banks, which in turn creates a low cost payment model for the service user while still providing a reasonable profit for the provider. Recent entrants will of course have more flexible systems to create and align innovation for the benefit of the service user. With more entrants, smaller niche players have an ability to offer bespoke solutions to niche markets which in the past have been too small for banks to service as they could not justify the return on investment in comparison to initiatives for more mass market appeal.

Question 4: What are the main factors impeding more effective competition at each level?

For indirect participants access is limited and the cost prohibitive to offer comparable payment services as currently provided by the banks.

For clarity, and in some cases already mentioned in the 'call for input' document, the following are the main areas of concern as an indirect member:

(1) Bank of England – a settlement account, which forms the basis for Payment System Operators, is not allowed for anyone except a 'Deposit Taking' Bank institution.

(2) Payment System Operators – besides the requirements of a BOE settlement account, some PSOs have membership criteria that preclude non-direct members.

(3) Infrastructure Providers – these have had the luxury of building the infrastructure for large scale enterprises that is bespoke for each client. These costs are prohibitive to any participant that doesn't have the immediate scale to justify these significant entry costs.

(4) **Direct Members – As per the above comments and others that are made within the 'call for input' document, the direct members have a conflict of interest in providing similar services to indirect members who will ultimately compete with Direct Members with similar if not more 'customer centric' payment services.**

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Access to the PSOs in a manner that is 'risk-based' rather than criteria-based is the first step. In addition to this, ensuring all potential participants have the same criteria for membership would make the whole payment ecosystem more standardised. Faster Payments is a brilliant solution, but why does it need its own governing body? Consolidation of BACS and Faster Payments might help in the standardisation of membership criteria.

The Infrastructure Providers, especially Vocalink, need to standardise a service offering where costs can be spread across numerous 'smaller' clients resulting in a lower entry cost. This is not to say that it should be immaterial but in recent conversations with Vocalink, our view is to reduce an 'infrastructure entry fee' into the PSOs from 7 figures down to the low 6 figures. A standardised Infrastructure platform should be able to achieve this for the benefit of all parties (except for the current direct participants).

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Yes it does create problems but an alternative that would be fair to the Banks, who built the solution, is a difficult one. If the banks could agree to 'divest' their interest in the PSOs that would be a major (albeit a challenging) solution.

No solution would be perfect but if an Enterprise Value could be placed on the PSOs, then it could be a start to look at options.

This is a very partial answer to one of your more complex questions as the timing of this response has not provided (at least us) sufficient time to investigate alternative solutions and provide an informed response group made up of the main participants could to some innovative solutions.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

As per Question 6, there might be an opportunity to create an industry body made up of representatives of the key participants (not just the direct members) who could shape the future structure.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Yes. Indirect participants have had limited say into the shaping of the existing governance processes. If there is support that the participants as defined by the PSR are valid (and we believe they are) should there not be some equal participation from those participants in any governance solution whether current or those proposed in the future?

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

As per comment under Question 8

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Advance Payment Solutions (APS) including its subsidiary APS Financial (AFL) are actually a direct (issuing only) member of MasterCard and an Indirect Member of BACS and Faster Payments via Cooperative Bank under an Agency Banking relationship. As it is public knowledge that Cooperative Bank is exiting Agency Banking as a service, APS is progressing this service with alternative banking providers, of which two high street banks seem most viable. It should be noted that one bank did decline to offer such services solely based on the sectors that we served.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Yes. As much as any provider wants lower costs, the current fees, even those in the Agency Bank model is fair and reasonable in isolation. Although they may appear to be fair to us, there is a gap between the cost that a direct member, and those that indirect members, are charged. This differentiation though is too great for a competitive landscape to encourage more entrants.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes. Services, especially those in an Agency Banking Model, are usually a subset of what the Direct Member actually provides to their own Service Users.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

No we do not have wide choice in agency banking services. And YES we would ABSOLUTELY prefer direct access to the payment systems.

The advantages are clear: more control, better pricing, more functionality. The risk are that access may be provided to too many 'innovators' that do not have the controls, governance, risk processes and some minimum financial capability to support the benefit that direct payment service access would provide.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes: **NO**

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

The model that VISA and MASTERCARD adopted to allow Electronic Money Institutions to participate directly might be one to review such that any best practices from that model could be adopted for the PSO, and supported by the PSR.

Question 16: Do you have any other comments regarding access?

No.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

There does need to be an alternative model which allows for legitimate payment providers to have direct access. Entry Costs are now very prohibitive for most to enter even if the regulations supported wider membership. But new entrants should not have a huge advantage over existing players.

One suggestion (already provided to the Infrastructure Providers) is to lower upfront costs of entry but charge a higher variable cost based on the lower volume new providers likely create. With higher participation of new direct members, this would likely create a positive revenue position for them.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Standardisation is good no matter what form (including ISO20022).

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Responses above should provide an initial roadmap for solutions to increase competition.

APS would be a major beneficiary of direct access and in fact more Service Users would ultimately benefit.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

In the responses above it was suggested that transaction fees could actually increase while being offset by lower entry cost. Current transaction fees are quite competitive in comparison to existing 4 party Schemes interchange (albeit that will change). If 'fair' interchange is defined in the range of current Debit interchange than all parties should be satisfied.

Payment Systems Regulation: Call for Inputs

Ref: 0314

April 2014

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About this consultation

The Financial Services (Banking Reform) Act 2013 requires the Financial Conduct Authority (FCA) to establish a new regulator for payment systems in the UK. This new regulator, currently referred to as the Payment Systems Regulator or PSR was incorporated as a subsidiary of the FCA in April 2014 and will be fully operational in April 2015. The FCA has published a call for inputs, focused especially on the issues of competition, access, governance, ownership and innovation. The findings from the consultation are expected to inform the PSR's approach as it develops specific regulatory options for formal consultation later in 2014.

About Age UK

Age UK is a charity and a social enterprise driven by the needs and aspirations of people in late life. Our vision is a world in which older people flourish. Our mission is to improve the lives of older people, wherever they live.

We are a registered charity in the United Kingdom, formed in April 2010 as the new force combining Help the Aged and Age Concern. We have almost 120 years of combined history to draw on, bringing together talents, services and solutions to enrich the lives of people in later life.

Age UK provides information and advice to over 5 million people each year, runs public and parliamentary campaigns, provides training, and funds research exclusively focused on later life. We support and assist a network of around 170 local Age UKs throughout England; the Age UK family also includes Age Scotland, Age Cymru and Age NI. We run just over 450 Age UK charity shops throughout the UK and also offer a range of commercial products tailored to older people.

Age UK also advocates for older consumers. Particular areas of focus in financial services in the recent past have been payment systems (including work on the future of cheques); access to banking more generally (for example accessibility of telephone and online options, treatment of powers of attorney); equalities (for example calling for blanket age limits in lending to be replaced with appropriate use of underwriting).

Key points and recommendations

- Payments are essential services but currently exclude some user groups.
- The PSR's objectives are all framed around 'the interests of those who use, or are likely to use, services provided by payment systems'. We welcome this focus on the user. .
- The PSR must understand what service users need and how they currently use payment systems. This will require the PSR to commission independent research.
- The PSR will also need strategies to ensure it engages effectively with service users, including consumers.
- The PSR may benefit from some of the FCA's recent work on engagement with consumer groups and should work with FCA colleagues to develop a culture which understands consumer issues.
- Vulnerable consumers should be a particular concern of the PSR. Issues affecting currently marginalised groups should be addressed directly by the PSR and not seen as optional corporate social responsibility issues.

1. Introduction and general comments

We are pleased to respond to this call for inputs from the FCA on behalf of the Payment Systems Regulator. We strongly support the establishment of the new regulator and welcome the decision to frame each of the PSR's objectives around 'the interests of those who use, or are likely to use, services provided by payment systems'. While there are many exciting opportunities for innovation in payments we believe that the PSR's objectives give it a clear mandate to focus regulation in a way which ensures all consumers have access to payment services which they can use safely and conveniently.

Payment systems are essential services. They are effectively the only medium through which consumers can access utilities and essential services such as gas, electricity and water – and most people also use them to undertake the most basic of everyday tasks such as grocery shopping. Almost without exception, everyone needs access to payment systems in order to be able to participate in society at the most elementary level. Payment systems also form an essential part of community infrastructure, particularly in rural areas where older people may be heavily reliant on small local businesses.

Older people constitute a rapidly increasing proportion of the population. Today over 14 million people in the UK are aged 60 or over, with this number expected to pass the 20 million mark in the next 20 years[i]. In fact, the percentage of the total population who are over 60 is predicted to rise from 22% at present to almost 30% in the next 20 years[ii]. Yet Age UK research in 2011 found that payment systems were not working well for many older people[iii]. New developments that make it harder to obtain wages and benefits in cash – including modernisation of their payment systems by DWP, HMRC and the private sector; changes to delivery of social care as part of the personalisation agenda– increase the reliance of consumers, particularly older people, on payment systems. Unless their needs are taken into account, a lack of access to non-cash based payments for this increasingly large segment of the population will further increase their exclusion from society. It is also important to note that issues experienced by older consumers are often also found among other marginalised groups, such as those living with disabilities or on a low income.

Age UK provided a full response to previous consultations on UK payments which may be relevant, our response to the most recent consultation on the establishment of the PSR can be found here.

In this call for inputs we focus on how the PSR will be able to ensure that it effectively meet its objectives 'in the interests of those who use, or are likely to use, services provided by payment systems'. We include references to some of the issues older people currently encounter in the payments landscape, however we would welcome the opportunity to talk about these in more detail as the PSR develops its thinking.

2. Understanding the interests of service users

Historically it has been difficult for consumer organisations to achieve adequate representation given the imbalance of power between consumers and the industry and within existing governance structures.. Experience of working within payments and in seeking to provide consumer insight to the FCA suggests that consumer organisations alone will rarely be able to provide the evidence required by the regulator either to determine its plans or to take action on a particular issue. Further, consultation exercises will tend to receive a much greater response from a range of industry players, some of whom may be particular types of service users, than from consumer groups. This means that:

- the PSR will need to undertake or commission its own independent research to understand the needs of service users and:
- the PSR will need to build links with and capacity within relevant service user organisations.

We believe that the PSR will need to be proactive in this area and focus on holding the industry to account in the interests of service users. The need for this has been demonstrated by past failings to take into account the needs of consumers, or even seek to understand their views. The tendency seems to have been a push for change before the implications for consumers have been fully understood, for example the cheque withdrawal programme, current voices pushing for cashless society, and a focus on innovation based around digital and mobile devices. This is contrasted by the lack of attention paid to improving existing services even where gaps have been documented, for example a lack of safe ways to delegate payments effectively. Progress in these areas has tended to require significant input from consumer groups and at times Government before industry responds. Further, we continue to see considerable PR activity around new payment systems and the role of technology which do not take into account the needs of older consumers or provide any more general context.

The mechanism for the new regulator's engagement with consumers therefore needs to be carefully thought through, both in terms of the formal structure it takes and getting the right kind of people around the table. We would favour either replicating – or expanding the remit of - the FCA's consumer panel as a means of achieving this.

Success in understanding the needs of service users will also require an appropriate culture within the PSR. We recommend that the PSR learns from the experiences of the FCA and where possible considers using resources developed in the Consumer and Market Intelligence team to help promote positive culture within the FCA.

3. Vulnerable service users

Because payment services are an essential service and in the light of recent experiences we would also argue that, over and above the need for consumer engagement, there should be a specific focus on how payment systems work for vulnerable consumers. A "vulnerable consumer" can be defined in various ways depending on the regulator but commonly includes those who are of pensionable age and disabled people. This is another area in which the PSR may benefit from sharing expertise being developed within the FCA. Although not all older people are vulnerable, and we would argue against stereotyping them as such, we strongly believe that suppliers of products and services can render people unnecessarily vulnerable because of the policies and procedures they employ. This is particularly the case in a sector such as financial services that is already intrinsically complex and where, for example, technological innovations designed without the needs of older people in mind leave them with no viable alternative to access money.

It is important that vulnerable service users and other marginalized groups are covered by the work of the PSR. These users are especially likely to experience a failure of competition and therefore need the intervention of an economic regulator to ensure that services promote and take account of their needs. The Payments Council has recently started some good work on understanding the needs of the older old and those living with disabilities and on delegated payments, however this has occurred following significant pressure from Government and consumer groups. We would therefore be concerned if this type of work was left as a corporate social responsibility 'extra' to the industry; it should instead be central to achievement of the Service User objective.

4. Older people and payment services

Age UK has found that payment services do not meet the needs of many older people.[iv] Common issues include challenges in safely and securely delegating payments and difficulties communicating with their payment service providers. Difficulties using PINs and feeling compelled to accept new systems that they do not feel confident using or cannot use without assistance are also reported to us. Some of our main concerns at this time, however, are around the future payments landscape. The vision expressed among many payments professionals does not appear to take into account the needs of a significant section of the public.

[i] Age UK Later Life Factsheet February 2014
[ii] Age UK Later Life Factsheet February 2014
[iii] The Way We Pay: payment systems and financial inclusion, Age UK 2011
[iv] The Way We Pay: payment systems and financial inclusion, Age UK 2011

Basic information	
Consultation title:	Payment Systems Regulation
Name of respondent:	AIB Group (UK) plc
Contact at respondent:	Name: Trevor Lightowler
	Email: Trevor.H.Lightowler@aib.ie
	Address: AIB Group(UK) plc 92 Ann Street Belfast BT1 3AY

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	Y
Indirect participant in payment system(s)	Y
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		X
If ‘Yes’, please submit both confidential and non-confidential responses.		

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

The payment systems listed above are considered appropriate for regulation.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Competition is most effective and evident between payment services offered using existing schemes i.e. the delivery channel available to the end user by their payment service provider. Competition is less evident between the non card payment schemes.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Competition between schemes, where relevant, has the greatest potential to drive benefits however this would need to be balanced against the risk of silo development and innovation thereby reducing economies of scale.

Question 4: What are the main factors impeding more effective competition at each level?

No comments.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Given the cross industry nature of payments, collaboration will always be required to ensure the effective design, development and implementation of industry level change.

A collaborative approach to development and maintenance of central utilities e.g. Sorting Code and payment scheme reach-ability databases will always be required.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

The current ownership structure does not appear to create problems.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

No comments.

Question 8: Do you have any concerns about the current governance of UK payment systems?

As a small payment service provider we have no concerns about the current governance structure. We fully participate in a wide range of governance committees and working groups and our views and opinions are actively sought and considered.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

The current governance structure is appropriate.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

AIB Group (UK) is a member of Bacs and LINK, an indirect agency of FPS and CHAPS via HSBC and is a member of the Belfast Bankers Clearing Company Ltd through which we are represented at Cheque & Credit.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

The access conditions and fees are not prohibitive and in the case of the indirect agency arrangements were subject to commercial negotiation based on a wider relationship with our parent organisation.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

The current access arrangement for FPS does not provide a real time 24/7 payment capability which significantly impacts the service-users experience both as sender and receiver. This limitation has effectively excluded us from the implementation of Mobile Payments until such times as a direct agency proposition is available.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

As per question 12.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

We do not act as a sponsoring bank.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We do not consider the access rules and conditions prohibitive however the governance and committee/board obligations of full membership can be difficult for smaller more remote organisations to devote adequate resources to.

A level of membership for smaller more remote organisations with a representative Director operating under a mandate from all such members with clear communication channels would be beneficial, similar to Constituency 3 Payments Council Members.

Question 16: Do you have any other comments regarding access?

No comments.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

As a small bank the relative cost of infrastructural change is very high in comparison to larger organisations and periods of sustained industry change reduce our capacity to develop and implement competitive products and services.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

We do not have any concerns or constraints that adoption of ISO20022 would alleviate. Adoption of new messaging standards would require significant IT change for ourselves and our customers.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

No Comments.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

The incentives to innovate are clear and we have no concerns regarding fee arrangements.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

As per question 12.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

No comments.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

The primary benefit of collective innovation is a product/service/scheme which delivers a consistent customer experience to a significantly higher number of consumers. This is limited however by the product only being competitively differentiated by the input channel and the capability of all parties to the innovation.

The primary benefit of unilateral innovation is the elimination of the constraints of competitors and existing schemes which is more likely to produce groundbreaking products/services. Unilateral innovation however does not deliver products which are immediately accessible to a high proportion of consumers.

Question 24: Do you have any other comments or concerns you would like to highlight?

No comments.

Question 25: What, if any, are the significant benefits you see regulation bringing?

No Comments.

Question 26: What, if any, are the risks arising from regulation of payment systems?

No Comments.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

No Comments.

FCA CONSULTATION:

PAYMENT SYSTEMS REGULATION

CALL FOR INPUTS

AMERICAN EXPRESS COMMENTS

FOR THE FCA

NON-CONFIDENTIAL VERSION

22 APRIL 2014

Introduction

American Express welcomes the opportunity to respond to the FCA's consultation on the UK payments industry (in particular on issues of competition, access, governance, ownership and innovation) and hopes that its views will inform and assist in shaping the new Payment Services Regulator's (PSR) approach to regulation.

The primary concern of American Express in relation to the current state of the UK payments industry and its future regulation is that players with a small sector share and no interbank pricing or governance structures such as American Express should not be designated for regulation by HM Treasury (HMT) as they do not meet the statutory criteria for designation. Any such designation would therefore be disproportionate and risks undermining the UK Government's broader goals of increasing competition and innovation in payment systems.

In addition, American Express also notes that under current conditions, users of essential interbank payment systems (e.g. BACS, CHAPS, Faster Payments, SWIFT, Cheque clearing, LINK) (referred to hereafter as "Essential Interbank Payment Infrastructure") that are not banks and therefore rely on sponsor banks to use such Essential Interbank Payment Infrastructure may be at a competitive disadvantage as against incumbent bank users.

American Express has set out below its substantive concerns and suggested recommendations under each relevant question heading. Some questions are dealt with together where appropriate.

Please note that the information contained in this document is provided to the FCA and PSR for the specific purpose of the Call for Inputs and on a confidential basis. The disclosure of any commercially sensitive data and/or other business secrets contained in this document could seriously and adversely affect the legitimate business interests of American Express, therefore any such information should not be provided to any third parties. A non-confidential version of this document will be provided in due course, as requested in the Call for Inputs.

PAYMENT SYSTEMS IN THE UK

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

American Express is strongly of the view that the scope of the new payment systems regulatory regime should not include players with a small sector share whose systems/schemes do not bear the characteristics of a utility (for example, three party closed loop proprietary payment networks such as American Express). This is on the basis of the following facts:

- three party closed loop proprietary networks such as American Express do not fulfil the designation criteria set out in section 44 of the Financial Services (Banking Reform) Act 2013 (the Banking Act);
- three party closed loop proprietary payment networks such as American Express represent a small proportion of the payment card industry in comparison with incumbents Visa and

MasterCard (whose combined sector share is 95%) and therefore cannot possibly be found to bear the characteristics of a utility or commodity;

- three party closed loop proprietary payment networks such as American Express do not give rise to the problems identified by the UK Government which formed the basis for proposing to introduce the regulation of payment systems in the UK; and
- there would be significant adverse consequences on competition in payment systems if American Express and other players with a small sector share and no interbank pricing or governance structures were to be regulated by the PSR.

1.1 Designation criteria under the Banking Act

Section 44(1) of the Banking Act sets out the basis on which HMT may designate a payment system as a regulated system:

> “*Designation criteria*
>
> *(1) The Treasury may make a designation order in respect of a payment system only if they are satisfied that any deficiencies in the design of the system, or any disruption of its operation, would be likely to have serious consequences for those who use, or are likely to use, the services provided by the system.*
>
> *(2) In considering whether to make a designation order in respect of a payment system, the Treasury must have regard to—*
>
> > *(a) the number and value of the transactions that the system presently processes or is likely to process in the future,*
> >
> > *(b) the nature of the transactions that the system presently processes or is likely to process in the future,*
> >
> > *(c) whether those transactions or their equivalent could be handled by other payment systems, and*
> >
> > *(d) the relationship between the system and other payment systems.*”

The PSR Call for Inputs comments in this regard that: “[t]*his is likely to be true for the major payment systems and payment card networks in the UK*” (i.e. that these may be designated by HMT).[1]

Quite simply, with a share of [✄]% [CONFIDENTIAL] of debit, credit, charge and prepaid cards in the UK by EEA billed business and [✄]% [CONFIDENTIAL] by EEA cards in circulation[2] and with no interbank pricing or governance structures, American Express cannot be considered to be a major payment card network in the UK and cannot be found to meet the requirements of section 44 of the Banking Act. In particular, the number and value of transactions processed in the UK by American Express is dwarfed in comparison to Visa and MasterCard and this is unlikely to change in future – this has been the case ever since American Express began to offer services in the UK. Moreover, the

[1] Page 5 of the PSR Call for Inputs.
[2] Source: Euromonitor January 2014 report.

nature of transactions processed by American Express is no different to its competitors. In this regard, it is important to note that American Express is a choice to both merchants and card holders. [✂] [CONFIDENTIAL].

On this basis, it is clear that American Express should not be designated.

1.2 Three party closed loop proprietary payment networks such as American Express do not bear the characteristics of a utility or commodity

Three party closed loop proprietary payment networks are very different in their operation both from Essential Interbank Payment Infrastructure and recognised open four party interbank card schemes. Importantly, and contrary to open four party interbank card schemes, three party closed loop proprietary payment networks do not bear the characteristics of a utility or commodity. These differences point clearly to the conclusion that the payment services regulatory regime is not appropriate for three party closed loop proprietary payment networks with a small sector share like American Express.

Furthermore, there is no need for additional regulation in this area as three party closed loop proprietary payment networks are already subject to comprehensive regulation, Eurosystem oversight and competition law at both national and EU level. None of the issues raised in HMT's consultation documents arise in the context of such networks. This broad range of measures therefore already provides adequate oversight for three party closed loop proprietary payment networks.

This is consistent with the designation criteria set out in section 44 of the Banking Act, which recognises that card networks with a small sector share would not need to be designated.

1.2.1 Significant differences between the dominant open four party interbank card schemes and three party closed loop proprietary payment networks like American Express

American Express is strongly of the view that, if the PSR is to designate some card payment schemes, then at a minimum three party closed loop proprietary payment networks should be out of scope. In particular, the concerns raised in HMT's consultation documents in relation to open four party interbank schemes are simply not applicable in the context of three party closed loop proprietary payment networks.

1.2.1.1 The American Express business model

American Express operates a global three party closed loop proprietary payment network in which it acts as both card issuer and merchant acquirer. Within the EU, the vast majority of American Express card volume is on cards issued and/or with merchants acquired by American Express entities.

In order to enhance geographic coverage and market relevance and better compete against the ubiquitous open four party interbank card schemes, American Express licenses a small number of carefully selected financial services institutions to issue American Express cards and/or acquire merchants on its network in certain countries, including [✄] [CONFIDENTIAL] licensees within the EU as at the date of this submission. This contrasts sharply with the thousands of member banks participating in the Visa and MasterCard open four party interbank card schemes.

It is important to stress that, in contrast to Visa and MasterCard member banks, American Express' licensees do not have the ability to agree fees, either collectively or even bilaterally with each other, nor indeed about any other aspects of the American Express network. Licensees contract directly and only with American Express for network licenses and related services. All terms are negotiated bilaterally and confidentially, and all transactions and fees are settled bilaterally and independently between American Express and each licensee, to the exclusion of any other licensee. Unlike the dominant open four party interbank card schemes, American Express does not have interchange fees (i.e., there are no collectively established fees due between licensee issuing and acquiring institutions, and no collectively-agreed fees paid to or from licensees – rather, all fees are agreed individually and independently between the American Express network and each licensee issuer and acquirer).

In addition, there is no concept of licensee "membership" in the American Express network, and the decision whether and to whom to license American Express' assets (most importantly, the intellectual property in the American Express brand) is taken solely by American Express in its complete discretion, without any direct or indirect involvement by any licensee. Furthermore, licensees play no role in the management of American Express and are not represented, directly or indirectly, in any governance bodies of American Express. American Express is a fully, publicly traded company and no shares are reserved for any partners. Relationships between American Express and independent licensees are carried out strictly at arm's length. Thus, even where American Express partners with a licensee, this does not make the network an open four party interbank card scheme, either in economic terms or under competition law, for all the reasons cited above.

1.2.1.2 Distinguishing characteristics of three party closed loop proprietary payment networks

It is important to the aims of promoting competition and innovation in payments that the PSR and HMT take into consideration the important differences in business models between three party closed loop proprietary payment networks and open four party interbank card schemes. These distinctions have been acknowledged in respect of American Express by the OFT in the official response to the consultation on the European Commission's Green Paper of April 2012 (the "Green Paper"):

> "*the OFT is not aware of any three party schemes whose cards are, at the present time, considered a 'must take' product by merchants to the degree that scheme exist is not a credible competitive constraint on merchant service charges (MSCs)* […]".[3]

[3] Response of the OFT to the Green Paper, 11 April 2012: http://www.oft.gov.uk/shared_oft/consultations/11_04_12_EC.pdf.

This perspective is further reinforced in the UK Government's official written submission to the Green Paper consultation, where it is stated that while "*action on MIFs is desirable* [...] *No similar action is required in relation to three party schemes or to reduce the non-MIF element of merchant service charges, which are negotiated in a competitive environment*".[4]

This position of the OFT and the UK Government, and American Express' strongly-held contention that three party closed loop proprietary payment networks should be excluded from the proposed regulatory regime, is supported by a number of fundamental and highly relevant differences between three party closed loop proprietary payment networks and open four party interbank card schemes:

- Three party closed loop proprietary payment networks do not have the characteristics of dominance that is a feature of open four party interbank card schemes, and which have been the subject of lengthy and continuing competition law scrutiny. Visa and MasterCard, the dominant open four party interbank card schemes, enjoy a staggering combined share of 95% of the total value of payment card transactions across Europe. They have built their duopoly strength and ubiquitous presence on the back of structures that have undergone significant competition law scrutiny due to their reliance on collective agreements and decision-making bodies involving thousands of competing banks. The market power, ubiquity and structure of these networks stand in stark contrast to their three party closed loop proprietary payment network competitors.
- Three party closed loop proprietary payment networks operate <u>proprietary</u> networks owned and developed by a single, unitary economic enterprise (e.g. the American Express Company and its subsidiaries) operating as both issuer and acquirer vis-à-vis card holders and merchants, which is in contrast to the networks of open four party interbank card schemes, that developed through collaboration among banks including shared bank ownership of the network. Three party closed loop proprietary payment networks do not therefore have the characteristics of collective practices that are the hallmark of open four party interbank card schemes.
- In order to enhance geographic coverage and market relevance and better compete against the ubiquitous open four party interbank card schemes, three party closed loop proprietary payment networks such as American Express have established licensing relationships with a small number of partners. Certainly in the case of American Express, these licensing relationships are not constructed or managed in any way like an open four party interbank card scheme. Critically:
    - all licensing arrangements are bilateral and confidential;
    - they do not operate as an association; and
    - there are no links or undertakings between licensee partners.

  In particular, there is no collective decision-making on fees or scheme rules, and licensees play no role in the governance of American Express or its card payment network.

- American Express relies on a differentiated, spend-centric, premium value based business model in order to compete with the open four party interbank card schemes. It is essential

[4] Response of the UK Government to the Green Paper, 11 April 2012: http://circabc.europa.eu/sd/d/c9785c17-0ef2-44fe-80cc-e34b1410d886-publ_auth-uk_government_en.pdf.

that American Express is free to determine its own price at such levels to deliver a viable proposition to enhance inter-brand competition.

- Three party closed loop proprietary payment networks have direct relationships with card holders and merchants. In the American Express business model, this in turn builds a "closed loop" of transaction information and, with it, a deeper knowledge of card spending across the network. This enables best-in-class fraud protection and valuable marketing programmes that benefit both merchants and card holders alike. Card holders and merchants who recognise the value created by investment in these programmes and benefits are willing to pay a price commensurate with the value they receive. The "closed loop" is widely recognised as a distinctive, value enhancing, pro-competitive characteristic of the American Express network.
- The premium value focus of the American Express business model also means it can negotiate a competitive rate with merchants vis-à-vis rates for other networks, which can then be reinvested in maintaining and building an attractive value proposition for merchants and card holders. However, where merchants do not believe that American Express can deliver value for money, they can, and do, choose to accept only cards from open four party interbank card schemes. American Express is acutely aware of the choices available to merchants and continuously works to demonstrate the value it can provide to merchants who are considering whether to accept, or to continue to accept, American Express cards.

For these reasons three party closed loop proprietary payment networks, including those with bilateral licensing arrangements, have not been brought into scope of any local or EU competition law investigations of card payments, nor existing EU system-level regulation of open access requirements (e.g. in Directive 2007/64/EC on Payment Services in the Internal Market, "PSD").

This is even more the case where the focus of the PSR and HMT in relation to payment systems is on access to utility based essential facilities – as is clear from the descriptions above, American Express does not have any such characteristics to warrant this form of additional scrutiny or oversight.

It is important to note that unwarranted regulation risks severely undermining American Express' value propositions for card holders, merchants and licensing partners and, with this, its ability to compete effectively with the much larger open four party interbank card schemes.

1.2.1.3 Three party closed loop proprietary payment networks do not give rise to the problems identified

American Express has considered each of the areas of concern highlighted in HMT's March 2013 consultation (the "March 2013 Consultation").[5] Plainly, none of these are relevant in the context of three-party closed loop proprietary payment networks.

- Efficient and transparent pricing:

[5] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221903/consult_opening_up_uk_payments.pdf.

The March 2013 Consultation document called for prices to be set at the appropriate level to benefit end-users and be delivered through a fair and transparent methodology. Licensed payment systems will have to present their pricing methodology to the regulator who will review and require amendments as appropriate and which will have the power to intervene to directly set prices for (i) direct access to a payment system; (ii) indirect access via an agency relationship; and (iii) interchange fees.[6]

<u>The concerns sought to be addressed do not arise in the context of three party closed loop proprietary payment networks</u>. As a small three party closed loop proprietary payment network American Express agrees its own prices with end users and licensees. Merchant fees are negotiated bilaterally and directly with merchants. Merchant fees are simple, transparent, easy-to-understand "discount rates" that do not vary by card type, issuer or other variable including interchange fees (which do not exist in the American Express business model), under any given agreement for card acceptance. Moreover, merchants can choose not to accept three party closed loop proprietary payment network cards (and there are many examples of this). This is in contrast to the way pricing is set by the open four party interbank card schemes which can be complex and is not transparent.

In respect of financial arrangements with licensee issuers in the UK, all fees are negotiated bilaterally and confidentially with each licensee to the exclusion of any other licensees. As with merchants, licensees are free to choose whether or not to issue or acquire for American Express whilst maintaining competitively robust issuing and acquiring businesses for other, larger card networks. There is no collective price setting or standard price setting for access that applies. Furthermore, there is no interchange fee or any other fees due between licensees or agreed among licensees, a position made clear by the OFT in its response to the Green Paper as follows:

> "*In three-party schemes, the issuing and acquiring functions are contained in one undertaking, meaning that there are no revenues in the form of MIFs flowing between independent economic entities. Accordingly three-party schemes do not exhibit an upward pressure on merchant prices concomitant with efforts to attract and win issuing banks through increased MIF income. The OFT does not consider that any action is required to lower the non-MIF element of MSCs in four-party schemes, or MSCs in three party schemes. These are subject to downward competitive pressure, with acquiring banks within four-party schemes competing for the business of merchants, and with three-party schemes competing with four-party schemes*".[7]
>
> Equally, as mentioned above, HMT also stated in its response to the Green Paper that while "*action on MIFs is desirable* […] *No similar action is required in relation to*

[6] March 2013 Consultation, paragraph 4.16.

[7] OFT Response to Commission's Green Paper, pages 7-8: https://circabc.europa.eu/sd/a/6c7caa06-7a20-4853-9999-0a76e3cc77e3/publ_auth-uk_oft_en.pdf.

three party schemes or to reduce the non-MIF element of merchant service charges, which are negotiated in a competitive environment".[8]

- Non-discriminatory access:

  The March 2013 Consultation document states that payment systems must ensure access on a fair basis, and that restrictions are justified and proportionate.[9]

  The concerns sought to be addressed do not arise in the context of three party closed loop proprietary payment networks. Open access is required only to address issues of dominance which, as regards payment systems, is only relevant to the open four party interbank card schemes of Visa and MasterCard. This difference has already been recognised in the exemption provided under Article 28 of the PSD. Article 28 is designed to address market access issues arising from dominant open four party interbank schemes. These structural differences, together with the low market share of three party closed loop proprietary payment networks, are significant given the competition policy context of the requirements set out in Article 28.

  The OFT acknowledged in its response to the Green Paper, as set out above, that the cards of three party closed loop proprietary payment networks are not "*considered a 'must take' product by merchants*",[10] so it follows that access to three party closed loop proprietary payment networks is not necessary to compete in the payments sector. The European Commission has also previously recognised the need to distinguish between three party closed loop proprietary payment networks and open four party interbank card schemes in this context in the *Visa/Morgan Stanley Dean Witter* case, where the Commission expressly acknowledged that three party closed loop proprietary payment networks such as American Express and Diners are not subject to the same requirements as were applicable to Visa in that case. The differences have also been recognised by the European Central Bank in its 6th SEPA Progress Report[11] and by the European Payments Council in version 2.1 of the SEPA Cards Framework Report.[12]

  We note the European Commission has proposed removing the exemption for three-party schemes from Article 28 in the draft revisions to the PSD ("PSD2"). We are particularly surprised and concerned by this development, as (i) the Commission has not provided any credible reasoning or evidence for proposing a different approach in PSD2, (ii) there has been no material change in the position of three party networks such as American Express since the PSD was adopted and (iii) the Commission has not undertaken any impact analysis in relation to this proposed change.

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8 HMT Response to Commission's Green Paper, page 4: https://circabc.europa.eu/sd/a/c9785c17-0ef2-44fe-80cc-e34b1410d886/publ_auth-uk_government_en.pdf.

9 March 2013 Consultation, paragraph 4.17.

10 OFT Response to Commission's Green Paper, page 8: https://circabc.europa.eu/sd/a/6c7caa06-7a20-4853-9999-0a76e3cc77e3/publ_auth-uk_oft_en.pdf.

11 See pages 23-24 of the 6th SEPA Progress Report, November 2008: http://www.ecb.europa.eu/pub/pdf/other/singleeuropaymentsarea200811en.pdf.

12 See section 3.2.5 of the Report, dated 16 December 2009: http://www.europeanpaymentscouncil.eu/documents/Cards%20SCF%20006%2009%20v%202%201.pdf.

Moreover, removing the exemption in such circumstances would breach the principles of the EC Treaty, as legislation adopted to further the single market must comply with the Treaty, which this would not. [✂] [CONFIDENTIAL].

- Good governance:

  The consultation aims to ensure that control is not abused, either individually or collectively in a way that is detrimental to end users.[13]

  The concerns sought to be addressed do not arise in the context of three party closed loop proprietary payment networks. American Express is a fully, publicly traded company (AXP on the New York Stock Exchange); no shares are reserved for its licensing partners. Relationships between American Express and its licensing partners are carried out at arm's length. The governance of American Express does not therefore raise any of the concerns raised by the collectively owned membership schemes. There is no concept of licensee "membership" in American Express, and the decision whether and to whom to license American Express' assets (most importantly, the intellectual property in the American Express brand) is taken solely by American Express in its complete discretion, without any direct or indirect involvement by any licensee. Furthermore, licensees play no role in the management of American Express and are not represented, directly or indirectly, in any governance bodies of American Express. Thus, even where American Express partners with a licensee, this does not make the network an open four party interbank card scheme, either in economic terms or under competition law. There is, therefore, no reason to treat American Express as akin to an open four party interbank card scheme.

1.2.2 Key operational differences between Essential Interbank Payment Infrastructure and three party closed loop proprietary payment networks

On a more general note, Essential Interbank Payment Infrastructure and card payment schemes (in particular, three party closed loop proprietary payment networks) are fundamentally different from an operational perspective. These differences are also relevant as to whether or not three party closed loop proprietary payment networks such as American Express should be designated for regulation. At the most fundamental level the purposes and ways in which the two categories of payment systems operate are entirely distinguishable.

When using an Essential Interbank Payment Infrastructure, the payer's payment obligation to the payee is not fulfilled unless and until the payee actually receives funds that are pushed through the system. The movement of funds is critical to fulfilment of the payment obligation between the payer and the payee; indeed, the mere movement of funds from A to B is what the payment is designed to do – no more, no less. In this sense, systems that are recognised as an Essential Interbank Payment Infrastructure are more akin to utilities or commodity services.

[13] March 2013 Consultation, paragraph 4.18.

[✄] [CONFIDENTIAL].

1.2.3 Conclusion on relevance of concerns sought to be addressed in connection with Essential Interbank Payment Infrastructure and dominant card schemes in the context of three party closed loop proprietary payment networks

American Express notes the UK Government proposes to designate open four party interbank card schemes for regulation and recognises that, by virtue of their dominance, they may be viewed as also akin to utilities or commodity services. Clearly, with a 95% stronghold over the UK card payments industry, Visa and MasterCard are compulsory partners for any new user of card payment services. Three party closed loop proprietary payment networks such as American Express are not. These facts were clearly established in the *Visa/Morgan Stanley Dean Witter* case brought by the European Commission in 2007. In its decision against Visa, the Commission stated:

> "*It should be added that, from an acquiring bank's perspective, other credit card brands such as Amex or Diners Club cannot constitute a viable basis for entering the UK market for credit and deferred debit/ charge card acquiring. In the first place, this is due to the fact that Amex and Diners Club are so-called "proprietary" card payment systems, within which acquiring is carried out by the owners of the network and not by the banks. Furthermore, even if acquiring for these proprietary brands were open to UK banks, the market share of these brands would be too small to serve as a basis for any significant acquiring business. A bank joining the proprietary acquirers of Amex or Diners Club in acquiring for these networks would be limited to capturing only part of the already small turnover of these networks. In contrast, Visa and MasterCard are the two most widely used credit card brands in the United Kingdom with 94% share of credit and deferred debit/ charge card transactions by value in 2003 and further growth potential. It is such volumes that can provide a sound business proposition to new acquirers*".[14]

American Express would urge the PSR and HMT to recognise the distinction that exists between these dominant open four party interbank card schemes, which may be designated, and players with a small sector share such as three party closed loop proprietary payment networks (including American Express) which should be excluded from the scope of PSR regulation, for the reasons set out above.

Finally, American Express also notes that the issues considered at the PSR's Stakeholder Event of 10 April 2014 focused entirely on Essential Interbank Payment Infrastructure, not card payment schemes.

1.3 Unintended consequences for the payment landscape

1.3.1 A disproportionate burden on players with a small sector share which would stifle competition

[14] See decision of 3 October 2007 in Case COMP/D1/37860 – *Morgan Stanley / Visa International and Visa Europe*, paragraph 105: http://ec.europa.eu/competition/antitrust/cases/dec_docs/37860/37860_629_1.pdf.

Designating all card payment schemes and in particular players with a small sector share for potential regulation would appear to be arbitrary and counterproductive when considering that card payment schemes themselves compete against emerging online and mobile payment solutions, including aggregators such as PayPal as well as other emerging payment system "standards" such as contactless solutions and mobile payments, which are not being considered for designation.

Drawing such an arbitrary line risks creating artificial costs and introducing inefficiencies in the market, potentially placing three party closed loop proprietary payment networks with a small sector share at a competitive disadvantage. This in turn would have an adverse effect on competition rather than stimulating and fostering competition in the emerging, online and mobile payment space.

The Call for Inputs states that:

> "[s]*maller and less systemic payment systems or services, such as mobile payment systems and other proprietary payment card systems, may not initially be designated for regulation" and that this position could be revised* "[a]*s new payment systems develop and grow*".[15]

We see no grounds for American Express, whose sector share for credit, debit and charge in the UK is a mere [✂]% [CONFIDENTIAL] by EEA billed business, to be designated when other small and/or new players in the industry are not. We therefore would urge the PSR and HMT to exclude American Express from the scope of designation, with the possibility of re-assessing the situation if the sector share of American Express in the UK ever increases to a significant extent.

1.3.2 Risk of eroding the American Express value proposition

American Express believes its card acceptance delivers premium value to its merchants. In order for UK merchants to continue benefiting from the value proposition described below, American Express should not be designated for regulation, as the burden of additional, onerous regulation at a UK level would risk significantly eroding the value of the network's offering.

On average, American Express cardholders spend is between [✂] and [✂] [CONFIDENTIAL] times the amount that Visa/MasterCard cardholders spend on a per card basis. Beyond the value that high-spending, loyal American Express cardholders already bring to UK merchants, UK merchants also gain access to a wide range of added-value options when they choose to accept American Express cards. By way of illustration only, these include:

- marketing opportunities – for instance, targeted offers to American Express cardholders, marketing campaigns where merchants can send marketing materials to cardholders that meet certain criteria specified by the merchant and who have consented to receiving such materials;
- rewards programme opportunities – to encourage customer loyalty and increased spending, merchants can become redemption partners, offering their goods and services

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in exchange for reward points in respect of which the merchants would receive a negotiated rate of compensation from American Express;

- access to insightful spend data (on an aggregated and anonymous basis) – merchants are able to access aggregated cardholder data on the American Express closed loop in order to inform their business and marketing strategies;
- superior fraud management – thanks to its closed loop model, American Express can link cardholder and merchant data more efficiently both within the UK and internationally in order to spot unusual activity and is able to contact most cardholders or merchants directly.

An example of a marketing initiative directed at small merchants around the UK is “Shop Small”. There have been three such initiatives so far, for one month in November 2012, one month in July 2013 and one day on 7 December 2013 (to coincide with the initiative known as “Small Business Saturday”, which itself is a concept and name borrowed from American Express in the United States). Approximately [✄] [CONFIDENTIAL] UK merchants participated in each campaign. As part of the Shop Small marketing initiative, American Express cardholders earn statement credits for shopping at a participating small merchant. American Express funds the credits to cardholders, promotes the campaign through email and direct-mail communications to cardholders and merchants, as well as on Facebook and Twitter. Participating merchants are given a toolkit to help them promote the programme in-store and via their own social channels. They benefit from incremental spend and new business at their location during the initiative.

This illustrates a clear focus on ensuring that American Express is capable of demonstrating value to merchants and on distinguishing itself from the larger, open four party interbank card schemes on the basis of its pro-competitive business model. The PSR and HMT should not run the risk of eroding the pro-competitive value that the presence of American Express brings to the UK payments landscape by designating American Express for regulation. Instead, the PSR’s role should focus on utility-style interbank schemes.

[✄] [CONFIDENTIAL].

COMPETITION IN PAYMENT SYSTEMS

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Question 4: What are the main factors impeding more effective competition at each level?

We deal with Questions 2 to 4 together.

<u>2.1 Card and mobile payments</u>

The European payments industry is clearly undergoing a fundamental change, and the very nature of commerce is in the process of being redefined. In particular, consumer behaviour has evolved significantly in the last decade and accelerated considerably in the last five years, resulting from a huge growth in digital channels and capabilities which appear to be increasing on a daily basis. The industry will undoubtedly continue to see great shifts in future (e.g. with the launch of Zapp scheduled for this coming autumn) as digital and mobile innovations continue to evolve and converge, both online and offline.

American Express, as well as its direct competitors, realise this and are actively pursuing developments in the emerging payments space in addition to traditional card payment activities. Across the globe, American Express is working to deploy mobile payments, viewing these as both complementary and competitive segments within the payments industry.

American Express urges the PSR to take into account the fact that these new payment methods and alternative payment networks and payment service providers are emerging/developing rapidly, and provide a real competitive constraint on traditional card payment networks, issuers and acquirers. The scale and diversity of digital advances across multiple sectors, including payments, demonstrates that the industry is clearly in the midst of significant change and disruptive innovation which will ultimately provide consumers and merchants with an increasing number of payment options to choose from.

2.2 Essential Interbank Payment Infrastructure

American Express notes that competition might not be as effective as it could be at the level of Essential Interbank Payment Infrastructure. Specifically:

- indirect users of Essential Interbank Payment Infrastructure may currently be at a disadvantage to banks who run these systems and/or have direct access to them; and
- there are inherent barriers to switching sponsoring banks.

2.2.1 Indirect access

It goes without saying that the owners of an Essential Interbank Payment Infrastructure incur costs and that they should be adequately remunerated when providing access to the infrastructure. Competition concerns may arise where the terms of such remuneration lack transparency and/or put certain categories of users at a disadvantage to other users. As owners of an essential facility, incumbent banks should ensure that they grant access (whether direct or indirect) on the basis of fair, reasonable and non-discriminatory criteria.

2.2.2 Barriers to switching

Choosing a sponsoring bank is, at present, a decision that tends to be made for the (very) long term. This is due to the existence of significant barriers to switching providers. In particular, each sponsoring bank uses its own, unique IT systems (a difficulty which the SEPA process has highlighted). When choosing a sponsoring bank, the indirect user will need to incur significant investment costs to ensure that its systems are compatible with its partner's.

As a result, indirect users tend to be "locked in" to this commercial relationship. We discuss options seeking to address this issue in the "Access" section of this response.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

A degree of collaboration is required in relation to the setting of common standards for new payment methods to ensure the interoperability of technologies on a global basis, as this is a crucial aspect of consumer demand. If a new technology is not interoperable with existing infrastructure, consumers will simply not adopt it. The payments industry is acutely aware of this and there are a number of initiatives aimed at addressing this issue – both at the level of trade associations and on an ad hoc basis. In addition, collaboration is necessary as part of the industry's fight against fraud.

Existing processes for the setting of common industry standards seem to work well, and it is not clear to American Express how any new regulation would benefit interoperability or foster competition in the already highly competitive environment of payments.

OWNERSHIP & GOVERNANCE

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

We deal with Questions 6 to 9 together.

As a general observation, structural remedies such as divestments (which the PSR has the power to order) are very intrusive and should only be applied in rare cases where it is considered to be the best means of solving the situation, after a careful impact assessment.

In terms of governance, ensuring that conditions of access to Essential Interbank Payment Infrastructure are based on fair, reasonable and non-discriminatory criteria might be best achieved where banks with direct access operate the upstream and downstream segments of their business on an arm's length basis. This would pre-empt any suggestion that such banks might be applying more commercially favourable terms to affiliated companies or segments of their business which compete downstream with indirect users.

ACCESS

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

American Express accesses Essential Interbank Payment Infrastructure via a sponsor bank (currently [✄] [CONFIDENTIAL]). American Express is therefore a corporate user of the following Essential Interbank Payment Infrastructure (as at the date of this submission):

[✄] [CONFIDENTIAL].

When using the above payment infrastructures, American Express effectively relies on its sponsoring partner [✄] [CONFIDENTIAL] to act on its behalf, as its agent.

Current fee arrangements per transaction are as follows:

[✄] [CONFIDENTIAL].

For the reasons set out in answer to Question 2 above, American Express notes that due to inherent barriers to switching, indirect users of Essential Interbank Payment Infrastructure will tend to be "locked in" to a commercial arrangement with a single sponsoring bank for a relatively long period of time. Barriers to switching may be lowered by:

- encouraging banks to put in place IT systems that are more compatible with each other (so that no prohibitive investment costs are required each time an indirect user switches providers); and
- requiring sponsoring banks to cooperate with each other when an indirect user decides to switch between them.

American Express realises that it will take time for banks to harmonise the way in which they operate and how their IT systems function for the purpose of facilitating access to Essential Interbank Payment Infrastructure. This issue has been highlighted in the context of SEPA, where it became clear that banks use a variety of different file formats and secure file transfer mechanisms for instance. However, increasing cooperation between sponsoring banks would be relatively easy to put in place and would have a positive impact on competition for sponsoring services.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- ***To whom do you provide indirect access?***
- ***What are the major irks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?***
- ***Are there any barriers to becoming a sponsoring bank?***

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Question 16: Do you have any other comments regarding access?

We deal with Questions 11 to 16 together.

American Express broadly supports moves by the Government to seek to ensure non-discriminatory access on fair and reasonable commercial terms as a user of the recognised Essential Interbank Payment Infrastructure. American Express has no visibility in terms of comparing pricing terms for banks versus non-banks, but is of the general view that access to Essential Interbank Payment Infrastructure should not be available on less favourable commercial terms for indirect users than for direct bank users (who compete with corporate users in the issuing and acquiring space).This would ensure that indirect users are able to offer competitive prices to their customers.

Although as already mentioned above, competition between sponsor banks on access terms and conditions is hampered by inherent barriers to switching, American Express is generally satisfied that it has a choice of sponsoring banks to choose from.

American Express has arrangements in place for indirect access to most of the Essential Interbank Payment Infrastructure schemes and does not have specific views in relation to direct access at this stage. As a general comment, American Express would be keen to obtain more information in relation to the alternatives routes that might be envisaged by the PSR. In particular, more information would be needed on the second tier membership proposition in order for American Express to be in a position to provide more meaningful comments to the regulator.

INFRASTRUCTURE

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payment systems?

Please refer to our answers to the Questions in the "Access" section above with regard to suggested changes to conditions of indirect access to Essential Interbank Payment Infrastructure schemes that are akin to facilities.

As an indirect user of Essential Interbank Payment Infrastructure, American Express is not in a position to comment on the potential costs of the proposed changes or on considerations regarding the impact of such changes on the resilience and reliability of payment systems.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

At present, we note that the ISO20022 standard is not mandatory, although it should be noted that the SEPA Cards Framework is partly based on ISO20022. In the view of American Express and by way of general comment, the consistency that common standards bring in the context of the payments industry has positive effects from the perspective of increased competition. In particular, it enables players to truly compete with each other as it facilitates switching between partners at a minimal cost. For this reason, global standards rather than national standards ought to be preferred, as this ensures greater competition across international borders.

American Express supports the adoption of ISO20022 as a global standard and notes that important players in the UK payments industry are in the process of considering whether to adopt it (e.g. BACS, CHAPS and Faster Payments).

Nevertheless, it is important that regulation does not pick and choose winners and losers without allowing market forces and customer choice to drive competition and change. This applies to the setting of standards as well. The PSR should therefore ensure its future actions do nothing to diminish or distort competition at this pivotal time for the payments sector. The UK payments industry must be given the opportunity to respond to rapidly evolving consumer demand, and to position itself in such a way that is flexible, nimble and easily adaptable to the changing landscape. Regulatory intervention that is too extensive risks stifling the UK industry at a critical time in its evolution and putting it at a disadvantage as against players located in other European and global jurisdictions.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will be the impact and benefits of this be to your business?

American Express has made recommendations regarding how to increase competition in the provision of indirect access to Essential Interbank Payment Infrastructure. Please refer to the "Access" section above.

INNOVATION

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

20.1 Incentives to innovate

As far as the card and mobile payments industry is concerned, and as explained in answer to Question 2 above, this sector is highly competitive as new payment methods and alternative payment networks and payment service providers are emerging/developing rapidly, providing a real competitive constraint on traditional card payment networks, issuers and acquirers. The scale and diversity of digital advances across multiple sectors, including payments, demonstrates that the industry is clearly in the midst of significant change and disruptive innovation which will ultimately provide consumers and merchants with an increasing number of payment options to choose from. There are clear incentives to innovate for card and mobile payments operators.

20.2 Comments in relation to interchange fees

20.2.1 The American Express business model does not justify the imposition of price regulation

As explained in section 1.2.1.1 (The American Express business model) above, American Express operates a global three party closed loop proprietary payment network in which it acts as both card issuer and merchant acquirer. American also licences a small number of carefully selected financial institutions to issue American Express cards and/or acquire merchants on its network. Within this context, all contractual terms (including fees) are negotiated bilaterally and confidentially, and all transactions and fees are settled bilaterally and independently between American Express and each licensee. American Express does not have interchange fees and there is no concept of licensee "membership" or representation at a governance level in the American Express network. For all the reasons cited in section 1.2.1.1, even where American Express partners with a licensee, this does not make the network an open four party interbank card scheme, either in economic terms or under competition law.

We strongly believe – and have every reason to think it is and should remain the UK government's and the PSR's belief – that pricing regulation is an extreme measure that can be justified only in the event of a breakdown of market forces. The pursuit of antitrust cases against Visa and MasterCard reflects a concern that the multilateral arrangements among their member banks constitute a type of collusion that constitutes such a breakdown. We therefore believe it is critical, when considering price regulation, to distinguish between those schemes that operate on the basis of multilateral agreements among competitors and those that do not, such as American Express. To do otherwise would constitute a form of overreaching which, would only serve to undermine competition rather than enhance it.

20.2.2 American Express should be exempt from price regulation

American Express' business model depends on the ability to provide a differentiated premium value proposition. The ability to differentiate is fundamental for networks with a small sector share to be able to compete and grow. Differentiated value is equally reliant on the flexibility to create alternative business models and constructs and the freedom to negotiate pricing and commercial terms on the basis of the value delivered by these models and constructs.

If three party closed loop proprietary payment networks such as American Express are not excluded from the scope of the proposed EU Regulation on Interchange Fees (or any future similar proposals at UK level), American Express will be precluded from continuing to provide a competitive alternative in the EEA which will:

- lessen competition and choice in the market;
- impact the EEA's ability to continue to develop a digital and innovative economy; and
- result in the loss of highly desirable jobs with American Express in the EEA.

It is important to note that the existence of licensee issuers or acquirers does not change the fundamental American Express business model, the bilateral and individually negotiated nature of all of its agreements, the value proposition to merchants and cardholders or the fact that American Express is a choice for licensees, cardholders or merchants. The fees agreed between American Express and its issuing licensees do not form any "floor" for merchant discount rates as these rates remain subject to negotiation between American Express and its merchants in an intensely competitive environment in which American Express must demonstrate its value in order to secure acceptance of its cards. In respect of its licensee issuing arrangements, American Express provides a competitive alternative product offering for the licensee issuer, but does not replace the dominant incumbent card products offered on the Visa and MasterCard open four party interbank card schemes.

Superficially, the American Express licensing model may appear to be similar to the models of the dominant open four party interbank card schemes, but in fact it is fundamentally different from an open four party interbank card scheme (see section 20.2.1 above).

As such, American Express' licensing arrangements should be exempt from any pricing regulation. If American Express' licensing business were to be brought within the scope of pricing regulation, this would dramatically undermine the economic viability of those partnerships and, with it, the ability of networks with a small sector share such as American Express to act as a counterweight to the dominant open four party interbank card schemes.

The policy implications of applying pricing regulations to the partnership arrangements of American Express are alarming, since the pricing regulation would then extend well beyond collectively-set and mandated fees (as in the dominant open four party interbank card schemes) and also regulate fees freely agreed between two commercial parties negotiating at arm's length (as between American Express and its licensing partners). This is particularly concerning, as it would apply the exceptional and blunt instrument of price controls to a scenario where issuers and acquirers, cardholders and merchants have total commercial freedom on multiple levels, including whether to do business with American Express at all, as well as the ability to negotiate the terms on which they do so.

In this regard, the reality is that American Express cannot force its pricing or any other commercial terms on merchants. Our terms are open to negotiation and our business is always at the risk of merchants choosing not to accept our cards. The merchants who choose to accept our cards do so because they recognise the value we deliver, for example, in the form of increased business from a high-spending cardholder base and opportunities to market products and promotions to those cardholders. We are continually put to the test by our merchants in terms of delivering on the value we promise. This fact is underscored by the lack of universal acceptance of our cards among merchants.

This contrasts dramatically with Visa and MasterCard. Merchants typically have no choice but to accept these cards and the multilateral interchange fees that accompany them in order to sell their goods and services and run their businesses.

If changes are introduced to the structures of multilateral interchange fee models, American Express urges the PSR (and the UK Government generally) to acknowledge the distinctive nature of American Express' licensing model and to take action to protect and foster competition and innovation in payments, by ensuring that networks with a small sector share retain the commercial flexibility needed to negotiate arrangements that allow them to compete effectively with the dominant open four party interbank card schemes. It is important to note in any event that, as a smaller network competing against the duopoly of Visa and MasterCard, any caps to competitors' multilateral interchange fees, and the consequent lowering of merchant fees in those networks, will exert downward pressure on the terms that American Express can negotiate with merchants and partners, so inevitably American Express will be indirectly impacted.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

[✂] [CONFIDENTIAL].

Question 22: What changes, if any, are needed to facilitate a greater space of innovation in UK banking and payments? Please refer to your previous answers where relevant.

The best way to foster innovation in the UK banking and payments industry would be to not designate parties which do not meet the Banking Act's section 44 criteria for regulation, as this would ensure that these challengers to the incumbent banks and open four party interbank card schemes can focus on bringing to market innovative services to service users and consumers rather than be stifled by the disproportionate regulatory burden which designation would impose on them.

In particular, American Express notes that HMT would retain the flexibility to revisit any initial decision not to designate certain companies should competitive conditions change.[16]

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

American Express does not have any specific comments to make in this regard. Both options present benefits and limitations (e.g. interoperability vs. first mover advantage) which would have to be considered in the context of specific situations for any meaningful input.

CLOSING QUESTIONS

Question 24: Do you have any other comments or concerns you would like to highlight?

American Express has no other comments or concerns to highlight at this stage.

Question 25: What, if any, are the significant benefits you see regulation bringing?

Properly focused regulation (that does not designate and regulate smaller schemes that are not essential facilities and do not operate interbank structures) could bring significant benefits in securing the delivery of efficiencies to service users and consumers by all industry players (banks and non-banks).

Question 26: What, if any, are the risks arising from regulation of payment systems?

[16] See, e.g., HMT's comments at paragraph 2.43 of its Response to the March 2013 Consultation, dated October 2013: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249085/PU1563_Opening_up_UK_payments_Government_response.pdf.

26.1 Only payment systems that are akin to utilities should be designated for regulation – any broader scope of regulation would be disproportionate and significantly impede competition from players with a small sector share like American Express

As a general point, all of the authorities and exploratory studies cited by HMT as instigating its shift in direction towards a "utility-style" regulation of payment systems – without exception – confine themselves to a consideration of the banking system.[17] To the extent any of these authorities identify problems with payments systems, these are expressly related to the banking system, and do not extend to card payment systems of themselves. While extending the regulation of payment systems to the major open four party interbank card schemes might be justified on the basis that these dominant schemes operate systems that are essential to the UK economy and are akin to a commodity or utility, the scope of regulation should not be widened to include players with a small market share such as American Express, whose comparatively small three party closed loop proprietary payment networks cannot possibly be seen as utilities. In particular, three party closed loop proprietary payment networks such as American Express have very small sector shares[18] and have not been the subject of any competition law investigation for their structure and payment terms in the UK or EEA. They represent a genuine and pro-competitive choice for card holders and merchants based on value delivered to these customers – not characteristics associated with the utility or commodity services.

Finally there is existing precedent for excluding three party closed loop proprietary payment networks from consideration of open access requirements in Article 28 of the PSD.

In this regard, the OFT made clear in its response to the Commission's Green Paper that the cards of three party closed loop proprietary payment networks are not "*considered a 'must take' product by merchants*",[19] so it follows that access to three party closed loop proprietary payment networks is not necessary to compete in the payments sector. The European Commission has also previously acknowledged in the *Visa/Morgan Stanley Dean Witter* case that three party closed loop proprietary payment networks such as American Express and Diners are not essential for market entry and are not subject to the same requirements as were applicable to Visa in that case.

This is also consistent with the European Central Bank's 6th SEPA Progress Report[20] and the European Payments Council's reasoning for carving out three party closed loop proprietary payment networks from open access requirements in version 2.1 of the SEPA Cards Framework Report.

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[17] See HMT Consultation "Opening up UK payments", March 2013; FSA Review "Barriers to Entry and Expansion in Retail Banking", March 2013; Wheatley Review, September 2012; HMT publication "Setting the Strategy for UK Payments", July 2012; Treasury Select Committee publication "Report on the Future of Cheques", 2011; Cruickshank Report, 2000.

[18] By way of example, based on a January 2014 Euromonitor Report, the share of American Express for debit, credit, charge and prepaid cards in the UK is [✄]% [CONFIDENTIAL] based on EEA billed business and [✄]% [CONFIDENTIAL] based on EEA cards in circulation.

[19] OFT Response to Commission's Green Paper, page 8: https://circabc.europa.eu/sd/a/6c7caa06-7a20-4853-9999-0a76e3cc77e3/publ_auth-uk_oft_en.pdf.

[20] See pages 23-24 of the 6th SEPA Progress Report, November 2008: http://www.ecb.europa.eu/pub/pdf/other/singleeuropaymentsarea200811en.pdf.

26.2 A fine balance to strike in order not to stifle an innovative payments industry

As noted above, the lines between traditional card networks and other payment options, as well as the different categories of service providers, are rapidly blurring as innovation proceeds. When considering the evolving payments landscape, it is important for the PSR not to be constrained by traditional definitions of what a “card payment” or “payment network” is for the purposes of designing regulation, and equally perilous to establish regulation that, by virtue of drawing an arbitrary scope in a rapidly evolving sector, could pick and choose winners and losers without allowing market forces and customer choice to drive competition and change.

With regard to standards for new payment methods, it is not clear how any new regulation would benefit interoperability or foster competition in the already highly competitive environment of mobile payments. To compete with the existing payments infrastructure, the technologies enabled must be interoperable on a global basis or else the consumer will not adopt them. Regulation should not limit this consumer choice by forcing the market to adopt a particular technology or business model; ultimately it should be the consumer who decides.

The PSR should therefore ensure its future actions do nothing to diminish or distort competition at this pivotal time when the payments sector is undergoing such tectonic changes. The UK payments industry must be given the opportunity to respond to rapidly evolving consumer demand, and to position itself in such a way that is flexible, nimble and easily adaptable to the changing landscape. Competition, consumer choice and consumer demand should be the key drivers of innovation. Regulatory intervention that is too extensive risks stifling the UK industry at a critical time in its evolution and putting it at a disadvantage as against players located in other European and global jurisdictions.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Regulation might affect American Express both positively and negatively.

With regard to improving conditions of access to Essential Interbank Payment Infrastructure and as explained in answer to Question 25 above, regulation in this area would enable American Express to deliver efficiencies to service users and consumers, which would be likely to materialise in the form of better quality and/or better prices of the products and services offered to them.

Conversely, as is evident from our response to Question 1 above, regulation could have a very negative impact on American Express if imposed too broadly. In particular, the network operated by American Express cannot be characterised as akin to a commodity and therefore should not be subject to designation.

ABCUL
Association of British Credit Unions Limited

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Dear sir / madam

Payment systems regulation – call for inputs

We appreciate the opportunity to respond to this consultation. The Association of British Credit Unions Limited (ABCUL) is the main trade association for credit unions in England, Scotland and Wales. Out of the 393 credit unions which choose to be a member of a trade association, 72% choose to be a member of ABCUL.

Credit unions are not-for-profit, financial co-operatives owned and controlled by their members. They provide safe savings and affordable loans. Some credit unions offer more sophisticated products such as current accounts, ISAs and mortgages.

At 30 September 2013, credit unions in Great Britain were providing financial services to 1,075,951 people, including 122,280 junior savers. The sector held more than £1.1 billion in assets with more than £641 million out on loan to members and £918 million in deposits.[1]

Credit unions work to provide inclusive financial services has been valued by successive Governments. Credit unions' participation in the Growth Fund from 2006 – 2011 saw over 400,000 affordable loans made with funding from the Financial Inclusion Fund. The DWP has contracted ABCUL to lead a consortium of credit unions under the Credit Union Expansion Project, which will invest up to £38 million in the sector and aims to make significant steps towards sustainability.

Response to consultation

On behalf of our member credit unions, we would like to express strong overall support for the importance of a payment systems regulator which takes a broad view of its remit and role in order to encompass as wide as possible a range of payment systems and services. Credit unions, as small deposit-taking co-operative financial institutions, increasingly seek to provide payment and transactional banking services to their members – through products such as the Credit Union Current Account or the Credit Union Prepaid Card – in order to attract a wide range of members and to operate sustainably. The full service model is one that has fuelled success for credit union sectors around the world where, in the US and Canada, for instance, as many as 40% of people

[1] Figures from unaudited quarterly returns provided to the Prudential Regulation Authority

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belong to a credit union. This is the kind of success which we wish to see emulated by credit unions in Great Britain and fair access to payment systems is central to that.

Currently, small providers of payment systems, such as credit unions are reliant upon arrangements with sponsoring banks in order to provide payment services. Credit unions have found significant difficulty in reaching agreements with such banks since their willingness to enter into sponsorship and agency arrangements is strictly limited. Where such agreements have, however, been reached it is very difficult for credit unions or similar operators to a. understand whether the access terms they are receiving are competitive – since the payments structure and its operation by owner-user banks is so opaque – and b. even were full knowledge of comparable terms is available, negotiate competitive terms where the supply of banks willing to facilitate access is so limited given the relative market power of the negotiating parties this necessarily creates.

Therefore we would like to see a payments systems regulator which has authority over the full range of payments infrastructure in the UK. We would also like to see it take a far-reaching view of the possible action it might take to reform the landscape keeping radical measures such as divestments on the table as the system and its conflicts of interest are reviewed. It should also look at fundamental structural and minimum capacity barriers within the availability of access arrangements for small players and how the number of willing agency and sponsoring banks can be increased.

We are also conscious that the payments infrastructure is critical part of the economic system and innovation within it is vital in this respect. Due attention must be taken to ensure any measures the new regulator pursues do not inadvertently hinder this important process. That said, we also feel that while collaborative action is critical to innovation in payments, there is also the potential for conflicts of interest to stifle innovation and improvement and the new regulator should look closely at these issues.

Consultation questions

Q1. Do you have any views on which payments systems should be considered for designation? If this includes parties other than the UK payments systems listed above, please explain why.

In general, we feel that the entire payments system infrastructure should be brought under the purview of the new regulator. This includes at least all of those payment systems listed. In order for the regulator to ensure a level playing field between payment services providers it is vital that all relevant payment systems are within its remit to review and intervene in.

Q2. Where do you believe competition is effective or ineffective within UK payment systems?

Competition between payments systems providers is not evident in any great degree given the collaborative development of payment infrastructure and the tendency for the each type of payment system to meet a particular niche need or market. The uniformity across UK payments and in terms of system providers and owners brings some benefits in terms of consistency of service across the country and avoids potential costs of more fragmented and disintegrated payment infrastructure for the consumer. However, there are concerns that this lack of competition might undermine consumer interests in terms of allowing costs to be held up or, critically for our purposes, preventing entry at retail level by small payment providers.

We do not attempt to provide a clear answer to these issues but wish primarily to urge that the new regulator looks carefully at these questions and the balance of interests between competition and collaboration without pre-empting the process by taking any early decisions on action.

Q3. At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

We feel that greater competition has the potential to yield significant benefits at all levels within the payment system infrastructure. Our particular concern is greater competition at retail level driven by measures to ensure fair access to payments infrastructure for small payment service providers, such as credit unions. Better access terms in this respect will drive competition between payment providers which will ultimately improve both outcomes for consumers but also financial stability through improved corporate diversity in financial services.

Beyond the case for competition at the retail level, however, there are strong arguments for the new regulator to examine the impact of competition or lack thereof in relation to payments systems themselves and in terms of innovations. Were new payment systems able to set up and integrate with existing systems more easily, for instance, this could increase the competitive pressures driving innovation elsewhere and improvement of services overall. The regulator should examine the full payment infrastructure and how it might respond to greater competition. It should consider the examples of payments internationally – both in the developed and developing world – where more open regimes are yielding great benefits in terms of innovation and consumer choice.

Q4. What are the main factors impeding more effective competition at each level?

There are a number of factors here that we would like to highlight. Firstly, there would appear to be signs that the conflict of interest between ownership of payment infrastructure and usage thereof is having a negative effect on competition. Secondly, the lack of competing platforms for different payment instruments is a concern. Thirdly, the market for agency banks, required by small players is particularly stifling of competition since it limits the opportunity to search the market since no real market exists. Fourthly, the lack of transparency around costs and access terms for various providers and a range of levels impedes effective negotiation. Fifthly, there are questions of volume and scale which can present a barrier to entry for small players both in respect of investment capital or lack thereof and in terms of access terms in relation to fees per payment and such like. Sixthly, there are questions about the opportunities for payments innovators to build new payments infrastructure outwith the existing infrastructure owners and structures without the ability to effectively integrate with said systems.

While we are in no position to suggest the degree to which each of these factors is stifling competitive forces or to propose clear solutions, we feel all of them are questions which the new regulator should seek to promptly address.

Q5. What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

We agree that the payment systems and infrastructure, by their nature, are required to be collaboratively developed at at least the level of setting the key protocols and standards as to how the system operates. However, the precise limits of the collaboration argument against encouraging too much competition in payments infrastructure must be a key task for the regulator to examine and establish. We would suggest that the level of collaboration and integration in UK payments to date is extremely close relative to systems operating in other places and that, therefore, the question should be how far this is necessary and desirable in light of other concerns over competition and consumer outcomes.

Q6. Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Yes. Our principal concern is quite clear in that there would appear to be the potential for a conflict of interest since those firms which own the payments infrastructure are its main users in terms of providing payment services to consumers. Therefore, as long as small providers are required to negotiate terms through these same providers, they have no incentive to provide this on a fair and comparable basis. Similarly, there are question marks regarding the minimum benchmarks which are set to access payment infrastructure directly and whether these could be lowered to avoid the need for agency arrangements.

Q7. How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

We do not have any clear preference as to how this might best be resolved. There would appear, however, to be two options – the first of these would be divestment and the creation of new payment infrastructure providers in order to create new competition; secondly, one could stop short of divestment but instead create a separate governance structure to oversee payment concerns with a clear focus on enhancing competition and consumer outcomes. In any case, the key criterion of success should be resolving conflicts of interest either through divestment or tighter regulation and the test of this should be the degree to which improved access terms are evident in addition to further innovation and transparency.

Q8. Do you have any concerns about the current governance of UK payment systems?

We do have concerns relating to payment system governance. Our principal concern is the lack of a clear avenue by which small payment providers without an ownership stake might take a role in payments governance. We would like to see such a role created under any reformed governance structure for payments post-regulation.

Q9. What do you believe is the appropriate governance structure for UK payments systems?

As above, we would be keen for any reformed governance structure to provide a voice for small payment providers and wider societal and consumer concerns regarding payment infrastructure.

Q10. How do you access UK payment systems?

Our member credit unions access payment systems in a number of ways and with a range of levels of sophistication. At the most basic level, this amounts to operating through the credit union's own bank account service and operating payments semi-manually in the same way that an ordinary business customer would do. This is limiting for a credit union, as a financial institution, in terms of being able to serve its own members effectively since it builds in extra delays and inefficient processing. At a further level up from this, some credit unions are able to provide payment systems such as the Credit Union Current Account or the Credit Union Prepaid Card which operate through agency bank arrangements.

The Credit Union Current Account is hosted on the Co-operative Bank's banking platform and provides full account number and sort code facilities to each credit union which operates the system. The account operates on Visa Debit and therefore allows point of sale and ATM access globally. There are disadvantages to the agency arrangement here since the credit unions do not benefit from multi-interchange fees and the account does not provide the full range of payments and access channels that direct participation might. Furthermore, there are limitations in respect of the fees which credit unions are required to pay for various account operations which we have difficulty in assessing against the market due to lack of clear pricing information.

The Credit Union Prepaid Card also has Visa Debit functionality but as a prepaid card does not offer the broader payment options available to the Current Account. The key element of note here is that, fees and charges for this product are tied closely to volumes which credit unions can find difficulty in achieving effectively in order to make the product sustainable. Similarly, we have recently experienced difficulties in relation to the availability of sponsoring banks as the bank we had used decided to withdraw from the market and there is a very limited availability of sponsoring banks in the prepaid card market with whom to partner.

ABCUL, as part of the Credit Union Expansion Project, is investing in the development of a banking platform which should provide the processing capacity to engage more closely with payment infrastructure through a collaborative model. Critical to this, however, will be the access terms that the new entity is able to negotiation with the available agency banks.

Q11. For the access you describe above, are the access terms and conditions fair and reasonable? If not, please provide details.

This is a difficult question to answer definitively. There are a combination of factors at play which partly relate to required capacity for direct participation in payment infrastructure and partly relate to access terms in terms of fees and such. Similarly, the lack of available partner banks puts small providers at a distinct disadvantage in negotiation with sponsoring banks. We believe that it is certainly the case that the terms we enjoy could be improved substantially were any of these key barriers addressed.

Q12. Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes. Credit unions at the most simplistic level – i.e. without even indirect access to payment systems other than as a retail customer – have very high barriers to fairly compete since their processes are necessarily inefficient and there are extra delays and costs for consumers from the laborious processing that is required. At the more sophisticated level, this is also the case since credit unions are not able to provide the full service that a market-leading provider can provide and also are required to pay higher costs – both Current Account and Prepaid Card are fee-charging to members – and this is very uncompetitive for those who have options about which provider to use.

Q13. If you access payment systems indirectly through a sponsoring agreement with a direct member banks, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

As set out above, credit unions can only access payments systems indirectly and to varying degrees. Where payment services are provided in any significant way, i.e. for those credit unions providing the Credit Union Current Account or the Credit Union Prepaid Card, the credit union sector has faced a strictly limited number of available sponsoring banks willing to facilitate access to payment systems for credit union members. The availability of sponsoring banks, or lack thereof, has been a particular concern in relation to the Prepaid Card service very recently since the credit unions' existing partner has withdrawn from the market with very few others available. The only alternative to agreeing these arrangements as a sector directly with sponsoring banks is to go through a third-party processor and this adds significant extra cost.

As a sector we would be very interested in exploring the possibility of accessing payment systems directly or, failing that, for the provision of access to small payment providers to be mandated in some other way. Direct access, in principle, would generally be the favoured approach, however, there are currently obligations and minimum requirements in which must be met and it is not clear whether credit unions would meet these in the short term as they are set. A key task of the new regulator should be in reviewing and testing these minimum requirements to ensure that they are not presenting undue barriers to access and market entry for small payment providers whose presence would otherwise yield competition benefits for the consumer.

Q14. Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK?

No

Q15. What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We would like to see a new regulator make a detailed examination of the access rules and conditions for payment systems with a view to removing and lowering any barriers to entry for small players such as credit unions. Currently, there are significant barriers, such as the requirement to have access to central bank funds which prevent credit unions' access wholesale.

On the basis of such a review, we would hope that either unnecessary barriers could be removed or least that alternative options to give small providers a more-direct access route to payment systems be considered. This could involve a new class of system membership or some other arrangement but the key objective should be to widen access and for access to be made as direct as feasible.

Q16. Do you have any other comments regarding access?

We would only like to stress the need for greater transparency around payment system access terms because currently it is very difficult to establish how far terms are competitive and fair. Better awareness and standardisation of access costs and such would be extremely beneficial to provide a well-functioning market with well-informed participants.

Q17. What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any chances or improvements on the resilience and reliability of payment systems?

We feel the payment infrastructure in the UK is in need of significant investment and improvement. Recent examples of banking down time are testament to this. Furthermore, currently the investment requirement for access to payment systems in order to obtain the appropriate level of automation and capacity is very significant. We wonder whether the new regulator could play a role in facilitating cheaper access to banking platform technology in order to address some of these challenges.

Q18. What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

We would only say here, in the absence of more detailed knowledge, that messaging standards should always be designed and implemented in order to ensure effective access for small providers.

Q19. What solutions can be developed to increase competition in the provision of infrastructure and / or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved and what will the impact and benefits be to your business?

There are no clear answers to this question assuming that the regulator would not be willing to take a direct interventionist role in the market in the sense of creating competitors and such. We would urge the new regulator to look at any steps it has available to it to increase the provision of infrastructure for accessing payment systems. There may be a case for some special intervention in order to ensure that all small payment providers can access infrastructure providers. At the least the regulator should examine where any barriers might exist to new providers entering the market. There would be untold benefits for businesses such as our members were the number of available infrastructure providers increased significantly.

Q20. Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

We do not feel that the incentives to innovate are particularly strong under the current arrangements. We feel that questions around ownership, market power and conflicts of interest have a key part to play in this which have already been addressed above. We would also stress here again transparency in the market – it is very difficult to establish the true cost or otherwise of running payment systems which is illustrated by the OFT having to operate on inference and appearance, rather than clear data, in assessing the question. We hope that the new regulator will be able to establish more clarity around these questions in order that better policy can be made.

Q21. Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Credit unions are limited here firstly due to their size and lack of available funds for investment. For small players more generally, there are barriers due to the difficulty of integrating new systems with the legacy systems which already exist. In other parts of the world – particularly the developing world – innovating mobile-based payment systems have become established extremely quickly thanks to the lack of legacy infrastructure with which to fit in and learning some of the lessons from this innovative environment will be useful in driving innovation in the UK.

Q22. What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

We feel that the issues of ownership, governance, transparency and access should all facilitate a greater pace of innovation in payments. There will be a need to open the market to new entrants and to provide the ability to integrate new systems with existing ones more easily than is currently the case.

Q23. What do you believe are the benefits and limitations of collectively-driven innovation vs. unilateral innovation?

Clearly, an element of collectivism is critical to the success of payment systems which require multiple parties to co-operate in order to function effectively. However, we feel that there is a greater place for smaller groups or individual innovators to operate more unilaterally in order to create a more competitive environment where incumbents are forced to keep up with more nimble innovators.

Q24. Do you have any other comments or concerns that you would like to highlight?

No

Q25. What, if any, are the significant benefits you see regulation bringing?

Regulation should provide an environment in which payment systems are challenged to justify their powerful market position. There are clearly a range of causes for concern which the regulator will be able to address particularly around ownership, competition, innovation, governance and access terms. A regulator able to look at and take action on these areas with a view to improving the experience of end-users should greatly enhance the operation of payment systems in the UK.

Q26. What, if any, are the risks arising from regulation of payment systems?

There is the possibility that inappropriate intervention in the market could take payment systems backward by not effectively recognising the pressures which payment system providers face and the significant investment requirements, for instance, which are required in improving payment systems. If the regulator is careful about how it addresses these questions, however, it should be able to improve the payment services market without negatively affecting the existing system.

Q27. How do you think regulation might affect your business and your participation in UK payment systems?

We hope that regulation will greatly improve access terms and availability for small payment providers such as credit unions which will allow us to compete more effectively and, therefore, to provide more effective competition in payment services thereby enhancing our ability to improve the financial well-being of our members.

Once again, we are grateful for the opportunity to respond to this consultation. We would be more than happy to discuss any of the points raised above in more detail. Please feel free to contact us.

Yours sincerely,

M Lyonette

Mark Lyonette
Chief Executive – ABCUL

Basic information

Consultation title:		**Payment Systems Regulation - Call for Inputs**
Name of respondent:		**Association of Foreign Banks**
Contact at respondent:	Name:	**Nigel Brigden**
Email:		**nigel.brigden@foreignbanks.org.uk**
Address:		**1 Bengal Court, London EC3V 9DD**

Nature of organisation (select as appropriate)

Infrastructure provider (e.g. Vocalink)
Payment system operator
Direct member of payment system(s)
Indirect participant in payment system(s)
Service-user
Other payment provider (e.g. ZAPP)
Third-party service provider (e.g. ATM distribution)
Trade / Government / Regulatory body **Trade Association**
Other
Please specify:

Confidentiality **No**

Do you wish any part of your response to remain confidential?
If 'Yes', please submit both confidential and non-confidential responses.

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

In a multi-currency environment, it is important to consider the role of other payment systems, which have a presence in the UK and provide payment services, for example SWIFT.

In addition, SWIFT provides a point of access for CHAPs and other sterling payments.

Consideration should also be given to other providers such as Western Union and Earthport.

All regulated payment services providers should be reviewed to see if they provide payments systems which are sufficiently large to warrant regulation.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Currently, the direct members of the major payments schemes control access based on the rules and procedures relating to the opening and operating of bank accounts. This enforces rules, which are not necessarily relevant to the sole provision of a payments system, and additional obligations on both sides.

The separation of these activities will enable all parties to provide payment services based on consistent and competing schemes.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Currently, schemes such as CHAPs and Faster Payments are controlled by the direct members and historically there have been different appetites to provide third party or agency facilities. This may be because of the issue of allowing third parties access to payment systems, which provides the ability to compete directly with the direct members, without having been party to the initial investment in such systems.

The current direct members control the membership terms for new entrants. A review of these terms and conditions should be undertaken so that they are not perceived as being anti-competitive.

The quality of the electronic systems/schemes is not an issue. It is how they are used which needs to be reviewed, as in some cases the usage of such systems has not kept up with the technology, for example payment cycles and real time settlement.

Question 4: What are the main factors impeding more effective competition at each level?

Please see question three. The reluctance to split between the wholesale and retail activities hinders competition. The costs of providing the scheme are often hidden and simply absorbed into the provision of banking services. In addition, in some cases the initial set up costs have long since been written down.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Collaboration may well be useful when it comes to basic data standards to ensure message compatibility. However, this should not be restrictive and should enable payment system providers to develop enhanced services, which will give users an improved level of choice.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

The merging of the retail and infrastructure activities of the direct members results in challenges for new members. There is considerable merit in these activities being split as it will enable a clear understanding of the costs involved in providing such services. Currently the infrastructure and the way in which it is managed enables current owners to develop services which appear very competitive to the customers and merge costs.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

The key is to identify and develop a model which not only addresses the current issues but encourages the existing direct members to continue their involvement in payment systems. It is essential that the changes do not threaten in any way the integrity and robustness of the current infrastructure.

Question 8: Do you have any concerns about the current governance of UK payment systems?

The Payments Council is making a substantial contribution through their Roadmap, identifying potential solutions which address the current issues.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

When the new Payments Regulator has been appointed, the future role of the Payments Council may well be questionable. There is a need for each Payments system to be independent and therefore independently managed.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

As a trade association we are representing our members who are primarily agency banks.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Our concern here is to ensure that the access terms and conditions are fair and reasonable for our members.

Access can be difficult for small banks with small payment volumes as many of the main banks are only selectively supplying agency services due to income or increased compliance costs for these services.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

As a trade association we are representing our members who are primarily agency banks.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

The current concern is that access to payment systems is controlled by the ability to have a full banking relationship with a direct member. This results in contractual obligations *being far wider, especially with regard to AML etc. which can result in a relationship being unattractive to a direct member.*

Direct access provides a clarity which currently does not exist and can benefit all concerned.

An increased number of direct members would assist.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

As a trade association we are representing our members who are primarily agency banks.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Please see above. It is essential that the routes to gain access to payment systems are clear and unambiguous. Other infrastructure providers, such as CLS, have experienced challenges, when access was not as such.

A two tier infrastructure is preferable:

- *Direct membership- an infrastructure provider*
- *Third party membership – a user who is not an infrastructure provider.*

A two tier infrastructure also protects the integrity and robustness of payment systems.

Question 16: Do you have any other comments regarding access?

No

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Our interests concentrate on the availability of the infrastructure on an equitable basis.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Our members have indicated that they would like the ability to provide an enhanced service for their customers, especially with regard to additional information attached to the payment and the ability to "see" the payment in progress and when it has arrived at the beneficiary's bank account.

The timescale needs to be sooner rather than later especially as other industries already have a similar service in place.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Please see 18

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).
We do not believe there are currently any incentives to innovate.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

The agency banks by definition are followers.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Infrastructure providers need to compete with one another. Currently, they tend to fill a "silo" need. It is only when they are in competition with one another, that there will be an encouragement to speed the pace of innovation.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

We do not see a difference at the moment. The difference will only become apparent when true competition appears.

Question 24: Do you have any other comments or concerns you would like to highlight?

No

Question 25: What, if any, are the significant benefits you see regulation bringing?

The benefits can be summarised as follows;

- *The development of a more competitive infrastructure*
- *The development of a more robust infrastructure*
- *A wider choice for the user*
- *Potential lower costs for the consumer*
- *A clearer understanding of the cost of the infrastructure*

Question 26: What, if any, are the risks arising from regulation of payment systems?

It is essential that the new Regulator ensures that the payments systems remain robust and that their integrity is not compromised in any way.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Our concerns are on behalf of the majority of our members, who are agency banks. It would be useful if trade associations could be used as a consultation platform providing the new Regulator with the widest input into any decisions which are made and as a channel to spread relevant information to agency banks.

ASSOCIATION OF FOREIGN BANKS
15th April 2014

Cover sheet

Basic Information	
Consultation Title	**PAYMENT SYSTEMS REGULATOR**
Name of Respondent	Association of Independent Risk & Fraud Advisors (AIRFA)
Contact at Respondent	Kevin Smith or Bill Trueman
	Kevin@airfa.net Bill@airfa.net
	AIRFA.Net Langwood House, 63-81 High Street Rickmansworth, Hertfordshire, WD3 1EQ

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	Trade Body
Other Please specify:	

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		NO
If 'Yes', please submit both confidential and non-non confidential responses.		

by 5pm on 15 April 2014.

How to submit your response

Please email the cover sheet (Annex 1) and your response to paymentsystems@fca.org.uk, by attaching your response document and any supporting material you would like the new regulator to consider. Additional hard copies are not required if you send a response by email.

Alternatively responses can be posted to: 25 The North Colonnade, Canary Wharf, London, E14 5HS

General Comments

It is important to address the wider document as a whole, as responses have been invited in the form of answers to specific questions that in themselves do not properly allow for a wider comment.

In general, there are major flaws in the document as:

- It does not clearly define many of the terms used, where it is quite clear from the comments and questions that the terms used will mean very different things in the commercial sector as they clearly mean in this document. This will only lead to further confusion and misinterpretation. Even some of the fundamental terms/issues contain ambiguity, e.g.:

    - INNOVATION in payments. This could mean at one extreme the evolution of new payment methods, systems, APPs, solutions and technologies – which are being launched globally every day in abundance and leading a market; or it could mean enacting legislation to enforce mergers, restrict practices upon say international card schemes or introduce UK taxes upon non-UK schemes, funding of costs or nationalising certain payment systems / organisations etc.

    - PSP – which has been defined here as a principle payment organisation, i.e. member bank, but is universally known as the opposite in the payments' industry, as the result of previous usage by card payment schemes.
        - Pages 7 and 26 state: *Payment service providers. This is any entity, which provides services to other stakeholders, who are not participants in payment systems, for enabling the transfer of funds using the payment system. For example, banks and building societies providing payment services to customers.*

      The challenge is that the more universal definition of Payment Service Provider (PSP) is more aligned to that of and Third Party Service Provider(s) as included in the same consultation document.

    - COMPETITION is now global and European rather than UK based. The payments markets operate globally now.

    - ACCESS – All comments in the document seem to refer to access to payment systems in general, but elsewhere to the CHAPS/BACS/SWIFT/Faster Payments organisations etc. Visa/MasterCard are excluded even though they are bigger. This seems to be driven by smaller players who feel excluded and who demand a fast track to full access of all payment system functionalities at little or no cost, and comments reflect a belief that there are monopolies/cartels. These organisations are not commercial but paid for and invested in by their members.

    - BANK – Reference is made to:
        - The cardholder's bank or issuing bank and
        - The merchant's bank or acquiring bank.

      It should be noted that increasingly, merchant acquirers are no longer banks in the traditional sense. They have divested of their issuing history to focus their energies on the merchant acquiring business. This enables such acquiring businesses to more effectively compete in the 'global' acquiring and acquirer processing spaces. There are numerous examples of this in the UK.

      It has also allowed for greater levels of governance validation, as acquirers and issues are now more able to and more freely debate within the membership and management of the payment system operators. This should ensure that both issuing and acquiring voices are better heard leading to more balanced discussions and agreements.

- The document has not re-defined/restated the original requirements and scope – i.e. what is trying to be achieved? It cannot be "just because regulation requires this"; so in addition to the regulatory requirement, it needs to define much more cogently "what is broken with the current payment services infrastructure?", so we can ask ourselves: "what is the business need?", and "what are the commercial imperatives?"

- The document has a number of footnotes and references to other documents, laws and decisions that are relevant but clearly obscured in other documents behind this consultation. There is a danger that the consultation will explicitly (or implicitly) endorse or absently avoid considering the issues that appear in these other documents.
- Whilst this is a learning/listening exercise we (the PSR) must be careful not to carry out superficial research on a complex, European and Global industry and come to conclusions driven forward by a small number of 'new market entrants' with 'strong voices'.
- It is important that in the desire to search for new innovation, that we also recognise that there is also already too much innovation running away with itself, seemingly unchecked by governance and legislation/regulation through an absence of clear boundaries in new technology areas.
- We must not be drawn into a false belief that PAYMENTS are simple and easy. They are a backbone behind the economy and have complexities associates with diverse risk, credit risk, fraud risk, transactional risk and settlement risk issues that all need to be accounted for and managed.

It is important, that, in looking at the role of the PSR in this paper that the regulator also looks inwards into the constituent parts and make-up of the PSR itself as it will attract significant criticism in the absence of any payments experience within its ranks (in the context of the release of the board of directors listing in the last few days – which does not evidence any such experience in what is a technical and complex field).

The financial services sector may not have done itself any favours when considering loans, LIBOR, insurances, cheque displacement, cash displacement, bad debt, bonuses etc., but the electronic payment services environment is vibrant, fiercely competitive, and innovative. Competition is healthy amongst existing players and new entrants, both through technology and new payment systems operators, providers and the introduction of new participants from outside of the UK. All of these drive merchant and consumer choice, extend options and competition – not just in terms of price, but also in value added components.

There is a concern that people within 'Government' have a clear problem with the operation of the UK Payments Council and probably with other senior officials within the financial services community, which they may seek to correct and control by attempting to regulate the whole industry. Historically, Government intervention in the financial services industry has met with mixed results and as such should be approached and viewed with extreme caution.

We have major concerns about the reasons and justification for regulation being considered appropriate or radical action being taken by a regulator to govern a business sector, or implement changes in areas that from this document is clearly not understood by the authors (as indicated by a series of misplaced assumptions, adoption of incorrect terminology and strange categorisations). A serious concern is that the Banking Reform Act's aims to redress wider issues in the banking sector (whether real or over-stated), should somehow lead to the formation of the PSR, that has been moving towards the adoption of an agenda to fix problems that may not exist; and if they do exist, will make little contribution to the wider Banking Reform Act objectives of 'cleaning up the industry'.

Furthermore it is worrying that the direction proposes (or implies) the introduction of measures that will actually have a reverse effect to those that are planned, i.e.

- Removing competition in the payments environment
- Restricting innovation through fear or over-regulation
- Making the UK non-competitive and driving innovation abroad
- Creating additional costs and work upon the sector as a whole
- Making access to payments harder, because of a removal of investment and development of solutions and infrastructures
- Destroying the foundations of payment systems that 'oil' the payments sector
- Introducing more unjustified government bureaucracy.

The consultation document seems to believe that innovation can be regulated for; whereas it is widely accepted that regulation destroys innovation and creativity. The UK is a 'hot-bed' of innovation that is either: developed in the UK or developed elsewhere and tested/launched in the UK prior to European-wide deployment and further afield. With unnecessary regulation, further intermediaries and barriers, innovators will be discouraged and will move/operate outside of the UK.

The proposals appear to be focused upon regulating BIGGER PLAYERS, which this and wider legislation and regulation are already all the time; whereas SMALLER PLAYERS are allowed (through their size and ignorance) to ignore or be exempt from the regulation, where they do not know about it, or feel that it may not apply to them. Ironically, these BIG PLAYERS are the ones that the regulations will apply to and are the organisation that are less able and capable true innovation.

AIRFA.net is aware that this is the first draft consultation paper on this topic. AIRFA.net recognises that further reiterations are required to get this document closer to the final product and look forward to being involved further in this process and being able to review subsequent releases to ensure that the proposal is fit for purpose, good for the payments business in the UK and supports the best interests of UK financial services abroad.

Question Responses

Question	Response
Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.	The payment systems that exist today – i.e. the established systems – are those that are regulated fully, and by virtue of historic losses and problems have evolved an appropriate commercial level of protection(s). For example, MasterCard / Visa (in the payment card arena) and CHAPS and SWIFT all have rules of engagement that fill many 1000s pages that require and 'live' security and regulation. These are embed within them many requirements such as DPA etc., that underpin the integrity and protect brand and reputation, security and consumer protections. Therefore all UK payment systems should be included, without exception. The assumption is that once the UK Government makes a decision on its position with crypto currencies like Bitcoin and others, this will determine their inclusion/exclusion. This starts to create uncertainty and multi-tier regulatory environments. Though cash management is excluded from the scope, FX exchange, Consumer / commercial facing payday loan and loan companies should also be included. Products and services that are evolving that are today driving innovation appear to be covered here, but it is implied that they may be excluded (initially maybe?) – but as they are evolving faster than is probably healthy, there is a significant concern that such organisations can expose UK Plc to significant risks and embarrassment if they evolve outside of a regulated environment. There are £billions being invested by venture capital companies globally into smaller start-ups covering new payment systems, solutions and propositions in the UK and elsewhere. Many/most must inevitably fail in due course, due to an absence in their offerings of one of more of the following: - Security - Infrastructure - Brand protection - Understanding of their product risk profiles - Economies of scale - Realistic commercial framework - Etc. Unfortunately, regulation may also drive businesses out of the UK and discourage innovation in the UK. Accordingly, "INNOVATION" needs to be better defined. In addition, confining things to the UK is short-sighted, especially as Visa and MasterCard have now agreed to work together to define global payment rules within MOBILE payments - i.e. removing the opportunity for the payment regulator in this context to have any form of impact in this (and other) areas.
Question 2: Where do you believe competition is	Competition and innovation in the UK seem to be rather more

effective or ineffective within UK payment systems?	‘running away with itself’ and is approaching ‘wild-west’ proportions in the area of new payment methods and schemes competing for a space in the market-place. There are a plethora of localised solutions and many more that have very ambitious national and international aims. A lot of these new and evolving systems / innovations piggyback on the already established backbones of strongly regulated payment systems – SWIFT / CHAPS / BACS / MasterCard & Visa etc. There is a significant amount of equity investment going into all categories of payment businesses, especially those involving mobile payments and wallets; where the EU and ECB are trying hard to legislate and direct (as well as MasterCard and Visa globally). It should also be noted that organisations like Visa / MasterCard / Amex / Discover, etc., are examples of where entities are purchasing competitor technology / processing solutions /loyalty providers in the market. The rationale behind all of the purchase may be unclear, but may need further review. It is also very notable that there is significant confusion in the paper (but also in the European Commission and ECB papers regarding ‘mobile’ payments and mobile payment security that is worrying. However, this is also reflected in confusion seen in the payments market itself at present relating to: a) What and where a wallet is b) What Mobile is (as there are several tiers involved) c) Which payment solutions involve the creation of value / money and which backbone onto other payments infrastructures. d) Where the risks are and what they are, but also how these are mitigated within the many products that purport to do similar things but can be very different.
Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?	Market-forces will drive all of these areas and it will be hard to regulate in these areas. It is hard to understand this question and it is particularly vague and broad as the terms used are not defined or clear – or the extent of the terms and how they apply – or would be applied by a regulator. Are ‘levels referring to: a) the bullets on page 10 b) The table (figure 1) contained in page 7 c) Levels in general – i.e. what aspects of the issues in the market? There are now hundreds of different ‘flavours’ of payment service providers (PSPs – as defined everywhere else (players: 5, 6 ,7 and 8) rather than PSPs are defined in this document (type 4). The clearest thing that arises from this paper is that there seems to be a complete lack of clarity and understanding of the current payments market infrastructure, but also of the regulations and innovation that

	exists today. Even the term 'innovation' can be considered completely differently: a) IN THIS PAPER – innovation may be viewed as: - Introducing faster telecom infrastructures - New mobile handsets/other devices - Access to data – liberalised laws - Cross-border movement of funds - Introducing BASLE 3 – 4 - Lowering boundaries for setting up new banks - Merging of schemes or service organisations - Introduction of new payment system operator(s) - Nationalisation of 'industry owned' non-profit-making centres of excellence. - Publishing costs and financials - Creating a centralise identity authentication bureau(x) - Creating legislation relating to the governance of and use of 'APPs' - Legislation to 'kill cash' - Legislating in the UK on scheme interchange rate levels - Introducing 'swiss-style' legislation restricting payment system ownership to be transferred outside the UK/European Union (e.g. MasterCard & Visa scenarios). - Etc. b) Commercially – innovation can mean – creating new money schemes, new card brands, new internet solutions, new wallets, new identify verification and authentication solutions. One of the biggest shortcomings of the PSR consultation is the lack of clarity on what is meant by 'innovation'.
Question 4: What are the main factors impeding more effective competition at each level?	It is hard to define this within the closely (and unhelpfully defined) levels. Within the innovation evolving today, the lines between each and all of these levels are far from clear. For instance, where would one place iZettle, Bitcoin, Droplet etc., Zap, PingIt, etc. Competition is rampant and everywhere. One would imagine that the question is led by the belief of the question-writers that the answer might be forthcoming as: MasterCard/Visa, or the Banks, etc. However, it is these organisations that create not only the regulations and safety and integrity of the systems, but also the backbone for innovation (and conversely the inability to innovate new global infrastructures/backbones). We should also make sure that new competition does not challenge to undermine the foundations of the payments industry in the UK. The biggest impediments to competition may well be aged-legislation and an increasing number of regulatory bodies – in the UK and externally.

	A payments regulator will, with a short-sighted vision or with the absence of a clarity of what is needed (or hidden true objectives) will be strongly detrimental to both competition and innovation and therefore payments in general. There is considerable concern that the entire agenda (of ACCESS, INNOVATION and COMPETITION has evolved from a successful lobbying of smaller 'new entrant' payment organisations in search of: - Cheaper / free / immediate access to long established payment systems – i.e. for other people to pay for their costs of entry and a desire to lower the barriers for entry without proper due diligence. - Payment systems without the protections and infrastructure, security and governance that is in place to protect the integrity of the systems and the UK payment infrastructure. - An almost freely accessible creation of a payments hub that would allow unaudited access without responsibility. These premises seem to be made upon the beliefs that: a) There are cartels / clubs and collectives that run the payment systems that also prevent entry thereto. This premise is poor, as all the UK payment systems are non-profitmaking where costs are met by the contributors. b) That payment systems are or should be accessible without cost to new entrants. Which is clearly difficult to conceive as the payment systems and infrastructures contain strong innovation driven ownership, clear and strong governance and without a direct regulator before now, a strong self-regulation. This all need to be paid for. The creation, management and funding of a payments regulator cannot be justified simply to manage expectations or whims of such market entrants or to control and manage the solutions and systems for an industry that has evolved as a world leader and one that is far ahead of for instance USA based payments architecture. It is fair to comment that b) above may be seen as unfair on the existing payment system operators and members, however of more genuine concern is whether the entrance and latterly participation fees are appropriate.
Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?	Proper regulation is required to ensure: - Prohibition of access to the payments backbones to new payment schemes that innovate outside basic payment organisation rules and/or legislation/regulation. i.e. if a new 'wallet' is created that obtains value through a BACS Direct Debit 'fill'; then the wallet provider must be regulated / managed / governed by the payment scheme (here BACS) to ensure that all payment transactions are legal (in all aspects of laws that relate not only to payments, CCA, MLR, but also to local and international laws relating to sale of goods restrictions – e.g. export of tobacco to the USA conforming with tobacco import restrictions for instance).

	There is an issue in the question – on what is the industry being discussed here, as: there are many dozens of *industries* 'patched together' in this 'payments sector' albeit unevenly, that form the UK payments system. Indeed, many (the majority?) of UK payments are carried out through non-UK based or non-UK owned payment systems. Collaborative action is required to: - Set a level playing-field around application of the rules - Early and quick application of rules within new and evolving payment solutions and products associated with 'new' payments. - Define rules that encompass laws, e.g. identity validation according to Money Laundering Regulations (MLR). - Etc.
Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.	Yes, but probably not in the way that seems to be presumed in the consultation document. The consultation document covers too many areas in a way that is unclear and unspecific and lacks a great deal of knowledge on the actual industry. This is reflected in most of the questions here. The responses to the questions asked will hopefully educate PSR staff significantly within the regulator such that the industry structure will start to become clearer to the regulator. In addition, it is hoped that the regulator will start to understand that the way in which the structure of the industry is detailed here in the consultation paper is wrong, and no longer (if it ever was) applicable. It is again regrettable that the newly appointed board of directors of the new PSR does not contain any payment industry representation. Many 'organisation ownerships' might benefit from change, but the key ones that would benefit from change will be those that fall way out of scope for the regulators to be able to change – due to the global nature of the organisations involved (MasterCard and Visa, AmazonPay, Stripe, Paypal are all good and key examples of those that are globally operating. Breaking-up of organisations in the payment sector in the UK simply because there are perceived examples of problems; will lead to stronger global (non-UK) innovation. There is seemingly very little that is controlled directly by any commercial organisation with commercial imperatives (e.g. BACS / SWIFT etc. are not controlled or owned by HSBC or Barclays). Whereas there exists cause for concern where organisations that are commercial, owned by shareholders or by collections of banks etc., with mono/duo/triopolies that control payments backbones AND commercial arrangements and the governance and regulation. However all/most of these are non-UK based international organisations such as those named elsewhere. Regulation against spurious or unfair card-scheme rules (MasterCard

	and Visa) could be useful in particular where these are mandated globally because they apply more in the USA, and/or for instance to meet USA based legislation. In particular where these support USA legislation that has underlying trade protectionism within it for example. A business such as Vocalink 'owns' key processes, but also innovate (ZAPP, Faster Payments etc.), and also professionally divest their involvement – so would appear to be an inappropriate target for the regulator to divert itself towards. Note: The authors of the PSR consultation document, very clearly do not understand the governance structures of MasterCard Worldwide and Visa (both Visa Inc and Visa Europe), which typically operate with the same set of client financial organisations but via differing governance.
Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership	See above. The question, though clearly seemingly directed at say, Visa, MasterCard, Payments Council, etc., is again too broad and open to elicit a response in any particular direction. Whereas the current model is clearly not understood by the PSR consultation request writers, this is understandable as the market is not only global but overtly complex. Proposing radical change or a new model here would be inappropriate, as the suggestions at this stage would be misunderstood and most probably ignored too. The PSR must first clearly form, define and publish the scope and objectives of the PSR to allow for an understanding of the type of changes that might be possible to suggest and implement. With respect to MasterCard and Visa the challenge remains that they have become omni-powerful as a combination of being, performing or owning one or more of the following: • Acceptance and brand mark owners • Technology providers • Transaction processors • Solution providers, e.g. processing, MI, risk tools and services • Transaction and individual authenticators • Innovators • Rule setters and regulators • Compliance enforcers • Card Issuers, through purchase/ownership of other entities • Merchant processors, through purchase/ownership of other entities. Moving ownership can only be in the interest of removing innovation abilities and causing regulatory havoc.
Question 8: Do you have any concerns about the current governance of UK payment systems?	MANY CONCERNS in this area. Many more are not documented here as it is too early to document and discuss. By default, most of the regulatory environment centres around the weaknesses of the Payments Council, but also around the rule books and procedures of both MasterCard and Visa. Increasingly, the

	agenda and regulatory framework is evolving from within the ECB and European commission too; and is instilled in a large number of other EU and UK legislation too. It is always important to retain legislation that covers the security, controls and procedures that protect the governance and integrity of payments' systems. In addition, commercial pressures protect the systems – e.g. if a bank loses a lot of fraud, then they will strengthen their controls on identity. Smaller players can and do enter the payment system, they identify and focus on the weaknesses of the incumbent banks, providers, 3 and 4-party card schemes, telco-operators etc. Their challenge is then in making a commercial challenge to them and the status-quo – and to evolve a product with a broad adoption, national rollout, and attract or avoid being purchased by another party (either for absorbing or killing)? Payments Council, through its own consensus model, appears to be inadequate for the role and significant tasks at hand. With the introduction of e-money directives, the FCA issues e-money licences without any (externally visible) strength of regulations, infrastructure and governance or enforcement. This means that there are many organisations evolving a series of products that do not have clear governance, regulation, infrastructure or enforcement. This leads to (where these products do not 'touch the MasterCard / Visa infrastructures) a new 'wild west' of unregulated innovation – i.e. without protections of basics such as identity validation and transaction audits and screening for illegalities – all of which are legal requirements contained in MLR for instance. This is compounded by the ability of e-money licence holders to 'passport' their licences from one European state to another without also themselves regulating, governing or providing a framework for doing so. The whole issue is much more global rather than EU or UK-centric, with some serious gaps in legislation for controls rather than gaps in innovation. It should also be noted that UK Government interference in the industry governance does not always have the desired effect and appears contradictory, e.g. concerns over the regulation and control of fining of 'super-large' individual banks, does not address these issues. Creation of such beasts as the Lloyds Banking Group by the government therefore does not help either.
Question 9: What do you believe is the appropriate governance structure for UK payment systems?	Probably anything but the one proposed here. Allow the industry to operate freely without unnecessary and excessive interference. Light-touch required. Consider a complete re-focus of the underlying requirements for regulation in the UK; batting for the UK in the international payments field.

	Re-examine the mandate for the Payments Council.
Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.	Not applicable or particularly relevant for the AIRFA respondents. The international card schemes (e.g. MasterCard / Visa) have an infrastructure that has been established over many years (50+) and involved major investment. Why would anyone with an infrastructure like these companies have, but also like many other suppliers in the UK want to share or let someone else use its infrastructure (and certainly why would they allow this to be done for free). And if it does have an infrastructure based in the UK – that falls under the remit of the UK regulator – i.e. that it can be divested of its interest by a UK regulator – then it is likely that the business will become weakened in the European and international competitive market place. It has long been proven that a commercial imperative is for stronger innovation than a regulated, governed, organised ownership / structured environment. We have serious concerns that a future regulator will want to divest interests of key infrastructure providers in the UK, and at the same time: a) Remove commercial imperatives b) Stifle innovation c) Destroy value d) Unfairly undermine existing players e) Remove the ability for UK / UK businesses to compete internationally with companies that do not have these constraints.
Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.	Not applicable for the respondent or respondent members.
Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?	Not applicable for the respondent or respondent members. CARE: This consultation must not unduly cater for the needs of a small number of 'loud' responders within the 'new entrant' category of payment solution provider.
Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?	Not Applicable for this respondent or its member organisations.
Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes: • To whom do you provide indirect access?	No. Not applicable. Care again as in Q12 Working with many organisations though, which **do** sponsor indirect access into the payment systems; it is clear that the questions here completely misunderstand the industry and how the industry is evolving.

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access? **• Are there any barriers to becoming a sponsoring bank?**	Most card acquirers for instance provide indirect access to 100s of organisations (PSPs – as defined widely in the industry rather than PSP as defined by this consultation document), who in turn can provide access to hundreds and thousands of 'sub-merchants', payment companies and other entities. And indeed some do so illegally, outside controls and rules and often do so naively. There are major risks of delegating the responsibility of functions to delegated parties and further risks of delegating the associated responsibility of governing, overseeing and enforcing compliance of these organisations with all the legal/rule requirements associated with the operation of a payment system within its immediate market and within whatever market payments are destined for. Most of the issues and responsibilities are brand and reputational risks associated with indirect access being given to people that do not understand the security issues, responsibilities, rules, laws and protections that are inherent in the systems: i.e. which protect Brands and the integrity of systems and infrastructure in the process. This situation is very prevalent in most payment systems and are particularly noticeable in the payment arenas where they are not governed by say, MasterCard and Visa – as these organisations have infrastructures that have evolved over many years with rules and protections. A major shortcoming today rests in the products and services that are provided through the FCA e-money licencing and e-money directive, and those to whom such services are '*passported*'. This is largely because the infrastructure, rules and governance are not 'owned' by anyone and certainly not regulated operationally, not monitored or inspected, and certainly not enforced. Accordingly, the move towards greater competition and the removal of regulation (and into a free-for-fall 'wild-west') has been significantly completed and demonstrated already. If an organisation that is providing indirect access to payment solutions is governed by a card schemes directly, then the barriers to entry and protections are clear. If traditional 'acquirers' / Banks are involved they are rigidly constrained by PCI DSS, Money Laundering regulations, Data Protection and Banking reporting (BASLE) as well as card scheme and payment system rules. Accordingly, such organisations will choose only to provide direct access to parties that understand the rules (contractually), identify customers and do due diligence freely, widely and in a way that legal requirements dictate. Issues arise where smaller companies create (usually around a web based solution or 'APP' development solutions) a new payment system or solution without an understanding of payments, legislation, rules, compliance requirements and infrastructures etc. Such payment systems can attempt to 'side-step' many rules and much governance. It is very dangerous to have as a starting position that which is proposed by the PSR consultation documentation for setting up a regulator.

	It is almost entirely appropriate for a set of completely counter-objectives to be created (i.e. 180 degrees away from those proposed) in the consultation.
Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?	The integrity of any payment solution needs protecting as the balance between utility and security is always very marginal. We know to the nearest £1 – what the losses in the UK are for card payments, together with the volumes and values etc. We can also set strategy, direction and tasks as UK Plc in the area of managing these losses. However, we have no concept of what the solutions are and losses are in the area of new solutions and payment methods. The Payments Council/UK Payments “club” needs to be revisited to ensure that smaller players have the ability to participate, if and as required and therefore comply with applicable national standards and requirements.
Question 16: Do you have any other comments regarding access?	Not at this time. Further reiterations of the consultation document will hopefully stimulate more debate.
Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?	Technical infrastructure standards relative to payments are typically governed and regulated through card scheme rules and processing requirements, but in most cases APACS standards, under the auspice of UK Payments and the Payments Council. These typically form the basis of the foundation for engagement. They may be seen as a barrier for smaller newer entrants, but need to be followed by all local and overseas participants in the electronic payments space in the UK.
Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?	ISO20022 as an international standard, apparently driven by organisations like SWIFT, and will have significant implications for UK financial services providers and players. APCACS processing standards in the UK for acceptance device to provider host (e.g. APACS Standard 70) and other messaging requirements are clearly under the microscope, but have acted as a control mechanism for UK payments - to ensure compliance by all participants in the UK including cross-border parties. Any standards change will have significant impact on the UK market place. Standards still take a long time to implement, in a market where changes take place faster than the process of implementation of new standards. There should also prevail a hierarchy of regulatory bodies and regulation. This is especially important where the EU and global requirements are in place, come into existence or change regularly. The costs of implementing new standards could be many £billions and yet still be ‘out of date’ and / or superseded faster than they could be introduced.

	Caution should be adopted in the removal of constraints to encourage innovation or the adoption of standards internationally; because: - The costs of implementing such standards would be high for retailers and/or payment providers. However, given time (say 10 years+) standards could be introduced - with lower costs, but the business case and change would have to be clear. - Any changes must be made protecting base-line security in compliance with e.g. MLR, DPA, etc. Standards would have to be applied equally though across other / many EU jurisdictions – which would make things a little prohibitive to introduce.
Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?	No comment. Little impact to this respondent or to its membership organisations.
Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).	Innovation is slowed down in general by regulation changes, controls and regulation itself. Innovation is not just new products, services, solutions, propositions and/or technologies. It can also relate to new functionality, standards, security, provision or use of specific data, information or new best practices, and many others. The international card schemes have typically used interchange and/or liability shift incentives to encourage parties to move, to do something or to stop doing something. In most cases this has been positive and enabled technology, security, value add services advancement across the payment system. The reduction of interbank interchange fees, though cross-border initially and closely followed by domestic and commercial, will have significant positive as well as less positive impacts. Existing revenue streams will need to be protected (not practical) or replaced through other or new revenue streams.
Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?	Not commented upon. Not applicable to the respondent or to its member organisations.
Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.	Review the functionality and operation of the Payments Council. Reconsider the scope of the Payments Systems Regulator in the UK and ensure that the agenda is not dominated by a perceived need of a few small vocal ‘new market entrants’. The Payments Systems Regulator must avoid encouraging through its actions the breaking up or weakening of controls and governance

	inherent in the various hurdles and barriers to entry of various payment schemes that are there to ensure observance of important legal requirements and/or the protection of the integrity and governance of the payment infrastructure in the UK. It is important that the mere focus upon creating innovation and regulating for and towards the desire to increase innovation, does not itself start to destroy a culture and environment in which innovation can prosper. Whenever a regulator tries to introduce layers of requirements and controls, it will hamper progress and/or innovative thinking.
Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?	See above. The premise of this question must be the focus of challenge itself.
Question 24: Do you have any other comments or concerns you would like to highlight?	There are many unaired questions, concerns and challenges from our team at AIRFA.net and from our members. Many of these need to be reserved for a later stage in the consultation process, largely as they enter the realms of detail that will not yet be understood by the PSR team, or which will need to be included only if and when the scope is clearer and the boundaries defined.
Question 25: What, if any, are the significant benefits you see regulation bringing?	Few benefits seen as the main issues relate to effectiveness and costs. Benefits that are clear include:- - Creation of jobs and enlargement of the civil service (assuming that this is a good thing). - Creation of jobs for payments systems specialists. - Work that will supersede and/or pre-empt European regulations and regulators or legislation.
Question 26: What, if any, are the risks arising from regulation of payment systems?	We do not understand fully what is in-scope and what is not defined as such by: ‘payment systems’. It is difficult to understand what is ‘in scope’ and what is NOT. The term could mean: a) Many different things b) Many organisations that operate across many segments / sectors c) Involve global businesses, operating in many areas with many standards d) Put pressure on competition where similar constraints do not exist in other markets.
Question 27: How do you think regulation might affect your business and your participation in UK payment systems?	Not applicable for this respondent and/or its member organisations.

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ATMIA
ATM INDUSTRY ASSOCIATION
E U R O P E

The Payment Systems Regulator:

ATMIA response to the Call for Input from the FCA

April 2014

Introduction

The ATMIA welcomes the establishment of the Payment Systems Regulator (PSR). We strongly support the Government's desire to give the UK a dynamic, innovative, cost-effective and consumer-focused payments market. To achieve that objective, we believe the FCA will need to ensure that the following core principles underpin the new payments regime in the UK.

Inclusive and open governance structures: It is crucial that the Payment Systems Regulator focuses on delivering an open and transparent payments system for end users and that it creates appropriate structures to facilitate communication between the PSR and the many parts of what is a complex payments market.

Encouragement of innovation and a variety of business models: As was recognised by HM Treasury, there is a prima facie conflict of interest in the current ownership and control structures of some of the UK's payment systems. We would urge that the role of the market in driving competition and innovation should be recognised and reinforced. Limiting or removing the vertical control structures that are currently in place and granting greater commercial freedom to the payment systems themselves could help deliver the innovation and cost reductions that the Government is seeking, as well as encouraging new entrants into the market, benefitting both individual and corporate customers.

The UK's extensive ATM infrastructure is viable because ATM operators are free to choose their own commercial models, with some ATMs being paid for by ATM interchange and others by direct charging. The PSR needs to recognise and protect this choice and give thought to extending and enhancing economic freedom for ATM providers in the best interests of both UK customers and the economy.

Transparency and fairness in the setting of interchange rates: We are particularly pleased that the PSR will be able to review, and demand changes if necessary, in ATM interchange rates. The current practice is based on the cost recovery principle, which does not encourage investment and penalises efficiency. ATM interchange is of huge importance to ATM operators, providing one of the main sources of revenue. A low or declining rate will result in a decline in the availability of ATMs, with obvious negative impacts on businesses and the public. The current approach is also somewhat opaque and is open to the claim by some stakeholders that it could be manipulated for commercial advantage by those who control it.

Preventing the unfair taxation of one payment system over another: The current policy of levying business rates on a large portion of the ATMs in the country unfairly discriminates against cash. At a minimum, the method of valuation for such ATMs needs to be reassessed and preferably the notion that access to cash is a taxable event should be revisited by HM Treasury and colleagues in the Department for Communities and Local Government.

A level playing field between cash and non-cash payments to ensure and extend choice and convenience for all: We welcome HM Treasury's view that all payment systems, including the international card schemes and new entrants, should be included in the new regulatory system. This will ensure a level playing field and a stable and predictable environment in which innovators will be able to develop and bring to market new products and services that will provide consumers with greater choice. We believe a modern economy should have a payments market that fosters both cash and non-cash payments so that consumers of all demographic groups have choice and convenience.

Promoting accessibility to payments infrastructure and ATMs: The UK is extremely fortunate in that it has the LINK scheme that allows most bank card holders to access ATMs. We would urge the PSR to ensure that all consumers with debit cards are able to continue to access the country's ATM network.

That having been said, whilst LINK is an open scheme (unlike many other European national schemes LINK allows non-banks to join), new market entrants can find the cost of VocaLink/LINK prohibitive.

Responses to questions

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

The ATMIA believes in a level playing field for all operators in the UK payments market. Consequently, our view is that all payments providers and all parts of the payments market must be included in the new regulatory regime.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

In some areas, there is currently insufficient competition in the UK payments market. This is probably due to a lack of transparency, which is a significant feature of the UK payments market. Processing is a case in point. ATMIA believes that companies should be able to join LINK or a similar scheme but have their processing provided by a processor of their choice.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

The ATMIA believes that there is scope for much greater competition at all levels of the payment system. There is no logical reason why competition cannot exist between, for instance, processors.

Question 4: What are the main factors impeding more effective competition at each level?

A significant factor that may have held back competition is the vertical ownership and control structures that characterise the market. Whilst these may have been appropriate in the past, in the 21st century such structures are no longer appropriate.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

There are occasions, such as security protocols and standards, when changes of technology are needed and when co-ordination can not only be useful, but necessary. When this occurs, the PSR will need to establish transparent and inclusive structures to address the issues in order to encourage innovation and competition.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

LINK and many other payment systems and schemes are effectively controlled and directed by the large retail banks. This has been beneficial in a number of ways, but in others it has had a negative impact. The same banks also effectively control Visa in the UK and BACs for instance.

This can mean that there are potential conflicts of interest that act against the interests of consumers and other companies. A hypothetical example may be a situation when a card scheme was rolling-out expensive new contactless technology. If there is plentiful cash available in the vicinity provided to consumers by bank-owned ATMs, the bank could have an incentive to remove ATMs and consumers' access to cash in order to drive people to the use of contactless cards, which would be considerably more lucrative for the card schemes and, therefore, the banks. The risks of such potential conflicts of interest need to be minimised.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

In our view, the payment systems and processors should be independent companies with no ownership or control by any large financial institution nor group of financial institutions. They should be driven by the normal laws of the market to compete on price, service and innovation.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Yes, in our view there has never been sufficient separation between the large financial institutions and the payment systems. The separation between VocaLink and the LINK scheme has been, for instance, more theoretical than real. Our preference would be for genuine separation, independence and competition, which would allow LINK members to contract with any one of a number of processors.

The concept of mandatory separation between schemes and processors was proposed in the European Commission's Payment Services Directive, which is currently going through the EU's legislative process. This would need to apply to all market participants, including the international card schemes. The ATMIA believes that there is merit in this proposal and would urge the PSR to give thought to early adoption in the UK.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

We are pleased that the Government has decided to create a new regulator for the payments sector. We believe that if the payment schemes and systems operated as normal companies many of the governance issues that have been so problematic would be resolved. Currently, the membership rules of some of the schemes, such as LINK and VISA Europe, not only limit membership but concentrate power in the hands of large financial organisations. This is - and has been - a concern for many years. Whilst resolving this will be complex and difficult, it is also very necessary.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

The ATM Industry Association represents the whole ATM sector, from banks and independent ATM providers to software providers and consultants. Our members access payment systems in a variety of ways, depending on the nature of their business. As noted elsewhere, accessing a payments scheme can be expensive for new entrants. Greater freedom to choose an appropriate payments scheme and/or payments processor may help to drive down costs and reduce this barrier to entry.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

As noted above, combined membership of LINK and use of VocaLink processing services can cost in excess of £ 120,000 per annum (with processing costs they are likely to exceed £ 120,000), which is a significant amount of money for a new entrant. There are a small number of other processing service providers, such as First Data, Evry, Wincor and TNS, but VocaLink is the dominant company. In other European markets, the costs can be as low as £ 7,500. It is also worth noting that ATM providers face significant telecommunications costs as well, all of which means there are significant barriers to new entrants.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes. It is far harder for some types of company to enter the UK ATM market, as membership of LINK and VocaLink are both necessary if you wish to provide an ATM service and the fees can be very expensive for a start-up. This means that, in comparison to a similar market, such as the United States, the UK has a less competitive and poorer market for ATM providers. That, in turn, means that prices are higher and innovation less than might be hoped*.

*Many innovations in the ATM sector need to be approved by LINK which some say could suppress innovation.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Our members would prefer more direct and transparent access arrangements across the board. Our membership of course includes banks as well as independent ATM providers, but it is obvious that a market cannot operate to its full efficiency when some participants need permission from other participants to operate and can even stipulate what prices they charge.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:
• To whom do you provide indirect access?
• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
• Are there any barriers to becoming a sponsoring bank?

n/a

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

If the UK's payment schemes and systems were operated as normal companies, this issue would likely to be less relevant as they would be actively seeking new customers. This is exactly what we hope the new PSR will be trying to achieve – an open and competitive marketplace.

Question 16: Do you have any other comments regarding access?

Nothing further to add.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

The infrastructure would be more robust and resilient if the payments infrastructure more closely resembled the internet i.e. it was made up of multiple, connected and parallel systems that users could switch seamlessly between. The market must be allowed to evolve away from the old 'single purpose, single track' model to a more organic and fluid structure. There is, for instance, no practical reason why ATM providers should not be able to buy their processing services from a number of service providers in the future.

Similarly, there is no real reason why consumers should not be able to choose between a wide range of payment service providers, making a choice based on the cost and quality of the service.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

The use of recognised standards, such as ISO 20022, can help to support competition and enhance access both to the market and to service providers.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

The market should be opened up to a broader range of participants, including non-traditional and non-bank providers. IT, telecoms providers or others may decide that they could provide a profitable infrastructure service. The current market structures would make market entry challenging. The PSR should endeavour to remove such barriers.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Innovation in the ATM sector may have been hampered by the fact that innovations have to be approved by LINK, which may not have been in the interests of some of the dominant LINK members.

We believe that wherever possible fees should be set by market forces to ensure that ATM deployers have the flexibility to apply direct charging or ATM interchange dependent on the circumstances of the site.

Currently the ATM Interchange rate is agreed on the basis of an annual study which derives rates on a cost recovery basis with no provision for a mark-up. The rate is agreed on the basis of an annual study - in which many of the 'costs' are unfortunately assumed - conducted by a consultancy - and is agreed in private between the members of LINK. We believe that this process and the outcome should be conducted in a more transparent manner and should include a reasonable mark-up.

We also believe that the role and function of ATM interchange must be understood in a broad economic and social context. Secure and permanent access by the public to cash means that they need access to an ATM. ATMs can, however, only be commercially viable if they generate a commercial return with either 1) consumers being willing to pay for the service of accessing cash and other services in the form of a direct charge; or 2) their financial service providers/banks being willing to pay to give their customers access by paying an ATM interchange. Low and declining ATM interchange rates combined with increasing costs of operating an ATM, such as the sudden application of business rates to certain types of ATM, means that ATM provision has become more commercially challenging. This does not provide an environment that encourages innovation and competition.

We urge the PSR to recognise that there are good economic and social arguments in favour of an increasing ATM interchange rate, which will drive greater ATM provision and reduce the risk of financial exclusion.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

As noted above, there is a view that the governance structure of some parts of the payments sector may have suppressed innovation. It is certain that ATMs in the UK perform relatively few functions when compared to some other markets. Our view is that as the market becomes more open and more transparent, innovators and new entrants will recognise the ATM network as an ideal IT platform on which to develop new products. That will, however, require LINK and other payment infrastructures to be open.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Please see our responses to questions 20 and 21.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Both collective and unilateral innovation can and should be possible. The idea promoted by some that innovation is only possible by committee is not borne out by experience. There is a need for some coordination, but this should be oriented towards facilitating and encouraging innovation, rather than the opposite, which was so often the case in the past.

Question 24: Do you have any other comments or concerns you would like to highlight?

No, we have nothing else to add.

Question 25: What, if any, are the significant benefits you see regulation bringing?

The ATMIA hopes that the PSR is able to create an environment that matches the ambition set out in the original 'Opening up UK Payments'. If so, the UK has the potential to develop the world's most innovative, inexpensive and fastest payments market. This would have benefits right across the economy.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Heavy handed, poorly informed regulation aimed at maintaining the status quo would create a further break on the UK's economy and it is important that access to cash is not hampered. The PSR should be mindful that increasing the costs of delivering a service has never resulted in an increase in quality, quantity or innovation.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

The right kind of regulation may well drive further investment in the UKs payment sector from those amongst the ATMIA's global membership.

About the ATMIA

As an independent, non-profit trade association, the ATM Industry Association's mission is to promote ATM convenience, growth and usage worldwide; to protect the ATM industry's assets, interests, good name and public trust; and to provide education, best practices, a political voice and networking opportunities for member organisations.

The ATM Industry Association, founded in 1997, is a global non-profit trade association with over 3,500 member contacts in 60 countries. The membership base covers the full range of this worldwide industry, comprising over 2 million installed ATMs.

ATMIA has chapters in the United States, Canada, Europe, Latin America, Asia-Pacific, Asia, Africa and the Middle East.

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Financial Conduct Authority
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15 April 2014

Via email: paymentsystems@fca.org.uk

NEW PAYMENT SYSTEMS REGULATOR – CALL FOR INPUTS

1: Introduction

Bacs Payment Schemes Limited (Bacs) is pleased to respond to the above consultation. Founded in 1968 Bacs is a not-for-profit, membership based industry body comprising of sixteen of the leading banks and building societies in the UK, Europe and US. Bacs is responsible for the schemes behind the clearing and settlement of automated payments in the UK including Direct Debit and Direct Credit and 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.

Since its inception over 100 billion transactions have been debited or credited to UK bank accounts via Bacs and in 2013 over 5.6 billion payments were made with a total value of £4.3 trillion.

On 5th March 2014 the Financial Conduct Authority (FCA) published a consultation entitled 'New payment systems regulator – Call for Inputs' and Bacs is pleased to submit this response and would be happy to meet and to discuss this response in greater detail.

Please find attached our responses to the questions and cover sheet.

2: Cover Sheet

Basic information	
Consultation title:	**Payment Systems Regulation – Call For Inputs (5 March 2014)**
Name of respondent:	**Bacs Payment Schemes Limited**
Contact at respondent:	**Name: Mike Chambers, Managing Director**
	Email: michael.chambers@bacs.co.uk
	Address: **2 Thomas More Square** **London** **E1W 1YN**

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	**X**
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other **Please specify:**	

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		**X**
If 'Yes', please submit both confidential and non-confidential responses.		

3: Response to consultation questions

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

Bacs considers the list of payment systems indicated by HMT to be appropriate for regulation.

Whilst Bacs is pleased to see that the scope of the schemes identified includes the main three and four party card schemes and we suggest that there is particular focus on the regular payments elements of the cards proposition so consumers and businesses can make more informed choices in payment mechanisms in different settings.

We note that smaller and less systemic payment systems or services may not be initially designated for regulation it is our view that the PSR should establish a strong working relationship with such systems or services ahead of any future designation decision.

We believe that it is important that where designated payment schemes have chosen to outsource the processing of their payments to a third party that a clear understanding of how the PSR's influence can be delivered via the designated system is established.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

It would be useful to define and agree a common definition of 'payment systems' or the 'payments market'.

Bacs understands the end user benefits provided by the wide range of payment transaction types offering complementary product provisions and believes that, whether for the consumer or a business, real competition occurs at the payment services provider level where payments represent only part of the range of banking services competitively offered.

We believe that it is Bacs' role to provide fair, open and transparent participation in the range of schemes and services we offer to financial institutions. This approach ensures that Bacs can contribute to the ability of providers of banking services to create a competitive market place and deliver real end user benefit.

Bacs is keen to see new members join the company and participate directly in the Direct Credit and Direct Debit schemes. New scheme membership applications are considered and approved by a nominated Admissions Official against a set of publically available membership criteria (http://www.bacs.co.uk/Bacs/Banks/BecomeABacsMember/Pages/CriteriaForMembership.aspx). Whilst the existing members of the company are advised of both the application and the resultant membership decision they have no part in deciding whether or not the applicant should be accepted into membership. As part of a bespoke and consultative enquiry, application, assessment and on-boarding process all costs are discussed and made available to the potential applicant based on their own infrastructure connection solution – this information is made available, under NDA, to all serious prospective applicants.

We believe that membership of Bacs and access to its primary schemes is offered on a fair, open and transparent basis for all participants, this includes transaction price equality for all members regardless of the volumes brought to the system, the absence of a one-off membership fee (including no requirement to contribute to the recovery of any previous or historic technology investments or any requirement to participate in share purchase obligations). Bacs currently has 16 members from 13 banking groups, has seen 3 new members (AIB UK, Danske Bank and Citibank) join in the past few years and is in discussion with a small number of potential new direct members. During the last decade Bacs has not received an application for membership which it has refused or been advised by a prospective member that the existing membership criteria represent a barrier to entry.

It is important to stress that our membership criteria are set to ensure fair and open access balanced against the need to minimise areas of systemic risk that a direct participant may bring to the system.

The banks and building societies that participate 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.

Additionally we see our role to ensure that a vibrant and competitive market place exists for agency banks requiring Bacs functionality. Those institutions that have decided not to join the Bacs scheme directly have chosen to procure services from one of the existing Bacs members on a competitive basis. The company has not been approached by an agency bank regarding any difficulty in procuring agency bank services from the market place. Agency banks are encouraged to consider becoming a member of our successful Affiliates Interest Group (http://www.bacs.co.uk/BACS/AFFILIATES/Pages/Affiliates.aspx) which provides the opportunity to provide feedback direct to the Board.

In the region of 300 agency institutions currently connect to Bacs either directly or indirectly for the submission or receipt of transactions. If Bacs is approached for advice regarding the most appropriate model of participation the institution is encouraged to consider a number of participation models based on their own situation by analysing their current or anticipated transaction volumes / values, strategic aspirations and technical / operating environment.

A number of levels of participation in Bacs represent a ‘pathway’ to full membership in Bacs, with agency banks choosing to progress through or limit their participation as demanded either by their operational or strategic desires.

For those institutions that choose not to become a direct scheme member it is our view that the existing scheme members can often facilitate competition from new entrants in the payments market. The Bacs agency model can provide new entrants with the opportunity to exploit the financial, technical and operational investments made by the existing direct members to reduce ease and speed to market of their own offering.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

The primary objective of a Financial Market Infrastructure is to ensure the stable operation of the payment systems it operates and Bacs’ systems (Direct Credit and Direct Debit) have a long track record of stability, reliability and efficiency.

However, in addition, a payment system should always seek opportunities to innovate and enhance end user propositions. Bacs has developed a suite of new services which seeks to offer innovative and improved end user propositions or processing efficiency in the market place. For example Bacs has implemented enhancements to the Bacs Direct Credit proposition to support the introduction of HMRC’s PAYE RTI reporting, launched an automated Cash ISA Transfer service, launched a Biller Update Service for use within financial institutions on-line banking applications and operates the Current Account Switch Service.

To ensure open access to all market participants Bacs has adopted an approach where any market participant can access the appropriate service directly and on equitable terms regardless of whether or not the institution is a member of Bacs or any other payment scheme.

An example of the direct participation model we have adopted for these new services is with our Cash ISA Transfer service where 48 brands have already joined the scheme under a direct access model including Market Harborough Building Society who has no other direct link with Bacs or any other scheme. A case study entitled 'embracing the Cash ISA Transfer Service' can be found at http://www.bacs.co.uk/Bacs/DocumentLibrary/Publications_MHBS.pdf. This direct, open access model is also being used with the new Current Account Switch Service and 33 brands that offer current account services representing in excess of 99% of the market place already participate in the new service.

Given the end user benefits provided by the wide range of payment transaction types utilised in the UK there are occasions where the objective of end user innovation is better served by collaborative innovation and planned payment type substitution initiatives amongst payment systems.

Having taken such an innovative and strategic approach to the suite of payment services offered Bacs believes that financial institutions have the opportunity to exploit these generic services as they seek to differentiate their own propositions in the market place.

As a Financial Market Infrastructure Bacs seeks to minimise the cost of operation while maintaining appropriate levels of integrity and innovation. These central costs are a relatively small proportion of the overall payment service provided to end users by its participants. As noted above there are increasingly complex offerings of payment services which blur traditional definitions of payment products and systems. It is evident that significant innovation is occurring in the provision of added value services around the core payment systems through the introduction of the automated Cash ISA Transfer service and the Current Account Switch Service for example.

Bacs has a track record of innovation which has been possible due to significant financial investment by its members. Over the last decade Bacs has funded and re-engineered its end user delivery mechanism (Bacstel-IP and other file transmission services), re-built its entire payment processing environment as well as a whole host of other developments based on a programme of two technology releases per annum. Bacs has also automated several services previously paper based (e.g. Direct Debit Indemnity Claims and a suite of messaging / exception reports) bringing further efficiencies and cost reductions.

These developments have been 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. Of particular note is the fact that Bacs has not required members joining the scheme part way through a development to incur any historic investment cost obligation which, we believe, lowers the cost of entry.

Our experience is that payments system innovation (utility innovation) is often a catalyst that stimulates innovation on a competitive basis amongst our membership.

Question 4: What are the main factors impeding more effective competition at each level?

Bacs is keen to see new members join the company and participate directly in the core Direct Credit and Direct Debit schemes. New scheme membership applications are considered and approved by a nominated Admissions Official against a set of publically available membership criteria. Whilst the existing members of the company are advised of both the application and the resultant membership decision they have no part in deciding whether or not the applicant should be accepted into membership. As part of a bespoke and consultative enquiry, application, assessment and on-boarding process all costs are discussed and made available to the potential applicant based on their own infrastructure connection solution – this information is made available, under NDA, to all serious prospective applicants.

We believe that membership of Bacs and access to its primary schemes is offered on a fair, open and transparent basis for all participants, this includes transaction price equality for all members regardless of the volumes brought to the system, the absence of a one-off membership fee (including no requirement to contribute to the recovery of any previous or historic technology investments or any requirement to participate in share purchase obligations). Bacs currently has 16 members from 13 banking groups and has seen 3 new members (AIB UK, Danske Bank and Citibank) join in the past few years and is in discussion with a small number of potential new direct members. During the last decade Bacs has not received an application for membership which it has refused or been advised by a prospective member that the existing membership criteria represent a barrier to entry.

It is important to stress that our membership criteria are set to ensure fair and open access balanced against the need to minimise areas of systemic risk that a direct participant may bring to the system.

The banks and building societies that participate 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. Each new member is extended the right to participate within the governance of the company on an equitable basis.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

There are occasions where a cross payment system collaborative initiative is required to achieve an innovation or end user objective. It is important that a capacity or framework is established that provides a mechanism for such change to be explored and subsequently delivered. Two current examples of such cross payment system collaborative change are the Current Account Switch Service and the Mobile Payments service.

Collaboration also can be beneficial in areas such as payment type substitution initiatives, fraud intelligence sharing, addressing common issues (e.g. customer credit payment recovery processes) and cyber security.

Such areas of collaboration would fit within a collaborative mandate if the outcomes have clear end user benefits and can work both on a bilateral and multi-lateral collaboration basis.

There are occasions where collaborative services between payment systems are a pre-requisite, for example the operation of the Sort Code management service which is operated by Bacs on behalf of a number of other schemes under a MoU arrangement.

Collaboration amongst the participants within a scheme (e.g. Bacstel-IP migration or service user compliance initiatives) often presents opportunity for end user benefits.

Additionally, there may be a case for a mechanism encompassing representation from the PSR, payment schemes and industry participation which should focus on addressing any strategic gaps or inconsistencies. It is, however, important that any regulatory direction whether from the PSR or the Financial Stability regulator should be directed solely to the payment scheme.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

As a System Operator or a Financial Market Infrastructure (FMI) designated under the Banking Act 2009 as being systemically important the primary purpose of Bacs is to operate a ubiquitous and systemically important deferred net settlement (DNS) bulk file automated clearing house (ACH).

Bacs Payment Schemes Limited is a company limited by guarantee from its direct participants, who utilise settlement accounts at the Bank of England. It has no shareholders, is not owned by its members but is managed by a board of directors consisting of an independent chairman, independent director, an executive director and a director appointed by each subscribing member. Bacs is keen to see new members join the company and participate directly in the Direct Credit and Direct Debit schemes. New scheme membership applications are considered and approved by a nominated Admissions Official against a set of publically available membership criteria. Whilst the existing members of the company are advised of both the application and the resultant membership decision they have no part in deciding whether or not the applicant should be accepted into membership. As part of a bespoke and consultative enquiry, application, assessment and on-boarding process all costs are discussed and made available to the potential applicant based on their own infrastructure connection solution – this information is made available, under NDA, to all serious prospective applicants.

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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).

Bacs has a track record of innovation which has been possible due to significant financial investment by its members. Over the last decade Bacs has funded and re-engineered its end user delivery mechanism (Bacstel-IP and other file transmission services), re-built its entire payment processing environment as well as a whole host of other developments based on a programme of two technology releases per annum. Bacs has also automated several services previously paper based (e.g. Direct Debit Indemnity Claims and a suite of messaging / exception reports) bringing further efficiencies and cost reductions.

These developments have been 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. Of particular note is the fact that Bacs has not required members joining the scheme part way through a development to incur any historic investment cost obligation. It is a measure of the effectiveness of these governance arrangements that the Bacs infrastructure has been effectively refreshed and a range of added value automated services have been introduced over the recent years.

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.

Question 7: How might the regulator address any issues with the current ownership structure?

The annual CPSS-IOSCO Principles for Financial Markets Infrastructures self-assessments completed by Bacs provide a useful assessment in ensuring that an appropriate governance model is in place to make broad based decisions that appropriately consider all relevant stakeholders.

Bacs standing as a ‘not for profit’ organisation protects against some of the dangers that are inherent in a ‘for profit’ organisation which could lead to outcomes not being in the public interest.

Question 8: Do you have any concerns about the current governance of UK payment systems?

The banks and building societies that participate 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.

The current governance arrangements between Bacs and the Payments Council do not reflect the current arrangements within Bacs or the new regulatory environment. For example, independent representation on our Board (including an independent chair) with an explicit public interest role and veto and Bacs is formally overseen from a financial stability perspective by the Bank of England in its duty to oversee systemically important payments systems.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

Bacs is a Financial Market Infrastructure (FMI) designated under the Banking Act 2009 as being systemically important. The primary purpose of the Company is to operate a ubiquitous and systemically important deferred net settlement (DNS) bulk file automated clearing house (ACH).

It is a company limited by guarantee from its direct participants, who utilise settlement accounts at the Bank of England. It has no shareholders, is not owned by its members but is managed by a board of directors consisting of an independent chairman, independent director, an executive director and a director appointed by each subscribing member. In this light Bacs is accountable for its own conduct.

Bacs expects to be accountable to the PSR in matters relating to the enabling of competition, enabling of innovation, and consideration of the interests of current and future end users of its payments services. Bacs also anticipates contributing to the thinking and outputs of any all-encompassing new industry coordinating body, acting under the guidance of the PSR.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Not applicable since Bacs is a payment system / Financial Market Infrastructure.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Not applicable since Bacs is a payment system / Financial Market Infrastructure.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Not applicable since Bacs is a payment system / Financial Market Infrastructure.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Not applicable since Bacs is a payment system / Financial Market Infrastructure.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)

Not applicable since Bacs is a payment system / Financial Market Infrastructure.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We believe that it is Bacs' role to provide fair, open and transparent participation in the range of schemes and services we offer to financial institutions. This approach ensures that Bacs can contribute to the ability of providers of banking services to create a competitive market place and deliver real end user benefit.

Bacs is keen to see new members join the company and participate directly in the Direct Credit and Direct Debit schemes. New scheme membership applications are considered and approved by a nominated Admissions Official against a set of publically available membership criteria. Whilst the existing members of the company are advised of both the application and the resultant membership decision they have no part in deciding whether or not the applicant should be accepted into membership. As part of a bespoke and consultative enquiry, application, assessment and on-boarding process all costs are discussed and made available to the potential applicant based on their own infrastructure connection solution – this information is made available, under NDA, to all serious prospective applicants.

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It is important to stress that our membership criteria are set to ensure fair and open access balanced against the need to minimise areas of systemic risk that a direct participant may bring to the system.

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In conjunction with direct member banks we see our role to ensure that a vibrant and competitive market place exists for agency banks requiring Bacs functionality. Those institutions that have decided not to join the Bacs scheme directly have chosen to procure services from one of the existing Bacs members on a competitive basis. The company has not been approached by an agency bank regarding any difficulty in procuring agency bank services from the market place. Agency banks are encouraged to consider becoming a member of our successful Affiliates Interest Group which provides the opportunity to provide feedback direct to the Board.

In the region of 300 agency institutions currently connect to Bacs either directly or indirectly for the submission or receipt of transactions. If Bacs is approached for advice regarding the most appropriate model of participation the institution is encouraged to consider a number of participation models based on their own situation by analysing their current or anticipated transaction volumes / values, strategic aspirations and technical / operating environment.

A number of levels of participation in Bacs represent a ‘pathway’ to full membership in Bacs, with agency banks choosing to progress through or limit their participation as demanded either by their operational or strategic desires.

For those institutions that choose not to become a direct scheme member it is our view that the existing scheme members can often facilitate competition from new entrants in the payments market as the Bacs agency model can provide new entrants with the opportunity to exploit the financial, technical and operational investments made by the existing direct members to reduce ease and speed to market of their own offering.

To ensure open access to all market participants Bacs has adopted an approach where any market participant can access the appropriate service directly and on equitable terms regardless of whether or not the institution is a member of Bacs or any other payment scheme.

An example of the direct participation model we have adopted for these new services is with our Cash ISA Transfer service where 48brands have already joined the scheme under a direct access model including Market Harborough Building Society who has no other direct link with Bacs or any other scheme. This direct, open access model is also being used with the new Current Account Switching service and 33 brands that offer current account services representing in excess of 99% of the market place have already committed to participate in the new service.

Question 16: Do you have any other comments regarding access?

No response.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Bacs has a track record of innovation, system integrity and resilience which has been possible due to significant financial investment by its members. Over the last decade Bacs has funded and re-engineered its end user delivery mechanism (Bacstel-IP and other file transmission services), re-built its entire payment processing environment as well as a whole host of other developments based on a programme of two technology releases per annum. Bacs has also automated several services previously paper based (e.g. Direct Debit Indemnity Claims and a suite of messaging / exception reports) bringing further efficiencies and cost reductions.

These developments have been 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. Of particular note is the fact that Bacs has not required members joining the scheme part way through a development to incur any historic investment cost obligation.

We are keen to participate in the further development of the Road Map initiative that has initiated by the Payments Council although any initiatives will need to encompass all payment types and be carefully balanced with the costs and risks of developing a new architecture (including the costs and risks of migration).

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Bacs utilises a proprietary domestic standard (Standard 18) for the majority of its messaging. This file format has been in use for Bacs schemes by its customers for over 40 years and is deeply embedded into the Bacs end-to-end payments chain.

The payments industry continues to consider migration to a single standard for all payments and messaging and ISO20022 has been identified as the preferred standard by the industry. Bacs supports a strategy that ultimately leads to a common standard and is generally supportive of the work being undertaken by Payments Council to develop a cost benefit case to consider the adoption / migration to ISO20022.

Bacs has already successfully introduced ISO20022 standard messaging for two of the managed services that it operates; Cash ISA Transfers and the Current Account Switch Service. Both these services have been developed on the existing Bacs infrastructure but in both cases the development of the services and their messaging sets have been new ‘green-field’ developments. The ISO 20022 messaging sets for both services have been successfully adapted to meet specific UK industry needs for each service. In order to support the strategic adoption of ISO20022 Bacs will continue to utilise ISO20022 (where appropriate) for green-field developments.

Bacs considers that any adoption or migration of existing Bacs schemes or associated services to ISO2002 must be driven by; the identification of appropriate industry triggers; a clear and compelling business case for a migration and full consideration of all stakeholder impacts. In particular, the impact that migration to a new standard would have on the users of Bacs and in particular Direct Corporate Access users.

Bacs further considers that any changes to current messaging standards must demonstrate additional value to the scheme and its end users. We note that a change that is aligned to or driven by additional data requirements or as a result of a strategic review of the technical architecture would provide additional benefits.

Whilst Bacs supports the strategic adoption of ISO20022 it does not believe that there is currently an established business case or driver for changes to the existing Bacs messaging standard. Bacs considers that the perceived benefits of migration to ISO 20022 require further analysis and that a detailed cost benefit analysis is required to ensure that the benefits and impacts are fully considered.

Bacs also notes that this position may change in the future should; a clear end user demand be identified; where there is a strategic change to payments infrastructure; through wider adoption of ISO2002 in other markets or as a result of regulatory requirement.

For new (i.e. green field) developments Bacs supports the strategic adoption of ISO20022 and will continue to utilise ISO20022 (where appropriate) for such developments. Although Bacs considers that adoption of ISO 20022 could serve as a good vehicle to transmit additional payments and / or payments related data, adoption of ISO20022 in isolation for Bacs, or indeed a single payment scheme, it appears to offer limited value against the perceived benefits of ISO20022.

Longer term strategic changes to the technical architecture that involved migration to ISO 20022 could support scheme access improvements as well as providing strengthened adherence to the CPSS/IOSCO principles (principle 22).

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Bacs supports a broad range of direct and indirect technical access models delivered by a range of third parties – including SWIFT’s STS product, Bacstel-IP solutions and bureaux offered products.

Bacs’ desire is, where appropriate, to encourage greater direct access to payment systems and ensure that the ubiquitous reach of Bacs is maintained for all users.

It is our view that payments system innovation (utility innovation) is an integral role of a Financial Market Infrastructure and is often a catalyst that stimulates innovation on a competitive basis amongst our membership

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

A payment system should always seek opportunities to innovative and enhance end user propositions. Bacs has a strong track record in innovation having developed a suite of new services which seek to offer innovative and improved end user propositions or processing efficiency in the market place. For example, Bacs has implemented enhancements to the Bacs Direct Credit proposition to support the introduction of HMRC’s PAYE RTI reporting, launched an automated Cash ISA Transfer service, launched a Biller Update Service for use within financial institutions on-line banking applications and operate the Current Account Switch Service).

From Bacs’ perspective the development of shared access mechanisms with flexibility to allow market participants to develop added value services for their customers around these mechanisms provide an effective mechanism for end user competition.

To ensure open access to all market participants Bacs has adopted an approach where any market participant can access the appropriate managed service (including the Current Account Switch Service and Cash ISA Transfer service) directly and on equitable terms regardless of whether or not the institution is a member of Bacs or any other payment scheme.

An example of the direct participation model we have adopted for these new services is with our Cash ISA Transfer service where 48 brands have already joined the scheme under a direct access model including Market Harborough Building Society who has no other direct link with Bacs or any other scheme. This direct, open access model is also being used with the new Current Account Switch Service and 33 brands that offer current account services representing in excess of 99% of the market place have already committed to participate in the new service.

Additionally, the Direct Corporate Access aspect of the Bacs Direct Credit and Direct Debit propositions places the UK at the forefront of submissions methods for bulk file Automated Clearing Houses internationally.

The ubiquity of Bacs often provides optimal conditions for innovation although the capacity for change amongst all Bacs users (including financial institutions, corporates and central government) can act as a constraint.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Factors that may limit the ability or incentive to innovate can include the capacity of e2e players in the payment chain. Change has to be systemically risk free, must maintain continuity of service and must demonstrate clear end user benefit. As can be evidenced by previous initiatives strong co-ordination of change is a vital ingredient to success.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Noting the significant amount of innovation that Bacs has delivered over the past decade it is important that, given the opportunity cost dynamic, any change has tangible end user benefits that are tangible both from a micro (one payment scheme) and macro (full suite of payments) perspective.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Cooperation is essential within payment schemes as by their very nature every payment has a ‘sender’ and a ‘receiver’ (or every ‘debit’ has a ‘credit’). Recent collective developments such as the Current Account Switch Service and the Cash ISA Transfer service have allowed a broad range of market participants to individually provide innovative and competitive services to the end user.

The undifferentiated nature of payment services provides ubiquity / inter-operability (including routing and reach), fair, open, transparent and equitable access and enable market participants to provide added value services competitively to the end user.

Question 24: Do you have any other comments or concerns you would like to highlight?

There are occasions where a cross payment system collaborative initiative is required to achieve an innovation or end user objective. It is important that a capacity or framework is established that provides a mechanism for such change to be explored and subsequently delivered. Two current examples of such cross payment system collaborative change are the Current Account Switch Service and the Mobile Payments service. Collaboration also can be beneficial in areas such as payment type substitution initiatives, fraud intelligence sharing, addressing common issues (e.g. customer credit payment recovery processes) and cyber security.

Such areas of collaboration would fit within a collaborative mandate if the outcomes have clear end user benefits and can work both on a bilateral and multi-lateral collaboration basis.

However, the current governance arrangements between Bacs and the Payments Council do not reflect the current arrangements within Bacs or the new regulatory environment. This new environment includes independent representation on our Board (including an independent chair) with an explicit public interest role and veto. Bacs is also formally overseen from a financial stability perspective by the Bank of England in its duty to oversee systemically important payments systems.

Bacs expects to be accountable to the PSR in matters relating to the enabling of competition, enabling of innovation, and consideration of the interests of current and future end users of its payments services. Bacs also anticipates contributing to the thinking and outputs of any all-encompassing new industry coordinating body, acting under the guidance of the PSR

Additionally, there may be a case for a mechanism encompassing representation from the PSR, payment schemes and industry participation which should focus on addressing any strategic gaps or inconsistencies. It is, however, important that any regulatory direction whether from the PSR or the Financial Stability regulator should be directed to the appropriate designated or recognised entities.

Question 25: What, if any, are the significant benefits you see regulation bringing?

The PSR will be able to establish output based end user benefits and economic objectives that government policy requires from the payments systems.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Risks arising from the regulation of payment systems will be avoided if the PSR adopts rigorous, evidence based, and proportionate approach to making interventions only where there is clear evidence of customer detriment.

It is important that change resulting from regulation of the payment systems is introduced in appropriate timeframes and, where there is cross scheme impact, that the change is co-ordinated.

The UK’s payments systems are part of the critical national infrastructure and whilst it is necessary that they evolve they must do so in a low risk manner.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Bacs has a responsibility and capability to play a leadership role in the provision of bulk file push and pull payments in the UK. As a systemically important payment scheme Bacs will continue to focus on maintaining integrity of the services whilst responding effectively to any changes in regulation that may be required.

The PSR provides an opportunity to deliver absolute clarity in the regulatory framework with a clear singular economic regulator. It is important that the PSR (economic regulator), Bank of England (financial stability regulator) and Competition and Markets Authority (CMA) develop clear protocols for working with regulated entities to ensure that the overall direction is consistent, coordinated and delivers maxim end user benefits at an economically sustainable cost.

Michael Chambers
Managing Director

FCA'S CALL FOR INPUTS ON THE UK PAYMENT SYSTEMS LANDSCAPE, MARCH 2014: BANK OF ENGLAND'S RESPONSE

1 Introduction

1.1 The Bank welcomes the opportunity to comment on the issues raised in the FCA's Call for Inputs on the UK payment systems landscape.[1] The Bank's comments are informed by the Bank's role as statutory overseer of systemic interbank payment systems,[2] resolution authority, operator of real-time gross settlement infrastructure and provider of settlement services, and supervisor of participants in the UK interbank payment systems.

1.2 The design and smooth operation of payment systems is important to financial stability and to the effective implementation of monetary policy. As noted in HM Treasury's consultation paper on payment systems regulation,[3] UK payment systems have demonstrated a high degree of stability and reliability. The Bank considers, however, that there is merit in revisiting some features of the current structure of payment systems in the United Kingdom. First, the Bank can see merit in revisiting the organisation of retail payment systems into separate scheme and infrastructure companies, both from its financial stability perspective and in the context of considering how competition and innovation objectives are best served. Second, there may be scope for simplification of the payments infrastructure in the longer term which could benefit financial stability, as well as enhance competition.

1.3 The Bank's comments are organised under the following headings:

- Do you think the current ownership structure of UK payment systems creates problems? (question 6 in the Call for Inputs)
- How might alternative models of ownership affect financial stability? (question 7)
- Issues raised by the separation of scheme company and infrastructure provider (with reference to questions 8-9 in the Call for Inputs)
- What functions do you think need to be performed collaboratively? (question 5)
- Issues affecting access to payment systems (questions 15-16)
- Could simplification of system infrastructure lead to benefits? (questions 17, 18 and 22)

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[1] http://www.fca.org.uk/your-fca/documents/payment-systems-regulation-call-for-inputs

[2] Under Part 5 of the Banking Act 2009, the Bank oversees the following interbank payment systems: CHAPS, Bacs, Faster Payments (FPS), CLS and the payment systems embedded in CREST, LCH-Clearnet Ltd and ICE Clear Europe.

3 HM Treasury, "Opening up UK payments", March 2013, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221903/consult_opening_up_uk_payments.pdf

2 Do you think the current ownership structure of UK payment systems creates problems?

2.1 The Cruickshank review of March 2000[4] noted the drawbacks of mutual governance and observed that the weakness of competition in payment systems would allow inefficiencies to persist. The review concluded that the mutual governance model performed badly in the areas of price transparency, governance, non-discriminatory access, efficient wholesale pricing and innovation. A subsequent OFT report on UK payment systems published in 2003[5] did not uncover any serious anticompetitive concerns in the pricing of services in UK payment systems, but did conclude that the pace of innovation had reflected disincentives arising from the need to cooperate.

2.2 Mutual ownership of retail payment systems by commercial banks appears to be the predominant model internationally. Of the overseas retail payment systems of which the Bank has most knowledge, most major schemes and their supporting infrastructures are owned by the banks using them. Notable exceptions include the privately-owned MasterCard and Visa Inc (but not Visa Europe), the German retail system (owned by the German central bank) and New Zealand's essentially bilateral payment processing model which does not have a bank-owned central infrastructure. The predominance of mutual ownership reflects the role banks have played in establishing systems to settle payments between them.

2.3 The Bank of England has not found that the current ownership structure of the Bacs, FPS and CHAPS systems has impeded its ability to oversee these systems, and to achieve change where the Bank has considered this desirable to maintain and enhance monetary and financial stability. An important advantage of mutual system ownership is that banks, as system users, have a strong incentive to make the system efficient, reliable and resilient. The central infrastructure of UK payment systems has generally been very reliable (though there have been various major incidents affecting the connecting infrastructures within individual bank participants). Consumers have benefited from the continuity of service a reliable and resilient system brings. Banks as users also have strong incentives to agree system rules and procedures that protect the participant banks and their customers from credit risks and fraud. From a financial stability perspective, important areas of system rules include default procedures, settlement arrangements and risk management.

2.4 A potential drawback of the current ownership structure is a slower pace of innovation. While there have been a number of significant innovations in UK payment systems over the past decade, including in the central interbank payment systems, these have in the most important cases been prompted by pressure from the public authorities – for example, faster payments and account switching. The nature and timing of many innovations designed to increase financial stability have similarly been driven by intervention by the Bank as system overseer, though usually with the constructive and willing co-operation of the current system owners.

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[4] Cruickshank, D. "*Competition in UK Banking: A Report to the Chancellor of the Exchequer*" (2000). Available at http://webarchive.nationalarchives.gov.uk/20050301195359/http:/hm-treasury.gov.uk/documents/financial_services/banking/bankreview/fin_bank_reviewfinal.cfm

[5] OFT (2003), "Payment systems", http://www.oft.gov.uk/shared_oft/reports/financial_products/oft658.pdf

2.5 That regulatory pressure has been required to achieve many of the innovations of recent years makes it important to consider whether the current payment system ownership and industry governance structures have impeded innovation. The Bank is not convinced that the separation of payment schemes from payment infrastructures has helped to facilitate innovation (see below). It may be an inherent drawback of mutually-owned systems that significant changes have a greater risk of taking place at the speed of the slowest due to the need for multiple parties to agree on cost sharing and technical specifications. Moreover, the fact that banks tend not to collect revenue directly from the processing of many payments for personal customers increases the tendency to regard payments as a cost centre, which may reduce participant banks' willingness to pay for innovation. These problems are probably not, however, entirely linked to ownership. Different ownership of the central infrastructure would not necessarily remove the need to seek the agreement and co-operation of participant banks in the implementation of innovative changes.

2.6 It would also be a matter for serious concern if incumbent owner banks used system rules and procedures to create barriers to the entry of new banks. As part of the statutory responsibilities for oversight of payment systems that the Bank has held since 2009, the Bank has, following consultation with HM Treasury, published Principles to which overseen payment systems must have regard. One of these is that system access rules need to be open and objective.[6] The Principle allows for risk-based entry requirements where these are appropriate. The Bank has not, to date, seen compelling evidence that incumbent banks have used their ownership deliberately to create unjustified barriers to entry to new entrant banks, or entry requirements that are inconsistent with this Principle. The Bank has in the past encouraged deferred net settlement systems, in which member banks take credit exposures to one another, to take into account creditworthiness in their membership criteria so that bank customers are not exposed to the risk that they do not receive value on payments sent to them. The cash pre-funding of settlement caps due to be introduced in Bacs and FPS later in 2014, in line with the Bank's oversight expectations of these systems, will help to allow these risk-based criteria to be relaxed without additional settlement risks falling on participant banks and their customers. Cash pre-funding will also remove the current need for participants to provide liquidity commitments as part of settlement arrangements in the event of another member's default. These have been cited by some as a deterrent to membership.

3 What are the main alternative models of ownership? How might alternative models of ownership affect financial stability?

3.1 Payment systems generally comprise rules for the processing of payments and for membership, and supporting infrastructure to facilitate the clearing of payments and the transfer of funds between participants. It is possible to group these functions under separate entities, for example having the scheme rules run by a different body from the infrastructure. Hence, different ownership models can be applied to different combinations of the functions making up payment systems.

[6] Until 2012, Core Principle IX "The system should have objective and publicly disclosed criteria for participation, which permit fair and open access" (BIS CPSS, 2001). In 2012, this was succeeded by Principle 17 "An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access" (CPSS IOSCO *Principles for Financial Market Infrastructures*, 2012).

3.2 From a financial stability perspective, any ownership structure of systemically important interbank payment systems should not put at risk objectives that help to maintain financial stability. These include:

i. The protection of system participants and their customers from settlement risks. Payments involve the transfer of financial assets and liabilities between participants and so involve risks to participants.

ii. An appropriate degree of robustness and resilience to operational risks. To avoid disruption to the UK financial system, key payment systems need to be operated with a view to minimising the likelihood of operational disruptions and ensuring the system can easily resume provision of services following an outage.

iii. Continuity of service in the event of failure of a member. The system should be able to survive the failure of members and, in the event of a member entering resolution, it should not impede action by the resolution authority.

iv. Continuity of critical services in the event of financial failure of the payment system itself due to, for example, the crystallisation of business risks run by the payment system operator.

v. The Bank of England's ability to oversee the payment system effectively as part of its duties to maintain monetary and financial stability.

vi. The ability of the system to satisfy the internationally-agreed Principles for Financial Market Infrastructures. These principles include the requirement to settle in central bank money where practical and available.

3.3 As noted above, the current ownership structures of the systemically important UK interbank payment systems overseen by the Bank have not impeded the Bank's ability to ensure that each of these objectives is given appropriate priority. The current commercial bank participant-owners have strong incentives to protect participants and customers from risk, and to ensure operational reliability and continuity of service. They also have substantial resources, and incentives to make these available, should these be needed to address weaknesses in the payment systems.

3.4 One important factor to consider in determining whether alternative ownership structures would create appropriate incentives, both to maintain financial stability and to promote the other interests of participants, is the degree of market power that the payment system owners would enjoy. Network effects in payment systems, economies of scale and the bespoke nature of parts of the payments architecture mean that incumbent suppliers can have considerable market power.

3.5 A for-profit private supplier of payment system services which enjoyed significant market power could raise concerns from a financial stability perspective, as well as from competition and innovation viewpoints. To maximise profits, the private owner would have an incentive to underinvest in resilience in the confidence that this would not undermine its competitive position, while some of the costs of lower resilience would be borne by participants and their customers rather than the system operator. The private owner would also have an incentive to take on business risk – for instance, by expanding into other products or markets – to maximise profits. Its risk appetite might be greater if its owners and investors perceive that it has the advantage of being 'too important to fail' because of its core business. More generally, where reducing risk to participants would carry a cost that would erode profits, owners might have less incentive to address these risks than in the current ownership model. The infrastructure provider may also have incentives to preserve its market power through actions that could frustrate competition or innovation, for example increasing or preserving the complexity of the infrastructure to make it more difficult for other potential suppliers to win market share.

3.6 Strong safeguards would be needed to mitigate these unhelpful incentives. Regulatory powers to require investment might mitigate the risk of underinvestment in resilience. It might be necessary to consider ring-fencing the systemically important payment operations from other business areas to limit business risk. It would also be important to ensure that critical payment services could continue in the event that the company was taken into administration or resolution.

4 Issues raised by separation of scheme and infrastructure

4.1 The current structure of Bacs and FPS involves the separation of scheme company and infrastructure, with their relationship managed through a renewable contract.[7] This degree of separation does not exist in many of the other financial market infrastructures supervised by the Bank, such as the securities settlement system CREST, the foreign exchange settlement system CLS, and UK central counterparties. It is unusual internationally.

4.2 The separation of scheme and infrastructure has its origins in the Cruickshank review although it was not an explicit recommendation of that review. The review recommended opening up payment systems to non-banks and new players to foster competition and innovation. Prior to the publication of the final report APACS[8] and Bacs started looking at the Bacs governance framework in anticipation of the Cruickshank report's findings. A working group was established, which recommended a separation of the infrastructure from the scheme.

4.3 There were two main intended outcomes of the separation. First, it was suggested that increased and differentiated membership of the scheme and ownership of the infrastructure would widen participation and ultimately increase innovation. Scheme members would no longer be required to purchase a stake in the infrastructure company and infrastructure shareholders would not need to have a settlement account or transact payments, opening infrastructure ownership to non-banks.

[7] For Bacs, Bacs Payment Schemes Ltd and VocaLink Ltd; for FPS, Faster Payments Scheme Ltd and VocaLink Ltd.
[8] The Association for Payments and Clearing Services; a non-statutory association (trade body) of major banks and building societies now replaced by the Payments Council ,UKPA, and the schemes.

Second, it was suggested that there would be more competition for the provision of infrastructure to the scheme, and that this would have the additional benefit of further encouraging innovation.

4.4 In the Bank's view, it is not clear that the separation of scheme company and infrastructure provider has in practice resulted in a material increase in competition in the provision of payment system infrastructure. The design of the Bacs infrastructure in particular is highly bespoke, with tens of thousands of organisations connecting directly to the system. This may be seen as a barrier to entry for potential competitors in a market that arguably already has some features usually associated with "natural monopoly", notably network effects and high set-up costs. The high costs and risks of changing supplier could also play a part in limiting the scope for competition.

4.5 From a financial stability perspective, separation of the scheme from a commercial infrastructure company run on a for-profit basis has drawbacks. It requires small scheme companies to develop and maintain the technical expertise required to monitor and challenge their infrastructure providers. This can be difficult, especially on technical issues such as system design and information security. Separation also introduces a potential obstacle to the flow of information. The free flow of information is important both in business as usual – for example, about performance, risks and controls – and in the event of an incident or stress.

4.6 Relying on a commercial contract to manage every aspect of the relationship between the scheme companies and the infrastructure provider can potentially delay and complicate change. For example, each change requested by scheme companies may require renegotiation of charges, whether the change is required for financial stability or other reasons. The infrastructure provider may be able to demand a high price for changes the scheme is required to make to meet regulatory requirements or directions, especially where there is no alternative provider.

4.7 The Bank can see merit in revisiting the organisation of Bacs and FPS into separate scheme and infrastructure companies, both from its financial stability perspective and in the context of considering how competition and innovation objectives are best served.

5 What functions do you think need to be performed collaboratively?

5.1 Many of the important innovations over the past decade have required a collaborative effort by payment system participants. Payment system members need to cooperate to agree on rules, on message standards, and on the timing of implementation. Sometimes this collaboration has taken place within a particular scheme, but sometimes it has needed to be cross scheme, for example for account switching. Collaboration between participants will almost certainly continue to be required.

6 Issues affecting access to payment systems

6.1 The Bank's discussions with potential members of the Bacs, CHAPS and FPS systems indicate that the main disincentives for direct system membership are the costs of technical and operational requirements. Some of these costs are relatively fixed regardless of the number of payments made which means that the costs per payment are likely to be higher for new entrants with lower payment volumes. Some of these requirements are driven by security and resilience – for example, some systems use private networks rather than the public internet for payments traffic. While it is important to ensure that security and resilience requirements are not an unnecessary barrier to entry, this may mean that some costs are not easily reduced without potentially increasing risks. Simplification of the payment system architecture (see below) could, however, offer a means to reduce the fixed costs in the longer-term.

6.2 Some of the large payment systems (CHAPS, Bacs, FPS, Cheque and Credit) require their direct participants to have a settlement account at the Bank of England. The Bank has eligibility requirements for settlement accounts.[9] Their purpose is to protect the Bank from risk. They are not intended to be an impediment to system membership. The Bank keeps these requirements under review with the aim of ensuring that risk management objectives are achieved without presenting an unnecessary barrier to participation in payment systems. Some systems, for example Visa Europe and LINK, settle across the Bank's balance sheet even though their direct participants do not all have settlement accounts at the Bank of England.

6.3 A July 2013 report on UK payment systems by the OFT[10] found that there was little choice or competition in practice for some firms seeking indirect access to payment systems, and that some firms with indirect access had slower and more limited access to payment systems than direct participants at relatively higher cost. The Bank's discussions with direct and indirect participants suggest that the terms on which payment services are provided do not address the risk that the service could be withdrawn in stressed circumstances when it is most difficult to find an alternative provider. From a financial stability perspective, there would be benefits in contracts which make explicit provisions for periods of stress, so that firms can better understand and manage the risks inherent in their payment relationships.

7 Could simplification lead to benefits?

7.1 Although innovations such as FPS have enriched the range of payment options available to users, it could be argued that the UK payments infrastructure is unnecessarily complex. For example, the processes for transmission of payment instructions in Bacs were designed decades ago when limitations in computing capacity made overnight batch processing the only feasible option. Excessive complexity and bespoke features can act as barriers to entry and stifle innovation.

7.2 The existence of multiple systems also contributes to complexity. All payments can be characterised as pull (initiated by the payee) or push (initiated by the payer), and settlement can take place as real-time gross or deferred net. It is feasible for one system to accommodate the whole range of retail payment instruments. For example, Canada's ACSS system handles all payments not processed

[9] See the Bank's settlement account policy published in 2013 onhttp://www.bankofengland.co.uk/markets/Documents/paymentsystems/boesettlementaccounts.pdf

[10] OFT (2013), "Competition and innovation in UK payment systems", http://www.oft.gov.uk/shared_oft/markets-work/OFT1498.pdf

by the country's wholesale system, including cheque payments, card payments and ATM payments. It is also feasible to have one central payments hub able to settle both real-time and deferred net settlements, or to have both wholesale and retail payments settling in real time on the same payments platform. The SIC system in Switzerland, for example, settles the country's wholesale interbank payments in real time as well as a portion of retail payments.

7.3 Although the current set of UK payment systems have delivered reliable services in a manner in which participant risk has been given appropriate priority, there could be benefits to financial stability from simplification. These could include:

- Increasing resilience. Common messaging standards (such as ISO20022) could facilitate redirection of payments to different systems in the event of problems in one system. At present, the UK enjoys limited resilience benefits from the existence of multiple systems because of the limited ability to redirect payments between them. Simplification could also reduce the overall cost of resilience as fewer systems would mean lower aggregate costs of back up and contingency planning.
- Facilitating resolution by reducing the number of systems affected by a member in difficulties, or by making it easier to implement a large scale transfer of payment accounts in resolution.
- Reducing liquidity requirements on banks as liquid assets needed for settlement could be pooled centrally.

7.4 Simplification should also reduce barriers to entry as new entrants would not need to build capability to link to multiple systems, each with its own standard and requirements.

7.5 Any large scale overhaul of the UK's payments architecture would carry substantial operational risks, which would need to be carefully managed. However, in the Bank's view, it is worth exploring whether a substantial simplification would offer long-term resilience benefits as well as potential enhancements to efficiency, competition and innovation.

Bank of England

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Dear Sir or Madam

Barclays response to the Call for Inputs

On behalf of Barclays Bank PLC and its relevant subsidiaries (Barclays) we welcome the opportunity to contribute to this Call for Inputs on the proposed regulatory approach for the Payment Systems Regulator (the PSR). A summary of key points is provided below and a more detailed response appears at Annex A.

The payments market place is one that has seen considerable activity over recent years and the pace of change, from innovation, competition and other drivers, such as regulatory change, remains high. The way people buy and sell is changing rapidly with the rise of e- and m-commerce, and an emerging "always-on", omnichannel world means that customers will be demanding more convenient ways to complete purchases and transfer money to others.

Barclays, like the market place, is constantly evolving and we recognise the need to stay abreast, if not ahead of market developments by improving the products and services we offer our customers whilst ensuring that the underlying payment systems remain safe and secure for users.

Barclays is proud of its investment in payment initiatives such as Pingit for mobile payments and, with the other providers, Paym. We were also at the forefront of the development of the Current Account Switch Service, helping customers move between account providers.

In terms of the future, we are engaged with HM Treasury on its consultation on cheque imaging, which we strongly support, to improve payments efficiency and deliver customer benefits. We plan to launch an image based paying-in pilot via smartphone next month. We cannot and are not sitting still in terms of future innovation.

Payments, the systems that deliver them and the regulatory environment within which they sit is a complex area and one which we consider will benefit from the PSR delivering on its objectives, in particular supporting the industry to deliver further innovation, improvements for users, whilst safeguarding the security and stability of the payments systems themselves. The need to maintain the UK payment schemes' resilience is crucially important and any developments that might threaten stability need to be carefully considered by all relevant stakeholders and UK regulators.

We would also encourage the PSR to take a holistic approach to its regulation of the payment systems. There are fundamental non-payment components that contribute to the make up of any payments eco system. Notably, payments give rise to both anti-money laundering and liquidity considerations, the importance of which cannot be underestimated. The evolving regulatory landscape further influences the payments eco systems including, but not limited to, Basel III and various structural reforms (e.g. Dodd-Frank, Financial Services (Banking Reform) Act). Furthermore, there are an array of non-traditional payment providers operating within the eco system, whom may not currently be regulated in the traditional sense. Resultantly the need for us to look holistically has never been greater.

Barclays are happy to engage with the PSR to help inform its understanding about UK payment systems and its dynamics from a banking perspective. In addition to this response, we also participated in the first round table industry event earlier this month. We look forward to further engagement in the future.

Yours sincerely

Barclays Bank PLC

APPENDIX A

FCA - Payment Systems Regulation – Call for Inputs – Responses to questions

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

The scope of payments regulation is wide-ranging and we would caution that certain schemes are very different to each other in function, geographic reach, commerciality and governance.

Some schemes are designed and built on an international basis, such as Visa, MasterCard, American Express and Discover Financial Services. They operate in a wide array of markets, with products available in major international currencies. They tend to be run on a for profit basis, with direct competition amongst these schemes for provision of services. There are also a number of local payment systems that are increasingly competing on a global scale, China Union Pay being the most notable of these.

Other schemes are designed and built to serve the needs of the domestic sterling market. They are collectively owned by payment providers, run on a not-for-profit basis, and centrally managed. CHAPS, Faster Payments, Bacs and Cheque & Credit Clearing Co. fall into this category.

These domestic schemes are typically, but not exclusively, serving differing needs / functions within the local economy. A further distinguishing characteristic of these domestic payment schemes is the relative coverage of the payments value chain; operating predominantly as a high value/low volume 'wholesale' system, e.g. CHAPS, or as a high volume/low value system, e.g. Bacs, or as a immediate payment system aimed at the consumer/SME segment, e.g. Faster Payments.

As intimated above, not all of the schemes can be characterised as "retail payment systems". For example, CHAPS is predominantly used for high value interbank and business to business payments; and Bacs and Faster Payments have both retail and business characteristics. The PSR will need to be cognisant of the differences in scheme function, scope etc and not take a "one size fits all" approach.

Across all schemes, it is important that the system of regulation is flexible enough to accommodate not only the differences within the schemes noted above, but also the changes to the way in which payments are processed (such as the current evolution in mobile payments). Regulation must be nimble enough to adapt to new innovations and recognise both the international and non-bank nature of many forms of payment, particularly those in the rapidly expanding digital economy.

In terms of the payments systems that should be designated, subject to the need to recognise and respond to the differences between the schemes, we would suggest that the PSR's coverage includes as many schemes as possible, to ensure as far as possible that there is a level regulatory playing field. Further the PSR should expect to have to expand its coverage to incorporate new market participants.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

The effectiveness of competition in the UK payment system should be considered in the context of a global market place where we have experienced a considerable degree of competition over a number of years. Firstly, there have been a number of new entrants not traditionally associated with payments, (e.g. Ebay (Paypal), Amazon, Apple and Google). Secondly, a number of start-ups in the payments space are challenging both the traditional and non-traditional providers, (e.g. iZettle, Monetise, Weve). Thirdly, instead of there being one or two membership based card payment networks in the market, there are now a number of networks, from a variety of countries and with different ownership constructs that are all competing within the network market. As such, we believe the market is a competitive one.

We have had to adapt to new challengers in the payments market-place and we are constantly looking for new and better ways to serve our customers. We believe every business is going through a process of trying to identify innovative and successful ways of delivering payment services to customers. Competition has been one of the key drivers for us to innovate and differentiate our product and service offerings. A recent example of the link between competition and innovation is the successful launch in 2012 of our competitive Mobile Payment service, Pingit, which increases customer choice. We have also introduced Barclays Personalised Debit Card, which allows our customers to choose an image with which to personalise their card and therefore encourages engagement with this method of payment.

The industry has also invested significantly in the collaborative central infrastructure with the aim of improving the stability of the payment systems and enhancing the payment services that financial institutions are able to offer e.g. an industry investment of £0.5bn for Faster Payments, £750m in respect of the new collaborative Current Account Switch Service and £100m spent in upgrading the Bacs platform.

We do not believe that this necessary collaboration to maintain and improve the infrastructure impedes competition, but rather increases it. If there were no collaboration in the payments system, everyone would have to develop their own platforms and approaches to payments. Collaboration has reduced confusion for consumers and merchants, has delivered highly functional and stable platforms, has increased the ease with which customers can pay recipients with accounts at a wide variety of payment service providers and helps ensure that new entrants can compete with traditional players. The global interoperability of an international scheme such as Visa or MasterCard enables a wide range of competitors to compete, separately, for the business of cardholders and retailers. This would not be possible in a non-interoperable world.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

The payments infrastructure in the UK is characterised by necessary collaboration between members of schemes as well as competition between providers. The payment schemes set the rules by which the financial institutions communicate and act to enable payments to flow and provide the environment for payment service providers (PSPs) to collaborate on the development of core central infrastructure e.g. a Real Time Gross Settlement System (CHAPS); Deferred Net Settlement Near Real Time Service (Faster Payments); a 3 day credit transfer and direct debit service (Bacs); a Central Clearing for paper cheques and credits (C&CCC); EMV standards (card schemes); and a linked ATM network (LINK ATM Scheme). There are some issues that are common to more than one of the schemes (e.g. cyber security, management of settlement risk) where it makes sense for the schemes to work together.

The payment schemes also provide the basis on which individual commercial organisations such as Barclays can provide innovative, market leading competitive offerings to their customers, so driving benefits in terms of costs, quality and innovation. For example, Pingit (the Barclays mobile payments offering) was introduced as a consequence of our investment in the existing platform provided by Faster Payments. Other banks have introduced their own variants of Pingit e.g. NatWest's mobile payments service is based on payment by debit card. Contactless EMV payments – which enables people to pay using their bank debit card without using a PIN – is ideally suited to low value payments such as mass transit, and Transport for London (TfL) is leading the way in moving over from a bespoke system, Oyster, to the more secure and interoperable EMV card-based infrastructure. Over time this will reduce TfL's costs, and enable people from all over the world to travel in London without using cash.

The pace of innovation by existing and new competitors in the payments space is already active and is not set to slow. Potential future developments by payment services providers include: biometrics, wearables, separation of financing from settlement, cloud only based identity and settlement, providing customers with a much wider range of more convenient and secure options for accessing payment systems by utilising technological advances.

Question 4: What are the main factors impeding more effective competition at each level?

For the reasons stated above in our response to Question 2, we believe that there is effective competition in the payment system and for Barclays that is exemplified by how we deliver payment services to our customers. We also believe that the payment schemes, as currently constituted are well placed to enable payment service providers to provide customers with a range of competing options when making payments.

Payments is, however, a complex and heavily regulated environment and players need to be able to invest in the necessary security and regulatory requirements which are crucial for the safety of the payments ecosystem and the consumer. Interestingly, some of the recent entrants to the payments sector are not subject to some of the regulations that bind the more traditional payment services providers. We would urge the PSR to ensure that there is a level playing field for all providers.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Payments require inter-operability and collaboration. The paying institution needs to send the payment instruction in a format that the receiving institution can understand and process. Equally, the receiving institution needs to take agreed actions within set time frames for the paying institution to have certainty in its customer proposition or particular service. Furthermore financial institutions need to agree on the points of payment finality, irrevocability and liability to be able to offer a secure and resilient service to customers.

Any changes that affect the way in which banks interoperate will require some collaboration. For example, standard messaging formats. If payment service providers want to move onto a new global messaging standard such ISO20022, then the whole industry needs to agree a common migration pathway. Equally, if some payment service providers want to embrace new ways of e.g. clearing a paper cheque using image, then the industry as a whole has to agree a common migration pathway for the central paper clearing.

The payment schemes effectively provide a largely collaborative function in terms of managing the membership process, on-boarding, rule sets, governance, and managing settlement liabilities. They provide a core central operational service which financial institutions then use to support their own product innovation.

There will be some functions which will have an impact across more than one scheme where it makes sense for the industry to collaborate via some form of central body to ensure there are no intra-scheme conflicts and thus ensure consistency. Examples include the new Current Account Switch Service, the Paym (both of which required changes to procedures and message formats in other payment schemes), EMVCo (which sets card-based standards across Visa, MasterCard, American Express and other domestic card schemes), Bacs and Faster Payments pre-funding and the provision of security and liability frameworks.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Please see our response to question 7 below.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

Historically, banks have owned the payment schemes because they needed to create a common platform and set of rules to allow the safe and efficient exchange and settlement of customer payment instructions. It is difficult to imagine what the payments infrastructure would look like if this had not happened; and if the banks had not made this investment (originally and continually over time).

Today, there are a number of systems still run on a not for profit basis, e.g., CHAPS, Bacs and Faster Payments. There are also a large and increasing number of systems run on a for profit basis, e.g., Diners/Discover, AMEX and Visa Inc. Maybe more importantly, there are a number of emerging payment systems that are for profit with no links to the traditional membership structure, e.g., Paypal.

It is clear that the payments market has since expanded and diversified beyond the traditional players. Changes have been made to the governance and ownership structures of many the payment schemes in the last 5 – 10 years. The key will be to maintain resilience and security of the infrastructure and ensuring trade-offs are understood and accompanied by appropriate checks and balances.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Please see our response to question 9 below.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

It is right that governance of the payment schemes is a key area of focus for the regulator given the importance of the schemes to UK Plc. We have witnessed an improving trend in the governance of UK schemes, partly in response to more demanding requirements from the Bank of England (BoE) which we support. We know that more can be done and this should be a constant area of focus for which the schemes must ensure they have adequate resource.

In the new regulatory environment, we absolutely see the need for a trade body to help facilitate and co-ordinate payment scheme projects such as the Current Account Switch Service and Paym etc.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

In the UK Barclays is a full direct member of all the major payment schemes as well as the newly introduced Current Account Switch Service and Mobile Payments Scheme. There is clearly an internal cost of scheme participation, in terms of industry participation, systems interfaces, availability expectations, collateral funding etc, but Barclays view is that cost is an integral part of being able to offer payment services and meeting our customers' expectations.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Barclays is able to provide a full range of services to our customers and to compete effectively with other service providers for customer business. Barclays currently provides cost effective solutions for other banks and other service providers wanting indirect (agency) participation in the payments schemes.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:
• To whom do you provide indirect access?
• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
• Are there any barriers to becoming a sponsoring bank?

14.1 Barclays provides indirect access (Agency Solutions) to other UK banks, branches of foreign banks, building societies and other PSPs into the following Payment Operators:

- CHAPS
- Bacs
- FPS
- Cheque and Credit Clearing

There are major risks (and costs) for us associated with the provision of indirect access. This list is not exhaustive, but we have sought to provide a high level synopsis of the key risks.

<u>14.2 Major Risks</u>

a) Credit and Liquidity Risk:

By providing agency banks with indirect access to payment systems we also provide daylight/intraday overdraft facilities to facilitate smooth payment processing and settlement. This results typically in unsecured credit risk which we bear. We are also reliant on our agency banks to submit payment instructions to us in a timely and responsible manner to allow us to manage the flow of intraday liquidity at a scheme and central bank level. We are further reliant on them to manage their cash positions and any failure to do this on their part ultimately impacts Barclays' central bank account.

b) Regulatory / Compliance Risk

The payment traffic of an agency bank sponsored by us effectively becomes Barclays' own payment traffic for the purpose of regulatory and compliance risk. This means that we are exposed to the risks associated with their potential failure to comply with regulations (e.g. non-compliance with anti-money laundering requirements).

c) Operational Risk

Providing agency banks with indirect access to our infrastructure and payments environment increases operational complexity for us in terms of processing payments and also increased the challenge for us in terms of providing continued system security.

d) Reputational Risk

Agency banks sponsored by us are identified by a Barclays sponsored sort code, and/or utilise Barclays' stationery and/or branch network which means that we are naturally associated with them. Anything that brings an agency bank's reputation into disrepute has a potential impact for Barclays by association.

<u>14.3 Sponsoring bank costs</u>

There are a number of significant infrastructure and expertise requirements associated with being a sponsoring bank which we have set out below at a high level.

- Knowledge and expertise: is required in order to become and remain a sponsoring bank. As a minimum, a sponsoring bank would need to retain a team of subject matter experts, product managers to design and maintain payment solutions and to review, assess and apply evolving scheme and regulatory change.

- Technology/infrastructure: must be maintained to connect with the indirect participants' systems.
- Legal and compliance expertise: is necessary to navigate the array of documentation, scheme and regulatory compliance.
- Treasury (liquidity) management: processes and controls (e.g. monitoring and reporting) have to be put in place to support the agency structure.
- Risk management: professionals and together with a related framework need to be in place and maintained to support indirect participation.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We are aware that the payment schemes have on-going work streams looking at second tier membership criteria and access. The continued resilience, integrity and security remains of utmost importance – most of the payment schemes are part of the UK's critical national infrastructure, and their high performance during the financial crisis has been widely commended. Any potential changes to access rules and conditions should take into account potential impacts on stability and costs, and should only be considered if there is genuine, clear evidence of detriment resulting from the status quo.

Question 16: Do you have any other comments regarding access?

There are a number of potential consequences for payment systems which may result from the evolving, multi-faceted, regulatory environment. In particular, consideration should be given by the PSR to other related regulatory changes that are likely to have an impact on our ability to continue to offer an attractive and competitive agency proposition. These include, but are not limited to, the new liquidity coverage ratios and the focus on intraday liquidity risk and reporting, as well as the provisions in the Financial Services (Banking Reform) Act which require us to limit our exposures to Financial Institutions.

Ultimately, there is a cost in accessing the payment systems directly or indirectly. Those entering the market have a choice between meeting this cost by investing to becoming a direct member or choosing to invest in other aspects of their business e.g. a new branch network or online customer interface and then paying to use a sponsoring arrangement.

It is important to note that there are parts of the world where Barclays has chosen not to be a direct participant in the payment system.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

The existing collaborative infrastructure has developed over time to address various payments needs and to some extent has developed in silos. Now might be a good time to look at rationalisation in line with current and future consumer and business needs.

We strongly support the proposed reengineering of the central cheque and paper credit clearing to facilitate the use of cheque images, provide open access and move to a fully prefunded cash settlement model which should facilitate market entry and provide a sustainable and more efficient central clearing.

From a resolution perspective, we need to identify in-flight payments and be able to transfer eligible balances in bulk to a viable institution. Operationally we need to be able to ensure continuity of the failed institution's operations and the infrastructure needs to be sufficiently flexible to support that.

Account number portability

There have been calls for "account number portability", sometimes conflated with the notion of the single, central utility and we are aware that the FCA will shortly assess whether there is a case for portability when it reviews the Current Account Switch Service. If the PSR intends to look into portability, we would urge it to do so in a way that takes into account the FCA's review to avoid duplication or confusion.

Barclays' own view on portability is that it brings little additional benefit beyond the Current Account Switch Service. We do not believe there is any evidence to suggest that portability would boost competition. This view is supported by;

- Research among consumers commissioned by the Payments Council finds little difference in appeal between portability and the Current Account Switch Service - because they deliver the same outcome (a seamless switch of provider). It also shows that consumers have little attachment to their account number. Indeed, most consumers and SMEs have more than one bank account, so it remains unclear that having a 'number for life' would be desirable.

- Experience from similar schemes. We understand that Sweden has a proxy system called the BankGiro number - it is limited in scope, but we do not believe there is any evidence to suggest that switching has increased as a result of its introduction. We also understand that the Netherlands introduced a version of account portability in 1980, allowing account numbers to be ported within the giro system covering approximately 50 per cent of Dutch payment transactions. We believe this was discontinued in 1983 due to a lack of demand. Also, the Australian Government conducted a study into portability which concluded that it would 'involve major costs which would ultimately be borne by payments system users, for relatively minor benefits'. Indeed, the cost of delivering portability would greatly impact the resources available for other innovative developments for a prolonged period.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

In answering this question specific regard has been given to the UK centric electronic payment schemes of CHAPS/Faster Payments/Bacs/LINK as well as SEPA Cards Framework (SCF compliant card schemes) such as Visa and Mastercard.

There are no identifiable issues that require immediate action in that the messaging formats used by each payment scheme meets the scheme level proposition. However it is our belief that wider benefits can be derived from each of the schemes adopting a common standard over time. Such high level benefits would include:

- A more consistent customer experience across the various banking interactions (e.g. Payroll, Bacs, CHAPS, and card payments) given the potential for consistent data enrichment.
- Ease of cross-scheme contingency and resilience. Member organisations would not be required to undertake message transformations in rerouting payments from one payment message type to another.
- Ease of industry wide system upgrades. A new standards change would apply equally across all schemes, therefore potentially saving rework (analysis, design etc) at central infrastructure and member gateway.

- Longer term potential for member banks to simplify their payments infrastructure landscape where transformations would not be required to format for specific payment schemes.
- Potentially a consolidated standard could reduce transaction management layers and on-going infrastructure costs in the long term.
- May potentially provide a step towards scheme consolidation where there is common infrastructure.
- The adoption of the common ISO format would also allow the UK payments industry to better compete with off-shore schemes that already use this format, in particular in respect of large corporate business (e.g. payment acquirers).

The above does not come without challenges and constraints. Again, in no particular order, these include:

- Significant investment call from scheme members to fund but any change would also impact the central scheme as well requiring in-house changes. In the current environment, any call for investment would be challenging as funding remains at a premium.
- Such widespread change (if undertaken simultaneously) would result in an industry wide resourcing issue (in terms of personnel/project resource/oversight and governance).
- Any wholesale scheme change would limit the ability for individual financial institutions to incept any individual proposition changes, in the main due to constraints on funding/resource.
- Any such change would also need to be carefully planned so as not to compete for priorities with other regulatory changes (e.g. PSD2, AML, Dodd Frank etc).
- Changes within the structure of banking systems would also need to be supportive of customer engagement and their ability and priorities. Significant time and investment from corporates will be required to migrate to a new standard. End users would need to be supported with a significant and open window allowing a 'time is right' approach to switch.
- Mechanisms should be considered to support significant engagement from all actors in any migration with translation tools to allow early adopters through to any potential mandated timeline. A "Big Bang" approach would likely be difficult if not impossible to manage.
- Experience of introduction of SEPA across Europe noted different approaches to implementation on a nation by nation basis due to flexibility within the legislation. This resulted in formatting issues and flags the need for clarity and certainty in any further introduction of ISO20022 (or similar) standards in the future.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Please see our answers to Questions 13-16 on access above.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

We would simply note that budgets are finite and that regulatory change and compliance with new regulatory requirements take precedence in terms of funding.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Incentives for innovation within UK payment systems come in three broad forms:

- Firstly, enhancements to existing systems to improve functionality, reliability, security, service levels, capacity, etc. such as New-Bacs.

- Secondly, innovation may be delivered through the launch of a completely new service/platform, such as Faster Payments.
- Thirdly, individual firms independently develop new products and services, using existing infrastructures in an innovative way, such as Barclays Pingit.

Currently, the cost of innovation and development is funded in one of two ways.

- Firstly, if set appropriately, interchange fees can support innovation at both a scheme and an individual bank level. For example, at the scheme level, the implementation of Chip and PIN in the UK was partially funded by reducing interchange rates for fully secure transactions, thereby incentivising retailers to invest and accept the change. Card schemes still use interchange rates to incentivise merchant to accept more secure transactions.

  Interchange fees also support innovation at an intra-scheme level. Issuers are able to invest in new technology to serve their customers, whether this is in the customer experience space, in fraud management, etc. The recent investments in contactless technology may not have been possible without the income provided by interchange.

- Secondly, in the non-card payment services, where there are usually no interchange fees, the cost of development and innovation is usually funded either, by an up-front call on members, or, by a loan from the payment developer/processor, which is recovered via a surcharge on its processing tariff to the scheme members.

In both options, the cost of innovation and development will ultimately be shared with the users in 'UK Plc'.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

The industry would benefit from certainty in terms of planned regulatory or governance changes, or confirmation that there are no regulatory changes expected or planned in particular areas, in order to facilitate planning/budgeting etc.

Greater success or pace across industry stakeholders has been seen in recent years with government support and advocacy of Faster Payments and more recently their support (and on-going consultation on) cheque imaging. Barclays has and will continue to engage with government when it identifies areas where it considers innovation and change are beneficial. However, change must always be balanced with the need to ensure security, resilience and financial stability and for that reason, will take time.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

As we have said in answer to Question 5 above, payments require inter-operability and collaboration. The paying institution needs to send the payment instruction in a format that the receiving institution can process, with the receiving institution taking the necessary agreed actions within set time frames for the paying institution to be able to promise its customers a particular service. Furthermore financial institutions need to agree on inter-party liability to be able to offer a secure and resilient service to customers. This all requires collaboration and that takes time and considerable effort by all concerned.

However, as we have said in our answer to Question 3 above, the payment schemes also provide the basis on which individual commercial organisations such as Barclays can provide innovative, market leading competitive offerings to their customers, so driving benefits in terms of costs, quality and innovation. Individual developments such as this can be taken forward more quickly but, whilst delivering significant value for individual firm's customer base, they will not achieve reach across the customers of all receiving institutions.

Question 24: Do you have any other comments or concerns you would like to highlight?

Question 25: What, if any, are the significant benefits you see regulation bringing?

On balance, we see benefits to regulation in terms of the certainty that it can deliver provided it is based on clear evidence and thorough cost benefit analysis as appropriate. Further, regulation could help to provide clarity on the boundary between the 'collaborative' and 'competitive' space for the industry. We look forward to working with the PSR in an open, positive and constructive manner as we have worked with the BoE as statutory oversight authority and the FCA in respect of conduct related payment issues.

We note that the proposed revisions to the EU's Payment Services Directive (PSD2) envisage a new regime for participation by third party payment providers (TPPs). There could be potential tensions between requirements of TPPs for access to data and the need of account-holding institutions to protect data and consumer rights. There may therefore be a beneficial role for the PSR to play (together with its regulatory partners) in ensuring an orderly adoption and operation of this regime in the UK in due course.

Question 26: What, if any, are the risks arising from regulation of payment systems?

In addition to the creation of the PSR, there is considerable on-going regulatory change which will directly or indirectly impact payment systems (Basel III, PSD2, the Payment Accounts Directive, ICB/Dodd-Frank/Liikanen, the FCA review of CASS/account portability, the Competition and Markets Authority's (CMA) review of SME competition etc.). Time, resource and attention will be invested on these developments to ensure proper engagement ahead of regulatory change and compliance with new requirements.

There are also challenges for those regulatory bodies who either share oversight of payment systems or who are stakeholders, in terms of liaising to ensure that a collaborative approach is taken and that there are not unintended consequences for the market place. This is something that the BoE, PRA and FCA already do in respect of financial services in the UK. This will be something that the BoE, PSR, CMA and FCA will also have to do going forward in respect of payment systems, especially in respect of the PSR's, CMA's and FCA's concurrent competition powers.

Regulators should anticipate that there will be differences of approach and priorities between individual regulatory bodies arising from their different objectives. A few of these may have inherent tensions, such as the competition objectives as against financial stability and integrity objectives. Any differences should be resolved by the regulatory bodies themselves, and not left to market participants to interpret and resolve in the market-place.

Additionally, in terms of overall regulatory approach, the PSR might want to adopt an approach similar to that of the BoE, focusing on high level issues and supervision, otherwise the new regulator might find itself drawn into micro-management of the schemes and member firms.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

We consider it essential that any new regulation or rule ensures that competitors remain on 'a level playing field', treating newer entrants proportionately, as required, for an introductory interim period.

Please also refer to our responses to questions 25 and 26.

FCA Call for Inputs

Thank you for giving us the opportunity to respond on the above consultation document. I am writing to you on behalf of the Belfast Bankers' Clearing Company Limited (BBCCL), which is the scheme company that oversees the clearing arrangements for cheques and paper credits in Northern Ireland (NI). There is no mention throughout your document of BBCCL as one of the UK's payment schemes so we thought it worthwhile to draw this to your attention.

BBCCL was formed in 2007, with the aim of formalising the governance and rules for paper clearing in NI, which had previously been the responsibility of an inter-bank committee. It is the only payment scheme in the UK whose remit does not extend UK wide. BBCCL's role and function is purely one of oversight and it plays no part in the day to day operations of cheque clearing. It does not operate any systems; the processing and settlement of items is handled solely by our four shareholding member banks – Ulster Bank, First Trust, Bank of Ireland (UK) and Danske Bank. BBCCL's prime responsibilities are to maintain the integrity of the clearing arrangements, ensure systems are stable and efficient, set and maintain the clearing rules and ensure that the member banks abide by them and meet the obligations that membership entails. The board is also responsible for setting the criteria for new entrants and for assessing any applications to join BBCCL. The board of the company comprises a director from each of the four shareholding banks and three independent directors, including an independent chairman.

It is also worth noting that unlike the other UK payment schemes settlement by the BBCCL member banks is not facilitated through the Bank of England. Instead each bank operates a net bi-lateral settlement with the other three banks and the net payment is made by a CHAPS payment.

Our responses to applicable questions within your document are as follows:

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We are entirely happy to comply with the requirements of the Payments Systems Regulator and clearly it is a matter for HM Treasury to determine which payments system merit designation. However in respect of BBCCL, as explained above, the scheme itself has no infrastructure or operating systems and the average net daily exposure between the banks is just over £2m each. We would anticipate these factors to be taken into account when considering designation. BBCCL is not currently deemed systemically important.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

We believe that the proposed new image based system for cheque processing will create benefits for end users, in terms of convenience and a faster clearing cycle. In addition it will enable challenger banks to compete on a more cost effective basis, should they wish to avail of the opportunities available.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Regulatory activity, public interest matters and access to payments could benefit from collaborative action across the industry. The Payments Council would appear to be ideally positioned to facilitate this however we believe it would be beneficial if their role and purpose was to be clearly defined and communicated.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

We do not consider the current ownership structure creates problems.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

We do not consider the current ownership structure creates problems.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

The cost of any changes should be commensurate with the benefits they will deliver.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

The three primary sources of innovation at present are competition, cost reduction / revenue generation and mandatory changes. Other than these there appears to be little incentive for banks to invest heavily in innovation. A clear remit from the new Payments Systems Regulator will certainly drive innovation but a reasonable business case to support initiatives should also be a pre-requisite.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

The views of our shareholders.

Question 25: What, if any, are the significant benefits you see regulation bringing?

The two key benefits will be the products & services launched as a result of the PSR's innovation remit and the wider focus on public interest matters for banks and payment schemes.

Question 26: What, if any, are the risks arising from regulation of payment systems?

That the costs will be disproportionate to the risks being regulated.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Will likely increase our costs.

If you would like to discuss any of the above points, or learn a bit more about BBCCL, please do not hesitate to get in touch. My contact details are shown below.

David Lemon
Company Secretary
Belfast Bankers' Clearing Co Ltd

lemondavid@btinternet.com

Tel: 02891 815439

BNY MELLON

Date: 15th April 2014

Contact: Laura Stevenson, Compliance Manager
Phone: 0131 635 2577
Email: laura.stevenson@bnymellon.com

Dear Sirs,

Call for Input: Payment Systems Regulator

We welcome the opportunity from the FCA to respond to their call for input in respect of the creation of a new Payment Systems Regulator and confirm this response is submitted on behalf of our UK regulated entities.

Basic Information	
Consultation Title:	Call for Input: Payment Systems Regulator
Name of Respondent:	BNY Mellon
Contact at Respondent:	Name: Laura Stevenson, Compliance Manager
	Email: laura.stevenson@bnymellon.com
	Address: 12 Blenheim Place, Edinburgh, EH7 5JH

Nature of Organisation	**Yes/No**
Infrastructure Provider (e.g Vocalink)	No
Payment System Operator	No
Direct member of payment system(s)	Scheduled
Indirect participant in payment system(s)	Yes
Service-user	Yes
Other payment provider	No
Third party service provider	Yes
Trade/Government/Regulatory Body	No
Other	N/A

Confidentiality	**Yes/No**
Do you wish any part of your response to remain confidential	No

Kind regards

Laura Stevenson

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.
We agree that the payment systems listed on page 9 of the related Call for Input should be considered for designation. We would also request that consideration is given to Mobile Payments. Mobile payments are a fast expanding industry which provides services to both consumers and corporate entities. There are a number of different solutions available and appropriate regulation would assist in ensuring that these solutions resulted in the fair treatment of customers.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?
We believe competition is ineffective in the following areas:

- There appears to be a lack of direct members of payment schemes in the UK compared to other countries which is apparent from FED/SEPA/CHIPS and Target 2. This is resulting in lower levels of competition.
- The cost of becoming a direct clearer in FPS and BACS is potentially a barrier to entry.
- The lack of competition with Low Value (LV) clearing schemes (e.g. 11 direct members of FPS compared to 21 CHAPS).
- Direct Debit processing has high barriers to entry with unlimited liability.
- The ability to compare agency banking offering and sponsoring banks offering and costs (BACS, FPS, CHAPS and Cheque Clearing etc.).

In terms of effective competition, we believe that there is increased competition in CHAPS which has been brought about by the revised Tiering Rules.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality of innovation?
In our opinion, LV direct clearing, increasing the number of Direct FPS and BACS clearers could potentially increase competitiveness and drive innovation. The majority of current innovation appears to be in respect of Mobile Payments and Payment UK / Global disbursement models.

Question 4: What are the main factors impeding more effective competition at each level?

- Set up cost of becoming a direct clearer.
- Ongoing operational cost of being a direct clearer.
- Cost of processing through an agency bank.
- The lack of transparency of agency banking offerings.
- The credit risk / liability of BACS credits and Direct Debits (this is regardless of whether the firm is a direct or indirect clearer).

The cost of investment, the diversity in the local and international markets and lack of defined preferences by the regulators mean that the move towards electronic and speedier payment mechanisms have been slow in the fund administration industry.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?
We believe that there is an opportunity for the clearing systems to address solutions to address regulatory changes or requirements. Where requirements are the same for all banks then it may be more efficient for all banks to collaborate on and deliver the change in the sector.

Question 6: Do you think the current ownership creates problems? If so, please explain your concerns with the current structure.
We believe that the current ownership structure has the potential to create high barriers for entry for new participants. In addition, there is a high cost in becoming a direct member of CHAPS, BACS and FPS. Also, becoming a direct member creates a competitive advantage for those banks with a large retail customer base.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

We believe that the Payment Systems Regulator should consider additional regulatory requirements relating to governance arrangements – for example, increasing independence from the systems owners to address any abuse of ownership. As indicated above, the current ownership structure has the potential to create high barriers for new participants and with access being important to enable the ability to influence, we feel that it is important that all members and participants have their views taken into account and no one bank should have a particular advantage.

Question 8: Do you have any concerns about the current governance of UK payment systems?
We do have concerns, or at least observations, that the UK payment systems comprise of a number of entities/companies providing specific services which form parts of the jigsaw. However it appears that it lacks a central strategy to bring all the pieces together. We explain some examples of challenges in this area later in our response. In addition, we believe that while the payment industry in the UK performs well, there is always an inherent risk when the ownership of the scheme lies with those that own and use it.

Question 9: What do you believe is the most appropriate governance structure for UK payments systems?
We believe that the new independent Payment Systems Regulator will enable payment systems to add additional oversight to the current ownership and governance structure. As indicated in our response to question 7, we believe that it is important that all members have a voice. We welcome the introduction of independent directors into the Payment System governance structure and feel that this brings independent challenge and oversight. It is highly important that a variety of members are included in governance decisions, particularly given the differences in membership profile. Therefore, some requirements may be appropriate for certain members but not others. An example of this is the requirement within CHAPS to submit a certain amount of payments by a certain time of day. This may be possible for some members, however, it is dependent on their portfolio of business and if that business is primarily dealt in the afternoon (such as our business), means that the time limits set by CHAPS cannot be achieved.

Question 10: How do you access UK Payment Systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard?
In relation to CHAPS, we participate as an indirect clearer, however, we will become a direct clearer from May 2014. In terms of BACS, we participate indirectly for BACS credits only. We participate indirectly for Faster Payment receipts.

From a Third Party Fund Administration perspective (where BNYM act as a Transfer Agent for a number of Fund Managers), we have an interest in the mainstream payments systems being considered for designation. These being UK CHAPS, Cheques, BACS and FPS. Of particular interest would be the wider emergence into the corporate banking market of the FPS or similar providing the flexible and better value ability of same day transfers within participant members (UK banks). BACS offers something similar, but appears deficient and outdated in its design and rolling 3 day cycle. We feel in this industry there is an extensive use of cheques. We therefore welcome the separate consultation from HM Treasury in respect of speeding up of cheque payments as this still remains a significant hurdle to find a solution for easier and quicker investor payments. Alongside the emergence of more "on-line" fund offering we have seen a general increase in the use of debit card but not all investment managers offer this capability and likewise some investors still don not feel comfortable in using cards in this manner.
There are some really good tools in our industry such as Crest settlement for funds and SWIFT. The cost of entry has been prohibitive for some groups as there is a requirement for expensive automation up front in order to offer a straight through service and we are aware many parties have struggled to be able to demonstrate a good return on that upfront investment required. Part of the challenge here is that there are several options and to build automation for each option duplicates such investment spend. If we saw significant market adoption then this could justify the investments also. As such solutions need to be simple, consistent and not require huge initial investment or take up will not be high enough to make a significant difference.

Question 11: For the access you describe above, are the access terms and conditions fair and reasonable? If not, provide details.
Based on the current prohibitive cost of entry and associated liability concerns (through the net settlement and lack of direct debit finality), the costs of the services we use on an agency basis do not appear unreasonable. The cost of entry would be significantly reduced to provide commercial rationale to join these systems directly. Furthermore, the agency arrangements allow agency members to appear direct to their underlying clients.

Question 12: Does your access arrangement you currently have limit your ability to compete or impact on the service-users experience in any way?
Yes, we have experienced issues providing our clients with the services that they require as an indirect clearer in LV schemes and these issues have been discussed elsewhere in our response (for example, Direct Debit liability).

Question 13: If you access payment systems directly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?
We do not believe there is sufficient choice or ability to evaluate the direct clearing banks propositions easily and therefore would prefer to be a direct participant. We see the benefits as reducing payment processing costs, enhanced visibility of changes to the payment systems and the ability to offer more flexible propositions to our clients. We see the risk of becoming a direct participant is the increase in our operating costs and exposure to additional regulatory requirements and changes.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If Yes: To whom do you provide indirect access? What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access? Are there any barriers to becoming a sponsoring bank?
We do not currently offer an agency bank solution but will act as a sponsoring bank for CHAPS. Currently we provide indirect access to Corporates, Non-Bank Financial Institutions and Financial Institutions. We have internal policies which adhere to regulatory requirements and local legislation regarding the customers that we provide sponsorship to. At this time we have not investigated the requirements to become an agency bank, however the costs in directly participating in BACS and Faster Payments may make this unattractive for us.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative solutions to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?
Creating a fixed cost model for a limited agency proposition (capped for service or volume) could encourage more agency banks to become direct participants in the schemes and increase competition.

Question 16: Do you have any other comments regarding access?
No

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?
We feel the harmonisation of payment formatting standards will increase the ease of adoption for Direct and Indirect members and increase payment systems competition across not only the UK but also Europe. E.g. adoption of ISO 20022 for CHAPS and LV. This could also lead to improvements in innovation though reduction in operating costs associated with supporting varied payment formatting standards. We would see that the cost of changes to the industry and banks would initially be high but should result in long term cost savings for not only banks but also their customers. If successfully completed, we would see benefit in a step away from UK-only payment mechanisms with their own propriety standards (such as BACS) and a much more progressive step towards longer-term consolidation onto internationally recognised platforms. In this regard, the adoption of ISO20022 standards in the UK would certainly be a positive move in this direction.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?
See above, we would envisage a notice period of 3-4 years to be sufficient.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?
We feel that innovation is driven through more competition and new entrants to the market. Currently it is expensive to join UK payment schemes and difficult to research which providers have the best agency banking solution. A standard agency offering with increased transparency of the agency offering may encourage new entrants as this may reduce reliance on costly RFI's / RFP's. Additionally the ability to purchase a standard platform from a 3rd party vendor which provides the ability to connect to payment systems may assist in increasing competition.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).
As a relatively new entrant to the CHAPS market, BNY Mellon is looking to innovation as a way to attract new clients and increase its market share.

The industry should be incentivised to improve customer experience and automate solutions, it should likewise be encouraged to reduce handling costs and improve query/error resolution. The challenge typically is making the upfront investment to automate system solutions with most system developments being expensive. The industry would be incentivised to make these investments with more certainty that automation would be adopted uniformly and consistently. With the currently uncertainty, with multiple providers and varying potential solutions and no clear view as to those that are likely to prevail, industry participants risk making investments in solutions that become redundant and/or never generate sufficient volume to justify them. In addition, in the third party service provider industry, there is potential for higher costs to be attributed to more labour intensive payment methods (such as cheque handling) which ultimately, could increase cost for investors.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?
As a global provider we consider all global markets for investment. We feel that the UK has a relatively mature payments market where the cost of innovation is quite high. We feel indirect members have a limited ability to influence the strategy of the schemes, regulatory changes and direction of innovation.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.
Please see previous responses.

As touched on previously, the greatest opportunity for the funds industry is to find a quick, easy and safe mechanism to transact payments with retail investors either directly or via an intermediary. There are options in our industry such as BACS, debit cards, CHAPS and Faster Payments, but it is not clear which ones will remain as credible options and what new technologies will emerge.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?
Collectively driven innovation has the benefit of potentially reducing costs for all involved. By acting collectively new ideas may be formed beyond what individual banks could produce in isolation, however, it may restrict the ability of individual banks to further innovate on these products. In a collective environment it may also be the case that time to market is longer, but others may benefit from enforced industry timescales.

Question 24: Do you have any other comments or concerns you would like to highlight?
No

Question 25: What, if any, are the significant benefits you see regulation bringing?
Regulation maintains UK's reputation as a safe haven to do business. It creates a fair transparent payment market for everybody from payment system operators, infrastructure providers, PSP's and their customers, where they are fully aware of their rights and obligations in relation to all aspects of the payment cycle.

Question 26: What, if any, are the risks arising from regulation of payment systems?
We believe that there is a potential risk that regulation makes participation in the schemes too expensive and reduces competition and therefore stifles innovation. The cost of regulation (and regulator fees) needs to be considered within future consultations to enable better cost benefit analysis.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?
Regulation may affect our expansion plans if the cost of doing business increases to a point where it is no longer viable or feasible to continue to invest in the UK payment schemes. Furthermore, the ability for each member to properly influence the payment schemes is important. Whilst we understand the need for Board restructures as the schemes increase in size, the participation and consultation of all members, in a fair and equitable manner, is critical for the schemes to develop properly.

BRITISH RETAIL CONSORTIUM
for successful and responsible retailing

British Retail Consortium: Payment System Regulator Call for Inputs

The BRC is the lead trade association for the retail sector; we represent about 80% of the sector. This diverse and exciting industry covers large multiples to independents, high streets to out of town and online to bricks and mortar businesses, and sells goods across all sectors: clothing, footwear, food, homewares, electricals, health & beauty, jewellery and everything in between, to ever more demanding consumers. The BRC's mission is to make a positive difference by advancing vibrant and consumer focused retail. We aim to achieve this by standing for what is important to the industry and working in partnership with our members to shape debates and influence outcomes.

Retail employs 3 million people and sales were £321 billion in 2013, contributing 5% to GDP. The UK accounts for one-third of the European payments market. We gather annual information about the UK's payment market and the retail sector – our next report is due out shortly.

Overview of response

The Call for Inputs asks for opinions on competition, innovation and meeting the needs of all users in the payments system. The BRC response provides a retail narrative as to why the existing payments system is anti-competitive, which hinders innovation and does not support the needs of all users. To remedy this market failure we support the introduction of a cap on domestic interchange fees as the most urgent priority for the Regulator. The response then explores how best to open up ownership and governance to ensure the wellbeing of future payments. Beyond these key areas, retail interest and engagement in payments systems is limited. Therefore we have chosen this narrative approach, which draws out key issues, rather than responding to individual questions. However, it is the intention that the narrative responds to the key issues addressed by the questions.

The UK payments system is anti-competitive, which hinders innovation and restricts market access

The Call for Inputs asks participants in the payments system how the Regulator can improve competition, innovation and representation of service users in the payments market. To answer this question most effectively from the retail perspective requires a vision for the payments market whereby all these elements are mutually supportive.

To make a payment requires that funds are sent from one account to another. Currently, there are a limited number of companies who control the infrastructure, mechanisms and rules to perform this function – the payments system. Correspondingly, it is these commercial entities who decide the cost that all other businesses pay to use the system, who control the access to infrastructure and ownership of governance. As profit making businesses, it is entirely in their interests to protect their existing commercial advantage – a system where they set the price and manage the market. While they may compete at a superficial level with each other, this inter-bank system of payments is detrimental to service users and in turn customers. Why? Because market experience has shown that the fees banks charge businesses to process debit and credit card payments is excessive and increases year-on-year. And because the rules are set exclusively, retailers cannot negotiate the fee. In turn, retailers cannot turn to other suppliers, because, outside the limited set of banks (and card schemes), there are no other providers that can (cost) effectively access the infrastructure to perform the payment function.

Taken together, the anti-competitive nature of the fee structure combined with a lack of access to infrastructure, means that there is a lack of innovation for two reasons. First, the existing interests have no commercial incentive to introduce new and cheaper ways to pay. Second, it blocks new entrants from entering the market and providing innovative ways to pay using the existing infrastructure in new and better ways. To protect their position, the incumbents dominate a closed ownership of the system, or charge a premium for access, and dominate the system of governance for policy and market development. This means that the interests of service users are effectively ignored, without any recourse. The cheque replacement fiasco illustrates how closed governance misfires spectacularly.

Across the world, politicians, policy makers, regulators and the judiciary have recognised that the nature of payments systems is fundamentally anti-competitive. USA, Australia, Canada, the European Union, France, Spain, Netherlands, Poland, Hungary, Romania and European General Court have all recognised and moved to counter the detrimental impact on businesses and their customers, who pay excessive costs for card acceptance.

But this is not a new argument. It was effectively articulated in 2000 by the Cruickshank Review of Banking Competition. While the Government accepted the recommendation to regulate payments and fees, corresponding action didn't take place. More recently, two consultations by HM Treasury have again clearly articulated the need for the payment system to be effectively regulated for the benefit of service users and their customers[1]. And there has been an Inquiry by the Treasury Select Committee that has recommended that ownership and governance of the system should be broadened beyond the narrow few, for the wellbeing of the future payments system. It is in our view therefore essential that we take this opportunity to introduce effective measures to help hard pressed businesses and consumers, as has occurred in other countries.

What should be the Regulator's priorities to improve competition?

Reduce excessive domestic interchange fees as its first action

Retailers sell products and services. The only reason we are interested in and animated about payments is because of the excessive costs charged by payment providers to process debit and credit card transactions. For retailers, payments are simply just one part of the supply chain, like any other. However, unlike any other paid for service, retailers have no ability to negotiate fees. And there is no transparency or accountability about the fee we actually pay.

For a retailer, the cost to accept one card is exactly the same as accepting any and all cards. There is no difference in the technology function required to process a transaction, nor do we derive any additional benefit from accepting one type of card over another. However, retailers are charged over 300 different card fee levels, which carry variable costs ranging from 0.1% to 2.5% of the product price.

As a result of this structure, over the last ten years we have seen significant year on year increases in costs. In 2012 interchange fees cost UK retailers £1 billion and the cost of collection as a percentage of turnover went up 7 per cent, leading to an additional £52 million for retailers. And premium cards – that tend to charge a premium fee – increased costs by £26 million a year, on average equal to between 7 and 10 per cent more for a retailer.

The average cost for a retailer to process a cash payment is 1.5 pence, for debit cards 9 pence and for credit cards a staggering 38 pence, 25 times more than for cash. While cash accounts for 54 per cent of transactions, it is only 10 per cent of costs. Debit cards are 30 per cent of transactions yet 35 per cent of costs and Credit cards 11 per cent of transactions but an incredible 50 per cent of costs.[2]

[1] HM Treasury, Setting the strategy for UK Payments (July 2013) and Opening up UK Payments (Oct 2013).
[2] The BRC Cost of Payments Collection survey measures the cost for UK retailers to accept and process different payment types. It covers 60 % of total UK retail sales and is exclusive data straight from the tills.

Naturally, retailers want to know what they are paying for. We have always been (and remain) happy to pay a fair price for a secure and diverse payment system. But at the most basic level, free banking is simply not free. Specific card rewards and loyalties – those inducements banks offer to customers to use their cards – are being paid for by retail interchange fees, and in turn consumers. At the very least cash customers are subsidising the benefits of others.

Because of this, retailers have successfully taken legal action against fees and system rules in the European Courts of Law. The Courts have found time and time again that interchange fees are anti-competitive, to the detriment of service users and their customers. The European Commission and Parliament have also found the same, and in turn proposed a cap on fees – 0.2% or 7 eurocents (whichever is lower) for debit cards and 0.3% for credit cards – which is strongly welcomed by retailers. A similar approach for a cap on debit and credit cards is urgently required in the UK.

A cap on fees is good for consumers. The market in which retailers operate is highly competitive. We compete on price and value every day and put our customers at the heart of everything we do. Any savings resulting from a reduction in card interchange fees will create capital to enable a range of investments to be made such as, investing in new store designs; improving customer service propositions; extending the range of products available; investing in technology to improve the customer shopping experience (multichannel, mobile); expanding our commercial footprint through new stores; and, crucially, enabling small and independent retail businesses to survive and compete more effectively.

In America, Dr Robert Shapiro, has found that interchange fee caps in the USA led to over $5 billion savings directly to retail consumers.[3] The independent nature of this research is in contrast to other published research.

A number of countries (already mentioned) have already decided this is sufficient to introduce more immediate domestic fee caps to their national payments markets. UK retailers want to see a similar approach for the UK. This is important because it affects business ability to compete across Europe and the UK's ability to compete and attract foreign investment.

While European regulation is moving ahead, notably in the European Parliament, it remains in discussion in the Council. As such, while we wait for European regulation to come into force and take effect, UK retailers remain obliged to pay excessive interchange fees. The delay in European action re-enforces the urgent need for the Regulator to immediately reduce UK interchange fees as its initial

[3] The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees (Oct 2013): http://21353cb4da875d727a1d-ccea4d4b51151ba804c4b0295d8d06a4.r8.cf1.rackcdn.com/SHAPIROreport.pdf

priority. In considering the appropriate approach to regulation of the levels of caps to UK interchange fees the Regulator should consider the "Merchant Indifference Test" used by the European Commission for competition cases.

The UK government has granted the Regulator the power to progress where necessary and this should be employed to lower domestic fees. Budget 2014 states the Government's desire to "introduce more competition at the heart of the banking system….by switching on key competition powers of the Payment Systems Regulator one year ahead of schedule, enabling the new regulator, should it decide to do so, to act decisively on competition issues, such as the ownership of payment systems by the big banks, as soon as it is resourced to do so".

It then goes on to say, "the government has today announced that it will switch on the Market Investigation Reference powers of the Payment Systems Regulator a year ahead of schedule. This will give the new payments regulator the power to take competition action over payment systems, including undertaking a market study over issues relating to their ownership by the big banks, as soon as it is equipped to do so".

If the Government and Payment System Regulator want to improve competition, innovation and representation of service users in the payments market, then it should introduce a domestic reduction and cap on interchange fees without hesitation.

It is also important to note that a retailer pays a total Merchant Service Charge to process payments. While the interchange fee constitutes the majority of this fee (c.80%), there are also card scheme and acquirer costs. Consequently, when considering what payment providers should be designated, to ensure a competitive market the Regulator should designate all four party international schemes, and be able to intervene, if necessary, on all pricing matters. Ideally, three party schemes should be included as well, to ensure that any new payment services are in scope of regulation.

The wellbeing of future payments – open access and inclusive governance

It is clear that there is a lack of fundamental competition in the payment market, which restricts innovation and market access. These market failures come at the detriment of high cost to businesses and consumers, and are a reflection of system inefficiencies. Currently, there is narrow and controlled access to infrastructure, limited ownership of systems, and governance frameworks that protect existing banking interests rather than represent the views of all participants in the payments system. Correcting these inefficiencies is the cornerstone of promoting the future wellbeing of the payments system.

When the Regulator looks at what competition in payments *really* means, it must not be bound by the considerations of existing interests, who fear losing market share because of new entrants. Improving competition in payments must not simply mean making the existing inter-bank system work better, improving scheme rules and providing quicker settlement. The great promise of technology is that it creates *new and better ways to pay*. Allowing new players' access to market and infrastructure is *real* competition. Allowing non-bank entities to have ownership of systems is *real* competition. Ensuring all users help to decide the shape and rules of the system is *real* competition.

Myth busting not bank bashing

Policy makers across the world have proposed and introduced greater regulation in banking because of the need to improve market conduct and governance. In the UK, HM Treasury has outlined the case for reform[4], which includes the creation of a Payment Regulator. While it is important that financial stability is maintained throughout the period of change, it is crucial that the scale of the change required is not misperceived as rationale for inaction or dilution of reform.

Cost of access – Non-bank entities can already access the existing infrastructure; however, the costs of entry and access are non-negotiable and prohibitively high. While reducing cost is important, maintaining this current approach also confines new entrants to operate within existing structures with limited ownership models. Access should be cost effective and open in order to enable innovation, not just more of the same broken system.

Integrity, risk, security and Anti Money Laundering – The mere fact of having new players in the infrastructure does not necessarily equate to more risk or less security. All companies still have to operate to compliance standards; not least they are not viable commercial entities if they do not. And the FCA would be expected to regulate this area. It is inaccurate to attempt to scare and distort the argument by claiming that new players will inevitably result in system instability and less security.

Telecommunications regulation is a useful analogy – Payments is not telecommunications. It is obvious that different industries are different. However, like payments, telecoms have a central infrastructure operated by a big few players who manage the terms and conditions of the system. The result has been an anti-competitive market that lacked innovation. Regulation opened up the pipes so that others could participate at a fair cost, bringing with it better ways to communicate and so more consumer choice and greater market competition. Therein lays the similarity. And the market and consumer benefits are clear. So while there are different market dynamics and specific policy

[4] HM Treasury, Setting the strategy for UK Payments (July 2013) and Opening up UK Payments (Oct 2013).

issues, the telecoms example demonstrates and illustrates that these are not impossible to regulate in a sensible way.

Lost revenue and the regulatory opportunity – Banks, like all other industries, should be regulated and should have to earn their profit. In retail, if the customer does not like the offer or service, they go elsewhere – and there are many shops that offer similar products. In banking, the consumer is faced with only a few players, all of whom offer more or less the same service. Competition is weak and regulation has not effectively addressed this to date. Change is overdue. The most forward looking banks are not looking at regulatory change in terms of how to defend existing interchange-based revenue streams, but re-appraising their offer to become more relevant, offer better products and provide better value.

Time for change

For over fifteen years, British retailers have been calling for a fair, transparent and competitive payments market and a reduction in excessive fees charged by banks to process card payments, which can be particularly detrimental to small businesses who invariably pay the highest fees. Attached is a letter that calls for caps on interchange fees, signed by the CEOs of 14 major retailers representing a third of UK sales, as well as the CEOs of 2 major Trade Associations representing the smaller independent retail community. This indicates how important payments reform is for retail and our customers.

And it's also the view of the UK Government in its engagement with the European Union. In October, the Prime Minister presented a report to the EU Heads of State meeting outlining key priorities to support growth.[5] The report was advised by a Business Task Force comprised of captains of industries from across sectors across Europe. This explicitly states the importance of supporting the payments reform proposals as a matter of urgency. The relevant page of the report is also attached.

And it's also the view of wider Europe industry. The European Payment Users Alliance is a group who have come together to call for more transparency and competition in the payments market. Membership is diverse, but includes hotels, restaurants, hospitality, transport, ticketing, petrol companies and small business representatives. This is also attached.

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[5] Cut EU red tape: report from the Business Taskforce (October 2013). Section D2, p.42, "High card fees that stop SMEs trading across frontiers".
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249969/TaskForce-report-15-October.pdf

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Payment Systems Regulation - Call for Inputs

BSA response to FCA consultation

The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 45 UK building societies. Building societies have total assets of nearly £330 billion and, together with their subsidiaries, hold residential mortgages of over £230 billion, 18% of the total outstanding in the UK. They hold over £230 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for about 28% of all cash ISA balances. They employ approximately 39,000 full and part-time staff and operate through approximately 1,600 branches.

The BSA welcomes the opportunity to respond to the FCA's consultation on payment systems regulation.

Building societies largely fall within the FCA's definition of *Agency Bank / Indirect payment service provider* (also referred to as *indirect participant*) as set out in Annex 4 of the consultation document. The FCA defines *Indirect payment service provider* as a payment service provider that accesses the payment system through an agency agreement (i.e. via sponsorship) with a direct member (i.e. one of the major UK banks). The BSA response therefore narrowly focuses on indirect payment service providers and agency arrangements. We have not sought to answer the questions set out in Annex 3 of the consultation document, as the questions are more relevant to other categories of payment participant.

The BSA agrees with the OFT finding, as set out in *UK Payment Systems – How regulation of UK payment systems could enhance competition and innovation* (July 2013) and repeated in the consultation document, that indirect participants have limited choice and bargaining power in negotiating the terms of access with direct members. We share the concern that lack of transparency and comparability in bilateral agency arrangements may make it difficult for indirect participants to evaluate and change their arrangements.

The BSA intends to conduct a survey of our members to get a better understanding of existing agency arrangements and issues. In the meantime, anecdotal evidence from building societies suggests that there are problems with communication between agency and sponsor banks, a lack of consultation and forewarning about future payment industry initiatives and complex contractual arrangements which act as a barrier to easily transferring business from one sponsor bank to another. In addition, sponsor banks are retail competitors to building societies and it may be that agency bank services are not seen as a commercial priority for the sponsor banks. This, coupled with the relatively restricted choice of sponsor banks, means that there is little incentive for sponsor banks to raise their game and improve the services they provide to indirect participants. We hope to be able to expand on these issues following our member survey and plan to feed this into future consultation responses.

The BSA has a good relationship with the Payments Council. We are aware of the Payments Council's work on its *Payments Roadmap* and we have seen the high level findings of its review of agency arrangements and challenger access. We support the Payment Council's proposals to improve agency arrangements. In the short term, this could include relatively simple solutions which should be quick to implement; such as a commitment from the sponsor banks to provide a single point of contact for each of its agency partners so as to help improve communication and moves to standardise contractual arrangements to help indirect participants to compare terms of service across the sponsor banks and reduce the complexity of transferring arrangements to another provider. In the long term, alternative arrangements for direct access to payments systems should be created which would enable current indirect participants and new providers to bypass the need to use a sponsor bank at all.

The BSA welcomes the creation of the new Payment Systems Regulator (PSR). When the PSR is fully operational in April 2015, it should make improving agency arrangements a priority. While it will be for the payments industry to develop and deliver on these improvements, we welcome the pressure that the PSR can bring to ensure that these changes are implemented quickly.

The BSA looks forward to working with the PSR and to contributing to future consultations on changes to the payments industry.

15 April 2014

CAPITA

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15 April 2014

Dear Sir

Payment Systems Regulation – Call for Inputs – March 2014

Thank you for the opportunity to comment on the Call for Inputs paper.

Capita Shareholder solutions provide share registration and value-added services to over 7 million shareholders on behalf of more than 1,500 companies in the UK and Ireland. We are responsible for share registers and share registration, corporate actions, share plans, share dealing and company secretarial support across a base of clients that range from small or recently floated to large multinationals.

Shareholder solutions also provides a custody and settlement operation supporting overseas companies listing on the UK market and a share dealing service primarily aimed at shareholders in its client companies. Some of these client companies are based in other EU countries. Shareholder Solutions is part of a FTSE 100 organisation, Capita plc.

As agents of our client companies, we make cheque and electronic dividend, interest and other share transaction payments to millions of shareholders each year. To date this year those payments have totalled £3.2 billion. We work very closely with our clients and partner banks to minimise payment risks and safeguard against cheque fraud. Additionally, on behalf of client companies, we manage a whole range of corporate actions, some of which require us to receive a high volume of cheques (e.g. rights issues and market listings) from shareholders/investors.

We have responded to the questions where we feel these impact the services we provide for our clients. Below are our responses to the specific questions raised.

We would be happy to discuss our comments further if required.

Yours sincerely

Phil Kershaw
Senior Manager – Industry and New Products

FCA Payment Systems Regulation
Call for Inputs

Questions

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Competition is ineffective regarding a lack of transparency around each banks' ability to process a CHAPS payment real time. It is not clear which banks lack liquidity to process a large value payment without waiting for receipts first.

Although most CHAPS payments are in practice instantaneous, CHAPS is not guaranteed as such, by participant banks and a large amount of time and cost can be used trying to resolve where payments are in the process which need not occur if the system was real time. For example, the wording on the Payments Council's Pay Your Way website states "same day":

CHAPS payments can be sent to most UK bank accounts and will arrive and can be drawn on the same day providing the funds are released before 3pm. It's only used for Sterling transactions and payments are unconditional – once they've been made they can't be recalled without the recipient's consent. There are no limits either so CHAPS is typically used for high value payments.

However, CHAPS Co's own website states that:
Since 1996, CHAPS has used an enhanced Real-Time Gross Settlement (RTGS) system where each individual payment is settled in real-time across its Participants' settlement accounts at the Bank of England

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Ability to always pay real-time.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

No.

Question 8: Do you have any concerns about the current governance of UK payment systems?

No. However, as an organisation that distributes significant volumes of payments in the UK, we feel we, and our colleague registrars, should have a voice when changes are being considered that could have a direct impact on our business and that of the quoted companies we are appointed to act on behalf of. Our membership is currently represented at the quarterly meeting of the Payments Council' Business Forum. It is crucial that such a level of participation continues to be afforded to our members so that any proposed changes can be properly considered and debated as an industry in conjunction with our quoted company clients ahead of implementation.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

We access UK payments systems via the major UK clearers, via their online tools. Fees are competitive.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

They are fair although one clearer struggles to incorporate all their charges in one view to make them transparent.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

No.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

We feel that we have sufficient choice of sponsoring banks and we would not prefer to access payment systems directly as we believe that settlement issues around debiting our accounts with clearers would, we assume, make this unworkable.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?
• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
•Are there any barriers to becoming a sponsoring bank?

No.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

As a downstream user of UK payment systems, banking and clearing charges are a significant cost to our business. The introduction of regulation could come at a cost. Our concern is how the cost of regulation will be borne and whether this cost will be passed downstream to users such as ourselves and the quoted company clients we act on behalf of. We would like to understand the answer to this question.

CHAPS Co

15th April 2014

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To Payments Systems
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Cc CHAPS Co Board of Directors

From Phil Kenworthy
CHAPS Managing Director

By email (paymentsystems@fca.org.uk) and by post

PAYMENTS SYSTEM REGULATION – CALL FOR INPUTS

CHAPS Clearing Company Ltd (CHAPS Co) welcomes the opportunity to respond to the above paper. The views in this response are those of both Company Management and the Board of Directors of CHAPS Co (who have endorsed this paper prior to submittal).

CHAPS is the UK electronic Payment System for High Value transactions which settle across the Bank of England's Real Time Gross Settlement (RTGS) system, thereby achieving irrevocable finality at the point of settlement.[1] Daily average settlement values exceed £280 billion (£70.1 Trillion in total for 2013) with a direct membership of twenty major financial institutions (see Appendix B) whom, in turn, service over 5,000 other financial institutions (many of which are international) on an indirect basis. Most of the daily value processed by CHAPS represents wholesale transactions where CHAPS acts as the portal through which international GBP flows take place. As a Payment System, it would be most popularly recognisable within the UK as the mechanism by which house purchases are paid for, although this represents less than 1% of the daily value processed.

CHAPS Co is a Recognised System under the 2009 Banking Act[2] and is thereby overseen by the Bank of England in its statutory Payment System Oversight capacity.

[1] Finality of settlement is underpinned by CHAPS' designation as a "system" by the Bank of England, as the relevant designating authority under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (the "SFRs"), which implement the EU Settlement Finality Directive 98/26/EC in the United Kingdom

[2] Recognition Order issued by HM Treasury on 5th January 2010.

The international nature of CHAPS' payment flows is also reflected within CHAPS' Direct Membership. By 2015, more than 60% of CHAPS' Direct Participants will be composed of non UK Financial Institutions and other Financial Market Infrastructures. In line with best practice, CHAPS Co has taken steps to ensure independence at Board level (and where prudent, also at Committee and working group level) via the appointment of an Independent Chairman and two Independent Directors. The Independent Directors hold a blocking minority power of veto (should the need arise) on matters of public interest (as set out in the Memorandum and Articles of Association which are publicly available on the company's website[3]).

CHAPS Co is currently contracted to the Payments Council with a number of matters reserved for Payment Council Board approval (see Appendix A). CHAPS Co's expectation is that this contractual arrangement will change either at or some time before the point that the Payment Council is superseded by the Trade Body anticipated in the Government Response to the HMT Consultation on Opening Up UK Payments.

The position of CHAPS Co as the UK's High Value Payment System is unique in comparison to other countries. There, the majority of Real Time Gross Settlement (RTGS) Systems fall fully within the ownership and operation of the local Central Bank. In the UK, the RTGS infrastructure is provided by the Bank of England and the High Value Payment System associated with it is operated by CHAPS Co (note however that, separately, CHAPS Co remains under Bank of England Oversight as a Recognised Payment System).

Normally, there is just one High Value Payment System per country. However, within the Eurozone area and the United States there is a further High Value Payment System (Euro1 and CHIPS respectively) that compete with the central systems (although they still require access to the central RTGS system (on a deferred net settlement basis) for daily settlement in "Central Bank money"). It is widely acknowledged that the size of these two currency bases can accommodate two systems in the high value settlement space (with CHIPS and FedWire settling c. $5 trillion each day between them) whereas, for the UK, only £280 billion is settled on a daily basis, suggesting that there is insufficient market size to warrant or support the operation of an additional High Value Payment System.

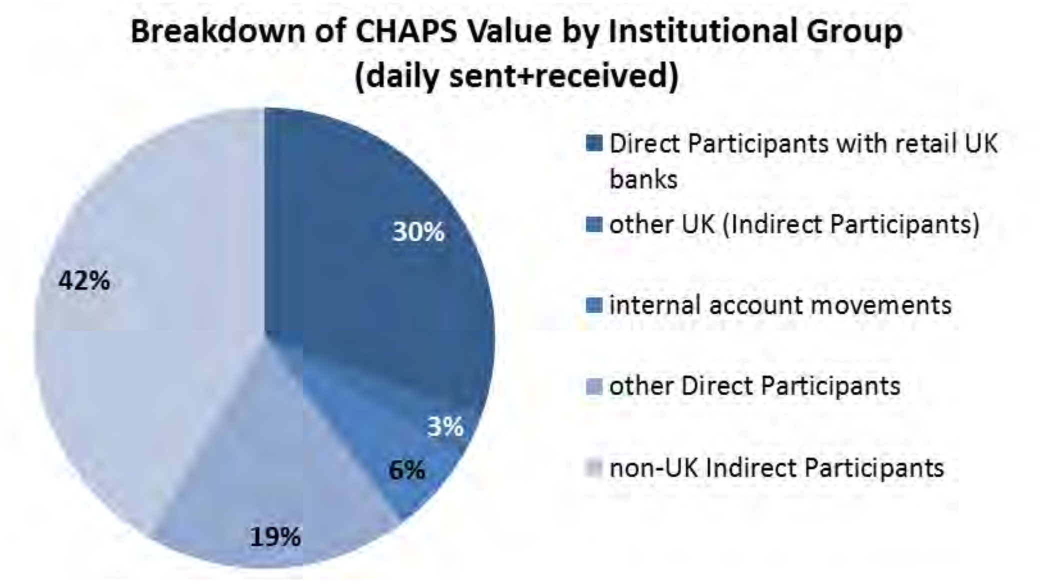
[3] www.chapsco.co.uk

Values and Payment Types

UK Payment Statistics (2013)	%
CHAPS' share of total UK annual payment clearing values	93%
CHAPS' share of total UK retail payment transaction volume (22 million out of 7,300 million)	0.3%
Percentage represented by wholesale transactions within CHAPS' daily total value processed	98.8%
Percentage represented by domestic transactions within CHAPS' daily total value processed	33%

Wholesale role of CHAPS

As highlighted above, CHAPS is principally a wholesale system by value, with 98.8% of CHAPS daily value settled (c. £277bn per day) being wholesale or high value (over £1m) in nature. Furthermore, as can be seen from the chart below, only 33% of CHAPS' daily value processed is generated by Participants with domestic banking business (the remainder deriving from CHAPS Co's International Direct Members, those international Indirect Participants of CHAPS Co's UK Members or system transfers between RTGS accounts).



It should be noted that within the "Other Direct Participants" segment is included the GBP netted settlement flows arising from CLS (ie where GBP is the counterparty currency to an FX deal across the other sixteen currencies settled through CLS). Since these are netted flows, the gross underlying consideration would be substantially greater than that represented in the chart.

Within the non-UK Indirect wholesale value processed each day are those substantial GBP payment flows transmitted by other Financial Market Infrastructures (e.g. Euroclear Bank). We anticipate that other Financial Market Infrastructures which are not already connected to the Bank of England's RTGS system may join CHAPS directly in the coming few years rather than utilise correspondent Banking arrangements given the systemic risk reduction in the wider GBP "eco-system" that this will provide.

CHAPS Co therefore represents the primary portal for international entities wishing to transact in sterling.

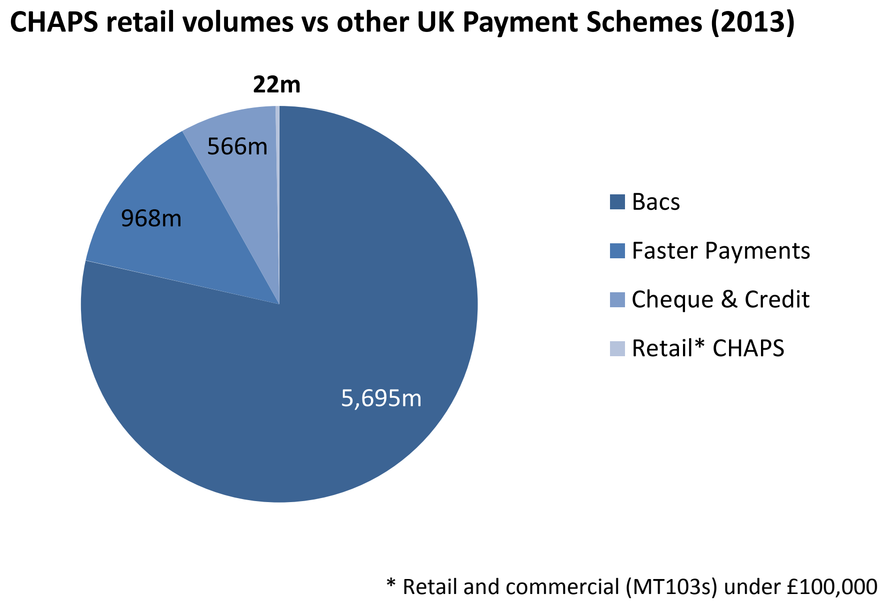
<u>Retail role of CHAPS</u>

As highlighted in the Chart below and elsewhere in this paper, CHAPS handles a fractional (0.3%) part of the UK's annual retail[4] payment volume. CHAPS would ordinarily only be used in retail transactions when irrevocable or critical same day settlement is required on relatively high value payments (e.g. housing completions) and which could not therefore be catered for within either Bacs or Faster Payments. For most high street consumers, a "litmus" test of when the last time a CHAPS payment appeared on their bank statements would be somewhere between "never" or "not in the past few years" which contrasts starkly with the frequency with which Direct Debits, standing orders, cheques and cash withdrawals would appear on their monthly statements.

Notwithstanding the predominantly wholesale nature of CHAPS by value, CHAPS remains an important payment system for retail payments. In particular, housing transactions are the most recognisable "retail" transaction within CHAPS. 1.08 million residential property transactions took place in the UK in 2013[5] (c.4,300 per business day).

However, overall and more generally,as anticipated, CHAPS retail payments have declined in recent years with the increasing use of the Faster Payment Service (FPS) by the retail UK Banks.

[4] Defined as retail and commercial (SWIFT MT103) where the transaction falls under the £100K Faster Payment Limit.
[5] Source: HMRC. Provisional figures for completions with value £40,000 or more.



Source: Payments Council Annual Summary of Payment Clearing Statistics for 2013

Taking the total daily CHAPS transactions volumes (138K average in 2013), retail currently represents 64% by volume (89K per day) but just 0.4% of CHAPS traffic by value. Analysis undertaken between FPSL and CHAPS Co shows that up to 50% of this retail volume could still migrate to FPS as Banks continue to manage their customer payments limits within FPS and offer wider access to this service. If FPS was to raise its transaction limit from £100K then additional volume could also migrate from CHAPS to FPS. In the same time period, CHAPS Co anticipates greater wholesale value and volume entering its system as a consequence of membership expansion (see below) and organic market growth.

Domestic vs International

CHAPS acknowledges that, whilst the HMT Consultation on "Opening up UK Payments" brought focus upon bringing the UK retail payment systems and their direct Participants under economic regulation, the subsequent primary legislation[6] was "silent" on the differentiation between retail and wholesale payments. As such, unless this position was to be modified via secondary legislation, the work of the Payment Systems Regulator might need to encompass both of these widely differing payment types that satisfy the needs of their respective markets. We would flag via this response the potential risk that London's competitive position in the international correspondent banking market and other international financial markets could be weakened, should the Payments System Regulator introduce different requirements upon the UK wholesale and high value payment market than exist in other major centres elsewhere.

[6] Financial Services (Banking Reform) Act 2013

Responses to Specific Questions

Payment Systems in the UK

Question 1

Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

CHAPS Co believes all payment systems should be considered for designation, provided that such designation (i) recognises and takes into account the distinctive nature of CHAPS as a primarily wholesale scheme and (ii) ensures a level playing field across the industry. It would also encourage the new regulator (and HM Treasury via the designation process) to consider whether different models/categories for designation ought to be introduced. These could differentiate between the UK primary retail payment systems (and the regulatory needs arising from these) and those specific to the wholesale / international Payment market (as catered for by CHAPS Co). Such an approach would enable differential focus to be applied where appropriate. As an example, the Call for Inputs paper makes several references to Indirect Access via agencies and the challenges that this brings within the domestic market. However, in the wholesale, international space, Indirect participation goes to the heart of the correspondent banking model. Here, access to the UK High Value Payment System would normally form part of a suite of services provided by the UK Clearing Bank to the offshore Financial Institution (whom may have little or no interest in having a direct financial footing in the UK). The needs and challenges arising here are clearly different to those of a domestic agency arrangement and a differentiated designation system would therefore be able to cater for this in terms of the expectations of the Payment Systems Regulator.

Competition in payment systems

Question 2

Where do you believe competition is effective or ineffective within UK payment systems?

CHAPS Co believes it is necessary to differentiate between the underlying core Payment Systems and the competitive services and channels offered by the Direct Participants of the Payment Systems. CHAPS Co believes the core purpose of a Payment System is to provide a highly secure, resilient, risk managed and, preferably, cost effective “eco-system” for the transmission and settlement of those payment instructions entrusted to it, which is then backed by strong legally binding rules. If competition at Payment System level was to be introduced, care would be needed to ensure these core attributes are not undermined.

The payment systems within the UK currently collaborate in the wider interests of the wider payment community (see below). We believe there is further opportunity for this to continue. With specific reference to CHAPS, we have worked with Faster Payments Services Ltd (FPSL) over the past year to review those FPS requirements that could potentially prevent the migration of lower value CHAPS payments to FPS and are working with the other Payment Systems in other key areas of importance such as Participant Resolution and Cyber Security. It is difficult to see how this could take place as effectively if the Payment Systems had to compete with each other.

Looking to the future, we believe that it is important that the core Payment Systems support industry standard access methods (see below) and that the Participants (offering services to SMEs, businesses and consumers) maximise these via the channels they offer.

Question 3

At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

On the assumption that the use of "service users" in question 3 includes any customer, CHAPS Co believes competition best rests at the Participant Service Channel level in terms of richness of end user functionality and that collaboration rests at the underlying Payment System level to ensure consistent core stability. Notwithstanding this, we do, however, believe there is an onus upon both a Payment System Operator and its Participants to attempt to ensure as consistent an end user experience of that payment system as possible, irrespective of the channel (or participation route) that the payment instruction is derived from.

As a "Not for Profit" entity, CHAPS Co also believes it is important that the core operating costs of the payment systems should be managed in such a way as to provide its Participants and end users with a cost effective service and to provide as much certainty as possible on the forward looking costs. For 2014, the costs for each CHAPS transaction are broadly split 60:40 between the Bank of England and CHAPS (17.5p per transaction (Bank of England tariff) and 11.5p per transaction (CHAPS operating cost share)).

Turning to innovation, CHAPS Co is dependent upon the Bank of England for the provision of its IT infrastructure (the Real Time Gross Settlement System) across which, settlement takes place. CHAPS Co currently supports 49% of the operating cost of this architecture and is therefore one of the key stakeholders. However, we are not the sole systemic user of the system (it forms the baseline Reserve Accounting System for the Bank of England and the settlement engine for the CREST Securities Settlement System) and therefore CHAPS Co cannot mandate functionality changes. Historically, the Bank of England has looked to implement changes that enhance financial stability and input from CHAPS Co and others feed into the Bank of England's Change Control cycle.

Question 4

What are the main factors impeding more effective competition at each level?

CHAPS Co offers no views other than those already expressed in this paper; we would however flag the need that any move to bring enhanced competition must not adversely affect the safety, security or resilience of the underlying Payment Systems or their backing infrastructure. Additionally, legal certainty and clear regulatory obligations are of paramount important to both payment systems and those that use them.

Question 5

What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

In terms of areas of collaboration, CHAPS Co believes this falls into two separate areas; Strategic and Operational. With respect to the latter, there are central challenges that are and should continue to be addressed in the collaborative space between the Payment Systems to avoid any gaps or inconsistencies in approach which could increase risk. Current key examples include Cyber Security, Participant Incident Management (given the integrated underlying IT systems present within the major Participant banks), Recovery and Resolution in a Participant liquidation event, Richer Data and common messaging standards.

With respect to Strategic Collaboration, in CHAPS Co's response to the earlier HMT Consultation on "Opening up UK Payments", we flagged the need for continued coordination between the Payment Systems at a Strategic level to ensure the evolution of the UK Payment services in a consistent manner. This view was echoed in the Government's response to the consultation[7] where it stated "*The Government expects that the industry will replace the existing Payments Council with a pure trade body to co-ordinate the owners and operators of payment systems and related infrastructure, to guard against the development of payments strategy in silos."* CHAPS Co position on this matter remains unchanged.

Ownership

Question 6 Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

As highlighted in the accompanying text to the above question, the HMT Consultation highlighted the challenge of *"smaller players and new entrants having to seek access to systems jointly owned by their most significant competitors"*. As set out by CHAPS Co in its formal consultation response, this is not something that we consider to be a significant issue for ourselves given:

- Our wider Participation base and the degree to which it is International (see appendix B)
- The challenge described above forms the basis of the International Correspondent Banking Service where International Financial Institutions will have either long-formed relationships with those UK based institutions offering correspondent banking services or a wide choice of those offering these services amongst the CHAPS Membership. It is not unusual for an international CHAPS Indirect Participant to utilise more than one Direct Participant for its Nostro GBP payment services (indeed, one of the larger Indirect Participants utilises seven Direct Participants). We have attached (Appendix D) a list of the largest CHAPS Indirect Participants (by value settled).

Notwithstanding the above, CHAPS Co continues to analyse opportunities that may exist to broaden its ownership proposition (see below).

[7] Published October 2013

Question 7

How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

Noting the separate Governance question below, CHAPS Co strongly believes that it is necessary to distinguish between those who “own” the Payments System as Shareholders, those that sit as Directors on the Board and those who use it as Direct Participants. The key challenge (as identified in a number of consultation documents) is when the same entities bridge all three roles.

CHAPS Co is receptive to looking at additional ways in which Indirect Participants could be given the opportunity to become more involved within the CHAPS payment scheme.

As an example of a recent initiative, the company has formed an Affiliates group in order to provide the Company with the views and feedback of its wider participation base. This, in turn, will be formally carried into the Strategic Governance process of the Company (in our case, the Business and Strategy Committee which reports directly into Board).

Governance

Question 8

Do you have any concerns about the current governance of UK payment systems?

Question 9

What do you believe is the appropriate governance structure for UK payment systems?

CHAPS Co cannot speak for the other Payment Systems. Noting the need for collaboration at a strategic level, CHAPS would look to a governance structure that:

- Reflects best practice in terms of Corporate Governance;
- Has a Board that is representative of its user and key stakeholder base as well as including a strong element of independence;
- Operates under an MOU with whatever trade body succeeds the Payments Council with respect to the coordination of Payments Strategy within the United Kingdom;
- Has a collaborative relationship with the other UK Payment Systems (under MOU where appropriate);
- Has strong relationships with the regulatory bodies that oversee it.
- Promotes the interests of London and the UK as a global financial centre.

Access

Question 10

How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

CHAPS Co can only respond to this as a Payment Systems Operator. Its participation criteria and costs are set out on its website (see Appendix C). A key participation criteria is the need for CHAPS Members to hold a Settlement Account at the Bank of England. The Bank published revised eligibility criteria for its Settlement Accounts in June 2013 as per the link below:

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

The text accompanying this question highlights comments made by the OFT[8] with regards to the fact that indirect participants have limited choice and bargaining power in negotiating the terms of access with Direct Members. CHAPS Co cannot comment on the specifics underlying this concern other than to note that as highlighted earlier in this document, for CHAPS, international Financial Institutions would operate under Correspondent Banking arrangements (often reciprocal) with UK Clearing Banks to provide GBP clearing and settlement services. As such, the Indirect Participant would not be competing with the Direct provider and often utilise more than one.

Any steps to be taken by the new regulator in this space needs to take account of the two disparate types of Indirect relationships that may exist here.

Question 11

For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

N/A - Given CHAPS Co's role as a Payment Systems Operator.

[8] OFT, UK Payment Systems - How regulation of the UK Payments systems could enhance competition and innovation

Question 12

Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

N/A - Given CHAPS Co's role as a Payment Systems Operator.

Question 13

If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

As highlighted above, CHAPS Co is aware that a number of its Indirect Participants access the Payment System via more than one Direct Participant.

Question 14

Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

N/A - Given CHAPS Co's role as a Payment Systems Operator.

Question 15

What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Given the diversity in its participation arrangements and the participants' respective usage of the payment scheme, CHAPS is currently in the process of moving to a three category participation structure.

As per our response at question 7, the Company is also seeking the views of its wider participation base via the recently formed Affiliates group in order to further inform its views in this respect.

We would note however that regardless of the initiative used with respect to gaining access, the continued paramount importance of maintaining (i) the certainty of the participation rule set (especially with regards to the protections that it provides via the Settlement Finality Directive) and (ii) ensuring that participants are clear as to the payment schemes regulatory compliance obligations.

Question 16

Do you have any other comments regarding access?

CHAPS Co offers no other view on this topic save for reinforcing its earlier comments that the new Regulator should remain cognisant of the different drivers backing international Indirect Participation as opposed to domestic Indirect Participation.

Infrastructure

Question 17

What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

The infrastructure requirements can be broadly split into two categories; that required of the Payment System itself and its underlying infrastructure and that required of any Direct Participants connecting to the Payment Systems. CHAPS Co offers the following observations with regards to these:

- As part of the UK Critical National Infrastructure, it is essential to ensure that the core payment systems remain secure and resilient in order that payments can continue to be made in a safe and timely matter and that confidence is not undermined in this core aspect of the UK economy.

- The needs for enhanced resilience and security will continue to grow given the continuing increase in the wider threat-base (eg cyber risk). Similarly, if payments systems were to consolidate in the coming years, the concentration risk increases as the mitigation options of diverting payments to alternative payment systems proportionally diminish. As such, the need for enhanced resilience is likely to grow further.
- The RTGS settlement infrastructure housed at the Bank of England is a core aspect of the UK Payment Systems (utilised real-time by CHAPS and on a daily basis by the other payment systems (three times per day for FPS). Its security and resilience is core to the wider UK Payments infrastructure. Its opening hours effectively dictate the length of the live “UK Payments day” and the Bank of England has recently embarked on a consultation exercise on this.
- It is widely accepted that any IT system (and, in particular, a Payments System) can only be as strong as its weakest link. As such, CHAPS Co (along with the other Payment Systems) set out strong minimum standards for Security and Resilience that Direct Participants are expected to attain and adhere to thereafter (the latter often proven by testing (either intra-day or out of hours). These are reviewed on a continual basis in line with the moving threat threshold outlined above.
- As such, whilst these standards may be perceived as a barrier towards entry (given cost <u>may</u> need to be incurred by an on-boarding participant to meet them), they are present for good reason. The wider payment eco-system would suffer if a Financial Institution whose IT infrastructure was insecure and/or prone to regular failure was to join a Payment System as a Direct Participant.
- As set out in the next question, there remain areas where improvement is possible and CHAPS Co continues to work with its members on areas such as message standards.

Question 18

What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Most countries have a legacy of differing standards and message routing conventions and the UK is no different with the legacy of sort codes and differing messaging types across its various Payment Systems.

Like many Central Banks, the Bank of England's core RTGS Infrastructure uses SWIFT message formats. SWIFT messaging formats are widely used internationally as is the use of SWIFT itself for the transmission of financial messages (including Payment Instructions) given its high security and resilience. CHAPS utilises both SWIFT message formats and SWIFT as its transmission mechanism. At present, the SWIFT MT format used by CHAPS and the Bank of England are not ISO20022 compliant. However, this is under continual review (and has, most recently, been the focus of a dedicated Working Group).

A key challenge to the adoption of enhanced standards (such as ISO20022) will be to ensure that the market does not simply employ message translation services to meet the new standards (resulting in the underlying message remaining unchanged). As such, any rollout should look to the other opportunities that could arise in parallel (eg the standardising of Legal Identifiers).

For its part, CHAPS believes that the adoption of SWIFT messaging standards[9] would, at a minimum, improve consistency and would bring the UK in line with international standards whilst simplifying message processing within the Banks. The presence of consistent message formats could also assist resilience by allowing, for example, urgent priority payments to be redirected from a stricken Participant/Payment System to another Payment system. Additionally, common messaging standards would benefit participants of payment systems in terms of consistency of access.

Question 19

What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

CHAPS Co offers no response to this question other than to re-emphasise the points made above with respect to ensuring that any changes in this area do not impact upon the security and resilience of those participating in the Payments Systems.

Innovation

Question 20

Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

[9] Note that for this purpose, this does not necessarily require the use of SWIFT itself.

The accompanying text observes that *"banks do not have significant incentives to drive innovation"* and *"with payments generating little or no revenue, it is unclear whether, or how, participants in payment systems will recoup the cost of investments".* CHAPS Co offers the following views on this:

- As most will be aware, CHAPS transactions are, for the most part, charged for by Direct Participants and this is clearly in the competitive space between them. As such, CHAPS Co is also not sighted on the approach the Banks take on the development of their differential pricing policies between the Payment Systems. Whilst CHAPS Co is not sighted on the costs that Banks incur with respect to processing payments, it is not unusual for the costs associated with participation in payment systems to form part of the standard "back office" costs. Whilst in practice it may be difficult for Banks to isolate individual and specific payment processing costs there is normally a desire for back office costs to be constrained given their collective impact on the product lines they support. This is not to say that investment does not take place. However, this would often be driven by parallel IT strategies (including product development, the need for ongoing enhancement in areas of resilience and security as well as ongoing investment as infrastructure reaches the end of its natural life cycle).
- With specific reference to CHAPS, we highlighted earlier in our responses that CHAPS Co's core ability to innovate at a system functionality level is restricted given its use of the Bank of England's RTGS system and the fact that it is just one of a number of stakeholders in this system.

Question 21

Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

As stated above, CHAPS Co's ability to innovate is, to a large degree, dictated by the Bank of England's change programme for RTGS (which CHAPS and its Participants can request changes to). As per Bacs and FPS, any strategic development that CHAPS Co wishes to undertake is currently subject to approval by the Payments Council as a reserved matter under the generic contract (see appendix A).

Question 22

What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

In order to facilitate a greater pace of innovation (and associated buy-in from key stakeholders), CHAPS Co believes that key payments and operational strategy could be collaboratively driven between the Payment Systems (with strategic input via an industry body with key stakeholder representation present). This collaboration (rather than competition) at the core level in turn could facilitate faster innovation by ensuring that industry efforts are expended in an efficient and expedient manner.

Question 23

What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

CHAPS Co is firmly of the view that unilateral innovation brings with it the risk of movement in diverse directions by the various Payment Systems which would not be of benefit to the wider stakeholder community (including end users of those systems). Collective and collaborative innovation brings with it the opportunity of consistent goals and aims, a consistency of delivery and approach and the opportunity for rationalisation over time.

Closing Questions

Question 24

Do you have any other comments or concerns you would like to highlight?

None that have not already been covered above.

Question 25

What, if any, are the significant benefits you see regulation bringing?

CHAPS Co believes that the third statutory objective of the Payment Systems Regulator (“The Service User objective”) offers the potential, subject to legal, regulatory and financial stability requirements, for payment systems to be able to further manage their end to end eco-systems with respect to end-users (historically seen as “out of scope” for a utility model Payments System and a responsibility of the channel provider) although we accept that this is ultimately something that the future regulator may opine upon.

Question 26

What, if any, are the risks arising from regulation of payment systems?

Earlier in this document, CHAPS highlighted the fact that the original HMT consultation was primarily focussed on the UK domestic retail market and the supporting retail Payment Systems whereas the subsequent Primary legislation was silent on the differentiation between retail and wholesale. Our responses above have also highlighted the difference between UK domestic agency arrangements and international correspondent Banking relationships. As such, we are concerned that rules imposed to address perceived shortcomings in one area may have detrimental (and unintended) consequences elsewhere. We would therefore recommend that the regulator views the implementation of each of its core objectives from both the domestic retail and international wholesale perspectives (and, for the latter, benchmarks any steps it may wish to take against rules and regulations present in other key financial centres to ensure a consistent and level playing field for Participants in the London wholesale market).

Question 27

How do you think regulation might affect your business and your participation in UK payment systems?

N/A - Given CHAPS Co's role as a Payment Systems Operator. However, as also noted elsewhere in this response, we would flag the potential that additional or unclear regulation may have with respect to either perceived or actual costs of entry (particularly for non UK entities) and any unintended consequence on international wholesale transactions via correspondent banking relationships.

CHAPS Co

APPENDIX A

Extract from the Amended and Restated Agreement governing the relationship between Payments Council Ltd (“the Company”) and CHAPS Clearing Company Ltd (“the Scheme”).

Schedule
Matters reserved for approval by the Company

1. Recruiting, hiring, offering employment to, or entering into or amending or varying any contract of employment or any part of such contract, (including, without limitation, remuneration or benefits) with the Scheme Managing Director and/or Scheme Chairman or dismissing or removing them.
2. Forming a succession plan for the Scheme's business critical roles.
3. Forming any subsidiary or acquiring shares in any other company or participating in any partnership or joint venture (incorporated or not).
4. Acquiring, amalgamating or merging with any other company or business undertaking.
5. Passing any resolution for the Scheme's winding up or presenting any petition for its administration.
6. Ceasing the provision of any product or service or significantly reducing the scope of any activity carried on by the Scheme.
7. Entering into, significantly changing or terminating any contract for the provision of infrastructure to the Scheme or with respect to its Payment System.
8. Altering the Key Performance Indicator (KPI) framework for reporting on operating performance to the Board.
9. Altering the framework for reporting to the Board on delivery against expectations set by Bank of England Oversight for the Scheme (the Scheme will be responsible for planning and resourcing the meeting of these expectations, and should include this in its Annual Strategic Plan, and will account to the Board on progress against the plan).
10. Approving the Annual Strategic Plan for the Scheme which should be consistent with the Company's Objectives and Company's Strategic and Corporate Plan and Bank of England Oversight expectations.

Appendix B - CHAPS Direct Participants

Current Participants

- Bank of America N.A.
- Bank of England
- Bank of Scotland
- Barclays Bank PLC
- Citibank N.A.
- CLS Bank International
- Clydesdale Bank PLC
- The Co-operative Bank PLC
- Danske Bank
- Deutsche Bank AG
- HSBC Bank PLC
- J.P. Morgan Chase Bank N.A.
- Lloyds Bank PLC
- National Westminster Bank PLC
- The Royal Bank of Scotland PLC
- Santander UK PLC
- Standard Chartered
- State Street Bank
- Svenska Handelsbanken AB
- UBS AG

Joining Participants

Five additional internationally domiciled institutions are committed to joining CHAPS Co between now and the end of 2015.

- BNY Mellon
- ING
- Northern Trust
- BNP Paribas
- Société Générale

CHAPS Co

Appendix C - CHAPS Participant Criteria and Costs

To be eligible for membership, a financial institution must:

- Hold a settlement account at the Bank of England.
- Be a participant which falls within the definition of participant in Financial Markets and Insolvency Regulations 1999.
- Comply with the technical and operational requirements as set out in the CHAPS Rules
- If required, provide a legal opinion issued by an independent legal adviser.
- Enter into a separate agreement with the current settlement Members.
- Be a shareholder of the company.
- Complete an Audit and Certification process.
- Pay external costs incurred as part of the Member onboarding process.

Participation Costs

CHAPS Clearing Company	
Joining Fee	**One off:** There is currently no joining fee. However, any external legal fees incurred by the company will be recovered from the new Member. The joining fee is subject to annual review by the CHAPS Board.
Annual Call **(Operating Costs Recovery)**	**Ongoing: £3.99m (annual call for 2014)** This figure is shared between all Members of the scheme. Minimum share is 2% of the company core overheads and is subject to a maximum of a 26% share dependent on the Member's level of volumes. Based on the total annual volumes for 2013 this equates to circa £0.115 per CHAPS transaction.
Bank of England	
Account Management Fee **(per annum)**	**Ongoing: £15,000** The Bank of England Tariff for 2014. Any legal fees incurred in opening a reserve account will be recovered from the new Member. There is also an annual charge per settlement bank for

CHAPS Clearing Company	
	each of the net payment schemes that the Bank settles for.
Debit Item Charge	**Ongoing: £0.175** The Bank of England Tariff for 2014.
SWIFT	
FIN Charge **FIN Y- Copy Charge**	**Ongoing:** Subject to Members' own SWIFT Tariff fees.
Enquiry Link Workstation	
SWIFTNet Webstation Two active Web Stations Profile	**One off:** Required if the new Member does not have existing SWIFT infrastructure. The actual costs are subject to negotiation between the new Member and SWIFT.
Hardware	
Subject to minimum configuration for both CHAPS and Enquiry Link requirements and Members own pricing with suppliers.	
Vocalink	
Charge for changing status on Industry Sorting Code Directory (ISCD)	**One off:** Covers the cost of Vocalink making the change, this is dependent on the complexity of the bank reference data associated with the on-boarding Institution.

Appendix D - CHAPS Top 100 Indirect Participants by value (anonymised via alphabetic order)

ABN AMRO Bank N.V. Ahli United Bank Allied Irish Banks (AIB) ANZ Aviva Plc Axa Bank of China Bank of Ireland Bank of Korea Bank of Montreal Bank of New York Mellon Bank of Nova Scotia Bank of Tokyo-Mitsubishi UFJ Banque ENI Banque PSA Bayerische Landesbank BBVA Blackrock BNP Paribas Bradford & Bingley PLC Brown Brothers Harriman Canadian Imperial Bank of Commerce (CIBC) Clearstream Banking Commerzbank Commonwealth Bank of Australia Compagnie Fin de CIC et de l'UE (Union Europeenne de CIC) Credit Agricole Credit Suisse DBS Bank Dexia DNB (den Norske) Erste Group Bank AG Euroclear Bank European Investment Bank Fidelity FMS Wertmanagement AOER Goldman Sachs Government of the United Kingdom Groupe BPCE HELABA - Landesbank Hessen-Thueringen ING	Intercontinental Exchange Intesa Sanpaolo Spa Investec KBC Bank Kreditanstalt fur Wiederaufbau Landesbank Baden-Wuerttemberg (LBBW) Landesbank Berlin GZ LCH Clearnet Legal & General Libyan Foreign Bank Macquarie Bank Marks & Spencer FSL Mizuho Monetary Authority of Singapore Morgan Stanley Narodowy Bank Polski National Bank Abu Dhabi National Bank of Canada Nationwide Building Society Nomura Norddeutsche Landesbank Nordea Northern Rock Asset Management Northern Trust OCBC Bank (Oversea-Chinese) Old Mutual Pohjola Bank Portigon Financial Services Prudential plc Rabobank Rolls-Royce Royal Bank of Canada RZB Group (Raiffeisen) Schroders SEB AB (Skandinaviska Enskilda Banken) SNS Bank Societe Generale Sofax Banque St James' Place Standard Bank Group [of South Africa] Standard Life State Bank of India	Sumitomo Mitsui Banking Corporation Sumitomo Trust Swedbank Tesco Bank Toronto-Dominion Bank Turkiye Is Bankasi UniCredit Union Investment Privatbank US Bank Virgin Money VISA VTB Capital Wells Fargo Westpac World Bank Yorkshire BS Zuercher Kantonalbank

Indirect Participants listed according to the main bank within the group, e.g. Clearstream for Deutsche Boerse.

14 April 2014

BY EMAIL

Dear Mary Starks,

Re. New payments systems Regulation - Call for Inputs

Thank you for the opportunity to contribute into FCA's Call for Inputs for the establishment of a new payments systems regulator (PSR).

By way of introduction, Charity Finance Group's (CFG) vision is to inspire the development of a charity sector that is financially confident, dynamic and trustworthy. CFG works with finance managers to enable them to give the essential leadership on finance strategy and management that their charities need; promoting best practice in charity finance, driving up standards, campaigning for a better operating environment and ensuring every pound given to charity works harder. CFG has more than 2,200 members, and collectively our members are responsible for the management of over £19bn in charitable funds.

CFG appreciates that that this is a targeted consultation aimed at supporting the PSR to understand the current concerns of the UK payments industry and to inform the development of its regulatory approach. Therefore, due to the specific scope of these consultation questions and because there are no charity-specific questions, our brief response aims to:

1. Register our interest in the review;
2. Outline the importance of payments systems to the UK charity sector; and
3. Highlight the importance of consulting fully with the charity sector when policies relating to payments systems are developed.

Payments systems & charities

Payments systems are used widely by the charity sector both to receive donations and make payments to staff and suppliers. While we support maximising choice and innovation in payments systems, we believe that the cost of any developments must not be borne by the end user. Charities with an income of £1 million or below (accounting for more than 93% of UK charities) typically do not have finance staff or have just one member of staff in their finance team, often unpaid.[1]

[1] Charity Finance Group & Small Charities Coalition. "Making it Count: A Report into Financial Management in Small Charities." May 2013.

Therefore in the charity sector, staff's ability to use new payments technology, if there is a significant requirement for them to change their behaviour, is likely to be limited.

Outlined below are two recent examples of announcements of changes in payments policy which have impacted on the UK charity sector. For each we have briefly described a few of the issues that arose.

- **Payments Council target end date announced for the removal of cheques**

The announcement in May 2011 of the 2018 target end date of cheques was a matter of significant concern to our members and the wider sector. It was our belief that the 2018 date was too ambitious given that it was unlikely that suitable alternatives would be developed and adequately adopted by the charity sector by this time. CFG worked closely with the Payments Council on the issue, both as part of their Charity and Voluntary Sector Liaison Group and outside of this group to oppose the move. We also provided written evidence to the Treasury Select Committee as part of their inquiry into the future of cheques.

Although we understood that overall cheque use is on the decline in the UK, we still maintain that cheques are ingrained in our giving culture. While many charities have moved away from cheques when making payments (particularly the medium to large sized charities) and increasing numbers are doing so, the number of cheques received by charities remains consistently high. The Payments Council estimate that 82% of charities received a cheque payment in 2012 and that on average, each charity receives 209 cheques per year.[2] There are a number of reasons for this. Their ease of use means that cheques are one of the preferred methods of payment for spontaneous donations. Many charities have donor bases predominantly made up of the older generation, who are more likely to use cheques, and consequently target their fundraising campaigns at this age range. Many donors prefer to send donations by cheque because of the tangibility – it enables a physical act of giving to a cause the donor is likely to feel strongly about or to have an emotional connection to.

In the future, CFG would welcome full consultation with the charity sector to develop sufficient alternatives for cheques.

- **HMT Cheque Imaging Consultation**

CFG recently submitted a response to HMT's consultation on proposals to implement a cheque imaging system whereby the receiver can process the cheques using smartphone technology.

CFG welcome the development of a new image based cheque and credit processing model as it provides improved ease of use and sustainability for cheques, an essential payment method for charities to receive donations. While we support this move to cheque imaging as an additional facility for cheque processing, we feel that it is important that HMT also maintain the current paper processing mechanism as we expect that take up of cheque imaging by charities is likely to be limited as charities will vary in their capacity to use the technology. This take up will depend on the size of their finance teams and their in-house ability to use smart phone technology. It is therefore crucial that any new legislation safeguards the ability for the charities to deposit the cheques at the bank and does not act as a disincentive for banks to remove in-branch processing options.

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[2] Payments Council. "Payments in Focus: A report on UK Charities and Community Organisations". January 2012.

Consultation with the sector

As the events of 2011 demonstrate, it is vital that there is a full and open consultation process before any policy decisions relating to payments systems are taken. It is not always possible to identify straight away how charities will utilise new payments systems and consequently a lack of consultation can result in legislation having unintended negative consequences for charities. It is therefore crucial that charities' unique needs vis-à-vis payment methods are considered in this call for inputs and incorporated into the PSR's policy streams once they are developed.

We hope the points raised in this response prove helpful. We would like to take this opportunity to offer CFG's support to FCA in establishing the Payments Systems Regulator. With a membership of in excess of 2,000 we are well positioned to draw on the experiences of a wide range of charities should you want to further explore any of these issues. Please contact Anna Bloch, CFG's policy and public affairs officer, at anna.bloch@cfg.org.uk should you require any further information.

Yours sincerely,

John Ingamells
Director of Policy & Engagement
Charity Finance Group

Cheque & Credit Clearing Company

14th April 2014

Direct Line 020-3217-8386
stephanie.watson@chequeandcredit.co.uk

Payment Systems Regulator
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Sirs

C&CCC RESPONSE TO FCA CONSULTATION "PAYMENT SYSTEMS REGULATION CALL FOR INPUTS'

The Cheque and Credit Clearing Company (C&CCC) is a membership-based industry body which manages the cheque clearing system in Great Britain. The Company was established in 1985 and from that time until the present day it is proud of its record in:

- providing consumers, via Financial Institutions, with the central payment system services for the exchange and settlement of cheques and credits. These services are underpinned by payments infrastructure including exchange centres, the network for the transfer of electronic cheque data, and an automated settlement system. It also includes a courier service for the return of unpaid cheques to the collecting bank;
- managing the operational processes of the central payment system services;
- determining the rules, standards, and procedures required to maintain the integrity of the clearings, including the criteria for joining the clearings and ensuring compliance with those rules;
- engaging with the full range of stakeholders, which includes consumers and businesses that use cheques, banks and building societies that offer cheque clearing services, cheque processors, cheque printers and other suppliers, as well as regulators, trade associations and other payment schemes.

Objectives

The overall objectives of the Company are to:-

- maintain the integrity and sustainability of the clearings which have been operating in a declining market for some time,
- respond proactively to changes in the business and regulatory environments;
- facilitate innovation in the clearing process in order to deliver improvement in the customer proposition and, equally important, improvements in industry efficiency
- maintain a trusted centre of excellence, experience and expertise in the cheque and credit clearings.

In December 2013, the C&CCC Board reached an important milestone decision to adopt, as its strategy, a future clearing model which would deliver its overall objectives, as above, utilising an image based processing system, replacing the current, largely paper based, approach.

We see the new image based clearing model, which is a C&CCC Board initiative, providing sustainability for cheques, thereby enabling further innovation to take account of technological developments as they occur and addressing customer requirements so that the cheque will continue to be available for their use for as long as the demand is present.

Since 1985 C&CCC has provided a cheque and credit clearing service to customers who wish to continue to use cheques, whether as the recipient or issuer, and those customers can be confident that the service provided is both safe and efficient.

Payments Systems in the UK

We believe that all payment systems should be regarded as equal in terms of their importance to the full payments industry regardless of volumes or values handled in order to ensure the competitive market can continue to offer customer choice over payment type.

C&CCC is one of the major retail payments schemes in the UK and would expect to be regulated. Designating some, and not all, schemes has the effect of making the non-designated schemes seem less important in the eyes of the industry which introduces a risk that the customers using these non designated services will suffer because resource, such as that required for innovation or integrity, will be directed towards designated schemes which, banks may consider, hold the higher regulatory risk. The approach to designation should ensure a level playing field, avoiding unintended consequences and the opportunity for regulatory arbitrage.

Customers have made it very clear that they want to be able to use cheques as part of the range of payment choices they have. While cheque usage has declined steadily over the past 20 years, a sizeable number of cheque users remain, particularly amongst older consumers, charities and small businesses, and they want to be sure that they can carry on using cheques for as long as they want to. The Company fully understands and supports this requirement. We would like to see C&CCC designated and have its remit extended to the UK, thus including the NI banks and customers within the C&CCC remit. Our recent decision to adopt as our strategy the Future Clearing Model, enabling industrywide image based cheque and credit processing, will secure process efficiencies throughout the UK and enable us to sustain economically viable services and improve the cheque using customers' experience , whether demand continues to decrease, plateau or whether, for any reason, it should increase.

Competition in Payment Systems

There is a place within the payments architecture for collaboration between schemes but we believe primarily that schemes should use their expertise to deliver/ enable innovation which they should be free to research, develop and implement in a competitive manner in line with Member agreement.

Direct collaboration between payment schemes, without third party intervention, is necessary and relevant in areas such as:-

- risk reduction measures in all areas including fraud prevention and settlement
- payment reference data (sort code) control and management
- defining rules and standards to provide interoperability and reach.

Bank of England co-ordination of industry-wide settlement is also a vital strategic area where collaboration is essential.

Collaboration can bring significant benefit where the aim is to improve the integrity or innovation of the UK's payment systems and the resilience of payments infrastructure overall. This is likely to be necessary in only a limited number of instances to ensure there is not excessive concentration on one particular infrastructure without adequate mitigation. Where there is a case, the collaboration should be progressed directly between the relevant individual Scheme companies.

C&CCC believe that there should be competition:

- between the schemes;
- within the schemes between Financial Institutions in the way that they offer services to the customer; and,
- within the schemes between the outsourced scheme infrastructure providers.

Ownership

The company would welcome a review of the different ownership models currently employed by the payment schemes in order to understand if there are benefits to be gained by moving to a different model.

The Company is owned by the System Members. The company has no assets so there is no intrinsic value in the single share that all Members of the System are required to acquire upon joining but all benefit from the option to appoint a non-executive 'Member' Board Director.

A list of our current Members is available on our website. www.chequeandcredit.co.uk

As part of the Future Clearing Model, a review of the membership criteria will take place, as a move to an image based model has the opportunity to enable new providers of infrastructure to enter the market (provided that they do not adversely impact stability, integrity, security and compliance with scheme rules and standards) with lower investment, and thereby increasing choice for financial institutions. It is anticipated that this will enable more banks and building societies to become Members and, therefore, under the current ownership model, owners of the scheme.

Governance

The C&CCC Board is the decision making body for the Company and is made up predominantly of non executive Directors who are directly employed and appointed by the Scheme Members, i.e. the shareholding owners. These Member Directors have very clear and frequent conflicts of interest (which they declare) as they balance what they believe to be a correct course of action to meet their fiduciary duties to the Company, with the legitimate concerns, of their own Member organisation and employer. Under our corporate governance model the Member Directors currently declare a number of additional conflicts of interest including where they undertake multiple directorships across payment schemes and where they are shareholders in infrastructure providers.

The Company appointed an independent Chairman, in 2004, before there was a regulatory drive to do so, to assist with mitigating Member Director conflict of interest issues and we have recently added two new independent non-executive Directors whose role is to represent public interest. The Member Directors can provide valuable experience and industry knowledge to the C&CCC Board.

Major decisions have been made by unanimity, or near unanimous consensus, which means change proceeds at the pace of the slowest Member or not at all. Historically, the Board has had difficulty in driving innovation where it has not been seen to be in the interests of all the owning Member organisations represented by Member Directors. The appointment of independent directors will help to ensure that the customer focus is maintained whilst formulating and driving innovative developments, avoiding Members' internal concerns which may have hindered progress in the past.

Access

The C&CCC has 11 settlement Members and participation by other financial institutions in the cheque clearing is achieved via these settlement Members. The C&CCC enables Members to have direct access to its central processing infrastructure and the scheme. It allows Members to provide the services to other financial institutions, such as agency banks, on a commercial basis. The provision of agency bank access is a matter for individual Members and is not mandated by the scheme, i.e. a settlement member can choose whether or not to offer such a service. The Future Clearing Model will make it easier for challenger and agency banks to switch between settlement member providers if they wish to remain as agency banks or, alternatively, to join as a settlement Member in the same way as they can in the electronic schemes because the model removes the total reliance the paper clearing has on sort code lead pairs to sort paper.

There is currently only one C&CCC membership category, i.e. a full settlement member. Access to the clearings is a key element of the Future Clearing Model which is likely to be achieved by introducing a wider range of distinct membership categories enabling challenger and agency banks to participate in the clearing at their preferred level. Proportionate criteria for such membership will be set at a different level to that required for settlement membership to protect the integrity of the clearing system.

The proposed introduction of a prefunded, capped settlement model, within the Future Clearing Model, means the provision of settlement services will become easier for banks to manage by moving from a 'survivor pays' to a 'defaulter pays' model in line with the changes the electronic schemes are implementing. There is, therefore, the possibility that more settlement members will enter the market or that some agency banks will choose to become settlement members.

Infrastructure

Within our current model, we have two types of infrastructure, Member Processing and Central Processing, further information on each is available on our website at www.chequeandcredit.co.uk.

In terms of Member Processing, since the first outsourcing of a cheque clearing operation in 1992 the infrastructure model has evolved in response to member requirements which have, wherever possible, been acknowledged and accommodated. Even if a Member uses a common outsourcer as their infrastructure provider their actual solutions are likely to be very different. This can also cause further conflicts of interest for Member Directors, whereby a particular change can impact disproportionately on different Members, which can result in difficulties agreeing a solution for any new innovation.

In terms of Central Processing, some elements of C&CCC infrastructure, such as the IBDE network, settlement system, unpaid cheques courier service and exchange centres, are managed by the Company but have been outsourced, within the rules of the Company's supplier policy, through a process of competitive tendering. There is no single infrastructure supplier to the Company.

Since 1990 cheque volumes have declined steadily and this has had an impact on the appetite for reviewing the current infrastructure model. It has become complex with multiple interested parties which has caused difficulties for the Company. For example, a recent tender exercise for improvements in processing efficiency did not attract potential credible bidders, perhaps due to existing or potential relationships with Scheme Members and outsourced contractors. The conflicting interests of the various parties within the current infrastructure model, therefore, had a direct impact on the Company's ability to innovate.

The main cheque processing infrastructure is managed on behalf of Scheme Members by two outsourced suppliers:-

- HPES – which holds the processing contract for RBS Group; and,
- iPSL and UPSL – which hold all other Members processing contracts.

In addition the Company sources a number of services from UK Payments Administration Limited.

The Future Clearing Model offers an opportunity for C&CCC to review the extent of the infrastructure that it manages and work is underway to consider:

- comparative scheme infrastructure models;
- the advantages and disadvantages of each;
- recommendations for the preferred model for the C&CCC; and
- proposals for how we could transition to the preferred model through the implementation of the new Future Clearing Model.

The UK payments system and the economy it serves could benefit from increased numbers of infrastructure suppliers. This offers increased competition and potentially innovation whilst providing contingency and resilience. It would be necessary for there to be some commonality on interface requirements. Increased commonality of standards could improve access for challenger and agency banks and their ability to switch between suppliers and schemes at minimal cost. For example, the Future Clearing Model is considering utilising a common messaging format (ISO20022) which will bring many of these benefits.

Innovation

Cheque clearing demands collectively driven innovation for the base clearing service to ensure customers can benefit from a common core service. Banks, however, are free to offer additional services for the benefit of their customers, in the competitive space over and above the core Scheme clearing service.

The schemes need to move forward by consensus to ensure a common customer experience and, to a large extent, unanimity which takes time to build. There has also been a multiplicity of, at times, conflicting regulatory pressures over the past 15 years which have both absorbed change management and investment capacity and resulted in the industry becoming risk averse in taking the initiative itself. More effective dialogue is needed between regulators and the schemes to ensure that innovatory scheme proposals do not conflict with potential regulatory issues.

Within these constraints, the C&CCC has a good record of delivering innovation albeit more recently only with a direct regulatory driver to mandate that change, e.g. the T+2-4-6 customer promise and the Cheque Redirection Service within Account Switching, but this is always set against a declining market and competing Member priorities in other payment schemes, e.g. mobile payments and FPS. To this extent the Company views regulatory intervention as positive where it helps Members resolve competing priorities. However, we believe regulation should define the required outcomes, leaving Schemes and competing Financial Institutions to determine how best to achieve that outcome.

Innovation may be iterative or result in a step change. Transformational change is only achievable if constraints such as the C&CCC's current heavy reliance on sort code lead pairs for sorting cheque paper, reliance on paper and potential barriers caused by, what may be seen as, prohibitive set up costs are removed. We believe the Future Clearing Model will address these issues, not only achieving significant savings now, but opening the way to further innovation and increased competition at all levels.

Summary

The Company would welcome a competitive and regulatory environment where consumers and businesses continue to benefit from an efficient cheque clearing system, providing the option to continue using cheques for as long as they wish. Our current experience during discussion on the Future Clearing Model suggests that some Members have a preference for projects to be mandated by a regulator to avoid internal budgetary and prioritisation issues. We need a robust and effective payments architecture and governance structure underpinned by the highest quality expertise. We believe that the expertise on cheque and credit clearings is found mainly within the C&CCC.

Any new payments architecture, scheme ownership and governance arrangements must support the Company in its efforts to improve cheque processing through its commitment to an industry wide image based cheque clearing in order to sustain cheques for as long as customers want to use them.

We would be happy to meet to discuss this response as we seek to deliver an excellent cheque clearing service for as long as it is required by customers.

Yours faithfully

Angela Thomas,

Managing Director

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April 15, 2014

Via E-mail

paymentsystems@fca.org.uk

The Payment Systems Regulator
25 The North Colonnade
Canary Wharf
London
E14 5HS

Re: CLS Bank International response to the Payment Systems Regulation Call for Inputs dated 5 March 2014 (the "Call for Inputs")

Ladies and Gentlemen:

CLS Bank International ("CLS") welcomes the opportunity to share its views on the Call for Inputs.

CLS is a special purpose corporation, organized under the laws of the United States, established by the private sector as a payment versus payment system to mitigate settlement risk (loss of principal) associated with the settlement of payments relating to foreign exchange transactions (the "CLS System").

As an Edge corporation, CLS is regulated and supervised by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York. In addition, the 22 central banks whose currencies are settled in the CLS System have established a cooperative oversight arrangement for the CLS System organized and administered by the Federal Reserve pursuant to a Protocol for the Cooperative Oversight Arrangement of CLS, as a mechanism for the fulfillment of their responsibilities to promote safety, efficiency and stability in the local markets and payment systems in which CLS participates.[1]

The CLS System is currently subject to oversight by the Bank of England, having been specified by HM Treasury as a recognized system under Part 5 of the Banking Act 2009. The CLS System was also designated in the United Kingdom in 2002 by the Bank of England for the purposes of the UK Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SI 1999/2979) which implement the EU's Settlement Finality Directive 98/26/C.

As a preliminary matter, CLS would like to express its broad support for the introduction of the new Payment Systems Regulator ("PSR") and the FCA's Call for Inputs on this matter. CLS recognizes, however, the need for clarification regarding the UK retail focus in respect of designation of payment systems (as indicated in the Call for Inputs, Question 1).

In its 2013 consultation "Opening up UK payments", the Government stated its intention "to proceed with bringing payment systems under economic regulation, and establish a new competition-focused, utility-style regulator for retail payment systems".[2] In the same consultation "HM Treasury indicated the schemes that it is likely to designate for regulation by the PSR as: CHAPS, Bacs, FPS, LINK, Cheque and Credit and the main three and four party card schemes".[3] This focus on retail payment systems is reiterated in the PSR's statutory objectives – "the competition objective", "the innovation objective" and "the service-user objective"[4] – which all place considerable emphasis on the interests of the service-user. In this regard, the FCA has defined "service-users" as "those who use, or are likely to use, services provided by payment systems to transmit funds. For example, businesses, consumers and government departments".[5] CLS therefore understands that HM Treasury will seek to designate only UK retail payment systems whose activities relate to opening and operating bank accounts and other retail financial payments and operations in the UK.

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1 http://www.federalreserve.gov/paymentsystems/files/cls_protocol.pdf.

2 *Opening up UK payments,* HM Treasury, March 2013 (chapter 2.4, p. 5) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221903/consult_opening_up_uk_payments.pdf.

3 As summarized in Call for Inputs (p. 9).

4 Call for Inputs: Background (p. 5), Financial Service (Banking Reform) Act 2013, section 49.

5 Call for Inputs: Background (p. 8).

In response to Question 1 of the Call for Inputs, CLS submits that payment systems which are not retail payment systems within the UK should not be considered for designation by the HM Treasury and thus should fall outside of the PSR's remit. Given the limited UK nexus in the Banking Reform Act which might bring a cross-border payment system within scope in principle, recognition of such retail focus will provide welcome clarification for primarily offshore wholesale / interbank systems which operate on an international basis but have some UK users.

* * *

We would welcome the opportunity to discuss any of these comments in further detail.

Sincerely,

Dino Kos

cc: Alan Marquard, Chief Legal Officer, CLS Group
Gaynor Wood, Executive Director, CLS Services Ltd
Lauren Alter-Baumann, Managing Director, Legal and Regulatory Strategic Affairs, CLS Bank International

Clydesdale Bank

Clydesdale Bank PLC
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Glasgow
G1 2HL

Telephone 0141 242 4363
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Douglas I Campbell
Head of Corporate Support

Our ref DC/JP
Your ref
Date 14 April 2014

Financial Conduct Authority
25 The North Colonnade
Canary Warf
London E14 5HS

Dear Sir

New payment systems regulator – Call for Inputs

Thank you for inviting Clydesdale Bank to respond to the *New payment system regulator – Call For Inputs.*

Clydesdale Bank notes that the Payment System Regulator (PSR) will be established as a subsidiary of the FCA and will have a number of general duties relating to payments systems. These are: giving general directives; giving general guidance, and determining the general policy and principles by reference to which it performs particular functions.

We also note that the PSR will have its own statutory objectives, distinct from those of the FCA: competition; innovation, and service user.

Clydesdale Bank is supportive of the aims and objectives of the PSR to promote effective competition, development, and innovation in payment systems in the interests of service-users and users of the payment services. We welcome the aim of ensuring that payment systems are operated and developed in a way that takes account of, and promotes, the interests of service-users of payments services.

Clydesdale Bank believes that key deliverables of the PSR include fulfilment of customer needs, collaboration between the regulator, Payment Schemes and member banks. Another key deliverable is the removal of barriers for both new entrants and smaller financial institutions to payment systems and enabling access to world leading innovation e.g. cheque imaging.

It is important that any regulator builds on what improvements have been achieved and that care should be taken to ensure that the PSR's aims are fulfilled without imposing unnecessary regulatory cost on business and the industry.

Finally, we would re-iterate that in implementing these reforms it is important that the government ensures that they do not penalise smaller banks or impose disproportionate costs on them.

Recent reforms have helped to ensure that smaller banks have a greater involvement in the governance of the overall programmes and we would wish this continued in any changes that result from this consultation.

Yours sincerely,

pp **Douglas I Campbell.**

Payment Systems in the UK

Question 1: ***Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.***

4-Party Card Systems:

We believe that members of the 4-party card payment network – card schemes and issuing banks - should be included in the remit of the regulator.

Cash Markets:

We maintain that there is a justification for bringing cash payment networks –cash processing and cash banking - under the control of the payments regulator as we are concerned that aspects of the markets lack the competitive forces necessary to allow them to function optimally for merchants as end users and, therefore, consumers.

Competition in payment systems

Question 2: ***Where do you believe competition is effective or ineffective within UK payment systems?***

4-Party Card Systems:

Multi-lateral interchange fees typically account for 80-95% of the Merchant Service Charge. These interchange fees are non-negotiable to acceptors of the payment (merchants). We understand these fees are set by Visa and MasterCard in conjunction with their members (issuing banks), with the methodology/modelling to reach such levels not disclosed to those who pay the fees (merchants). We do observe healthy competition amongst acquirers but this is limited by the high level of interchange fees payable being fixed and non-negotiable amongst participants.

Cash Markets:

The Cash-in-Transit market is competitive with regular customer churn, but we have for a long time been concerned that high barriers to entry mean that the cash processing market is not competitive with only 4 NCS members and low churn. We are also aware of significant improvements in the technology and costs involved in processing but that prices paid by merchants have not seen altered much over the past 10-15 years.

Question 3: ***At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?***

4-Party Card Systems:

From a retailer's perspective, interchange currently imposes high, non-negotiable costs, absorbs funds which would otherwise be invested in enhancing service quality, innovation and promotion. We think that significant benefit will be derived for the entire economy if interchange is either determined by legitimate market forces or at least regulated at a reasonable level.

Question 4: ***What are the main factors impeding more effective competition***

at each level?

4-Party Card Systems:

The existence of interchange heavily impedes competition in the merchant acquiring market. This is because interchange consumes more than 90% of the total card acceptance budget for many merchants, so acquirers are virtually unable to differentiate themselves by cost which has resulted in a long-term lack of movement between providers. Thus, we have seen a situation for many years now where 2 acquirers hold around 80% of the market.

Question 5: ***What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?***

N/A

Ownership:

Question 6: ***Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.***

4-Party Card Systems:

Yes – particularly with regards to the card schemes who set interchange fees. For instance, we understand that Visa Europe is owned by banks whose shareholding is directly proportional to the number of Visa card transactions they receive. Therefore, we see a conflict of interests in that interchange is effectively set by the people who benefit from it, and we think such a structure creates the potential for artificially high fees. Indeed, cost-based approaches in the US, where interchange fees were set in much the same manner, indicate that more than 50% of debit card interchange income could be considered pure profit.

Question 7: ***How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.***

4-Party Card Systems:

The only way to overcome the current issues surrounding card fees would be to either devolve ownership of the card schemes or regulate the interchange fees that they set. As the former is not feasible, the answer must be the latter.

Hence, we encourage the PSR to implement regulated interchange rates in-line with the caps recommended by the European Commission as soon as possible. Visa have committed to lower interchange rates for cross-border acquiring from 1st January 2015 and this will advantage foreign acquirers for as long as full regulation is not yet in place, causing confusion for both merchants and acquirers.

The aim of the methodology employed by the EC – the Tourist Test or Merchant Indifference Test – is that a merchant should ultimately be indifferent between their customers paying by cash or card, so the cost of accepting the two should be identical. Thus, if the regulator wishes to equate the cost of cash and card acceptance as per the EC's intentions, then a cost of cash study is necessary as the UK is a very different cash market to those which formed the basis of the EC's cost of cash study.

Governance

Question 8: ***Do you have any concerns about the current governance of UK payment systems?***

4-Party Card Systems:

We have observed that there is currently no clear statute to govern 4-party card systems. We are increasingly concerned that other European countries such as France, Spain and Poland have already successfully regulated interchange fees but the UK has shown no signs of doing so yet. Moreover, the 2 year timeline quoted by the European Commission for Europe-wide regulation of interchange fees once approved by member states seems unnecessarily long in our view, given what has happened in other countries.

Cash Markets:

The maintaining of high barriers to entry to become an NCS member does create issues in this industry. Whilst we accept that many of these barriers are necessary to ensure that UK cash centres are secure, we would like more governance and reviewing of the fees charged to retailers.

Question 9: *What do you believe is the appropriate governance structure for UK payment systems?*

Access

Question 10: ***How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.***

CMS Payments Intelligence does not have direct access to UK payment systems but does regularly consult with their end users. Hence, we are very much a participant in the payments market.

We are the UK's leading payments consultancy and help our merchant clients to reduce their costs of cash and card acceptance by breaking down complex cost structures to expose the true margin paid to their suppliers and using market forces to minimise the cost and maximise the efficiency of their payment cycles.

Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*

Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:*
• To whom do you provide indirect access?
• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
• Are there any barriers to becoming a sponsoring bank?

Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*

Question 16: *Do you have any other comments regarding access?*

Infrastructure

Question 17*:* ***What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?***

4-Party Card Systems:

Because the Visa/MasterCard platforms and then the issuer sit between the merchant and the consumer, there is no direct way for the merchant to access the consumer. With other payment systems – PayPal and BACS for instance – this is possible. This means that many merchants cannot contact their customers in relation to a transaction. Currently, this is only possible for transactions where the merchant's acquirer is directly affiliated to the issuing bank of the cardholder.

The payment system needs to provide greater transparency to acquirers and merchants, particularly in relation to the payment products that are issued by its members and may be used at the merchant. For example, the merchant should be able to recognise (electronically) at the point of sale basic information about the card presented, - which enables the merchant to calculate how much that payment will cost - such as a card product and interchange fee category.

The payment system should also enable merchants to contact its customers in relation to genuine transaction queries via the parties involved in the transaction.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What* *timeframe and considerations would need to be taken into account in adopting new standards?*

Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*

Question 20: ***Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).***

4-Party Card Systems:

Our clients will typically only implement innovative technology if there is a clear benefit to doing so. This benefit can come in many forms - reduced fees, improved customer experience, loyalty or customer interaction.

We see limited appetite from many merchants to introduce Contactless terminals, for instance, simply because there is only an interchange benefit for transactions less than £10 and this may not justify the fixed and ongoing costs of implementing the terminals. Moreover, many of these transactions displace cash transactions which are typically cheaper so actually lead to an increase in net costs.

With mobile payments it is the same – unless fees are set at a reasonable level and either the merchant or the consumer is offered something they do not already have through cash or credit/debit card, merchant adoption of these solutions will continue to be limited.

For many merchants, there are cost constraints too, particularly given the economic climate. However, evidence from discussions with our client base suggests that far more funds would be available to invest in value-added innovative payment solutions if interchange bills were to be reduced.

Question 21: ***Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?***

4-Party Card Systems:

PCI DSS compliance standards means that any new payment solution that a merchant implements must be safe and secure. As take-up of many innovative solutions such as mCom has so far been minimal, merchants can be forgiven for being wary of innovation on security grounds as the downside of security breaches is significant and long-standing. For that reason, the security of payment systems will always take precedence over any innovation. The news that UK card fraud increased to £450mn in 2013 and the recent breaches at Target and Neiman Marcus in the US demonstrates this.

Additionally, the compliance cost to the merchant can be significant and can prohibit implementation of innovation

Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*

Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*

Closing questions

Question 24: *Do you have any other comments or concerns you would like to highlight?*

Question 25: ***What, if any, are the significant benefits you see regulation bringing?***

4-Party Card Systems:

Interchange regulation should lower the cost of card acceptance to merchants. This will lead to wider adoption of card acceptance for merchants, a reduction or removal of surcharging and minimum transaction amounts, greater investment in customer services and potentially lower consumer prices – all of which will provide great benefit to the end users.

Question 26: ***What, if any, are the risks arising from regulation of payment systems?***

4-Party Card Systems:

We have seen similar interchange regulation in the United States misapplied by the Federal Reserve. This has meant that for many merchants, interchange fees actually increased post-regulation.

We think it is imperative that the regulator is vigilant in implementing and regularly reviewing the caps to ensure that they continue to achieve their objectives.

Question 27: ***How do you think regulation might affect your business and your participation in UK payment systems?***

Annex 1: Cover sheet

Basic information	
Consultation title:	Payment Systems Regulation – Call for Inputs
Name of respondent:	The Co-operative Bank
Contact at respondent:	Name: David Fawell
	Email: david.fawell@cfs.coop
	Address: 2nd Floor Miller Street Manchester M60 0AL

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	X
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		X
If 'Yes', please submit both confidential and non-confidential responses.		

Financial Conduct Authority – Payment Systems Regulation 'Call for Inputs'
The Co-operative Bank response

The Co-operative Bank welcomes the opportunity to respond and assist the Payment Systems Regulator in developing its regulatory approach and design. We fully support the objectives of competition and innovation within payment systems and meeting the needs of the service user and likely users of payment services.

We remain committed to providing alternative banking options for individuals and small and medium sized businesses with customer service at the heart of our offer. Our responses therefore are focused on the potential opportunities and benefits for customers which could arise from the delivery of demonstrable improvements to payment systems.

The right balance between competition and collaboration is required to enable innovation whilst maintaining a high level of security and widespread reach. Our customers expect to be able to use our payments services "anytime, anyplace, and anywhere". It is also important to ensure a level playing field for all participants highlighted in the 'call for inputs' paper, including new players, to ensure the right outcome for the end users of payments.

Payment Systems in the UK

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

The lines between payment service providers, payment systems, infrastructure providers and third-party service providers are becoming increasingly blurred. For regulation to be effective it is important that all payment systems operating within the UK, including the global card schemes and new/emerging payment providers are captured.

Customers increasingly expect to be able to make payments conveniently and securely on a global basis, with increasing use of what are international schemes e.g. Visa, MasterCard and PayPal. Whilst we accept it will be challenging to regulate systems based outside the UK, failure to get the scope of regulation right may have the effect of driving payments away from the core UK providers because they can no longer compete internationally. Without a level playing field, regulation may make it especially difficult for smaller banks in the UK and new entrants.

Competition in payment systems

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Question 4: What are the main factors impeding more effective competition at each level?

The core UK payment systems give universal provision of a core set of payment types which underpin UK plc. We believe each scheme has its own characteristics serving different needs with clear objectives to maximise benefit, minimise cost and maintain appropriate security and integrity.

There are consumer and regulatory requirements for security and integrity in payment systems and participants' infrastructure which inevitably brings a level of cost. The reality is that the central infrastructure costs are relatively low; the majority of the costs are with the payment service providers in the running of payment accounts and the channels that can access them. Regulations such as the Payment Services Regulations put a huge onus on payment service providers with a requirement for sophisticated fraud, credit risk and banking systems to participate. Thus there is a challenge for new competitors is providing reach for their payment initiatives and achieving volumes to cover costs.

A high level of collaboration is required to make innovation work for consumers; any change to a payment scheme requires changes by that system and all participants both as senders and receivers. Successful innovation in payments requires widespread reach, without it technically good ideas will inevitably fail.

The main competition to the UK payment systems comes from the global card schemes. Although their current target market is in the 'face to face' and online environments, there are movements to enhance their proposition within the person to person space. They will compete against UK initiatives such as the Payments Council's 'Paym' which is launching with Faster Payments or Link as the underlying payment system.

Additionally, PayPal which is in some ways a system, an infrastructure and a provider, is now used as extensively for online purchases as debit or credit cards with usage having grown significantly over a relatively short period of time. This is a significant level of competitor shift in a growing market, illustrating that competition exists. This competition will evolve naturally, however to ensure a level playing field there needs to be the same level of regulatory oversight.

Whilst a level of competition within infrastructure provision is probably a good idea, this has to be considered alongside the costs and risk of changes to that infrastructure and the downstream impacts on the payment service providers using it. A drive for "competition", fragmenting infrastructure, could ultimately lead to higher rather than lower costs and with no apparent benefits to customers. On balance we believe that there should be common infrastructure(s) with appropriate governance and control to ensure access and availability to all prospective users allowing them to offer competitive services to their customers.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Industry co-operation within a network environment is essential to drive the benefits of efficiency, innovation and consumer benefits. The UK has one of the most advanced payment environments in the world which in part has been due to industry collaboration and drive to ensure consumer needs are met and sufficient reach is achieved. The reach and universality required by consumers necessitates a collaborative infrastructure.

Maintaining the integrity and security of the payment systems will be achieved most effectively through collaboration e.g. addressing the risks of cyber-attacks. Incident management also requires collaboration from all participants; schemes and payment system users. Driving change requires participation from all stakeholders to maximise benefit to consumers e.g. the launch of the Current Account Switching Service, and thus also needs collaboration.

The Payments Council currently undertakes this role, evidenced by the recent successful launch of the Current Account Switching Service and, in the past, the introduction of Faster Payments.

Whilst in the future this role may not be fulfilled by Payments Council as it currently stands, we believe there remains a requirement for a body to organise industry collaboration and deliver innovation for the benefit of all payment system users. There is however a challenge to find an ownership and governance model that will be more effective than what is currently in place.

Ownership

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

Whilst there may be a perception that the payment systems are controlled by the 'big four banks' our experience as a smaller bank is that payment system board structures have evolved and decisions are made reflecting the needs of the public interest and the total membership.

Again the challenge is to find something that is demonstrably more effective; it is questionable whether alternatives such as a payments utility or privately-owned infrastructure would provide cheaper, more inclusive, more innovative or a more resilient infrastructure than the current model. If the ownership structure is changed, consideration has to be given as to how the new owners are incentivised to meet the needs of the smaller banks and new entrants, and how this will provide improved services to end users.

We believe that an economic regulator could provide the oversight and governance to ensure that the existing ownership structure works for everyone and the costs and risks of change are fully considered.

Governance

Question 8: Do you have any concerns about the current governance of UK payment systems?

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

The governance structure of the UK payment systems has changed significantly over the past 12 months with the introduction of Independent Chairs and Directors; changes which were designed to address perceived governance issues. This ensures that public interest matters are considered and not just the needs of the direct participants. The Co-operative Bank with direct access to all UK payment schemes is represented at board level, however we recognise this is not the case for some smaller banks who are non-direct participants.

Whilst our membership of the various schemes is not a huge overhead; to be a fully engaged and a participative member in the current scheme structures can stretch our resources. This can be a challenge for us and is likely to be for other smaller members.

We believe that there is potential around the idea of a central UK scheme management company. It would maximise flexibility between the schemes, promote strategic cross scheme thinking and innovation whilst maintaining an efficient and flexible cost base. This would make our (and others') engagement with the industry much cleaner and more efficient, reducing the resources required to manage participation.

Access

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- **To whom do you provide indirect access?**
- **What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?**
- **Are there any barriers to becoming a sponsoring bank?**

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Question 16: Do you have any other comments regarding access?

The Co-operative Bank is a full member of all UK payment systems as a direct participant and has a c3% market share of payments.

Providing a complete banking offering with a full suite of payment services comes at a significant cost. The main costs stem from the core banking infrastructure, distribution to customers (network, call centres and internet/mobile), fraud and credit risk systems. We do not see the cost of being a member of the payment systems as prohibitive or a barrier to providing payment services.

The Bank has been a provider of agency services for many years; however we are now in the process of exiting that market. In our experience, the business case to offer this service is marginal with the high costs of continuing to provide a regulatory compliant agency service. These costs have increased through the upgrades to services that have come from regulations such as the PSRs. We do not believe that customers who have adopted an agency approach have suffered from uneconomic or restricted services; rather they have been paying the costs that are attached to being a payments bank. The costs and depth of regulation for sponsoring banks to deliver agency services to indirect users has become prohibitive and is making the market contract.

Infrastructure

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

The technical requirements to gain access to payment system infrastructures are not as complex as the wider requirements of maintaining security and availability of banking / payment service provider systems to ensure the overall integrity and robustness of payments. It is costly to deploy fraud detection, credit risk and anti-money laundering systems which are required in order to provide protection to consumers and satisfy regulatory requirements.

As stated previously any changes to the infrastructure of any payment system invariably requires changes to be made by all participants. As evidenced by the changes made to support the new Current Account Switching Service these changes can be significant and costly for payment service providers, therefore real clarity and analysis is required over what benefits changes will bring to payment system users and ultimately consumers.

Due to the systemic importance of the payment infrastructure, we believe priority should be given to changes that improve security and availability because of the real fraud threats that exist in today's online environment, and where non-availability of service has a significant impact.

The adoption of ISO20022 in the UK has to be given careful consideration with the impact and benefits fully assessed. Whilst we understand that ISO20022 is a widely accepted international standard with extended payment and remittance data, moving to this standard in the UK will come with significant costs for all participants including corporate end users. Undoubtedly there are benefits in having extended data attached to a payment, however whether to have it specifically carried with the payment or more simply linked to it warrants further investigation. The benefits of a simple approach to linking payments to data are well illustrated by the HMRC RTI initiative.

The complexities and challenges for all users when migrating to international standards has been evident in the SEPA migration project with the regulatory end date having to be extended. In this case the extension was not due to payment system participants not moving quickly enough but end users – with a failure to recognise the changes needed by large payments users' e.g. large businesses, government departments, etc. This is an example of where there may be an unintended consequence of further concentration in the market because smaller providers cannot afford the changes.

Innovation

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

There have been a range of innovations in recent years, e.g. contactless cards, Pingit (person to person payments), mobile / digital wallets, and contactless capability with mobile phones. Few have been able to achieve significant reach – only contactless cards are near universal, Pingit appears also to be a marketing success. The technological challenges of delivering new initiatives and the failure to achieve "reach" and or critical mass have limited success and created a number of failures. Gaining reach to give success requires collaboration – this inevitably is going to slow down apparent progress.

We are concerned about the current EU proposal to regulate interchange. We believe that regulation is required to ensure the Multi-lateral Interchange Fees are set at the right level for all parties, however the latest changes do not seem to reflect the costs that operating a card scheme bring to card issuers nor the value of a guaranteed payment service that issuers provide to merchants (particularly for those sales made online or by phone where the card is not present). At the proposed levels it can only increase the costs of banking services to retail customers vis a vis business customers and limit the appetite of card issuers to innovate in this space.

There has been a stream of regulatory initiatives in the payments arena since 2008 – from within the UK and from Europe. A consequence of this has been reduced innovation – not only because investment funds are focussed on regulation but even if funds were unlimited, there is only a certain amount of change that can be delivered safely at any one time on the legacy systems that are in place across the industry.

There is a risk that only the largest banks will be able to invest in innovation, if this is the case the government will not meet its desired objectives and consumers could be denied the choice they desire.

Closing questions

Question 24: Do you have any other comments or concerns you would like to highlight?

Question 25: What, if any, are the significant benefits you see regulation bringing?

Question 26: What, if any, are the risks arising from regulation of payment systems?

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

The new regulator could bring benefit in ensuring that the market is demonstrating to all stakeholders a focus on end users and competitiveness and taking away some of the uncertainties that come through self-governance.

We are however concerned that a level playing field will no longer exist; with global and very large payment providers the only ones able to keep pace with regulatory change and still have the investment and resource capacity to continue to innovate.

The risk of over-burdensome regulation has to be considered – higher costs could stifle innovation or industry collaboration could be delayed whilst waiting for a regulatory lead, something that is evident in some European developments e.g. SEPA.

Response to "Call for Inputs" from Payment Systems Regulator by The Department for Work and Pensions.

The Department for Work and Pensions (DWP) is the biggest single user of the UK's payments systems, making some 690m payments each year worth £443bn through the Bacs system alone. Those payments provide not only financial support to millions of pensioners, claimants and their families- including those in the UK most in need of that support- but also inject into local economies the funds that kick-start much of the UK's consumer-based economic activity each day.

The DWP therefore has a significant interest in the immediate and strategic state of the UK Payments systems. This is not just as an end-user with significant and often unique (qualitatively and quantitatively) requirements, but as guardian and representative of the interests of its payees many of whom have no other voice or advocate in the discussions about payments systems currently taking place.

We have made clear in earlier responses to the HMT consultations that we consider there to be considerable benefits to the UK's citizens, taxpayers, benefits and pension recipients and businesses from the re-use and extension of the data-carriage capability of the payment systems.

As things stand though - those who own, run and regulate those systems are interested in the integrity and resilience of the limited function for which the systems have been traditionally used - the carriage and processing of the necessary and sufficient data to enable a transfer of value to be made between one account and another. To that extent those involved have done exactly that which was required of them.

The interests of the banks whose reliance on those systems has been as great as anyone's – including DWP's – have been served well by a cautious and risk-averse approach to their development and exploitation. That approach has meant that wider interests capable of being served by those systems' expansion and development have had difficulty being represented. That includes those of government as maker and receiver of electronic payments.

Government with DWP as the largest maker of payments and HMRC as the largest receiver of Payments have a clear and clearly stated interest in that data being of greater scope to enable the government's administration of tax and benefits legislation and its financial transactions with its citizens and businesses to be better, cheaper, speedier, more secure. It also provides the opportunity for Government dealings with citizens and business to become more analogous to those they have with their banks, suppliers and friends.

If the data capacity of the UK's payments systems were expanded to enable payers, to include in addition to the payment instruction, sufficient data to enable that submitter to discharge all his reporting obligations to government and to enable prompt and unequivocal matching of the payment against a liability or invoice, then the capability of the UK's payments system immediately increases and that increased capability can be exploited by any and all competitive and innovative participants in the market.

In collaboration with the existing scheme owning banks, the schemes themselves and the Payments Council and with the awareness and agreement of existing regulators work is already in train to establish such a richer data carriage capability in the system. This involves the design and building of functionality allowing simultaneous submission by the payer of

- payment data;
- the corroboration of that data at the point of payment; and
- its being made available to third parties (including Government) for consumption and action.

Such a capability offers -

a) big taxpayer' savings through reducing fraud and error in our distributive systems (HMRC Tax Credits and DWP Benefits) and in public sector procurement and spending;

b) cost savings to UK businesses –

    - as financial and physical supply chains come closer together;
    - business processes (account payable/receivable, cash management, personnel/payroll) can be rationalised; and
    - a prompter payment culture (see BIS consultation) established;

c) better outcomes for pensioners, taxpayers and benefit claimants. As financial data relevant to their debtor/creditor position towards government (central and local) can be gathered at the time financial transactions are made, so reducing the need for separate returns, reports and post-event corrections.

All this is, in principle, achievable without major "open-heart" surgery to the existing payment schemes, using existing, proven technology, at relatively modest expense and in a relatively short time-frame. Discussions with the payments industry – the effectiveness of which have been enhanced by Payments Council involvement and a long-overdue strategic and unified approach from Government – proceed apace and a collaborative solution is in prospect to a 2016/17 timetable.

Initial work looking at richer data functionality indicates that minimum of change to the central payments infrastructure is the most attractive way forward. As such this would enable data and payment handling services up to the entry to the payments system to be innovated and competed to the extent the market will allow. If significant cost can be taken out of the current, separate processes of making payments and reporting data about them then innovative service providers can attract some of that back into investment in value-added services up to entry into the payments systems themselves.

While the Treasury consultation has set out a lot of the negatives associated with the current Payment System governance and regulation -

- few new entrants driving innovation;
- no competition driving costs; and
- little concerted collaborative action to improve customer outcomes,

there are nevertheless positives from which DWP has benefited. The schemes are reliable, secure, resilient and ubiquitous.

By reducing the payments schemes themselves to more of a utility, the cost represented by them will be minimised and innovation and competition through the potential to develop new services right up to the payment system itself can be achieved with relatively low disruption of and low risk to current operation and integrity.

In such a model “access” to the system is redefined and reduced, the role of the “sponsoring bank” will be thus a reduced and strictly fiduciary one for which the “premium” chargeable will be lower. “Ownership” of the system itself becomes less relevant – but, in the interests of risk-reduction can be left as they are – at least pro-tem while the market develops round it.

The development of a scheme neutral richer data functionality would also introduce the possibility of flexible submission. So a payer need only specify the date and speed of the payment/data required and the actual processing would proceed invisibly to the payer through whichever scheme meets his requirement. This would be a first and, in DWP’s view, necessary step towards scheme convergence and ultimately alignment which again would take cost out of the system at the payers end which could be re-cycled into data-handling services developed off the newly enabled payments infrastructure.

Scheme convergence would provide to end-users such as DWP an enormous benefit. What we, and our claimants and pensioners require is a guarantee that the financial support, on which they and their dependants rely, will be paid on the expected day and on the basis of the most up-to-date possible information held by government, especially as regards income.

The provision of Welfare support to the UK’s citizens is in the process of changing significantly as DWP works fully to roll-out the new Universal Credit system which merges six existing benefits/credits paid across DWP and HMRC. It is designed to make work pay and to smooth the transition between being out of work and in work by responding dynamically to the changing circumstances of those in need of support. Such a system depends on a constant supply of automatic and reliable data and the payments system has already shown it can supply that through the Bacs leg of HMRC’s existing RTI system. However we need a more generic and reliable solution than is currently on offer and richer data functionality offers this.

Universal Credit is already being rolled out nationally and full operation is expected to a 2017 timetable. We are, as stated, making progress with the banks in collaborating to develop the design of the richer data functionality to such a timetable. With a cross-Whitehall approach we are also ensuring that this does not turn into a DWP-only solution, but that HMRC, HMT, BIS and Cabinet Office are involved as well as a number of other interested and innovative stakeholders. The PSR will, of course, want to be and be seen to be independent of government, but in doing so it will need to consider the needs of government as the largest user of the payments system and those of its citizens and businesses as consumers of both payments and government services.

The millions of pensioners and claimants taxpayers and businesses whose are often affected by the cost of “red-tape” and regulation can all benefit from this reasonable, incremental and relatively non-risky proposition and can so benefit soon. We have the attention and co-operation of the payments industry and real change is in prospect to the required timetable. We must not lose that momentum.

To summarise the DWP position

a) the starting point for any strategy for the payment system needs to be based on clearly identified beneficial outcomes for end-users
b) innovation and competition are means to those ends, not ends in themselves and can be achieved without (necessarily) requiring wholesale change to existing ownership and fiduciary arrangements
c) the work already going on with the industry and Payments Council (e.g. through Government Co-ordination Committee and the payments Roadmap) provides a foundation for a strategy that could underpin the work of the PSR in its early stages.

Introduction

This document is Earthport's response to the Questions posed by the FCA in its document 'Payment Systems Regulation - Call for Inputs' of 5 March 2014.

About Earthport

Earthport is a global financial services organisation specialising in cross-border payments. Founded in 1997 and traded on the London Stock Exchange (AIM EPO), Earthport is regulated in the United Kingdom by the Financial Conduct Authority (FCA) under the Payment Service Regulations 2009 for the provision of payment services (Registration number: 537580); and by the Prudential Regulatory Authority (PRA); and supervised by the FCA for both conduct and prudency.

Earthport is also registered with Her Majesty's Revenue and Customs (HMRC) as a 'Money Services Business', (registration number: 12161856).

Earthport is also a member of and participant in SWIFT as a Supervised Financial Institution (SUPE).

Earthport's Clients

Earthport's clients are based in the UK, continental Europe, North America, the Middle East and Asia.

Office Locations

Earthport is a UK PLC based in London with a regional office in New York.

Earthport key differentiators

Earthport provides payments services to banks and others. Its business model operates through accounts held with multiple banks around the world. It executes a cross-border payment as a linked two-stage process in which funds are received into Earthport across a domestic payments scheme in the sender's country; the corresponding payment is made from Earthport's account in the beneficiary's country, across the domestic scheme there. The resulting service is:

- efficient (STP rates above 99%)
- transparent (fees and charges are known by sender ahead of sending)
- predictable (timing and amount of funds due to beneficiary are known)

and is thus significantly differentiated from the service most banks have traditionally used, and particularly well suited to low value (values which process within the value limits of national domestic payments schemes such as Faster Payments).

Earthport's customers are largely regulated entities including:

- banks clients include Bank of America Merrill Lynch, American Express, PNC Bank
- remittance service providers - clients include Western Union, Xoom, Azimo

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We fully appreciate the need for and benefit of payments schemes being designated. However, in general we believe that designation should be avoided where possible, as it raises barriers to entry.

Our experience with Faster Payments is that it was designated only after we enquired as to the process for applying for direct participation, as we had just become entitled to by the PSD. The effect of designation was to increase the barrier to entry (cost of technology, and lack of choice between providers of that technology) to a level that was untenable for us, and probably for any API (which by definition will be smaller than a bank, as the scope of their business is limited by regulation).

We currently access Faster Payments as an indirect participant, which means our transactional prices are higher, and the service levels lower, than those which are offered by direct members to their direct customers. Though we appreciate that costs must be spread in some equitable manner, the effect is to inhibit competitiveness, which was one of the aims of the PSD, since smaller firms cannot provide a functional service level to their customers which is comparable with the service level a direct participant offers to its customers.

We recommend that, when schemes become designated, consideration be given to the rights of access, and cost of gaining access, by regulated non-banks.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Competition largely works well for direct customers of member banks but it breaks down at the boundaries, in areas where banks choose not to offer services; such as remote communities and ethnic communities.

For example:

Over recent months banks have withdrawn accounts from many APIs (FCA-Authorised Payments Institutions). Whilst undoubtedly individual banks have the right to make such decisions, if market or regulatory forces act such that all banks withdraw services, those firms become financially excluded – despite having invested in technology and training to reduce their risk, and without any specific contraventions identified – and counter to the intention of the PSD (EC Payments Services Directive), which was in substantial part to increase competition between providers and choice for users. The risk appetite of all the larger UK banks to facilitate international transactions is significantly impacted by their extraterritorial exposures, namely the prospect of additional penalties in the USA. Smaller UK direct members of the schemes are not geared up to offer access services to third parties. Indirect members cannot help, because they are dependent on the direct members.

The APIs employees jobs are at risk; and their clients are left with less and, in some cases, no choice. Correspondent banks need to adopt a more consistent and considered application of the risk-based approach (as recommended by FATF (AML/CTF measures and Financial Inclusion: FATF Guidance 2013) and the engagement required to ensure that it works in practice. At present meeting regulatory obligations for international transactions requires all participants in a transactional chain to cooperate, and some correspondents currently choose not to (remaining opaque about process, tools, policies, information sharing etc.) as such, the chain breaks down.

We recommend that the end-to-end model for any payments service, including each of clearing, settlement, and compliance in turn, be reviewed to ascertain whether there are any bottlenecks which might inhibit competition.

As the absence of transparency is inhibiting access to the payment system (a player can't meet terms that are opaque, or challenge unspecified 'failures' to meet such terms) we recommend that correspondents be obliged to provide appropriate transparency to other partners in the transactional chain, regarding their application of policy, practice and tools related to the risk-based approach.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Costs: the G8, of which the UK is a participant, has sought through its 5x5 initiative to reduce the fees charged to diasporas to send money home. Reducing fees has been shown to increase private sector funds going to developing countries by a sum comparable with the national aid budget. The UK has a number of regulated payments service providers (e.g. Earthport) whose pricepoint is substantially lower than the current approx. 9% fee charged to senders.

Quality: UK APIs (e.g. Earthport) offer transparency and predictability in international payments which today is rarely offered by banks; and which could serve to encourage import and export and the UK's position as a trading nation generally.

Innovation: There is considerable potential for benefits for retail and corporate-service-users in information flow. Consistently, including again at the International Payments Summit in London in April 2014, corporates requested flow of information to enable reconciliation of receivables against invoices. On other occasions corporates have requested a single view of payments services across all banks; a Moneysupermarket-like service.

Safety: APIs such as Earthport provide UK consumers and corporates with greater choice of service, delivered at or above bank-grade. Earthport is certified to ISO27001, and has passed the compliance and audit requirement of its Bank customers including Bank of America Merrill Lynch.

"I made a payment from Belgium to the UK the other day and it just goes into a black hole," said Wim Raymaekers, head of banking and treasury markets at financial messaging provider SWIFT. "You do not know exactly when the payment will be made. It is only when you receive your statement that you see that your bank deducted charges, the other bank deducted charges, and you know how long it took."

http://www.gtnews.com/Articles/2014/Clear_Potential_for_Global_Payments.html

We recommend the PSR should require all PSPs to inform customers of fees, FX margin, and outcome for all international payments (i.e. transparency).

We recommend the PSR should inform the market of the full range of regulated financial service providers, and services.

Question 4: What are the main factors impeding more effective competition at each level?

Banks act as 'gatekeepers' to access to the financial system, including the payments schemes. A bank account and access to payments systems is as critical for a small innovator as is investment and working capital. If the established banks decline to provide a bank account, competition is impossible.

Established businesses such as banks tend to innovate for their current customers; studies have shown that innovators can disrupt (with positive consequences) such models; but in a multi-sided dependent system as payments is, for which they need fair access.

'Their customers were pulling them along a trajectory of 22% capacity growth in a 14 inch platform that would ultimately prove fatal'.

'The problem established firms seem unable to confront successfully is that of downward vision and mobility'.

The Innovators' Dilemma, Clay Christensen

We recommend the PSR should require incumbent banks to make banking services available to innovators and new entrants.

Government: In our experience, government procurements for payments services sometimes have restrictions (e.g. bid bonds). We can see no material reason why such restrictions are necessary. APIs are by definition smaller than banks (as they are restricted in the services offered); their scale results in their being unreasonably precluded from bids, which in turn may result in taxpayers being forced to pay for substandard services.

We recommend the PSR should require Government departments to open procurement to all regulated providers as a matter of course.

APIs and other regulated non-bank providers. Our experience has been that it has been difficult to engage at policy level with the Payments Council. The cost of membership is high relative to the size of an API, and is higher than other comparable organisations.

We recommend the PSR should facilitate consultation across all stakeholders, including corporates.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Without doubt the management of schemes, and to a large extent policy, should be done collaboratively. Furthermore the UK has an admirable track record of building, maintaining and operating the clearings. We urge the regulator to continue to place experts (i.e. bankers) at the heart of scheme management.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

The current structure favours the organisations which fund and manage the schemes, and the Payments Council. The mandate should encompass and provide fair access to all stakeholders, including APIs.

The current structure is also focused on £ schemes; the UK is both a global trading nation and a centre of competence for provision of financial systems and technology.

We recommend the new Regulator's mandate have a global perspective, especially around the innovation and growth elements to its purpose

The current structure tends to focus on existing schemes and infrastructure, which may inhibit future potential.

We recommend the PSR should have a 'future-oriented vision'; perhaps the Lisbon Agenda could be adapted 'to make the UK the most efficient e-economy in the world'.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternative model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternative ownership models.

PSR might consider a new industry utility which would act as an entry point for appropriate regulated entities (credit unions, APIs, agency banks, challenger banks), giving them access on equal functional terms (timing of transactions etc.) and reachability as direct members. This is a proven model, for example Eurogiro which provides a service to Postbanks, and ASL in Australia. Such a service would not be inhibited by exposure to US markets (which affects the risk appetite of the main clearers) and would thus enable smaller players in the UK to access the clearings without incurring the 'risk overhead' under which the main clearers are currently operating. Cost of establishing and operating such model to be determined and thus options for its funding need to be defined.

We recommend the PSR give consideration to the establishment of a 'payments schemes access utility' if other remedies cannot be found.

Question 8: Do you have any concerns about the current governance of UK payment systems?

There are concerns regarding potential for overlap by the PSR with other bodies; as an API we currently operate under FCA, PRA, HMRC. There is already inconsistency and duplication between the reporting requirements of some of these, for example regarding 'fit and proper' executives. It would be helpful if the PRA might establish a clear definition of scope, roles responsibilities with respect to each of these other agencies.

We recommend that that clarity of purpose supersedes definition unless the definition of a PSR is much more cleverly defined.

The definition of a 'payment system' in the FCA briefing document is a set of rules designed to enable transfers of funds. It is not clear whether that definition includes availability of accounts; absent an account, access to the payments schemes is pointless. It is also essential that participants be 'reachable'; for example, credit unions have concerns regarding obtaining sort codes.

stakeholders; SMEs, corporates, credit unions, building societies, APIs and more may each have substantially different and changing needs from the payments systems. Current governance models are bank-centric, and sender (rather than beneficiary) centric. Open consultation with all such groups is important.

International scope: Governance has historically focused on UK domestic schemes. We think the role of the new regulator should expand to encompass and encourage international trade. Rather than identifying issues and barriers, we see an opportunity for the Regulator to inform and encourage. It might consider adopting, as one of its missions, making the UK the most efficient e-economy in the world.

Though international transactions are a very small percentage of total transactions by volume, they are disproportionately valuable economically. The UK has a unique position in international financial services and trade; yet the Payments Council's mandate has been domestic-only. For example, the Payments Council does not gather and publish statistics on international transactions.

We recommend that the PSR should gather and publish statistics on international transactions.

Seek forgiveness not permission, or 'safe harbour'. Since technology develops ahead of regulation, innovations based on new technology frequently occur in an unregulated space. For example, the very successful MPesa in Kenya is a largely UK-driven innovation, with involvement from DFID, Vodafone and Consult Hyperion, which developed in a relatively unregulated space.

Frequently, potential investors and innovators in the UK are inhibited from innovating because of uncertainty. Though that is the case in all industries, it is especially so in payments; rules are often indeterminate, and embodied in documents which are incomprehensible to all but the most expert. Penalties for transgressing an oft-unclear rule are extremely serious.

The ultimate test is surely, would an established or startup firm, having decided to invest in innovation in payments, choose to do that in the UK, or elsewhere? Inhibitors and incentives to do which need to be clearly understood, and those which are unintentional or undesirable, eliminated.

We recommend that the PSR should identify ways in which innovators are not unfairly inhibited; for example, perhaps through setting parameters and guidelines within which a business operation is permitted ahead of and prior to formal regulation.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

The management and operation of the payments systems has been done well and safely for many years, by experienced bankers; that should continue. The model should be broadened though to encompass all stakeholders more directly; and to encompass a global element, as outlined above.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Earthport accesses UK payments systems indirectly, through relationships with direct members. We would be able to offer our customers a better service level if we had direct access; our systems, security and compliance functions are to bank grade. We are certified to ISO27001, and have been subject to and passed the extensive compliance and due diligence checks of our client banks including Bank of America Merrill Lynch. However the cost of access is prohibitive for a firm of our scale.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

We appreciate that costs must be apportioned in a fair manner. However it is unclear what the real costs are, and the methodology for apportionment. It is not therefore possible to answer this question.

We recommend that the PSR should require transparency in the operational and access costs of the payments schemes

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes; for example the speed at which we are able to settle a £ transaction via Faster Payments is much slower than a direct member can achieve.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

We have limited choice in access, predominantly because most UK banks have elected not to support our business model; for example HSBC closed all our accounts held with them, despite an excellent and longstanding commercial relationship and no breach of operating nor compliance rules on our part. We were, like many other regulated payments service providers, left with a choice of 1.

Direct participation in the clearing systems requires a settlement account; if the member banks won't provide such an account, direct access to the clearings is of no value.

We recommend the PSR should ensure fair and open right of access to bank accounts for regulated PSPs.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

Earthport provides access to UK clearings for a range of FIs and other regulated entities, based in various countries; including BAML, PNC, IBM, remittance service providers including Western Union, Azimo, Xoom and others. Further detail of Earthport's clients is shown on our website.

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

We provide access to regulate third parties which pass our compliance and commercial requirements
We are aware of the potential for systemic risk; however the aggregate values transacted by Earthport are not yet at a level at which there is cause for concern.

• Are there any barriers to becoming a sponsoring bank?

We lack detail on the costs and obligations regarding direct access to the schemes.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Please see response to Q7

Question 16: Do you have any other comments regarding access?

No

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

We fully recognise the economically critical nature of the UK's payments systems and that the fundamentals of reliability, resilience and security are paramount. We do, however, believe that regulated non-bank providers are willing and able to operate to the necessarily high standards – for example Earthport is certified to ISO27001 and has passed the exacting compliance and due diligence checks of its client banks, including Bank of America Merrill Lynch. Indeed, new entrants may well use more modern technology which, if designed correctly, may provide higher levels of security and resilience than the systems operated by some banks.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

The adoption of ISO20022 would provide a welcome platform for innovation especially in interbank communication and services. However, it should not be the sole focus; payments innovators at the International Payments Summit in London in April 2014 are using tools such as REST and JSONin preference to SOAP and XML. Standards, like regulation, often follow rather than precede innovation; their adoption should not act in such a way as to stifle it.

The SWIFT message standards are old and have limitations around the amount of reference data that they can carry. "They are fit for purpose if you are just looking for balance information, but if you really want to get into automation, reconciliation and all the other additional value from financial messaging, in my view the MT standards have had their day," concluded the banker.
http://www.gtnews.com/Features/Blogs/Financial_Messaging_Challenges_and_Opportunities_for_Corporates.html

Standards are often slow to implement, and slower than innovation. The original trigger for SEPA was around inconsistent and unpredictable p2p transfers within the EC – arguably, that requirement could be met well ahead of the SEPA end-date via new technology (smartphones) in conjunction with non-bank providers (Paypal, Earthport). SEPA has also delivered well below expectations; corporates have seen little if any material benefit.

We recommend the PSR should require clarity in the purpose and business benefit of standards adoption, and regularly review these throughout the adoption in the light of new innovations

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

See response to Q7. Earthport would be delighted to be invited to bid to provide appropriate parts of such a service; such as on-us transactions within the member community, and cross-border transactions.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

No comment

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Access to bank accounts; access to schemes; engagement with policy-makers; as covered in responses to previous questions.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Please see response to Q8 and Q18.

Regulation is typically perceived to mean control, restraint. We recommend the PSR should counter that perception by having a clear vision statement which might echo that of the Lisbon Agenda – 'Make the UK the most efficient e-economy in the world'. Such a framework would attract and encourage innovation in financial services (of which payments is a necessary but in some ways relatively unimportant component) whilst encompassing safety, security, resilience, and rights of all stakeholders.

We recommend the PSR should have a clear vision statement –

'Make the UK the most efficient e-economy in the world'

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

There are benefits to both approaches.
Innovation is possible within existing schemes, at the collaborative level. However, per the Innovators Dilemma, such innovation tends to improve, preserve, and extend existing models.
Innovation can also occur competitively, or in consorcia with different characteristics; occasionally, such innovation may disrupt the incumbent model and deliver quantum improvements.

Question 24: Do you have any other comments or concerns you would like to highlight?

We would welcome the Regulator's views and assistance on 'SEPA OLOs'. A SEPA OLO (one leg out) is a transaction in which one party – the sender or beneficiary – is outside the Eurozone, and the other within it. There are variants depending on whether the non-Euro party is in the EC, EEA or International. Earthport's business model, approved by the FCA, operates across this boundary-line.

Question 25: What, if any, are the significant benefits you see regulation bringing?

In Earthport's experience, the Payments Services Regulations have acted to legitimise an established innovative small business, which in turn has helped us grow.

When deftly written and appropriately implemented, regulations provide a commonly understood standard which can result in a level playing field for all participants as well as providing assurance to consumers/users

The threat of regulation has successfully catalysed action which in turn has taken risk out of the financial system, through education and encouragement rather than laws and penalties. The Allsopp Report, authored by an executive at the Bank of England, was the precursor to the globally successful CLS Bank.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Risks include

- Duplicated rules and reporting, or confusion between rules of different regulatory bodies (competitive regulators – seeking to secure their own continuance, may act against the interests of an industry/consumers).
- Unintentionally inhibiting innovation; risk-averse regulated entities may exclude riskier innovators
- A temporary but nonetheless significant planning blight
- Reducing competition. The CSFB in the USA incorporated impracticable requirements into the first iteration of DFS1073, resulting in some banks exiting the market for person-to-person payments, thus reducing competition; and causing costs and delays which could have been avoided through better prior industry consultation.
- Regulators (e.g. HMRC for the MLR 2007) adopting an audit approach without sharing the standards against which they are auditing, or providing any published opinion which undermines the supervision regime in the eyes of some foreign (US) banking providers.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

We may be 'caught' by a definition not really designed to manage risks related to businesses like ours (e.g. the banking reform act definition that is referred to in the paper. This could mean that we end up obligated to comply with a third supervisors expectations (FCA, HMRC and another) and that because they were not really designed for our business model, compliance won't actually reduce risk anywhere, but the existence of the definition will raise the risk of punitive actions for non-compliance for us. This is the worst outcome of all, no real risk, so no real risk management, but the development of regulatory risk for us, and the associated burden of cost of implementation etc.
But done right, the potential is enormous:

"The future of the payments industry is an intriguing subject and as I am from a different industry, I'm still trying to get my head around in which direction this is heading. I kind of have the feeling that the payments industry is some kind of forgotten, isolated island, not yet over taken over by the IT storm that has been blowing the last decade with its new concepts and business models."
[private note; a non-UK participant at a recent conference]

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Because there’s a better way.

Payment Systems Regulation

Call for Inputs

Edgar, Dunn & Company Response

Edgar, Dunn & Company
Management Consultants

Contents

1 Payment Services Regulation – Call for Inputs

Basic Information	
Consultation title:	Payment Services Regulation
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Nature of organisation	
Other Please specify:	Management Consultancy focused on the payments industry

Confidentiality	**YES**	**NO**
Do you wish any part of your response to remain confidential?		X

2 Executive Summary

Payment systems form a vital part of the UK economy. The HM Treasury and the Office of Fair Trading have found that the UK payments industry has a number of issues including a lack of competition, difficulty in gaining access to the incumbent ecosystem and the governance and ownership of the incumbent players. Both the HMT and OFT also noted that innovation in the payments ecosystem has been very limited.

Similarly, EDC has found that innovation and competition in the payments industry has been limited. The issuance of open loop payment cards and acceptance of card products, for example, has traditionally been available to direct and indirect members of the card payment networks. New entrants have found it difficult to access the payment systems to establish new products. Although, this has been partially alleviated as a result of the implementation EMD (1 and 2) and the PSD. The new payment categories, namely, authorised Payment Institutions and authorised e-money Institutions, have opened the market to new entrants. As a result, some innovation in the market, yet limited, has been seen.

A lack of competition across the main high-street UK banks and members of the card networks has been observed. They operate within an exclusive network, albeit, open in that it allows consumers to use their card payment products across a variety of channels and across geographic borders with relative ease. This has led to an environment where there has been very little economic incentive to be a new participant or develop a new payment method that is able to compete with the incumbent players. This is commonly found in other markets that operate similar card networks.

EDC believes that true competition in the UK payments industry is likely to come from outside players, such as from the technology providers, mobile networks, start-ups or merchants. Recently EDC has found there has been significant venture capital invested into mobile payments and solutions that focus on improving the traditional point-of-sale (POS) terminals in brick and mortar stores. An outside player will be a company that does not have any of the legacy payments infrastructure or regulatory history (or even scheme membership). They will be able to offer a payment instrument and a means for businesses to accept it in a frictionless way – allowing for consumers and businesses to interact in a seamless manner. A new payment solution will be futuristic and as easy to use as cash without the inherent challenges of the cost of cash handling and issuance. A new payment ecosystem will be able to bring incremental value add services to both consumers and businesses.

EDC believes that a UK regulator has the ability to promote the interests of current and future users of existing payment systems and new, yet to be created, payment systems. The regulator's priority should aim to promote competition and innovation in the payments environment through independent regulation and licencing.

3 Introduction to Edgar, Dunn & Company (EDC)

Edgar, Dunn & Company (EDC) is an independent global financial services and payments consultancy. Founded in 1978, the firm is widely recognised as the world's preeminent expert in the payments industry.

EDC assists organisations in developing and implementing strategies and capitalising on the opportunities change provides within the financial services industry. EDC projects include strategy development, new product development, market entry strategies, cost-based analysis and benchmarking, end-to-end operational reviews, customer and product segmentation evaluations and organisational and operational improvement. EDC is particularly successful in developing as well as implementing practical yet innovative solutions in the payments industry.

EDC is currently engaged with a number of clients who are paying very close attention to the evolution and development of the Payment Service Regulations in the UK. EDC is a founding member of the Prepaid International Forum (PIF) whose members are taking an active role in the consultation and interpretation of the PSD2 and EMD2.

EDC clients include:

- Payment system operators
- Infrastructure providers
- Payment service providers

In referring to the payments industry, EDC refer collectively to any, or all of, the stakeholders and participants within the UK payment systems. Therefore, EDC is in a position to reflect the concerns of the UK payments industry and are happy to assist in the approach and design of the regulatory approach.

4 Use of examples in this response

Throughout this response, there are a number of example organisations, each following a variety of business models. It should be noted that these are used for illustration purposes only and it should not be assumed they are or have been EDC clients. The views and the planning for the payment services regulations by EDC clients are bound by confidentiality agreements and EDC will not infringe these in order to provide the following answers in this call for input. However, the following responses are representative of a number of clients who have expressed an opinion or are interested in how the UK plans to regulate its payments industry.

5 Payment Systems in the UK

Question 1: *Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed, please explain why.*

The illustration in Figure 1 of the FCA Call for Inputs document (March 2014) is a comprehensive representation of the UK payments industry. According to CB insights, payments technology companies raised $1.2 Billion Across 193 Venture Capital Deals in 2013. This is a five-year high. EDC has found that much of the investment focus has been in and around mobile payments and solutions that focus on improving the traditional point-of-sale (POS) terminals in brick and mortar stores. These would typically be categorised as "other payment providers" or "third-party service providers" within the payments industry as illustrated by Figure 1 in the FCA Call for Inputs document. Therefore, EDC believes that some of these may be considered as small or propriety payment solutions (e.g. closed loop); however, they will be touching (i.e. processing) consumer, business or government funds and should be designated for regulation. There should be a level regulatory playing field for new entrants into the payments industry and existing players ensuring an even regulatory regime for all players. The aim will be to ensure the appropriate protection of the processing of funds. Furthermore, to ensure there is innovation and regulation will not stifle new entrants then there ought to be differing levels of regulation. As to how this could be exactly achieved is described in later questions.

6 Competition in payment systems

Question 2: *Where do you believe competition is effective or ineffective within UK payment systems?*

EDC has found that in certain elements of the payments industry competition is limited. The issuance of open loop payment cards and acceptance card payments, for example, it has traditionally been a very much a "closed shop" available to members (direct and indirect) of the card payment networks. New entrants have found it difficult to establish a new solution. This has been partially alleviated as a result of the implementation EMD (1 and 2) and the PSD. New payment categories, authorised Payment Institutions and authorised e-money Institutions, have opened the market to new entrants and some innovation, yet limited, has been seen in the last few years.

Where new entrants that could represent new competition in the payments industry EDC has found that they usually "piggy back" the existing payment infrastructure and therefore they are reliant on the incumbent players. EDC believes this has not really represented true innovation in the payments industry or gained any significant economies of scale.

EDC believes there is room in the UK for new competition in the payments industry. Businesses and consumers have been constrained to work with and use the traditional payment players (i.e. the card schemes, the issuing and acquiring banks). There has been an upsurge of alternative forms of payments in both the UK and Europe, such as e-wallets focused on the web, direct debit models and other forms of payments. Many of these (e.g. PayPal and Skrill) have worked in synergy of the existing traditional infrastructures. EDC is not aware of any new payment solutions that exist entirely outside the existing ecosystem (with the exception of niche virtual cryptology based solutions, such as Bitcoin) and has achieved the necessary scale of economies to reach a sustainable business model and compete against the existing brands.

EDC is aware of easy and inexpensive payment acceptance solutions, such as GoCardless, Stripe, Optimal Payments, Skrill and mPOS solutions, such as iZettle and Square that have either already launched in the UK and about to launch. Some of these solutions have certainly helped small to medium businesses to establish themselves either online and/or with a bricks and mortar operation. This has been encouraging in a sector where many of the larger acquiring banks have traditionally failed to serve start-up businesses or micro merchants. As a result of these developments in the market the traditional players, e.g. WorldPay and Barclays, have had to review their business models and start to serve the underserved businesses and micro merchants who would have not been able to accept the traditional electronic card payment methods.

WorldPay launched their mPOS product, called Zinc, in June 2013. Barclays has also launched their mPOS product, called Barclaycard Anywhere, in February 2014. Both products are targeting small to medium enterprises. By helping SMEs to accept secure, on-the-spot payments is expected to improve their cash flow, grow their business and encourage growth in the economy. However, these examples from two of the incumbent high-street banks are late in the history of the industry.

Outside the UK there are two examples of third party payment services providers that have introduced cost effective solutions and therefore, have already proven capability to represent a meaningful competition for the internationally branded payment card schemes. These are:

- Sofortüberweisung (Sofort) in Germany
- iDeal in Netherlands

Sofortüberweisung (Sofort), which means 'instant payment', is based in Germany but is currently available in 11 European countries. Sofort integrates its services into the merchant's website as a payment option. When a customer arrives at checkout page they are presented with the option to pay via the Sofort link as well as other conventional online payment options. Customers do not need to be pre-registered with Sofort to use this service. Customers are asked to select their bank and enter their online banking details, including their PIN (personal identification number) and TAN (transaction authorisation number). Sofort accesses the customer's bank account to check availability of funds and initiates a payment for the purchase directly from the customer´s bank account to the merchant's bank account. Sofort acts as a middleman and provides a real time confirmation to the merchant, who then completes the order (e.g. shipment). Sofort does not store the payer's login credentials.

iDeal was established in 2005 in association with the Dutch banks. iDeal is integrated into a merchant's online checkout page, similar to Sofort and provides an iDeal link on their website. If the consumer selects this payment option they are redirected to their online banking site. The customer enters their account number and authorises the transaction using a two-factor authorisation method, typically a personal identification number (PIN) and a transaction authorisation number (TAN).

Both Sofort and iDeal can be seen as working examples where the existing payments systems allows a broader access to the established systems by new providers. See question 5 for more on collaborative solutions.

One area where EDC has found a lack of price pressure and therefore limited competition is in the remittances sector of the payments industry. In some areas of the remittance business AML, KYC and other regulatory burdens, including some risk-averse partner banks, have been anti-competitive, thus, discouraging the entry of new players with new propositions in the remittances business. This has meant that the traditional cash over the counter agency businesses (e.g. MoneyGram and Western Union) has retained their high margin market share. This has meant the consumer fees for sending money home have remained relatively high. This cannot be good for migrate workers and specific diaspora who want to send money home.

Question 3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*

EDC believes that true competition in the payments industry will come from outside players. Outside players will not have any of the legacy payments infrastructure or regulatory history (or even scheme membership). They will be able to offer a payment instrument and a means for businesses to accept it in a frictionless way – allowing for consumers and businesses to interact in a seamless manner. A new payment solution in the future will be something that consumers and merchants cannot comprehend today. It will be futuristic and as easy as cash without the inherent challenges of the cost of cash handling and issuance. A new payment ecosystem will be able to bring incremental value add services to both consumers and businesses. It will be cost effective, highly secure and innovative. It will not be leveraging existing payment infrastructures such as Vocalink or, for example, the Faster Payments Service. It will be entirely outside these existing legacy solutions. It will be able to gain rapid economies of scale through internet based technologies and leverage the network of connected and interrelated consumers and merchants. It is highly likely to be on a smartphone for the consumer.

The potential for competition from an outside player must be able to drive benefits for service-users (i.e. the consumers), in terms of costs, quality or innovation. Security and trust will coexist and will be the fundamental cornerstones of any new payments ecosystem. Facebook, Apple, Google, and others are all potential entrants into the payments landscape and they each possess capability to create a technology that will be both sustainable and competitive.

The potential for competition at different levels is dictated according to the relationship with the existing payments infrastructure – this can be summarised in the following table:

Level of integration with existing (i.e. traditional) payments infrastructure	Barriers of entry	Status of this type of business model	Relative level of competition
Inside – i.e. an existing Financial Institution as a scheme member	High	Established/mature	Limited
Integrated – i.e. working in partnership with a scheme member bank	Medium to High	Emerging/developing	Limited
Outside – i.e. working separately to the existing providers	High	Rare	Nascent

Table 1.0

Question 4: *What are the main factors impeding more effective competition at each level?*

There are many factors that will impact effective competition. They will all typically impact the economic business case. The business proposition in question and the level of integration with the existing payments infrastructure largely determines this – whether they are "inside", "integrated" or "outside" the existing payments infrastructure, as illustrated in Table 1.0 above.

Any competitor in the payments landscape that relies on or has a solution that must work in conjunction with the existing ecosystem will find barriers to entry either in terms of technological integration, certification and/or the commercial management. This will in turn lead to a business case that will not be economically viable. To decrease these barriers to entry by new entrants it will require an economically efficient access to the existing infrastructures. Two examples, of which there are many other examples, include PayPal and GoCardless who have achieved access to the existing payment infrastructures – PayPal has leveraged the card network ecosystem whereas GoCardLess has leveraged the direct debit scheme.

Money remittances through an e-wallet solution, such as Skrill, is low-cost and in some cases a zero cost for consumers to perform an e-wallet to e-wallet account transfer. However, where consumer fees can be prohibitive is where funds need to withdrawn from the e-wallet scheme through an agency, bank branch or ATM network. Likewise, funding the e-wallet can equally incur relatively high fees because of the third party banks and networks involved in the process.

This is the main factor impeding competition where the incumbent players are acting as gatekeepers to their systems and payment networks. This is where the economic business case proves to be challenging for new players.

Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

Where a payment solution involves a push-or-pull payment system as seen in the Sofort, GoCardless and iDeal examples above, there will be the need for the "old" legacy ACH infrastructure to be working in collaboration with the "new" and innovative third party providers. This is an example of where the old and the new can work together and this has been achieved and proven to be valuable to both consumers and businesses.

EDC believes that the scope of collaboration seen today is limited to specific circumstances. GoCardless, for example, which operates as a small Payment Institution in conjunction with Royal Bank of Scotland. This is an example where the regulations are clear, as such collaboration exists and there is transparency in the current PSD regime. This has only allowed, EDC believes, limited competition. This has not been the most effective manner in which to deliver innovative and far-reaching changes in the payments sector.

Technology is driving change in how merchants and businesses are dealing with consumers. This is seen today in the nature that consumers interact and deal with merchants across a variety of channels, from point of sale, the web, mobile devices, social media and in-store devices (such as kiosks, tablets, interactive touch screens and Bluetooth Low Energy beacons). This is also rapidly driving change in payments and commerce. The current UK payments regulator is not ready for this increasingly digitalised and virtual relationship that consumers and businesses are developing.

Interestingly, the European Commission's second draft of the Payment Service Directive (PSD2), which, amongst other regulatory changes, provides for a new category of potential category in the payments market which will be referred to as "Third Party Providers" (TPPs). This change in the PSD is aimed at promoting innovation and low cost electronic payment solutions while ensuring that security and data protection are not compromised. TPPs offer services based on access to payment accounts provided by a Payment Service Provider (PSP) in the form of payment initiation services and/or account information services and will be subject to all PSD2 provisions applicable to Payment Institutions (PIs). Therefore, it is expected that such businesses are likely to be included as TPPs in the new draft PSD2 regulations - although the scope of the services to be included is yet to be determined. Services provided by "third party payment service providers" (or TPPs) will only be involve in interfacing with a payment account; whereas providing or maintaining a payment account is the role of an "account servicing payment service provider" (ASP or the bank). TPPs will be considered medium risk for initial capital purposes (expected to be €50,000), although they are neither operating a payment account nor handling funds. They are also subject to the full weight of the information and contractual requirements, and the obligation to contribute to losses arising from the parts of the transaction that are under their control. This appears to be a step in the right direction and potentially a workable solution for the promotion of a healthy collaborative competition.

There are a number of other companies that work in a similar manner to Sofort (mentioned above), offering payment initiation services, bill payment services, P2P money transfer services, etc. However, there has been some criticism from the established banks, for example, Giropay (in Germany) filed a lawsuit against Sofort in 2010 arguing unfair competition and misuse of customer credentials. EDC expects that new entrants using an integrated approach with the existing infrastructure will continue to grow. The PSD2 is only expected to encourage this collaborative innovation. Further technology change in how merchants and consumers interact in a digitised environment will be expected for both payment and non-payment interactions, such as loyalty, gifting, promotional vouchers and couponing.

The different use-case scenarios expected in the future of commerce are too numerous and some are yet to be defined. To identify all the potential functions that need to be performed collaboratively in the payments industry is impossible. What is required is a regulatory framework that allows new entrants the necessary access to the existing "legacy" payments infrastructure yet encourages invocation in both payment and non-payment interactions that consumers and businesses are expected to perform in the future.

7 Ownership

Question 6: *Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.*

The ownership of the infrastructure such as Vocalink and Faster Payments System are the banks and the banks are members/stakeholders of the major internationally branded card networks. This close ownership and relationship between all parties within the value chain has not been an incentive to promote or allow for significant investment in new systems, new solutions or alternative solutions. Consumers and businesses have high expectations and the developments from around the world have demonstrated that the application of new technologies, such as mobile payments, has been well received.

However, the necessary IT costs to issue internationally branded card payment products and/or accept them across a broad merchant community is extremely high. The IT systems required must be able to provide a very high degree of business continuity. Every single point of failure has to be duplicated and alternative arrangements must be in place to allow for real-time handling of transactions across the network. No room for failure is allowed. The availability of these payment-processing systems must be high, and are typically available 99.999% of the time, 24 hours a day, 365 days a year. Similarly, the card networks that link the card issuing banks and the merchant acquiring banks must equally provide business continuity. Collectively, and on a bank-by-bank basis, payment card processing is a very resource intensive operation. This has meant that the investment in innovative payment solutions, by the existing players, has been very limited. Barclays, one of the more innovative UK based banks, would argue that they have brought payment innovation with the launch of the person-to-person payment service called Pingit. It ought to be noted that Pingit is outside the internationally branded card payment schemes and leverages the Faster Payments Service from Vocalink. It is not expected to be challenging the internationally branded card payment ecosystem that exists today. Pingit is only UK based and has a limited consumer-to-business proposition.

It is not necessarily the current ownership of the payments landscape that creates the problem. It is the very nature of its membership and its 50 to 60 year old history that has seen very little technological innovation in the period since its birth in the 1950s. It has simply not evolved significantly. The plastic card is not really designed for the online environment and it is not really designed for the smartphone environment. However, consumers are familiar with the plastic card and they are not likely to move en masse to a smartphone payment solution or any other, yet to be invented, payment solution. Consumers are slow to change and they are creatures of habit (see question 26 below for further input on this topic).

The lack of investment in the card payment networks has been recently highlighted by the inertia experienced by the banks not updating their ATM networks from the old Microsoft XP software. Five of the UK's largest banks together with a number independent ATM operators that must pay Microsoft to continue updating Windows XP after the company suspends support for the aging operating system.

The OFT made the observation that the level of fixed costs and economies of scale may seem to permit competition between rival payment systems in principle, the combination of network effects and the ownership structure of payment systems mean that in practice, competition has not developed. EDC would agree with this observation of the UK payments industry because of various circumstances and constraints described above.

Visa's e-wallet, V.me, is another example of the technology complexities that exist in the card payment networks. The ability to integrate new technologies such as V.me and MasterCard's equivalent e-wallet, MasterPass, have been prone to launch delays and a reduced functionality on the launch day as a result of the integration of the new software with the old software.

In addition, EDC is aware of cross-subsidisation of issuing and acquiring bank operations, which has meant that gaining significant scale is the only way to allow for new competitors into the payments ecosystem. This has resulted in the main high-street retail banks and members of the card networks to operate within a "closed network", albeit, open in its transactional nature (i.e. it allows consumers to use their card payment products across a variety of channels and cross geographic borders with relative ease). This has meant that there is very little economic incentive to be a new participant or develop a new payment method that is able to compete.

Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.*

The main concern that EDC sees is the ability of new entrants to gain the appropriate scale of economies. Ownership is not a primary concern; trying to alter the current ownership could be disruptive to the status quo. The current ownership structure of the card payment networks, for example, is as a result of the historic development and forms part of the wider payments landscape in the UK market. The regulator ought to focus its attention on encouraging the development of new alternative payment solution models not change the current ownership structure. Alternative service providers that own new business payment models and that exist outside the current payments ownership structure will result in greater competition, innovation and investment in new technologies. New and alternative service providers should be regulated in the same way as the incumbent providers.

8 Governance

Question 8: *Do you have any concerns about the current governance of UK payment systems?*

EDC believes that innovation and competition in the payments ecosystem has been very slow. Some of these are described above. The launch of the Faster Payments Service was probably a decade too late and is indicative of the slow nature of creating innovation in the existing systems. Similarly, mobile payments have been slow to be endorsed by the stakeholders of the UK payments infrastructure and any collaborative development in the interests of UK consumers remains to be seen. Zapp, a mobile phone based payment product, from Vocalink, for example, has managed to sign-up the banks (i.e. the Vocalink owners) relatively easily. The challenge that Zapp will have is to provide a compelling proposition to the retailers to accept Zapp in-store. The future of mobile payments will not be reliant or determined based on the future of Zapp in the UK. Zapp's future, VocaLink believes, is related to the payment method being more secure than using a debit or credit card because none of the personal information about the customer is handed over to the merchant. If the consumer wants to pay online through a smartphone or tablet they can select "Zapp" as an option to pay; if they're online on a PC, they can download a Zapp icon, which will send a notification to their mobile device. There is also the option of paying for bills - as long as the company provides a QR code in the paperwork that can be scanned using the smartphone's camera. Much of these online solutions are not really innovative and many are already proven or already exist in the market today. Where true challenge will exist is where consumers wish to pay in a store using Zapp by tapping their phone on a near-field communication (NFC) terminal, scanning a QR code from a screen or by asking the retailer for a six-digit code. This will require investment by the retailers who may not support NFC or QR codes today at their point of sale locations.

EDC believes the bigger challenge for Zapp will be convincing consumers that mobile payments is a more convenient way to pay than cash or cards. Furthermore, the Payments Council's "Paym" service has the potential to offer consumers new ways to pay via their mobile phones. If the Paym and Zapp serve similar demographic segments with a similar service model then there is the potential for consumer confusion. This can lead to exclusion or deception of certain consumers segments. See the response to question 26 regarding the inertia that exists in changing customer payment habits.

The immediate concern that EDC has with the current governance of the UK payments systems is any possible alternative governance could be contrary to the European Commission regulations. The HMT stated in their "Opening up UK payments" paper published in March 2013 that "on good governance, licence holders will be required to maintain governance structures, according to guidance from the regulator, such that control of the company cannot be abused, either individually or collectively, in a way that is detrimental to end-users for instance by erecting unnecessary barriers to entry, or unfairly discriminating between users". EDC believes there is already appropriate legislation in place to ensure that there is proper governance is in place, particularly for public companies that are listed on the stock exchange – many of the existing owners (i.e. the banks) of the payment infrastructures are listed companies. The Competition Act 1998 and the Enterprise Act 2003 are just two examples of legislation that ought to be sufficient in providing the proper governance regime.

If the proposal were for a payment services regulator is to publish guidance on how it expects potential licence holders to demonstrate that they are complying with licence conditions, it could duplicate what the FCA is already doing for Authorised Payment Institutions and registered Small Payment Institutions (firms providing payment services) under the Payment Services Regulations 2009. The EMD2/PSD established an authorisation regime for non-bank payment service providers, such as money remitters and non-bank credit card issuers, and sets out conduct of business rules for all firms providing payment services, e-money issuers including banks and payment institutions. Similarly, the Financial Institutions who are issuing debit cards (linked to bank accounts) and credit cards are already regulated through the Financial Services & Markets Act 2000 (FSMA), and the Money Laundering Regulations 2007.

Additional licensing for the incumbent payment systems and card networks could be duplication of what exists today and secondly, it has the potential to be misaligned with the European Commission's intent with the PSD2.

Question 9: *What do you believe is the appropriate governance structure for UK payment systems?*

The current Payments Council membership is dominated by the banking industry and it is recognised that there is a lack of effective public accountability. It lacks independence and objectivity from the payments ecosystem that it is meant to be governing. The FCA has already established a competency in the registration and authorisation of new payment providers such as e-money Institutions and Payment Institutions under the EMD2 and PSD respectively. The FCA is independent and able to provide an objective view of the payments industry. Therefore, the Payments Strategy Board (PSB), as described by the HMT, could naturally be part of the FCA role. Self-regulation in the financial services industry has not proven to be the best regulation in the last decade. EDC believes the FCA is the appropriate home for the governance of the UK payments systems.

9 Access

Question 10: *How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.*

Within the UK, EDC would be considered as a small to medium enterprise. As a global management consultancy our current access to UK payment systems is only for the management of a business banking account and the payment of suppliers and employees and the receipt of funds for the provision of professional services to our clients.

As mentioned above EDC represents a number of stakeholders who participate within the UK payment industry. The concerns or constraints of our clients have in with regard to the UK payments systems are confidential. It would not be appropriate for EDC to describe them within this response to the call for inputs. However, our clients will make their own response to this consultation.

Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*

No comment.

Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*

Not applicable.

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

Not applicable.

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:*

To whom do you provide indirect access?

What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

Are there any barriers to becoming a sponsoring bank?

Not applicable.

Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*

Not applicable.

Question 16: *Do you have any other comments regarding access?*

Through client work EDC is aware that smaller firms or start-up businesses, that inevitably have lower transaction volumes, and wish to launch new payment services must access the payment systems via a larger financial institution. The process of access can be complex and direct or indirect membership information from the card networks is not always clear or even readily available. There are also differences between the different card networks. This can be daunting, economically prohibitive and make it difficult to assess the competitiveness of the card payments market. Access to the payments system is an area where transparency in the process requires further improvement.

10 Infrastructure

Question 17: *What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What* *considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?*

As described in the response to Question 6 above, the IT costs to issue payment cards, accept them at merchants and provide the network links between the issuing banks and the merchant acquiring banks is extremely high. The IT systems required must be able to provide a very high degree of business continuity. The system availability of payment-processing systems is typically available 99.999% of the time, 24 hours a day, 365 days a year. This has been seen to be a barrier to entry for new players; it has proven to be difficult to truly innovate because the business and technical model has largely been unchanged in the last 50 years.

EDC has been involved in developing a detailed cost and benefit assessment of both creating new payment propositions and developing payment products that must access the existing payments infrastructure. Obviously, most of this work is bound by client confidentiality; however, we are able to indicate that to create a new payment infrastructure can be as much as £20 million to £500 million depending on the size of the market it serves. This investment cost would include the issuance of payment instruments and the necessary payment acceptance network. To bring to market a new payment product that leverages the existing card payments network (such as an open loop prepaid payment card) it can be £2 million to £4 million investment. This would include the necessary IT issuing platform infrastructure and the regulatory requirements for initial funding. To build and launch a merchant acquiring business (which is compatible with the existing card networks) an investment of £10 million to £20 million would not be unusual.

Given the inherent costs associated with the incumbent payments ecosystems EDC would suggest that promoting the introduction of new players would be a preferred option. Creating an environment for new entrants to leverage new technologies and create a new and innovative payments solution should be possible. One way in which to introduce competition between payment cards and payment systems is to create an alternative to payment cards.

Non-bank payment businesses, for example, could offer banking services to consumers and businesses but they would be able to have easy access to the incumbent payments infrastructure. This would be similar to utility companies pulling funds from consumer accounts for their payment of their utility bills via the BACS Direct Debit scheme. This could be a simple route to smartphone-based payments as demonstrated by the Barclays Pingit person-to-person money transfer service.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*

EDC has seen that both the banks and corporate clients have been frustrated about the lack of end-to-end straight through processing (STP) for payments. EDIFACT, an international electronic data interchange standard, tried to deal with this problem but failed because it never was accepted as an international standard. The new standard eXtensible Markup Language (XML) and ISO 20022 has been very much part of the introduction of the Single Euro Payments Area (SEPA). There is already a ISO 20022 Cards and Related Retail Financial Services message standards which the industry can implement.

The proliferation of ISO 20022 XML schemas and usage guides for different payment schemes, both from the payment schemes themselves, and also from payments industry groups such as the EPC (the European Payments Council) is an encouraging sign that standards are being adopted.

However, self-regulation (e.g. SEPA) has been fraught with implementation delays. Independent regulation of the payments industry will find that forcing a messaging standard, such as ISO20022, will experience significant resistance from the incumbent players because of the enormous costs associated with upgrading their legacy systems.

Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*

A regulator could set a standard charge to allow for agency banks to participate in the UK payment systems. The existing infrastructure has its limitations (because of its age) and EDC is aware that an ACH (bank transfer network) and a card network are not always compatible. New payment methods must be mapped into existing transaction formats to allow them to be processed through the existing networks. This is expensive and prone to the lost of vital information along the value chain. EDC firmly believes that a new payments network is required to accommodate for a greater number of different payment methods. A new network should be able to accommodate for new payment methods of the future, some of which have not been invented. Therefore, a new payments infrastructure should be able to be flexible and not dictated by a specific payment instrument.

The OFT highlighted the importance that a payments regulator should set minimum terms of access and conditions, including the service levels. The PSD goes someway in achieving this and more could be achieved for the agency banks and corporates wishing to gain access to the existing payments infrastructure. The regulator should be able to review pricing where it believes this could be constraining competition.

11 Innovation

Question 20: *Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).*

There is very little or almost no incentive to innovate in the UK payments industry. That is a major concern for the industry and the UK economy as a whole. The fee arrangements for merchants for the acceptance of card products do vary significantly. This is due to the different payment products (e.g. credit vs. debit), different product branding, volume of transactions, the value of the transactions, the type of products the merchant sells and other factors such as where the card was issued relative to where the merchant is located.

Merchant pricing can be unbundled and transparent for the merchant to understand the different fees for different scenarios. Unfortunately, this is typically post-transaction rather than pre-transaction because no merchant has any clarity about where the cardholders are from and what cards they will use. For larger merchants, where the volume of transactions is high, the merchant fees are commonly "Interchange Plus". Interchange Plus Pricing is also referred to as Cost Plus, True Pricing or Pass Through pricing. The Interchange is the fee set by Visa and MasterCard but the "Plus" refers to a per-transaction fee charged by the merchant acquiring bank and the transaction processor. For smaller merchants pricing is commonly bundled whereby all of the fees (Card Associations, the "assessment" fees, card-issuing banks "Interchange" fees, and payment processors, the processing fees) are combined into a single rate that may include a percentage-of-sale fee, a fixed per-item fee, or a combination of both. The problem with this model is that it is virtually impossible to discern exactly what the merchant is paying, and to whom these payments are allocated.

EDC has found that when interchange has been regulated in a downward trajectory this has not been reflected by the merchant acquiring banks in their pricing to the merchants. This has been seen for all types of pricing – whether it is bundled, interchange plus, or unbundled. This lack of transparency in changes in pricing, especially in the favour of the merchant, is a concern. EDC feels that a regulator would find it difficult to ensure that changes in the interchange is appropriately reflected to all merchants. This could be a very onerous task. An alternative approach could be for merchants to report changes to their pricing arrangements or for the regulator to advertise changes to encourage merchants to contact their acquiring banks to update their pricing.

Question 21: *Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?*

The cost of access to the existing payment networks is commonly the one significant limiting factor to innovate. Non-banks and start-up businesses often underestimate the cost, the time and the complexity to engage with and build a relationship with the incumbent banks and owners of the payment networks. This can be very frustrating for non-banks wishing to be part of the payments ecosystem. EDC has heard that some non-banks are told that their business model is too risky or their operating practices do not comply with certain bank policies for risk management. These bank policies are not published or shared and they are like a "black box" which has not reason or logic in the methodology as to how the risk assessment is performed.

The payments regulator must be able to define what is considered to be non-discriminatory access to the existing payments ecosystem. All members of the ecosystem should be required to ensure that the payment systems can be accessed on a fair basis, and that any restrictions on access are transparent, justified and equal for all applicants.

Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*

Refer to the response for question 6 regarding ownership and the responses for questions 20 and 21 in relation to innovation. EDC has also observed that there has been a greater pace of innovation as a result of the entrepreneurial nature of technology-based start-ups (from both Europe and silicon valley) looking to introduce new payment solutions. The cost of technology has also fallen and the speed of software development that leverages internet technologies has shorten time to market. These factors have fuelled the development of new customer propositions and innovative business models. It is important that the UK regulator nurtures an environment that will see further innovation in the financial services sector.

Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*

It is absolutely essential for the co-ordination of collaborative projects, such as Faster Payments Service, which cut across the whole of the banking and payments sector. Implementing initiatives, which will impact all the stakeholders across the payments value chain, can be very expensive and slow to implement. There can only be benefits in creating an environment that will encourage improvements in the existing infrastructure. Unilateral innovation that may occur between two banks has only limited benefits and there has not been any evidence of this in the UK.

An external regulator that is independent of the payment stakeholders should be encouraged to coordinate and drive change in the payments industry.

12 Closing questions

Question 24: *Do you have any other comments or concerns you would like to highlight?*

EDC believes that a UK regulator has the ability to promote the interests of current and future users of payment systems for the existing payment infrastructure and new, yet to be created, payment systems. The regulator can promote competition and innovation in the payments environment through independent regulation and licencing.

The payments regulator, whether it is part of the FCA or independently organised, must have in-depth knowledge of the payments ecosystem. Building up that specialist knowledge can take a significant amount time and resources. This should not be underestimated.

Question 25: *What, if any, are the significant benefits you see regulation bringing?*

As mentioned in the response for question 17 and 20, the key benefits must be twofold; firstly, it should promote innovation and the creation of new payment products and services. Secondly, it must encourage the appropriate investment in the existing payments infrastructure to ensure it is stable, secure and future proof for the future needs of consumers and businesses.

Question 26: *What, if any, are the risks arising from regulation of payment systems?*

There are a number of risks that EDC believe could be present in the new regulation of the payments systems. These include:

- If price setting powers are part of the new payments regulator's remit, one area of concern is the risk that inter-bank fees are set and the benefit is not appropriately transposed into the end-user's pricing
- Should the cost of regulation be covered by licence fees to the players then they may pass on these extra costs onto the consumers and/or the merchants
- Regulation in the UK of the payments ecosystem could duplicate or overlap existing payments related regulation that the European Commission is driving, such as the PSD2
- If licensing will be one mechanism of payments regulation, then this could be over and above the existing licensing for credit institutions, payment institutions, money remitters and e-money institutions, etc. Again, there is the high risk of overlap with existing legislation
- The ability to create what is perceived to be a level playing field of regulation for the incumbent players and the new entrants is expected to be difficult to achieve. This is commonly observed by the existing banks saying the regulatory burden is so much lighter for e-money institutions, for example, compared to their own banking regulations
- Consumer inertia to change. This is not a direct risk to any new payments regulator but it can have an indirect impact on a regulator that aims to promote innovation and greater competition. Consumers are creatures of habit and their ability to adopt new payment methods can make or break a new proposition.

Cash, for example, has been used for thousands of years; in the UK it is used for more transactions than all other forms of payment combined; although the value of cash transactions is comparable to that of debit cards whereas value of credit/charge cards, direct debits and direct credits is significantly more than the value of cash[1]. Cash is unlikely to be replaced by electronic payment products. Plastic payment cards have been around for 50 to 60 years and very little has changed. Consumers are comfortable with their function and Chip & Pin at the POS in-store has been relatively successful in encouraging a safe payment method. On the other hand, contactless and mobile payments are only just launched and it will take a long time for consumers to migrate from cash or plastic cards to these new methods. Contactless payment cards for transactions for less than £20 are only just starting to show any traction amongst consumers and merchants. This is likely to erode the number of cash transactions in the UK. Its slow take up by consumers demonstrates the inherent problems that a new payment method will have in changing consumer behaviour.

Question 27: *How do you think regulation might affect your business and your participation in UK payment systems?*

Not applicable.

[1] Source: The UK Cards Association

Basic information	
Consultation title:	Payment Systems Regulation - Call for Inputs
Name of respondent:	Electronic Money Association
Contact at respondent:	Name: Thaer Sabri
	Email: thaer.sabri@e-ma.org
	Address: Electronic Money Association 5 The Crescent Surbiton Surrey, KT6 4BN

Nature of organisation (select as appropriate)	
Infrastructure provider	
Payment system operator	
Direct member of payment system (s)	
Indirect participant in payment system (s)	
Service - user	
Other payment provider	
Third – party service provider	
Trade / Government / Regulatory body	
Other Please specify:	Trade association - a list of members is provided in the Annex

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?		x
If 'Yes', please submit both confidential and non-confidential responses.		

Question 1: *Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.*

The systems that merit inclusion are those that represent established participants, with considerable market share of the UK payment transaction volume. These are more likely to give rise to issues relating to competition, innovation and user interests; in other words to issues pertaining to the objectives of the Payment Systems Regulator ("PSR").

It would be prudent to restrict the scope of designation whilst there is little evidence of an impact on these objectives, as intervening in the business model or business rules of new payment services may have an adverse impact of the same objectives.

Where a system is designated however, then services that are based on such systems should also be designated; an example is that of PayM being attached to Faster Payments.

It would be helpful if more detailed criteria for inclusion were to be published for discussion, and which could form the basis of objective evaluation.

Question 2: *Where do you believe competition is effective or ineffective within UK payment systems?*

The growth in emerging payment products has largely been driven by opportunities created by:

(i) New business needs, such as the growth in e-commerce. The Internet created numerous opportunities for payment and new providers were quick off the mark in offering solutions.

(ii) The ability to offer consumers and merchants greater convenience, such as products that are easier to use or that offer value added benefits. Some new acquiring products for example offer better merchant tools for reconciliation and stock management, while consumer products populate fields with user's address and payment details etc.

(iii) The creation of new technologies that have enabled payments to be embedded into different commercial propositions; an example is a payment facility embedded into a flight booking mobile application.

In order to facilitate wider competition however, access to products such as direct debits needs to be enabled, and this should be direct, not intermediated through agency banking. Our members experience of agency banks is universally poor.

Question 3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*

Competition has to date been at the level of products and payment service providers. This places emphasis on equal access to payment systems.

There have also been competition concerns that have arisen from payment scheme rules that obligated new payment providers to furnish data or impose obligations that were adverse to their business practices.

One example is the requirement for e-money issuers under some card scheme rules to furnish card acquirers with information about electronic money merchants whom they have contracted with. The card transaction relates to the purchase of e-money by consumers, and is unrelated to any subsequent use of the e-money by the users.

Wider access to payment systems at reasonable prices is key to enabling effective participation by new payment service providers.

Question 4: *What are the main factors impeding more effective competition at each level?*

Commercially viable access to payment schemes would enable more effective flow of funds from different financial institutions, to the benefit of the consumer. For example, the easier and more economic it is for users to fund their e-money products from other instruments, the greater the potential efficiencies of the e-money product, and the competition between different products in the market.

At a higher level, participation by the electronic money and new payment industry in the policy and strategic decision-making process would be welcome. This is currently based on transaction volume and consequently excludes all new entrants.

The main restriction on wider competition is access to payment systems at reasonable price points and directly without intermediation.

Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

There are common issues such as fighting fraud and governance. These should be collaborative, and are in the interests of users.

Similarly, strategic planning should also be collaborative and open to participation by representatives of all payment service providers, irrespective of market share.

There are opportunities in collaborating for interoperability, but this should not be mandated, but rather encouraged.

Question 6: *Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.*

The current ownership structure has given rise to a disincentive to innovation and a disincentive to provision of access,, as owners seek to protect their investment. As innovation usually requires the participation of all owners, the ability to agree on changes and to drive new products is restricted.

Access to the systems are prohibitively expensive and do not allow for commercial propositions to be offered by new payment service providers. Direct participation is often not available, and indirect participation is priced so as to make it unrealistic.

Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have* *identified and also highlight any potential concerns associated with such alternate ownership.*

Access to existing systems should be facilitated, and regulatory oversight of the process imposed. This will reduce the impact of the ownership structure.

Access should be on the basis of the provider having the requisite regulatory permission to offer the service, and not quasi-regulatory scheme based requirements.

Question 8: *Do you have any concerns about the current governance of UK payment systems?*

We have had a long-standing issue with the manner of participation that has been afforded to the electronic money and alternative payment industry. Governance of bodies such as the Payments Council has been predicated on payment volumes, thus excluding all new payment service providers, except perhaps with the exception of the very largest.

This has resulted in exclusion from discussions on policy, strategy, and participation at a governance level in new product initiatives. The industry has been relegated to user forums, and put in the position of providing sensitive information to its competitors without the benefit of participation in the use of the information.

Exclusion of the innovative and evolving payments community from policy and governance at a UK level delays and places barriers in the growth of innovative payment products and services. This should be rectified.

Question 9: *What do you believe is the appropriate governance structure for UK payment systems?*

Inclusion of the innovative and alternative payment sector, as well as smaller payment service providers in governance and decision making will ensure better access to evolving payment systems, and better service delivery to users. Inclusion in decision on investment will better serve evolving technologies and introduce greater efficiencies.

Question 10: *How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.*

EMA members will address this question individually.

Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*

Our members' universal experience of agency banking and indirect access to payment schemes has been negative. Access is hard to come by and where it is offered, it is offered at unrealistic terms.

Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*

Our members have found access conditions to be unreasonably restrictive and inflexible.

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

The choice available is very limited, and the terms prohibitive. Indirect access is not a reasonable solution. Even where access is provided, there is dependency on the priorities and objectives of the sponsoring institution, and on the terms offered. Many larger institutions are unable to react at the speed needed by innovative and new payment providers. They similarly do not have the incentive to address the needs of the emerging sector.

Indeed, given the large scale closure of bank accounts held by MSBs and alternative payment service providers, denying access to any banking services, it is unrealistic to expect the same institutions to act in the interests of these providers by intermediating access to payment systems.

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:*

- *To whom do you provide indirect access?*
- *What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?*
- *Are there any barriers to becoming a sponsoring bank?*

EMA members will address this question individually.

Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*

Facilitating un-intermediated access, is key to encouraging wider competition. New payment service providers have demonstrated their ability to compete by creating alternative products that exploit inefficiencies in existing payment systems. They interact with the payment system as users, not as payment service providers. They have however made great progress and have demonstrated commercial success. Enabling direct access to payment systems would introduce significant benefits to users, and enable greater competition.

Question 16: *Do you have any other comments regarding access?*

The current revision of the PSD may provide an opportunity to change access rules at an EU level enabling universal access to all regulated payment service providers. If this requires Financial Institutions to be included in the Settlement Finality Directive, then this should be considered.

Question 17: *What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?*

EMA members will address this question individually.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*

EMA members will address this question individually.

Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*

EMA members will address this question individually.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

The consultation document arguments on the impact of governance and ownership structures are persuasive. These may be addressed through greater access and access at reasonable cost to avoid barriers to entry. This should both generate revenue for owners and create an incentive to compete with new services offered by innovate competitors.

Question 21: *Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?*

In order to facilitate the use of new payment products, whether card, account or mobile based, easy and prompt access to existing payment instruments is necessary.

This includes access to:

(i) Customers' bank accounts

(i) Credit and debit card payments

(ii) Direct debit and other payment instruments

Scheme rules that discriminate or place barriers on use of such products to fund other payment instruments will discourage innovation, and introduce inefficiencies.

Scheme rules that place barriers are varied and range from requirements to prefund outgoing payments in certain circumstances, to rules that do not recognize the legal nature of electronic money, and treat payments to issuers as though they were payments to the end merchant. This creates legal, regulatory and competitive difficulties.

Other factors include access generally, the cost and terms of access as well as the absence of incentives for owners and members to facilitate access to competing service providers.

Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*

A more proactive regulator that is able to review instances of apparent discrimination, or of barriers to entry or of inappropriate rule-making would provide a welcome relief. The process will however need to be accessible and easy to pursue.

Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*

Payments in common with other network-based services are subject to 'network effects', and give rise to exponential benefits as the size of the network increases. There is therefore universal potential benefit to both users and providers of payments services with increased participation.

Innovation is not however always realised through collaboration, but payment service providers that are integrated into the payment system should be able to innovate both individually and collaboratively.

Question 24: *Do you have any other comments or concerns you would like to highlight?*

Whilst access to payment systems is the focus of this paper, and the objectives of the PSR; many factors that impact effective competition lie in other collective industry bodies, such as those enabling the sharing fraud related data. Access to such institutions is equally significant.

Question 25: *What, if any, are the significant benefits you see regulation bringing?*

The areas we have set out above relate to access, provided directly and at a commercially viable price point. The regulator will need to intervene to address barriers created by ownership and governance structures that discourage access.

Question 26: *What, if any, are the risks arising from regulation of payment systems?*

The concern of our industry is that of over-regulation particularly at an early stage in the evolution of new payment products and services. Payment systems may emerge over time, perhaps focusing on the mobile channel or on specific market opportunities. It is important that such systems are able to develop and mature before regulatory intervention. This would allow business propositions to be developed and to evolve and for the inherent risks to be identified. Regulation at that stage would be more appropriate and effective.

Question 27: *How do you think regulation might affect your business and your participation in UK payment systems?*

Our industry has sought inefficiencies and new opportunities the in payment value chain, and have innovated to create business models that work. Participation in the payment system as a whole continues to be limited by the current structure.

Enabling access in the manner set out above is likely to lead to significant benefits to users, through innovation and competition.

The Electronic Money Association (EMA) is the trade body representing electronic money issuers and payment service providers. A list of EMA members is given in the Annex to this document

Annex

EMA members as of April 2014

3mlati Ltd
Advanced Payment Solutions Ltd
American Express
Blackhawk Network Ltd
Boku Inc
Citadel Commerce UK Ltd
ClickandBuy International Ltd
Cornèr Banca SA
Emoney s.r.o.
Euronet Worldwide Inc
Ewire Danmark A/S
Facebook Payments International Ltd
Google Payment Ltd
iCheque Network Limited
IDT Financial Services Limited
Ixaris Systems Ltd
Kalixa Pay Ltd
National Australia Group
Novum Bank Ltd
One Money Mail Ltd
Optimal Payments Ltd
Orwell Union Partners LLP
PayPal Europe Ltd
PayPoint Plc
PayU
Paywizard
PPRO Financial Ltd
Prepaid Services Company Ltd
PrePay Technologies Ltd
PSI-Pay Ltd
R. Raphael & Sons plc
Securiclick Limited
Skrill Ltd
Syspay Ltd
Transact Payments Limited
Ukash
Wave Crest Holdings Ltd
Wirecard AG
Worldpay UK Limited
Yandex.Money

Response to the FCA Payment Systems Regulation Call for Inputs

15th April 2014

Emerging Payments Association Response to the Payment Systems Regulation Call for Inputs

The Emerging Payments Association applauds the three key objectives of the new Payment Services Regulator (PSR):

- The **competition objective** is to promote effective competition in the market for payment systems and the markets for services provided by payment systems in the interests of service-users or likely users of payment services.
- The **innovation objective** is to promote the development of, and innovation in, payment systems in the interests of service-users and likely users of payment services, with a view to improving the quality, efficiency, and economy of payment systems.
- The **service-user objective** is to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of service-users and likely users of payment services.

In our view, the primary impediment to realising these objectives is the lack of direct access to clearing and settlement systems at a fair price.

This situation negatively impacts both competition and innovation, which ultimately results in fewer choices for consumers in terms of payment products and services. This situation is a result of the current ownership structure of the payment systems and infrastructure within the UK and/or the Capital cost barriers to entry coupled with an imbalance in governance. At present to join the clearing systems smaller banks and non-bank payment companies need to have an Agency Banking relationship with a major Bank player such as Barclays or RBS.

The Emerging Payments Association recognises that a balance must be struck between the need to incentivise investments in large-scale infrastructure developments (such as Faster Payments or Link which are owned by the dominant banks) and the need to open up such systems to new entrants to allow competition and innovation. However, the current ownership structure is effectively locking out new entrants and even established payments companies because of the costs of entry and the capital requirements involved. This lack of competition is ultimately hurting the service-users and leaving large segments of the population underserved. As such, it is imperative that we find a way for payment providers and challenger banks/organisations to obtain direct access to clearing and settlement at a reasonable price.

We recommend creating a non-profit 'central hub' or platform that allows smaller banks and non-bank payment companies direct access to the central banking and payment systems.

We propose the creation of a cooperative non-profit "Agency Bank" platform with a single account with the bank of England, which would allow emerging payments companies' access to clearing and settlement at a reasonable price.

Furthermore, we suggest that the initial investment in such a platform be subsidised through a governmental grant to open up payment systems and encourage competition and innovation.

The elements of such a non-bank platform would likely be as follows:

- Non-profit 'central hub' with the sole purpose of providing direct access to clearing and settlements – serving the same functions as an Agency relationship with a major Bank but obviously at lower cost.
- Centralised standard that allows companies to tap into the central banking and payments systems directly, quickly, cheaply and easily.
- Single collective account with the Bank of England with the possibility of Government supplying the necessary capital reserves to underwrite this account at least in the first two years of operation.
- Governance structure established to determine appropriate eligibility and capital requirements especially post any Government capital subsidy (see above).
- Government grant for the start-up of the entity to open up UK payment systems and enable competition and innovation.
- Once established and critical mass achieved, on-going funding costs charged to members based upon their respective transaction volumes.

The above would make it possible for larger payment service providers and challenger banks to obtain direct access to clearing and settlement without being sponsored through an Agency bank. The license for access should be collectively negotiated in terms of eligibility, capital requirements and pricing, such that the barriers to entry are not insurmountable and pricing is transparent and reasonable.

We also recommend forming a sub-committee between the PSR and the EPA to ensure the interests of emerging payments companies are represented.

To facilitate the two-way dialogue, we recommend that EPA representatives and members of the new PSR form a sub-committee which could be used to exchange views on emerging payments and the potential impact of future regulatory changes being proposed and serve as a key point of contact between our members and the PSR.

- The EPA will serve as a link between our members, the broader emerging payments industry and the PSR.
- We will collaborate with the PSR to map the emerging payments landscape and maintain a database of participants in the ecosystem.
- We will provide input to the PSR on new developments and technologies within the fast moving payments industry to keep abreast of change.
- We will invite the PSR to participate in regular roundtable discussions on matters of topical interest as they emerge.

Our response to the specific questions posed by the FCA in the Payment Systems Regulation Call for Input follows.

Designated Payment Systems

Question 1. Which payment systems should be designated for regulation (CHAPS, Bacs, FPS, LINK, Cheque and Credit, and the main three and four party card schemes)?

The Emerging Payments Association believes that regulation is most beneficial and efficient in the form of principles and industry guidelines, rather than structural rigidities, hard rules or price setting. A principles-based approach will help regulation keep pace more efficiently with rapidly changing market dynamics within the global payments industry.

We would also like to see the PSR act as an enabler for competition and innovation by helping to open up and facilitate access to the payment systems and infrastructure by emerging payments companies, new entrants and even disrupters. This would require a certain degree of regulation of the major payment systems, particularly CHAPS, BACS, FPS, Link, Cheque and Credit and the emerging connected systems such as PayM. The main three and four party schemes require less regulation as long as competition and alternatives between schemes exists.

Although it may be too early, consideration needs to be given as to whether or not there is a need for a formal regulatory framework around Crypto Currency such as Bit Coin which is increasingly interfacing with the main clearing and payment methods. If left unregulated there is a risk to the security and integrity of the main clearing and payment systems.

Last but not least, we believe the regulator should seek to promote consumer safety and security throughout UK payment system to ensure consumer confidence in existing and emerging payment methods. We encourage the provision of additional powers to enable police authorities to pursue organised fraud more effectively and vigorously.

Competition in Payment Systems

Question 2. Where do you believe competition is effective or ineffective within UK payment systems?

The current payment system within the UK is not effective at fostering competition. Competition is suppressed primarily because the major banks dominate the system at every level. There are several challenger banks, most notably Virgin, Tesco, Sainsbury and Aldermore, yet only Metro Bank offers full service banking including a current account. Payment accounts, which are a growing and viable alternative to the standard current account to meet the transactional banking needs of the wider population, are also not allowed to flourish.

Prepaid debit cards, could have the potential to provide good quality, fairly priced 'bank-lite' transactional banking services to underserved consumers who feel let down and indeed fed up with their current banking arrangements. The concept of "free Banking " is increasingly seen as a myth with banks charging a myriad of differing fees for premium products and high charges for individuals who go overdrawn. As a result such consumers are seeking an alternative straight-forward transactional account, which the major players are not interested in providing. Some of EPAs members are building such alternatives accounts, but as mentioned earlier in this document they , have to rely on an Agency Banking relationship with an existing major regulated retail bank in order to access the clearing systems and provide customers with an individual bank account number and an associated sort code. Current regulatory controls mean that it is not possible to break the link between card issuance, fund holding and the provision of a payment service to consumers. This protects the established banks from competitors that see the opportunity to deliver a new form of banking service that is built around the use of prepaid cards as light-touch, low-cost bank accounts.

Using a prepaid card to deliver this level of service is technically possible today. However it requires either the active collaboration of a bank to provide the supporting accounts or a full banking license. The need for either of these support mechanisms acts as a major barrier to the entry of competitors and forces the cost of the resulting service to the end user to be higher than the complimentary service provided by the Agency bank provider. The new entrant has to add the costs charged by the Agency bank to its own costs, making it more expensive for the consumer. The regulations are partly there to protect consumers from the maladministration of their banking services. But do they stimulate competition and innovation in the provision of payment services? We do not believe that they do.

It is also the case that using a prepaid card account to deliver higher value, more innovative products to consumers means that providers must be able to connect to the clearing and settlement systems that underpin electronic value transfer in the UK. These systems, BACS and Faster Payments, are fundamental to the provision of an effective light-touch bank account. Without them salaries and benefits cannot be paid into the account efficiently and standing orders and direct debits cannot be offered. Access to these services for potential market entrants is possible but the costs and regulatory hurdles to participation are high and the alternative is to become the agent of an existing player and by default of a competitor.

Question 3. At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Referring to the levels outlined by the FCA (see Figure 1 below), some levels (primarily 1, 2 and 3) would benefit from increased '**collaboration and collectively driven innovation**', while others (primarily 4, 5, 7 and 8) would benefit from '**competition and unilateral innovation'**. Benefits to service-users, in terms of costs, quality and innovation, can be achieved through the optimal mix of collective and unilateral innovation. We will detail our recommendations within each respective level outlined below.

Figure 1: UK payments Industry

1. The Bank of England facilitates settlement for the major UK payment systems.

Collaboration – Enhanced market competition and efficiencies would be achieved if the Bank of England were to enable more entities to hold a direct settlement account and/or create a 'collective non-bank platform' for challenger banks and payment providers to hold a joint settlement account with the Bank of England. Such a collective non-bank platform would essentially serve as an 'Agent Bank', similar to the function provided by the big 5 Agent Bank sponsors today without any loss of Regulatory control, but at a lower cost of entry.

2. Infrastructure providers (e.g. VocaLink, RTGS) control and operate the infrastructure over which the transfer of funds is executed for the purposes of operating the payment system.

Collaboration – Infrastructure providers, such as Vocalink, should be regulated by the PSR. Guidelines should also be established to enable broader access to such providers, to ensure that funding costs are open and transparent, and to encourage utility-style collaboration between different parts of the payments value chain.

3. Payment system operators are the schemes and networks (e.g. Bacs, Faster Payments (FPS), CHAPS, Link, the Cheque and Credit Clearing Company (C&CCC), and three and four party card schemes). For card schemes, the payment system operator and infrastructure provider may be same entity.

Collaboration – Payment systems operators, such as BACS, CHAPS, Faster Payments and Link, could potentially benefit service-users through utility-style collaboration and collective innovation. They should be regulated by the PSR and guidelines should be established to enable access by challenger banks and other payment providers at a transparent and fair price.

Competition - While the three and four party schemes can and do benefit from some level of collaboration, it is important to ensure that there is sufficient competition between the schemes and that alternatives exist. The schemes must have the profit incentive to invest and innovate, yet must not become monopolistic. Therefore, the regulators must strike a delicate balance to promote investment and innovation, yet deter anti-competitive behaviour.

4. Direct members are payment service providers that have direct access to payment system operators, and can provide access to indirect participants. The major banks in the UK are direct members of most of the UK payment systems.

Competition – The major banks do compete against each other, but increased competition with challenger banks, payment service providers and new entrants would benefit the consumer through increased innovation within the payments industry.

5. Indirect participants are payment service providers that access the payment system through agency agreements (i.e. via sponsorship) with a direct member. This may include, for example, smaller banks and new entrants.

Competition – Challenger banks, payment service providers, new entrants and disrupters welcome a competitive payments landscape, but seek a more level playing field with fewer barriers to entry. More competition will ultimately benefit the consumer through increased choice and innovation within the payments industry.

6. Service-users are those who use, or are likely to use, services provided by payment systems to transmit funds. For example, businesses, consumers and government departments.

Competition – Consumers, SMEs and government agencies would all benefit from increased choice and competition.

In our view, there are too many ring-fenced payment agreements supporting the public sector such as PayPoint and the Post Office. These quasi-oligopolies need addressing. Today the government benefits dispersal system appears to be a pointed solution that is dated and biased to incumbents. Having a lack of competition in this space has to be an issue for the consumer who is ring-fenced to using the Post Office and PayPoint.

7. Other payment providers include non-banks and other service providers that use the payment systems to provide payment services to service-users. This could include overlay services, such as a mobile phone payment service that enables payments to be made with mobile phones over the Faster Payments Service.

Competition – Other payment providers welcome a competitive payments landscape, but seek a more level playing field with fewer barriers to entry. More competition will ultimately benefit the consumer through increased choice and innovation within the payments industry, especially as new form factors such as mobile, encouraged by the telecommunications industry, become available and attractive.

8. Third-party service providers provide services across the value chain to facilitate the processing, acceptance, management and/or transmission of payments (e.g. technology providers, telecommunication providers, payment gateways/platforms, point of sale terminal providers, fraud management services).

Competition – Third-party service providers would benefit from a robust, competitive payments landscape. More competition would ultimately benefit the consumer through increased choice and innovation within the payments industry.

9. Trade bodies, consumer groups and regulators represent the external stakeholders active within the payment industry (e.g. the Prudential Regulatory Authority, The European Commission, the Payments Council).

Collaboration - The trade bodies and regulators could provide industry leadership by conducting an end-to-end mapping of the consumer journey and alignment of programs, infrastructure and channels. For example, consumers are demonstrating a need for non-proprietary wallets with integration across multiple payment and cash in options. Offering modularity of integration and ease of use for the consumer would be a significant step forward for the consumer. (Think about a consumer downloading a wallet, say Starbucks, and having the capability to issue that wallet to host other payment options in other channels.)

Question 4. What are the main factors impeding more effective competition at each level?

See answers outlined above in Question 3 at each of the nine levels.

Question 5. What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

See answers outlined above in Question 3 at each of the nine levels.

Ownership Structure

Question 6. Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Yes, it appears to protect existing payment programs and stifle market entry, competition and innovation.

Many of the issues relating to challenger banks and non-bank payment companies offering competing services, such as current, debit or prepaid products, stems from the fact that the large banks dominate and largely own the current payments infrastructure. In order to move money, new entrants must access that infrastructure. The major UK banks have historically dominated the decision-making process of the Payments Council. They own the payment schemes. They own the clearing technology. And since their core product offering is a current account, it is often not in their best interest to provide infrastructure access to potential competitors, even at a reasonable price.

On the surface, the ownership structure seems to make sense. Banks that offer payment services also own and manage it. The key to the conundrum is that by setting the bar for direct access to the payment schemes and clearing services so high that a new entrant can't reach it, the big banks force the new entrants to use their Agency services. Conflicts of interest are common as a result.

New entrants have to buy a sort code and transaction processing from the big banks as an Agency service. Then they must buy the technology they need to process payment transactions from a company approved and/or owned by that same Agency Bank. When Faster Payments was introduced, the big banks all got first access to Faster Payments and then slowly rolled it out to their client banks. The explanation was that this was a low risk way of providing access to a brand new payment system. However, for the consumer, this meant that if you held your account at a bank that used Agency Services to access the payments systems, you received a second rate service at a higher price. The challenger banks or payment providers that have to gain access through an Agency Service also pay more – as much as 10 times more - for each transaction. Lastly, client banks face a tremendous operational risk in that the Agency Bank can decide to discontinue the sponsorship at any time.

To illustrate the operational risk associated with the Agency Bank relationship, following is an example given by an Emerging Payments Association member:

"There are recent examples where major banks such as Barclays and HSBC have, without warning, given notice to their Agency clients that their banking facilities are to be withdrawn and with no right to appeal this decision. Such decisions detrimentally affected these customers and resulted in some cases of companies going out of business. Apparently the decision by the banks was taken in response to regulatory concerns about a lack of knowledge about the source of such funds being remitted. Nonetheless, the feeling remains that it was an opportunistic way for the banks concerned to stifle competition rather than attempting to find an alternative solution for these clients to enable them to remain in business."

Question 7. How might the regulator address any issues with the current ownership structure?

We recognise that a balance must be struck between the need to incentivise investments in large-scale infrastructure developments (such as Faster Payments or Link which are owned by the dominant banks) and the need to open up such systems to new entrants to allow competition and innovation. However, the current ownership structure is effectively locking out new entrants and even established payments companies. This lack of competition is ultimately hurting the service-users and leaving large segments of the population underserved. As such, it is imperative that we find a way for payment providers and challenger banks to obtain direct access to clearing and settlement at a reasonable price.

We recommend addressing this issue through direct access to clearing and settlement as outlined in Question 15 under Access.

Question 9. What do you believe is the appropriate governance structure for UK payment systems?

We believe there is merit in establishing a new competition-focused, utility-style regulator for retail payment systems. We think that moving closer to the model in the current electricity market could be more effective in that it is a more open and transparent model than the current payments structure.

In the future, a case could be made for the payments infrastructure being treated as a utility. Consolidation among the different payment schemes – BACS, CHAPS, Faster Payments, Cheque and Credit Clearing and Link – would bring down the total cost of technology ownership and simplify the movement of money.

Access

Question 10. How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Most of the members of the Emerging Payments Association access UK payments systems through Agency Bank relationships or are service/product providers to companies that do so. As a condition of having an Agency Bank arrangement, our members are prohibited from divulging fixed and variable costs charged by the Agency Bank. As such, The Emerging Payments Association is not able to provide hard data for each of our members.

Following are a couple of anecdotes from our members describing some of the challenges related to access:

"Our biggest concern is in getting direct access to clearing and settlement at a reasonable cost.

Recently, we were working with a large client that wanted to give their users of our multi-retailer stored value card (currently processing £70m in transactions annually) access to their balances in cash rather than spending in one of our retail partners. We went to Link to find out if we could use their network of ATMs to allow cardholders to extract cash using their cards. We accepted that if we did this, we would have to become a member of Link and pay a fee to process these transactions. But we were told that to qualify as a member, we would have to also have a real-time settlement account at the Bank of England. So we went to the Bank of England, and were told that to open such an account, we would need to be a 'bank' (although this was not initially specified as a requirement). To become a 'bank' would have required us to have very large collateral deposits and pay significant fees. The Bank of England did not explain why we needed to be a 'bank'. In the end we tried to obtain a banking service indirectly. We believe that the requirement to have an account, which is only provided to a bank, represents a barrier to entry for new entrants, even when they are established and listed companies such as ours that have been operating successfully for 40 years."

"When wishing to develop capabilities to have cards processed using the acquirer network, we looked for a cost-effective route. When approaching the leading bank providers, they made it both difficult and expensive. Their price tag of circa £500,000 was not commercially feasible, and as such, was a barrier to innovation and competition."

"We would like to see a centralised standard that allows companies to tap into the central banking and payments systems directly, quickly, cheaply and easily. The

solution could provide new entrants access to a central hub at a competitive price, possibly operating on a not-for-profit basis, that would allow them to give their customers more choice at a fair price."

Question 11. For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

The fixed- and variable- costs related to Agency Bank sponsorship varies significantly from client to client. While some clients are able to negotiate reasonable on-going costs, the up-front fees are often cost prohibitive. Additionally, on-going costs are typically charged at a significant premium – as much as 10 times more per transaction.

Question 12. Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes. Many of the products and services that service-users need or want are not commercially viable due to the high barriers to entry and/or incremental costs associated with Agent Bank relationships.

One of the most underserved populations in the UK is the unbanked or underbanked community. While less interested in serving these customers than premium customers, the big banks do not have an incentive to encourage competition in this segment. While many emerging payment companies would relish the opportunity to create a simple, transparent and reasonably priced 'payment account' to serve the unbanked population, the costs associated with Agency Bank sponsorship make the pricing for the end customers artificially high and commercially unviable.

Payment accounts (or prepaid accounts) are slowly evolving into viable alternatives to current accounts. However, most prepaid card accounts cannot be used to support standing orders or direct debits. There are also limits on their issue and use that make them a slightly less capable product than a full current account with a debit card.

Question 13. If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Whilst in theory there may be a choice, usually there is a significant amount of integration work required in order to link into an Agency sponsoring Bank, so in reality the barriers to exit are very high.

Question 14. Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?

Not applicable to most of the members of the Emerging Payments Association.

Question 15. What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We propose the creation of a collective non-bank platform with a single account with the bank of England, which would allow emerging payments companies' access to clearing and settlement at a reasonable price. Furthermore, we suggest that such a platform could be subsidised through a governmental grant focused on attracting start-ups in the payments arena to the UK to create a global hub for payments industry R&D and innovation. The elements of such a non-bank platform would likely be as follows:

- Non-profit 'central hub' with the sole purpose of providing direct access to clearing and settlements – serving the same functions as an Agency relationship with a major Bank but obviously at lower cost.
- Centralised standard that allows companies to tap into the central banking and payments systems directly, quickly, cheaply and easily.
- Single collective account with the Bank of England with the possibility of Government supplying the necessary capital reserves to underwrite this account at least in the first two years of operation.
- Governance structure established to determine appropriate eligibility and capital requirements especially post any Government capital subsidy (see above).
- Government grant for the start-up of the entity to incentivise competition and innovation.
- Once established and critical mass achieved, on-going funding costs charged to members based upon their respective transaction volumes.

Additionally, we recommend that it be made easier for larger payment service providers and challenger banks to obtain direct access to clearing and settlement without being sponsored through an Agency bank. The license for access should be collectively negotiated in terms of eligibility, capital requirements and pricing, such that the barriers to entry are not insurmountable and pricing is transparent and reasonable.

Governance

Question 8. Do you have any concerns about the current governance of UK payment systems?

The big five banks have a direct line into the FCA and tremendous resources for lobbyist and legal activities to protect the existing establishment, while the emerging players are primarily focused on operations, R&D and customer-focused innovation.

In response to this situation, the Emerging Payments Association (EPA) was established in 2013 and is governed by emerging payments companies. The aim was to provide a body, which would represent the collective views of its members and as a result be a spokesperson for such views with regulators and Government alike and therefore act as an agent of change. EPA is also dedicated to creating an innovation hub in the UK to attract and enable new payments methods and systems to prosper and be accepted.

Inevitably changes in regulation are often driven by historic events that have caused concern or where it is felt regulation is not sufficiently clear. However, technology is changing so rapidly that it is difficult for Regulators to keep abreast of such changes and the positive or negative impact on consumers. EPA intends to be a focal point of information provision so that Government and Regulators will have access to relevant information quickly and objectively.

To facilitate the two-way dialogue, we recommend that EPA representatives and members of the new PSR form a sub-committee which could be used to exchange views on the emerging payments and the potential impact of future regulatory changes being proposed and serve as a key point of contact between our members and the PSR.

Question 16. Do you have any other comments regarding access?

No further comment.

Infrastructure

Question 17. What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

While not an immediate priority, a case could be made for the payments infrastructure being treated as a utility. Consolidation among the different payment schemes – BACS, CHAPS, Faster Payments, Cheque and Credit Clearing and Link – would bring down the total cost of technology ownership and simplify the movement of money.

Question 18. What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

We believe that ISO 20022 can bring significant long-term benefits to the global financial services industry, as it realises end-to-end processing across domains and geographies that currently use vastly different standards and formats. Just as aircraft controllers use a common language, so too should the global financial services industry. The Emerging Payments Association welcomes the opportunity to participate in the development of a strategy and roadmap for the adoption of ISO 20022.

ISO 20022 reflects the global nature of the financial services industry. ISO 20022 creates a level playing field empowering a broad group of stakeholders including end-users, suppliers and IT service providers to express their interests in a common work product whilst ensuring maximum transparency in the process. Furthermore, this cooperative and inclusive approach avoids a situation where multiple standards are developed by different groups in response to the same business need that may materialise in different areas or domains across the globe.

19. What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

See Question 15.

Innovation

Question 20. Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Unfortunately, the incentives to innovate are not clear and indeed are getting less clear with the impending regulation of interchange fees. The regulation of interchange will likely have a negative impact on innovation within the payments industry and will result in higher financial services costs for consumers. Assuming interchange is reduced to 20bp for debit and 30bp for credit, card issuers are likely to charge consumers higher card fees and interest rates to make up for the lost revenues. Additionally, card issuers may decide not to invest in new product development or underserved markets due to the lower associated margins. Innovation may have to shift to retailers themselves through merchant funded rewards and closed loop payment schemes, such as MCX in the US.

Interchange fees are paid by acquirers to card issuers every time a payment card is used to make a purchase. The fees serve partly to compensate issuers for the higher risks and costs they entail for the commensurate benefits that retailers receive from accepting electronic payments (payment guarantee against fraud and cardholder default, free funding period, processing of incoming transactions, etc). Additionally, interchange serves to balance the demands of consumers and retailers, so as to maximise the number of transactions, but also to allow issuers to invest in innovation, security, efficient payments administration, etc.

The evidence from studies in other countries, such as Spain and Australia, is that when interchange fees are artificially reduced, there are consequences for consumers. Following a regulation-imposed reduction of interchange fees, card costs for consumers in other countries have increased. This is because retailers no longer adequately compensate issuers for the benefits they receive and as a result, issuers instead seek to recover those costs by increasing prices and reducing rewards and services for consumers. Moreover, retailers in other countries have not passed on these cost reductions to consumers in the form of lower retail prices.

Of key concern to the Emerging Payments Association are the following four unintended consequences:

1. **Adverse Consequences for Innovation:** In addition to direct consequences to consumers of increased prices for credit, debit and prepaid solutions, consumers and retailers are likely to see less investment in developing new payments technologies, improving security, and protecting consumers and retailers from fraud.
2. **Universal Credit & Prepaid Accounts:** Even more difficult is the situation for pre-paid accounts, which primarily rely upon interchange fees. For example, prepaid cards are now a viable cost effective alternative to basic banks accounts for the receipt of Universal Credit. However, to the extent that an interchange fee regulation increases charges to card users, this would increase costs to claimants and could well eliminate the hoped-for option of offering a low / no cost bank account / prepaid cards for these purposes. This could result in problems for the implementation in Universal Credit and wider financial inclusion efforts.
3. **Small Business Cost:** The reduction of interchange fees (a cost to acquirers) is generally passed onto the larger retailers as they have greater negotiating power over the merchant service fees (charged by the acquirer). By contrast, small businesses may see their card acceptance costs rise from the acquirers. This has the potential to distort

competition in favour of larger retailers. This will have an impact particularly on e-commerce, where the majority of e-commerce retailers are classified as SMEs.

4. **Hindering e-commerce:** The UK is a global leader in ecommerce, which has grown rapidly as a result of accessibility to card payments. Interchange fee regulation could potentially reduce incentives to invest in the maintenance and improvement of online security measures, therefore discouraging the use of cards online.

Question 21. Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

The primary factors that limit our ability to innovate within the UK payment systems are: (1) lack of direct access to clearing and settlement at a fair price; (2) growing cost burden of implementation of anti-money laundering legislation, particularly in high frequency, small transaction volume stored value business models.

Question 22. What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments?

No further comments.

Question 23. What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

See Question 3.

Closing Questions

Question 24. Do you have any other comments or concerns you would like to highlight?

Transparency of Pricing

As the big five banks currently enjoy a dominant position in the market through complex, bundled service offerings of deposit accounts, cards, payments, insurance, mortgages and ancillary financial products, the pricing for the consumer is often hidden and not transparent.

Additionally, large segments of the population are not eligible for deposit accounts with the big five banks, creating a tremendous population of underserved individuals and SMEs. This situation is exacerbated by the "free deposit account" market dynamics within the UK. While the banks may not be motivated to serve the unbanked, they also do not have any incentive to allow challenger banks or payment providers to serve the underserved.

In fact, through their dominant position, the banks are able to determine which competitors have access to the payment systems infrastructure and the terms by which such access is granted. This results in less choice and higher consumer prices for the underserved markets, because the fees that the agent banks charge payment providers for sponsorship ultimately must be passed on the consumer.

Anti-Money Laundering Legislation (AML)

Whilst AML may not be within the remit for the PSR due to the global nature of such regulations, we recognize the need to have a voice in the debate. There are countless examples of how such regulation impacts the prepaid industry for relatively small transactions and creates a situation that jeopardizes profitability and therefore viability of various pre-paid solutions for the underserved market.

Virtual Currency

We recognise that virtual currencies do not currently fall within the FCA's authority for regulation, however, we believe that we should keep a close eye on global developments and develop a framework to consider virtual currency within the UK.

Virtual currencies are treated very differently from country to country.

- Singapore, already a regional hub for currency trading, was among the first to clarify tax rules that offer a liberal treatment of virtual currencies and in April 2014 said it would move to regulate Bitcoin exchanges.
- The US tax authorities have recently decided to treat virtual currencies as property for tax purposes (resulting in capital gains/loss treatment), a ruling welcomed by some investors keen to take virtual currencies mainstream as a speculative investment, financial instrument or means of payment.
- The UK has decided against adding value added tax on trading of virtual currencies, thus treating Bitcoin like any other currency, while Finland is treating it as a commodity and Sweden is treating it as an asset. Such difference between EU member states may mean that the European Commission would eventually have to reach a view to harmonise rules.

Regulators in many countries are cautious of involvement with virtual currencies – whether because of doubts as to their potential for abuse by criminals, incredulity as to their future given the fluctuations in value, or uncertainty over how they should be classified. But there is also a desire to create a framework to attract investment in what could become a vibrant sector.

"Bitcoin, and other digital currencies, currently lie somewhere on the boundaries between currency, commodity and financial asset. Our best definition would be that it is currently a speculative financial asset that can be used as a medium of exchange," economists at Goldman Sachs wrote in a recent report.

While we agree that virtual currencies should be approached in a deliberate fashion, the Emerging Payments Association also recognizes the need to regulate and create a framework within the UK to attract investment in the virtual currency industry, not only as a financial instrument but also as a transaction medium and potential payments platform. Perhaps initially it will behave like a speculative investment, but over time it will likely emerge as a more mainstream means of payment. If we sit on the side-lines for too long, such investment and innovation may gravitate toward and be dominated by the likes of Singapore or the US.

Question 25. What, if any, are the significant benefits you see regulation bringing?

We believe there is a tremendous opportunity to turn the regulatory environment in the UK into a global competitive advantage by opening up the payments systems to innovation and competition.

Moreover, regulation that promotes open access to clearing and settlement will bring significant benefits to the underserved market segments in the form of innovative new payment and 'bank-lite' products.

Lastly, we believe that the regulator has a role to play in promoting service-user safety and pricing transparency.

Question 26. What, if any, are the risks arising from regulation of payment systems?

The primary risks for any regulator in such a rapidly changing and dynamic industry is that the pace of change is too great for the regulator to keep pace. As such, we believe that it is important to avoid rigidities within the system in the form of rules or price controls and instead focus upon broad objectives, principles and guidelines.

See answer to Question 20 with regard to unintended consequences of pricing controls.

Question 27. How do you think regulation might affect your business and your participation in UK payment systems?

We hope that the new regulator will create an emerging payments sub-committee that the Emerging Payments Association could participate in and/or lead. This sub-committee would provide a voice amid on-going developments in the dynamic and rapidly changing payments industry.

About the Emerging Payments Association

The Emerging Payments Exchange brings together companies across the emerging payments spectrum to help shape the future of the payments industry landscape. Our mission is to make the UK a global leader in payment innovation by attracting investment and creating a hospitable regulatory environment for innovators, new entrants and disruptors.

The market is a complex interaction of regulatory, technological, infrastructure, human and economic factors that make change challenging. Innovators and new entrants are struggling to emerge on an equal playing field from the constraints of the existing infrastructure and payment systems that have dominated the market for so long.

By working together, the members of EPA can clear the path to change through stakeholder dialogue, market intelligence and meaningful networking between members, capital markets and the public sector.

- **Regulatory Influence** – We are actively working with the regulators to ensure that our collective voice is heard. We seek safe, yet simplified regulation and a more level playing field to enhance competition and innovation.
- **Public-Private Partnership** – We are partnering with the government on the digital transformation of the public sector and identifying opportunities for digital payments within various government agencies.
- **Innovation** – We aim to create a non-profit, regulated payments platform for non-bank players to gain access to clearing and settlements through Faster Payments at a fair price.
- **Capital** – We seek to bring together growing companies and private equity, venture capital firms and investment funds, providing introductions and research to size and map markets.

Current EPA members include key players across the emerging payments spectrum and it welcomes new members who understand the power of being part of a progressive, forward-thinking group that can show real leadership for the industry.

For more information, please contact Frank Lambe, Chairman on frank.lambe@emergingpx.com or Laura McCracken, Executive Director on laura.mccracken@emergingpx.com. Also, visit our website at www.emergingpx.com.

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Managing Director
Faster Payments Scheme Limited

PAYMENTS SYSTEMS REGULATION – CALL FOR INPUTS

Faster Payments Scheme Limited (FPSL) is the Financial Markets Infrastructure (FMI) responsible for operating the Faster Payments Service (FPS) launched in May 2008. It is a Recognised System under the 2009 Banking Act and is therefore overseen by the Bank of England in its statutory Payment System Oversight capacity.

FPSL welcomes the opportunity to respond to the FCA's call for inputs as a payments system operator that is expecting to be designated for regulation by the Payments Systems Regulator (PSR).

FPSL is centrally involved in many of the areas covered by the PSR's objectives. The scheme has played, and continues to play, an important role in supporting innovation in the UK payments sector, for example in our current work underpinning Paym, the new mobile payments service. We are also very aware of the challenges of working to minimise the costs and complexity of participation in the scheme, while also delivering a ubiquitous, high integrity, and continuously available service for all end customers.

Given our position in the sector, we believe we have relevant perspectives on very many of the questions you have raised, and have answered accordingly. We will, of course, be very happy to discuss these perspectives further with you in wave two of your consultation exercise.

Please find attached our question by question responses and covering sheet.

Basic information	
Consultation title:	**Payment Systems Regulation – Call For Inputs (5 March 2014)**
Name of respondent:	**Faster Payments Scheme Limited**
Contact at respondent:	**Name: Craig Tillotson, Managing Director**
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Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	X
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		X
If 'Yes', please submit both confidential and non-confidential responses.		

Question 1:	Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.	1.1 The schemes indicated by HMT should be designated. 1.2 Given the position of VocaLink as the, currently, sole critical infrastructure provider for the Faster Payments Service (FPS), the PSR may wish to consider whether designation of VocaLink might be required to ensure that it is fully included in the new regulatory regime, albeit that VocaLink is not formally a payments system, service or scheme. This may not be necessary if the PSR's influence can be delivered through an alternative approach. 1.3 The PSR should build working relationships with smaller payments related services ahead of any designation.
Question 2:	Where do you believe competition is effective or ineffective within UK payment systems?	2.1 Proper market definitions need to be developed. There is not a well-defined payments system or payments market; or rather there are a number of possible markets that might be being referred to. 2.2 The most important market to consider is the retail banking market, as payments are part of that service offering, and it is in this market that the most significant benefits can be delivered to consumers, businesses and the economy through the effective operation of competition. This is where availability of competitive payments products will benefit consumers most. Hence, ensuring access to payments infrastructure by all banks, whether directly or through some form of agency, is also a key issue. The PSR should primarily consider how the interventions it can make in the 'payments industry' can promote competition in the retail banking market, amongst existing players, and by enabling the entry of new players. This is the main prize for consumers, businesses and the economy in general. 2.3 A robust assessment of the effectiveness, or otherwise, of competition can only properly be made once these clear market definitions have been developed.
Question 3:	At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or	3.1 There is a growing opportunity for the quality and capability of the overall payment experience to be used by financial institutions as a competitive weapon in acquiring and retaining their customers. As payments schemes, like Faster Payments Scheme Limited (FPSL), and Paym, the cross-industry mobile payments service, deliver services that are increasingly visible to end customers, there is the potential for financial institutions to differentiate in the Service delivery models they provide to their customers e.g.

	innovation?	accessing these services via their individual mobile banking and payment apps. 3.2 There is future potential for more competition to develop between the interbank systems and the payment card networks, for example in the provision of underlying account to account payments for retail and online purchases. 3.3 Incremental benefits to service users and the support of further innovation are less likely to come from FPSL, Bacs, CHAPS and C&CCC independently contesting the same sub-markets, as the payment services these schemes provide are broadly complimentary and have, to date, focussed on different customer requirements. Future innovation is more likely to come in this area from coordinated development activities and planned substitution. 3.4 There is a strong emerging market space coming from interbank systems developing equal access Application Programing Interfaces (APIs) for third party add on services, e.g. SEQR, ZAPP etc. to promote innovation in meeting current and latent needs of end customers. 3.5 At infrastructure provision level, competitive supply should be promoted, but there is a need to analyse the benefits this can bring against the costs and risks to resilience and security of infrastructure change, bearing in mind the relatively small share of cost in the central infrastructure versus the complete ecosystem costs which will include direct and potentially indirect participant's systems. The transitional costs of regression testing new systems, and almost certainly constructing and testing parallel running capability also need to be considered in this equation. 3.6 Given that the costs and risks of transitioning from one infrastructure to another may mitigate against a time-based competitive supply model, could concurrent supply of multiple directly competing infrastructures (or schemes for that matter) serving the same payments needs make sense? If the costs of delivering payments were highly variable with transaction volume, then the incremental system cost of multiple infrastructures might well be offset by efficiencies derived from on-going competition. However, the nature of electronic payments systems (at the centre) is that they are broadly fixed cost. While adding participant connections adds some cost due to the physical nature of add-ons (more gateways, telecommunications etc.). Adding transactions from existing participants normally makes only a marginal difference due to the growing processing power of the core IT systems that can simply handle

		more-of-the-same. 3.7 If regular market testing or multiple directly competing infrastructures cannot be economically used, then non-market mechanisms will need to be applied to establish good value and quality from suppliers.
Question 4:	What are the main factors impeding more effective competition at each level?	4.1 For Faster Payments, minimising costs of participation by reviewing the membership requirements and criteria to facilitate access needs to be balanced against the need to provide ubiquitous, high integrity and continuous service for all end customers. The real time requirements of a system that must also operate 24/7, where linkage of the end-to-end capability and high interdependence creates a need for capable and auditable systems and processes also places essential technical and operational requirements on direct participants. In addition, the Bank of England requires all direct participants to have a settlement account. Some potential direct participants we have talked to have indicated that they do not meet the current requirements laid down by the Bank of England. These are all factors that potential new entrants have to consider when weighing up the options/benefits of direct or indirect participation. 4.2 FPSL has seen a recent growth in the number of enquiries about direct participation in the Scheme which is extremely positive. We are actively engaging with all applicants to assist them in understanding the requirements and participation options available to them. We have recently conducted a thorough review of our Rules and Membership criteria and are confident that they are fair and reasonable. We are also proactively reviewing the indirect proposition to see what improvement can be made – see further detail below in answer to question 13.
Question 5:	What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?	5.1 Some collaboration between some interbank payment systems can be highly beneficial to consumers, businesses and the economy. This can include collaboration to substitute products, buy infrastructure services and enhance capability that enables better competition by the direct suppliers of services to consumers higher up the value chain. It can also include intelligence sharing in fraud and cyber security and the use of common routing and addressing protocols. Services where customers benefit from reach and ubiquity, such as the recently launched Paym, cross industry mobile payments service and the Current Account Switching Service (CASS) are good examples of the benefits of collaboration. 5.2 Investment funding, a key issue for the further development of innovative capabilities, is also an area

		where a collaborative approach should continue to be considered. 5.3 Where there is a concern that a particular collaboration might be considered anti-competitive, then industry players should be able to make the case to the PSR to continue in the best interests of customers, provided that the evidence supports such a conclusion. 5.4 The interbank payment schemes are currently working on a number of joint projects which have common attributes i.e. where it makes sense to collaborate to tackle common issues. A current example of this approach is the development of the customer credit payment recovery process between FPSL, Bacs and CHAPS Co. We think this approach to bilateral or multilateral collaboration between schemes and other industry players makes sense and should continue to be supported by the PSR. 5.5 For interbank schemes, efficiencies, which can be ultimately passed on to customers, can be gained by continuing to source common facilities from a service company, e.g. HR, physical facilities, Finance, IT, Security, Internal Audit, Communications. This needs to be provided as a service to the interbank schemes, should have no conflicting regulatory or quasi-regulatory oversight role and could be provided by any competent outsource provider. It might make sense from an economic and security of supply basis for these shared services to be provided to schemes by a company controlled by the schemes and operated on the same not-for-profit basis as the schemes themselves. The UK Payments Administration does much of this for FPSL, Bacs, CHAPS and C&CCC today, although is not owned or controlled by the schemes directly, see 8.3. 5.6 Operational services that could or must be shared, like Sort Code database management, or credit recovery processes, can be managed by the most involved scheme on behalf of other scheme users, on a cost recovery basis, with clear MoUs and SLAs between provider and user schemes, as is current practice. Clearly, these could equally be provided by any competent outsource provider, but probably not on a not-for-profit basis, adding costs to the eco system and, ultimately, end customers. 5.7 A small industry coordination working group, with payment schemes, industry participant and other stakeholder representation, should focus on the broader cross-industry issues on behalf of the PSR and the industry, working to eliminate any gaps or inconsistencies in strategy between individual schemes and other participants.

		5.8 The scheme and other industry participants may also benefit from having access to an industry change management capability, such as that which coordinated the delivery of the Current Account Switching Service and Paym by various schemes, infrastructure suppliers and industry players. This capability probably sits best in a company that provides shared services to the schemes, and should focus on change management, not long term operation of industry-wide services which should be operated as in 5.6. 5.9 Regulatory direction to schemes and participants, while it may be informed by work done at an industry coordination working group, needs to come unequivocally from the PSR and Bank of England (BoE), not from any working group itself. 5.10 It is clearly essential that, as planned in the legislation, the PSR and BoE work together to ensure that FPSL does not receive conflicting direction. 5.11 A clean transition from the current arrangements is needed if we are to have a transparent and well-articulated approach to industry coordination, both in the strategy and change domains that can secure the confidence of all stakeholders. A transition/change plan, including milestones for the handover or wind down of reporting and other responsibilities between schemes, Payments Council, the PSR and any industry coordination working group, needs to be developed and agreed quickly between stakeholders to ensure we can move into a new regulatory environment with clarity, focus and certainty.
Question 6:	Q6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.	6.1 *What is FPSL (The Faster Payments Scheme Limited)?* The scheme is <u>not</u> a membership body designed simply to agree rules that facilitate interoperability and reach of its payment system. It is an internationally recognised Financial Markets Infrastructure company responsible for the payments system behind the clearing and settlement of real time automated payments in the UK. The company, as an FMI, plays a significant role in ensuring the smooth day-to-day operation of the payments system it controls, ensuring the continued integrity of the system, managing the systemic risks involved and contributing to the financial stability of the UK. Its board is structured to ensure that, while it retains the support of its direct participants, it both protects the public interest and supports the development of innovation in payments. It does this both directly, through industry-wide changes it supports and delivers, as well as indirectly, through the open access to innovative third parties it promotes. Whilst

		FPSL outsources its technology operations, currently, to its main supplier, VocaLink, FPSL retains full accountability for the quality and integrity of those operations. 6.2 *What is the ownership structure of FPSL?* FPSL is a company limited by guarantee from its, currently, ten directly connected, settling participants, known in company law terms as members. These direct settling participants have agreed to become members of the company and abide by its rules. The company does not issue any shares or pay any dividends, members hold no capital stakes in the company, and have no mechanism for trading any part of the company. While it is ultimately controlled by its members, it is essentially a freestanding corporate entity. It is managed by a board of directors consisting of an Independent Chair, a Chief Executive/Managing Director, two Independent Non-Executive Directors, and ten individual non-executive directors appointed by each of the company's members. 6.3 *Does the current ownership structure of FPSL prevent any appropriately qualified organisation becoming a member?* No. No requests to join the scheme have ever been rejected. A number of challenger banks have recently entered the joining process. Approval to join the Scheme is only in the hands of the Chief Executive and independent directors. Criteria for approval to join are clear, proportionate to the risks new participants bring to the system, objectively justifiable, and publically available. Member appointed non-executive directors are not permitted to be involved in this approval process. The independent directors both generally, and specifically in their governance role in this process, look out for the interests of potential new members. 6.4 *Does the current ownership structure distort the running of FPSL?* No. All members, and independent directors and executive directors have equal say in the running of the company as board directors – one director, one vote. The public interest is protected by 3 independent directors, including the independent chair, each of whom has a right of veto in the public interest. Even though the non-independent, non-executive directors are appointed by their member organisations, they have an overriding fiduciary duty, just like the independent and executive directors, 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. In some circumstances, if, for particular decisions of the board, these conflicts are not manageable, they

		will, and have, excluded themselves from participation in such decisions. 6.5 *Does the current ownership prevent the company developing its services to meet the public interest?* No. Independent directors provide protection and one director one vote prevents over representation by members with larger payments volumes. 6.6 *Does the current ownership structure limit the funding available to invest in the development of the scheme to better serve its direct, indirect, and end customers?* Not to date. Because the current investment model assumes funding is provided in proportion to use of the system, board decisions have to be agreed by both 75 per cent of all directors, and directors appointed by direct participants covering at least 50 per cent of volumes and therefore likely to provide at least 50 per cent of funding. The current direct member funding model has proved effective to date, however there is no reason why alternative sources of funding might not be considered in the future as long as they do not introduce incentives that might put at risk the key payments systems objectives of integrity and availability. In considering future ownership models, the benefits of removing potential conflicts arising due to the key users participating in the operation of the board of the company must be weighed against the benefits of having access to the considerable knowledge and funding capabilities they provide together with important considerations around continuity of service, certainty, reliability, and economic and financial stability. 6.7 *Does the current direct user based ownership deliver benefits that might be lost in a different model?* Yes, possibly. The current direct user membership model, supplemented by executive and independent non-executive directors has the benefit of ensuring a common interest in the reliable and cost effective operation of the payment system. 6.8 The overlapping ownership of VocaLink with the membership of FPSL does have some advantages in terms of providing long term confidence that the infrastructure company will always be fully funded. These advantages might be lost if the ownership of VocaLink changed. VocaLink, as the critical infrastructure supplier to FPSL needs to continue to maintain effective internal 'Chinese walls' between the work it does in this area, and its operations in adjacent technology markets, for example as one of a number of competing suppliers of FPS gateways, to ensure that it is not seen to be leveraging its position

		as scheme supplier to unfairly improve its competitive position elsewhere.
Question 7:	How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.	7.1 The ownership question needs to be broadened to include governance and funding if it is to be properly considered. How and by whom decisions are made within schemes, and how and from whom are financial resources provided? The operating model of the scheme company, as described in 6.1 and 6.2 need to be factored into this debate. 7.2 The PSR needs to satisfy itself that payments schemes have in place the appropriate governance to make broad based decisions that appropriately consider the interests of all relevant stakeholders. The CPSS IOSCO Principles for Financial Markets Infrastructures self-assessments completed by the FPSL, Bacs and CHAPS will be of value here and should take priority. 7.3 FPSL has proactively reviewed its governance structure in the last eighteen months and we are confident that it is fair and reasonable e.g. through initiatives such as the introduction of Independent Directors and changes to member voting rights. 7.4 Alternatives to member/user based funding models, such as the introduction of alternative providers of financial resources, may bring with them the need to introduce a for-profit objective into payment schemes. This might not be in the public interest, in that it introduces competing corporate objectives for the schemes and may potentially drive up costs for end users. 7.5 Any change should be subject to a full review of the issues such a change is trying to resolve, and confidence gained that such action actually solves the purported problems. 7.6 In the event that, for good economic reasons, VocaLink became the longer term sole supplier of infrastructure to the scheme, potentially on a regulated basis, then consideration of whether further separation of this service to FPSL from the fully competitive offerings from VocaLink to other Payments Service Providers would be required.
Question 8:	Do you have any concerns about the current governance of UK payment systems?	8.1 FPSL has been working over the last 18 months to ensure that its governance and board decision making processes fully represent the needs of all participants. Modifications to the board voting system to move away from larger direct participants having greater influence than smaller participants has recently been completed. Today, the four largest participants (who represent around three quarters of the current account market) only have 4 votes out of 14 on the board – 10 member appointed directors, 3

		independent directors and 1 executive director. Over the last year, the recruitment of three independent directors, with a specific public interest responsibility and focus on the broader needs of new entrants has continued to enhance the situation. The collective influence of smaller members, under one-director-one-vote, and the responsibilities and veto power of the independent directors has given smaller members and other potential participants a much clearer voice in decision making. 8.2 The current governance arrangements between FPSL and the Payments Council (PCL), specifically the relationship agreement and reserved matters between PCL and FPSL may overlap and/or conflict, with the newer arrangements and will be reviewed by FPSL in the context of the new regulatory environment. FPSL now has a number of independent directors, including an independent chair, with an explicit public interest role and veto, is formally overseen from a financial stability perspective provided by the BoE in its duty to oversee systemically important payments systems, and will come under the economic regulation of the PSR. 8.3 Likewise, the relationship with UK Payments Administration Limited (UKPA), the company providing services to FPSL and other interbank schemes, including facilities and staff, shares leadership and direction with the Payments Council, and this will be reviewed by FPSL and the other interbank schemes. UKPA needs to be able to focus solely on providing quality services to its scheme and other customers, where it can add significant value and drive efficiency.
Question 9:	What do you believe is the appropriate governance structure for UK payment systems?	9.1 The electronic schemes (BACS, CHAPS and FPSL), with their independent chairs and directors are standalone Financial Markets Infrastructures (FMIs), accountable for their own services and conduct. 9.2 The schemes will remain accountable under the Banking Act 2009 to the BoE in matters of financial stability, and to their members for the efficient operation of their services. 9.3 FPSL expects to be additionally accountable to the PSR in matters relating to the enabling of competition, enabling of innovation, and consideration of the interests of current and future end users of its payments services. 9.4 FPSL would also expect, alongside the other schemes, to contribute to the thinking and outputs of an industry coordination working group, acting under the guidance of the PSR, as mentioned in 5.7. 9.5 Consideration should be given to the definition of “payments industry” to ensure that any representative

		body or bodies are providing input from across the board to a coordination working group. This might consider input from mobile operators or substitutes such as Bitcoin.
Question 10:	How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.	10.1 FPSL provides direct access to Payments Service Providers (PSPs) that can obtain a settlement account at the BoE and meet the Scheme's rules for technical availability and security etc. 10.2 As potential direct participants are required to have a settlement account at the BoE, the scheme imposes no additional credit worthiness requirements on members. Until the implementation of settlement cash prefunding at the end of this year, members do have to lodge specific high quality collateral to support the Scheme's current Liquidity and Loss Sharing Agreement. 10.3 Potential new members are taken through a joining process, and reviewed for compliance with the joining requirements by the Scheme Managing Director and an independent director. Existing scheme members have no visibility of the take on of new members until the decision to accept has been taken. 10.4 From November 2014, with the advent of settlement cash prefunding, members will no longer have to accept any shared liability or losses for settlement default with other members, simply provide cash from their existing liquidity pool at the Bank of England to act as collateral for any credit positions they need to hold with other scheme members. 10.5 All scheme operating costs, and transaction processing costs are divided amongst all members in direct proportion to their use of the service, i.e. all members have the same variable costs per transaction. There are no minimum costs or discounts for volume to particular participants. Unit cost reductions resulting from increasing transaction volume are shared evenly across all participants through reductions in the per transaction tariff. 10.6 Each member technologically connected to the central infrastructure has to pay the same fixed costs of connection, although the scheme is currently planning to undertake a systemic risk review to consider whether the smallest members represent a sufficiently reduced systemic risk, that the current dual high availability connectivity can be relaxed, reducing this fixed cost further. 10.7 Each member has to undertake an annual code of conduct review to assure the scheme that it has sufficient security measures and systems reliability in place to ensure that it does not pose a systemic risk to the Faster Payments central infrastructure, the other members or their end customers. For the

		system to operate effectively, not only does the sending bank and central infrastructure need to be fully operational, but the receiving bank as well. It is the particular risks that the member places on other participants as a receiver of payments that is the focus of the scheme. 10.8 Half of the scheme's members choose to provide various forms of direct agency and indirect agency propositions to around 250 financial institutions in the UK. 10.9 The scheme has one large PSP that gains direct technical access to the central infrastructure using a direct agency proposition from a member who settles on their behalf. 10.10 The indirect agencies vary in size, and buy a variety of different connectivity and service propositions from their sponsoring directly connected members, depending upon their needs and sophistication. Some of these agencies have a single relationship with one sponsor across a number of different payments systems; others pick and choose different propositions from different providers for different systems. 10.11 These arrangements are commercially negotiated, both in technical and financial terms between the agency and their sponsor. Some of these arrangements have been created as a result of competitive tendering, while others may have arisen as incremental offerings added to existing agency relationships. 10.12 The nature of these commercial relationships means that FPSL has no visibility of their terms and conditions.
Question 11:	For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.	11.1 We have reviewed the terms and conditions of direct access, including how costs are apportioned and recovered, extensively over the last 18 months and are confident that they are fair and reasonable. With the exception of the fixed costs of connectivity, and settlement at the Bank of England, which are identical for each member, all charges are entirely variable with actual usage. FPSL operates on a cost recovery model and makes no profit. The transaction charges to members generated under the scheme's contract with its infrastructure provider (i.e. the provider's underlying costs and margin) have recently been extensively reviewed by an independent professional services firm to ensure that they are fair and reasonable. 11.2 As stated above, we have no visibility of the terms and conditions of indirect access.
Question 12:	Does the access	N/A

	arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?	
Question 13:	If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?	13.1 Faster Payments is a relatively new, but growing payments scheme. Significant numbers of agency banks have only opted for indirect access in the last three years or so as a result of the consequences of the Payments Services Directive and D+1 requirements coming into force. Many of these decisions were made on short timescales, quite close to the enactment of the regulations for a variety of reasons. 13.2 As stated above five of the Scheme's 10 direct current members currently offer indirect agency access products, although one member, for its own business reasons, has recently decided to exit this market. . FPSL does not have a direct view of the operation of this market, as it is within the competitive space; however we would encourage the PSR to engage directly with the providers of these services to understand the fundamental economics of provision. Such analysis might point to other structures, such as demand aggregation or bureaux services that might deliver a better outcome for all. We would like to work with the PSR to see if there are additional steps the scheme can take, for example, in the provision of information to agencies, to help make this indirect market work as effectively as possible for all participants 13.3 FPSL's aim is to minimise the fixed costs of direct participation to allow as many institutions as possible to participate directly, however, it is also seeking to identify ways to help its members improve the forms of indirect access so that all participants, and their end customers, can benefit from the full Faster Payments near real time experience, irrespective of their volume. However, it will always be a balance between delivering ubiquity of near real time, 24 x 7 experience to end customers and minimising participation costs.
Question 14:	Do you act as a sponsoring bank,	N/A

	providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes: • To whom do you provide indirect access? • What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access? • Are there any barriers to becoming a sponsoring bank?	
Question 15:	What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?	15.1 We are starting to explore new routes for providing cost effective access to Faster Payments, including the development of bureau/demand aggregation services with third parties, or as part of a scheme service, and would welcome further discussions with interested parties about new forms of participation.

Question 16:	Do you have any other comments regarding access?	16.1 No
Question 17:	What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?	17.1 Those payments systems providing, essentially, store and forward or asynchronous payments services should technically, be relatively straight forward to connect to, albeit there are always necessary obligations on the connecting party to maintain overall system security. The Faster Payments Service provides service users with a near real time 24 x 7 service that will confirm, at the point of initiation, that a payment has been received by the destination bank and will be credited to the destination account, normally within seconds of submission. This essential feature of the end-customer proposition, which is almost unique internationally, requires the Faster Payments Service, and all directly connected institutions, to operate in a tightly coupled, synchronous mode of operation. Specifically, this proposition can only be delivered to the customer if the sending institution, the central infrastructure and the receiving institution are on line and fully available. This means that compared to more mature batch based payment systems, the technical requirements for availability and response are very much higher, and at one level, unavoidably more complex. This is an unavoidable consequence of the service being offered to end customers. For challenger institutions, participating in a real time payments service requires real time bank side capability – this is a cost of doing business. 17.2 As use of Faster Payments continues to grow and the service becomes even more systemically important and visible to end customers, the importance of directly connected institutions (certainly the larger ones), maintaining very high levels of technical availability and operational discipline also grows. While there are always opportunities to optimise the technical requirements, this may well be unavoidable if the heart of the financial system is to remain stable and reliable. 17.3 Against this back drop, Faster Payments are working on a number of projects that will, wherever possible, loosen the tight technical and operational coupling between participants without introducing additional risk into the system. These projects include increased provision of stand-in capability to insulate other users from temporary unavailability of a direct participant, and some early stage thinking on techniques that can further protect the bulk of the payment system from any untoward events

		coming from any individual participant. Both of these protections, while working for the common good, may well increase the technical requirements on direct participation. 17.4 The Payments Council's roadmap consultations and work are developing some interesting models in this area. We are keen to participate in the further development of this thinking, possibly through an industry coordination working group. However, any benefits resulting from significant change to the architecture of payments systems, and potentially bank account management systems, for example to some form of central utility, will need to be carefully balanced with the costs and risks of developing a new architecture, the costs and risks of migration, any concentration risks inherent, and the risk that ultimately, more common platforms, especially bank side, would, in the long term, diminish the prospects for differentiation between banks and consequent competition.
Question 18:	What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?	18.1 In the bank to central infrastructure space, FPSL has deployed the ISO 8583 global standard. This international standard was developed in the cards space and specifically supports the synchronous, highly choreographed, near real time payments propositions that are at the heart of Faster Payments, and centrally important to our end customers. The ISO 20022 standard, which is essentially an asynchronous standard, is unlikely to be able to act as a comprehensive alternative to ISO 8583, requiring extra, potentially non-standard elements that would undermine any general standardisation benefits. 18.2 FPSL can see a benefit in the customer-to-bank space of having common interfaces and standards, including the use of ISO 20022, specifically to support richer data with payments. FPSL has developed a high level model for the delivery of richer data between end customers, which is scheme-agnostic. This would entail the development of data repositories (probably vertical market or supply chain specific) in to which the initiators of payments, or their banks would place the "richer data" and then include a unique link to that data within the body of the payment message. This would allow the receiver to collect the data from the data repository when they receive payment. We have prepared a paper on this, and would be glad to discuss with the PSR in due course. 18.3 The Direct Corporate Access (DCA) service, allowing batch input of payment instructions to the central infrastructure by corporate customers is based upon Bacs Standard 18. This is to ensure compatibility, and ease of migration for the many thousands of current Bacs direct submitters. Standard 18 is a mature

		standard, but has the benefit of very wide adoption in the UK corporate banking market. The cost and change impact on these service users would have to be considered when planning a move to a different standard such as ISO 20022. Lessons from the, not quite complete, SEPA migration in the Eurozone are likely to be informative. 18.4 A key element in the end-to-end payment flow is the ability of the receiver to handle the information sent to them. As with the use of Bacs Standard 18 on the send side, the UK corporate banking market has receivables reconciliation systems and processes broadly based on Bacs Standard 18. The cost and change impact in this space would have to be considered.
Question 19:	What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?	19.1 To directly connect to the Faster Payments Central Infrastructure, a gateway is required. There are currently three different third party gateway solutions in operation, and one participant developed solution. Assuming prospective new members do not choose to develop their gateway in-house, they have a choice of three third party providers today. The Faster Payments Scheme is keen to promote a similar breadth of choice in the agency indirect connection market whether through a variety of solutions provided by direct participants on a wholesale basis, or via third party demand aggregation/ bureaux solutions. However, at some point, real time connections into the agencies' bank account management systems are required if agencies are to deliver the end to end proposition to their and others end customers. 19.2 Alternatively, direct participants could look to utilise a "managed service" solution which provides richer functionality than a pure gateway. To date there is no effective market for the supply of such services, with FPSL being aware of one commercially available solution. FPSL is discussing the provision of such with a number of technology companies who operate in similar spaces; however they need to be confident that there is sufficient demand for such services before committing resource. A clear articulation of what is required of PSPs offering retail banking services may support the development of a healthy competitive market in this space. This could reduce the cost of accessing the technology needed to participate directly in Faster Payments, opening direct participation to a wider range of organisations.
Question 20:	Are incentives to	20.1 The OFT has suggested that the development of the UK payments systems is slow. However, the UK is at

	innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).	the forefront of the deployment of near real time systems like Faster Payments, and is one of the first countries internationally to launch, this month, a near ubiquitous mobile payment system using mobile phone numbers as proxies for account details (Paym). In the last 12 months, FPSL has met with representatives of the central banks of a number of countries (Australia, Brazil, India, Indonesia, Japan, Saudi Arabia, Singapore and USA), all of whom are keen to understand how to best introduce a real-time payment solution, like Faster Payments, in their own country. 20.2 FPSL would observe that the principal constraint on the deployment of innovative new services in the UK at the moment is not lack of incentive, but lack of capacity for change. Payments do benefit from, indeed really require, ubiquity and reach to be effective. The bulk of participants in the market do need to cooperate for new payment services to be effective, indeed, not allowing for the inclusion of all players in some form or other, may undermine retail competition. The delivery of ubiquitous payments services with reach across all industry players requires full coordination, and extensive testing and interworking to be effective. This takes time, and always risks moving, not at the pace of the least interested, but at the pace of the least capable, or otherwise busiest player. Balancing speed of innovation against extent of inclusion is a perennial challenge. 20.3 Fees for the use of FPSL services are transaction based and calculated to cover costs, not deliver a profit. Please see earlier comments on the costs of access. How these are passed on to consumers is a part of the competitive provision of services from the banks and should be viewed in that context by the PSR and CMA. FPSL is not aware of any provider requiring payment of transaction fees by consumers for this service particularly when initiated through the principle telephone and internet banking channels.
Question 21:	Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?	21.1 FPSL's ability to innovate is constrained by the capacity of industry participants, both large and small, to manage change volume while containing systemic risk and ensuring continuity of service. 21.2 As eco system wide capacity for change is not unlimited, every change, whether customer-need led, or driven by regulatory requirements has an opportunity-cost. 21.3 There is additionally a potential constraint on the development and deployment of innovation imposed by access to investment funds.
Question 22:	What changes, if any, are	22.1 Given the very real opportunity-cost of change, from whatever driver, the optimum portfolio of change

	needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.	for the payments eco system will need to consider the amount of benefit delivered for each unit of constrained resource required to achieve that change. Regulators (and politicians) need to be aware of the full costs of any change they might wish the payments ecosystem to undertake, not so much in direct costs terms, but more in opportunity- cost terms. The question always needs to be asked: *'How confident am I in the value of the benefits this change could deliver, given the other changes and innovations that will not be able to be made at the same time, and the benefits from those changes that will be lost.'* Reviewing not only the 'bang for buck' question, but the degree of certainty associated with both the 'bang' and 'buck' *is essential.* 22.2 However, against this backdrop of constraints to integrated change, wherever possible, with due regard to security and resilience, FPSL would like to promote a layered technical and operational architecture that creates equal access APIs (Application Programming Interfaces) that allows a wide variety of players to freely and independently innovate on top of the existing highly integrated infrastructures such as FPS.
Question 23:	What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?	23.1 The most impactful innovations in payments require, in simple terms, capability for both sender and receiver. Faster Payments works, because any customer can send a Faster Payment to any other customer. Paym, the mobile payments service, will only really reach its full potential when sending customers are confident that most of the other people they try to send money to are also registered to receive. Given these dynamics, collaborative approaches will sometimes be essential to deliver substantial innovation for consumers, and other service users. However, once these core, ubiquitously interconnected, services with reach are in place, innovation at the customer interface (for example in the mobile banking apps that use Paym), can, and should, happen completely independently. Collectively developed core services can be the enabler of competitively driven and delivered innovations for customers and a critical lever for positive differentiation between financial institutions. 23.2 Collaboration between schemes can provide the potential to enhance current services and improve choice for example through innovation in current account switching services and cheque handling.
Question 24:	Do you have any other comments or concerns you would like to	24.1 No.

	highlight?	
Question 25:	What, if any, are the significant benefits you see regulation bringing?	25.1 Payments is a complex area with the potential to deliver huge economic good, and, if not properly managed, create huge economic risk and damage. There are strong network effects in payments systems, meaning it may be economically rational to operate a shared central infrastructure in some situations. The critical national role of these infrastructures and the relatively high risks of change due to the high level of interconnection they have with industry players may limit the potential for regular competitive tendering to drive the optimal results for customers or the economy. If this is the case, the oversight the PSR could provide may be valuable. The operation of this oversight by an economic regulator, deploying the principles of economic regulation will allow the delivery of optimal solutions in key areas that properly balance the needs of customers and the economic realities of sustainable delivery. 25.2 The PSR, as an economic regulator, should also be able to clarify and codify output based customer and economic objectives that government policy, as enshrined in legislation, requires from the payments systems, and then agree and track the delivery of the practical, low risk, benefit focussed change plans that can deliver those outputs. The PSR can also play a critical role in fully considering the opportunity costs of change. 25.3 The PSR can review, as part of the economic regulatory considerations, how funding of specific initiatives can be determined to promote their rapid and effective deployment. 25.4 Finally, the introduction of formal regulation may catalyse the development of clearer and more transparent relationships between all parties involved in payments and help build even stronger customer confidence in the payments system.
Question 26:	What, if any, are the risks arising from regulation of payment systems?	26.1 The PSR must have the capability and independence of action to truly adopt a rigorous, evidence based, and proportionate approach to making interventions only where there is clear evidence of customer detriment. Payments systems are part of our critical national infrastructure, they must evolve, but they must do so in a risk aware, rational way. In spite of political pressures to reach conclusions quickly, and to adopt particular solutions or apply specific remedies, the discipline of properly defining markets,

		identifying any failures, and considering the minimum interventions required to deliver the maximum net benefits to customers and the economy must be safeguarded.
Question 27:	How do you think regulation might affect your business and your participation in UK payment systems?	27.1 It is our hope that the advent of the Payments Systems Regulator will further enhance the effectiveness and impact on the economy of the Faster Payments Scheme, and Paym, the mobile payments service it will also be operating in due course. The introduction of the PSR provides an opportunity to deliver absolute clarity in the regulatory framework with a clear singular economic regulator. FPSL believes it has the responsibility and capability to play a leadership role in the continued deployment and take up of real time payments services in this country, and welcomes the support to this objective that a well-structured PSR could provide. 27.2 At a practical level, it is important that the PSR, BoE and Competition and Markets Authority (CMA) develop clear protocols for working with regulated parties such as FPSL, to ensure that the direction they provide is consistent, and that interactions with the various regulators are coordinated to minimise the costs, and maximise the effectiveness, of this new regulatory regime.

Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
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25 the North Colonnade
Canary Wharf
London
E14 5HS

3rd April 2014

Dear Sir/Madam

Payment Systems Regulation – Call for inputs

This is the Financial Services Consumer Panel's response to the call for inputs on payments systems regulation.

The Panel believes that delivering good consumer outcomes should be a key focus for the regulation of this area[1].

Secure and reliable payment systems are an essential part of modern banking. The Payments Council has played an important role in driving some development (e.g. introducing payments via mobile telephone numbers) and promoting best practice. However, ultimately the current ownership arrangements and lack of effective regulation have stifled innovation and investment in better service provision.

The Office of Fair Trading (OFT) has provided some useful suggestions to stimulate competition in this area[2]. For example, it suggests that:

- barriers to accessing payment systems should be minimised in order to ensure fair, reasonable and non-discriminatory direct access to existing payment systems is available to all banks and building societies (paragraph 5.17); and

- the parameters, oversight and coordination arrangements for ongoing collaboration are considered (paragraphs 8.13 and 8.14).

We are pleased that its recommendations have been incorporated into the call for input document. We would advise the Financial Conduct Authority to continue to engage with the Competition and Markets Authority and utilise the knowledge it has in this area.

We look forward to providing further detailed input as part of the formal consultation process later in the year.

Sincerely,

Sue Lewis
Chair - Financial Services Consumer Panel

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1 http://www.fs-cp.org.uk/publications/pdf/CP%20Response%20to%20the%20Opening%20Up%20UK%20Payments%20Consultation20130617.pdf
2 http://www.oft.gov.uk/shared_oft/markets-work/OFT1498.pdf

Annex 1: Cover sheet

Basic information		
Consultation title:	PAYMENT SYSTEMS REGULATION	
Name of respondent:	FIRST DATA EUROPE LTD.	
Contact at respondent:	Name:	PHIL CURTIS
	Email:	pcurtis@firstdatacorp.co.uk
	Address:	FIRST DATA JANUS HOUSE ENDEAVOUR DRIVE BASILDON SS14 3WF

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	✓
Indirect participant in payment system(s)	
Service-user	✓
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify: PAYMENT PROCESSOR	

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?	✓	
If 'Yes', please submit both confidential and non-confidential responses.		

First Data response to FCA consultation paper

(Non-confidential version)

Introduction

First Data is a leading global payments processor and merchant acquirer, with 23,000 employees in 35 countries, serving customers in 62 countries on five continents. We have over 40 years of payment processing experience and in merchant acquiring.

In 2013, we processed over 59 billion electronic payment transactions, securely held 829 million consumer accounts and had approximately 6.1 million merchant locations.

We provide payment processing services to financial services customers including large, mid-tier and small card issuers in the United Kingdom. We also have fully-owned merchant acquiring businesses in the UK and Poland and joint ventures with bank partners in the UK, Ireland, Italy and the Netherlands.

As a company with a long history of providing innovative solutions in the payments space, we support thousands of financial institutions and merchants, large and small, in their management of domestic and cross-border electronic retail payments, whether these are by card, e-commerce or mobile payments.

First Data provides a comprehensive array of solutions, including debit, credit and prepaid card processing, card production, print and correspondence, customer contact, internet banking and bill payment, loyalty and marketing, risk and fraud management, data analytics and mobile commerce.

We also facilitate merchants to accept consumer payment transactions (e.g. credit, debit, stored value, contactless and loyalty cards) at the point of sale, whether those transactions occur at a physical world merchant, over the phone or by internet.

First Data comments on issues raised in FCA Consultation Paper

- **Competition**
  - There is little alternative to reduce costs (as an acquirer) by utilising other mechanisms as acceptance of a particular scheme card is unattractive to process other than through that scheme's network.
  - Whilst interchange payments passed from acquirers to issuers are the same for all participants, scheme fees (split by brand usage and processing fees) are generally 'stepped', enabling the high-volume players to have a considerable advantage when competing for larger contracts [NB: we

recognise that these fees are now 'tiered' rather than 'stepped']. This effectively ensures that smaller players and new entrants are unable to gain scale and the market order is preserved.
  - There is intense price competition in large volume merchant acquiring contracts and, at the small and medium enterprise level, merchants are very price sensitive.

- **Collaboration**

  Key areas for industry collaboration include:
  - Fraud
  - Security
  - Standards and any other initiatives that will be universally applied. Chip & PIN is an excellent example of how well the industry can work together when there is effective leadership.

- **Ownership**
  - It is important to note that in the UK in general, merchant acquirers are not banks.
  - In terms of UK governance, we see the new industry regulator as an opportunity for the industry. We welcome its consumer and merchant focus and the need for robust and highly secure financial systems. We also want to work collaboratively with regulators in an atmosphere of trust where issues, although potentially conflicting, are well understood on both sides in order that optimal, preferably, win/win solutions can be implemented.

- **Access**
  - We have access to the major card schemes and indirectly to BACS for merchant settlement. First Data is a major global processor with a first class track record in the merchant acquiring discipline where it has mainly participated via joint ventures but recently, in the UK, with its own payment institution (PI) license and direct Visa and MasterCard membership

- **Infrastructure**
  - We believe the current underlying infrastructure is very robust, recognising that there have been high profile outages in recent times within certain institutions (which we do not consider to be infrastructure issues as such).
  - There are many third-party suppliers to the payments industry that handle transactions that should in our view attract more scrutiny and perhaps take more regulatory responsibility.

- **Innovation**
  - The major benefit of innovation is improved market share and profit
  - Innovation must be encouraged by regulators, which includes allowing innovators to reap the rewards from their talent and creativity.
  - Where there is a common objective and purpose e.g. contactless and wallet-type payments, speed to market would be greatly enhanced by more collaboration through assertive industry leadership, which we would like the regulator to encourage.

- **Closing questions**
  - As the EU inches towards a single market vision, participants are seeking efficient and clear passporting arrangements and gradual harmonisation of general specifications, rules and processes across the Union. We feel that the FCA has an important and leading role to play in this journey.
  - In the UK, the merchant acquiring space is predominantly made up of non-bank-owned entities, with a single focus on delivering excellent service and value to predominantly UK customers, but also increasingly to cross-border clients. We welcome competition but not market distortion. For example, Visa Europe's recent settlement with the European Commission reintroduces the possibility of Multi-lateral Interchange Fee arbitrage on Visa transactions, which clearly disadvantages UK acquirers.
  - Separately, we hope the FCA will seek to achieve a collaborative and supportive environment for the payments industry to thrive and develop for the benefit of all stakeholders. It is especially important to strive for a sensible and sustainable balance of commercial considerations that exist between consumers and providers to ensure that high standards of system resilience, service and innovation can be maintained.
  - We believe that the UK payments system is mature, robust, secure, and serves its customers well. That is not to say that it cannot be improved by greater 'co-opertition' between industry players and a more collaborative relationship with regulators.

Good afternoon,

I wish to input evidence, for the consideration of the new Payment Systems Regulator, regarding the service-user objective in the operation of the cash machine network in this country.

I would urge the new regulator to pay particular attention to the LINK network of cash machines in this country. It is important that the regulator seizes this opportunity of reshaping the financial landscape for service-users by setting LINK the objective of ensuring free, universal access to cash for all customers.

There are three key barriers here that the new regulator must overcome if it is to make a real difference for service-users. The first of these is the issue of surcharges on ATM transactions – a prime example of the poverty premium faced by low-income customers. These charges of up to 20% on each cash withdrawal appear most prevalent in areas of highest deprivation, and their impact is felt most heavily by low-income customers. More than half of all cash machines in the poorest parts of my constituency are pay-to-use machines. One key goal of the new regulator should be to improve access to free-to-use ATMs and reduce the industry's reliance on surcharges.

The new regulator should begin by asking LINK to reassess the validity of the 1km distance ratio used in measuring access to free-to-use machines. This ratio fails also to consider that service-users may be unaware that they are within 1k of a free-to-use machine, or that they cannot easily reach these machines. It fails also to account for natural barriers, such as rivers or hills, as well as main roads or railways. The cash machine market cannot work for the service-user if their knowledge of the market is incomplete.

The second key barrier is that many basic bank account holders are currently prohibited from using any cash machine that doesn't belong to their own bank. Independent ATM Deployers are therefore more likely to place surcharges on other machines to make up for the reduced footfall.

Basic bank account holders are more likely to be poorer households who use cash to budget and cover the cost of living. If all basic bank account holders were able to access all ATMs on the LINK network, this would give them more convenient access to cash and likely reduce the need for surcharges on transactions at LINK ATMs.

Thirdly, the interchange fee setting process between banks and other organisations should be opened up to include social factors such as choice and access. The level of the interchange fee appears to be a key determinant of the likelihood of cash machines being either free- or pay-to-use, and subsequently in the charges faced by low-income service-users.

My general concern is that in poorer areas there is a greater chance of paying to withdraw cash. This is an example of low-income service-users paying more for basic services. We therefore want solutions to eliminate this bias against the poor.

Best wishes,

Frank Field

The Rt Hon Frank Field MP DL

Member of Parliament for Birkenhead

Handelsbanken
Great Britain

Handelsbanken response to the FCA's Payments Systems Regulation Call for Inputs

Introduction to Handelsbanken

Handelsbanken was founded 143 years ago in Sweden and now has over 800 branches and more than 11,500 employees in 24 countries. Having first established a presence in the UK in 1982, today the bank manages a network of 173 branches across the country.[1] Judged one of the world's strongest banks, and indeed Europe's strongest, Handelsbanken has substantially increased its lending support to British businesses and households throughout the financial crisis, whilst continuing to consolidate its capital and liquidity positions.[2] During this period, Handelsbanken did not require or request state or shareholder support.

Handelsbanken specialises in providing highly personalised, local and competitive banking services to both businesses and individuals. In our relationship banking model, all customer-related decisions are devolved to experienced branch teams who understand their customers' circumstances and their local market best.

Branch staff are not incentivised by targets or bonuses, helping to ensure that their advice and decisions are given with the customer's best interests in full focus. As a result, Handelsbanken has consistently maintained the highest banking customer satisfaction ratings since independent surveys began in 1989.[3]

Handelsbanken is not currently a direct member of all of the UK payment systems. We rely on agency relationships with some of our banking competitors to access the Cheque and Credit Clearing System (CCCS), as well as for BACS and Faster Payments. The first includes arrangements to provide counter services for our customers' cash and cheque pay-in requirements in England & Wales, and separately in Scotland too. In order to minimise risk to our customers, we pursue a multi-provider strategy in respect of counter services and our other agency arrangements.

Question 2: *Where do you believe competition is effective or ineffective within UK payment systems?*
Question 4: *What are the main factors impeding more effective competition at each level?*

It is evident that there is a fundamental competition issue pertaining to the indirect access granted to non-members of the payment systems, via agency agreements. We identify with the FCA's comments that, "direct members provide wholesale functionality to indirect participants with whom they also compete at the retail level" and that there are tensions in result.

Currently, not being a direct member puts banks such as ours at a distinct competitive disadvantage.

Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

There are a number of developments which have relied upon effective collaboration within the industry. The recent proposal for cheque imaging is one an example of this, of which we have been very supportive. The creation of central infrastructure to facilitate the imaging process – ultimately resulting in better outcomes for consumers – is something that could only be brought about by industry collaboration.

The industry-wide Current Account Switch Service (CASS) is another example of successful collaboration. As a challenger bank that has participated in CASS from the outset, we have been net

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[1] Announced branches, as per 15 April 2014
[2] "The World's Strongest Banks", Bloomberg Markets and Bloomberg Rankings, May 2013
[3] EPSI UK Ratings and Swedish Quality Index (SKI)

beneficiaries of the easier switching process, which provides customers with a guarantee for their service expectations.

Some innovation in payments is evidently reliant upon industry-wide collaboration.

Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership*

We are confident that the PSR will be capable of ensuring that the current ownership structure works more effectively and for the benefit of end users. In doing so, we believe that its following proposed powers are fundamental:

- The ability to ensure payment systems operators and their direct members, adhere to principles of efficient and transparent pricing, and non-discriminatory access.
- The ability to ensure that prices are set at the appropriate level to benefit current and future end-users of the payment systems.
- The power to ensure pricing structures are transparent to end users, as well as to third parties, which are given indirect access through agency arrangements, and that they are derived through a fair and transparent methodology.
- The ability to review and require amendment to pricing methodology where appropriate, and to intervene, if necessary, to set prices for both direct access to payment systems and indirect access via agency arrangements.
- The ability to ensure fair access to the payment systems, on reasonable commercial terms, both in terms of direct access and indirect access via agency arrangements.

It is important to point out that we consider “reasonable commercial terms” to encompass a contractual arrangement, as standard, to cover agency agreements. This would represent a significant step forwards from the loose agreements that the agency banking market currently operates upon.

Given these intended powers, we would not presuppose the necessity for a change in ownership structures from the outset, but would be open to this should the need become apparent. As such, we do not have a view on an alternative structure at this time.

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

With regard to costs, those associated with joining the three electronic systems (CHAPS, BACS and FPS) are more readily available than for the CCCS, once a Non-Disclosure Agreement is signed.

With regard to the CCCS, the highest cost is for the development changes required to the other members’ systems to enable them to accept a new member sort code into the process. These costs are to be picked up by the new member and run into millions, though significantly in terms of planning, no-one can say how much until each of the members advise accordingly.

Having recently concluded a pre-study into joining Faster Payments, we have determined that this would involve a very substantial capital investment for a bank of our size.

Payment Systems Regulation - Call for Inputs

Response of IBOS Association

Respondent - Bob Lyddon, General Secretary of IBOS Association

15 April 2014

Annex 1 – Cover Sheet – sent by separate scan

Response Contents:

IBOS is responding on the following questions only:

Question 1 – Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why

Question 3 – At which level(s) is there potential for competition to drive benefits for service-users, in terms of cost, quality or innovation?

Question 5 – What functions do you think need to be performed collaboratively within the industry? How best can this be achieved?

Question 8 – Do you have any concerns about the current governance of UK payment systems?

Question 18 – What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Question 25 – What, if any, are the significant benefits you see regulation bringing?

Question 26 – What, if any, are the risks arising from the regulation of payment systems?

Responses

Question 1 – Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why

If the service-user objective is to be fulfilled, at least all Payment Service Providers should be within scope, whether they fit within the narrow definition of 'systems' or not, and whether they are banks, Payment Institutions or eMoney companies or not. The minimum guideline definition for Payment Service Providers ('PSP') should be the EU's Payment Services Directive 2007 and its upcoming successor PSD II which was passed by the European Parliament in early April and will now go into the trialogue. That means that Third Party Providers should come in scope. The remaining question is whether bitcoin and digital virtual currencies fit within the meaning of Third Party Providers and, if not, how they would be brought within scope.

Another yardstick for the PSR's scope should be the European Commission's Green paper of January 2012 entitled "Towards an integrated European market for card, internet and mobile payments", of which PSD II is a derivative.

This paper would indicate that payment mechanisms like bitcoin and digital currency should come within PSR scope, noting the issue that such offerings to consumers may constitute any or all of a PSP, a payment scheme and payment system: they do not so easily qualify themselves into just one of the categories in the definitional framework.

These are payment companies because the consumer thinks they are a mechanism for transferring value.

PSD I was transposed into UK law as the Payment Service Regulations. It should be considered that the PSR become the UK's oversight of Payment Service Regulations rather than the Financial Ombudsman, in order that the PSR be all-encompassing, and that it is not possible to offer a payment mechanism in the UK without it coming under the purview of the PSR.

While recommending that new mechanisms come within scope of the PSR, IBOS Association sees challenges in fulfilling the criteria of access to clearing and settlement if these mechanisms are seeking an agency arrangement and do not intend to reach the criteria for direct clearing membership.

In order for the agency arrangement to be established at a direct member, the mechanism has to be onboarded as a customer and simply running a payment account for them raises the mismatches of business model compared – for example - to the traditional IBOS customer, which is a corporate registered in a particular jurisdiction, able to identify itself, its principals, its officer and signatories, its five main customers and five main suppliers and so on, in line with the Anti-Money Laundering, KYC and KYB requirements laid upon banks.

Such new mechanisms present particular challenges in the areas of place of incorporation, identifying the principals, Ultimate Beneficial Ownership and PEPs.

Question 3 – At which level(s) is there potential for competition to drive benefits for service-users, in terms of cost, quality or innovation?

We would like to explore the assumptions that lie behind the usage of the word 'level', in terms of the acceptance of the layered market model for the payments 'business'. We place 'business' in inverted commas as well, because payments was not always a business in its own right, and may not be now, but it is widely viewed as one on the strength of an internal unit in banks existing with that name. The validity of payments being viewed as a business at all should be examined based on its genesis and emergence.

Payments is normally (in banks) a subset of a Line of Business that has been established called variously Transaction Banking or Transaction Services, the first instances of which emerged in the late 1980s in US banking as 'Non-credit Services'.

US banks had lost significant amounts in lending and were looking for revenue replacement via services that did not tie up capital. These were identified as derivatives and off-balance sheet business, and Transaction Banking. Transaction Banking, having been previously seen simply as a utility or a service centre aimed at handling the clearing for the bank's own dealings and for customers, then became a profit centre.

The profitability of Transaction Banking as a unit is, however, nebulous in that it depends significantly on the internal deals struck with other parts of the bank over:

- Whether Operations is part of Transaction Banking, or whether Transaction Banking buys services from a separate Operations unit;
- Ownership of overdraft interest margin between Transaction Banking and the Relationship Manager, and what that margin is between what the customer pays and what Treasury defines as the cost-of-funds;
- What rate Treasury pays on current account balances compared to the rate the customer obtains, and how the difference is split between Transaction Banking and the Relationship Manager;
- What rate is applied to converting customers' payments if they go out or come in in foreign currency, whether that is a different rate to the one that Treasury deals on, and then, if there is a difference, how it is split between Transaction Banking and the Relationship Manager.

In IBOS' experience no two banks have drawn the lines in exactly the same place, or apply identical factors such as payback period for investments, internal rate of return, cost-of-funds or – for overdrafts – the Credit Conversion Factor and the Return on Capital target.

Differences at this level can cause huge discrepancies in the view of whether the business is profitable or not.

Now regulators have introduced both Basel II and III in order to cause banks to hold capital against risks in the Transaction Banking business, some of which are product-level risks (crystallised as Operational Risk Capital) and some of which are customer-level (e.g. intraday risk).

These developments belie any ongoing reference to Non-Credit Services and it becomes questionable whether Transaction Banking has a separate life beyond the Relationship Management divisions, especially when pricing is falling and the time and effort of maintaining – and then liaising with – separate divisions is significant.

A reversion to the status quo ante in this respect might bring with it a reversion to service centres for processing whose sole aim would be cost containment, and a disappearance of Transaction Banking as a Line of Business – meaning the Payments unit as a business would also be unwound.

By contrast we have a significant amount of regulator interest in payments, accepting it as a 'business' and not simply as an activity, and subjecting it to an analysis in terms of a certain template. IBOS would question the validity of this assumption, and suggest that regulators do not regulate a target that has moved in the meantime.

The recent Payments Council 'Payments Roadmap' accepted as its framework the EU working model of the payments business, which is that it must be transformed from Vertical Integration – the historical model – to Horizontal.

The premise is that there should be a Collaborative layer, in which market actors work together to create the 'rails' or infrastructure, and then a Competitive Layer, in which the market actors make their competitive offerings to service users based on feature, function, price and whatever.

The motivation for the change is the view that a Vertically Integrated market concentrates power in the hands of a small number of very large suppliers, who are then able to share the substantial revenues via allocations within their own business model, or with parallel large players in different geographical markets i.e. correspondent banks.

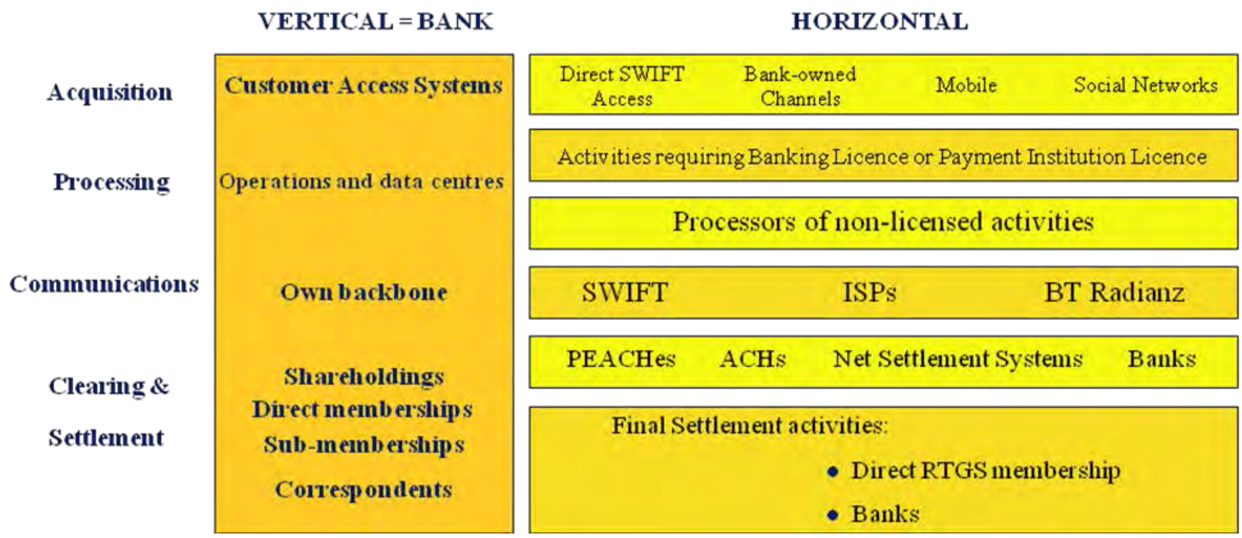
In the banking industry the existence of parallel large markets defined by geography and currency permits such a model to persist, but it is threatened when currency markets merge, as into the Euro, even if there were no further regulatory moves to force the market onto a different model.

Vertical Integration of the payments business

Under the vertically integrated model banks own and run the entire Value Chain through its different layers as shown in Figure 1:

- Banks own the customer access channel – a proprietary electronic banking or web channel
- Banks formulate the data standards and communications protocol themselves or via their cooperatives – internationally via SWIFT or domestically via a Bankers Association
- The communications networks are bank in-house or SWIFT, or tightly connected to a local clearing house (e.g. in the past Etebac in France, tightly linked to CFONB data standards and the SIT clearing)
- Clearing houses are either run by the Central Bank (who only allow banks to be direct members) or are run and owned by the major banks in the country concerned (e.g. BACS)
- The security methodology is bank-proprietary or taken from a small universe of IT vendors, and in the latter case it is the bank that controls the distribution to the users

Figure 1: Vertical and Horizontal integration in the Payments business



The EU Vision for the future market structure of payments is quite different: it is away from Vertical to Horizontal Integration and is shown on the right-hand side.

Under this model the layers are separate market spaces, each containing a competitive landscape of their own. It is perfectly possible to act in only one layer.

Restrictive practices are illegal, where a player or players in one layer can combine to either exclude new entrants or use their market dominance in one layer to distort competition in another.

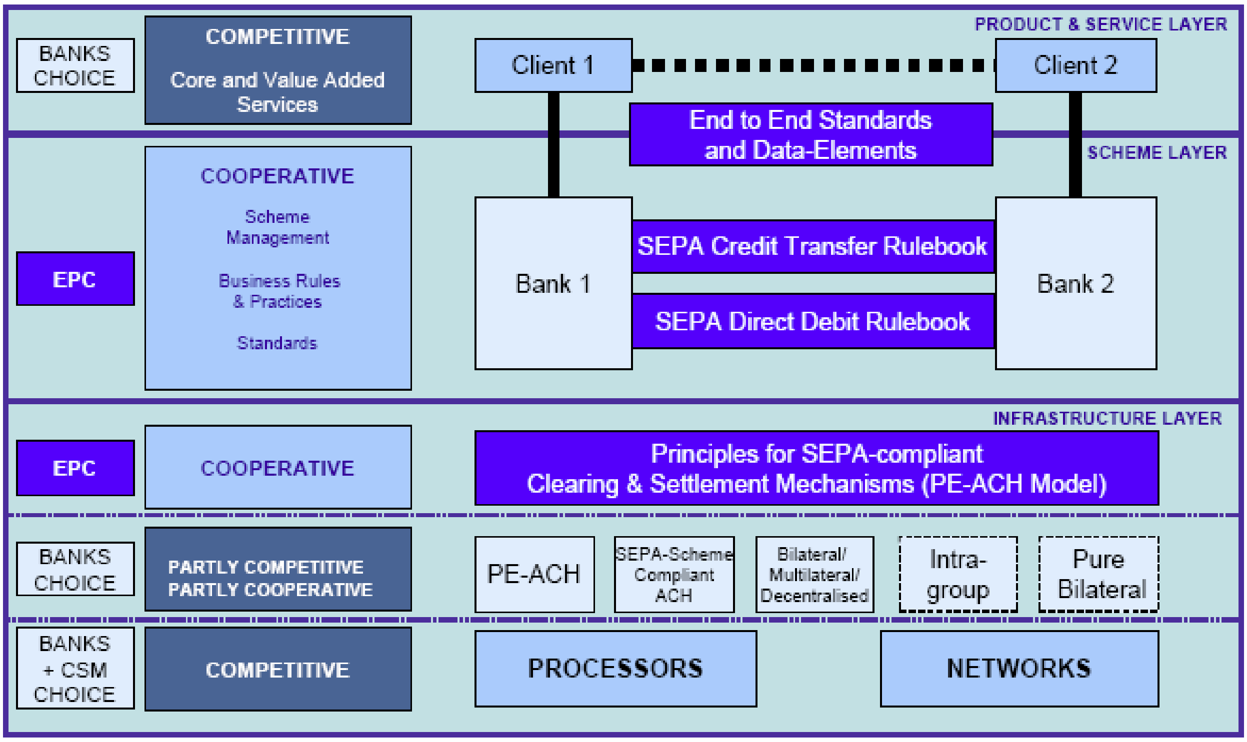
In the EU market model only two areas of activity are the unalterable preserve of Banks:

- Activities requiring a full Banking License (as opposed to a PI or eMI)
- RTGS clearing membership

This new market model is fully reflected in the EPC Design Model for Payments in Figure 2 (Source EPC). It shows:

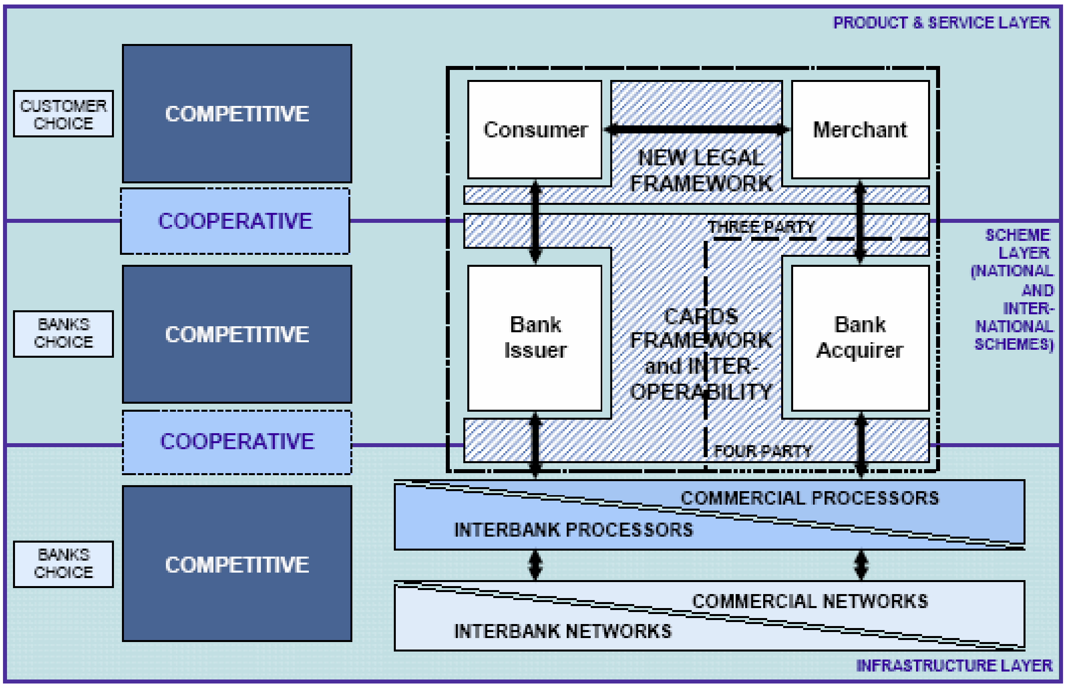
- The layering – a big change from status quo
- More layers and a more complex model than for Cards
- In principle a lot of space for non-bank "horizontal" players

Figure 2 – EPC Design Model for Payments in the SEPA Area



The EPC Design Model for Card Schemes in Figure 3 (Source EPC) reflects the Cards market as it is now, already layered, with plenty of space for non-banks like Mastercard and Visa, First Data, to have an important position in one or more layers.

Figure 3 – EPC Design Model for Cards in the SEPA Area



What's the point?

All well and good – but has it worked? The Cards market model above has been the de facto one in that market for many years, and yet the EU has identified difficulties of greater import and intractability in that one than in the Payments model. That means interchange, the perceived dominant market share of Visa and Mastercard, and the contention that these players abuse their dominant market share via interchange practices.

By contrast EU Reg 2560/2001 substantially eliminated lifting fees on cross-border payments in EUR, the major price issue, and subsequently the abolition of transaction-level Central Bank Reporting and the abolition of any money limit to which EU Reg 2560/2001 applies have eliminated all price points at which a regular payment becomes a much more expensive payment due its amount, currency and destination. It can be argued that Single Euro Payments Area adds very little to what was achieved by these regulations and that there is a case of lack of proportionality: SEPA has been vastly expensive for no noticeable benefit for the service-user, be they a consumer, a government body, an SME or a large corporate.

Many years of dispute have so far failed to deal with the sometimes very high Card interchange fees. This is issue will now be addressed by the Multilateral Interchange Fees Regulation that, with PSDII and 4AMLD, is part of the European Payments Legislative Package.

Single Euro Payments Area has been designed in accordance with this market model and the PSR, in IBOS' opinion, would be well advised to take a critical look at how that project has developed before accepting the market model as the appropriate one for the UK.

Question 5 – What functions do you think need to be performed collaboratively within the industry? How best can this be achieved?

IBOS recommends a detailed study of the SEPA project and of the collaboration methods used:

1. in creating ISO20022 XML and
2. within SWIFT, SWIFT being closely connected with ISO and having its messages labelled as SWIFT MX messages in its own message book.

IBOS recommends the PSR make a study of:

- The composition of the membership and boards of SWIFT (main board and national user groups), ISO20022, the EPC and its plenary and office holders, as well as some of the main executors of SEPA – Clearing & Settlement Systems such as EBA, STET and Equens
- The procedure for the creation of an ISO message involving SWIFT and ISO itself, and resulting also in a SWIFT MX message
- The history of ISO20022 through its various guises of TWIST, UNIFI, Corporate-to-Bank STP, SWIFT C2B XML and finally SWIFT MX
- The history of SWIFT-based collaborative initiatives such as ePayments+, eLeanor, TrustAct, Identrus, Bolero, Trade Services Utility and so on

IBOS can share some observations about SEPA. EPC created the schemes, and wrote the Message Usage Guidelines, using ISO20022 messages as the base messages. EPC then defined each ISO field in the base messages as:

- Red = must not be populated
- Yellow = mandatory
- Yellow = optional/mandatory (i.e. if a preceding field is filled in a certain way, the next field must then be filled in a prescribed way). A **SEPA <u>Core</u> Payment** only has Yellow fields populated
- White = available, not defined; 'communities' can define and use the field within their own sphere but its usage by some should not preclude others from sending and receiving payments to and from those users without the White fields being populated. This condition is known as interoperability. Filling of white fields is known as AOS – Additional Optional Services; a **SEPA Payment** has both Yellow and White fields populated.

Each Member State was asked some years ago to create its own Migration Plan off the back of the EPC documents and this has been done variously with the support of:

- The organisations in that country that are EPC members
- The national banking association
- User group associations
- The central bank

In such a decentralised approach not all of the elements of the plans are identical, and EPC has not shown great appetite to be directive that they should comply with a strict standard.

EPC has not issued:

- Conformed copies of each plan
- Master lists of transaction types in the legacy environment and how each one fits into the categories used in the SEPA Migration End Date Regulation (SMED)
- Lists of out-of-scope services
- Lists of Transitional Provisions taken up by each country (i.e. rights to delay SMED deadlines beyond 1/2/14)
- Lists of Additional Optional Services defined by each country (i.e. local variations of the EPC standards) that would result in 'SEPA Payments' as opposed to 'SEPA Core Payments'

With so little and such weak coordination from the centre, it was inevitable that harmonisation would not be the result.

In particular there is the issue of conflicting data in payment messages, caused by communities adopting AOS for their internal activity (e.g. within Finland) and then sharing data with other communities for inter-community payments.

This issue does not occur when Finland is the only country with AOS. It only starts when other communities define conflicting AOS which, if included in inter-community messages, threatens to cause the messages to fall out of the process flow.

The SMED Regulation addresses this issue by stating that it must not occur: that no adoption of AOS in one community should interfere with a two-way of communication to/from other communities.

It is easier to write that into a Regulation than to make sure it occurs, when the framework that has been created ensures the risk of it occurring is high: that two different communities define different AOS but using the same White Field and there is no formal plan to test conflict.

Bank statements

In the world of ISO20022 there is a series of advice and statement messages (with the prefix camt. standing for Cash Management) to carry the results to a client of payments going in and out of an account (out = pain. for Payments Initiation; in = pacs for Payments Clearing & Settlement).

As a result a customer should naturally take a camt. statement for SEPA because that statement layout is aligned to the contents of the SEPA payment messages.

SEPA is supposed to allow a user to run just one bank account for Euro payments but that cannot mean that the accounts will only have entries running over it that are originally in ISO20022 XML.

The statement will naturally have other entries running over it.

For SEPA it would make sense to take the account statement in ISO20022 XML camt – and code up the interfaces to internal systems to do cash application, reconciliation and cash management based on the data in camt..

However, where existing interfaces work off bank statements in other formats (national legacy formats, BAI, Edifact BANSTA etc), a number of issues arise:

1. Do the SEPA Payments contain the same data as the legacy payments and which is needed in order to drive the back-end processes at the user?
2. If some of the legacy data has been replicated in the form of nationally-defined AOS, does that appear in the camt. statement (as well as all the data for the SEPA Core Payment)?
3. What happens when the bank account is used also for:
    - Payments that are outside the scope of SEPA?
    - Other banking operations?

'Payments that are outside the scope of SEPA' and 'Other banking operations' will be originating in formats that are not ISO20022 XML.

If a customer continues to take a statement in the national legacy format, the data received will continue to support the back-end processes around 'Payments that are outside the scope of SEPA' and 'Other banking operations' – but not necessarily SEPA payments, where the data supplied will be different as from the migration date.

If a customer takes a camt statement, there will be some work to do (including handling AOS) to ensure the back-end processes around SEPA payments are retained, but then there will a lot of work to do to retain the back-end processes around 'Payments that are outside the scope of SEPA' and 'Other banking operations'.

Which is the lesser amount of time and effort? It is essential that these back-end processes do not revert to manual in any way. Legacy format statements usually contain codewords or numbers that support automation on the user side, but ISO20022 has no such system.

Should the corporate take two statements on the same account: camt to handle the SEPA payments and national to handle 'Payments that are outside the scope of SEPA' and 'Other banking operations'?

Should the corporate open separate accounts, thus frustrating the objectives of SEPA?

There is no policy on these matters from the EPC because they have limited their remit to the payment schemes and not the statements on the accounts on which those payments are booked.

This is a typical problem of a layered market model – the Horizontal Model – where, having created so many market actors operating on different aspects of the same deliverable, gaps and shortcomings inevitably appear. The result as of today is that the mature legacy EUR payments markets have been converted into the same number of immature SEPA markets, sacrificing the progress of 20 years, progress admittedly designed by the banks primarily within the Vertical model.

The outcome for service users – and in this case the concern is amongst corporates and government bodies – is a reduction in efficiency and a rise in overall cost: managing queues of unreconciled items.

Question 18 – What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

As referred to in the section about Bank Statements above, ISO20022 has the potential to resolve certain problems:

- Other bank statement formats being very good for one country but not for international business or for reporting activity that involves more than payments

- Real- or near real-time reporting that also gives the user the balance and the transactions together, and enough detail to run through their own IT application to adjust for items that the customer knows about and the bank does not

- A global entry coding system to enable automated reconciliation by systems like SAP, Oracle and Sage when they are deployed for the customer on a centralised basis (e.g. within a Shared Service Centre or Payment Factory), replacing the single-country systems available at the moment

However, what we have currently is disconnection, with multiple 'collaborative' streams of work going on in SWIFT, ISO itself, the Common Global Implementation Initiative, International Payments Framework, EPC and local associations. ISO has been 12 years in the creation and has not achieved its original aims, that is the aims framed by the TWIST group.

ISO20022 is so closely connected to SEPA and to the EPC market model for payments, and indeed to the Horizontal Market Model, that it is worthwhile to consider the history and development of ISO20022 laid out at some length below. Please forgive the repetition here of some of the previous content but it is important in our view that the story be told in the way it developed.

Essential to the Market Model for SEPA is the concept of creating a level playing field as regards the basic components of the service:

- The data formats
- The means of communication
- The communications protocol
- The way payments clear and settle

Just like in the Telecomms sector, the basis of competition should not be the basics:

- Can I phone you when you use a different network?
- Is it much more expensive to phone someone using a different network?
- Is it much more expensive to phone Frankfurt from Paris than from Hamburg?

This concept is variously referred to as "the Collaborative Space" compared to the "Competitive Space". In the above models , "the Collaborative Space" is referred to as "the Cooperative Space", and it is also known as "Commoditised" or "Core" or "Core&Basic", or, figuratively, as the establishment of the rails for the trains to run on. That is in contrast to the "the Competitive Space" which is also known as "the Value-Added Space".

It was then accepted that the SEPA Schemes sat within the “Collaborative Space” in this Market Model, without regard for the initial SEPA promises:

- That the new schemes would be “Best-in-class”, better than any pre-existing service in a Euro-In country;
- That as a result no customer would experience a loss of functionality or added-value through the introduction of SEPA

As a result the benefits to the customer at once became expressed within a somewhat theoretical model for how free markets should work.

EPC took up the model and began to produce rulebooks and frameworks:

- Rulebooks where the subject was within their remit to define it according to the layered Market Model;
- Frameworks where it wasn’t, but where certain principles (in the EPC’s view) had to be adhered to for the market to work.

EPC’s designing a framework precluded – de facto if not de iure – any other body emerging with a different view, such that the SEPA deliverables increasingly came from one ultimate source (if not in all instances directly from it).

This leads us to the next area where SEPA has expanded in scope, or, looked at another way, how the SEPA Project has delivered precise definitions not just for the rails, but also for the rolling stock, the signals, the timetable, the staff uniforms, thus severely compressing the “Competitive” or “Value Added” space.

The results of a market like that are:

- Commoditisation of the service
- No space for product differentiation
- Low pricing… and no profits for the supplier
- No investment case for new services
- Stagnation
- Lack of innovation
- Customer dissatisfaction

Role of SWIFT s.c. – Brussels-based cooperative for payment messaging

SWIFT is a bank owned cooperative for secure financial messaging. Started in the 1970s, its staple offering is a book of standards for messages for Payments, Reporting, Trade, Securities and Statements containing what are, in effect and originally, structured telex messages. Banks composed telex messages to their own layout and terminology so that it was difficult to subject them to data processing. SWIFT’s versions emerge as SWIFT messages that are composed of quite short strings of characters, and which can be subjected to data processing.

SWIFT is a big organisation with thousands of banks as members and its original market space is what used to be done by telex:

- International messages
- Between banks
- Enabling clearing and settlement of transactions that customers initiated by other means

The SWIFT messages go under the prefix MT:

- MT103 = Customer Payment
- MT202 = Interbank payment
- MT940 = Customer bank statement
- MT950 = Bank's bank statement

A key point is that the main traffic over SWIFT was interbank payments such as settlement of Foreign Exchange, and these payments:

- Have a large amount
- Must be settled on a specific value date
- Need to be settled in a high-value payments system like TARGET or CHAPS

So SWIFT's history places it into the same space as TARGET, CHAPS, EBA Euro1 and other high-value payments system, LVTS, RTGS... but SEPA plays in the low-value space.

In a SEPA context there was a real threat that existing volumes of cross-border payments would shift from high-value execution to low-value because of cost, as soon as a low-value circuit became available.

This might damage SWIFT's cost economics – fewer payments over an existing and expensive infrastructure – and leave SWIFT as a peripheral player:

SEPA	**SWIFT**
Domestic	Cross-border
Low-value	High-value
Net settlement	Gross settlement

In addition to this, SWIFT's MT messages were used by banks to execute customer payments, but the customers themselves issued their instructions by other means: eBanking, fax or a letter.
SWIFT thus saw barriers to propagating their existing service to more users, as well as a threat to the volumes going through the existing service.

SWIFT had been successful where there was new demand for high-value clearing systems:

- It became the network carrier for TARGET, which is both domestic and cross-border
- It benefited from the condition attached to IMF loans that any country that needed balance of payments support from the IMF had to install a Real-Time Gross Settlement payments clearing system for domestic high-value payments – so Sudan has an RTGS system even though the daily money movement is minimal

SWIFT thus secured a global leadership position in domestic and cross-border high-value payments. But it needed to respond to the threat proposed by SEPA to its existing business – and also to see if SEPA presented opportunities.

Whether SEPA was the chicken or the egg, SWIFT then set its future objectives in such a way as to correlate very closely with SEPA:

- To penetrate domestic and cross-border low-value clearing
- To ensure its message book was used end-to-end and not just bank-to-bank (i.e. customers to use SWIFT messages to instruct their payments, and the banks to execute them using SWIFT messages)
- To ensure that no other organisation held the standards book for any of the above

This is all clear from the paper "SWIFT2006 – SWIFT Vision paper for the SWIFT Board 21st February 2003" from which key extracts are around the so-called "Banking Market Strategy":

- "XML is the basis for the future" (p7)
- "[SWIFT is] an international open forum for the world's financial institutions to address industry level threats" (p12)
- "Strategic Priorities (p20):
    - Market infrastructure and Bank-to-Bank: establish strong position in low-value bulk payments
    - Bank to corporate: gain position in bank to corporate connectivity"
- "Standards Strategy (p30) – to maintain standards leadership…to ensure standards convergence and interoperability across the industry by supporting and pursuing the adoption of the ISO methodology and data dictionary"
- "our offer is based on SWIFTNet FileAct.. we will support all bulk payment models (like) Pan-European ACHs" (p51) – ACH means an Automated Clearing House, like BACS, for low-value payments

This is expressed in SWIFT-speak and needs some explanation in order to "read the tealeaves":

- SWIFT would come up with a new message book expressed in Extensible Mark-Up Language (XML)
- That – combined with their file transfer service called FileAct – would be the service set to get them into "bulk" payments, meaning domestic and cross-border low-value payments
- SEPA was both domestic and cross-border low-value payments, so SWIFT's aim of supporting Pan-European ACHs meant they saw SEPA as a major market entry opportunity

A Pan-European ACH – PEACH – was the clearing and settlement outlined at the time for SEPA: it would handle low-value domestic payments within Euro-in countries and low-value cross-border payments between SEPA Area countries.

SEPA thus offered SWIFT the opportunity to realise several of its strategic aims simultaneously, since SEPA would offer immediate critical mass to any new offering that could be adopted for:

- All low-value domestic payments within all Euro-in countries
- All low-value cross-border payments between SEPA Area countries

When two opportunities presented themselves, SWIFT was well placed to capitalise upon them

- The EPC needed a Secretary General
- A well-backed non-bank initiative called UNIFI emerged to create a message book written in XML for interactions between corporates and banks

The result was:

- The EPC would take on as its first Secretary General the SWIFT Executive responsible for the Banking Market Strategy quoted above
- The EPC would adopt SWIFT's emerging standards in XML as the message book for SEPA and help them obtain critical mass
- The EPC would help SWIFT take over UNIFI and run it as a SWIFT initiative: UNIFI was perceived as a threat to SWIFT because it too was developing standards for payment messages

It was taken as read that SWIFT's emerging standards in XML could deliver:

- Best-in-class payment services
- A guarantee of no loss of value-adding features

It was taken as read that the new XML messages would resolve known shortcomings in the SWIFT MT message set:

- The normal coding one sees against an entry on an MT940 Customer bank statement is either MSC or MSD, standing for Miscellaneous Credit or Miscellaneous Debit
- That is no good for the automation of accounting
- The field for remittance information in SWIFT messages is rarely greater than 6 lines of 35 characters, far fewer than in Electronic Data Interchange formats

A partnership was established with the UNIFI initiative and its name progressively changed into Corporate STP, SWIFT C2B XML, SWIFT MX and finally ISO20022 XML. It is important to appreciate the lustre of the International Standards Organisation etiquette. Registering these XML messages as ISO messages lends them a credibility that their content and history may not on their own merit. The ISO label is a statement of the claim that these messages are global and all-encompassing, and the sole rightful occupant of this market space.

Note that the other "partners" in the UNIFI initiative soon faded into the background, and the original aims of the project were not carried forward as the future focus.

Instead the initiative was pursued within the grouping of SWIFT acting with EPC, EBA, ISO, such that now it is mandatory for all SEPA payments to use SWIFT's product: ISO20022 XML.

SWIFT has thus been granted a de facto and a nearly de iure monopoly over a major component of the European payments market: is that the indicator of a free market?

This monopoly has been entrenched by the European regulators within the SEPA Migration End Date Regulation: bank-to-bank messaging must already now be carried out in ISO20022 XML and by February 2016 all customer-to-bank traffic – when done in bulk files – must be in ISO20022 XML. There are strict conditions for any new format to be allowable: it must obtain critical mass of both countries, banks and users within a short time after start-up, an impossible hurdle.

Genesis and emergence of the ISO20022 – supposed global payment messaging standard

Once upon a time corporate customers had a problem (and they still have it). Corporates have an internal Treasury unit for managing foreign exchange risk, loans, deposits, liquidity risk and so on, and the technology application for managing these issues is known as a Treasury Workstation (TWS).

This is not the same as an electronic banking system provided by a bank (eBanking):

Treasury Workstation (TWS)	eBanking
The product scope is foreign exchange, loans, deposits etc – with banks but also with other parts of the same corporate, with payments and account balance information needed to settle and manage the main business	The product scope is payments and receipts, account balance information The bank may offer other systems for: • Foreign exchange, loans and deposits • Trade services
A TWS is agnostic as to which bank the customer uses	The purpose of the system is to drive business into the bank offering the service
Data format used is selected by the vendor	Geared to data formats used within the bank's applications
The TWS will support a range of standard communications methods (e.g. File Transfer Protocol) to deal with other parties	The system will use a communications method selected by the bank
The TWS will support an industry-accepted security methodology e.g. SSL	The system will have its own security methodology and tokens

The key point was that the bank might be willing to send out statement information to the TWS through a method different from eBanking, but it would not accept the security methodology of the TWS for transmission of payment orders to the bank.

Payment orders had to come to the bank through an approved and secure channel (approved by and secure for the bank):

- The customer had to install as many eBanking systems as it used banks for payments
- This led to a multi-banked customer having a wallet full of different security tokens and passwords, and even having to log on to different PCs
- Customers simply started to scratch their ID and password onto each token
- The internal audit department did not like this, and did not also like the elephantine internal process for authorising payments in the TWS, encrypting the file in the TWS and moving it securely into eBanking, and then decrypting the file and re-authorising it in eBanking: multiplied by the number of banks with each eBanking having different workflow and authorisation levels/procedures

As a result a group of corporates – led by Shell and Ernst&Young – kicked off an entirely sensible initiative called TWIST – Treasury Workstation Integration Standards. Its aim was to create messages in XML for all of the operations customarily conducted between the corporate's Treasury and other parts of its own company, and between the corporate's Treasury and its financial counterparties (banks, brokers, custodians..).

The aim was that the same operation could be conducted in the same way and using the same data formats regardless of:

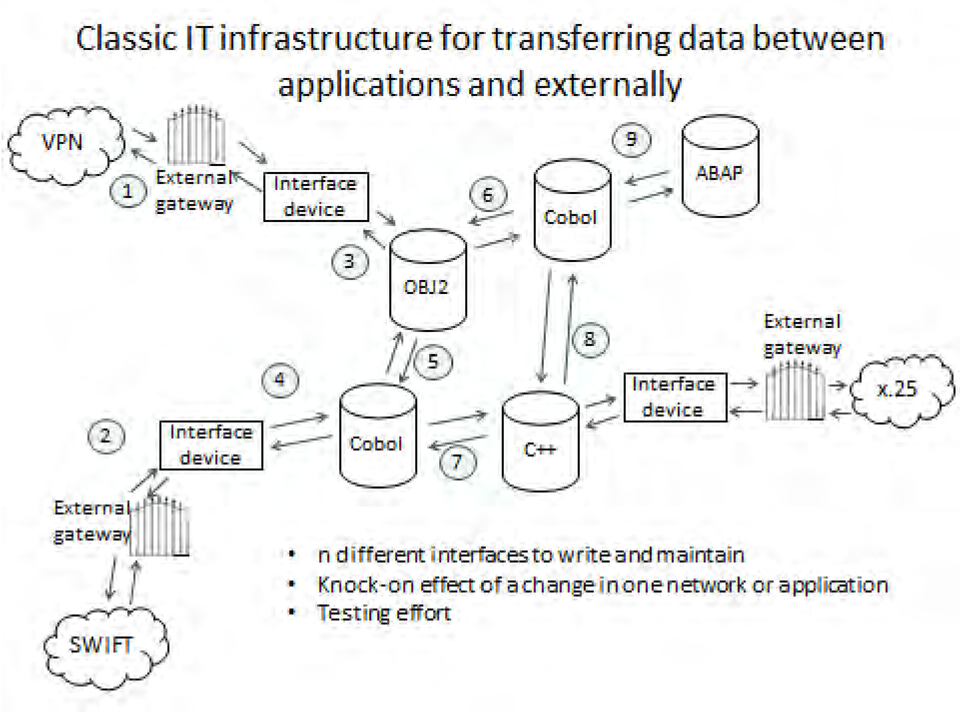
- Which the Treasury Workstation was being used (all the suppliers were non-banks like Wall Street Systems, Sungard, Trema, Richmond)
- Which banks were being used

TWIST's groundwork soon led to the creation of a powerful combination of similar parties (like OAG, OFX and RosettaNet) into a grouping called UNIFI.

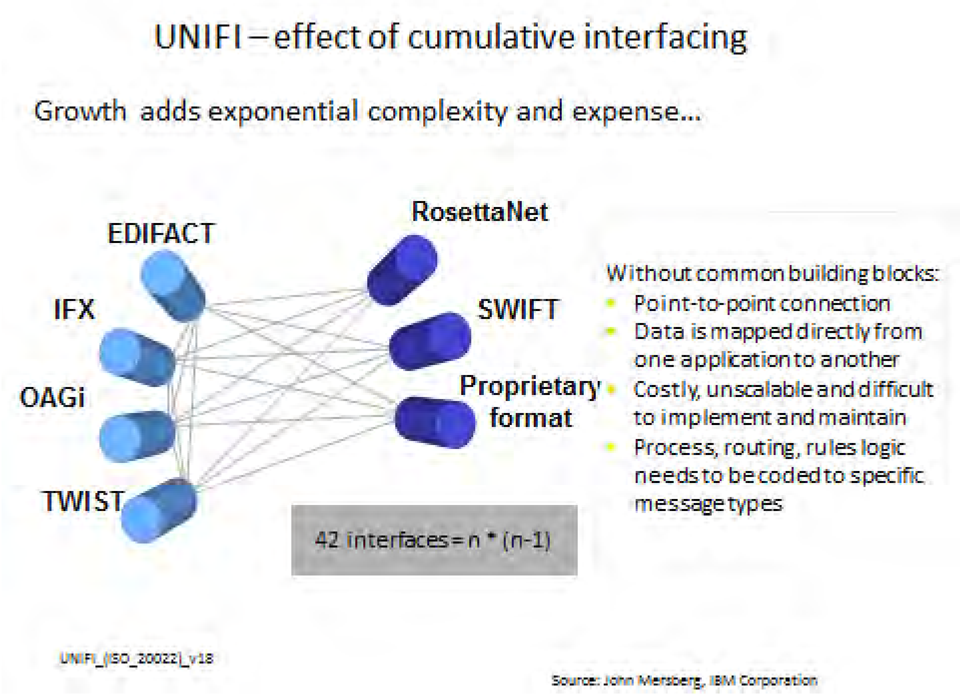
UNIFI's aim was to create an agnostic data format to ease sharing of data between different IT applications within a complex organisation and with its external business partners.

The classic IT infrastructure would involve direct interfaces between applications and to external gateways, interfaces needing to be maintained and altered whenever a change was made at one end or even in a further application. Any change would need to be submitted to complex testing – unit testing, integration testing, regression testing.

This issue can be graphically represented as follows:



This is the same problem of interfacing IT systems that UNIFI depicted as follows:

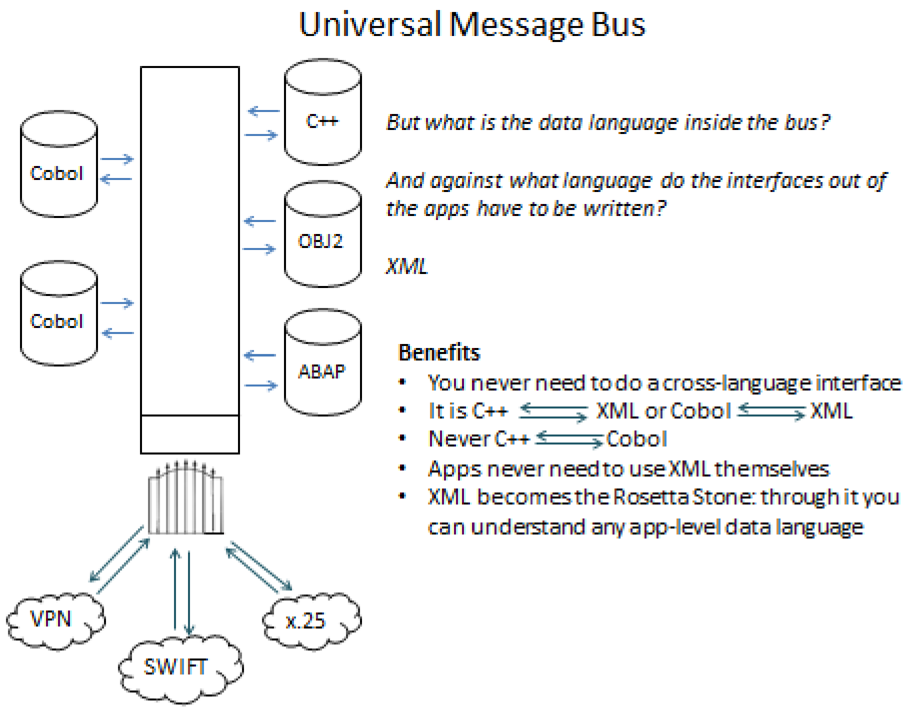


Instead of this spaghetti, there should be a single communication highway established to carry all messages that need to go from one application to another or into/out of a gateway.

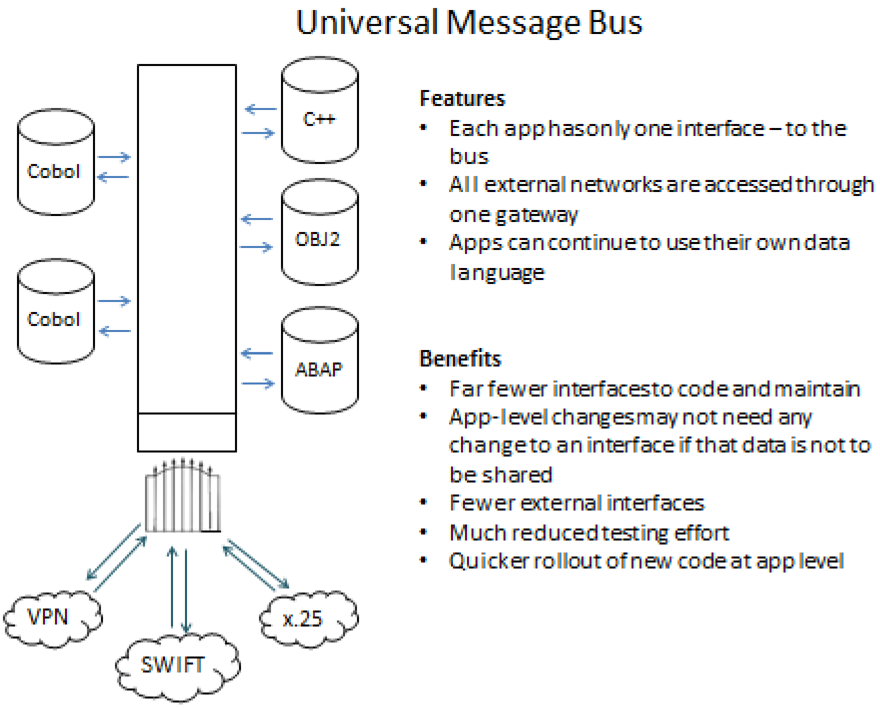
The highway is known as a Universal Message Bus and the traffic along the highway would be messages written in XML.

XML messages would flow up and down a Universal Message Bus, and each system would speak to the Bus only in XML. No longer would each system need to have a direct interface coded to every other application with which it wished to share data.

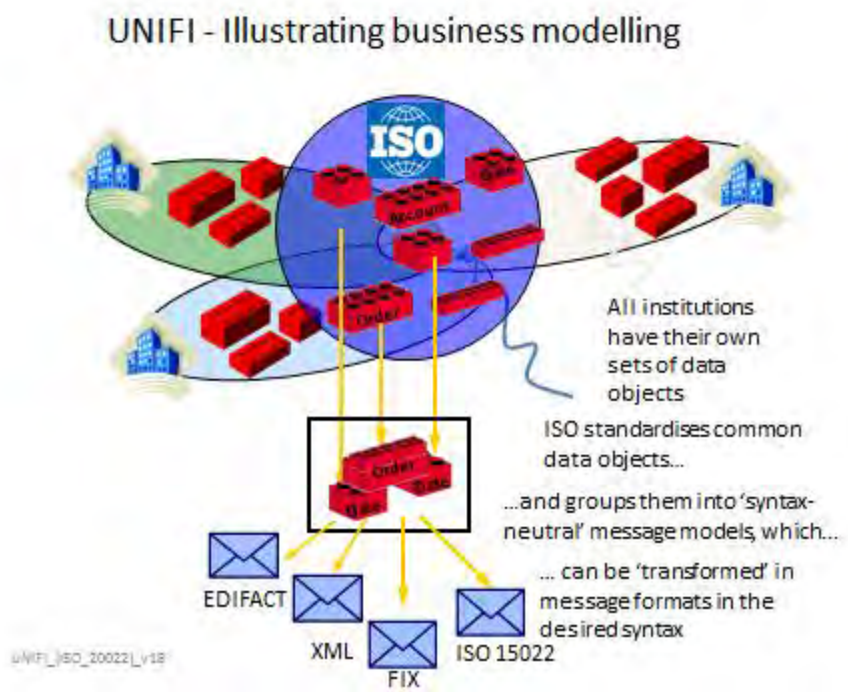
Instead – and regardless of which data language a particular application used internally – only one interface would ever need to be coded per application, between the data language used by that application and XML:



This would have numerous benefits:



This topology is expressed in UNIFI's own presentation:



The reason RosettaNet was named as it was comes to the comparison with the Rosetta Stone: the three-sided stone from which the known content of Ptolemy's decree written in classical and demotic Greek led to the unscrambling of the third side ~ Egyptian hieroglyphics.

It was unnecessary to directly understand Egyptian hieroglyphics when one had the crib in Greek.

Likewise it would be unnecessary to code from C++ into Cobol when one had the crib in XML. Each data language then only needed to show its plaintext in its own language and its accompanying crib in XML: to do the other half of the interface the programmers needed only the crib in XML for the other data language.

Entirely logical, but already one can see SWIFT inserting itself into the picture, at the initial stage as a format to be translated to, on a par with EDIFACT and any proprietary format (such as CFONB or other national formats).

Already one can also see the concept of having the XML cribs mutating into ‘messages’, and of having those messages registered as ISO messages – International Standards Organisation.

Mutation of ISO20022 from Rosetta Stone to mandatory data format

SWIFT inserted itself into UNIFI as a “partner”, and is now the effective owner of the ISO messages that emanated from the UNIFI initiative.

SWIFT’s current status on ISO20022 XML is in line with major parts of its 2006 Vision. It has become the registration authority for the message standards under the overall standard ISO20022, and has made its new message series – SWIFT MX replacing SWIFT MT – identical to the ISO20022 messages.

At the same time SWIFT ensured that SEPA used its messages in the SEPA Data Model: all messages used in the SEPA payment schemes are ISO20022 XML messages registered with SWIFT.

Now the European Parliament’s SEPA Migration End Date Regulation has made the usage of ISO20022 mandatory:

- For all messages between banks, and between banks and clearing mechanisms
- For all files of messages sent between customers and banks

This entrenches a key deviation from the UNIFI vision, that XML was never meant to be used at the application level, or ‘end-to-end’. The effort and cost in achieving that was deemed unnecessary, and it would limit freedom to code applications in languages appropriate to the task in hand. Instead all payments applications now have to use ISO20022 XML, forcing that data language on all actors in the supply chain of payments.

ISO20022 will by definition become best-of-breed in the SEPA Area because all other message standards for payments (Edifact, CFONB, DTA...) will have been retired. There will be no further discussion of no user losing out due to SEPA or of the comparison of value between SEPA Schemes and legacy schemes – because the latter will have been expunged.

In the case of SEPA the pursuit of the layered market can be construed as creating a de facto monopoly for a single supplier, which will result in the elimination of customer choice in the hunt for the harmonisation of the ‘Collaborative’ layer.

Question 8 – Do you have any concerns about the current governance of UK payment systems?

The current configuration with Vocalink at the centre, and with Faster Payments and BACS being cleared through it, seems to be the main bone of contention and thus our concern would be that there be a full and proper study about the creation of Vocalink, and its relationship with the Cruikshank Report, the creation of Faster Payments, and the Benefits Payments Automation Project.

There are also the related issues of conflict of interest amongst advisers, and decision-making.

Conflict of interest

Starting with conflict of interest, IBOS would like to raise an issue about influencers of the current governance of UK payment systems, whereby we would pick out two consultancies in particular that have a payments practice and who will undoubtedly show an interest in the work of the PSR and even seek to work on engagements for them, but who are conflicted in a way in which the PSR may be unaware.

There is a concern about the very close connections between Vocalink and one of the Big 4 accountancy firms in the matter of propagating the Faster Payment model into the rest of the world. The Big 4 firm and those with close associations with them – past and present – are conflicted in matters of payment services regulation in the UK because they have so vested an interest in the success of the Faster Payments solution.

A major IT consultancy, which supported the PSR's Call for Inputs event, are also conflicted due to their major business in constructing the IT infrastructure for new payments entrants, and resulting interest in making sure that these players gain unfettered access to the market.

Decision-making

The next issue is decision-making, using examples from the initial implementation of Payments Services Directive in 2007-8, and then reacting to the provision to reduce cycle time in 2012 to D+1.

Cruikshank Report basically concluded that the BACS cycle was too slow at D+2, or even with availability at D+3 if the beneficiary account was with a building society.

Payment Services Directive allowed D+3 to remain the maximum from transposition (+/- 2009) until 2012, but then the maximum cycle time had to reduce to D+1: BACS remained and remains at D+2, as it was in 1990.

How was it decided to create Faster Payments as the response to Cruikshank instead of simply cutting the BACS cycle to D+1? How was it then decided that BACS could remain at D+2/3 for the first period of PSD when maximum cycle time was D+3 i.e. from 2009-2012?

This was within the same timeframe as Vocalink was created and as Voca had obtained a large investment (£500million) to replace the infrastructure for BACS, but without altering the BACS cycle.

When the cycle time had to be reduced to D+1, the banks and Vocalink were faced with the dilemma that there were two submission models for BACS:

- Direct to Vocalink via Bacstel-IP
- Through a bank's eBanking system

The models had different outcomes in terms of when the payer was debited:

Direct to Vocalink via Bacstel-IP

- On D+2, after processing on D+1
- There is thus no float under this model
- All debits and credits are booked on D+2 with value D+2
- This method can be deemed PSD-compliant if the order party for the payment agrees that these are "agreed future dated payments"
- No IT work was thus necessary on this model to prepare for D+1 in 2012

Through a bank's eBanking system

- The customer is debited on D, unless the bank wants to run a credit risk by sending the payment in its own BACS file to Vocalink on D and waiting until D+2 to debit the customer
- Or else the bank could make a shadow debit on D blocking the amount between D and D+2: that would be a new IT process and highly complex and expensive, and needing explanation to the customer
- This second variant would inhibit operations where a customer instructed the payment on D while expecting funds in on D+1 to cover settlement on D+2
- Instead it was decided (Who by? When? How? On what criteria?) that all payments instructed by customers via eBanking would be settled by Faster Payments after 1.1.12, with a limit set by each bank but never higher than £100,000 and where not all sort codes were at the time addressable

How was it decided and by whom that files submitted to Vocalink direct should be classified as "agreed future dated payments"? In what way was the agreement of the instructing customer obtained? Was the customer offered any choice that was a real choice, if they had large bulk files that needed to go through BACS because the bank's eBanking channel was not a realistic alternative?

How much reliance was placed on the legal concept of deemed agreement by the customer on the basis that the customer continued to use the service?

Creation of Vocalink and the BPAP

The major investment in Voca in the early 2000s was timed both to respond to the Cruikshank report and to the Benefits Payments Automation Project ('BPAP').

The BPAP, based on the Department of Work & Pensions office in Longbenton in Newcastle, was tasked by the UK government in 1999 with reducing fraud in benefits payments by moving them onto a 'fast, modern and efficient payment system – BACS' (quoted from the yellow paper). Of course BACS at the time was efficient but neither fast nor modern. There was a lack of understanding at the government level.

The DWP hired EDS and PwC to create a design for and to realise the project (note the lack of separation between design and implementation and the consequent possibility of a conflict of interest). The internal lead client at DWP was Martin Wilson, who became Deputy CEO at Voca under Marion King, around the time Voca was merged with Link.

The BPAP project design should have been quite simple: insert a customer accounting system like Sanchez or iFlex as the application interfacing to the DWP 'benefit computers' – the separate computers that calculated the different benefits.

The purpose of the customer accounting system was initially to receive a benefit payment onto the applicant's account, enabling 'One View of the Customer' for DWP:

- One account per applicant per NI number per home address, thus eliminating the same person having multiple NI numbers and home addresses and drawing the same benefit under each from the same benefit computer

- One benefit computer would not be able to make two payments to the same destination account number, further controlling the problem of same person/multiple instances of the same benefit

- Enabling sanity check on money amount of benefits to one person (number of Child Benefit payments) and enabling a total benefits payment limit per person, had the government decided them to introduce one

There would have been little reengineering in the DWP benefits computers themselves as they would have continued to output files of entitlements, in future each one crediting applicants' accounts on the customer account system, rather than giving rise to a book of foils or a girocheque.

Having established one view of the customer from the DWP's side in a relatively easy manner, there would then be significant advantages for the applicant:

- The same person would be able to see all their individual benefits being paid to them, and the supporting information about their entitlement and future payments;

- No need for a separate book of foils for each benefit;

- Freedom of choice as to how and when to receive their money.

With that accounts system in place, it would have been workable to fulfil the last point above by placing a User Interface level using a standard CRM application such as Broadvision and a payments processing application such as CoACH, through which the customer could:

- View their account
- Choose how they would like to have the money paid to them:
  - All by BACS to themselves
  - In parts by BACS to pay their landlord, the council, Visa…
  - Continue with the books of foils
  - Stored value card etc
- Request a payment, see it debited and obtain a payment reference

Instead BACS was ‘modernised’ at huge cost but without improvement of functionality or timing, and apparently without solving the problem of benefit fraud, and not eliminating cases of applicant having two or more NI numbers, receiving multiple instances of the same benefit and so on.

Then at the same time Voca created Faster Payments, at huge cost.

The governance and machinations of all of that need to be thoroughly examined as a test case for how the payment systems work.

Question 25 – What, if any, are the significant benefits you see regulation bringing?

To construe, for the benefit of service users, the many actors in the Horizontal Market Model as collectively responsible for the outcome to the service user

To protect the consumer from holding assets/value in or sending assets/value through payment arrangements that are unsecure, improperly capitalised, improperly or not licensed or supervised

Compelling all offerers of payment arrangements to comply with the same set of regulations (Data Protection, Consumer Credit, Payment Services Directive, Anti-Money Laudering Directive, Funds Transfer Regulation and so on)

To identify and eliminate conflicts of interest

Question 26 – What, if any, are the risks arising from the regulation of payment systems?

The risks rotate around the potential conflict between:

1. the direction of travel of the regulation of payment systems; and

2. the direction of travel of other regulators.

Other regulators are concerned with de-risking the banks, via Vickers, Basel III, 4AMLD and so on, which is resulting in banks exiting or reducing presence in many activities, and then retrenching to so-called 'Home Markets'. 'International' becomes the black sheep.

For example, the new challenger bank TSB has in its advertising a clear conflation of overseas business with speculation. RBS has been asked by regulators to dis-invest outside the UK. Barclays is an example of an institution where International is being bundled with Investment banking, outside the ringfence. Thus Barclays' international network is aligned to BarCap and has as its role to raise the liabilities to fund BarCap's balance sheet.

In this movement the Financial Institutions division (aka Correspondent Banking) is being aligned into International/Investment banking, a unit that certainly has no interest in retail payments or helping new entrants access payment systems in the UK.

The issue is that the new operational model in banks shuns International and as a result lacks the facilities and knowledge to get to grips with customers that have an international dimension. This will inevitably lead to an Access problem if the new players seek an agency relationship.

This is important for the PSR's work because, in IBOS' opinion, it is not possible to segment the payments business into Domestic and International. Certainly this is not plausible on the corporate side, where the service user is anything larger than the low-end of SME, because corporates participate in global supply chains.

In fact, IBOS would disagree that even the retail side can be so segmented because:

- Payment service providers could either be foreign and be using EU passporting, or have shareholders or principals who are foreign and who need to go through non-resident AML checks;
- The PSR's activities will inevitably be circumscribed by EU law and global initiatives such as FATF.

The impacts of these high-level trends find resonance in the payments business and PSR's remit as follows:

- 'International' business is seen as high risk, domestic as low risk

- If the mandate of the onshore bank (the other side from International/Investment banking) is to concentrate on business in its home market, there may simply be no division within whose target market fall the new payment providers, and their having an international angle will act as a further deterrent to such a division being created

- The expertise for banking financial companies will have gone off to International/Investment banking with the FI division
- New payment providers have a profile that makes them unattractive to a domestic banker
- A domestic banker may have no access to departments such as RiskMan and Compliance who see it as their role to facilitate onboarding such new players, and indeed their view may be that these new players should be shunned

This latter view would contradict sharply with that of the new payment providers themselves, who would ask why the licence they have obtain from financial regulators does not represent an automatic credential for them to be onboarded by a direct clearer.

The profile of new payment provider would frequently tick many boxes in the onboarding process that point to the need for Enhanced Due Diligence or a straightforward turn-down:

- Funded by VC
- Leveraged with debt as soon as they come out of the Angel phase
- Relatively low capital
- Technology of a medium level of robustness when measured against what is required by central banks of banks that wish to become direct clearing members
- International aspects
- Would be classed as a Money services company in the industry segment definition framework in the bank

A Money services company is the last target market for which any Relationship Manager would wish to be responsible in the current regulatory climate:

- Fresh memories of HSBC Mexico
- Very difficult to see how the bank can get satisfaction on the payments traffic of the Money services company when the EU's Funds Transfer Regulation comes into force
- Very difficult to get a Money services company through the initial Onboarding checks for AML/KYC/KYB – identification of the entity, its principals, its managers, its premises, its signatories etc…
- Where venture capital is involved, the identification of the Ultimate Beneficial Owners is time-consuming
- Where it is VC and international, the application is tagged as High Risk and the UBO percentage falls to 10%, exponentially increasing the AML/KYC/KYB workload

A Relationship Manager might well require indemnities from their employer for taking on such a portfolio with career-limiting risks attached, but it is hard to see how indemnities can be forthcoming when the Relationship Manager would be the named individual for the customer, and where legal action, for example in the USA, can easily be against an individual as well as, or instead of, the institution.

The new payment providers themselves will surely react to this by demanding that the regulator mandate that direct clearers accept them as customers if they have passed the AML/KYC/KYB checks for the financial regulator from whom they have obtained their licence.

What would be the reaction of regulators to that demand? Do they have the powers or the will to demand that of a private business? In other words to determine the Customer Acquisition Policy of a privately-owned bank? Or would the PSR limit that to the banks in which the UK government has a stake? If the PSR did that, what would happen when the government sold down it stake?

Alternatively should there be a special bank through which new payment providers could access the clearing and which would buffer the risks between the new payment providers and the private clearing banks?

That concept of a special purpose payments bank is not unknown; an example would be SECB Swiss Euro Clearing Bank GmbH, Frankfurt:

http://www.secb.de/secb/index1.htm

This bank was created in order for the Swiss banks to access the TARGET system: SECB is a TARGET member bank through the Bundesbank in Frankfurt, as well as a participant in the euro sic domestic EUR clearing in Switzerland being run by the Swiss Central Bank. As a result the many savings and cantonal banks in Switzerland do not have to join TARGET themselves but can make TARGET payments through their membership of the domestic euro sic system: once they meet the Swiss Central Bank criteria, they get TARGET access without further investment or holding of collateral. IBOS believes that central bank money held at the Swiss Central Bank – whether in EUR or CHF – is viewed by the Swiss Central Bank as fungible between the paying bank's EUR and CHF payment orders, due to the low volatility of the EUR/CHF exchange rate.

SECB Swiss Euro Clearing Bank GmbH is thus a special-purpose bank created to enable a linkage to a foreign currency clearing, while offering efficiencies in the holding of cash/collateral. Should there be a special bank in the UK to enable new payment providers to access CHAPS, FP, BACS etc in GBP, and perhaps to access TARGET and a SEPA CSM as well?

That bank would in effect be offering an ongoing warranty to the other clearing banks that its customers had passed UK-standard AML checks in order to be onboarded, and that payments traffic in production would be filtered to the correct level. The bank would also be guaranteeing settlement of the traffic under clearing house rules.

In other words that bank would be taking the risks that the private banks may be unwilling to take, and indemnifying them against the consequences of regulators promoting access for these new market participants.

Should that special-purpose bank be the Bank of England?

The Bank of England is the best-placed institution to take that role as it would be trusted by the private banks for the purpose envisioned, and should be willing to trust the endorsements of other regulators as to the bona fides of the new participants.

Admittedly this move would necessitate the reversal of the government's decision to have the Bank of England withdraw from running payments accounts and carrying out day-to-day banking.

icsa
Trust through governance

The Institute of Chartered Secretaries and Administrators Registrars' Group

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15th April 2014

Dear Sir/Madam

Response to New Payment Systems Regulator – Call for Inputs

The Institute of Chartered Secretaries and Administrators Registrars Group ("the Group") is the representative body for all the main service registrars (quoted company agents) in the United Kingdom and Ireland. The Group's members are registrars for more than 99% of all quoted companies in the UK and Ireland. The Group is responsible for formulating policy and best practice guidelines in all areas relating to share registration.

Our members are appointed agents for quoted companies in the UK and Ireland providing registry and receiving agent services. The Group is specifically interested in the consultation as our members combined are one of the leading distributors of payments in the UK, by value and volume, in support of dividends and corporate actions.

We have restricted our comments to those elements which impact on the services provided to UK companies by our members.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

We believe competition is ineffective, specifically regarding a lack of transparency around the ability of each bank to process a CHAPS payment in real time. The CHAPS process does not make clear which banks lack liquidity to process a large value payment without waiting for receipts first. Clients query a receiving bank's ability to view incoming payments when it is the sending bank's lack of liquidity that causes the problem and which appears unwilling to take responsibility or enter into discussions to explain the issue to their client.

Question 8 – Do you have any concerns about the current governance of UK payment systems?

The three organisations that contributed to this response are some of the largest distributors of payments in the UK. It is therefore essential that our members have a voice and are consulted when changes are being considered that could have a direct impact on their businesses and that of the quoted companies that they are appointed to act on behalf of. Our membership is currently represented at the quarterly meeting of the Payments Council' Business Forum. It is crucial that such a level of participation continues to be afforded to our members so that any proposed changes can be properly considered and debated as an industry in conjunction with their quoted company clients ahead of implementation.

Question 27 – How do you think regulation might affect your business and your participation in UK payment systems?

As a downstream user of UK payment systems, banking and clearing charges are a significant cost to our members businesses. The introduction of regulation will come at a cost. We would like to understand how the cost of regulation will be borne and are concerned that this cost will be passed downstream to users such as our members and their quoted company clients without a compensating benefit.

If you have any queries regarding this letter, please don't hesitate to contact me at michael.sansom@computershare.co.uk, or by telephone at +44 870 889 3113.

The Registrars that contributed to this response are Capita Asset Services, Computershare Investor Services and Equiniti.

Yours faithfully,

Michael Sansom
Chairman

iPSL Response to the FCA Payments Systems Regulation Call for Inputs

Title	iPSL Response to the FCA Payments Systems Regulation Call for Inputs
Version No	1 0
Classification Level	Proprietary
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Retention Period	6 years
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Basic information	
Consultation title:	Payment Systems Regulation Call for Inputs
Name of respondent:	Intelligent Processing Solutions Limited (iPSL)
Contact at respondent:	*Name:* Dick Simmons
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	Address: Blaise Pascal House,100 Pavilion Drive, Northampton, NN4 7YP

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant of payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	✓
Trade / Government / Regulatory body	
Other Please specify:	

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?		✓
If 'Yes', please submit both confidential and non-confidential responses		

About Intelligent Processing Solutions Limited (iPSL)

iPSL Limited is a Unisys company that provides UK Cheque Clearing and related services to all UK Clearing banks with the exception of Royal Bank of Scotland Group whose processing is currently undertaken by HP Enterprise Services (HPES). iPSL processing includes circa 300 ‘Agency’ customers via relationships with the parent clearing banks.

The company was established in 2000 as a joint venture between Unisys, Barclays and Lloyds to benefit from the efficiencies of scale in a declining cheque market. HSBC joined the venture as a shareholder in 2001.

iPSL is managed by an independent Board of Directors, the majority of whom are non-bank employees and there is an independent chairman. iPSL also has independent Audit, Remuneration and Nomination Committees managed by non-bank and non-iPSL personnel.

iPSL currently operates nine processing sites and employs circa 1,800 Full Time Equivalent (FTE) personnel undertaking a number of services for clients and their associated Agency customers:

- Clearing processing
- Fraud Detection
- Payment Activities
- Settlement and Reconciliation processes
- Exceptions handling, including Research & Adjustment functions
- Returns Processing
- Signature Mandates

25 The North Colonnade
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15th April 2014

Dear Sirs,

iPSL Response to the FCA Payment Systems Regulation Call for Inputs

iPSL welcomes the Financial Conduct Authority 'Payment Systems Regulation Call for Inputs' document and are grateful for the opportunity to comment on this. We have set out the response to your questions from iPSL within the attached document.

Our response is based upon current experience within the cheque processing market as we have no direct exposure to other Payment Systems.

We welcome any opportunity which allows small service providers to participate in the definition and planning of future strategic direction for Payment Systems. We believe that with closer integration of all interested parties will have a positive effect on the level of innovation and outcomes for consumers.

We hope this contribution will be of interest as you seek to progress with the associated changes. Should you have any questions regarding the content or wish to partake in further dialogue with iPSL, please contact Dick Simmons, iPSL Business Strategy Director, on 07590 390040 or dick.simmons@ipsl.co.uk.

Yours faithfully,

Dick Simmons,

Business Strategy Director, iPSL

Royston Hoggarth,

Chairman, iPSL

Call for Inputs

iPSL's specific answers to the questions raised in the consultation are detailed below.

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

iPSL do not believe there should be any restriction on the payment systems considered for designation. With the growth of payment systems options it will be better to apply regulation at the outset and not look to develop regulation after the market has developed. For example, the use of mobile payments has grown dramatically in recent years and, although such mechanisms may leverage pre-existing backbones in the shape of FPS and / or LINK to effect transactions, their wider use should be subject to the same regulations as are in place for other payment channels.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

This depends upon how competition is determined.

iPSL, as a supplier, believe that competition and innovation is most effective when there is more than a single supplier in any specific market place.

Where a single supplier is selected the competition is generally ineffective.

Where a true competitive market exists with multiple suppliers the competition remains effective throughout the contract as the suppliers always recognise that the customer has a choice.

Our experience of C&CCC is that this operates as a monopoly, governed by the Settlement Banks, and could therefore be viewed as ineffective. Vocalink operates in a similar way.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Benefits can be driven from all levels but will be determined by how competition is introduced.

Question 4: What are the main factors impeding more effective competition at each level?

Within the supplier market competition is stifled by selection of sole suppliers. Competition is only prevalent during the procurement process.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Collaboration is needed when setting rules, defining processes and to ensure common objectives are achieved (e.g. reduction of fraud). iPSL and HPES are currently working collaboratively to support an Industry wide fraud reduction initiative in Cheque processing. There are instances where collaboration should support competition.

It is important that those best placed to identify opportunities for improvement are engaged in the process. With particular focus on the cheque processing service the two processors have been kept at 'arms length' rather than being embraced in defining how best to implement change. Recent examples include the definition of the customer promise (T246) and the Account Switching project.

As a processor we have often been engaged to deliver solutions once they have been defined and not at inception which has resulted in processes that do not always meet the best interests of the consumer or the direct members.

Late involvement of all parties can often result in difficult implementations.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

C&CCC are the scheme owners for Cheque processing. They are owned and run by the Settlement Banks and until recently have had no independent representation. The non Settlement Banks and the processors have limited opportunity to influence the decision making for the scheme.

The indirect nature of engagement with C&CCC, for non settlement banks and processors may result in decisions and strategy being set without consideration of the full implications.

Question 7: **How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership**

With respect to C&CCC the introduction of Indirect and Associate membership would facilitate the removal of schemes owned by their key users. Concerns around funding such membership from the ~400 FIs / processors and how the process would function will need to be considered. I.E. how do those institutions get a voice, is it through the independents or some other vehicle?

Question 8: Do you have any concerns about the current governance of UK payment systems?

C&CCC has until recently been owned and operated by the Major UK banks with governance set up to establish consensus which could be seen a stifling innovation and moves at the pace of the slowest.

The introduction of Imaging for Cheque processing is long overdue and has led to the UK falling behind other countries. The technology proposed has been available and being used around the world for many years and is widely accepted as the way forward however it required the government to create the culture change via the recent HM Treasury consultation paper.

iPSL has limited exposure to other schemes however, if they are to operate in a similar manner, it is likely that the same effect will be witnessed elsewhere.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

Payments systems governance, whilst recognising the investment made by larger FIs, should be representative of all key stakeholders – including consumer, processor / service suppliers, SMEs and FIs – and governed by independent boards. Objectives for all systems should be, at least, broadly consistent across the piece.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

iPSL is a processor providing cheque clearing services to UK Clearing banks and some 300 associated Agency customers via their relationship with sponsoring banks. HPES provide similar services to the Royal Bank of Scotland Group and their agencies.

Our concerns are articulated in our responses to Q6 and Q7 above.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Not applicable.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

iPSL is often engaged through association but is not engaged in decision making. Therefore, we feel that we have limited impact on the solutions delivered for service-users.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Not applicable.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- **To whom do you provide indirect access?**
- **What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?**
- **Are there any barriers to becoming a sponsoring bank?**

iPSL provides cheque clearing services to nine clearing banks and through agency agreements to a further three hundred plus agency banks. In all cases one of the clearing banks operates as the sponsoring bank.

iPSL is set up to offer services to any UK financial institution and believes that this should remain as an option in any future model.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

iPSL believes that all payment systems should be Open Access. By this we mean that any FI should be able to procure services from any provider and should not be restricted to taking services from their 'host' bank.

It should be noted that in some cases current cheque processing arrangements are complicated with FIs undertaking core banking activities and cheque processing with multiple settlement members. Any change to regulation should be flexible enough for an FI to have a choice on how it processes.

The current cheque Settlement process requires all FIs to operate through a Clearing Bank and the Clearing Banks must meet the BoE collateral requirements. iPSL believe that to be truly open access, the Settlement process should be available to all FIs and thus remove the requirement for a Clearing Bank to settle on behalf of another FI.

iPSL already provides services to non-clearing banks and is working to develop services and products that can be made available to any FI for current or future processing demands, including the collaborative provision of data where appropriate.

iPSL believes it is essential that all interested parties should have access to scheme membership and be part of the decision making processes.

Question 16: Do you have any other comments regarding access?

We have no further comments on access.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

iPSL believe that key infrastructure should be provided in the most appropriate manner suitable to the problem. Where data is needed for a simple centralised process then a single infrastructure should be provided. However, as per our comments relating to open access we believe that provision of localised infrastructure for individual solutions is perfectly acceptable.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

iPSL believe that standards for data transfer are central to open access and would suggest that ISO20022 is an acceptable format.

Migration to ISO20022 or any other solution would need to be planned and tested appropriately to mitigate any risk to service-users.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Development and support for full competitive open access will increase competition. Market forces should be used to drive competition.

With specific reference to Cheque processing there are a number of solutions the Agency banks can pick up within the C&CCC space directly from a processor or from the scheme? EG Fraud detection, payment activity, and settlement.

Leveraging these opportunities would provide iPSL opportunities in the market place, not necessarily additional work as we would be undertaking those activities (at least in part) in any case.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

As stated above the current governance structures appear to stifle innovation. Governance / legislation needs to be such that it supports innovation and allows those organisations willing to promote new ideas the flexibility to progress.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

As a processor we are limited by current legislation. However, we seek to deliver benefits to service-users and shareholders through innovation within the existing legislative framework and by working collaboratively with the other processor within our market.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Increased competition should provoke acceleration in innovation. Allowing processors and small banks to more directly influence could have a positive effect on innovation and timeliness of change.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Collectively driven innovation tends to mean that you move at the pace of the slowest whereas unilateral innovation moves at the pace of market demand. This will ultimately drive each market forward as once unilateral innovation has taken place competition will demand action from others resulting in increased benefit for service-users.

Most innovation should be driven through consumer demand. It is unlikely that underlying infrastructure will be a catalyst for innovation.

Question 24: Do you have any other comments or concerns you would like to highlight?

We have no further comments or concerns to highlight.

Question 25: What, if any, are the significant benefits you see regulation bringing?

Delivering an open, competitive market place that has consistent objectives and common approaches to tackling industry wide impacting issues. EG Fraud.

Question 26: What, if any, are the risks arising from regulation of payment systems?

That development and change becomes prescriptive with limited opportunity for innovation.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Allowing organisations like iPSL to participate proactively provides the opportunity to generate tangible benefits for service-users throughout UK payment systems. iPSL's track record of innovation in Cheque processing demonstrates the value that we can deliver if legislation and governance permits.

If regulation provides an open competitive market it will provide opportunities for growth. If regulation chooses an alternative approach then it is likely that the future of iPSL would be under threat.

<End of document>

Dear Sir/Madam,

Please see below IBB's views in response to the 'Payments Systems Regulations : Call for Inputs'.

Financial Conduct Authority's Consultation title: **Payments Systems Regulation : Call for Inputs** (5 March 2014)

Name of respondent : **Islamic Bank of Britain PLC**

Contact at respondent:
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Nature of Organisation: **Indirect participant in payment system(s)**

Confidentiality: **No**

Do you wish any part of your response to remain confidential?

If 'Yes', please submit both confidential and non-confidential responses

Question 1: *Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.*
We are in agreement that the systemically significant and accordingly the proposed main stay UK payments systems run by the schemes: CHAPS, Bacs, Faster Payments (FPS), LINK, Cheque and Credit Clearing Company (C&CCC), and the main three and four party card schemes should be those initially designated by the HM Treasury to be regulated.

The new Payments Systems Regulator's (PSR) initial focus must be with those areas that represent the biggest risks and greatest influence over the end to end payments service chain within the UK payment landscape. Getting to grips early with these known market operators /participants and their interactions with its regulatory focus and strategic objectives will ensure traction and momentum for a new era at the earliest opportunity. There will be ample opportunity within the current schemes likely to be designated for regulation we believe for efficiency and competitive market forces to come into play as the formative years of new regulatory oversight get underway.

As lesser prominent payment systems/operators establish themselves and start to exert greater influence over the UK payments landscape they can be assessed and brought into the fold from an early juncture , as the new PSR with its framework and modus operandi would expected to be established and ready for proactive intervention.

Question 2: *Where do you believe competition is effective or ineffective within UK payment systems?*
Currently the biggest areas where we believe that competition is stifled are i) Infrastructure providers and ii) Direct Members. We argue this as from our own experience as an Indirect Participant (Agency bank sponsored into many of the payment schemes via a Direct Member bank), having seen over the years the difficulty in getting to influence the decision processes around system accesses via different technological methodologies that one may have as its core banking architecture, to the main payments schemes and indeed to the day to day provision of a payment service on the same timescales/service offerings as the Direct members themselves.

Generally the 'understood' norm seems to be that investment capital put in by Direct Members and the particular IT infrastructure provider in setting up the particular payment system and further to how it's to operate via the appropriate scheme, then shapes the future direction with little time afforded to the multiple smaller entities operating services within the particular Payment's system once access is achieved . Perceptions and in many a case actually being left on the peripherals due to lack of economies of scale and initial investment potential/participation seem to rule the day. Whilst the market economics seems to dictate that this may right in terms of those with most invested should have the greatest say/stake , it does seem that by the inadvertent exclusion of a tangible voice(s) until the latter stages /after the fact, may well be stifling innovation and stronger competition.

There just seems to be too few large a player in point i) above and a closed grouping / and on occasions aspects of sentiment revolving around 'our way or the highway' within point ii) from above.

Question 3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*
Opening up the access to the payments systems infrastructure with more IT/Technology providers partaking in the payment system infrastructure configuration/set up/sourcing, may lead to driving down the transactional traffic and alike costs. This should propagate a top down ripple effect of benefits throughout the payment chain. Furthermore it should give rise to greater scope for the introduction of agile technologies that whilst being robust are efficiently deployed and able to create alternative access operating points with more choice opening up to the Direct Members and Indirect Participants. In turn this would translate into the cost effective provision of wide spread payment services within the various payments systems to the benefits of the service users.

Question 4: *What are the main factors impeding more effective competition at each level?*
We believe the biggest opportunity for parity of services being available in the retail payments market place. This would occur if the Direct Members and Indirect Participants were able to 'bridge the gap' between them in the main provision of many a payment service offering , based on timescales of processing , access hours, turnaround times and completeness of ranges of services. As newly rolled out services by Direct members may have a lead time for them to become available to agency banks through sponsorships /agreements. In essence many a new service being rolled out within a payment scheme, are offered out to the Direct members own retail and corporates as a priority and time is expended in developing various models and flavours to meet the needs/create niche offerings and then the provision of agency offerings are offered with limited scope in some instances and with considerable time lag/time to market. In effect the hundreds of agency banks with a multitude of consumers , businesses and corporates are

potentially 'shoe horned' in later in some cases and that must lead to a distortion of the payments landscape in our opinion.

Service users don't necessarily get to benefit from a common UK wide payments experience of the highest order with regards to standards of efficiency, timeliness and reliability which the actual infrastructure is capable of delivering. However, as service seems to digress between the Direct Member's offerings for their service users (payments services consumers and also amongst varying agency /indirect participants of theirs) and that of those Indirect Participant's downstream payment services to its service users/their customers. For example cheque clearing timescales passing through various central clearing hubs could mean certain limitations to downstream agency banking offerings/cut-offs, faster payments processing availability not being 24/7 for certain agency banks offerings etc.

Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

Collaboration can be best achieved we believe when the following stakeholders : Indirect Participants , Service Users , Trade bodies have a collective and meaningful active representation at the Payment System Operators level. Ensuring that any common efficiencies, accessibility and scalabilities are leveraged for the benefit of all service users foremost and to this backdrop it should be ensured that no grouping/vested payments industry service user should be excluded from the common benefits enjoyed by all i.e. not to the exclusivity of Direct Members initially of any new service roll out.

All participants will still then be able to compete on their own bespoke service features , fees , package offerings and continue to attract customers and ensure commercial viability/competition and not at the expense of a two tier payments system service evolving and operating for a payment system that falls within the designation of being regulated.

Question 6: *Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.*

The main area of concern is the potential for conflict of interests arising and competing priorities between the Direct Members and Indirect Members and to the extent the Direct Members will always be able to articulate governance practices and frameworks through their common memberships of schemes, the schemes rules creation and coupled with their settlement accounts at Bank of England. Indirect participants will not be able to match on human and capital resources and may not require to do so but would somehow require an ownership structure that ensures a degree of shared ownership when it comes to the running's of provision of payments services and equal access to allow for competing priorities, without size and resources not in some respects being the deciding factors all the time.

We also believe differing Direct Members of certain payment schemes i.e. FPS , CHAPS etc. may apply differing levels of interpretation to the changes in regulatory/compliance regimes with regards to payments being sanctioned /filtered for further screening etc. leaving indirect participants at the mercy of their clearer and it's regulatory/compliance approach with little ability open to the indirect participant to manage/influence the process. This then tends to lead to indifferent experiences for service users/consumers and participants alike all from within the UK Payments Systems landscape.

Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership*

Consider the possibility for ensuring a casting /voting rights (a healthy percentage/weighting) for non Direct Members & Payment System Operators for other UK Payment Industry stakeholders from Indirect Participants , Service Users and Trade Bodies at the Payment Scheme level committees and strategic events/decisions protecting the service user's interests.

Question 8: *Do you have any concerns about the current governance of UK payment systems?*

As identified from last year's HMT (Mar 13) consultation, 'Opening up UK payments' outputs the governance structures need to incorporate a greater say for the smaller payment service providers/agency banks and service users themselves. The emphasis should be shifted to a holistic view of the end to end payment chain with the consumers at the heart of the focus and then worked back to the payments systems participants to determine what value they offer and how they make a difference or not, with bold actions to bring to bear changes that benefit an equal footing /platform to work from all. A single regulator with the powers of direction and guidance will assist in the shaping of a new landscape.

Question 9: *What do you believe is the appropriate governance structure for UK payment systems?*

A single Payments Systems Regulator that will ensure the payment industry can devolve/divest the vertical silos (synergies of associations of the few) that have evolved and that have led to the few Infrastructure providers to have established what feels like their 'quasi' stranglehold over the payment systems, loosened enough to permit other IT /Technology companies access. This is not just to compete but actively have assigned participation levels /percentage share to ensure a spread of interests and further innovation invoked with more pragmatic access options offered to other participants of the payment systems both upstream and downstream.

Question 10: *How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.*

We access the various payment systems via the Indirect participant route through agency bank agreements (i.e. via sponsorship) with a Direct member bank. We have bilateral service agreements for each of the payment schemes systems services that we use /access as an agency bank and adhere to the relevant terms and conditions, providing the necessary indemnities to the Direct member. We get access to bulk inward and outward clearing infrastructures and counter facilities of the Direct members with their assigned sort codes , effectively locking in our ability to move elsewhere. It's far simpler and more cost effective and efficient for a small bank like ours to continue to service our needs from the one Direct Member Bank's agency services in the access to and use of Bacs, Faster Payments (FPS), CHAPS, the Cheque and Credit Clearing Company (C&CCC). We have principal licensee membership of a card scheme for our debit card issuing offering.

Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*

These arrangements and associated terms and conditions carry pricing structures that we've negotiated and that we believe on the face of it offer reasonable value (without the full investments that come with Direct membership) but we have not been able to compare at will to other Direct Members offering similar services to other smaller banks under their agency arrangements, to actually know categorically where we stand as compared to our peer group.

There are some limitations within some of the system access features offered to agency banks i.e. within our Faster Payments services we have limited capability to make payments outwards on behalf of clients in evenings and over weekends whilst inward faster payments arrive 24/7. Such anomalies mean we continue to push to have better /broader service coverage created and offered for the bank as is the case for the Direct member's own retail customer and corporate offerings etc.

Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*

The best service we can offer our service users/retail customers (personal and businesses) is governed by the agency bank servicing offerings that the Direct Members/ our sponsoring bank will offer to us. Whilst we have access to the mainstay payment systems within the UK it can come with many interfaces /integration points and sometimes convoluted arrangements to aid for example the logistics of conveying unpaid cheques for speed by courier runs, not being able to offer full 24/7 outward faster payments, having slightly shortened CHAPS cut-offs to our settlement /sponsoring bank, using web portal services to Bacs / A services for Direct Debit indemnity claims processing all areas where as an agency bank we have to put in place solutions to bridge the gaps that arise from not having an agency servicing offering made available or having to share infrastructure with Direct member but not necessarily always of an equal footing but more so to fit into their timetable/arrangements/logistics etc.

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

Pricing difficulty also affects our ability to possibly drive harder bargains or more bespoke services in fear of having services withdrawn by sponsoring Direct member and then being left with no quick alternative to switch payment services too. As when seeking another Direct Member agency agreement into a particular UK payment system scheme, most Direct Members would require full transfer of all the Agency Banks/Indirect Participants business/volumes to make it commercially viable for them. Also the timescales to switch can be prohibitive with the likes of sort codes specific to banks and being stored in standing payment instructions and in particular printed on payment account collateral such as paying in books , cheque books, front of card plastic all requiring extensive implementation /transition/replacement times not only for the payment service providers themselves but more importantly for service users/consumers.

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?*
If yes:

- *To whom do you provide indirect access?*
- *What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?*
- *Are there any barriers to becoming a sponsoring bank?*

Very limited in this regard , we offer one indirect sponsored Direct Debit origination service user number to a corporate client of ours for purposes of their donation collections activities and to that end we have indemnified our Member Bank through their agreements, who in turn cross invoice us for transactional flow (clearings) for the relevant scheme commitments and we also hold indemnity agreements with our corporate client and similarly we have one extremely low volume payroll bureau sponsoring of a Service user number through a similar process. In both cases the services are offered by the Member bank and have lead times to set-up and numerous documentations to complete to ensure a scheme rules and requirements get passed through to the bank from the sponsoring member. These services are more a necessity in order to service particular client needs as opposed to commercially viable business opportunities, we just cover the operational costs.

Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*
We don't believe agency banks would command the investment capital nor the economies of scale to set-up direct membership to UK Payment Schemes/systems with all the associated physical assets i.e. central cheque clearing hubs, Settlement bank accounts etc., hence we would like to see if the new PSR could explore a second tier memberships structure where memberships of schemes by many agency banks can be purchased via a pooled /user group arrangement and that units of access to the main Payments Systems afford a common shared entry and opening up services which still have to be then passed through to the Indirect Participant by the Member Bank of their choice and the Member bank/s have to open up to this alternative on the basis it allows transparency and more equitable access rights at reasonable costs shared by the existing members , for the betterment of the UK Payment industry at this juncture.

Question 16: *Do you have any other comments regarding access?*
None

Question 17: *What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?*
Addressed in our responses to Q2 and Q3 above.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*
Rushed change could set the industry back and needs to be carefully considered as the core banking systems and *associated* payments interfaces operating not just in the UK but globally being interconnected, don't lend well necessarily to a simplified 'one size fits all' philosophy. Whilst the aspiration may be to arrive at one common protocol /standard it could be a step to far at the early stages of the PSR's work.

Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*
Addressed in our responses to Q3 & Q15.

Question 20: *Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).*
As per our response to Q2 , once fundamental changes start to take shape in the areas of Infrastructure providers and Direct Members, we are then likely to see the space opening up for more competition and incentives arise for participants within the UK Payment industry to want to innovate and drive home new business opportunities and services that fundamentally deliver new improved service user experiences.

The charging structures appear to be less than transparent and bespoke. As Direct Members negotiate behind closed doors under commercial bilateral arrangements and these can lead to tangible distortions across payment schemes for similar like type transactional processing events i.e. paying a supplier with a debit card may lead to a positive interchange for an agency bank via Card Scheme settlements, whilst doing the same payment via FPS may lead to the same agency bank paying a fee to its clearer/ sponsoring bank to cover that bank's FPS scheme fee aspects , bank to bank interaction charges and also make them a margin /profit. This seems contradictory in practice and agency banks /indirect participants can be facing excessive charges without really comparing the market rates and knowing the differences across the schemes/payment systems.

Question 21*: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?*
Addressed in our responses to Q20 & Q15.

Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*
Addressed in our responses to Q11 & Q12.

Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*
Addressed in our response to Q15 & Q9 as both these articulate where changes at a collective and individual level can result in innovative changes supported by positive regulatory oversight.

Question 24: *Do you have any other comments or concerns you would like to highlight?*
We propose a creation of a provider of payment services (clearer) that purely exists to serve agency banks (indirect participants). This provider would not be a bank itself but a standard provider of services/accesses to the varying UK payment and card schemes, be owned by the members/payments industry similar to how the CREST (now part of Euroclear UK & Ireland) type model is for settlement within the UK Securities arena, but arguably here the new entity specifically for Indirect participants would have a more far-reaching brief across multi payment schemes.

Question 25: *What, if any, are the significant benefits you see regulation bringing?*
Accountability and clearer traction on what is the standard to drive towards under one focused market place, where the common goal requires at a minimum 'a level playing field' for all when it comes to access and choice.

Question 26: *What, if any, are the risks arising from regulation of payment systems?*
Disproportionate measures being instigated in the early years causing a crippling of parts of the UK Payments Industry. Active involvement and participation of key stakeholders from the outset under a policy of inclusion will help mitigate against this.

Question 27: *How do you think regulation might affect your business and your participation in UK payment systems?*
Offers the opportunity to open up more choice and access to the other services within the Payments Industry that may well have been only available to a few participants at the differing levels of entry/membership and could allow for better barraging power, transparency and ultimately new and improved useful service user offerings.

Kind regards

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LINK Scheme Response to Payment Systems Regulation - Call for Inputs

15th April 2014

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

LINK Scheme is a competitive and pro-consumer scheme committed to innovation. We therefore welcome the introduction of the Payment Systems Regulator and the intention to designate LINK, to help facilitate the Governments objective of increasing competition and innovation for the benefit of consumers. As LINK already operates in a competitive marketplace, it is important that the other schemes that we compete with face equivalent regulation (these are primarily the international card schemes at present) and welcome the government's stated intent to do this.

LINK believes that, as a well-functioning scheme, we should be responsible for ensuring the performance of our processing activities through robust oversight and contractual arrangements. We also believe that the rules of LINK should (and do) ensure that the behaviour of members in relation to LINK activities is in the best interests of the economy and consumers. LINK therefore does not see a need for designation by the Payment Systems Regulator of VocaLink (our supplier) or of bringing into scope LINK Scheme members.

Clear regulatory control is best achieved through direct LINK Scheme designation. This also limits the risk of confused governance if multiple points of formal interaction with the new regulator were to be established, for example, with our supplier VocaLink as well as with the LINK Scheme.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

LINK believes that most consumers are broadly well served by the UK's payments systems. However, there are segments that LINK has identified as potentially not always having their needs met well at present. This includes approximately 9 million lower income consumers who find that some existing payments products can lack the flexibility and control required by those operating on tight budgets. This also includes consumers and SMEs relying on branches for counter transactions where branch closures may reduce availability, especially in more deprived and rural areas.

LINK can potentially innovate to provide products that could meet these unmet consumer needs, for example, through LINK payment accounts and LINK branches. We are currently exploring with our members whether this makes sense commercially and what changes might be required to the structure of LINK and its relationship with VocaLink to deliver any new consumer propositions.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

LINK believes that payment schemes are the right focus for the regulator to drive increased competition and innovation in payments. The schemes are where various participants come together to agree the nature of the payments that they need to provide to their customers that are in the collaborative space. Individual organisations cannot achieve payments innovation where the network nature of payments requires multiple participants to come together. Schemes are the most commonly successful vehicle to achieve this networking innovation activity in markets across the world.

Processors provide the technical infrastructure to join up the various infrastructures of scheme participants, but this is distinct from the development of the consumer proposition and rules of engagement between participants. For some payments arrangements, the same organisations have both scheme and processing activities under the same group umbrella (examples are LINK, VISA, and

MasterCard). Arrangements exist in most markets to require a degree of separation and contestability between scheme and processor in order to promote competition.

LINK is an example of scheme and supplier existing under one group umbrella (VocaLink) with governance arrangements designed to ensure separation. LINK and VocaLink are reviewing whether this arrangement should be developed as part of an overall review of how to increase competition, innovation, and consumer benefit.

Question 4: What are the main factors impeding more effective competition at each level?

Also the Answer to question 6 and 20.

It is possible that the existing governance and ownership arrangements surrounding LINK Scheme and VocaLink can be developed to enhance innovation, and LINK and VocaLink are reviewing their joint arrangements to see if they should be changed.

Any successful solution to maximise competition and innovation will need to incentivise scheme owners to innovate and scheme members to join the scheme. Both are needed for success. This is complex to achieve because the incentives are different and sometimes conflicting.

Incentivising owners is achieved through fair risk and reward for the owners/investors in the various scheme assets (in LINK's case this is currently VocaLink).

Incentivising members is achieved if they decide to join and then continue to stay in a particular scheme. In LINK's case, member interest is represented through a member-governed Network Members Council that sets the rules of LINK and ensures, for example, that LINK does not expose members to categories of business that they do not wish to engage in (such as business with high consumer dispute levels and associated costs). This is a collaborative activity designed to achieve a member-friendly set of payment products.

Both owner's and member's interests need balancing in a successful scheme. LINK Scheme and VocaLink have achieved this balance well in the past when the primary focus for all parts of the bank-owned payment systems was integrity and efficiency and hence driving down costs. It is also understandable that with common ownership there would be an inherent desire to keep each payment system focused on its specific area of expertise. Now that competition and innovation are also being optimised through regulation, the existing ownership and governance arrangements for LINK Scheme and VocaLink may need to be developed. LINK and VocaLink are assessing this as part of the overall review of how to increase competition, innovation, and consumer benefit.

Note: Today's position is that the LINK Scheme is independently governed by a Network Members Council that comprises all of the members of the Scheme. LINK has no corporate form and its assets, such as brand and IPR, are owned by VocaLink. VocaLink is also the processor for the Scheme's members. The Scheme is administered by a ring-fenced group of VocaLink employees. The Scheme contracts through VocaLink. The overall agreement between VocaLink and the Scheme's members is set out in a detailed contractual agreement called the Network Members Agreement that also sets out the rules of the Scheme and the terms of the processing contract.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

LINK believes that there will sometimes be issues shared across multiple schemes where cross-scheme collaboration makes sense. This will often be in areas where a joined up approach could reduce overall industry costs, and improve overall system integrity. However, LINK recognises that any collaboration to achieve benefits in areas such as industry cost reduction and integrity must not be at the expense of competition and innovation.

Areas of potential collaboration include; the merits of ISO20022; the risks from fraud and cyber security; the benefits of richer data; the approach to authentication; some aspects of public relations; some aspects of industry information; scheme shared services such as IT and HR. Here, some form of industry body could add good value to help coordinate collaborative activities. LINK will be happy to take part in this approach as now with the Payments Council. Many of these areas, such as ISO20022 and fraud, are international matters and LINK will also continue to directly participate in a number of international forums where a detailed understanding of the payment system that LINK provides is required.

LINK will consult with the other schemes to see how they might wish to develop this coordinated approach. One option for consideration is potentially developing the Payments Council in some way so that it can support all schemes in exploring these collaborative areas. We would expect to work closely in this matter under the guidance of the Payment Systems Regulator to ensure that competition, innovation, and end-user benefit is maximised.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Also the Answer to question 4 and 20.

It is possible that the existing governance and ownership arrangements surrounding LINK Scheme and VocaLink can be developed to enhance innovation, and LINK and VocaLink are reviewing their joint arrangements to see if they should be changed.

Any successful solution to maximise competition and innovation will need to incentivise scheme owners to innovate and scheme members to join the scheme. Both are needed for success. This is complex to achieve because the incentives are different and sometimes conflicting.

Incentivising owners is achieved through fair risk and reward for the owners/investors in the various scheme assets (in LINK's case this is currently VocaLink).

Incentivising members is achieved if they decide to join and then continue to stay in a particular scheme. In LINK's case, member interest is represented through a member-governed Network Members Council that sets the rules of LINK and ensures, for example, that LINK does not expose members to categories of business that they do not wish to engage in (such as business with high consumer dispute levels and associated costs). This is a collaborative activity designed to achieve a member-friendly set of payment products.

Both owner's and member's interests need balancing in a successful scheme. LINK Scheme and VocaLink have achieved this balance well in the past when the primary focus for all parts of the bank-owned payment systems was integrity and efficiency and hence driving down costs. It is also understandable that with common ownership there would be an inherent desire to keep each payment system focused on its specific area of expertise. Now that competition and innovation are also being optimised through regulation, the existing ownership and governance arrangements for LINK Scheme and VocaLink may need to be developed. LINK and VocaLink are assessing this as part of the overall review of how to increase competition, innovation, and consumer benefit.

Note: Today's position is that the LINK Scheme is independently governed by a Network Members Council that comprises all of the members of the Scheme. LINK has no corporate form and its assets, such as brand and IPR, are owned by VocaLink. VocaLink is also the processor for the Scheme's members. The Scheme is administered by a ring-fenced group of VocaLink employees. The Scheme contracts through VocaLink. The overall agreement between VocaLink and the Scheme's members is set out in a detailed contractual agreement called the Network Members Agreement that also sets out the rules of the Scheme and the terms of the processing contract.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

It is important that any governance and ownership changes consider the interests of both the members of a scheme and the owners of a scheme. This is especially the case for LINK which operates in a competitive marketplace.

All schemes, including LINK, need to attract and retain members to operate effectively. In LINK's case, it is in competition with alternative schemes. For example, VISA and MasterCard in the UK already offer directly competing services to consumers for ATMs. Barriers to change are low because most ATMs are already connected to VISA or MasterCard for use by credit card holders and overseas consumers. Should changes in LINK's governance and ownership adversely impact the members of LINK, in comparison to VISA or MasterCard, then LINK risks losing those members. Without a broad membership, LINK would be damaged, as the network benefits to consumers in areas such as using any card at any ATM, would be diminished. Areas of potential concern to members will include commercial matters such as fees, and also the nature of the transactions that scheme membership implies supporting. Different types of transaction have different profiles of risk and cost in areas such as disputed transactions, credit risk, and administration costs. So it is important that any change of scheme governance through, for example, changing ownership, adequately protects the interests of members to encourage them to stay with LINK as opposed to moving to a competitor.

In addition, it is important that LINK Scheme membership does not also imply having to make investments as Scheme owners. Most members of a scheme such as LINK join to gain easy and efficient access to the payment services that membership brings and that can then be provided to their own customers. It is important that this easy and open access to membership is retained and that there is no obligation to also have to invest as an owner. The owners of the LINK Scheme (who may or may not be members) should be the investors in innovation, sharing in the risks and rewards of the commercial outcome.

Question 8: Do you have any concerns about the current governance of UK payment systems?

LINK Scheme believes that its operation as a competitive and pro-consumer scheme demonstrates the benefits of competition leading to innovation and increased consumer benefit. LINK expects to continue to develop in this manner and welcomes the increased competition that economic regulation will bring.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

As outlined in previous answers, LINK believes that:

- Payment schemes are the right focus for designation (Question 1).
- A regulatory level playing field across all competitive schemes is essential (Question 1).
- Suppliers should be controlled through robust contractual arrangements with the schemes rather than through direct regulation (Question 1).
- There are a small number of collaborative matters where the schemes may need to commission a separate entity to help them coordinate (Question 5).
- LINK Scheme governance and ownership needs to recognise the different roles of its members and owners. This means carefully balancing member and owner interests to ensure that the Scheme remains competitive for attracting members, and that the owners are incentivised to invest in innovation to benefit competition (Question 4, 6 and 7).

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

See Answer to Question 16.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

See Answer to Question 16.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

See Answer to Question 16.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

See Answer to Question 16.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?

See Answer to Question 16.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

See Answer to Question 16.

Question 16: Do you have any other comments regarding access?

LINK is an open access scheme and membership is open to all on equal terms. Attracting members to LINK is essential to survival in a competitive market as there are alternative schemes available. LINK's members tell it that its open access approach is an important competitive advantage and a reason for choosing LINK.

LINK members have no control over potential members joining the Scheme. This process is controlled by the LINK management team and, whilst there are criteria around solvency and security requirements, no potential member has ever had an application refused. There is a single tier of membership with all members being represented at LINK's prime governing body, the Network Members Council. Decisions may be made by consensus or if necessary by ballot. 75% of the total votes are allocated on the basis of LINK transaction volumes, in addition to the remaining 25% which are divided equally amongst all the members. Individual member's votes are capped at 15%. The number of votes required to agree a change varies from a simple majority to an 80% super-majority for items such as changing the constitution or pricing.

All members need access to a Bank of England RTGS settlement account and these are only available to certain categories of financial institution under the Bank's rules. LINK monitors closely whether this presents a barrier to entry to LINK. Our view is that this is not a barrier at present. All of LINK's non-financial institution members have commercial relationships that provide RTGS access. No LINK membership application has failed because of lack of RTGS access. There are multiple providers of RTGS access to the various LINK non-financial institution members.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

There are a range of potential processing suppliers available to LINK, and many of LINK's members already have connections to the two most established alternatives, VISA and MasterCard. These are typically used for non-domestic transactions such as the use of some overseas cards to withdraw cash at UK ATMs.

The existence of an alternative supply market for LINK Scheme means that it is possible to establish competitive processing arrangements provided that the contractual and commercial approach is robust. LINK Scheme and VocaLink are reviewing if the existing contact is robust from a contractual and commercial perspective as part of an overall assessment of the structure of the LINK Scheme and its relationship with VocaLink.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

LINK does not currently have a business need to change its message standard. ISO20022 is at an early stage of development for card schemes and LINK is engaged in a range of national and international forums to help develop the thinking. LINK also maintains a dialogue on these topics with the Payments Council and VocaLink. ISO 20022 is an area where cross-scheme collaboration makes sense, as described in the answer to Question 5.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

As described in our answer to Question 16, LINK is an open access scheme and has no agency arrangements.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Also the Answer to question 4 and 6.

It is possible that the existing governance and ownership arrangements surrounding LINK Scheme and VocaLink can be developed to enhance innovation, and LINK and VocaLink are reviewing their joint arrangements to see if they should be changed.

Any successful solution to maximise competition and innovation will need to incentivise scheme owners to innovate and scheme members to join the scheme. Both are needed for success. This is complex to achieve because the incentives are different and sometimes conflicting.

Incentivising owners is achieved through fair risk and reward for the owners/investors in the various scheme assets (in LINK's case this is currently VocaLink).

Incentivising members is achieved if they decide to join and then continue to stay in a particular scheme. In LINK's case, member interest is represented through a member-governed Network Members Council that sets the rules of LINK and ensures, for example, that LINK does not expose members to categories of business that they do not wish to engage in (such as business with high consumer dispute levels and associated costs). This is a collaborative activity designed to achieve a member-friendly set of payment products.

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Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

This is addressed in our answer to Question 20.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

It is possible that the existing governance and ownership arrangements surrounding LINK Scheme and VocaLink can be developed to enhance innovation, and LINK and VocaLink are reviewing their joint arrangements to see if they should be changed. Any new LINK Scheme structure will need to provide incentives to both its members and its owners, as both groups need to support the Scheme for it to be successful. Members need to choose to join and stay with LINK versus the alternative international schemes. Investors and owners need to see the prospect of a fair return for investment in innovation. This is set out in more detail in the answer to Question 20.

The commercial model adopted by the competing international schemes is that they contain a strong members organisation and a separate strong commercial organisation all under one commercial umbrella. This allows member's and investor's interests to be balanced and the schemes to work in a manner that drives innovation. LINK Scheme with VocaLink are reviewing whether an approach based on separate member and commercial structures within a new LINK Scheme company should be developed as part of an overall review of how to increase competition, innovation, and consumer benefit.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Individual organisations cannot achieve payments innovation where the network nature of payments requires multiple participants to come together. Schemes are the most commonly successful vehicle to achieve this activity in markets across the world. Some schemes operate competitively like LINK. Others are part of national, often bank-owned, structures and operate more as national utilities.

LINK's experience is that it can compete more effectively by offering individual organisations that want to innovate the ability to easily join and access its payment services. Hence LINK is as open a scheme as possible on the basis that this makes us more attractive than the other schemes with which we compete. Examples of organisations that have joined LINK, and increased innovation in access to cash, include independent ATM deployers and challenger banks, most of whom are full LINK members. This diversity of membership also reinforces the attractiveness to existing members and sustains the competitive advantage of the Scheme.

Hence LINK's experience is that strong competition and innovation by LINK reinforces the ability of our members to unilaterally innovate – and that this is a critical competitive role for LINK to deliver to remain attractive to members.

Question 24: Do you have any other comments or concerns you would like to highlight?

As outlined in previous answers, LINK believes that:

- It is possible that the existing governance and ownership arrangements surrounding LINK Scheme and VocaLink can be developed to enhance innovation, and LINK and VocaLink are reviewing their joint arrangements to see if they should be changed (Question 22).
- Any new LINK Scheme structure will need to provide incentives for both its members and its owners as both groups need to support the Scheme for it to be successful (Question 20).
- Open access is already an important feature of LINK as the ability for members to easily join is a competitive advantage over other schemes (Question 16).
- LINK's ability to innovate to allow individual members to develop payments innovation is also a competitive advantage. This is the area where a move to a more commercial corporate structure may bring additional benefits in areas such as LINK payment accounts and LINK branches. However, any change will need to balance the needs of members and owners (Questions 2 and 23).

Question 25: What, if any, are the significant benefits you see regulation bringing?

Increased competition and innovation for the benefit of consumers.

Question 26: What, if any, are the risks arising from regulation of payment systems?

There is a risk that uncertainty causes innovation to be put on hold across parts of the industry whilst the new regulator is put in place. LINK believes that it is important for it to proactively move ahead to investigate innovation opportunities that can benefit consumers, rather than waiting for direction from the new regulator down the track.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

LINK Scheme expects that regulation may lead to it being established as a competitive commercial structure in its own right with a strong executive team driving innovation to meet the various objectives of members and owners.

An open and collaborative approach to LINK members will remain a vital feature of LINK as this is a key competitive advantage in attracting members from other competing schemes.

LINK also believes that there may be commercial opportunities available through payments innovation that can address unmet consumer needs. Most consumers are broadly well served by the UK's payments systems. However, there are segments that LINK has identified as potentially not always having their needs met well at present. This includes approximately 9 million lower income consumers who find that some existing payments products can lack the flexibility and control required by those operating on tight budgets. This also includes consumers and SMEs relying on branches for counter transactions where branch closures may reduce availability, especially in more deprived and rural areas. These are the initial area of focus for potential innovation of any new LINK Scheme governance structure.

PAYMENT SYSTEMS REGULATION:

CALL FOR INPUTS

LLOYDS BANKING GROUP RESPONSE

EXECUTIVE SUMMARY

We support the Financial Conduct Authority's aims for UK payment systems as set out in the Call for Inputs document.

Lloyds Banking Group's vision is to be the UK's best bank for customers and we are therefore supportive of the Payment Systems Regulator's (PSR's) objective that payment systems should operate in the interests of their users. As the largest retail bank in the UK we aim to continually improve the customer experience and support increased choice, ease, interoperability and availability that ensures our customers are able to make and receive payments that are accurate, quick and safe. Lloyds Banking Group ensures that the payments infrastructure is highly resilient, stable and secure through its shareholding, contribution and representation on the various industry bodies. This includes significant ongoing investment in our own infrastructure (please see separate LBG Facts and Data Pack).

The objective of our response is to achieve an outcome that works in the best interests of customers, other payments users, the wider economy and the industry. The new regulatory framework for payments must be proportionate, should facilitate innovation which will benefit the end user and should have appropriate checks and balances.

The primary goal for the industry and for policy makers should be to create the right framework for a competitive, efficient and innovative payments system in the UK and the EU. Drawing on lessons from other UK regulated sectors, LBG considers that the most appropriate solution is a flexible, outcome-based regulatory regime which has the customer at heart. We would like to see this complemented by a new collaborative payments body to implement cross-industry change and the continuing existence of payment schemes in one form or another to ensure the effective interoperability and compliance of the different participants in the UK payment systems.

Competition already exists in many aspects of payment systems and has been enhanced by the **Current Account Switch Service** (CASS) and the forthcoming **Mobile Payments Service** (Paym).

Many aspects of UK payment systems are world leading - the UK Direct Debit, Faster Payments, CASS and Paym. UK customers also benefit from the choice of a broad spectrum of different payments and cards mechanisms allowing them to transfer money in real time if they wish. This includes internet and telephone banking initiated payments and traditional payment methods such as cheques and cash.

During the financial crisis, UK payment systems continued to operate effectively without disruption and despite operating in a challenging market they have and are continuing to innovate. In 2008 the UK introduced the **Faster Payments Service**, one of only a very small number of systems in the world that offers real-time payments end to end in seconds, 24 hours a day, 365 days a year. The industry-led **Current Account Switch Service** (CASS), launched in September 2013 at a cost to the industry of £750m, has already seen a significant increase in the number of customers switching. It offers customers a quick, consistent, guaranteed and hassle-free switching experience. **The Mobile Payments Service** (Pay**m**) will be launched in April 2014 and will enable customers to send and receive near instant low value payments via a mobile device, using a mobile telephone number as a proxy for account details. HM Treasury has also issued a consultation, **Speeding up cheque payments: legislating for cheque imaging.** This will enhance the experience of cheque users.

There is also a mature and competitive card payments market in the UK with the use of debit and credit cards being far more prevalent than in any other EU country. Strong competition is supported by the variety of third party providers and new entrants into the market ensuring that both the consumer and corporate are furnished with good innovation and fair pricing. It is recognised that a change in governance and control in respect to bank and non bank card payment service providers is required to ensure a level playing field, and more importantly a fair and reliable product and service for the customer. It has not gone unnoticed that there are increasing numbers of players in card payments, especially ones supporting the e-commerce environment. The concern is that some firms may be providing services without the appropriate consumer protections in place. The new regulator should also consider the impact of EU regulation on the UK market, for example, the proposals on multilateral interchange fees which will have a potential affect on the broader payments space. There is a risk that global systems will be replaced by national systems thereby damaging value to the industry and creating risks for consumers.

Card Payments is a key functional and product requirement for our economy and we strongly support any changes which drive fair competition and good outcomes for the consumer and corporate alike.

The Payment Systems Regulator (PSR) should promote and facilitate innovation within existing schemes, entry from new schemes and competition between schemes. **The PSR should retain a reluctance to intervene, except where there are clear failures of competition that could lead to customer detriment.** When making decisions, the PSR must ensure UK payments networks can remain financially sustainable for providers and operators of infrastructure. The regulatory framework and decisions taken within it must not jeopardise the pre-eminent position of the UK and London as a financial centre. The Government should take care that regulation does not impair the competitiveness of UK payments compared with European or other global equivalents, or the interoperability of UK payments with existing and new global payments standards.

We are in favour of innovation that brings benefits for users of payments. However, we believe that **the PSR should limit itself to specifying the high level "Desired Outcomes" and a timetable** that it expects the industry to deliver against (and only where it observes market failure and having consulted widely). We believe it should then fall to designated entities to develop solutions that will bring about those Desired Outcomes. It will be important for the PSR to have some powers over other stakeholders in the payments landscape (e.g. direct debit and continuous payment authority originators) to ensure that the benefits of innovation get to the end users of payments. Beyond specifying high level Desired Outcomes and a timetable, we do not believe that the PSR should set or direct industry strategy.

We support the PSR having concurrent competition powers but think the PSR and other competition authorities should clearly signal that the PSR will now take the lead on any competition concerns affecting UK payment systems.

We acknowledge the concerns expressed by HM Treasury and the Treasury Select Committee over governance of the payments system (e.g. abolition of cheques) and we intend to work constructively with the PSR when it becomes operational. **Looking ahead we would propose the following priorities for the PSR:**

1. To work with the industry to ensure all banks and building societies get access to UK payment systems in a way that enables them to provide products and services to their customers. We consider Faster Payments and Cheque Clearing to be the systems where action is required.
2. To implement a new cheque clearing model to deliver the outcomes for cheque users noted in the HMT Consultation – Speeding up cheque payments; legislating for cheque imaging. We believe the UK is in a strong position to use existing infrastructure to deliver a world leading solution for cheque clearing.
3. To commission an early study to definitively benchmark UK payment systems globally and work with the industry to identify opportunities for improvement. We also believe that the PSR has a role to work with the industry to support engagement with government and other stakeholders regarding the UK's position relative to our peers.

LLOYDS BANKING GROUP
RESPONSE TO SPECIFIC QUESTIONS

***Question 1:** Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.*

It is important that designation of payment systems does not create an uneven playing field or regulatory arbitrage where entities could achieve a competitive advantage depending on whether or not they are designated for regulation. As a result, we believe that all inter bank payment and card schemes and infrastructure providers operating within the UK as highlighted by the PSR should be considered for designation.

Given that consumer protection and fair competition are two of the PSR's three key objectives, designation should be extended to all payment systems that have mass market appeal. We see no reason to exclude three-party card schemes if their four-party competitors are being included (please refer to our response to question 2).

Whilst we understand the logic for not initially designating smaller and less systemic payments systems, these systems nevertheless have the ability to cause significant detriment to consumers and competition if not regulated appropriately. We therefore support the inclusion of new emerging card payment systems/operating models such as payment facilitators, aggregators, electronic wallets, mobile payment providers and micro merchant solutions in the designation process.

The PSR should also give due consideration to any new legislation being brought into the UK payments industry which may necessitate bringing new participants, such as PSD II bringing Third Party Providers, into the scope of regulation.

That said, we recognise that a one-size-fits all model of regulation may not be well-suited to the wide range of different payments models. The PSR must therefore have the appropriate powers and a clear approach and criteria for designating such systems in the future. There should also be scope to designate any new and emerging cards or payment schemes as long as they meet the required criteria for designation. We would however like to highlight that any criteria for bringing a payment system should be appropriate, proportionate, and transparent.

***Question 2:** Where do you believe competition is effective or ineffective within UK payment systems?*

Users of payments identify their preferred payment method for any given transaction based on their own needs in terms of speed, convenience, ease and, where applicable, price. Schemes are therefore required to compete on the complete transactional bundle which includes all four elements. Given the importance of the service and experience, competition cannot, and does not, focus entirely on price. As an example, despite being more expensive, retailers are willing to accept PayPal because some customers find it simpler than schemes which require more information, such as the card number, to be input.

The last few years have seen significant developments in competition in several aspects of the payments industry, driven by investment in innovation and technology from existing players and new providers alike. Market forces are driving competition in the payments sector and users have a comprehensive choice of payment services via multiple channels such as online, mobile, telephone and branch.

The recent implementation of CASS is a good example of where competition can drive benefits for the end user at an account and product level. CASS has made it easier for consumers, micro enterprises, charities and trusts to move current accounts between banks. This in turn is driving an increase in competitive behaviour amongst current account providers who are differentiating services and offering incentives to encourage customers to switch.

Card schemes operating in the industry have developed in such a way that they involve significant direct and indirect competition amongst each scheme. Visa and MasterCard compete against:

- each other;
- existing three party schemes (such as American Express);
- new proprietary schemes, and
- other forms of payment, such as cash (and hence indirectly LINK), cheque (indirectly C&CCC) and direct debit (and hence indirectly Bacs).

Visa and MasterCard are open schemes, and therefore each involves significant intra-scheme competition, as issuers and acquirers compete against each other though arguably the basic framework of the scheme rules is agreed collaboratively.

Downstream, competition for acquiring and commercial cards payment service providers is highly competitive and efficient, creating several benefits for service users. Client service users of acquiring and commercial cards are predominantly business clients in a commercial banking context. The majority of payment service providers in the acquiring market are non-bank competitors including the market leader, a global monoline acquiring specialist.

Payment service provider competition for commercial cards extends beyond UK Retail banks and includes global banks and non-banks like the market leader American Express. The Acquiring market sees intense competition among hundreds of payment service providers for merchant service user acquiring business and as a result, price competition is fierce. It is important therefore that the four-party and three-party schemes are treated equally to avoid any significant distortions to competition.

When considering the number of competing payment systems within the industry, it should be recognised that UK payment systems have been developed to ensure interoperability, reach, security, end-to-end connectivity and systemic resilience. While this approach has had many advantages, including strong collaboration between institutions and the avoidance of inconsistent and duplicate infrastructure, it may have resulted in fewer systems competing directly.

Question 3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*

In principle, competition can exist at several levels of the payments industry and it is about finding the right balance between effective competition and collaboration that produces the best results for UK customers and the economy.

One of the principal benefits of competition to end users is often in the form of lower prices. This is less applicable in retail payments because end-users in the retail segment are not charged for their use of payment systems (except for CHAPS). Nevertheless, we give retail customers a choice of how to pay dependent on who they are paying and what their circumstances are e.g. direct debit for bills often offers a discount. Cash enables people to manage their money.

In contrast, at corporate level, there is regular competitive tendering for payment and card transaction business. Commercial companies put their card services business out to tender to gain an improved deal. Tendering exists at several levels including price, reliability or service quality and may be as part of an overall package, single solution or suite of services; e.g. merchant acquiring services such as card transaction processing together with value adding services such as fraud prevention, reporting and reconciliation.

Therefore, we believe that competition should be focused at an account and product level where it can drive noticeable benefits for the end user via the channels, products and services used to make and receive payments. The implementation of CASS has made it easier for consumers and businesses to switch their account to another bank and in turn, it has encouraged current account providers to tailor their products and services to differentiate themselves from their competitors in order to attract customers.

It is also important to note that customers themselves are changing their behaviour in response to changes in digital and mobile technology and banks can best meet these changes in behaviour by developing new services such as Barclays' Ping It and Pay**m**. It has also driven the development of additional payment systems such as PayPal and Google Wallet which aim to provide customers with alternative methods of payments to suit their needs.

Any competition at an infrastructure level must take into account the national criticality of its function, whether the UK is large enough to house more competitors, and the commercial aspects of running such a function. These include whether creating new payment systems or expanding the scope of existing payment systems will increase costs and inefficiency with duplicate networks and infrastructure, for little ultimate benefit. Whilst Europe does have a number of infrastructure providers which compete against each other, this stems from a legacy landscape, prior to the introduction of SEPA, where many countries only had one national infrastructure provider. In addition, the introduction of SEPA encouraged a consolidation of infrastructure providers to a considerably smaller number.

Question 4: *What are the main factors impeding more effective competition at each level?*

In respect of "utility" style inter-institution payment systems, arguably competition is limited because industry members have to collaborate to create the systems. However, these systems would never have been created but for collaboration (e.g. FPS). Therefore, the collaboration must be pro-competitive.

Riding 'off these' payments systems are a number of other payment systems e.g. PayPal, Google Wallet, mobile payments. Their rapid growth shows that competition is in fact vibrant. But, these systems nevertheless warrant the same scrutiny as the utility style payment systems to avoid consumer harm.

Turning to payment infrastructure providers, given the cost of resilience and ongoing investment to keep these systems working, one needs to ask whether the UK is big enough to have competing providers. For several of the other critical UK infrastructures there is only one provider in place, such as Network Rail, National Grid and Air Traffic Control.

In some parts of the EU there are competing providers. But the number of infrastructure providers is contracting from circa 27 to three or four under SEPA. In terms of Real Time Gross Settlement (RTGS) high value payments, there is only one equivalent of CHAPS in Europe, namely Target2 and this is the case for most economies globally.

As mentioned previously, we believe that competition should be at account level based on the channels, products and services that are offered to customers to initiate payment and card transactions.

Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

Historically, payment systems have been developed to ensure interoperability, reach, end-to-end connectivity, security and systemic resilience as paramount considerations. As such, they have been fashioned through extensive collaboration between different UK institutions, and would not have been possible without collaboration.

We therefore believe collaboration is critical for all utility style payment systems those systems that must have resilience and be able to guarantee performance ever day, 365 days a year. It is critical that these systems are maintained because they provide the payments backbone by which the financial services industry continues to operate day after day. This can be performed through clear and transparent governance rules, which allow third parties access and which are subject to regulatory scrutiny.

From an operational perspective, collaboration allows the industry to provide a smooth end to end process for customers making payments or card transactions. To make and settle a simple individual payment or card transaction, banks and building societies must exchange messages and move and settle the underlying value of the transaction over their account at Bank of England either on a real time or deferred basis. In order to achieve this, the following areas of collaboration are essential:

- Agreeing and maintaining the messaging standards for each payment type in order for the system to operate effectively and efficiently with minimal repair required to the information in the messages. This is often referred to as Straight Through Processing (STP) and minimising repair is essential to minimising the cost of providing payment and card transactions to end users.
- Agreeing and adhering to scheme rules to ensure to an orderly market including but not limited to:
    - Determining scheme cut-off times so input can be converted into output at the central infrastructure and end of day settlement totals provided;
    - Setting rules for transactions per second (TPS) rates in Faster Payments at an agreed performance level;
    - Meeting throughput targets in CHAPS as set by Bank of England to ensure smooth settlement throughout the CHAPS day and to avoid the inefficient use of liquidity;
    - Signing up to and participating in Loss Sharing Agreements to ensure settlement will always complete in multi-lateral deferred net settlement schemes if one of the settlement member defaults and thereby insulating customers from this market shock;
    - Demonstrating scheme oversight on member compliance, performance and resilience through annual attestations known as the Codes of Conduct.

From a strategic perspective, collaboration allows for a consistent approach to the development of UK payment systems in a manner that can enhance competition and innovation but at the same time ensure that payment systems continue to work uninterrupted for end users.

Whilst we acknowledge the importance of competition in driving innovation, some of the most significant innovations within the payment industry, such as FPS, CASS and Pay**m**, and infrastructure enhancements, such as CHAPS Liquidity Savings Mechanism (LSM) and Market Infrastructure Resilience Service (MIRS), have been achieved by the industry working collaboratively. These enhancements have allowed for the simplification of payment systems in terms of connectivity, rules and relationship management which ultimately leads to a core system which is better suited to support competition and the needs of end users.

Such initiatives often require high investment costs and the scope of such projects are often greater than one individual entity could support alone. As a result, initiatives such as CASS, which cost the industry

£750m, may not have been implemented without industry wide support and collaboration. Many of these critical infrastructure developments are funded by the larger incumbent banks and building societies for the benefit of the UK financial system as a whole and all its participants. CASS is a good example of this case in point, it was funded based on current account market share however, new participants such as Tesco Bank and Turkish Bank can join on a 'plug and play' basis provided they pay transaction fees (the same as other established participants) based on their utilisation.

Collaboration will also be critical in the development and implementation of a new UK cheque clearing model and as mentioned previously we see this as a priority area where the industry can work hand in hand with the PSR.

Whilst we believe collaboration is critical for payment systems, we also recognise it must take place in both a suitable and appropriate environment. As such, we would welcome the continuation of a collaborative payments body, such as the Payments Council or its successor, to facilitate industry wide forums and support industry wide delivery of projects and enhancements agreed with the PSR.

Question 6: *Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.*

Payments

Lloyds Banking Group is neutral on the ownership of the shared payments schemes and infrastructure. We believe that ownership which rests with payment scheme members and/or the Bank of England must support rather than hinder compliance to the rules and standards necessary to make payments work day to day. We would however like to highlight the need to impact-assess fully any potential changes to the current ownership structure in order to mitigate any unintended consequences.

The current ownership structure reflects how the payments industry has developed over many years and operates on a number of different models. The most common model is a split between scheme company and infrastructure provider – (please see table in supporting Facts and Data Pack). Vertical integration has led to a high degree of common ownership with the largest banks and building societies typically being shareholders/members of all the payment schemes, infrastructure providers and representative organisations. However, there is no single membership model and the membership varies across all the payment systems reflecting the different nature and interests of the schemes and infrastructure providers.

Generally, separation of scheme and infrastructure works well and has many advantages. It allows for the infrastructure providers to focus on processing and maintaining stability and resilience, whilst the schemes retain responsibility for the membership, rules and smooth running of the system. It also provides an element of competition, as evidenced by the recent contract negotiations between VocaLink and Faster Payments and Bacs schemes. This structure allows for future competition through alternative or additional suppliers, if this was the right thing to do for users and the UK economy. This model is supported by the authorities; e.g. Bacs was separated in 2003 following the OFT Report on UK Payment Systems.

Schemes typically operate on a ‘not for profit’ basis ensuring costs are minimised. Membership criteria are open and transparent and also allow for financial institutions to join a scheme and have a voice at the table without incurring the costs of 'buying into' the infrastructure.

The UK has an excellent payments infrastructure. VocaLink operates high-availability, resilient and class-leading payment clearing and ATM switching platforms responsible for processing 9.6 billion payments in 2013. VocaLink is a commercial company which has 18 shareholding banks and building societies and an active Board that recognises the importance of the core processing alongside its remit to develop commercial products and services. There is necessarily a high degree of collaboration with scheme companies which has led to the successful development of services such as Faster Payments, CASS and Pay**m**.

It is important to note that infrastructure providers incur high costs to ensure the resiliency of payments and no-fail systems. Costs are increasing to support the core systems and the increasing regulatory burden is falling on the members. In addition, new services such as Zapp are high risk and capital intensive. As such, VocaLink relies on the strength of its shareholders to stand behind it. VocaLink has required recapitalising (please see supporting Facts and Data Pack) to enable it to replace ageing infrastructure (New Bacs) and to deliver new services (Faster Payments) and also following losses incurred in commercial ventures (Euro Services and Bankgiro). VocaLink has never paid a dividend and, with the large capital requirement to deliver Zapp, one is not envisaged in the short-medium term.

The CHAPS infrastructure is operated by Bank of England in conjunction with RTGS and Reserve Account facilities provided by the Bank to UK-based banks and building societies. Regarding other schemes, VocaLink operates the central payments infrastructure for Bacs, Faster Payments and LINK ATM schemes. Settlement of the interbank obligations occurs on a multilateral deferred net basis through the RTGS system over accounts held at the Bank of England.

The current arrangements for CHAPS, Bacs and Faster Payments ensure all direct participants pay the same unit transaction cost regardless of the volume or value of payments submitted and received, creating transparency and certainty.

<u>Cards</u>

The ownership structure within card payments is unique with card acquiring banks and non-bank acquirers competing fiercely. The market has been joined by third party providers and payment facilitators and in addition, commercial cards are supported by a variety of three and four party models, with similarly diverse service offerings.

The above are supported by multiple processing providers and card schemes all supporting strong competition and diverse innovation leading to customer benefits.

- Ownership of Acquiring and Commercial Cards payment service providers is sufficiently diverse today to foster competition to the benefit of service users;
- Acquiring payment service provider ownership is well spread amongst a diverse base utilising a variety of business models and structures – the majority are not bank owned;
- Some larger Acquiring payment service providers maintain in-house card payment processing platforms, i.e. they perform both payment service provider and payment service operator roles; and
- The majority of payment service provider competitors source card payment processing from these Acquirers or specialist card payment processors

Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership*

UK payments schemes are an integral part of the UK economy. A high level of investment has and continues to be made in UK payments, with the larger members continuing to pay a disproportionate share of the Industry costs. Cumulatively, the Industry has invested in excess of £3.0bn in the past 10 years on developments that enhance and maintain the speed, resilience, security, compliance and customer experience, including New Bacs, Faster Payments, Chip & Pin, CASS and Pay**m** (please see supporting Facts and Data Pack for LBG investment in payment and card systems in 2013).

There are multiple models of ownership that have advantages and disadvantages. We do not believe that there is a 'one size fits all' approach and each model must be evaluated against the benefits and risks for each scheme(s). The most common models are;

- **Bank/member ownership**: e.g. VocaLink.
- **Independent ownership:** e.g. Hewlett Packard, Unisys (majority shareholder in iPSL) cheque processing
- **Central bank ownership**: e.g. Bank of England operating CHAPS RTGS
- **One scheme company, multiple infrastructure companies**, European model (many Automated Clearing Houses); UK Cheque Clearing (C&CCC with IPSL and HP).
- **Integrated model**: combined scheme and infrastructure; i.e. Bacs pre-Cruickshank, although the 2003 OFT review of UK Payments led to separation of Bacs into BPSL and Voca, Visa, MasterCard and LINK
- **SEPA model**: Strategy setting body (SEPA Council) with day to day operation of the Schemes vested in the infrastructure providers

Any model will require transparent rules and common standards to facilitate the day to day operation of payments. Similarly, Bank of England or members will need to act in an oversight role to ensure compliance with scheme rules and integrity of the system. Any proposals need to ensure continued innovation and development, whilst ensuring continued resilience of the infrastructure; for example, VocaLink has recently concluded a multi-million pound programme to renovate and upgrade its data centres.

In many ways the existing model has served the UK well to date. The UK payment schemes have been effective in setting rules and standards, ensuring their members meet these on an ongoing and consistent basis and thereby making sure payments operate for all users on a day to day basis. The Payments Council has provided an effective level of oversight of the UK payment schemes and has also provided the governance, drive and pan industry collaboration to the deliver initiatives such as Faster Payments, CASS and Pay**m**.

When proposing changes to models, the following fundamental questions need to be considered:

- How any cost or investment needed to change the ownership structure will be financed or paid for. A cost-recovery model based on the item charge or call may impact the smaller member's disproportionately.
- Infrastructure is capital intensive; ultimately; who would build, pay for and own the infrastructure? A commercial company may require access to debt finance.
- Any proposed solution must improve the status quo and deliver the PSR's objectives for access and fairness. If costs are recovered from all members, this may actually be a disadvantage to new entrant banks and create additional (and potentially restrictive) costs to new entrants.
- If the PSR is too prescriptive; e.g. price, innovation and access then this may prove a disincentive to ownership and require a premium to ensure a commercial return on investment

It is important to note that UK payments are currently run as a cost centre by the members and the operation of the central infrastructure delivers efficiencies and facilitates cost reduction. Changes to the ownership structure may result in fragmentation and inefficiencies that have cost impacts on all payment services providers, that may have unintended consequences on the 'free banking' model and therefore customers.

An alternative approach to any change of ownership may be to keep ownership in place, but to review the governance structure to provide for greater representation for small and indirect participants. Much work has been ongoing; for example the Payments Council has independent directors with power to veto and is reviewing Tier 3 membership (smaller and new entrant banks) on the Board. Scheme companies have appointed independent chairman and directors in accordance with CPSS IOSCO principles.

iPSL and Hewlett Packard are competing infrastructures that process the UK cheque clearing allowing for more efficiency and economies of scale in the wake of declining volumes. The separate HM Treasury consultation will review issues arising from the current cheque clearing model.

Question 8: *Do you have any concerns about the current governance of UK payment systems?*

In recent years, there have been a number of changes to the governance structures with the UK payments industry. Many of the entities operating in the market, such as Vocalink, Payments Council and Bacs, appoint independent chairmen and directors. In addition, such directors have the power of veto on matters of public interest. Work has also been done to ensure smaller members have a voice. For example, there are three board seats allocated to smaller (Tier 3) members at the Payments Council.

We have recognised that the Call for Inputs envisages no formal role for the Payments Council in the new regulatory setup. However, given the specific nature of the payments sector and the need for close collaboration to deliver industry change, we believe an industry body of some kind will still be necessary under the new regime. There will be the need for a body to implement cross-industry change that sets rules and standards and holds participants to account.

Such a body could also act as a 'sounding board' for the PSR and provide it with access to payments expertise. We believe this new cross-industry body should support collaboration and help to manage the delivery of innovation and change across the payments industry with the PSR. It should also give a greater voice to indirect/agency banks.

Future governance models will be informed ultimately by where the PSR wants competition to exist but should continue to support and build upon the improvements which have been made over recent years.

In Card Payments governance is currently provided by varied bodies such as the Payments Council, the UK Cards Association and the Card Payment Schemes – these providers do not always collaborate leading to multiple governance arrangements and confusion within the market. Not all Payment Systems have a voice at these tables, leading to their payment models not always being included in new governance, guidance and compliance. Competition and innovation in Card Payments is impacted by the lack of a sufficiently consistent approach. We are unclear around the consistency in approach to governance of banked versus non-banked and established versus emerging providers of card services and are fully supportive of a fully consistent approach for all.

We would also welcome the PSR taking an active role in EU regulation particularly where such regulatory changes, such as changes to interchange fees, may impact UK payments industry, This will ensure that a consistent approach is taken and that the UK payments industry and its customers are fairly represented in the broader payments arena.

.***Question 9:*** *What do you believe is the appropriate governance structure for UK payment systems?*

As highlighted in the previous questions, we believe that the current governance model has served the UK well and has enabled significant pan industry development and innovation such as Chip & pin, Faster Payments, CASS and Pay**m**.

We do however recognise that governance could be improved by ensuring that indirect participants, small and new banks have a greater voice in the future and would support any changes made to resolve this.

Any changes to the current governance structure should:

- Ensure a consistent approach;
- Strongly support innovation and competition;
- Consider both UK and European payment industry developments and;
- Undergo careful consideration in order to avoid unintended consequences.

We would also suggest that perhaps the governance of cards and payment schemes are reviewed separately to accommodate for the different regulatory and compliance requirements each one faces.

Question 10: *How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.*

Payments

Lloyds Banking Group (either via Lloyds Bank and/or Bank of Scotland) is a direct member of all UK Payment Schemes (CHAPS, Bacs, Faster Payments, C&CCC and LINK) and sponsors a number of indirect members through 'agency banking' arrangements to access said payment schemes.

Fees and membership requirements are transparent and apply to any financial institution wishing to join as a direct member. Transaction fees are based on volumes and do not give any discounts to higher-volume users thus neither disadvantaging nor advantaging smaller members.

Though current arrangements have served the industry and end-users well and we do not have any concerns regarding our own direct access to payment systems, we acknowledge and are engaged in driving forward changes that see new entrants gaining direct access more easily (see question 11).

(Please see supporting Facts and Data Pack)

Cards

Lloyds Banking Group acts as a Card Acquirer and Commercial and Consumer Card issuer. To enable the processing of Card Payments, we are members to several schemes and systems and such membership is open to all participants in the payments industry. These schemes and systems include:

- Visa
- MasterCard
- Diners Discover
- American Express
- Japanese Card Bureau
- Union Pay International

A direct relationship is held with the Card Schemes, where:

- All appropriate fees are set out and documented

- The current fee structure can cause confusion to both users of the payment systems and payment instruments – the different schemes offer different fee structures leading to varied pricing and cost models
- Greater consultation with banks and other participants could create a more consistent approach
- The fees are currently under scrutiny by the European Commission and cause confusion to the merchants and cardholders, the users of payments instruments
- The terms and conditions allow for a fair and competitive market – greater governance can be considered to ensure that other participants and new models are included
- New members can join the schemes but this requires considerable technical development

Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*

As a direct member, Lloyds Banking Group accesses payment systems on a fair and reasonable basis. Generally speaking, new entrants face four key considerations regarding access to payment systems:

- Their ability to offer compelling customer propositions;
- How to meet technical and system requirements to secure access to payments;
- How to put effective settlement and liquidity arrangements in place and;
- Meeting the regulatory standards necessary to gain access to a system, such as having a minimum credit rating and holding a reserve account at Bank of England.

We recognise that current access arrangements can pose burdens on new entrants with regards to the above. We have worked across the Industry on potential solutions addressing some of these concerns.

We proposed what we referred to in our submission to the Parliamentary Commission on Banking Standards as "Infrastructure Lite" to overcome some of the technical requirements for direct access which in turn, will potentially enable smaller payments participants to offer a more compelling customer proposition (e.g. overcoming any time lags with regards to Faster Payments).

Work is currently being undertaken at the Payments Council on "Challenger Access" looking at both the technical requirements and others and we are continuing to support such efforts. As mentioned previously, it is important we address these access concerns without affecting the robustness or credibility of the payment systems.

Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*

As a direct member, Lloyds Banking Group is not limited in our ability to compete or provide high standard service user experiences.

However, as mentioned in Question 11, we recognise that indirect access may limit such ability especially with regards to real-time payments through FPS and Pay**m**. Work is being undertaken at Industry level on this which we support fully and we believe this should be a priority for the PSR.

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

This question is not applicable to Lloyds Banking Group as we access all of the UK card and payment schemes directly. Please see questions 10-12 for responses regarding direct participation.

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:*

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

Lloyds Banking Group sponsors approximately 330 different banks based in the UK and internationally, giving them indirect access to a combination of CHAPS, Bacs, C&CCC and FPS.

The greatest proportions of sponsoring bank relationships are in place to provide access to CHAPS. Only approximately 30 sponsoring bank relationships provide access to Bacs, C&CCC and FPS and in many instances, these relationships also support access to CHAPS.

There are a number of risks associated with providing direct access. As a sponsoring bank, the indirect member must hold an account with ourselves and we are responsible for settling their payment obligations, often by using our own liquidity to do so. In the event of one of these banks running out of money, LBG is still expected to settle this bank's obligations in the payment system(s) concerned.

As a sponsoring bank, depending percentage of payment flows deriving from indirect members, we face challenges in managing our intra day payment profile. As a result, a sponsoring bank may have to work considerably harder to meet throughput requirements set by Bank of England. As it currently stands, approximately 13% of our average daily gross throughput derives from our largest five indirect members in CHAPS. In 2012, CHAPS tiering rules were introduced to reduce this risk impacting the stability of the payments system by bringing the largest indirect users of CHAPS onboard as direct members.

At any point in time, an indirect member may have a credit or debit position on their account, exposing the sponsoring bank to counterparty risk. Prudent limits are set for each indirect member to minimise the level of exposure a sponsoring bank has to any one direct member. Maximum exposure limits to an individual indirect member is also being reviewed under the ring fencing regulation being introduced into the UK.

We do not see any barriers to becoming a sponsoring bank. The key requirement is to be able to provide a robust and resilient proposition and solution that meets the requirements of the indirect participant on a competitive basis and at a competitive price. These indirect participant relationships and contracts are tendered in the open market on a regular basis.

Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*

UK payments systems benefit from open, transparent and non-discriminatory access and membership criteria. Furthermore, agency arrangements, far from being a barrier to entry, promote access by avoiding the need for small banks to invest millions of pounds on IT development and ongoing resilience.

The arrangements offer access on fair terms and are subject to competition between direct access providers. LBG promotes third party access through its agency and GBP correspondent clearing services: we sponsor around 330 of the 4500 financial institutions connecting indirectly to CHAPS. We note that in 2010 the Office of Fair Trading found that access to payment networks do not raise significant barriers to entry or expansion.

The evolution and innovation in UK payments in recent years has led to an increasing reliance and use of real time payments, specifically Faster Payments. This is an area where we believe that the PSR should work with the industry to provide better access to small and new entrant banks and building societies. This in turn would help all consumers and business benefit, if their bank wishes, from the world leading features of Faster Payments.

We also believe that the HMT Consultation – Speeding up cheque payments; legislating for cheque imaging will present an opportunity to improve access to cheque clearing, specifically but not exclusively relating to the lead sort code pair restriction inherent in the cheque clearing model today.

The case for action being required in relation the CHAPS and Bacs is less clear with the customers of indirect participants noticing little if any difference to that of a direct participant. Nevertheless, we support that the PSR should review access in these systems at the same time as Faster Payments and C&CCC.

Question 16: *Do you have any other comments regarding access?*

The rules of access may need to be reviewed as new innovative players delivering new solutions which compete with bank owned products participate in card payments solutions. Access to payment systems must be controlled and governed to ensure that the card payments market is not flooded with products which may impact the success of cards we have today in the UK to the detriment of consumers and corporates. We are unclear around the consistency in approach to governance of banked versus non-banked and established versus emerging providers of card services and are fully supportive of a fully consistent approach for all.

It should be noted that the Payment Services Directive II (PSD II), currently passing through the European legislative process, brings Third Party Providers (TPPs) under regulations of PSD II. Lloyds Banking Group welcomes such a move to bring these new players in the payments industry falling under regulation. However, there are a number of concerns on security, access to customers' bank accounts, authentication and liability arrangements that need addressing. Similar careful consideration should be given in the UK to achieve the right balance between protecting customers and the integrity of the industry and infrastructure whilst at the same time encouraging innovation and competition from such new payment service providers.

Question 17: *What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?*

The UK payments industry is predicated on secure, highly resilient payments systems with oversight provided by Bank of England. Systems are recognised under the Banking Act 2009 and the Bank, as overseer, publishes annual Expectations that mirror the CPSS IOSCO principles for financial market infrastructures.

The UK payments infrastructure is class leading and performs to the highest standards. It proved resilient through the financial crisis, although stability comes at a cost and substantial sums have and are being spent on ensuring the payments systems continue to function. For instance, Cyber security is an emerging threat and identified as a key national government and industry issue for the UK Critical National Infrastructure.

The Payments Council has undertaken study as part of its Payments Roadmap strategic review to capture possible future end-state models of the UK payments infrastructure. Options range from incremental change to the existing state to a radical central clearing hub model. We believe that any future model must deliver greater access, interoperability and integration, but we do not favour one model over another at the time and reiterate that a solution will be dependent on meeting clear outcomes set by the PSR.

We support the replacement of components within the industry's regular investment cycle and for these changes to be future-proofed to meet the needs of the industry, regulatory and end-users. Interoperability and common standards in the centre will allow for competition at products and service level.

The greater the change is, the more likely it will increase cost. We would be pleased to be engaged in any pan-industry discussions to define the work. We acknowledge that there may be aspects of the infrastructure that might be opened up to competition, e.g. value adding services but our preference would be to retain a single supplier for core services to avoid additional cost, complexity and risk.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*

The electronic payments industry has developed over forty years and has adopted different payment standards to accommodate the requirements to deliver timely and secure payments;

- Bacs – Standard 18
- CHAPS – SWIFT MT Messaging
- FPS – ISO8583

The global financial payments message standard, ISO20022 is increasingly being adopted internationally, in Europe and in the UK. The Current Account Switch Service (CASS) and Cash ISA Transfer service both use ISO20022.

We support HM Treasury's interest in understanding how ISO20022 might meet the government's objectives around competition and reduced barriers to UK payment systems, but believe that the case for the UK payment schemes to migrate to ISO20022 is still to be made. Principally, migration may entail substantial expenditure on systems that do not make payments go faster or be more secure. The demand from corporate customers is low and the impact on the smaller corporate and SME end-users is uncertain and may outweigh the benefits. There will be no benefit to ordinary consumers with any benefits resting with larger corporate clients and government departments.

Whilst we perceive that the government envisages ISO20022 as a key enabler to deliver Universal Credit and capture substantial cost savings, we believe that ISO2002 is only an enabler and not a solution. Further work and detailed analysis is required to ensure that the outcomes that the PSR wants to achieve are fully defined and the Industry should then work with the PSR to deliver those outcomes. This may, or may not be, through migration to ISO20022 and potentially other solutions may deliver the same outcome at a lower cost, time or impact on the end-user.

The use of ISO20022 to support SEPA is without parallel in the UK and was driven by a political imperative to support financial unity within the EU. The recent extension granted by the European

Commission highlights the risks in imposing legislation driven end dates on the payments industry. The announcement at SIBOS 2012 by the ECB and EBA Clearing to migrate the Target 2 and EURO1 schemes to ISO20022 provided for a five year lead time to achieve migration by November 2017. We would envisage similar timescales should the UK plan to migrate. This would support any potential major development to be undertaken within the bank's investment life-cycle.

We are engaged and fully support the Payments Council's proposed study that focuses on the key outcomes, to reach an agreed payments industry position on the impacts of ISO20022 ahead of a full cost/benefit analysis later in the year. It is also essential that the UK learns from the mistakes of Europe when reviewing the case for ISO20022.

HM Treasury is consulting on proposals to introduce Cheque Imaging. Infrastructure changes will be needed to speed up cheque payments but every opportunity should be taken to reuse existing infrastructure and avoid creating another electronic payments scheme.

Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*

The majority of Agency Banks operating in the UK are subsidiaries or branches of International banks, as a consequence of London's importance as a financial centre. To that end, their needs will be driven by their customers and global trade and finance.

Integrity and stability will continue to be of overriding importance and any solutions will need to guard against increased settlement and operational risk. In 2010, the OFT found that access to payment networks do not raise significant barriers to entry or expansion. Since then, the Industry has sought to improve engagement with Agency banks through the Payment Council's Access to Payments Forum and Bacs Affiliates Group. Any payment service provider is able to attend, whether or not they are a member of the Payments Council.

Lloyds Banking Group together with VocaLink has developed the concept of Payments Infrastructure Lite. Infrastructure Lite is a 'plug and play' solution allowing smaller/agency banks direct access to the UK clearings without the underlying complexity or costs as the larger banks and provides a potential solution to the perceived barriers to entry. We support further work to develop Infrastructure Lite through a Proof of Concept. This could be delivered as a commercial service by VocaLink or collaboratively via the Payments Council or a future collaborative body.

As highlighted above, we are supportive of work to establish outcomes based cost/benefits case to migrate UK payment schemes to ISO20022. Adoption of a global financial standard is likely to benefit the International Banking community, but not as mentioned previously the vast majority of UK end users.

We understand that the Faster Payments Scheme is considering developing a 'Bridge/Bureau' concept that will allow LINK members to send and receive LINK payments into the Faster Payments system through VocaLink. Whilst engagement with the Faster Payments Scheme and VocaLink is ongoing, this is in the early stages of evaluation with further detailed assessment required to assess the risk and liability models.

Considerations to improve the cheque clearing will be driven the response to the HM Treasury Consultation.

Question 20: *Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).*

Question 21: *Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?*

Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*

Payments

Incentives to innovate are clear under the current arrangements and can broadly take two forms. Innovation can come from within existing schemes by reducing costs and/or improving the service and customer service. Alternatively, innovation may come from new schemes and payment systems that compete with existing schemes.

The UK has a very strong track record of innovation in UK payments in both forms. The payments industry has successfully delivered initiatives such as Faster Payments and Chip & pin (which has substantially reduced fraud). It also continues to innovate and will deliver secure mobile to mobile payments through Pay**m** and simpler and easier cheque payments. This demonstrates that existing fee arrangements and structures are not impeding innovation within existing schemes or preventing the development and growth of new payment schemes and methods.

New payment methods, such as PayPal have successfully entered the UK market and grown rapidly. However, uncertainty over the scope and extent of regulation of existing payment schemes (for example interchange fees) may blunt the incentives to innovate and invest.

There is a need to deliver certainty over planned interchange regulation both in the EU and in the UK and clearly establishing the principles that will be applied by the PSR when regulating schemes will avoid any prolonged impact on incentives to invest.

UK payment systems work well and the UK has high penetration and usage of cards including amongst lower income customers relative to other developed countries. It also has world leading services such as Faster Payments, CASS and high usage of relatively low-cost payment schemes such as Direct Debit. With the launch of Pay**m** and changes to the way cheques can be processed and paid the UK will continue to have some of the best payment systems and services internationally.

This strongly suggests that significant change to the existing arrangements is not necessary.

Cards

The nature of the merchant acquiring environment spurs collaborative innovation. Visa and MasterCard's role as membership-based organisation has helped drive several high-profile initiatives (e.g. contactless payments) which members can choose to build into their own commercial objectives within the competitive space. Membership of these organisations makes collaborative innovation considerably easier than attempting to form a series of relationships independently.

The UK is already at the forefront of payment innovation, certainly when compared to Europe. Consumers have been quicker to adopt online and mobile payments than in any other European market and this is reflected by higher adoption of new payment methods or channels. This speaks to a vibrant innovation environment that has been driven by both collaborative and individual organisation initiatives.

The clear benefit to collective innovation, as has been demonstrated with initiatives such as the global card schemes' contactless payments or the Payments Council's Mobile Payments service (Pay**m**) is that it provides a common infrastructure for initiatives, which makes life considerably easier for all members of the payments value chain. Common initiatives that facilitate a common infrastructure are proven to help build awareness and advocacy amongst both consumers making the payments and the businesses accepting them. It is also beneficial in enabling smaller suppliers to participate in initiatives that may otherwise be cost-prohibitive. Specifically within merchant services, this is important for businesses who have neither the time nor the budget to make widespread changes when switching their provider.

However there is serious concern that such innovation will be severely impeded in the future because the current draft of the EC Interchange regulation includes any incentives paid by the schemes within the interchange cap. This will prevent any sharing of the costs incurred by issuers in future. This lack of funding will certainly stifle innovation in the future putting the UK behind competing markets in the global economy.

Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*

Many payment schemes and systems need to have some degree of interoperability and universal access to facilitate competition in the products and services customers want to purchase and use. Core payment services such as cheques, ATMs, Direct Debits, Standing Orders and Faster Payments that allow customers to access cash, receive and make payments, must have these features.

This facilitates competition by making it easy for customers and businesses to choose who they hold their payment account with, but still safely and securely make and receive payments in the manner which suits their individual needs. In these core payment system innovations, for example to reduce costs or improve service through adopting new technology, require collective innovation, in the form of collaboration to ensure interoperability.

Collective innovation takes time to engage stakeholders and requires investment from all entities often leading to a slower pace of progression. However, it is more likely that innovation in this form will be closer to the needs of all operators. It also provides significant benefits to customers by allowing these schemes to evolve and become better and more efficient over time while maintaining universal access for customers.

Furthermore, collective innovation at an industry level can facilitate unilateral innovation at other levels within the industry. For example, payment account providers may innovate different ways for customers to interface with the core banking systems, such as the mobile applications and internet banking, whilst maintaining a common infrastructure at the core

Individual innovation can be developed more quickly and be more radical than collective innovation, but it can often struggle to find support, leading to it ultimately failing. E-commerce makes it much easier to disintermediate traditional financial institutions and set up a proprietary payment scheme in which PayPal and Google Wallet are examples of where this has successfully been achieved.

As a result, it would be fair to suggest that the industry participates in a combination of collective and unilateral innovation which provides a range of benefits within the industry. Both existing providers and new entrants can still compete effectively and innovate even though there is collaboration.

Question 24: *Do you have any other comments or concerns you would like to highlight?*

Regulation is usually enacted to mandate agreed actions or conduct on markets and participants to enforce desired behaviours. We believe that the PSR objective for innovation does not sit comfortably with traditional regulation. We believe the PSR should set the framework for innovation, primarily by putting in place a stable environment in which incentives to innovate exist, and the underlying infrastructure is in place. Any more specific interventions should be in the form of high-level “Desired Outcomes”, rather than the PSR attempting to dictate centrally how new innovations should come about.

Banking, payments and transaction management is already a highly regulated industry. The FCA regulates conduct relating to payment transactions via the Payment Services Regulation. CHAPS, Bacs, Faster Payments and other systemically important systems are recognised under the Banking Act 2009 and Bank of England expects these systems to adopt the CPSS IOSCO principles for financial market infrastructures. Payment transactions are subject to a range of financial crime Acts and regulations including; Proceeds of Crime Act (POCA) 2002, Anti-terrorism, Crime and Security Act 2001, Money Laundering Regulations 2007, Counter Terrorism Act 2008 and Serious Organised Crime and Police Act 2005. Global regulation such as FATCA and Dodd Frank also affect UK payment systems. Therefore, it will be important that the PSR works with the industry to recognise the impact this has on UK payment systems and the burden of regulatory and mandatory change facing the industry.

Question 25: *What, if any, are the significant benefits you see regulation bringing?*

Regulation should be clear, proportionate and focussed on clear outcomes that address specific consumer needs whilst building on the successful work that the industry has undertaken and continues to address.

The PSR should work with the industry (through an effective collaborative industry body) and stakeholders and should be tasked to deliver the outcomes against quality, costs and time to ensure that the industry can plan change, investment and development instep with the PSR’s expectations.

The PSR should recognise the evolving payments market and seek to encompass emerging payment providers and services within the regulatory regime to ensure stability and a level playing field.

Question 26: *What, if any, are the risks arising from regulation of payment systems?*

There are a number of risks which may arise from regulating the payment industry depending on the model of regulation adopted. The risks could include:

- Heavy price regulation or loss of all significant rule-making discretion, leading to nationalisation-by-stealth of systems in which operators have invested billions of pounds developing, deterring future investment;
- Development of significant stranded infrastructure, forcing write-downs and creating high uncertainty that will deter or increase the risk (and hence required return) of future payments innovation and investment;
- Removal of potential upside from successful payment innovations and development of infrastructure, which will deter investment in those innovations;
- UK not adopting future international standards that may develop in European and North American payments infrastructure, or international developers of payment systems choosing not to launch in the UK because of the regulatory environment;
- A shift in the balance of power from collaborative and open four-party systems to closed for-profit systems which, aided by network effects and more lax regulatory scrutiny, entrench their market position and gain significant market power.

Question 27: *How do you think regulation might affect your business and your participation in UK payment systems?*

Lloyd Banking Group is the UK's largest retail bank and has a stated aim to be the best bank for customers. We are therefore committed to providing outstanding customer service and view continued participation in the payment schemes and their services as integral to this.

There is an opportunity for the PSR to work together with the payments industry and key stakeholders to agree, produce and deliver a holistic and coherent strategic plan that meets the needs of UK Plc, end users and future-proofs the UK financial industry to maintain its pre-eminent role within global finance.

If legislation is not joined up and/or poorly executed then the potential benefits may be lost.

Cover sheet

Basic information	
Consultation title:	Payments Systems Regulation Call for Inputs
Name of respondent:	Maclay Murray & Spens LLP
Contact at respondent:	Name: William Sprigge
	Email: william.sprigge@mms.co.uk
	Address: One London Wall London EC2Y 5AB

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	Law firm

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?		X
If 'Yes', please submit both confidential and non-confidential responses.		

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OUR REF WLS//SHARED/WLS

YOUR REF

mms | Maclay Murray & Spens LLP

The Payments Systems Regulator
25 the North Collonade
Canary Wharf
LONDON
E14 5HS

15 April 2014

Dear Sir

Payments Systems Regulation – Call for Inputs

Maclay Murray & Spens LLP ("MMS") is a full service commercial law firm with strong practice interests in competition, financial services and corporate law. We are responding to the Call for Inputs because we have comments to make on a number of the questions it asks. These comments derive mainly from our experience advising clients on competition issues.

Our response comprises answers to those of your questions on which we have comments. We make no reference to questions on which we have no comments.

Responses to Questions

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

We suggest that this question needs to be considered at three levels:

(1) at the level of the providers of systems infrastructure to payment service providers ("Level 1"),

(2) at the level of providers of payment systems to financial institutions ("Level 2"),

(3) at the level of competition between financial institutions in merchant acquiring ("Level 3"), and

(4) at the level of private and commercial customers of financial institutions ("Level 4").

We doubt whether competition is effective at Levels 1 and 2. We believe that there is potential for competition at Level 3 but that there may be barriers to entry which limit its effectiveness. We doubt whether any competition occurs at Level 4. Our reasons are given in our responses below.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Competition has the potential to drive benefits for service-users, in terms of costs, quality and innovation at all Levels. The experience of every industry that we have observed in which competition has been introduced (energy, bus services, post, airlines, telecoms) is that it is followed by cost reductions and more innovative service offerings which benefit consumers.

Question 4: What are the main factors impeding more effective competition at each level?

Ownership

The CHAPS, BACS and Faster Payments systems are owned and run by their members, which include the main high street banks in the UK. These payments systems are effectively joint ventures by the main high street banks which result in a near monopoly for each system in the transaction value ranges provided by the system. Competition between the banks as regards these payments systems is limited to the upper and lower limits on the value of the transaction that each bank will be prepared to attach to each payments system and the cost of the transaction.

At Level 1, any new provider of infrastructure will face very significant barriers to entry. In particular it will face the difficulty of displacing incumbent infrastructure providers who may also be infrastructure owners. Strong existing business relationships will need to be interrupted and sunk infrastructure costs will not be written off unless compelling cost advantages can be demonstrated.

At Level 2, any new service provider will have to overcome the difficulty that the financial institutions who are the main customers for a payments system also are its competitors. Such customers may have little interest in doing business with the new provider: competition will put pressure on their margins and reduce volumes of transfers across the systems they own (and therefore revenues from those systems).

Concentration and market power

The limited number of payment service providers, which is partly a consequence of their ownership, means that some, such as Visa and MasterCard, are sufficiently dominant that merchants cannot afford to refuse to take their cards for fear of losing considerable business. This is likely to have an effect on competition at Level 3: merchants who feel bound to deal with the dominant providers of payment services are unlikely to want to deal with additional cost of working with other providers who will add relatively little additional business. Dominance therefore has a reinforcing effect on dominance.

A lack of effective competition at Level 3 has implications for the wider economy, beyond the market for payment services. The reinforcing effect of dominance, leading to fewer providers reduces competition in the level of the "swipe fees" that are extracted from the merchant when a customer makes payment using a dominant provider's card. This transaction fee is borne by the merchant, and ultimately by the merchant's customers if the merchant is able to pass on these charges to its customers by way of higher prices. Any passing on is to consumers generally with even those paying cash footing an equal share of the bill. The smearing of these higher fees has two effects. Firstly, it reduces the revenues available to consumers to purchase other goods and services, distorting competition in the economy generally in favour of payment service providers.

Secondly, it adversely affects competition at Level 4 because customers are unaware of the costs of using different payment service providers, so there is no competitive incentive between them on price at that Level. Indeed, competition between credit card providers for consumer customers is typically on interest rates offered and on ancillary benefits such as air-miles. This disconnect between the choice of payments system and payment of any transaction fee further reinforces the ability of dominant payment services providers to levy excessive transaction fees on merchants, which is likely to have raised prices to end consumers. Insofar as any part of the payments system is permitted, through lack of competition, to earn above a reasonable rate of return, that imposes a cost on the economy in terms of resources being allocated inefficiently.

Market structure

The effect of competition between the banks on payments systems being in terms of the upper and lower limits on the transaction value that each bank attaches to each payments system is that consumers wanting to take advantage of this competition would have to change their high street bank. This is unlikely to happen: the inconvenience of changing banks is great and the number of transactions made by consumers, large enough for a change of payment service provider to make a financial saving, is small. This structural feature of the market affects competition at Level 4 and may have allowed relatively expensive transaction fees to be charged by the high street banks, possibly at above a competitive level, for payments that are too large to be made through the free Faster Payments Service and have be made through another payments system such as CHAPS, which typically costs the consumer around £35.00.

Another structural feature is the fact that the issue of credit cards is also often linked to consumers' banks. This is convenient for customers as their banking can be done at a 'one stop shop' and their credit card can be integrated with their online banking but it gives credit cards associated with banks an advantage compared with other credit card providers. It also has the effect that the consumer's ability to choose a payment service provider is restricted because their bank will offer only certain credit and debit cards and the customer will have to use the payment service provider associated with those cards. This limits the existence and effectiveness of competition at Level 4.

Information

At the level of the private consumer the awareness of the existence of a market for payment services, of the names of companies operating in the market and of charges for payment service provision, in our view, is very low. The familiarity of these consumers with CHAPS charges and similar costs will be limited to the few occasions when they make a major transaction, such as buying a house and we would doubt whether they are aware of the existence of Vocalink and ZAPP, which are not consumer brands. SME consumers will be better informed, but overall this lack of awareness appears to us to be a major factor in contributing to a lack of any competition at Level 4.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Our concerns about the adverse effect on competition in payment services provision of the current ownership structure are set out in our answer to the Question 4.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

Powers under the Competition Act 1998 would enable the regulator to take action in relation to anti-competitive agreements and abuse of dominance in the provision of payment services. The possibility of fines and the need to justify agreements between undertakings in terms of section 9 of the Act (and Article 103(3) of the TFEU) already should be providing an incentive against anti-competitive activity. The effectiveness of that incentive should be increased by the establishment of a specialist regulator dedicated to the sector. Such a regulator should be able to bring to bear greater expertise on payments services than is immediately available to the Competition and Markets Authority (the CMA"); it will also bring resources additional to those available to the CMA.

Powers under the Enterprise Act 2002 will enable the regulator to consider making a market investigation reference to the CMA if it has concerns about structural issues and to obtain and enforce undertakings in relation to anti-competitive behaviour in lieu of such a reference. Although these powers already exist and are available to the CMA, a dedicated regulator will bring specialist knowledge and additional resources. The sort of undertakings that might be obtained include managerial and financial ring-fencing of undertakings, possibly supported by clear accounting separation requirements; separation of ownership could be introduced if offered.

If the threat of a market investigation failed to lead to competition being more effective, a reference could be made, leading to a wide range of remedies being available to the CMA. These could include separation of ownership of payments systems, prohibition of vertical links between banks and credit card providers and a requirement to offer choice in payment service provision to customers.

Separate ownership would not, of itself, necessarily address all the concerns we have identified: it could simply lead to the separation out from existing ownership of a limited number of concentrated providers. Following any separation, the regulator therefore might need to apply additional remedies, for example to require interoperability between any payments systems, to control prices, or to provide access to market entrants (and in that event to prohibit margin squeeze).

Question 8: Do you have any concerns about the current governance of UK payment systems?

We are concerned that because payments systems effectively are bundled up with other services provided by or through financial institutions they are not subject to distinct governance regimes which address the concerns about potential for the sort of anti-competitive activity described above.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

There are two aspects to this question: governance within the businesses providing payment services and external governance of the payments service sector as a whole. Without specific external pressure at the level of the sector as a whole, it is unlikely that that governance at the level of the business will be particularly strong: governance carries a cost and there is little reason for a business to incur that cost if profits are good and there is no clear business reason to put specifically targeted governance measures in place.

MMS therefore sees merit in the establishment of a specialist regulator for payment services. Precisely what the governance structure it should put in place should be is something on which we think it is too soon to express a view. The required nature of the structure should evolve as the industry responds to the establishment of the regulator and the initiatives it takes.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

There are advantages and disadvantages in either approach to driving innovation. Collective innovation may give less innovation than unilateral innovation because there is less incentive to innovate if you have to share the benefit of the innovation and are unable to obtain market advantage from it. There also is the risk that collective innovation suits the incumbent innovators, at the expense of competitors and consumers.

However, collective innovation can provide access to greater resources and expertise for a project and can yield benefits in synergies with other products and services from the innovators. Furthermore, a certain level of industry standardisation can be beneficial in some markets, for example debit and credit cards from major banks being accepted by other banks' ATMs, which can perhaps be more easily be achieved via collective innovation.

Question 25: What, if any, are the significant benefits you see regulation bringing?

If regulation leads to a more competitive provision of payment services it should lead to innovation and cost reduction in the provision of these services, with cheaper and better services to users.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Regulation imposes cost and there needs to be clarity that these costs are exceeded by the benefits to consumers from regulation. This is especially the case where the existing system has the consumer benefits of interoperability and convenience. These benefits would need to be protected by the regulator should any action be taken.

Poorly designed or heavy handed regulation can increase the risks faced by investors, raising the possibility of deterring investment by unduly increasing the cost of capital. Regulation also can have unintended consequences, for example if providers are incentivised more to meet regulatory targets than to concentrate on customer needs. Regulation therefore needs to be carefully designed, with constant reflection on how consumer needs are being advanced through investment in, and the supply of, services that they value.

Yours faithfully

William Sprigge

William Sprigge
Consultant, EU Competition & Regulatory
For Maclay Murray & Spens LLP

MasterCard response to the Financial Conduct Authority – Payment Systems Regulation: Call for Inputs

MasterCard Worldwide ('MasterCard') submits this response to the Financial Conduct Authority ('FCA') "Payment Systems Regulation – Call for Inputs", which seeks views on the UK payments industry in the context of the creation of a competition-focused, utility-style, Payment Systems Regulator ('PSR'), in particular on issues of competition, access, governance, ownership and innovation.

We welcome the opportunity to provide our comments on this important matter and view it as part of the ongoing dialogue between the PSR and MasterCard, with the aim of creating a regulator that has the most effective focus and that approaches any regulation of the sector in a suitable and proportionate manner. With this in mind, before answering specific questions, which we have grouped to reflect the clear themes present in the Call for Inputs, we make some overarching points that we hope will further facilitate this discourse

MasterCard's view of payments regulation is underpinned by a belief that a truly competitive UK electronic payments system will play a pivotal role in improving the productivity of the UK economy. Numerous studies undertaken by central banks, economists, academics and Ministries of Finance demonstrate the economic benefits to economies of displacing cash with electronic payments – these studies include countries as diverse as the United States, Germany, South Africa, Canada and Turkey and underline the costs of cash in both developed and emerging economies and the positive role electronic payments play in increasing efficiencies and productivity.

For comparable levels of usage, the unit cost of card payments are substantially lower than the unit cost of cash payments, and they fall more rapidly as usage increases. This can produce an economic benefit of anything up to 1.5% of GDP, and this figure does not include tax evasion, corruption and other forms of illegal activity. MasterCard estimates that as much as $16 trillion dollars is spent in cash every year worldwide in black and informal economies. It is clear that by reducing cash usage, all participants in the payments value chain benefit.

The PSR has a unique opportunity to consider anew the debate around competition in UK payments. As we explain below, there are areas where we believe the PSR could utilise its powers to improve competition, access and innovation amongst interbank payment schemes. However, from our experiences as a global leader in electronic payments and new payments technology, MasterCard believes that there is already a high level of competition and innovation in UK card payments and in many ways the UK leads Europe and the rest of the world in this regard.

While we offer examples of this throughout our response, we believe that as the PSR explores these issues in increasing depth it will discover that the historic debate around card payments has very much been focused on merchant costs. This in turn has generated claims that competition is lacking and demands for market intervention are therefore necessary. MasterCard urges the PSR to change the terms of this debate and examine if this is true by assessing the position of all end-users of retail payment systems. In so doing, we believe the PSR will find that all end-users derive tremendous benefit from card payment systems that outweigh the costs of running and developing them. Given the network effect of payment systems, we also believe that the PSR will realise that reducing the costs for one group of end-users via regulatory action will most likely have negative consequences for other end-user groups.

Executive summary

The creation of the PSR is a culmination of over 10 years of investigations and inquiries into the competitive landscape of payment systems in the UK, particularly interbank payment systems. Certainly during the course of 2012 and 2013, the focus has been on the interbank payment systems and the Payment Council with which they contract, most notably around the issues of ownership, governance, access, competition and innovation. Card payment systems were not thought to pose any significant issues in these areas, as demonstrated by the lack of any evidence in Government consultation documents or accompanying impact assessments, the Treasury Select Committee inquiry into the withdrawal of cheques and the inquiry by the Parliamentary Commission on Banking Standards.

In fact, competition is fierce not only between card payment systems but also within them, with new entrants in each part of the value chain who directly and indirectly benefit from the long-term investment and development that organisations like MasterCard have made in payment s technology and who use our system at low cost and with low barriers to entry.

It is precisely because of these high levels of competition and investment that we believe it is in the interests of the PSR to become more directly involved in the proposed interchange regulation by the European Commission (‘EC’). The current proposals seek not only to cap interchange fees at arbitrary levels but to also fundamentally alter the structure (and possibly ownership), rules and operations of four-party card payment systems, without any assessment of the impact this may have at Member State level. As we explain below, interchange is an essential mechanism to ensure that not only are costs balanced in the system in order to reflect the value that merchants derive from accepting cards but fundamentally to ensure the continued growth of the system and commensurate levels of investment and innovation.

Regulatory intervention in other countries has seen this balance affected, benefiting large merchants at the expense of consumers and smaller merchants. This will particularly be the case if Europe-wide interchange caps and other restrictions are introduced by the EC rather than the PSR, which would be much better placed to assess the UK landscape and determine the most appropriate interchange levels for the UK, in consultation with all stakeholders. Otherwise, the PSR runs the risk that not only will it merely act as a monitoring and compliance body, but it may also be restricted in applying its regulatory powers wider than the scope of the interchange regulation, impacting upon its ability to create a truly competitive payments environment. For example, if three-party schemes such as American Express (“Amex”) are excluded from the interchange regulation, it is still unclear to us whether they can be designated for regulation at all – and even if they can, whether the PSR could, for example, utilise its price-setting powers to regulate Amex.

MasterCard believes that even if interchange regulation is implemented by the EC, the Government and the FCA should adopt a cautious approach towards the designation of card payment systems for regulation. The PSR could be granted the authority to ensure compliance with any regulation without the need for the Government to designate card payment systems for wider regulation. There certainly appears to be a presumption from both the Government consultations and this Call for Inputs that card payment systems will meet the criteria for designation as set out in legislation. As set out in detail below, we do not believe this to be the case.

In addition, we believe that MasterCard already meets the PSR’s statutory objectives of competition, innovation and service users. The success and growth of MasterCard’s “open” system is a result of high levels of competition, innovation and end-user satisfaction. Not only do consumers benefit from cards, such as access to credit and the protections that cards provide but merchants both large and small also receive tremendous value from accepting and using cards, such as increased sales, lower cash costs and guaranteed payment. A new revolutionary era of payments innovation is also underway in the UK, which includes, for example, the widespread adoption of contactless payments and the development of mobile e-wallets. And as previously mentioned, there is fierce competition in card payments in the UK.

Finally, if following consultation, card schemes are designated to be regulated, MasterCard would welcome the opportunity to work with the PSR to ensure the adoption of a suitable approach to regulating card payment systems. It is important that the PSR has the best possible understanding of not only MasterCard as a company but the UK card payments landscape in general. We therefore recommend that the PSR undertake a proper analysis of the sector alongside the current consultation process and that as part of any outcomes, the PSR should seek to create a level playing field by clearly setting out how it intends to apply its general regulatory principles and specific regulatory powers.

OVERARCHING POINTS

1. An introduction to MasterCard

MasterCard is a publicly-listed, global payments technology company that connects billions of consumers, thousands of financial institutions, millions of merchants, governments and businesses in more than 210 countries and territories around the world, including the United Kingdom. MasterCard owns the MasterCard family of well-known brands, including MasterCard®, Maestro® and Cirrus® and licenses financial services providers to use those brands in conducting payment transactions. We operate the world's fastest payments network to facilitate the processing of payment transactions in more than 150 currencies, including authorisation, clearing and settlement. We also provide value-added offerings such as information services and consulting. MasterCard's 'open' system delivers solutions for consumers, businesses and governments who seek faster, more secure and smarter payment methods for the widest possible range of goods and services.

A typical transaction on our network involves four participants in addition to us: the cardholder, the merchant, the issuer (the cardholder's financial institution) and the acquirer (the merchant's financial institution). We do not issue payment cards of any type, extend credit, determine or receive revenue from interest rates or other fees charged to cardholders by issuers and we do not contract with merchants to accept payment cards of any type. In most cases, cardholder relationships belong to, and are managed by, our financial institution customers.

Our ability to grow is influenced by personal consumption expenditure growth, driving paper-based form of payment towards electronic forms and increasing our share of electronic payments and providing other value-added products and services. We continue to drive growth by;

- Growing our core businesses globally, both through our products – credit, debit, prepaid and commercial – and increasing the number of payment transactions we process;
- Diversifying our business by seeking new areas of growth in markets around the world by focusing on:
    - Existing and new markets

  - Encouraging consumers, businesses and governments to use MasterCard products for new payments areas, such as transit, parking, e-procurement, person-to-person transfers and bill payments;
  - Small merchants and merchants who have historically not accepted MasterCard products; and
  - Financial inclusions for the unbanked and under-banked
- Building our business by:
  - Taking advantage of the opportunities presented by the ongoing convergence of the physical and digital worlds
  - Using our data analytics, loyalty solutions and fraud protection and detection services to add value

Our technology, expertise and data make payments safe, simple and fast. We work with merchants to help them enable new sales channels, create better purchase experiences, increase revenues and fight fraud. We help national and local governments drive increased financial inclusion and efficiency, reduce costs. Increase transparency to reduce crime and corruption and advance social progress. For consumers, we provide better, safer and more convenient ways to pay. We provide financial institutions with solutions to help them increase preference for their MasterCard-branded products.

We generate revenue by charging fees to our issuing and acquiring customers for providing transaction processing and other payment-related products and services, as well as by assessing these customers based primarily on the dollar volume of activity, or gross dollar volume ("GDV"), on the cards and other devices that carry our brands.

Payment Services and Solutions

We provide transaction processing and a wide range of payment-related products and services to enable the design, packaging and implementation of our products and programs. Our payment solutions are built upon our expertise in payment programs, product development, payment processing technology, payment security, consulting and information services and marketing.

Our Operations and Transaction Processing Network

We operate the MasterCard Network, our unique and proprietary global payments network that links our customers around the globe to facilitate the processing of transactions, permitting MasterCard cardholders to use their cards and other payment devices at millions of merchants worldwide. Our network facilitates an efficient and secure means for merchants to receive payments, and a convenient, quick and secure payment method for consumers and businesses that is accepted worldwide.

With a typical transaction through our network involving four participants in addition to us, our network supports what is often referred to as a "four-party" payments network. In a typical transaction, a cardholder (or account holder who may not be using a physical card) purchases goods or services from a merchant using a card or other payment device. After the transaction is authorised by the issuer, the issuer pays the acquirer an amount equal to the value of the transaction, minus the interchange fee (described below) and then posts the transaction to the cardholder's account. The acquirer pays the amount of the purchase, net of a "merchant service charge" (MSC) to the merchant.

- *Interchange fees* – interchange fees are per-transaction fees that represent a sharing of a portion of payment system costs among the issuer and acquirers participating in our four-party payment system. They reflect the value merchants receive from accepting our products and play a key role in balancing the costs consumers and merchants pay. Globally, MasterCard's interchange methodology aims to achieve the correct balance by taking into account costs, competition, issuer and merchant behaviour, possible fraud losses, the business environment, the regulatory environment, systems implications and other relevant factors, Under the fee structure matrix usually adopted by MasterCard, transaction criteria, product criteria, category criteria and volume are all taken into account when determining the level of interchange. We do not earn any revenues from interchange fees. Generally, interchange fees are collected from acquirers and paid to issuers to reimburse the issuers for a portion of the costs incurred by them in providing services that benefit all participants in the system, including acquirers and merchants. In the UK, MasterCard establishes 'default interchange fees' that apply when there are no other established settlement terms in place between an issuer and an acquirer. We administer the collection and remittance of interchange fees through the settlement process.

- *Merchant Service Charge* – the MSC is established by the acquirer to cover its costs of both participating in the four-party payment system and providing services rendered to merchants. The fee includes, amongst other things, the interchange fee.
- *Additional Fees and Economic Considerations* – Among the parties in a four-party system, various types of fees may be charged to different constituents for various services. Acquirers may charge merchants processing and related fees in addition to the merchant service charge. Issuers may also charge cardholders fees for the transaction, including, for example, fees for extending revolving credit. As described below, MasterCard charges issuers and acquirers fees for the transaction processing and related services we provide.

In a four-party payment system, the economics of a payment transaction relative to MasterCard vary widely depending on such factors as whether the transaction is domestic (and, if it is domestic, the country in which it takes place) or cross-border, whether it is a point-of-sale purchase, card-no-present transaction or cash withdrawal and whether the transaction is processed over our network or a third-party network or is handled solely by a financial institution that is both the acquirer for the merchant and the issuer for the cardholder (called on "on-us" transaction).

- *MasterCard Network Architecture* – the MasterCard Network features a globally integrated structure that provides scale and connectivity for our issuing customers, enabling them to expand into regional and global markets. It features an intelligent architecture that enables the network to adapt to the needs of each transaction by blending two distinct processing structures – distributed (peer-to-peer) and centralized (hub-and-spoke):
  - Transactions that require fast, reliable processing, such as those submitted using a contactless card, can use the network's distributed processing structure, ensuring they are processed close to where the transaction occurred.
  - Transactions that require value-added processing, such as real-time access to transaction data for fraud scoring, or customisation of transaction data for unique consumer-spending controls, use the networks centralized processing structure, ensuring advanced processing services are applied to the transaction.

Our network's architecture enables us to connect all parties regardless of whether the transaction is occurring at a traditional physical location, at an ATM, on the internet or through a connected device. It has 24-hour-a-day availability and world-class response time. MasterCard uses "tri-dundant" processing, or multiple routing paths, for triple-layer protection against processing failure at all three points of potential vulnerability in payment processing (network, issuer, acquirer) and to address cyber-security challenges. We engage in multiple efforts against such challenges, including regularly testing our systems to address potential vulnerabilities.

- *Participation Standard* – we establish, apply and enforce standards surrounding participation in the MasterCard payment system. We grant licenses that provide issuer and acquirers that meet specified criteria with certain rights, including access to the network and usage of cards and payment devices carrying our brands. As a condition of our licenses, issuers and acquirers agree to comply with our standards surrounding participation and brand usage and acceptance. We monitor areas of risk exposure and enforce our standards to combat fraudulent, illegal and brand-damaging activity. Issuers and acquirers are also required to report instances of fraud to us in a timely manner so that we can monitor trends and initiate actions when appropriate.
- *Customer Risks Management* – we guarantee the settlement of many of the transactions between our issuing and acquiring customers to ensure the integrity of our network. We do not, however, guarantee payment to merchants by their acquirer, or the availability of unspent prepaid cardholder account balances. As a guarantor of certain obligations of principal customers, we are exposed to customer credit risk arising from the potential financial failure of any principal customers of MasterCard, Maestro and Cirrus, and affiliate debit licensees. Principal customers participate directly in MasterCard programmes and are responsible for the settlement and other activities of their sponsored affiliate customers. To minimise the contingent risk to MasterCard of a failure of a customer to meet its settlement obligations, we monitor the financial health of economic and political operating environments and compliance with our standards by our customers. MasterCard operates as a Central Counterparty (CCP), replacing a host of bilateral customer obligations with obligations between MasterCard and individual customers, thus reducing risk for all parties. It is a recognised best practice, in the view of regulatory and industry bodies such as the Bank of England and the Bank of International Settlements, for CCP's to have a loss allocation mechanism as part of their default management options. This rule relates to the management of the settlement system covering loss allocation mechanisms / default management options. The Bank of England has asked for MasterCard to advise them on any material changes to rules relating to liquidity risk and default procedures and manages an overall annual oversight process with MasterCard to review these rules.

Processing services

- *Transaction Switching – Authorisation, Clearing and Settlement* – through the MasterCard Network, we enable the routing of a transaction to the issuer for its approval, facilitate the exchange of financial information between issuers and acquirers after a successfully-conducted transaction, and help to settle the transaction by facilitating the exchange of funds between parties via settlement banks chosen by us and the customer.
- *Cross-Border and Domestic Processing* – the MasterCard Network processes transactions throughout the world where the merchant and issuer are located in different countries (cross-border transactions), providing cardholders with the ability to use, and merchants to accept, MasterCard cards and other payment devices across multiple country border. We also provide domestic (or intra-country) transaction processing services to customers in every region of the world, which allow issuing customers to facilitate payment transactions between cardholders and merchants within a particular country. We process globally approximately half of all transactions using MasterCard-branded cards, including most cross-border transactions. We process the majority of MasterCard-branded domestic debit and credit transactions in the UK.

2. The Payment Systems Regulator has a vested interest in the debate on regulation of interchange fees by the European Commission

Europe is in the midst of a debate on regulation of card payment schemes, not only in terms of interchange fees but also, for example, structures (and possibly ownership), rules and operations. This debate has significant implications for the PSR because the regulatory proposals will significantly restrict the PSR application of its general regulatory principles and specific regulatory powers, particularly its ability to set domestic interchange rates, which if they are to be regulated should be undertaken at a national level by the PSR, to determine the most appropriate level in the UK, so as to meet the needs of small businesses, consumers and merchants in the UK.

What is interchange?

Electronic payments offer a wide range of benefits to all participants in the payments value chain – consumers and businesses who use our products to make payments; businesses that accept payments using our products; banks which issue and acquire MasterCard products and transactions respectively; and governments. Like any valuable service with advanced technology behind it where innovation and development is vital, flexibility in pricing is essential to ensure the service keeps pace with the needs of all stakeholders.

As described above, interchange fees share a portion of these costs among issuing and acquiring institutions who participate in the four-party payment system. It is a small fee that reflects the value merchants receive from accepting our products. The idea behind interchange fees is to ensure merchants pay for the value they receive rather than forcing cardholders (e.g. consumers and small businesses) to pay for that value on their own. Setting interchange at the appropriate levels provides a balance between consumers and merchants in which each party pays its fair share of the costs of the value and benefits it receives and each receives maximum value at the lowest possible costs.

This concept has historically been misunderstood by both merchants and policymakers in the EU. In Europe, Merchants and the EC claim that a lack of competition in card payments has led to persistently high costs of acceptance, when in fact competition in the acquiring market has actually driven MSCs down. For example, over the past 10 years MSCs in the UK have, on average, fallen by 25% from 1.60% to 1.20%. Merchants believe that interchange rates should fall even further because they view interchange as a processing fee that should be reduced as greater economies of scale are achieved. However, as explained previously, interchange is a fee merchants pay to compensate issuers for taking all the risk on their behalf and generating the value merchants receive when accepting cards. Rather than a processing fee that declines with economies of scale, interchange is a fee paid for the value merchants receive and that value has been increasing while interchange fees have remained relatively steady.

By setting interchange at the appropriate levels, MasterCard is able to achieve a balance that delivers maximum value to consumers and merchants at the lowest costs possible. Other payment card models do not achieve this balance and force one party to pay for value received by the other. For example:

- When retailers extend credit themselves, such as store based credit, the interest rates charged to consumers are almost always higher than for a MasterCard credit card because in a retail credit program the consumer pays for all of the benefits the consumer receives AND all of the benefits merchants receive.

- Amex operates a different model to MasterCard, where the bulk of the costs are paid by merchants and consequently, merchants typically pay significantly more than they do for accepting MasterCard-branded cards. The market response to Amex is instructive — because it imposes higher costs on merchants, fewer merchants accept Amex cards and as a result, far fewer consumers have Amex cards in their wallets, making the overall utility of Amex to consumers and merchants lower than with MasterCard.

By using interchange to balance the costs between consumers and merchants, we address both the store credit and the Amex problems. In our network, consumers and merchants receive the benefits of electronic payments at lower costs than they would incur if forced to absorb them on their own. This is a major reason why more consumers hold, and more merchants accept, our cards than store cards or Amex.

Since the interchange fee compensates issuers and not MasterCard, the question sometimes is raised why MasterCard cares about the issue. Ultimately, interchange is essential to maximising consumer and merchant demand for our cards because it ensures both consumers and merchants receive maximum value at the lowest possible costs. By delivering our services more efficiently and at greater value than other payment methods, we attract more merchants and more consumers to our network, thereby meeting our obligation to grow our business and deliver value to our shareholders.

The Value of Interchange and the Impact of Regulation

Flexible interchange rates ensure that merchants, consumers and small businesses receive maximum value for electronic payments at the lowest costs:

- Merchants receive tremendous value from accepting cards, from reducing cash usage and the associated costs to generating higher sales and a guarantee they get paid even if the consumer never pays for the transaction. In the UK between 2010-2012, we estimate this payment guarantee exceeded interchange costs by £1.4bn.
- Cards also provide significant benefits to consumers, from furthering financial inclusion to extending lines of credit and providing protection to cardholders when making payments.
- Small and Medium Enterprises (‘SMEs’) benefit from the availability of credit provided by cards to help them run their businesses, with as many as 55% relying on business credit cards in the UK. In addition, over €17bn was spent by SMEs in the UK using commercial cards, 57% of the cumulative spend across the whole of Europe. Cards also help SMEs to better manage their cash flow when accepting payments, replacing the purchase order and cheque writing process.

Despite these benefits, merchant concerns about interchange costs are putting pressure on the EC to significantly limit interchange rates. Because interchange is paid by merchants, there is a tendency to view it simply from the merchant perspective. EC legislation calls for interchange to be capped at 20bp for debit and 30bp for credit transactions. These caps represent an approximately 60% reduction in interchange across the European Union and a 70% reduction in the UK. These proposed caps are based on the EC’s so-called “merchant indifference test” and the limits are designed to ensure that merchants are indifferent as to whether a consumer pays in cash or by debit or credit card.

This test begs the question why the merchants’ indifference should trump the consumers’ and ignores the very significant consequences for consumers when interchange levels are set solely to achieve merchant indifference. It also incorrectly assumes that card payments are simply a substitute for cash payments when, in fact, card payments are more valuable to merchants than cash because card payments enable consumers to spend more and merchants therefore earn more revenues when they accept cards.

Unfortunately, experience shows that when policymakers attempt to address merchant cost concerns by reducing interchange, consumers and small businesses, including smaller merchants, actually suffer cost increases and reduced benefits:

- When interchange fees are artificially reduced through regulatory intervention, merchants no longer pay adequate compensation for the benefits they receive from issuers. As a result, consumers end up paying higher costs and receive fewer services and benefits. The experiences in Australia, Spain and the US bears this out, where consumers have seen card fees increased by over 50%, rewards reduced and free-banking greatly diminished.
- Artificial reductions in interchange also impede financial inclusion. As governments around the world are facing the challenge of how to include consumers who are unbanked or underserved by existing financial service providers. Increasingly, prepaid cards are being viewed as one possible solution. These cards can be issued to any consumer regardless of whether the consumer has a bank account, and can be used at any location that accepts a more traditional debit or credit card. For example, many governments are using these cards to replace government benefits cheques and are reducing costs dramatically as a result and the UK is no exception. The private sector version of these cards (so-called “general purpose prepaid cards”) also can be made available for purchase in retail locations and enable unbanked consumers to transact online, in many cases for the first time in their lives. When interchange is regulated, the business case for issuing these prepaid cards becomes significantly strained. The significance of these problems has not gone unnoticed—they were recognised during the U.S. debate on debit interchange and caused the U.S. to exempt prepaid cards from its interchange regulation. The EC legislation contains no such exemption.
- SMEs will not only see increased fees for their own cards and a reduction in credit availability but also a rise in their acceptance costs. This is because larger merchants are able to negotiate to obtain the full cost reduction from interchange fee regulation while SMEs find that negotiation much more difficult. The impact on SMEs will be exacerbated because the legislation also severely affects them as cardholders. Many UK SMEs are cardholders and rely on their credit cards to provide an essential line of credit they can use to bridge cash flow shortages and keep their business running and growing. While the EC’s initial proposal excluded these commercial cards from the interchange limits and would have helped ensure credit availability to SMEs, that exclusion was removed by the European Parliament. If commercial card interchange is regulated in this way, SMEs, like consumers, can expect to pay higher prices for their cards and it is expected that many will no longer have these cards available to them at all.

If the EC proposal is adopted, the UK will be one of the EU countries most severely affected – not only is the UK the most mature payments country (comprising around 30% of card payments in the EU) but also the largest user of credit cards (comprising circa 70% of credit card usage in the EU), the largest e-commerce market and one of the strongest innovation economies. There are 150m+ cards in the UK (90+ million debit cards with £340bn spend; 60+ million credit cards with £110bn spend) – 45.7 million debit card holders, equivalent to 90% of the adult population and 30.9 million credit and charge card holders, equivalent to 62% of the adult population. All of these cardholders will be forced to pay more (at least £17 per annum for just a standard credit card; more for rewards cards) if merchants no longer pay for the benefits they receive. Moreover, while the consumer harms of interchange regulation will be felt by both debit and credit cardholders, the pain for credit cardholders will be the greatest. This will be particularly substantial for the UK, not only because very few consumers currently pay monthly/annual fees for their credit cards but also because the EC’s proposed interchange caps of 0.3% for credit card interchange rates represent ~70% reduction from the average UK domestic interchange rate of 1.03%.

Nonetheless, it is essential that merchant concerns about interchange costs be examined and appropriately addressed. MasterCard is committed to doing this through direct engagement with merchants in the UK and around the world. We believe this process will address merchant concerns while protecting consumers and merchants from the consequences of arbitrary interchange restrictions.

We appreciate that the UK Government is responsible for determining the UK position in regards to any negotiations on the EC interchange regulation proposals. However, given the significance of the potential impact to the UK MasterCard encourages the PSR to impress upon the UK government the importance of intervening on EU legislation to preserve the ability of the UK to control its own economic interests and preserve its dominance as a leader in electronic payments. If interchange regulation is to occur, it should be up to the PSR (rather than the EU) to ensure the most appropriate level for the UK.

3. The designation process must be robust enough to provide the PSR with a solid foundation upon which to regulate

The decision to adopt a designation rather than licensing regime is, we believe, a positive step to ensuring equal treatment across the whole of the payments value chain. As the Government explained in its previous consultation, "Opening up UK payments" ('Consultation'), this removes the need for every entity involved in payments to apply for a license and instead means that indirect access to or participation in a designated payment system is automatically with scope of the PSR.

However, MasterCard believes that even if interchange regulation is implemented by the EC, the Government and the FCA should adopt a cautious approach towards the designation of card payment systems for regulation. While we understand that the designation of payment systems will be determined by HM Treasury ('HMT') following consultation during 2014, we believe it is important, as part of an ongoing dialogue with the PSR, to restate our concerns about what appears to be almost a presumption that card schemes should be designated for full economic regulation by the PSR. The Call for Inputs states that HMT:

> "may only designate a payment system as being regulated if they are satisfied that any deficiencies in the design of the system or disruption of its operation would be likely to have serious consequences for users or likely users of the system. **This is likely to be true for the major payment systems and payment card networks in the UK** [MasterCard emphasis].

Under Section 44 of the Financial Services (Banking Reform) Act 2013 ('the Act'), when considering designation HMT must have regard to:

> (a) the number and value of the transactions that the system presently processes or is likely to process in the future,
> (b) the nature of the transactions that the system presently processes or is likely to process in the future,
> (c) whether those transactions or their equivalent could be handled by other payment systems, and

(d) the relationship between the system and other payment systems.

The current regulatory regime for payment systems in the UK is determined by HMT designating payment systems as "recognised systems" and the Bank of England having responsibility for formal oversight of these recognised systems. Currently these systems are Bacs, CHAPS, CLS Bank International, the Faster Payments Service, Link and the payment systems embedded in the Crest, Ice Clear Europe and LCH Clearnet systems. These systems are recognised systems because any deficiency or disruption would either threaten the stability of the UK financial system or have serious consequences for end users. This is because the average payment amounts in these systems run into the £millions and the average daily transaction volumes run into the £billions or even £trillions.

Financial regulators have not classified MasterCard or other credit/debit card systems as systemically important. The ECB has issued guidance on quantitative measures to be used by EU member state central banks regarding the identification of systemically important retail payment systems in the EU.[1] In the same guidance, the ECB has established an intermediate level of importance, assigning certain retail payment systems the designation of prominently important payment systems ("PIPS"). These are systems that "play a prominent role in the processing and settlement of retail payments," and the failure of which "could have major economic effects and undermine the confidence of the public in payment systems and the currency in general."[2]

As the ECB notes, such systems "always provide clearing and settlement services and generally take the form of an automated clearing house." [3] A market share of more than 25% of the retail payments market in a country (*i.e.*, the payments processed via interbank retail payment systems and via other payment arrangements, and not just a particular mode of payment, such as card payments) is an indication that a system is of prominent importance. The ECB indicates that these systems should be subject to some, but not all, of the regulatory standards that apply to systemically important payment systems.

Finally, the ECB recognises that other retail payment systems are neither systemically nor prominently important because they "have a lesser impact on the financial infrastructure and the real economy."[4] MasterCard falls into this category. In practice, the retail payment systems that the ECB has designated as either systemically or prominently important have been interbank clearing and settlement systems, operated either by national central banks or by banks themselves.[5] Neither the ECB nor any other regulator of which we are aware has attempted to designate a privately-operated card payment scheme as systemically important (and the ECB has not designated any such schemes as prominently important). Rather, regulators have historically imposed only limited supervision on card payment schemes, recognising that such schemes generally do not impose a systemic risk.

While retail payment systems undoubtedly contribute to the smooth and effective functioning of national economies, a disruption or deficiency of a retail payment system—in which the average payment is less than £50 for debit card and less than £85 for a credit card and the total daily volumes of the schemes above are comparable to the annual dollar volume process by MasterCard — is unlikely to have serious consequences for users or likely users of the system. We say this because users have at their disposal many substitute forms of payment, including using payment cards

[1] *Oversight Standards for Euro Retail Payment Systems*, ECB (June 2003) at 2-3. A "netting ratio" is the net settlement balance as a percentage of gross transaction revenue.
[2] *Id.* at 3-4.
[3] *Id.* at 4.
[4] *Id.*
[5] *Retail Payment Systems*, ECB, *available at* http://www.ecb.europa.eu/paym/pol/activ/retail/html/index.en.html.

branded by other retail payment systems, interbank payment systems or similar processing services and more traditional payment methods, such as cheques and cash.

MasterCard also has an established Business Continuity Planning (BCP) Programme, which provides a consistent methodology and planning approach with associated processes, tools, and plans to protect MasterCard's critical assets – people, business, and operations. This program is implemented and maintained on a global enterprise-wide basis.

The BCP Programme includes procedures to communicate with MasterCard customers during a significant disruption of MasterCard operations and also includes disaster recovery plans for core systems and tests such backup plans regularly.

MasterCard has co-processing sites which function as data and network operations centers processing both production and recovery workloads. The MasterCard data processing and storage system is highly redundant, fault tolerant, and designed to eliminate single points of failure. Many systems utilize this environment for Operations Resiliency during maintenance windows. MasterCard systems and data are backed up on a regular basis. Backup media is clearly labeled, encrypted, isolated, and protected. MasterCard stores backup media in secure areas away from the location of the original data.

We therefore contend that, when applying the criteria in section 44 of the Act, card schemes do not meet the threshold for designation. We encourage the PSR to engage with HMT on this matter.

4. MasterCard's 'open' system already meets the PSR statutory objectives

However, should card payment schemes be designated for regulation by HMT, it will of course be essential for the PSR to have a strong understanding of their business models. In our response to the Government's consultation we explained that, while the Government's aims for payments in the UK were in the context of reforming the governance and operation of UK interbank payment systems, MasterCard fully agreed with those aims in a wider sense. These aims have essentially been condensed into the PSR's statutory objectives:

- **Competition objective:** promote effective competition in the market for payment systems and the markets for services provided by payment systems in the interests of end-users or likely users of payment services. This may include promoting competition between different operators of payment systems, different payment service providers and different infrastructure providers.
- **The innovation objective:** to promote the development of, and innovation in, payment systems in the interest of service-users and likely users of payment services, with a view to improving the quality, efficiency and economy of payment systems. This includes promoting the development of and innovation in payment systems infrastructure.
- **The service-user objective:** to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of service-users and likely users of payment services.

In particular, the phrase, "in the interests of end-users or likely users of payment services", which can be found in all three statutory objectives, is extremely important. Regulatory requirements should not be imposed unless they can be proven to benefit the end users and the assessment of any regulatory changes must examine the impact on all end users at the same time. All too often, however, regulatory initiatives are focused on one set of end users while ignoring the impact on others. The interchange regulation is a prime example of this, where regulatory initiatives are put in place to assist one set of end users—the merchants—while ignoring the unavoidable consequences for other end users—the consumers. If regulatory initiatives are to be successful they must balance the needs of all who are impacted and a balance must be found to ensure the most efficient and effective operation of the system.

We believe that these statutory objectives are already being met by card payment schemes such as MasterCard as a result of our open, four-party system. Our desire is for an environment that recognises and accounts for the importance and success of electronic payments as an efficient, convenient, safe and cost-effective means of transacting, as well as one that facilitates vigorous competition and continuing innovation, for all stakeholders in the system. E-commerce, mobile payments and much of the cross border commerce that we now take for granted would not exist without the type of electronic payments MasterCard's open system and network technology provides. Below we set out some examples of this:

- **Consumers already benefit in a myriad of ways as a result of payment cards.** By offering a wide range of products and solutions, card schemes provide equal opportunity to everyone – from the wealthiest to the unbanked – to participate in the modern economy. This democratisation of electronic payments has transformed a product once available only to the well-off into one that is now available to consumers in all income brackets. Cards provide consumers with protections against loss, fraud, theft and liability and enable consumers to make transactions across the globe.
- **Merchants, such as retailers, benefit in many ways when they accept payment cards.** These merchants move customers more quickly through checkout and reduce costs, such as counting, transporting and depositing cash, not to mention the cost incurred when cash collected at the cash register fails to make it to the bank because of loss or theft. Card acceptance brings with it a guarantee of payment, as the merchants receives monies owed even if the even if consumer does not pay for the transaction. Moreover, merchants who accept cards enjoy one of the most significant commercial benefits --increased sales.
- **Small businesses now also experience the beneficial impact of payment cards.** As payment schemes such as MasterCard have invested and innovated, it has become easier and more cost effective for merchants of all sizes to accept payment cards as a means of payment. Payment schemes like MasterCard have invested in technology and innovation to make it easier and more cost effective for merchants of all sizes to join payment networks. Today, even the smallest merchant, including merchants such as individual market traders, plumbers and electricians, can join and compete for the same customers as the largest retailer and receive the same benefits of increased sales, lower cash costs and reduced fraud losses.
- **Innovation is at the heart of global card schemes such as MasterCard.** For example, MasterCard Labs, our Research & Development arm, adopts a test and learn approach via incubation to develop some of our cutting edge products and solutions. This ethos drives the development of new technologies and enabling solutions for all end-users across multiple platforms. As a direct result of open, competitive systems such as MasterCard's, which are able to respond rapidly to demands from consumers, merchants and governments for better products, a new revolutionary era of payments innovation is underway. Developments in the UK include the widespread adoption of contactless payments, with this extending into the transit sector; mobile e-wallets that will revolutionise the way we transact; prepaid cards, providing the ability for anyone to have access to a transactional bank account; and Mobile Point of Sale solutions, enabling even micro-merchants to accept card payments at competitive costs anywhere there is a 3G, 4G or Wi-Fi signal.

- **Open access is central to the success of a four-party payment system such as MasterCard**. Although we are subject to the access requirements under Article 28 of the Payment Services Directive (as implemented into UK law in 2009), in any case the very nature of our system means that it is open and accessible. Unlike closed three-party systems, four-party systems ensure competition between issuers and acquirers. Subject to compliance with the scheme rules that govern their interaction and certain mandates linked to products, issuers and acquirers are entirely free to set their charges or define specific product features. Scheme rules are vital for ensuring global interoperability and the smooth, efficient and effective operation of the system. Working under the rules of the scheme, every single issuer can offer its customers the combined acceptance level of all the scheme's acquirers, and every acquirer can offer its customers access to the combined customer base of all the scheme's issuers. MasterCard does not decide, for example, on the level or structure of merchant service charges for accepting its cards, nor on many of the features that issuers may offer to their cardholders. This drives down prices and improves service levels without losing the network effects that are so crucial for the success of a payment product and explains the growth of these 'open' four-party payment systems as opposed to 'closed' three-party ones.
- **A partnership approach is already the norm in card payments.** Wide interaction between different parties has been a crucial factor for much of the innovation expected to take place in the payments sector and that will involve many different parties to pull together. The obvious case is the development of efficient mobile payments, where a workable solution has required competing handset developers, mobile operators, banks, payment networks, merchants and technology companies to work together to develop a reliable and efficient system. Another example is the success of Transport for London adopting an 'open-loop' system to enable passengers to use their contactless cards rather than Oyster, which involved the three international card schemes working in partnership with multiple stakeholders.

What is particularly apparent in almost all points above is the beneficial interaction that is absolutely vital in network systems such as electronic card payments and which is best fostered without, or at the very least with minimal and well-considered regulatory interference. This interaction has facilitated fierce competition amongst an ever increasing number of market players, as individual companies make investment decisions to which the market is able to quickly respond. This in turn has resulted in UK card payments being at the forefront of innovation in Europe, with the direct result that these market conditions have enabled an expansion of electronic payments with increasing numbers of consumers and merchants using card payments.

We recognise that the extraordinary success of electronic payments in the UK has occurred against a backdrop of criticism, much of it focused on the costs merchants pay for accepting those payments. Unfortunately, until recently this debate has been almost entirely one sided with the merchant voice being the only voice represented. To the extent the other key end users have been represented it has (until recently) been the voice of the European consumer body BEUC, which approximately 10 years ago took the simplistic view that if merchant costs were reduced, so would retail prices paid by consumers. This view was based entirely on theory and completely ignored other more direct and demonstrable consequences for consumers in countries where interchange regulation has occurred. As outlined above, since that time there has been considerable research on the topic which conclusively shows that when merchant costs are reduced by regulation, consumers and small businesses pay more. Fortunately, this research has caught the attention of a growing number of consumer groups around the UK and EU and these groups are making clear the harm to consumers that results from this type of regulation. The groups recognise that consumers currently enjoy a system where they share costs with merchants and if governments intervene to reduce the costs that merchants pay, consumers will pay more.

5. Any regulation of payment card schemes should be developed and implemented together with the sector to ensure an appropriate and proportionate regulatory regime

As both the PSR and the Government acknowledge, being designated for regulation does not necessarily mean that regulation is automatically necessary. If, following consultation, card schemes are designated to be regulated, MasterCard would welcome the opportunity to work with the PSR to ensure the adoption of a suitable approach to regulating this sector. We believe that a number of factors should be considered as part of this process.

The preceding Government consultations focused on issues related to the Payments Council and domestic, interbank payment systems in regard to their impact on competition; the independence of the Payments Council and responsiveness of these schemes to end-user needs; and the decision-making and collaboration processes. The lack of evidence provided by the Government of any troubling market behaviour in card schemes highlights the desirability of adopting a systematic and thorough approach, and to proceed carefully with any regulatory activity:

- **There are significant risks to regulating without evidence of failure**
  In the absence of any evidence of market failure in card payments, there is a real and significant risk of the application of misdirected "corrective" measures. The scale of potential payments regulation proposed under the PSR is unprecedented and untested and could easily distort competition, inhibit innovation, and ultimately harm consumer and merchant interests. This is particularly true for an international payment scheme that enables global interoperability and all the accompanying benefits. Policymakers must weigh the benefits of regulation with the costs of such action, in so far as their solutions have net benefits.
- **The PSR should liaise with other MasterCard regulators to ensure it is fully informed**
  A primary concern would be a set of UK-specific requirements, as opposed to pan-European/worldwide rules and requirements. UK-specific regulation will make it more difficult for international payment schemes to successfully operate, invest and innovate, resulting in a negative impact on competition, choice and efficiency coupled in a likely increase in cost, to the detriment of end users. To the extent that supervision is needed for a card payment scheme such as MasterCard, MasterCard is already subject to significant supervision by U.S. banking regulators. It is also subject to supervision by the National Bank of Belgium ('NBB') in the EU, acting as the lead overseer on behalf of the Eurosystem of central banks, which ensures MasterCard's compliance with the ECB's "Oversight Framework for card payment schemes – Standards"[6]. We believe it would be beneficial for both the PSR and MasterCard for the PSR to work with U.S. regulators and/or the NBB to achieve an understanding of the MasterCard system, and to avoid wasteful duplication of efforts.
- **Proper analysis should be undertaken before proposing actions**
  We encourage the PSR to undertake an analysis of card payment schemes prior to applying instructions or directions, both to identify where actual market failures may exist and to assess in a systematic fashion the additional costs and burdens that regulation might impose on both providers and users of payment card schemes, while also giving the market a chance to respond to any market failures that are identified. Such an analysis could be undertaken during the formal consultation process and be published for wider scrutiny.

[6] http://www.ecb.europa.eu/pub/pdf/other/oversightfwcardpaymentsss200801en.pdf

- **The PSR should strive to create a level playing field by establishing clearly how it intends to apply both the general regulatory principles and its specific regulatory powers**
  As we have set out earlier, the problems identified so far have focused on the Payments Council and the interbank payment schemes with which it contracts, particularly around ownership, governance, access, innovation and competition. As a result, the PSR and its wide-ranging suite of powers are being created primarily to address these concerns. This can be seen, for example, in the specific powers of granting access to payment systems – the agency agreements by which smaller banks gain access to payment systems via larger banks have been identified by HMT as opaque and as a result it is very difficult for smaller banks to ascertain value for money. In comparison, the very essence of an "open" four-party system such as MasterCard's means that the process for becoming a MasterCard customer who holds either a principal or affiliate license is relatively straightforward and cost effective. This can be demonstrated by the tens of thousands of issuing and acquiring banks, payment systems processors and others that are currently able to utilise our network and develop specific products and services on a fair basis.

  In addition, it is unclear to us whether the PSR can in fact apply regulation to card schemes wider than that which is covered by any EU regulation. This is particularly relevant if three-party payment schemes are excluded from the scope of certain provisions of the interchange fee regulation (e.g. the caps on interchange fees, the requirement of legal separation of scheme and processing), which is particularly worrying given the imperative to ensure equal treatment. Given Amex's share of the consumer credit card market (~10%) and the level of acceptance amongst large and medium-sized merchants in the UK (~75%), the PSR should be absolutely sure that it would be able to regulate Amex and other pure three-party schemes in the same fashion as four-party payment systems.

In any case, notwithstanding the imperative to include pure three-party schemes under designation, even if the PSR can take action wider than the scope of the regulation, we do not believe that it should automatically do so, particularly as "the PSR will be under a duty in line with the Legislative and Regulatory Reform Act (06) to have regard to principles of better regulation, which includes the concept of proportionality."

Therefore, in order to ensure the most appropriate and proportionate outcomes and develop a true working relationship with retail payment systems, (either via PSR direction/instruction or market response) MasterCard encourages the PSR to clearly set out, in consultation with stakeholders, how it will apply the general principles of regulation, to which it must have regard, when discharging its general functions. For a globally interoperable, publicly-listed scheme such as MasterCard, this is particularly important for principles (b), (c), (f) and (h).[7] The PSR should also do the same for the use of its specific regulatory powers towards card schemes[8]. This will help to ensure a focus on best practice, the appropriate application of principles and powers towards card payment schemes and an emphasis on the importance of a rigorous observation of process from the outset. A relationship of mutual understanding will be the basis for enduring cooperation in the interest of all end-users.

[7] http://www.legislation.gov.uk/ukpga/2013/33/pdfs/ukpga_20130033_en.pdf, section 53. The principles include (b) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

[8] These are: (i) giving directions to payment system participants; (ii) imposing requirements on operators regarding system rules; (iii) the power to require the granting of access to payment systems; (iv) the power to vary agreements relating to payment systems; (v) the power to require disposals of interest in payment systems

ANSWERS TO SEPCIFIC QUESTIONS

Payment Systems in the UK

Q1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above please explain why.

As we have outlined above, we do not believe that there is sufficient evidence or need for card payment schemes to be designated for regulation by HMT. No evidence has been produced in the previous two Government consultation documents or accompanying Regulatory Impact Assessments ('RIA'), the RIA accompanying the Act nor by the Treasury Select Committee or the Parliamentary Committee on Banking Standards during their inquiries into cheques, payments and banking. The focus of all of these papers and inquiries has been on interbank payment schemes, particularly those which contract with the Payments Council, the problems identified as a result of this focus and the decision to establish the PSR to improve competition between, access to and governance of these interbank schemes.

Given this focus, plus the criteria and threshold for designating payment systems for regulation, we believe it is appropriate that interbank payment systems in the UK should be considered for designation. This should also go wider than LINK to include VocaLink, who similarly to the interbank payment systems mentioned in the Call for Inputs are also owned by a consortium of banks and building societies and operate payment clearing systems and ATM acquiring platforms. VocaLink recently announced the launch of Zapp, in which its bank owners agreed to provide investment. Zapp seeks to compete with card schemes by using "real-time payments on people's mobile phones through their existing mobile banking application allowing secure payments to happen between consumers and merchants." VocaLink have been able to develop this solution because they operate the Faster Payments scheme, access to which is only provided once agreement has been reached with the consortium of bank owners. While MasterCard welcomes competition, it must occur on a level playing field and therefore, should MasterCard be under the scope of the PSR, VocaLink should also be included under the scope of the PSR.

As we have already stated, we also remain unconvinced that the criteria and threshold for designating card payment schemes for regulation is appropriate. Even if deficiencies in the design of the system were identified, or disruption of the operation of the system were to occur, it is unlikely that there would be serious consequences for users/likely users of the system, particularly in relation to the points to which HMT must have regard in section 44 of the Act. This is not only because of the relatively small volumes of payments taking placed under MasterCard's brands in comparison to interbank payment schemes, but also because there are a number of suitable alternative forms of payment to including cards with alternative card payment brands, interbank or similar processing systems, cheques and cash.

If card payment systems are designated for regulation, we feel that the rationale for doing so also warrants not only the inclusion of three party schemes such as Amex, Diners, JCB and China UnionPay but also digital wallets such as PayPal in particular. PayPal in the UK now has almost 10% market share of digital commerce spend and can increasingly be used to pay at both a growing number of physical merchant locations, including many national and regional chains.

Competition in payment systems

Q2: Where do you believe competition is effective or ineffective within UK payment systems?

Q3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Q4: What are the main factors impeding more effective competition at each level?

It is important to restate that while we can comment in general about where we believe competition is working and where there are areas of potential concern, it is the responsibility of the PSR to demonstrate that there is market failure/significant competition problems in the market, particularly when, in the case of card payments, we argue there appears to be significant competition in all areas of the sector and this is leading to demonstrable investment in innovation.

Various outcomes provide evidence of the vigorous levels of competition in card payments in the UK. Debit cards are now the preferred method of payment for UK consumers, overtaking cash in 2012 and the growth of the UK e-commerce industry to the largest in the world measured per capita spend is largely down to the investments in card payments technology. In addition, we are increasingly now seeing cards displaced at both point of sale and online and the spread of digital convergence to not only smartphones and tablets but many other form factors.

Consumers want to be able to use their payment cards and devices anywhere in the world and global schemes such as MasterCard, Visa, Amex, Discover, JCB and Diners Club (and increasingly China UnionPay) compete for a share of this market. In the card payments sector there is fierce competition amongst an ever increasing number of market players and there is considerable innovation resulting from this competition. The direct result of these market conditions is the expansion of electronic payments with more consumers and more merchants flocking to electronic payments every day.

The PSR should seek to ascertain the existence of any real evidence that competition in retail payments is not as effective as it could be. The calls for greater competition have been generated because only one side of the equation has been heard and the position of that side is based on a false premise that their costs are too high. There are many alternatives to the open four-party system – if the costs that the four-party system imposes were truly too high, there would be examples showing that the same level of value could be obtained by merchants at lower costs but those examples simply do not exist. While there are examples of less expensive alternatives for merchants they, not surprisingly, deliver lower value for both them and consumers. As the PSR considers this issue further, we urge an examination of all of the alternatives. It would also be important to examine merchants' own credit programs to determine the costs they incur and the value they drive in comparison to cost benefits of open systems.

In addition to competition between card payment schemes, there is also vivid competition between card payment schemes and interbank payment schemes, not only schemes such as Faster Payments but new products such as Zapp and also Paym, recently launched by the Payments Council, and the overlay service providers that help to facilitate such technology. As outlined above with PayPal, there is also growing competition in the form of digital wallets and this will only expand as digital convergence increases. The proposals in the PSD II for Third Party Payment Service Providers ('TPP') to gain access to bank accounts will also facilitate increased competition. This competition can be seen already, for example in the creation of joint ventures such as Weve in the UK, and in the growth of specialist payment gateways.

However, where we believe that a restriction of competition is particularly evident is in the bank ownership of VocaLink and the interbank payment schemes, particularly schemes such as Faster Payments, identified as difficult for anyone other than the major banks to achieve access – this process is detailed later below. Bank ownership of these schemes has seen levels of investment stagnate and has been an underlying factor behind the slow rollout of contactless payments and the use of smartphones to make payments at the point of sale. The scheme contracts have not been put out for tender but rolled over and retained by VocaLink.

In addition to the unfair and anti-competitive position in the market of bank-owned schemes, the importance of the PSR creating a level playing field cannot be overstated. If legislation and/or regulation only captures certain market players, it provides an unfair advantage to those outside the scope. This not only applies at a European level – where interchange fee capping and forced separation of scheme and processing will lower investment and creating inefficiencies via duplication – but also domestically. These two factors are the greatest risks to impeding more effective competition.

Collaboration

Q5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Payments and in particular card payments are a network industry, so it is inherently necessary to find the right balance between collaboration and competition. Four-party card payment schemes such as MasterCard have a very limited direct to consumer/ direct to merchant relationship and so must adopt a partnership approach to be able to bring products and solutions to the market. Examples of where collaboration has worked well include the implementation of Chip & PIN (replacing magnetic strips and signature) and the spread of contactless payment technology. A good example of the latter is the transformation of the Oyster card system into an open-loop acceptance network, which required the international schemes working with Transport for London to agree, for example, common messaging and processes such as how to manage refunds.

There may well be a role for the PSR to play in, for example, facilitating collaboration to gain agreement on open standards that allow faster roll-out of new technologies. This is the work currently being done as part the SEPA Council, now called the ERPB (European Retail Payment Board). As part of this, the PSR might seek to understand why card payment schemes have never been granted a seat at neither the SEPA Council nor the ERPB. The PSR could also play a role in resolving gridlock on projects where there are entrenched sets of commercial views. Industry standards affecting security and adoption of new technologies are where collaboration should be focused and at this very strategic level, MasterCard could see a role for an industry body that works with the PSR to facilitate and drive more effective collaboration. However, we strongly believe that the PSR should allow the industry/market to develop and drive innovation, rather than instructing where innovation should occur.

Ownership

Q6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure

Q7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues

you have identified and also highlight any potential concerns associated with such alternate ownership models

MasterCard does believe that current ownership structures of interbank payment schemes create problems, as outlined above in general and also below regarding Faster Payments. Much of this has also been explored in some depth during the various preceding consultations and inquiries as outlined above. As already explained, we strongly believe that an early inquiry should be undertaken by the PSR with a view to drastically improving access to interbank payment schemes and exploring the possible benefits of divesting ownership by the banks of these schemes and how that might be undertaken. The Government had previously stated that it would ask the PSR to examine this and has now granted the PSR early investigation powers to do just that. In particular, banks should divest ownership of VocaLink to create an independent company, whereby other payment providers can bid to provide services, resulting in VocaLink operating in a similar way to MasterCard's open scheme.

We do not believe that there currently exist any ownership problems or failings in ownership of publicly-listed card schemes such as MasterCard. In fact, as outlined above, we believe that MasterCard's ownership model as a publicly listed company, with its obligation to serve the interests of its shareholders, means that we must operate a successful business. In order to do so, it is paramount that we take into account equally both merchant and consumer interests, in order to maximise their demand for our products and services.

Governance

Q8: Do you have any concerns about the current governance of UK payment systems?

Q9: What do you believe is the appropriate governance structure for UK payment systems?

We believe that the most appropriate governance structure is the one that MasterCard operates, in particular in the UK. This involves an independent company, consulting with both its issuing and acquiring customers and making independent changes to the scheme whenever considered appropriate, in the interest of end users both domestically and globally.

MasterCard would be very concerned if the PSR sought to create a set of domestic rules, for example, which could undermine the global interoperability of our system. MasterCard's network of global bank relationships provides customers with a single access point for domestic and cross-border settlement. As a global operator, MasterCard provides global solutions to its customers. Increased scale brings a number of benefits to payment system participants. For instance, greater scale translates into reduced financial institution costs, which in turn result in lower consumer costs. Domestic rules could actually reduce product development, introduction and innovation for the domestic electronic payments market.

Access

Q10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fess and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate

within the UK payment industry and detail concerns or constraints you may have in this regard.

Q11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details

Q12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Q13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Q14: Do you act as a sponsoring bank, providing indirect access to any payment systems in the UK (please provide details for each payment system you provide access to)?

Q15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment systems operators)?

Q16: Do you have any other comments regarding access?

As outlined above, as a scheme itself MasterCard operates an 'open' system that provides access to tens of thousands of issuing and/or acquiring banks globally and we believe that our licensing conditions and rules and prudential requirements continue to help to facilitate this incredibly wide access. The fact that we are a publicly listed company only strengthens this imperative. Four party card schemes are subject to access requirements on objective, non-discriminatory and proportionate conditions under Art 28 of the PSD, as implemented in UK law. However three party schemes (e.g. Amex, PayPal) are not currently subject to any access requirements, which results in the absence or at least competition in terms of issuance and acquiring of their products, which in turn results in higher prices for end users. It is MasterCard's view that three-party card schemes should be subject to the same requirements, as currently proposed by the EC in the PSD II.

We also have considerable concerns in seeking access to the Faster Payments service. Eligibility for the service does not appear to be straightforward and there is a bank 'sponsorship 'arrangement. We understand there to be three options for gaining access to Faster Payment:

- Become a Full member of Faster Payments - amongst other criteria, a requirement to hold a settlement account with the Bank of England and be an authorised credit institution.
- Direct Agency member - this requires a sponsor bank and currently there is only one sponsor (three other major banks are developing this capability but not until at least mid-2014 for one and into 2015 and beyond for the other two). The current sponsor bank is only undertaking for one other participant at the moment and it took 18 months to complete the process.
- Indirect Agency member - all major banks offer this service using different connections (including Swift and regular batches). The major drawback of this is that the Swift service has a weekly blackout of up to 14 hours between 16:00 Saturday - 06:00 Sunday, which would not be appropriate for a P2P solution (or alternative propositions the faster payments connectivity could be used to deliver) to compete in the market (similarly, batch processing would mean a delay in the payments being processed, although without the blackout period).

Even through a sponsor bank there is a requirement to be a Payment Services Provider as laid down in the Payment Services Regulations 2009, i.e. one of:

a) Authorised payment institutions;
b) Small payment institutions;
c) EEA authorised payment institutions;
d) Credit institutions;
e) Electronic money institutions;
f) The Post Office Limited;
g) The Bank of England, the European Central Bank and the national central banks of EEA States other than the United Kingdom;
h) Government departments and local authorities.

This therefore limits access for many financial players. We also believe there should be greater transparency around fee structures relating to VocaLink and the sponsor bank.

Infrastructure

Q17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We should be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payment systems?

Q18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Q19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved and what will the impact and benefits of this be to your business?

The EC is proposing to force four-party payment card schemes to separate their scheme activities and processing activities (two separate legal entities, two separate organisations, separate management, duplicate all functions such as Legal, HR, Finance, sales force, etc). This will result in significant inefficiencies and additional costs that will ultimately be borne by end users. No market failure has been identified in this area and this proposal was not included in the accompanying Impact Assessment. On the contrary, the SEPA Cards Framework (which already requires separation of scheme v processing, albeit no two separate legal entities) is being complied with by MasterCard, the best evidence of this being that MasterCard only processes around **[CONFIDENTIAL TO MASTERCARD – AROUND ONE THIRD]**% of the transactions that take place under its brands in Europe. In addition, the EPC's Card Stakeholders Group (CSG) is currently working on a Processing Framework for payment schemes, which makes the separation as proposed by the EC all the more unwarranted.

Finally, connected to our comments earlier about level playing field, if a separation of scheme and processing is going to be imposed on four-party schemes, it should also be imposed on all payment card schemes – there should be no exception for three-party card schemes nor newly established card schemes. The PSR must be sure that it is able to adopt this approach if three-party card schemes are exempted from the European legislation.

The EC is also proposing to impose the use of interoperable messaging standards. MasterCard's messaging protocols today are already based on international standards (i.e. ISO8583) and there is a plethora of processors processing MasterCard branded transactions, demonstrating significant levels of competition. In addition, the industry (the EPC's CSG) is pursuing standardisation efforts. Therefore the EC's proposed requirement for interoperability is unwarranted.

Innovation

Q20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures

Q21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Q22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant

Q23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

As stated earlier in this response, MasterCard believes that our "open" four-party system is ideal for driving forward innovation, whether generated primarily by MasterCard, by other existing players and new market entrants that utilise our system to innovate or in collaboration with a multiplicity of different stakeholders. The greatest risk to innovation in card payment systems disproportionate regulation, whether interchange regulation or wider. As we have already explained, setting interchange fees that favour one set of end-users over others will create an imbalance in the system, making it less efficient, more costly and less profitable. This reduction in revenue will translate to lower levels of investment, not only in new technologies but existing innovations that need to be scaled up.

As touched upon earlier in this response, we believe that the PSR could work at a very strategic level around industry standards, such as contactless payments to facilitate and drive more effective collaboration. However, we strongly believe that the PSR should allow the industry/market to develop and drive innovation, rather than instructing where innovation should occur, otherwise there is a real risk that innovation could be inadvertently stifled.

Closing questions

Q24: Do you have any other comments or concerns you would like to highlight?

Q25: What, if any, are the significant benefits you see regulation bringing?

Q26: What, if any, are the risks arising from regulation of payment systems?

Q27: How do you think regulation might affect your business and your participation in the UK payment systems?

The PSR has an opportunity to revisit and fundamentally reassess the debate around the regulation of card payment systems, a debate that has until very recently been focused on one set of end users rather than taking into account the views and needs of all. The lack of any identified problems with card payments in the UK should serve not only as a cautionary note of unnecessary regulatory action but also serve as an opportunity for the PSR to reassess the tremendous value that they bring to the UK economy.

Draft EU interchange regulation is in the process of being adopted – on the basis of experience in other countries, MasterCard expects this to have significant negative consequences on the four-party payment system in the form of higher costs for UK consumers and small merchants, a reduction in investment in the system and a resulting diminution of competition. The PSR can have a strong role in the UK to influence the discussions that are currently taking place at the EU level.

Even if interchange regulation occurs, the Government and the FCA should not presume that designating card payment systems for regulation will be either necessary or desirable. In the absence of any market failure, we recommend that the PSR does a proper assessment of the card payments market in the UK while simultaneously tackling the numerous problems identified with interbank payment systems.

The Mobile Broadband Group

www.mobilebroadbandgroup.com

15th April 2014

The Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Sirs,

Payment Systems Regulation – Call for Inputs

The Mobile Broadband Group (MBG) is the group through which the UK's mobile network operators (EE, Telefonica UK [O2], Three and Vodafone) work on a broad range of public policy issues. Our interest in making a submission to the Call for Inputs relates to what are broadly referred to as 'Mobile Payments'.

Over the years, this term has grown to cover a very broad range of payment/transaction models, such as:

- Accessing and operating personal bank accounts from mobile
- Apps that are integrated into customers' mobile banking where the mobile number is used as a proxy for the account number and sort code
- Partnerships between mobile operators and payment providers (mobile wallets)
- Mobile versions of specialist providers such as Paypal
- Payments for thirds party services, where the charge is applied to the customer's telecommunications bill

In establishing the role and scope of the Payment System Regulator (PSR), it will be necessary to be very clear about the characteristics of a 'mobile payments' business model that would make it potentially within the remit of the PSR.

The MBG has a particular interest in the last of the examples set out above. In the other examples, the mobile operator does not come into possession of funds. The operator's role is to provide the connectivity, transport and potentially some elements of security. Any necessary regulatory compliance and licensing is obtained by the financial partner.

In the last example (where the charge is applied to a customer's mobile account), the regulatory framework is different. Regulation is enforced by Ofcom and, where applicable, their contracted agent, PhonepayPlus, who administer and enforce the Code of Practice for Premium Rate Services.
When a customer purchases a third party digital good or service and is able to apply the charge to his or her communications account (either by decrementing a Pay as You go account or by adding to the 'pay monthly' bill), there are generally a number of actors in the value chain.

Take, as an example, a game that is downloaded onto a mobile device; there may be a) the merchant provider (the game developer), an 'aggregator' (an organisation that can provide an interface to all the UK's mobile networks) and the mobile operator. These chains can have more or fewer players, depending on the commercial and technical necessities. The communications network is employed by the customer to find the desired product, execute the order and receive delivery. His or her financial liability to the merchant is discharged by virtue of the commercial arrangements in place between the mobile network and the aggregator. The merchant receives settlement through the normal commercial arrangements that have been negotiated between the respective actors along the chain.

The MBG supports the notion that the customer should be offered a wide range of payment options and that increased competition should deliver customer benefits. What we want to avoid, though, is confusion over regulatory remit. It must be clear that Ofcom is the responsible regulator where charges are being made to the communications account and the FCA/PSR for other regulated mechanisms. Moreover, it would also be very helpful to drop the generic term 'mobile payment' and be much more specific about the business models to which consultation documents and regulations refer in the future.

The MBG would be very willing to discuss in more detail with the FCA/PSR the matters raised in this letter and the Call for Inputs generally.

Yours sincerely

Hamish MacLeod

Hamish MacLeod
Chair Mobile Broadband Group

Payment Systems Regulation Call for Inputs

April 2014

Bank Anywhere

Pay Anyone

Buy Anything

Introduction

Monitise is a world leader in Mobile Money - banking, payments and commerce through a mobile device. Leading banks, payments companies, retailers, mobile networks and media owners use Monitise's technology platforms and services to connect people securely with their money in developed and emerging markets amid exploding consumer demand for Mobile Money services. Monitise simplifies the complexity of the Mobile Money space for these businesses, helping them open up new revenue streams via the mobile channel. From an innovative idea, Monitise built the world's first mobile banking, payments and commerce ecosystem.

Today, Monitise provides services to more than 350 financial institutions and other leading brands globally, and has strategic partnerships with Visa Inc., Visa Europe, RBS Group, Telefónica, IBM and FIS to develop and deliver Mobile Money services.

There are a wide variety of different payment landscapes in the countries in which Monitise operates. Our platform is therefore, by design, agnostic as to payment mechanism. Monitise believes that the supreme convenience, ubiquity and security of mobile devices means that mobile payments will give consumers clear benefits versus existing payment mechanisms.

Monitise is a third party service provider to banks and other financial institutions around the world and is pleased to respond to the FCA's Call for Inputs on Payment Systems Regulation.

As a general comment we observe that participants in payment systems are natural competitors operating in a collaborative way and space which is clearly very difficult. The entirely rational drive is to innovate in such a way (that is, as an individual institution) that competitors are beaten and a better service is offered to that institution's customers. Collaborative innovation requires extensive preparation and negotiation about objectives and is inherently slower. The difficulties are compounded in the majority of payments systems because most institutions are both owners and customers of the payment system and in the former role may sit on the Board of the payment company and hence direct its strategy.

Please find below our responses to your call for inputs.

Response to Questions

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

- We have no comment on this question.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

- We have no comment on this question.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

- We have no comment on this question.

Question 4: What are the main factors impeding more effective competition at each level?

- We have no comment on this question.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

- As businesses increasingly collaborate across all industries and functions, the benchmark for minimum security standards and payments standards must be agreed across the full spectrum, particularly for emerging systems such as mobile payments. With global ecosystems evolving across new geographies and into new channels it may be efficacious for the benchmark to be agreed at a macro level rather than being established and enforced locally.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

- The current ownership structure of payment systems and service providers does not necessarily facilitate collaboration, enhance competition, or provide an environment for innovation. This is because payment system members are natural competitors; however an efficient and effective payment system/s requires co-operation. Drawing the line between these two aspects is difficult.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

- There are two major parts to payment systems: the schemes (sets of rules determining how the members interact), and the service providers who provide the technology. The ownership structures of both these two parts are often simultaneous. Some degree of separation between these two parts of the payment system services is already present, but the regulator may consider greater separation to be desirable. If this was so, it would be appropriate for the regulator to encourage a greater degree of independence of the service providers, and to mandate the separate ownership of the schemes and the service providers. The regulator should be sympathetic to current issues and take account of what is already changing, ensuring that any such changes are moving in the right direction.

Question 8: Do you have any concerns about the current governance of UK payment systems?

- It can be observed that the common ownership of schemes and service providers (as outlined in response 7 above) tends towards the inhibition of collaboration, competition and innovation.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

- Monitise would broadly agree that the separation of schemes and service (infrastructure) providers would deliver a more appropriate environment for enhancing competition and innovation within payment systems.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

- This question is not relevant to Monitise.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

- This question is not relevant to Monitise.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

- This question is not relevant to Monitise.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

- This question is not relevant to Monitise.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- To whom do you provide indirect access?

- What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
- Are there any barriers to becoming a sponsoring bank?

- This question is not relevant to Monitise.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

- This question is not relevant to Monitise.

Question 16: Do you have any other comments regarding access?

- This question is not relevant to Monitise.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

- Monitise would agree that the adoption of open standards is likely to improve the provision and use of payments infrastructure. We cannot comment on the costs of such changes though we would expect overall positive growth for the British economy as a result of such increased usage.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

- Monitise has no comments on this question.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

- Where it is said that changes in the ownership and governance of payment systems would help to increase competition, we would expect the opening-up of payment systems to smaller players such as building societies and credit unions, the result of a reduction in the economic barriers to entry.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

- It can be said that the incentives to innovate are unclear and complex, and may even be seen as operating counter to the innovation within individual institutions or companies. Again, perhaps, this lack of clarity may be bound-up within the inherent conflict between collaboration and competition. Some commentators suggest that under the current fee structures gross imbalances occur within the interchange fee payment system, such imbalances being only partially addressed by the averaging function of multilateral interchange fees.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

- Monitise is not directly affected by the structure as we are a supplier to participants in payment systems.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

- The separation of owners and customers may assist payment systems to operate more efficiently through independent innovation (for sale to customers) rather than having to sell and agree concepts prior to innovation.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

- We believe that collectively driven innovation will require the early definition of common standards.

Question 24: Do you have any other comments or concerns you would like to highlight?

- Monitise has no other comments.

Question 25: What, if any, are the significant benefits you see regulation bringing?

- If the regulation is introduced as intended, it will enhance competition and help to drive innovation.

Question 26: What, if any, are the risks arising from regulation of payment systems?

- Monitise has no comment.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

- Monitise currently works closely with partners and clients to ensure that the products and services provided by our partners are fully compliant with regulation. As mobile payments, banking, and commerce grows within the economy, it may become sufficiently important and therefore a designated system, with the resultant compliance obligations on all participants including Monitise.

Thank you.

Monitise

Nationwide

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15th April 2014

Mary Starks
Director of Competition
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
LONDON E14 5HS

Dear Mary

Introduction

Nationwide Building Society welcomes the opportunity to respond on the Financial Conduct Authority's Consultation into the New Payment Systems Regulator and the Call for Inputs.

The Society is a Member of the Payments Council and also of the Bacs, Faster Payments and Cheque & Credit Clearing Schemes (C&CCC). We are also Members of VISA, the LINK Network Members Council and a shareholder in VocaLink.

Nationwide is a growing organisation and has a strategy to become a more significant player in UK Payments marketplace delivering secure and quality products and services to its customers. We see ourselves positioned somewhere between the big banks, the new entrants and the smaller challenger organisations having a distinctive perspective on payments issues. We are both direct members of schemes and operate in some channels as an agency and therefore believe we provide crucial insight to a number of the questions posed. In our response we have looked to emphasise what safeguards, assurances, governance structures, appeal mechanisms etc. will be needed for the new regulator to be successful and will look to provide constructive solutions to the issues the FCA is grappling with.

We have watched closely the development of the Government's interest in how payments, the Payment System Operators together with other parties that play a role in the UK are governed. This Consultation provides us with the vehicle to express our views on how the new Payment Systems Regulator (PSR) may oversee the industry in the coming years.

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

Nationwide agrees with the list of all interbank Payment System Operators, i.e. Schemes, infrastructure providers, Payment Service Providers (PSPs) and other entities as noted. It should also include the 4 party card schemes model including Visa and MasterCard and the 3 party model including American Express and Paypal; the rationale for the latter is that it is a material player in online commerce. The PSR will need to consider other entities like UKASH, and paysafecard that whilst not currently material enough to warrant inclusion, could develop and so a watching brief should be maintained on such organisations.

Whilst HM Treasury will decide which participant is to be regulated the PSR will need to determine how it uses its wide ranging powers to monitor the criteria, which should be proportionate, transparent and appropriate to promote competition, innovation and look after the interests of service users across the spectrum of the industry. This should include the potential to identify and refer to HM Treasury which new payment system participant could be considered for inclusion under the Regulatory regime.

In addition the PSR should, within its remit, ensure that in the cards marketplace there is a level playing field for new entrants from outside the current UK and Europe jurisdiction. Where there is already global interoperability (e.g. Visa, MasterCard and JCB) the UK PSR should not disadvantage the UK market by stifling innovation or providing additional burden to UK domiciled schemes/systems which may result in 'off-shoring' of same.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

We believe competition is effective in the UK payments industry; however, this is very much seen as the remit of the PSPs and not necessarily the Payment Systems Operators (Schemes) themselves. Our experience is that the Schemes do not compete with each and it is difficult to identify in what areas they could do so. Each of the electronic Schemes, CHAPS, Bacs and Faster Payments, C&CCC and the Card Schemes serve the UK for different services and it is the offerings of the PSPs that differentiate how competition works. It is important for the Schemes to work collaboratively wherever possible to develop and enhance existing or new services: a good recent example of this was the Account Switching Service where the above all play their part to enable end user customers to transfer from one bank to another without disruption to payments associated with accounts.

It is more appropriate for infrastructures to compete so that Schemes have a choice from providers who will look to offer the better capability and competitive pricing. Whilst there is no evidence of this taking place in the UK market, it might be appropriate for the PSR to encourage competition at infrastructure level since those providers will be subject to the same Regulator. Care however needs to be taken in any migration from one provider to another since the important payment systems will require certainty of supply, be risk free and retain high standards of integrity.

Payments is a network business that aids commerce and is fundamental to the effective working of UK plc and nature of competition is different dependent on the structures of the different payment systems, but in both models we believe competition is effective.

In a single network model, where all users access the same payment system, competition is effectively delivered by adherence to two measures:

- Open access – Can companies access the payments systems as long as they meet membership criteria and obligations with reasonable risk thresholds so that they do not endanger the whole system? Much work has been done within the Schemes to minimise risk, particularly Settlement risk and there are further improvements in train with pre-funding initiatives; these need to be incorporated such that they don't present future barriers to entry.
- Consistent service levels - so indirect service users don't get a detrimental service. This is an important element in all the Schemes through sponsorship arrangements and also via Bacs bureaux services. Execution of Faster Payments strategy to allow indirect members to get real time service is key to ensure there is effective competition between PSPs using the FP service.

Having said that, effective competition can be delivered in a number of ways: having two or more comparable and completely independent systems or having common infrastructure and allowing participants to access the infrastructure on a level playing field. The benefit of the latter is that it is more cost effective for UK plc and does not need to duplicate infrastructure spend. We believe that within UK payments there is effective competition via both methods.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

If there was to be competition between schemes it is necessary to have the schemes providing fundamentally the same service, and where this is the case you would expect most of the focus of competition to be on the financial costs for participants.

The card schemes are examples of competition at this level both from a global and national perspective:

- Point of Sale market[1] where Visa, MasterCard, JCB provide fully interoperable global services under the four party model.
- Point of Sale market where – Amex, Diners, Discovery, Pulse provide an interoperable global service within the three party model.
- ATM market – where Visa, MasterCard, JCB, Amex provide global ATM service offerings whilst LINK provide the primary domestic ATM access.

Competition can best support innovation by allowing fair and open access to payments systems and let PSPs develop solutions. An example of this would be Paypal developing an online payment solution and using Direct Debits as a consumer friendly and cost effective funding mechanism, or Barclays developing Pingit though transferring funds via Faster Payments. We can't see how competition between schemes that offer different services can deliver benefits though recognize that unless there are collaborative initiatives between Schemes we could experience silo developments.

The current Payment System Operators, e.g. Bacs, CHAPS, Faster Payments provide complementary services and have recently worked well in delivering the Account Transfer Service. The introduction of an economic regulator can bring about a level of direction that can be used to consider and drive cross scheme initiatives and by influencing individual schemes to address issues within their own strategies.

We believe there are potential and substantial risks in building economic regulation against a backdrop of competing Payment System Operators In particular it could lead to a continuation of silo services from Payment System Operators that are not encouraged to collaborate to develop new services against an ever changing customer proposition. This could also result in limited added value for all the Payment System Operators. We understand that other countries such as Australia are seeing fewer and simpler models both in terms of the payments system operators and the supporting infrastructures.

Question 4: What are the main factors impeding more effective competition at each level?

Competition at infrastructure level would need to be facilitated by open tender processes against defined service requirements. If we consider VocaLink, their service to Bacs has been developed over fifty years and processes in excess of six billion transactions a year. For a suitable competitor to emerge it would need to build or adapt the capability to process a significant proportion of those transactions over a short period of time to warrant a return on investment. This is in itself would present cost implications for payment systems and PSPs contracting with the infrastructure and could present a serious barrier to the take up of same. The Faster Payments infrastructure development went through a tender process and was based on a clear set of requirements which would ensure that it would be a suitable model for any future consideration for provision of infrastructure. Unless there are a number of potential infrastructure organisations with the capability to readily provide services, competition may not thrive and existing infrastructures could operate in a monopoly. It will therefore be an important objective for the

[1] Point of Sale means the provisioning of services whether face to face, internet (e-commerce), wallet, mobile, contactless, telephone

PSR to determine how such competition can be fostered that will ensure the UK payments industry is fit for purpose in the future.

At the Payment Systems Operator level, i.e. Schemes, competition could only exist if the Schemes were providing same services; this is not easily reflected in the UK industry and each of the current Schemes satisfies certain sectors of the market with respective services. We are however experiencing new virtual payment operators, i.e. PayPal that are providing a certain level of competition and over time can be judged as to whether they are true competitors to the established companies.

A payments system is as vulnerable as its weakest member so for prudential reasons it is necessary to have certain risk mitigations, e.g. pre-funding or minimum capital levels. These could be considered a barrier to competition by potential new entrants if they are set at the wrong level. Membership criteria is an important consideration for challenger banks, such criteria need to be transparent and proportional yet robust enough to ensure such organisations do not bring unacceptable risks to the system. Consideration should also be given to the physical costs of entry as the operating and IT investment can be a high hurdle and could be seen as an impediment to entry. Service users and potential entrants into the system have seen over the past years such barriers as minimum volume thresholds and membership fees removed so it is the implementation costs that present the barrier.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Collaboration should focus on areas where it benefits all users, e.g. removing duplication, reporting, market research; setting of standards or agreeing new standards; co-ordination and delivery of pan-industry change like the Current Account Transfer service and PAYM.

Further collaboration in searching for utility provision will support people to then invest in competitive elements. Taking away disproportionate investment demands (for smaller players) on generic requirements (screening, repairing etc.) could really help.

This can be best achieved through setting of strategic goals that benefit all parties whether at Scheme level, PSP or end user customers. It is within the remit of the PSR to direct Schemes to venture into the collaborative space where there are payment gaps or where customer detriment needs to be addressed. The PSR must work closely with the Schemes so that good relationships emerge, that the PSR learns from the Schemes and all their experience with the PSR bringing a 'fresh pair of eyes' to identify where change might be required.

Collaboration within the Card Payment arena provides a good example of where there are significant benefits which can be derived by the consumer and merchant together with the payments sector (e.g. Chip and PIN, e-commerce).

We would suggest the formation of a collaborative industry body, drawn from Scheme Executives and Independent Directors that should be the source of technical expertise together with representatives from the Regulator. This body should be responsible for co-ordinating industry delivery innovations against the Regulator's judgements.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

The current ownership of infrastructures has been built up through historic investments made by the banking organisations. The ownership of VocaLink as an example is predominantly the same as the membership of the Schemes it contracts with. It was a joint entity with the Bacs Scheme until December 2003 following Cruickshank recommendations that Scheme and infrastructure should be separate entities. Whilst this could present governance issues, the process has worked for many years and the owners have a vested interest in maintaining a minimal risk and cost effective infrastructure. Were this to be placed in private ownership, the company could venture into more speculative operations that would be to the detriment of the payment system.

There are no perceived problems with the 'ownership' of Payments System Operators (Schemes) since they develop and manage services utilised by their members to provide services to the end users, both in the personal and corporate markets. The fundamental principles of the Payment System Operators is to ensure integrity and quality of service through rules, procedures and service levels to their members and enabling access to new entrants through transparent membership requirements. They are 'not for profit' companies limited by guarantee with banks and building societies being the principal 'owners'.

One of the benefits from this ownership model is that infrastructure costs for development and changes are paid by the incumbent 'owners', other PSPs only pay for the services they use which ultimately enables them to compete. If these costs were paid equally by all parties this could impact challenger banks and new entrants and potentially provide a barrier to entry; the PSR must implement processes to ensure this does not occur.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

The Regulator might look to address any weaknesses in governance arrangements so that membership of Payment System Operators is divorced from ownership of infrastructures. There may however be a prudential risk if the banks are forced to divest and see ownership of the infrastructures move to third parties who have a solely commercial interest in operating as opposed to safety, security and customer outcomes.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Recognizing the concerns from regulatory bodies regarding access, lack of innovation and insufficient focus on end users, we do not have any major concerns regarding the governance of Payment System operators. These have increasingly been overseen by the Bank of England through compliance to CPSS-IOSCO principles. Most Schemes have appointed independent Chairpersons and non-Executive Directors and introduced disclosure policies that provide greater transparency of their existence and role. This work continues to develop in the recognised electronic Schemes and to some extent in non-recognized Schemes, we expect this to be applicable to any element of the payments industry that the Regulator has responsibility for.

We also believe there is a clear requirement for the PSR to act in the best interests of the consumer and UK payments industry when considering the implementation of European regulation within the UK. This is to ensure that the consumer and payment systems are not disadvantaged and welcomes the stated position of the PSR in terms of an evidence based approach to change where collaboration can ensure the right outcomes, e.g. ECB recommendations around security of internet payments where the UK already has well established and consumer friendly approach to e-commerce transactions which may be stifled by the ECB/EBA approach.

One area of concern relates to the associated costs of regulation which appears, to date, to have been disproportionate to the size of the business model; this in and of itself may impact the ability of smaller players and new entrants to compete.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

A collaborative body that supports the new regulatory regime in managing the delivery and assurance across the industry, this must include a regulatory level playing field across all Schemes. This is essential together with an all encompassing approach to future proofing possible new entrants including those potentially from outside of the UK. The regulatory framework must be appropriate to ensure that the UK Payment schemes remain competitive and able to drive innovation for consumer benefit.

The PSR will work directly with the Schemes and should consider the appropriate structures to ensure that they operate in the most efficient way to deliver services that PSPs can provide to their customers.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Nationwide has direct access to Bacs, Faster Payments, Cheque & Credit Clearing, LINK and VISA through Membership arrangements. We comply with all Rules, Operational procedures and pay our appropriate fees and dues. Attendance at Board and relevant committees is maintained and we regularly promote our views to the collective objectives within each Scheme.

Nationwide has indirect access to CHAPS and SWIFT through HSBC. Being a provider with relatively small volumes we do not have a need or business case to become a direct member and currently are not considered so in terms of value by CHAPS as part of their 'tiering' objectives. This arrangement is acceptable to Nationwide and should values/volumes change in the future we will reassess our membership potential.

We have Regional Brands (the Cheshire, Dunfermline and Derbyshire Building Societies) and similarly adopt indirect services for CHAPS, C&CCC, Bacs, and Faster Payments, though we have a plan to integrate these organisations into Nationwide within the next two years.

All these indirect memberships are maintained through contracts with our settlement agent and subject to regular review, performance is monitored through service levels and any areas for improvement are discussed with the provider.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

We believe the access terms and conditions for direct membership of the Schemes is reasonable, both in terms of costs and the obligations within the System Rules and all related documentation that we have to comply with. Our attendance at committee and groups determining annual fees and costs ensure we are aware of the financial aspect of each company, we also attend development groups that determine costs for new or improved services and have full opportunity to present our views.

Nationwide has spent time working with agent providers for our indirect access to ensure we have appropriate contracts in place so that both parties are aware of their obligations. These are managed through regular meetings and discussions with review of service levels and at the appropriate time through contract renegotiation or procurement.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Nationwide through its direct Membership is responsible for its own development of service user experience and where necessary has the ability to raise with the Payment Service Operator through appropriate governance arrangements, concerns, improvements and developments of new services. Card schemes provide open access and membership to all on equal terms.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Nationwide has sufficient choice for primary indirect services through direct member banks, although those services sometimes operate on the margin, e.g. our low volumes of foreign cheques, are becoming squeezed.

Where appropriate we would prefer to have access directly to payment systems giving us influence and control of benefits, though understand the risk trade off in doing this through compliance to rules and operating procedures.

For the MasterCard arrangement Nationwide has only indirect connections in to the scheme via LINK. This decision was taken a number of years ago as part of the overarching strategy at that time (pre-2003). From an NBS perspective this provided significant benefits at the time as there was no requirement to build a direct connected service, at significant cost, to meet the requirements of the MasterCard scheme. This has provided, during the intervening period, a reduced cost based model for us and we would recommend that such arrangements should continue to be provided as a viable alternative to full access to service providers where appropriate.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

This question is not applicable to Nationwide, we only act as a sponsoring bank to those parts of the Nationwide Group acting as Service Users, e.g. Nationwide Credit Card and Payroll.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We are aware that the regulators have concerns regarding access and that access to the Payment Systems should be transparent and proportionate in terms of what is involved. Most current Schemes have or are introducing Open Disclosure Statements which goes a long way to addressing this. The rules and conditions should be fair and achievable to new entrants; however it is important that the Rules and Service Levels are robust to maintain the integrity of the payments schemes and that Members and other participants at customer level know what is expected of them. The Direct Debit scheme is probably a good model and has a number of Guide & Rules for each party, i.e. the Paying Bank, the Sponsoring Bank and the Direct Debit Originators which are further supported by operating manuals and procedures. Similar documentation exists in all other Schemes.

Card Schemes operate in conjunction with Membership Agreements and the access to the systems is already provided with full transparency which we do not believe provides any barrier to entry.

There are financial and risk obligations that come with direct membership of the payment systems; these need to be proportionate to what new entrants bring to the system, they also need to be fair to existing members and as far as possible should prevent risks of all kinds.

Question 16: Do you have any other comments regarding access?

Opening access to challenger banks and other organisations must have some element of risk based approach and the industry, i.e. the Regulators and the Payment System Operators, need to ensure that broader access does not add risks to the integrity of the payment systems. A solid and sustainable reputation of the system, its Members, the Infrastructure and all participants is critical to providing the end user a robust and quality service that will bring confidence to the UK economy.

As already stated in response to Question 8. above, there is a requirement to ensure that regulation is proportionate and does not provide additional burden to challenger banks and new entrants which is disproportionate to the size of the business.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

The payments infrastructure should be stable, able to develop and support new services that each of the payment system operators can utilise for their members so that customer propositions can be developed in the competitive marketplace. The current infrastructures do well in supporting the individual payment system operators; however, there is a lack of interoperability, i.e. no common data standards so that one system can easily be contingency for another without significant intervention at the time.

Payments Council is developing their Roadmap that identifies a number of potential models for the future of payments. However, we consider that the costs of implementing any of their solutions whilst possibly providing a future proofed model will be significant and potentially having an unquantifiable benefits case. The introduction of the Regulator will help to determine what the landscape should look like in the future and will have the influence to ensure it is delivered in time.

By the very nature of the operating model deployed for the global card schemes there is already a full interoperability model in existence and this has proved to minimise the impact on:

- scheme innovation;
- membership costs;
- consumer experience.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Most of the payments systems have been built over the past fifty years and predominantly use proprietary standards, e.g. Bacs uses Standard 18, Faster Payments uses ISO8583 messaging. Using these various standards prohibits interoperability; therefore it is not easy to move payment types from one system to another in contingency arrangements. Moving these embedded protocols in all the front and back office systems within banks and building societies, software houses, originators of payments, i.e. customers, to ISO20022 would be a significant undertaking. The amount of change across the payments system would add a significant amount of risk, e.g. changing messaging standards for BACS would require the change of all payroll systems in the UK.

There is a common understanding that all future payments systems and services would be built using ISO20022, recent deliveries of the Electronic Cash ISA transfer and Account Switching services both utilise this standard. Work continues within the industry to find future uses of the standard and whilst ISO20022 has benefits it may not be the full answer and there is of course a cost – it needs work and will need a substantial journey to be realised. When specifically reviewing the initiative, in respect to card and card payments, by the European Central Bank (ECB) and European Commission (EC) to support the implementation of a single standard - ISO20022 - to help achieve its aim of a unified Single Euro Payment Area. However, we believe this would be too simplistic given the complexity of participants who have a vested interest in the workings, investment cycles and interdependencies across Europe.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

There is already competition in the provision of infrastructure services as the schemes complete tender processes for infrastructure provision.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Over the past years, much criticism has been levied at banks that innovation takes place at 'the pace of the slowest' and it is right that the authorities would like to see this improved. Nationwide has welcomed most of the initiatives and has participated where we see a business benefit in terms of service to the customer.

Changes to interchange fees is likely to have a range of unintended consequences, potentially increasing risk into the payments systems; for example, pricing cannot be used as a tool to encourage merchants to adopt latest anti-fraud measures and innovation in new payment types, such as 3D Secure for internet payments and contactless

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Participating in payment systems costs more money than the revenue we generate directly for providing those services and so it is difficult to justify innovations on a direct economic basis. This with the inherent risks associated with introducing change into payment systems will limit the total capacity for the UK Payments Infrastructure to implement change and develop a more sustainable model is around providing open and fair access to the systems.

It should be noted that the UK Payments System has been innovative over recent years, e.g. Faster Payments is a world leading near real time transfer service, Current Account Switching, Electronic Cash ISA transfers and the imminent introduction of PAYM are all innovative services that have delivered improved customer service propositions.

Card schemes have driven innovation within their area of expertise during the past 30 years, however, there has been slow adoption to innovation within the market place where the basis has been 'pace of the slowest' rather than as we have seen in more recent years (last 3-4 years) the membership moving at their pace. However, there are some risks around confusion of choice for the consumer which can be evidenced by the current plethora of mobile payment solutions being developed – let the market decide?

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Following on from our initial comment in Q20, the introduction of the PSR with an objective to promote the development and innovation in payment systems in the interest of service users needs to have a clear focus and specify the end result, e.g. reduced cheque clearing time, rather than how this is achieved, e.g. by building a new Payment System. In its Regulatory decision making the PSR must identify the right areas where this takes place; if this is directed at firms rather than systems there needs to be common standards, interoperability and security etc.

Whilst our response to Q21 highlights some of the recent innovations, the pace of development and introduction has been difficult. Faster Payments, launched in May 2008, came out of work since the Cruickshank report in 2000 and took two and half years to build from project inception. The new Current Account Switching Service took a similar time to build although the gestation period was shorter.

The banking community has rightly been criticised in the past for moving at the pace of the slowest and whilst this has improved slightly, there still remains some lethargy about speed of delivery. It must however be recognised that banks and building societies do not have bottomless resources to invest in all developments and each has to be based on sound principles. These principles will include majority customer or member benefit and we must be careful not to disproportionately or inappropriately invest in items that may be driven by relatively small interests.

It is therefore important that if the Regulator wants innovation to take place in the UK payments industry it has to be a balanced approach with clear and established reasoning with good financial benefits for the UK economy as a whole.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Payments benefit when the solutions are available to all as this means the benefits are enjoyed by the broadest range of service users. This is best facilitated by collective innovation; however we have two recent examples where Barclays:

1. announced their Pingit service that prompted activation by Payments Council to accelerate their development of the Mobile Payments Service.
2. announced their potential pilot to enable their customers to capture cheques through an image solution on smart phones has accelerated the movement both by Cheque & Credit Clearing to look at their Future Clearing Model and the Government to take steps to facilitate legislation changes to enable images of cheques to be exchanged.

Had neither of these innovations taken place it is legitimate to ask whether Payments Council and/or HMT have taken such strides to develop alternative customer propositions?

A further example would be ZAPP, where the industry has taken a commercial approach to collaboration. In this instance, the infrastructure provider has embarked on creation of a new ecosystem with support of its shareholders but not necessarily with the involvement of that full group. The development of an appropriate level of scale to drive a competitive offering is enabling the company to move at pace.

Question 24: Do you have any other comments or concerns you would like to highlight?

None at this point.

Question 25: What, if any, are the significant benefits you see regulation bringing?

Dependent on the remit of the Regulator and the powers exercised we should see clearer direction given to the payments industry in addressing concerns raised through recognised forums. If there is a perception about the pace of innovation then this direction should help the industry facilitate and focus on enhancements to existing and development of new services to cater for customer demands.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Given the PSR's extensive powers and the complex and fast-moving nature of payments, the risk of poor regulatory decisions is high, e.g. industry could be required to spend several billion on a system which is out of date by the time it is delivered, or which does not actually improve outcomes for users of payments. The PSR should therefore have governance structures which give it access to relevant payments expertise and should be required to consult widely ahead of any decision. The industry should also have recourse to a robust appeals mechanism against decisions which it feels are inappropriate.

We consider that if too much or too rapid change is required it will potentially bring significant new risks and costs into the payments systems. The regulation of payments systems should be balanced, proportionate to the desire for change and innovate without damaging the reputation or impacting the integrity of existing systems.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

We consider that there will be increased costs to participate as the regulatory body will need to be funded, although we don't believe it will influence our participation in the payment systems.

Yours sincerely

PAUL HORLOCK
Head of Payments & Service Strategy

Annex 1: Cover sheet

Basic information		
Consultation title:	PAYMENT SYSTEMS REGULATION	
Name of respondent:	NEW FINANCE	
Contact at respondent:	Name: EDDIE GEORGE	
	Email: eddie@newfinance.org	
	Address: 605 LYNDHURST COURT 31-38 FINCHLEY RD. ST. JOHN'S WOOD LONDON NW8 6EX	

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	✓
Other Please specify:	

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?		✓
If 'Yes', please submit both confidential and non-confidential responses.		

Payment Systems Regulation

Call for inputs

A group response to the FCA

April 2014

#London

NewFinance is a network of over 2,300 professionals actively involved in financial innovation through technology. Our members include entrepreneurs, technologists, investors, service providers, academics, students and other interested parties. Many of the new web and mobile platforms that are emerging today and changing the face of financial services are being created by members of this group.

This document captures the discussions from a workshop held on April 8th in London; the delegates are listed on the last page. Our thanks go to the team leaders, the delegates for their contributions and to Wragge&Co for kindly hosting the event.

Please see the following links for further information:

- Event listing: http://www.meetup.com/newfinance/events/173052632/
- Video: http://youtu.be/dv6u5Z1o8y8
- Photos: http://www.meetup.com/newfinance/photos/21143332/

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Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

1. It would be useful to have a stamp of approval that's regulated by the FCA for all payment companies
2. Start-ups will need a lighter touch so a turnover/payments processed threshold could be used to determine whether a company should be regulated
3. Virtual currencies should also be included e.g. Bitcoin, Ven
4. Standards for the whole industry should be the goal not just the regulation of specific payment systems.
5. Scope - Priority to given to operators - if resources are limited, priority should be given to operators rather than the infrastructure itself; providing the infrastructure has been separated from the payment scheme.
6. Service Users should not be designated – a business which is interfacing with a payment scheme should not be affected by the Regulator. (Most likely they will be regulated as a payment service provider in any event under Payment Services Regulations)

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

1. Competition is ineffective from level 4 upwards (but how do you compensate direct members, and ultimately their shareholders, if you take control / divest?)
2. There is reasonable competition on level 5 downwards, but by its nature it is difficult to break into this market without some form of regulatory standard or industry association.
3. Competition is ineffective at the interface between level 4 and 5. Indirect participants and direct members compete, but direct members are the gatekeepers to the systems that grant access to payments to competitors creating a barrier to entry
4. It would be more effective to lower the barriers to entry, and create an official price system; a transparent open model is required
5. Level 2 - Infrastructure is expensive which limits competition
6. Where payments are outside banking circles competition is greater as barriers to entry are lower
7. Card schemes, such as VISA and MasterCard, have a high concentration of power. They can control who can access the scheme or not. Also, it appears that they have not separated the scheme from the technology infrastructure. Incentives and pricing devised by card scheme operators should be closely monitored for anti-competitiveness. In particular, the regulator should prioritise any abuse of a dominant position within the market. In summary, due to the elements of anti-competitive behaviour displayed by the card schemes, regulation becomes a necessity.
8. In any event, VISA/ Mastercard, should separate their technology infrastructure from their scheme.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

1. Realistically we should allow equal access to the underlying network at fair prices for level 5 and below.
2. You might also allow indirect participants to access the direct member network at a subsidised rate but at the same technical and service standard as any other members.
3. There should be more competition around level 6 and it should be consistent on pricing and be more transparent.
4. There needs to be a consumer protection structure to protect consumers and more transparency regarding withdrawals taking consumers over their limit (which ultimately costs consumers money if they don't have an appropriate relationship with their bank).
5. Essentially payment system operators and direct member systems should fully reflect the underlying consumer agreements between the bank and the consumer.
6. Better online balance updates/services can facilitate this process and help consumers be aware of what they have to spend.
7. Competition at all levels would be useful but the biggest impact on costs and service for consumers would result if the compulsory sponsoring through direct members was abolished. This would directly enable more competition and would lower transfer costs for consumers.
8. At all levels costs should not be a flat percentage, they should taper down as volume increases because they are largely fixed

Question 4: What are the main factors impeding more effective competition at each level?

1. Indirect participants are reliant on the direct members which limits competition.
2. Ineffective regulation creates an artificial market while payments (i.e. the relocation of funds) have very little inherent value. There is only a market because of artificial barriers.
3. Monopolies by existing players and gate keepers that control access to payments
4. Disproportionate access to regulators and influence on regulation by existing monopolies
5. Poor consumer financial literacy, the perception that traditional brands provide best services
6. The high cost of infrastructure
7. An inability to identify consumers correctly
8. New entrants need to be able to enter the market without having to fulfil onerous requirements imposed by their competitors e.g. the "the last mile" in the Telco space is a good parallel example

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

1. Infrastructure - a protocol/standards approach similar to the bitcoin protocol could decentralise the payments infrastructure. This is an effort that could be undertaken by the industry collectively (i.e. set up an impartial representative industry body to determine and implement an open, equal-access protocol)
2. Rules on payment processing
3. Clearing systems
4. Settlement
5. Fraud controls

a. Ask for financial contributions from levels 5 and 6 upwards, increase fraud controls by funding innovation in this space and use the fraud savings to reinvest downwards.
b. Risk of fraud, identity theft, card compromise should be industry wide initiatives driven by strong regulation e.g. if real card details had to be replaced by tokens this would eliminate the need for real cards and the risk of the data being stolen

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

1. Direct members own the system and may limit competition on the levels above
2. Ownership may be less of a problem than the way ownership is and might be regulated in the future; consider limiting regulation to the requirement to open a stakeholder's system to others, regardless of how it is implemented or operated i.e. enforce interoperability
3. The vertical integration of Banks in owning payment structures creates a monopoly and hence the ability to block new entrants
4. Bank of England - could be a potential barrier to access settlement accounts. This could be improved by the Regulator supervising the application process for settlement accounts and ensuring that the process is fair, objective and transparent. Note that barriers in the UK to settlement accounts could discourage EU providers from entering the UK market.
5. Faster Payments/ BACS - has the potential of being a rival to the card schemes such as VISA/ Mastercard but:
    a. It is difficult to access Faster Payments/ BACS membership; and
    b. The pricing model discriminates against new entrants and/or small players.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

1. Government intervention is not ideal; a code of conduct could be imposed on indirect members. Direct members must allow tier 5 to operate and use their services at a subsidised cost.
2. Make individuals liable instead of limited companies liable as a way to ensure compliance and raise the stakes for negligence.
3. Alternatively, the Regulator could actively encourage competition, again transparent to create trust
4. If P2P payments (a regulated virtual currency) existed it would create competition for the existing players because it would be cheaper by design. Current systems were designed 30 years ago and haven't changed since inception
5. Set a maximum price on Faster Payments - By way of example, the big banks pay approximately 2.5p for a Faster Payments transaction and a small bank will pay at least 12.5p. We would suggest either enforce a uniform price or, if volume based pricing is permitted, then the maximum price should be capped at twice the weighted average price for all users.

Question 8: Do you have any concerns about the current governance of UK payment systems?

1. We want to make sure that the Direct Members do not have too negative an impact on the Indirect Participants.
2. It is self-governed; we need a system that enables the Indirect Participants to have input. Consider using the Federation of Small businesses to take soundings and put it forward to banks i.e. a forum to take the Indirect Participant's concerns to the Payment System Operators.
3. Indirect participants should have a seat on the governing bodies of the payment systems either directly or via an association.
4. Indirect participants should have full membership of the governing bodies of payment systems operators. This would require an appropriate voting structure e.g. veto would not work and could be out voted. It would need some form of Government adjudicator.
5. The main concern about current governance was the creation and inflation of an artificial market resulting in a heavy tax on the UK economy as whole. Payments have very little inherent value and the market participants should focus on providing a good end-point experience instead of profiting from a walled garden.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

1. Limit regulation to the end-point companies and services that use the payment grid instead of payment system implementation or the general movement of funds themselves. This would reduce bureaucracy and decrease complexity as other financial regulation would provide much of the needed framework.
2. A more open and diverse governance structure
3. Smaller players need to be protected regardless of the chosen structure

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

1. One member of the group is building a business that requires access to the payments infrastructure and described the difficulties of finding sponsor banks. They were also describing high fees and long negotiations which limit their competitiveness.
2. Payment systems overcharge on international payments, fees and commissions

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

1. The group member requiring access to the payments infrastructure regarded the conditions imposed as unfair and costs as too high. They mentioned that it was almost impossible to make a profit and be competitive under the current conditions.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

1. The current arrangement of the member in question limited their ability to provide competitive rates to their end users while still making any margin.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

1. At the SME/Start-up level there is hardly any choice because few sponsors are interested in catering to this market.
2. Fees are restrictively high.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

No

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

1. Standardise technical interfaces between agency providers to enable easier switching between providers and therefore more competitive pricing between providers.
2. Transparency of pricing
3. A code of conduct that imposes restrictions on direct members and how they treat indirect members.
4. A framework agreement similar to ISDA for derivatives business where any changes / amends to the standard agreement can be clearly highlighted. Issue is that ISDA type agreements are always amended.
5. Lower barriers to entry to enable competition
6. Make processes less complex so compliance is easier to achieve
7. Impose rules on access providers to disclose details about their pricing and process and require overall more transparency
8. Why can't someone access the system directly without recourse to a sponsoring Bank?

Question 16: Do you have any other comments regarding access?

1. We need to make sure whilst increasing access for service users we don't restrict growth of agency providers that relative to Payment System Operators are innovators.
2. Inefficient regulation and barriers to entry inflate prices of transactions themselves because the current system allows for price monopolies. This in turn imposes a massive penalty on the whole of the economy.

3. Addressing the underlying problem, which is competition in the banking system:
    a. If the rationale for opening up payment systems is to increase competition in the market and allow new entrants in the market then fundamentally this cannot be done in a genuine way without creating more competition in the banking system itself. It is apparent, that banks may be becoming barriers to innovation in financial services, as it appears that they refuse to open accounts (or close existing accounts) for FinTech businesses, including licensed e-money institutions or other emerging financial services providers. To remedy that problem we suggest that it is either made easier for companies to set up banks (creating more diversity in banking and therefore more options for businesses seeking accounts), or the FCA should force banks to provide their infrastructure to licensed institutions. Also, having genuine contender banks means better innovation and better pricing for the consumer.
4. Scheme membership and access to Settlement services:
    a. Scheme provider to provide a guarantee (upon a successful application for membership) that the applicant will have access to settlements. Also, there should be non-discriminatory pricing imposed on the applicant.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

1. A clear strategy and plan for updating systems to minimum standards and base software level to facilitate future enhancements/changes and remove legacy systems.
2. Regulate for 5 year review period for system security and efficiency infrastructure. Use regulatory guidelines to improve standards of technology and processes, e.g. all transactions have to be completed in a minimum time frame.
3. Infrastructure should be decentralised to decrease impact of low-quality implementations as well as decrease the cost burden of infrastructure operation/acquisition.
4. Improvements/changes required:
    - IT, data security is very onerous for start-ups to establish
    - knowledge of integrations is lacking
    - it’s costly to make changes
    - be mindful of the impact of new regulations and rules on the providers of infrastructure who need to adapt and change infrastructure
    - allow the development of decentralised autonomous networks e.g. the Bitcoin block chain protocol to develop
5. Reduction of Fraud, identity theft, identity verification should be inherent
6. Real card details should be replaced by one-time cards across the whole system, eliminating card theft as an attack vector. Issuing banks should be the only organisation that have access to real card details (along with the customer)
    - This would also largely eliminate PCI card issues

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

1. ISO20022 standards would work higher up at level 1-3.
2. It would not make sense to impose these standards on start-ups
3. Be aware that standards are often too easily imposed and quickly outdated
4. Cross-compatibility is also a concern

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

1. Innovating in infrastructure requires significant resources and is therefore usually only available to larger companies with scale
2. Solutions that would increase competition:
    a. shared identity verification services
    b. virtualisation of cards
    c. fraud monitoring services
3. As in telecoms a few years ago, de-regulate the 'plumbing' to facilitate easy entry of new players; de-regulation drives choice

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

1. It's not clear at levels 1-3
2. How do you get a share of the 7 billion transactions through innovation?
3. There are minimal incentives for large banks to get together to create a quick payment system
4. The current governance structure and industry is characterised by a lack of competition, little incentive to innovate for larger players due to monopoly status, and little incentive to innovate for SMEs due to restrictive conditions on market participation that make building a sustainable business difficult.
5. We note the development on the regulation and further reduction of interchange fees with a high degree of concern. There is an ongoing battle between large retailers (principally supermarkets and petrol companies) and the card schemes and their issuing bank members over the level of interchange payments. The battle is between large retailers and large banks and as smaller early stage companies we are bystanders as the battle takes place. However as innovative newcomers to the industry we suffer collateral damage from this battle and our business prospects are being materially damaged. We are developing innovative new services, many of them mobile-based, but every time the interchange rate is reduced, the price that we have to get below is also reduced. We continually hear regulators at the UK and European level encouraging more financial and payment services innovations but the impact of significantly lower interchange destroys many of our business cases. Therefore the

very organisations that should be encouraged are rendered unprofitable as a by-product of the battle between mega-retailers and issuing banks.

6. In the USA, it has been decided that financial institutions below a certain size should receive higher interchange than the very large banks. We urge the FCA to look at ways to allow innovative, financial companies (usually non-banks) to receive higher interchange rates than large, established players.
7. There are few incentives to innovate but there is space to create companies to innovate
8. Government should back the innovation space and support FinTech Accelerators

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

1. Bureaucracy as a result of monopolies and ineffective regulation
2. Prohibitive cost at entry level
3. As a small player the ability to enter a 'collective' scheme can be really difficult and can stifle the ability to innovate

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

1. The Regulator needs to play a key role in driving innovation because it is not clear which one body would innovate to progress the payments market. Why would one bank invest in creating a new payment system when all others would benefit.
2. Abolish the difference between Direct Members and Indirect Participants to enable equal access and level the playing field
3. Require transparency down to end user level about costs and processes to increase the pressure on monopolies to change
4. Directly incentivise SMEs to participate in the market (e.g. subsidise fees for access/sponsorship) while taxing Direct Members on their monopoly advantage
5. If the regulator took more ownership of innovation and facilitated connections to the big players it could speed up the whole process
6. We need more guidelines specifying operations and rules

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

1. Unilateral innovation is currently considered prohibitively expensive
    a. you could incubate unilateral innovation and then push it out to the collective allowing small innovations
    b. done in isolation it can be very difficult to get adoption because other players may view it as a competitive disadvantage
2. Collective innovation is likely to produce valuable solutions due to more diversity:
    a. sharing costs & resources
    b. sharing risks
    c. sharing knowledge
    d. influencing regulation
3. However there are also limitations:
    a. it's a disincentive to innovate with your competitors
    b. there are unclear responsibilities and objectives

c. it only makes progress through agreement therefore you lose innovation/speed of innovation
d. collective innovation gets v. slow, political, bureaucratic

Question 24: Do you have any other comments or concerns you would like to highlight?

1. How should companies such as Western Union be regulated in this space? If you over regulate then will drive innovation outside of the traditional payment providers/bank network. Bitcoin is an extreme example, but other products/based on real currencies could develop.
2. How do you regulate payment institutions which don't have owners and can be used by everyone?
3. Regulation needs to be specific to each payment area/system
4. Does the FCA does have the resources to keep abreast of activities, are they trying to regulate the technical areas which do not lead to innovation?

Question 25: What, if any, are the significant benefits you see regulation bringing?

1. Creating incentives/targets/obligations/reviews that will improve the overall performance of the sector.
2. Ironing out the inequalities in the system to protect the indirect participants.
3. Improving the investment appetite of entrepreneurs and driving investment.
4. Improving the image of the sector.
5. Better representation of the sector to retail customers through payment provider standards
6. Enabling higher productivity in the industry by moving away from cumbersome legacy processes and systems
7. Creating more players and competition in the market
8. Accelerating change & innovation
9. Enabling the nation to stay competitive in a global economy
10. Done correctly we will see more competition, lower costs for the consumer, a level playing field for large and small participants and regular innovation

Question 26: What, if any, are the risks arising from regulation of payment systems?

1. Over regulation stifles innovation and detracts from investing and increases operational & compliance costs. It could be a disincentive for a new start up if the regulatory burden is too high, we need to have a threshold under which start ups can operate.
2. The failure of regulators to recognise that the movement of funds in itself has very little inherent value and regulation continuing to inflate and enable an artificial market on that basis.
3. More bureaucracy and higher barriers for small disruptors/competitors.
4. Stifled innovation due to a lack of freedom
5. May hamper revolution of what payment systems should look like by entrenching traditional systems
6. Increased costs
7. The danger of making the existing structure so rigid that new entrants can't play
8. The focus should be on the future systems as much as existing ones, some current systems e.g. cheques are being phased out

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

1. Consumer – anticipation of lower costs and higher transaction speeds
2. Business owner – hoping for greater competition and market competency

Team Leaders

Corinne Thompson, works in KPMG’s High Growth Technology Group; her main focus is on engaging with entrepreneurs, start-ups and high growth companies in the technology sector. KPMG have a very experienced team in this area, and are always keen to meet new companies and find out about their business and the challenges that they are facing. Corinne’s main focus is on finance tech companies, having spent three years in financial services audit with KPMG working across a variety of clients. Outside of KPMG you will see her training for her Ironman.

Rob Leslie is the CEO and founder of Sedicii. He has held senior management / director level positions with Datacraft Japan, PTS Ltd., eSafe Japan and Dell Japan where he was part of the initial management team that launched Dell into the Japanese market. In three years the company grew from zero to over 270 employees and annual sales of over $300 million. After leaving Dell, he became a partner in PTS, a niche technology services company which was acquired in 2000 by Datacraft Asia for $26million. Rob is also co-founder of the Global Business Register which specializes in identity and compliance solutions for companies with AML & KYC regulatory needs. Since 2011 he has been actively working on the Sedicii identity exchange project.

Adam Vaziri is an entrepreneurial and solutions focused professional, highly proactive and able to work with complex regulatory issues and find a workable and compliant way forward. He believes that technology has the answer to rising compliance costs, so with a team of developers, he created a workflow based system to ensure consistent policy implementation within a firm - see Precede.eu for more details. His interests are financial inclusion, entrepreneurship, reducing friction through technology and encouraging, gradually through education and awareness, individual financial responsibility. The UK is leading in FinTech and with crowdfunding regulations in place he believes that we can start at a grass-roots level to build more resilience into the financial system.

Dominic Crosthwaite is a founder of Black Swan Partners a consultancy and data analysis company focused on improving the customer experience through every aspect of a client's lifecycle. Most recently Dominic worked on the impact of UK and EU regulation on social trading in the CFD / FX sector and the identification and implementation of differentiators in the D2C online investment market. Dominic was previously a Partner at Cantor Fitzgerald and Managing Director of Cantor Index. Before Cantor he worked at The Hackett Group. Dominic has 12 granted patents in his name, including the first real-time regulated online account opening system.

Elias Haase is the CEO of the software development company Bitsilk, the Software Engineering Service for Startups. They build high quality web, mobile and desktop platforms for startups, from early first versions to later stage systems. They also take over existing platforms and provide fix, maintain and new feature services.

NewFinance
Financial Innovation through Technology

Workshop Delegates

Roundtable #1	
Corrinne Thompson (Team Leader)	KPMG
Duncan McCann	New Economics Foundation
Lillian Artaban	Groupe INSEEC
Alister Robert	Groupe INSEEC
Karim Bennouna	ComexFX
Roundtable #2	
Rob Leslie (Team Leader)	Sedicii
J D Miller	Independent
Stuart Millson	Black Swan Partners
Jonathan Sadoun	Groupe INSEEC
Roundtable #3	
Adam Vaziri (Team Leader)	Diacle Ltd
Ben Leong	Hotwire PR
James Smith	FinTech Entrepreneur
John Chaplin	Ixaris Systems
Roundtable #4	
Dominic Crosthwaite (Team Leader)	Black Swan Partners
Richard Ellis	Wragge & Co
Jack Carnell	Camberton Strategic Communications
Hanae Bassy	Groupe INSEEC
Roundtable #5	
Elias Haase (Team Leader)	BitSilk
Magnus Bray	miiCard
Avishek Singh	StyloPay
Gareth Grobler	IceCubed
Hamza Benchat	Groupe INSEEC

Orwell Group
110 Fenchurch Street
London EC3M 5JT - UK

London 2nd April 2014

Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Sir or Madam,

Re: Orwell Group's ("Orwell") response to the call for inputs on the Payment Systems Regulation and the role of the Payments System Regulator issued on the 5th March 2014.

Orwell is a financial services group who owns two payment services providers, Orwell Union Ltd (FRN 533647) and Orwell Union Partners LLP (FRN 900122), both authorised and regulated by the FCA as API and EMI respectively. Each company has a different business model that requires different levels of access to payments systems. Orwell Union Ltd has been in operation since 2010 whilst Orwell Union Partners LLP was authorised in November 2013.

We are grateful for the opportunity presented by this consultation as we find it crucial for the future of the payments market that the new regulator pragmatically addresses the real and very tangible problems affecting the payments industry in the UK.

The importance of this new regulation on payments is significant when considering that the UK payments industry is broadly limited to sterling payments, so the position of London as a financial centre also in the payments sector is de facto limited by its currency. However London has the opportunity to inspire and spread innovation in this sector thanks to the large number of financial institutions and other players in the payments market, which create the right environment for the appearance of new business models. In order to achieve this, the UK must show regulatory leadership so that it can attract challengers and innovators rather than losing them in favour of other European countries.

Summary

Our contribution to the consultation can be summarised in the following points:

I. We do believe the entire payments industry's access and governance in the UK is dominated and quasi regulated by a few large banks, who are limiting, if not making it very hard to innovate or compete. A level playing field simply does not exist.

II. We do believe that the PSR will not succeed in opening the market without a radical review of access criteria in line with the relevant European directives.

III. We do also believe that the BoE cannot remain on the side, but its role in payments must also be opened up in the same way as the designated payment system operators.

IV. We think that AML regulation (along with the market structure) is also one of the major reasons behind the current market impasse.

Structure of our contribution

We will structure our contribution in the following way:

1. Firstly this paper analyses the structure of the UK payments industry.
2. Secondly we identify the issues inherent in the UK payments landscape.
3. Thirdly we provide our view of the short-term and mid-term solutions which would work towards solving the most critical problems.
4. Finally we will answer one by one all the questions asked by the consultation, most of which would have been already addressed in the previous sections, but for completeness are included in this section too.

Orwell Group
110 Fenchurch Street
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1. Structure of the UK payments industry

1.1 Preamble

The picture provided in the consultation paper about the structure of the payments industry in the UK defines "Other Payment Service Providers" as "all non-bank service providers, including overlay providers and mobile application providers...".

We find this misleading. By delineating payment services and categorising participants solely as banks or non-banks, there is a clear ambiguity as to what kind of entities are or may be part of each block and why.

The European Payments Directive includes in its definition of Payment Service Providers include Credit Institutions (as per Directive 2000/28/EC) and a new kind of Financial Institution devoted to payments (the creation of which is one of the purposes of the Directive).

All these entities, old and new, are regulated, which may not be the case of some of the kind of entities included in the consultative paper's definition provided of "Other Payment Service Providers".

In addition, your definition of Direct and Indirect participants hints at a restriction as to who could be a Direct or Indirect participant. Banks are again used as an example where the word "bank" does not describe anything to which legally it is possible to attach a clear meaning in this context. Instead, we suggest it would be more appropriate to use the terms found in the relevant directives, rather than limiting the scope of entities allowed in each block, thus it takes into account whether they are regulated for the purpose of providing payments or not.

The depiction of the market as it is or should be, is incredibly important as it frames the discussion. The issues highlighted above are part of the problem with the UK payments industry, where the lack of understanding of the new scope of regulation and the actual meaning of the new kind of payment service providers, perpetuates a payments system that is clearly not in line with the very Directives that regulate the payments industry. Evidence supporting this can be found, among others, in the access criteria, processes and behaviours of key payment operators.

We suggest the following changes to your depiction of the UK payments industry landscape:

A - We will refer to "**payment service provider**" as any entity regulated to provide payments (so, Deposit takers, Electronic Money Institutions and Payment Institutions) and authorised either by the PRA or FCA.

B - The picture of the value chain formed by the central bank, infrastructure providers, system operators, direct participants, indirect participants and payments users must be completed with potentially different layers of various kinds of indirect participants, all of them falling within the term of payment service providers.

It is important to observe that not all payment service providers require an agency agreement, but in many cases (as it is the case for Authorised Payment Institutions and also often for EMIs), a clearing account that can be operated in various ways is sufficient for their needs. We will call these **clearing participants**.

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On the other side of the spectrum, direct participants and indirect participants may require access to all or most system operators.

The UK payments landscape must be flexible enough to cater to all such needs, as not all competition issues in this industry are related to access problems with BACS, CHAPs or other system operators.

C - We will redefine the entities that are most likely will be part of each block:

- Direct Participants: typically Credit Institutions (as per Directive 2000/48/EC), so Deposit Takers and Electronic Money Institutions, but also APIs, since at this point in time, when business models are yet to be tested and proven, their exclusion would be discriminatory and is indeed prevented by article 28 of the PSD 2007.
- Indirect Participants: they can be the same kind of entities as Direct Participants.
- Clearing Participants: third and further layers of payment service providers not needing direct or indirect membership to payments system operators, but simply a clearing account or accounts. These can be the same kind of entities as Direct or Indirect Participants.

D - the block labelled in the consultation paper as "Other Payment Providers" should be either removed entirely or renamed as "payment service applications" where any non-authorised firm providing applications, such as Zapp or mPay or other, can be represented.

In this way the value chain is formed by: central bank, infrastructure providers, system operators, direct participants, indirect participants, clearing participants and payments users; plus the other entities supporting the value chain.

2. Characteristics of the UK Payments Industry

The UK payments industry is characterised by:

I. Very few (less than a handful) Direct Participants, are able to actively provide service to indirect participants and clearing participants.
II. An AML regulation that disincentives the provision of service by any Payment Service Provider to another Payment Service Provider.
III. The UK's legacy narrative on access criteria and eligibility to payments systems and market infrastructure
IV. Further conflict of interest due to the concentration of access tools and bodies in the hands of just a few Direct Participants.

Here below we analyse these points and their consequences.

I. Very few direct participants

The list of Direct Participants that could potentially give access to Indirect Participants is very small. There are only 16 members of BACS but in reality they represent only 10 banking groups, out of which only 5 actually provide or are organised to provide agency banking services to other Payment Service Providers. Also, out of these 5 only 2 are known to us as offering agency-banking service to non-deposit takers.

This situation creates an unhealthy concentration of the sector. Not only does it create an inherent competition issue, but it also creates a significant and fundamental business risk for payment service providers requiring services from those Direct Participants (details below).

II. An AML regulation that disincentives the provision of service by any payment service provider to another payment service provider

Bearing in mind new Payment Service Providers cannot provide their services to end users without access at some point in the value chain to clearing services, AML regulation is probably the single most important factor driving the ever-decreasing competition in the payments market and often making it impossible for new entrants to survive.

The reason is that providers of clearing services and direct participants are left with the burden of being responsible for the entire AML chain until the ultimate beneficiary. A Direct Participant that provides services to an Indirect Participant who provides services to a Clearing Participant is responsible for the AML systems and compliance of the entire chain. Each layer of the value chain is responsible for the part of the value chain below them until they reach the end user.

> Article 24 of the 4th AML directive: "*Member States may permit the obliged entities to rely on third parties to meet the requirements laid down in Article 11(1)(a), (b) and (c). However, the ultimate responsibility for meeting those requirements shall remain with the obliged entity which relies on the third party.*"
> Article 25 of the 4th AML directive: "*For the purposes of this Section, "third parties" shall mean obliged entities who are listed in Article 2, or other institutions and persons (...)*"
> Article 26 of the 4th AML Directive: "*Member States shall ensure that obliged entities obtain from the third party being relied upon the necessary information concerning the requirements laid down in Article 11(1)(a), (b) and (c).*"

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Moreover the new AML regulation goes ever further and requests that, among others, businesses that meet any of the following criteria:

- non-face-to-face business relationships or transactions;
- businesses that are cash-intensive;
- new products and new business practices, including new delivery mechanism, and the use of new or developing technologies for both new and pre-existing products

be considered as high risk and therefore subject to enhanced due diligence and enhanced monitoring. Basically all new payment providers fall under at least one of the three criteria, if not more than one.

The sum of both elements creates an unjustifiable burden for any Payment Service Provider that services other Payment Service Providers. Those providing the service must undertake a very costly onboarding and monitoring process for each new payment provider to which they provide service. Payment Service Providers above those in the delivery chain have to assume the risk of all those below them in the chain, in addition to their own. All this is for the provision of a wholesale service, which must be priced accordingly.

Also, putting this AML regulation in perspective with the recent cases of money laundering by very large and well-known banks, it is possible to understand why direct participants see no incentive in providing this service, when they are often trying to control their own operations and to present themselves under a better light to avoid and compensate for their own home-grown scandals.

Moreover, no account is taken that these two entities (a Payment Service Provider providing a service to another Payment Service Provider) are both authorised and regulated by the FCA. Yet to succeed in being authorised by the FCA and gain permission to become a Payment Service Provider, often requires a lengthy and detailed due diligence of the whole business, including AML compliance.

It is therefore necessary to question the need for this redundancy of responsibility promoted by the current regulation when referencing two entities that are authorised by the FCA and the impact the current regulation has in the market place.

In practical terms, Direct Participants and Clearing Providers have become quasi-regulators. The payment providers, to whom they provide services, are seen by regulation as mere agents of the Direct Participants and Clearing Providers. The Payment Service Providers seeking to be a client are therefore obliged to comply, at minima, with the AML policies, procedures and particular choices of their service providers.

Also, the zeal of the service provider in keeping a tidy house elicits the application of double standards. While a service provider may understand that AML is a process and that compliance is a continuous improvement process allowing for errors and corrections along the way; the view it takes of its Payment Service Provider client's AML process is more absolute in its appraisal. A service provider is therefore likely to judge their client more severely for AML compliance errors and corrections, than if these exact same errors and corrections had occurred in one of their own departments. It is just common sense that an interested party is not a good judge of AML compliance, yet this is exactly what is being promoted by regulation.

The consequence of this situation is the following:

- Permissions granted to Payment Service Providers by the FCA are not considered good enough by Direct Participants and Indirect Participants.
- Onboarding process often takes as long as obtaining the FCA permission and involves a similar level of scrutiny which is very costly for both parties.
- The environment deters investment and innovation: there is no certainty that even once FCA authorization has been obtained after the lengthy authorization process, the entity will actually be able to operate.
- AML can be used to conceal anticompetitive behavior.
- New Payment Service Providers must adapt their business model to please those from whom they receive service, which constrains innovation and therefore competition – the opposite effect of the intended PSD regulation.

It must not be forgotten that innovation is often sparked by a start-up that grows into a recognised player. Service providers must gamble on the odds of a new business model succeeding, so that the time, cost and effort to onboard it, setup their service, as well as take on their AML risk, will one day be compensated by the large volumes transacted.

We question the intention behind such short-sighted regulation on AML. Either authorised and regulated companies providing payment services are considered to be fit and able to be responsible for their own AML systems and controls, or they are not, in which case the quasi-regulators status of the Direct Participants should be regulated, to ensure the following: the provision of service cannot be denied to any firm having been granted permission by the FCA, double standards will not be applied, business models while in line with regulation will not be restricted, etc.

In summary, current AML regulation is a major deterrent for providers to service other Payment Service Providers. The industry structure together with this restrictive AML regulation hampers competition as it leaves no choice to either the providers or to new Payment Service Providers needing access to an indispensable service. As detailed above, the former have often no other choice than to decline to offer the service, whilst the latter have no other choice than to be serviced by them.

III. The UK's legacy narrative on access criteria and eligibility to payments systems and market infrastructure

The Directives relating to Electronic Money Issuance and Payment Services, EMD 2000, EMD 2009 and PSD 2007 and those in the pipeline, are seeking to separate payments from credit, or more precisely cash management from credit. The PSD 2007 as explained above, refers to Credit Institutions and the new Payment Institutions as the two possible kinds of Payment Service Providers (other than those subject to authorisation exemptions). The Directive already assumes that Credit Institutions enjoy free access to payments infrastructure and payment system operators, but in order to remove any doubt it expressly imposes a non-discrimination clause for Payment Service Providers (regardless of their regulatory flavour) to access these key resources, in order to ensure them the freedom to develop new business models and effectively compete in the European market.

In the UK, market practises have not evolved accordingly and even the assumption that any PSP is already capable of accessing key market infrastructure and payment systems operators is not yet a reality. Electronic Money Institutions and Payment Institutions are not allowed, should they decide to follow that path, to open a reserve account in the Bank of England and thus they are not allowed to join BACS, CHAPS or Faster Payments directly, for instance.

PSD 2009 says in its article 28:

> *Member States shall ensure that the rules on access of authorized or registered payment service providers that are legal persons to payment systems shall be objective, non-discriminatory and proportionate and that those rules do not inhibit access more than is necessary to safeguard against specific risks such as settlement risk, operational risk and business risk and to protect the financial and operational stability of the payment system.*
> *Payment systems shall impose on payment service providers, on payment service users or on other payment systems none of the following requirements:*
> *(a) any restrictive rule on effective participation in other payment systems;*
> *(b) any rule which discriminates between authorized payment service providers or between registered payment service providers in relation to the rights, obligations and entitlements of participants; or*
> *(c) any restriction on the basis of institutional status.*

Whilst not all deposit takers would be able to fulfil the liquidity obligation to access certain Payment System Operators, all other Payment Service Providers would, since they segregate client monies, so automatically hold all the liquidity required to cover payment instructions. Of course both the technical ability and the financial cost of implementing the systems and operations required to comply with direct access should also be taken into account, but such business decisions should be left to the Payment Service Providers themselves, who must decide whether it is worth the investment.

The UK payments industry and structure is very bank-centric and by "bank" it must be understood to be deposit takers, i.e. credit institutions able to turn clients' deposits into credit or investment for their own account (Directive 2000/28/EC, Article 1.(a)). The industry seems reluctant to accept the arrival of a new kind of entity able to compete with these deposit takers in the payments market on equal terms.

IV. Concentration of access tools and bodies in the hand of a few banks

Not only do the biggest banks in the UK control BACS, but they also control the UK Payments Council, who allocates sort codes, thus payment providers can only be assigned a sort code when one of their member banks sponsors it, for instance.

In summary, the UK payments industry includes built-in processes, definitions, access and eligibility criteria not in line with the relevant EU directives aimed at fostering competition and targeting the gradual separation of cash management from credit, thus seeking an increased specialisation of the financial players in the economy, for the benefit of consumers.

3. Short-term and mid-term solutions which would work towards solving the most critical problems

The ideal market structure is one that offers choice and does not limit payment providers in the way they want to setup operations (other than restrictions imposed by laws and regulations).

This general statement can be implemented in various ways, striking a balance between the actual structure and the constraints imposed on relationships. For example in the current market structure, the very limited number of possible providers, alongside the unreasonable AML responsibilities imposed on them, makes the market completely imbalanced. Moreover, as it is the same providers who control both direct and indirect access to Payments System Operators, there is no alternative once indirect access has been denied. Many Payment Service Providers are thus at an impasse.

We understand that the remit of the to-be-created PSR is fairly broad but also limited to the designated systems indicated in the consultation and that any other regulator, such as the Bank of England, PRA or FCA will retain their roles and scopes without change. We also understand that some of the solutions we will suggest here below may fall outside of the scope of the PSR itself, however if the intention is to really open up the payments industry, all issues should addressed by the relevant authorities. We think the PSR should maintain an industry monitoring role to detect and report on the relevant issues, even if the PSR is unable to act on all of them directly.

(i) Update of criteria and eligibility to access key market infrastructure and acceptance by payment system operators as per Article 28 of Directive 2007/64/EC

The objective is to limit the accessibility criteria to any payment systems operator and market infrastructure to:

- Being regulated as a Payment Service Provider so a Deposit Taker, Electronic Money Institutions and Authorised Payment Institutions.
- Being able to meet technical connectivity requirements
- Being able to meet liquidity requirements
- In the case of being a deposit taker, a minimum credit rating or similar criteria may be appropriate

Any criteria based on specific volumes is not relevant, as new entrants would be penalised by firstly having to integrate with a sponsor's system and then later migrate to the Payment System Operator's system. Moreover, a volume criterion reinforces the current situation whereby new Payment Service Providers are left in the hands of a sponsor, with all the potential negative consequences listed above.

This level of openness should be applied all the way up the value chain, up to and including the Bank of England, where in line with the Directive, they would offer direct account access to Payment Service Providers who request it.

When looking at other jurisdictions such as New Zealand and Australia, where authorities have faced the same concern about the reduction of competition in their own payments market,

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payment systems operators such as PaymentsNZ for example, have adopted procedures to ensure that new members are accepted away from the influence of the large banks that own and control the Payments System Operator itself. PaymentsNZ has a minimum of three fully independent directors that review and evaluate new members and this process is kept strictly confidential, without any of the other directors representing the large banks, being aware or having a say in the process. Since in New Zealand as there is no regulation on payments and Payment Services Providers do not require permission from any authority, the NED of PaymentsNZ perform the checks and reviews required before accepting a new member. In the UK, such a mechanism would not even be necessary as Payment Service Providers are regulated, which should be the key access criteria..

(ii) Create an exemption to the AML regulation so that each regulated player in the delivery chain is only responsible for its direct customers; thus seeking to remove the responsibility for the AML systems and controls from any Payment Service Provider for any other payments provider down the delivery chain

We understand that PSR has no responsibility for AML, whether it is to enforce it or amend its laws or scope. The problem however is so acute that it requires immediate attention.

Other countries, within Europe and outside its borders, are facing this exact same issue and are granting exceptions for regulated financial institutions.

In Italy, the Bank of Italy has exempted one large bank from being responsible for the AML systems and controls of any Payment Service Provider that they provide service to, (source: Italian Association of Payment Institutions).

In New Zealand, the Banking Association (NZBA) and some large banks have written to the Financial Market Authority (FMA) and the Reserve Bank of New Zealand about the damaging consequences of the AML regulation which imposes the responsibility on whoever is up in the financial market value chain[1]. They have requested limiting their responsibility to the next step in the value chain, rather than all those below it. The Reserve Bank of New Zealand and the FMA are discussing the exemption to be granted and the market is expecting it to be approved by the summer of 2014.

While such measures are needed, there is also a need for stopping the double standards applied by Direct Participants and Clearing Providers. They consider themselves an extension of the FCA in enforcing regulation (as they acknowledge openly) yet they do not apply the same tolerance to their clients as they do their own operations. Given the concentration of the market and the lack of choice for Indirect Participants and Clearing Participants, it is important that Direct Participants are somehow obliged to provide service and include AML standards in the service contract, thus protecting Payment Service Providers from changes in "perceptions of risk" by those that service them, which can trigger the discontinuation of service and thereby effectively preventing the Payment Service Provider from operating.

4. Answers to the questions

[1]http://www.nzba.org.nz/assets/Uploads/130801-Submission-on-Factsheet-on-Managing-Intermediaries2.pdf

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Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We think the list includes the system operators that need to be regulated at this point in time, however we also think that direct access cannot be granted if the Bank of England (BoE) is left out of scope.

In this sense, the BoE could be considered also a Payment System Operator as far as payments alone are considered. Payment System Providers (PSPs) who are Non-Deposit Takers would immediately meet liquidity criteria and thus would not consume BoE's balance sheet resources and therefore should not fall under the prudential screening and criteria imposed on Deposit Takers.

Moreover, we think that regulation should also allow for the creation of new payment operators to replace existing ones. The current payment operators are for the most part based on old standards and technology – except for Faster Payments which seems to be fairly contemporary.

The development of payment operators and the openness of the new ones are at the heart of the evolution and innovation of the payments industry. For this reason we think that membership, and by that we mean direct membership, should be open to any payment provider that requests it, and not based on volume or status (Credit Institution or not), but simply based in the fact that they are authorised and can meet the technical requirements for connection and operation. In this sense maybe Faster Payments should be completely open and its rules changed so that there is no value limit, thus facilitating the potential disappearance of BACS and CHAPS should they no longer be needed.

Other than the payment operators, the surrounding elements such as the allocation of sort codes should be also open and not subject solely to the sponsorship from member banks.

Finally, it is important to bear in mind that the payments industry is in the middle of a transformation, where card schemes will eventually disappear or transform into something entirely different. It is fundamental therefore to regulate taking into account the potential arrival of new schemes, which will not be based on cards but on mobile and the issuance of electronic money. These schemes have an imperative need to have direct access to key market infrastructure and operators: settlement accounts with the BoE and access to Faster Payments for example. They cannot appear and flourish if left as Indirect Participants or worse. It is unlikely that trade bodies such as the Payments Council (under its current configuration) will be, in the future, a driver of innovation; so it is important to open the space effectively so that new operators can be born and prove their value.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

The main card schemes are far too powerful and do not leave much room for innovation. Competition in this space is non-existent. As we said earlier, the solution to

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this problem is to ensure direct access to key payment resources to any payment provider offering new schemes, so that card schemes can be effectively challenged. Card schemes are very old technology and their fundamentals are expensive. Merchants must wait many days to receive the paid amounts and fees are in many cases too high, this is poot of both the lack of competition and innovation in this space.

Generally speaking competition is not very effective in any part of the payments industry. Money transfer and currency exchange are areas where competition is fairly developed, but it is now threatened by the reaction of Direct Participants and Clearing Providers to AML regulation, closing their service to Payment Service Providers.

This point is not restricted to just the areas of money transfer and currency exchange, but the whole of the UK payments landscape, where Direct Participants and Clearing Providers' reaction to AML regulation leads them to reassess or reduce the service they provide to Payment Service Providers.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Introducing new payments schemes and payment operators that offer cheaper services, better services and faster settlement periods, not only benefit the merchant as users of these payment systems, but ultimately the end user who pays for it indirectly, whether they are individuals or businesses. Moreover, the convenience and speed of transactions would encourage more transactions to be made, use less time to make them and thus increase productivity for the service-users, be they merchants or businesses or individuals.

However for this to be possible, new Payment Service Providers need to have certainty that all their investments in building new payment schemes and developing innovative technology, will not be put at risk with a payments service that is withdrawn suddenly and without just cause, by the Direct Participants or Clearing Participants who currently provide them with indirect access to the payments network.

It is also necessary to separate out completely the system operator from the foundations that allow for new entrants to exist, such as obtaining sort codes, gaining direct access to the BoE, etc.

Question 4: What are the main factors impeding more effective competition at each level?

There are several factors that we would like to highlight for the Payment Service Providers (PSPs):

- No direct access to payment systems
- Lack of choice of Direct Participants or Clearing Providers providing indirect access to new PSPs – this hampers the services these new players can offer, as new PSPs are exposed to the inconsistent and unreliable behavior of banks who decide which business models to support
- Restrictive AML regulation that discourages access provision
- The UK legacy narrative of needing to be a Deposit Taker (ie to provide credit) to be given access, when providing credit has nothing to do with payments.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

The industry should collaborate in ensuring interoperability; however it is hard to devise a proper way of achieving this without imposing technical choices that may actually limit service evolution and competition.

At this point in time competition must be left to act so that is ends up devising new technologies and business models.

We think it is too early to define collaboration, when actually banks by co-owning the payment infrastructure, assigning the sort codes etc have shown that significant collaboration today and in the past, has closed the door to innovation.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Yes the current structure is a problem: large banks own payment systems operators and control the UK Payments Council. It is obvious that it is in their best interest to restrict access and to impose criteria that protects their business and existing market shares.

As suggested earlier in this document, ownership is one thing, but access and access governance should be changed to make it independent from ownership. As a starting point, a confidential application and acceptance process should be introduced, as per the PaymentsNZ example described earlier in the document. Thereafter, the change in eligibility and access criteria in line with the inherent and overriding objectives of the regulation would go some way to resolving the problem of the current structure.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

By limiting the accessibility criteria to any payment systems operator and market infrastructure to:

- Being regulated as a Payment Service Provider so a Deposit Taker, Electronic Money Institution or Authorised Payment Institution.
- Being able to meet technical connectivity requirements
- Being able to meet liquidity requirements
- In the case of being a deposit taker, a minimum credit rating or similar criteria may be appropriate

Any criteria based on specific volumes is not relevant, as new entrants would be penalised by firstly having to integrate with a sponsor's system and then later migrate to the Payment System Operator's system. Moreover, a volume criterion reinforces the current situation whereby new Payment Service Providers are left in the hands of a sponsor, with all the potential negative consequences listed above

Question 8: Do you have any concerns about the current governance of UK payment systems?

Yes, it is structured as a close club that sets eligibility on out-dated criteria that is not in line with recent regulation and ignores the intention to open up the system to new players.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

They should remain costs centres only. Ownership is not important, as long as their access criteria are open and limited to the criteria defined in Q7.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Orwell has two regulated entities:

- Orwell Union Ltd: an API using a clearing account only
- Orwell Union Partners LLP: an EMI with an agency banking agreement with a Direct Participant

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

The general commercial terms seem fair to us. There is always scope for negotiation on price depending on volumes.

The terms however leave it to the entire discretion of the provider to discontinue the service on any grounds at quite short notice. This creates a very asymmetric relationship. Such terms could be acceptable in an open and competitive market, but not in the current situation, where there is no alternative if the service is discontinued. As mentioned below in Question 13, only one Direct Participant agreed to offer us service as a PSP – this is not a competitive market with many choices.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes, but it is not explicit in the contract.

Our provider does not allow us to provide service to other Payment Service Providers of any kind (Credit Institution or Payment Institution). However, this is actually part of our business plan. Whilst our provider gives this privilege to other agency banks (to whom it also provides service) as they are Deposit Takers. This is yet another example of the double standards which limit the scope of our activity and effectively curbs our business model, by those who reluctantly provide us with service and who have potentially the most to lose if we are successful.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

NO, we could only find one Direct Participant that was willing to provide service, all the others declined to even initiate discussions about it. RBS and Lloyds would not even answer our calls or emails.

Accessing directly is the only viable solution for us to develop our full business model which will provide innovation to merchants, individuals and businesses.

The benefits include:

- Able to execute our plan without having to discard areas based on the decisions by our provider/competitor;
- Reducing the time spent by management attending to the provider's constant requests for supervision and monitoring;
- Limiting the business risk of finding ourselves without service, given a change in the management (new perception of risk) of our provider;
- We would not have to disclose our innovations to our provider before it is made public.

As risks, we do not see any when comparing it to the current situation. Technical integration is equally costly and requires the same level of attention.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?

No

If yes:
- _To whom do you provide indirect access?
- _What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
- _Are there any barriers to becoming a sponsoring bank?

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

As explained in Q7, repeated here for the sake of completeness:

By limiting the accessibility criteria to any payment systems operator and market infrastructure to:

- Being regulated as a Payment Service Provider so a Deposit Taker, Electronic Money Institution or an Authorised Payment Institution.
- Being able to meet technical connectivity requirements
- Being able to meet liquidity requirements
- In the case of being a deposit taker, a minimum credit rating or similar criteria may be appropriate

Any criteria based on specific volumes is not relevant, as new entrants would be penalised by firstly having to integrate with a sponsor's system and then later migrate to the Payment System Operator's system. Moreover, a volume criterion reinforces the current situation whereby new Payment Service Providers are left in the hands of a sponsor, with all the potential negative consequences listed above.

Question 16: Do you have any other comments regarding access?

The BoE should be seen as far as payment is concerned as a payment system operator, in as much as the Payment Service Provider can meet liquidity obligations, requests to access the payment system directly should be granted.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

We are not knowledgeable about the technical deficiencies of the UK's payment infrastructures. We can observe however that processes seems to be driven by old standards and technology, but we do not know enough as to comment on the real cost of updating them.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Standardisation ultimately reduces costs and simplifies operations and interconnection. The standardisation of messages would also allow an easier interconnection of the payment systems that will emerge to ensure interoperability. It is hard to comment generally on the timeframe for standardisation, as not all possible changes bear the same level of urgency.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Direct access would facilitate the emergence of Payment Service Providers that would behave as payment hubs, devoted to allowing access to Direct Participants. This would therefore reduce the connection costs due to a shared infrastructure.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Current terms and fee arrangements are not favourable or unfavourable to innovation, since the blockage is not in the actual terms or fees but in all what is not written: the specific application of AML policies aimed at limiting business models, the changes in direct participant's management that modifies their perceptions of risk, , etc

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

The UK payment industry is full of opportunities for innovation, but it is the execution of the innovation that is very difficult to achieve because of the lack of access, which ultimately undermines any attempt to innovate in the payments sector as the business risk is too high.

As mentioned earlier, even after a lengthy due diligence process to get FCA authorisation and permission to offer payment services, the Direct Participants providing access to the payment systems, carry out their own due diligence and can still reject or restrict the service offered, based on the business model presented and the AML systems and controls in place.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Grant full and direct access to regulated Payment Service Providers.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Innovation is not different if created collectively or unilaterally, but collectively it is harder to achieve, whilst unilaterally it is harder to adopt. Both should have equal chances to occur, the market will adopt the innovation that best solves the problems. Regulation should intervene at some point in time depending on adoption levels purely to facilitate interoperability.

Question 24: Do you have any other comments or concerns you would like to highlight?

All our comments are summarized in the initial sections of our response, detailed in this document. We refer specifically to examples in New Zealand and Italy who are facing some of the same issues as the UK and are looking at solutions to ensure a competitive payments market is delivered.

Please refer to pages 1-16 in this document for more detail on the points below:

I. We do believe the entire payments industry's access and governance in the UK is dominated and quasi regulated by a few large banks, who are limiting, if not making it very hard to innovate or compete. A level playing field simply does not exist.

II. We do believe that the PSR will not succeed in opening the market without a radical review of access criteria in line with the relevant European directives.

III. We do also believe that the BoE cannot remain on the side, but its role in payments must also be opened up in the same way as the designated payment system operators.

IV. We think that AML regulation (along with the market structure) is also one of the major reasons behind the current market impasse.

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Question 25: What, if any, are the significant benefits you see regulation bringing?

We hope it will result in a full implementation of the article 28 of the PSD 2007 that will allow all players to fully test their business models and make the UK payments industry a competitive environment that ultimately brings innovation, drives down cost and enhances the service users' experience.

Question 26: What, if any, are the risks arising from regulation of payment systems?

We do not see regulation as a barrier or a potential risk in current circumstances. It would be hard to make the market a more closed reality than it is today. Instead, we perceive the risk as regulation not taking the full steps required to ensure that direct access is granted and thereby open up the market effectively to competition.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Regulation is fundamental for the opening of the market and therefore to allow our participation in it. Without a regulatory framework that ensures us the freedom to compete without limits imposed by existing competitors, our ability to deploy our intended service will be hugely limited.

Ultimately we look at the entire EU market (including the UK obviously) so a regulation regime not conductive to free competition, would eventually force use to leave the UK market and concentrate all our resources on the rest of Europe.

Yours sincerely,

Carlos Sanchez

CEO of Orwell Union Partners LLP

15 April 2014

PAYMENTS COUNCIL RESPONSE TO FCA CALL FOR INPUTS: PAYMENT SYSTEMS REGULATOR

Introduction

The Payments Council welcomes the establishment of the Payment Systems Regulator (PSR). Economic regulation of the payments industry can help deliver effective competition and promote innovation for the benefit of UK customers, businesses and the economy.

The UK has one of the most advanced and innovative payments markets in the world. Since 2003, the industry has spent nearly £4 billion on designing and implementing major new services and innovations for UK customers, making UK payment systems world-leading. These collaborative innovations include: chip & PIN for credit and debit cards; the Faster Payments Service (FPS); contactless cards; ISA cash transfers; and most recently the Current Account Switch Service (CASS) (launched in 2013). A new mobile payments service (Paym) is launching on 29 April 2014. These collaborative innovations allow payments providers, banks and others, to offer greater choice for the customer and greater competition for suppliers.

Economic regulation of the industry is best supported by collaboration in achieving efficiencies and promoting investment and innovation across the whole system, as well as the building of new shared platforms. The network nature of payments means that collaborative action can increase competition by harnessing and sharing network benefits cost effectively, as in the delivery of CASS and Paym.

- **Supporting competition:** Collaboration at the centre of the industry enables a level playing field for incumbents and new entrants – both to access the systems cost effectively and to develop their competitive propositions for customers. For new entrants, joining existing shared platforms means they can enter the market more quickly and achieve customer reach and scale without huge investments upfront and long start up periods while they build bespoke systems. Collaborative behaviour is not at the expense of competitive behaviour, but supplementary to competition and the competitive process.

- **Supporting customers:** Any payment intrinsically involves two parties. Consistency and common standards are therefore crucial for enabling payments to give customers reliability, security and consistency. Customers also want flexibility and convenience, often best achieved by collaboration across the system. CASS was a multi-scheme innovation that enabled a consistent, secure, reliable customer experience by making necessary changes to banks' systems across the board. As well as improving the customer experience, it has also sparked considerable competition for retail customers with banks vying to enhance their offers and increase market share. The first full six months of CASS in operation saw over 609,000 switches take place as personal, SME and voluntary sector customers choose to move their current account provider.

- **Supporting efficiency:** implementing a change once across a whole industry is generally cheaper than fragmented change which creates stand-alone systems that are not inter-operable. Greater efficiencies and cost savings can be found across systems than in overlapping silos. The Payments Council thinks that efficiencies could be achieved through potential consolidation of payment systems. Working collaboratively, the industry can identify cost efficiencies, freeing up funds for investment. However, much more analysis is needed to fully test this. In the intervening period before the PSR becomes fully operational and decisions may be made, we need to ensure the continuity and integrity of the UK's payment systems as they are currently run.

- **Supporting innovation:** collaborative innovation spurs competition by providing a common platform built by sharing costs on which incumbent and new market participants of all sizes can develop their own competitive customer propositions. This collaborative innovation enables change to be achieved at a lower cost overall (a particular benefit for new entrants), and provides the ubiquity and reach in payments that is crucial for customers.

Payment systems in the UK

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

The Payments Council believes all interbank and card payment schemes operating in the UK (CHAPS, Bacs, FPS, LINK, Cheque and Credit Clearing Company (C&CCC), Belfast Bankers Clearing Company (BBCC) and the main three and four party card schemes) should be considered for designation as they meet the criteria for designation. Any deficiencies in the design of these systems or disruption to its operations would have serious consequences for users of the system.

The Payments Council also believes that there is a need for a proportionate framework to be in place so that new payment systems that emerge in the future can be included in the new regulatory regime, if appropriate.

Competition in payment systems

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?
Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?
Question 4: What are the main factors impeding more effective competition at each level?

Payment systems facilitate competition

Collaboration by banks has given rise to shared platforms and joint payment systems which facilitate competition in retail and other banking services. As a result, all banks can use the same pre-existing payment systems platforms and all can potentially achieve the same reach. A small challenger bank can offer the same payment methods to its customers as a large incumbent. This allows market entrants to focus on developing competitive and attractive customer propositions, rather than committing scarce resources and time to develop their own payment solutions. Importantly, processing through collaborative interbank payment systems also delivers efficiency and integrity. This would be at risk if, for example, banks were required to set up their own bilateral arrangements for exchanging payments with each other.

The industry has successfully delivered a number of collaborative initiatives, such as the Faster Payments Service, the Current Account Switch Service (CASS) and Paym, the new mobile payments service. These enable participating institutions to innovate and develop their own-branded customer products and differentiate themselves from competitors. Banks see the benefit of investing at the centre, even though innovative platforms will be available to rivals. They recognise that collaborative innovation enables change to be achieved at a lower cost overall, as well as achieving ubiquity, reach, integrity and reliability in payments for their customers.

At the same time, the Payments Council believes that effective competition at the retail level, facilitated by the pre-existing payment systems and platforms, can be impeded if some firms or institutions experience barriers to its core services. Different levels of access can be beneficial for smaller institutions choosing to use agency arrangements rather than developing their own systems, however, this can also have a restrictive impact on the payment services they are able to provide their customers. This is why ensuring fair and reasonable access to payment systems is so important and why it should be a priority area for the PSR. Accessing payment systems cost effectively and securely is fundamental to a new entrant’s ability to operate.

Barriers to entry could potentially be reduced or removed, subject to further analysis, by creating standard cost effective interfaces that allow new entrants to access the whole payment systems and all the platforms, rather than having to sign up and pay for access repeatedly either directly or through agency arrangements. Competition in pricing is a matter for the regulator, not for a collaborative body like the Payments Council. Access to payments is further discussed under the 'access' section in this response.

The place where competition should thrive is between firms and institutions dealing directly with end users, particularly retail and SME customers. Competition at this level will vary from sophisticated customer interfaces through apps to branch opening hours. This is relevant across the different customer groups, where banks and other financial institutions compete to provide attractive products and new services suited to consumers, SMEs, charitable organisations and corporates. It is at this level where competition best aids customers, creating a competitive, efficient banking industry which delivers the best economic outcome for the UK.

Competition between the interbank systems

The Payments Council does not believe that competition at the level of the inter-bank systems would either remove barriers to entry for new entrants or improve customers' experience. Competing payment systems would not have produced the collaborative innovations already outlined.

The inter-bank payment schemes provide complementary, rather than competing service lines. The current inter-bank payment scheme structure includes a number of scheme companies (CHAPS, Bacs, FPS, C&CCC, Belfast Bankers Clearing Company (BBCC) and LINK) with infrastructure provided separately (VocaLink, Bank of England and Swift). Each interbank scheme has evolved to serve a specific purpose in terms of the clearing needs of service users and customers. For example, CHAPS processes high value transactions, Bacs is used by payroll services and to set up direct debits and FPS is the UK's real time payment engine.

Inter-operability and cooperation at the inter-bank level delivers efficient and resilient services to end users. We believe that the potential for competition at the scheme level to drive benefits for service users is limited; it is the coordinated effort across the schemes that will help drive efficiency, resilience and benefits to end users. The Payments Council thinks that there is an argument in favour of consolidation, particularly between electronic payment schemes. This requires further detailed cost benefit and other analysis and extensive consultation, however early indications are that it would create efficiencies and cost savings which could be released for investment in innovations to reduce barriers to entry and improve the customer experience.

It is right that the major card payment networks should continue to compete. The structure of these organisations, where they provide both the rule-setting functions and infrastructure, means that there is natural competition between them as financial institutions choose which to use for their card payments. They are also bigger than purely card payments as they increasingly innovate and move into other markets. However, there are still areas where the payment card networks do not compete, such as standards and access where cooperation and collaboration still play a significant role.

Competition at the infrastructure level

Currently VocaLink is the main infrastructure provider for the UK payments system. Having a main supplier can be crucial when considering integrity and resilience for critical components of the infrastructure. A provider who has a long-standing supply agreement will have a comprehensive understanding of the challenges of maintaining the integrity of the system. There will be significant costs and challenges of introducing a new provider without at least some disruption to the system, which is critical given that the effective functioning of this infrastructure is integral to the functioning of the wider UK economy.

On the other hand, opening up this part of the market to a wider choice of providers would produce a more competitive supply of infrastructure services. If the UK were to pursue a consolidation of the payment schemes then this would require an infrastructure re-procurement. As part of any work to consider the costs and benefits of moving towards consolidation, we will look at the options for infrastructure supply over the long term.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

We believe there are certain key functions that are best delivered by and for the industry in the collaborative space. This approach means functions are coordinated, holistic, efficient and effective, and work is not duplicated over a number of payment services incurring unnecessary additional cost and resources. We have outlined these key functions below:

- **Strategy:**
  - The development of a pan-industry collaborative strategy that addresses the needs of all stakeholders (customers, industry, public policy and regulators) as well as new entrants and incumbent providers, and which supports the PSR's vision and objectives. Importantly it should put customer (particularly retail and SME customers) experience and outcomes at the centre.
  - A collaborative approach would help prevent payments strategies developing in silos and enable solutions to be considered that could potentially address two or more problems simultaneously. This would benefit customers as well as create easier access for new providers.

- This would include addressing payments integrity and security, as a collaborative approach across these areas is recognised as the most effective in terms of efficiency, information sharing and identifying threats and risks.

- **Delivery:**

  - Coordinating delivery across the industry of codes of conduct and common standards and processes that strengthen the customer experience when using payment services; ensuring consistency and common minimum standards where needed.
  - The design and delivery of innovative industry services (e.g. CASS, Paym, FPS) requires coordination across more than one scheme or payment type, or the routing of payments (e.g. the database that sits at the heart of the Paym proposition); ensuring delivery in a manner that reduces costs for banks and new entrants and generates efficiencies that can be passed onto customers.
  - Ensuring a common high standard of delivery that moves the industry together, and which effectively facilitates the involvement of a broader number of participants than the membership of a particular scheme. This is good for competition as it enables firms and institutions of all sizes to work together. Having the appropriate governance in place means an equal voice for all, regardless of size as well as independent challenge and scrutiny.
  - A collaborative body retaining a direct interest and oversight of these industry services (while still working with the scheme companies who have the day-to-day management role) means they can be managed and developed to meet broad customer and industry interests.

- **Broad stakeholder engagement:**

  - This entails broad stakeholder engagement to understand the requirements, needs and concerns of customers (consumer, business, charity and voluntary sector), government (as user and as public policy), industry, public policy and regulators.
  - This function would co-ordinate and bring these views together. The Payments Council currently achieves this through its customer forums (Consumer Forum, Business Forum, Technology Forum, Charity & Voluntary Sector Forum, Access to Payments Forum and the Government Co-ordination Committee). We actively engage with around 300 organisations and representative bodies.
  - Ensuring the on-going inclusiveness of payment services through effective education and communication campaigns, and acting as a trusted spokesperson on payments issues.
  - The collection, research, analysis and publication of industry data and market research.

- The dissemination of regulatory developments (and their impacts) from the UK, Europe and internationally. In some instances this is providing a service that smaller institutions don't have the capacity to undertake themselves.

Our preliminary thinking on the proposed governance structure for this collaborative body is outlined in the section on governance.

Ownership

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.
Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

The current ownership structure in the UK's payments industry has evolved as banks have invested in an infrastructure to allow the safe and efficient exchange and settlement of payment instructions. Banks have chosen to develop these systems collaboratively through joint investment because payments by their very nature require systems to be shared. It is also common practice in other international jurisdictions for the payment systems to be owned by the banks that created and use them.

We believe there are a number of benefits derived from the current ownership model that would need to be considered in any review of ownership.

Firstly, the current ownership model allows for costs of infrastructure change (which ultimately benefits all end-users) to be split amongst direct members. While indirect members without an ownership stake 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. If ownership and thus costs were split equally amongst all, this could disadvantage smaller challenger banks and create additional (and potentially restrictive) cost to new entrants. However, this current structure can mean that they have a limited voice in what the changes are and how they should be implemented.

Secondly, ownership by the banks of the scheme companies allows shared resources and shared infrastructure, minimising costs passed down to consumers. This is also beneficial for resilience of the system. Under a 'for-profits' model, scheme owners could pursue speculative investments that may undermine the stability of core payment systems. Similarly, in the case of VocaLink, bank shareholders effectively underwrite the company's financial position, resulting in minimal risk that a key part of the UK's financial infrastructure could ever face financial difficulty and withdraw its services as a result.

Finally, it can be argued that the current ownership structure, where banks have a vested interest in the payment systems they own, means that the payment systems are developed and adjusted to meet the changing needs of customers – which the banks are well placed to understand. Indeed, new payment systems have emerged from within the joint ownership structure to meet entirely new customer demands. Faster Payments was developed in the past six years to provide for real-time payments, and Paym has been developed to meet the payments needs of increasingly mobile-centric customers.

However, real concerns about the current ownership model and its impacts have been raised by regulators, public commentators and parts of the industry that need to be addressed. These concerns relate to access, barriers to entry and a lack of competition in the market (whether perceived or real). Changing the ownership model may be one way of addressing those concerns and issues; other actions may achieve similar results. For example, the PSR will have the regulatory power to allow direct access to the payment schemes; require changes to payment systems rules and governance; and have the remit to encourage innovation within the payment systems.
Another option may be to look at the governance rather than the ownership; we have already seen substantial change and increase in the number of independent representatives on the scheme boards, and further changes may be considered to increase the voice of indirect members and challenger institutions. The exact problems that currently exist need to be identified and then possible solutions considered – which may or may not include the need to change the ownership model.

Governance

Question 8: Do you have any concerns about the current governance of UK payment systems?
Question 9: What do you believe is the appropriate governance structure for UK payment systems?

We believe that for the PSR effectively to achieve its key objectives of competition, innovation and looking after the interests of both service and end users, there is a strong need for a collaborative payments body. This needs to sit within the governance structure of the UK payments industry to fulfill the functions set out under question 5.

Working with the PSR, the Bank of England, the Government and industry, a collaborative body would be best placed to deliver a pan-industry strategy that supports the PSR's high-level strategic objectives. It would undertake a number of functions that need to be undertaken collaboratively due to the network nature of the payments industry:

- developing a strategy for the collaborative action in the payments industry;

- implementing policy, executing and delivering projects and managing services that require coordination across more than one scheme or payment type; and

- informing and influencing stakeholders to reach a consensus and a positive outcome for the benefit of users, industry and the UK as a whole.

The Payments Council, working with the industry and regulatory stakeholders, has already delivered several key industry services for the benefit of the UK customer and economy. These initiatives have been delivered successfully as a consequence of the collaborative layer that sits below the current combination of regulators and regulations, and above the individual payment service providers and payment schemes, making the most of the network benefits. We are able to extend beyond the membership of individual schemes.

The organisation that takes forward this function needs to have the appropriate governance structure in place that allows it to fulfill the role outlined above. We recognise that changes need to be made to the current set-up, including the creation of a new collaborative body. If the Payments Council were to undertake this change role, it would need to fundamentally review its current governance arrangements. This would be done in full consultation with the regulator, the Bank of England, HM Treasury and other stakeholders.

In terms of a future governance structure, there is a wide spectrum of possibilities dependent on what the PSR and industry require from the organisation ranging from a 'pure trade body' to a 'public interest body'. Its membership should be representative of the industry as a whole (any Payment Service Provider (PSP) that relies on the payments infrastructure), and the payment schemes (domestic, international, cards) and other market participants would need a presence in the structure to allow for engagement in debate and policy development.

The responsibilities of the collaborative body should relate to the PSR's objectives (access, innovation and service users), designing and delivering solutions that meet the desired outcomes. A good current example of how this relationship could work is CASS, where co-operation was necessary to meet a regulatory objective, and the industry, through its collaborative body, very quickly designed and agreed a solution. It met the high-level strategic outcomes required by a regulatory driver and with a structured collaborative programme in place has delivered a major new service in two years.

We will continue to develop proposals for the governance, functions, membership and structure of this collaborative body.

Access

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- To whom do you provide indirect access?
- What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
- Are there any barriers to becoming a sponsoring bank?

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Question 16: Do you have any other comments regarding access?

The Payments Council has been engaging with challenger banks and building societies to fully understand their needs in accessing the payment systems; through this engagement we have sought to understand those issues, perceived or real, that challengers have experienced while considering direct or indirect access to the schemes. This is a diverse set of organisations with different requirements; it includes banks, building societies and other PSPs that do not hold a banking licence. They also differ in terms of size, ownership and nature of their core businesses.

Our analysis of agency arrangements for access has shown that there is no one thing they all feel is needed; views range from having greater transparency on options will help them take business decisions concerning access, to others who feel that a more fundamental innovation, such as a single interface to access all payment systems, is required. Banks and payment schemes are also continuing to respond by developing or delivering initiatives to improve wholesale payment services and scheme membership requirements.

Collaborative action can develop and set standards, best practices and codes of conduct. Investment in new infrastructure and innovative payment services can be cost effectively achieved through collaboration. Competition plays its role in pricing and should mean that suppliers look to provide access solutions, and some commentators feel that there could be greater competition between sponsor banks looking to acquire new business. Further work and analysis is required to better understand the barriers and costs of entry issues that can be faced.

In summary, through our engagement we have found that challenger institutions face three key considerations when considering access to the payment systems: their ability to provide customer propositions in a competitive environment but on a level playing field; how to meet the technical and system requirements to secure access to the full range of payments systems; and how to put settlement and liquidity arrangements into place. The Payments Council has a project underway to identify simpler and more cost effective interfaces to facilitate access for new entrants, but without undermining the vital integrity and security aspects of the payment systems.

One immediate requirement we have sought to address is the need for a collaborative information sharing function by setting up the Access to Payment Systems Forum. This is aimed at increasing the information flow with challenger and agency banks on Payments Council and scheme (interbank and card) work and provides a platform to educate, share information, network and discuss common issues amongst this community (at the same time respecting competition law responsibilities concerning the sharing of information).

Direct Access

Direct access requires underlying IT infrastructure investment, considerable technical expertise in staff and the requirement to participate in meetings and other engagement for each of the payment schemes. Another associated cost of full membership is the requirement to have a settlement account at the Bank of England. Direct access can require considerable technical development and expertise; resourcing this can be arduous for a bank of any size, but in particular a challenger institution may not have the capacity to dedicate such resource to this one area of its business.

These costs and resource requirements for direct access may dissuade organisations from joining a particular payment system as a direct participant.

Indirect Access

Sponsor banks, which also face the cost, compliance, liquidity and resource requirements of direct access, offer payment services to other institutions through agency arrangements. Some existing banks and new entrants find that the most cost effective and commercially viable way to access a suite of payments is through a sponsor bank.

As there are several payment systems in the UK, agency institutions need to ensure that they have technical and settlement arrangements in place with sponsor banks for each desired payment system. Each arrangement potentially requires its own resource and development cost, adding to the level of investment needed to become part of the payments ecosystem. Agency banks do not need to use the same sponsor for each scheme but doing so provides efficiencies.

Agency services represent a relatively small part of sponsor banks' overall business operations across both retail and wholesale services, and sponsor banks allocate considerable resource to these services in relation to the size of this line of business. A feature of these 'supply side' dynamics – and as evidenced in other networked markets - is that the number of sponsor banks providing these services is relatively small.

Furthermore, under the new ring-fencing proposals it may become more challenging for some of the ring-fenced banks to offer agency services, due to the stricter exposure limits and the monitoring requirements.

Institutions operating through agency arrangements have indicated that they would like us to focus on the following areas to help them procure services via a sponsor:

- Clear and simplified governance and rules.
- Relationship management by the sponsor, joined up across all services taken by the agency.
- An appropriate range of levels of technical connectivity with the payments infrastructure, offering challengers a choice that determines the features of their own customer propositions.
- Single or streamlined access to all desired payment systems (e.g. Bacs, CHAPS, Faster Payments Service, Cheque and Credit Clearing Company), potentially including common ISO20022 standards.
- Service level agreements that determine the service experience for challengers when receiving these payment services.
- Capability to settle payments across the various payment systems, and arrangements to manage the challengers' liquidity requirements.

The Payments Council Board has endorsed the creation of a work stream to address these issues, looking at potential solutions and improvements that could be delivered in the near and longer term. Whilst the work needs to continue to determine what these should be, it is likely that they will involve agreed service levels and common definitions, processes and standards, simplifying and standardising cost effective access arrangements, except for those aspects that should remain in the competitive domain.

Infrastructure

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

The Payments Council believes that simplification and 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.

The key requirement to support competition and innovation is likely to require standardised, easy, cost-effective and open access to the payment systems – such as a single interface to access all the systems - to a range of sectors. This includes smaller and challenger banks, e-money institutions, corporates and other types of payment providers now and in the future.

The central payment systems and infrastructure could be developed and managed with a view to:

- pursue opportunities for cross-scheme co-ordination, harmonisation or consolidation in the provision of current operational services, delivering continuous improvements to existing processes and services;
- identify common actions that will improve value for money, resilience, integrity (for example data communications network sharing or cross-scheme resilience);
- identify requirements for new capabilities in the central systems, and pursue new collaborative developments in a coherent cross-scheme approach; and
- identify opportunities for a coherent collaborative approach to be inclusive of card schemes in some processes or capabilities.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Standards exist to ensure that the messages travelling with payments can be understood in a consistent and reliable way by all the counterparties in a transaction. This is crucial to ensuring that payments can be routed correctly to the right account and that the information provided with a payment makes sense to the recipient or the recipient's system. Standards are key to ensuring that payment systems work. In the UK, payments adhere to a number of standards (some of which are only used in the UK) and these standards are tried, tested, efficient and very reliable.

ISO20022 is a messaging standard aimed at institutions that want to streamline their communication infrastructure and associated costs by opting for a single, common "language" for all financial communications, regardless of business domain, communication network or counterparty. It provides a framework which typically allows businesses to use a richer data set than standards currently in use when transmitting payments. Because the framework is based on an internationally agreed approach, ISO20022 also allows for greater interoperability between institutions, both globally and domestically.

The Payments Council has been looking at the potential of ISO20022 for some time. Our Board has previously agreed that when new additions to payment systems are built, they should be designed using international standards - the most significant of which is ISO20022. Both the Current Account Switch Service and ISA Cash Transfer service have been built using ISO20022 as a payments messaging standard.

Work already undertaken on this issue includes a high-level consideration of its benefits and risks and the potential for it to deliver against the policy objectives of competition, innovation and integrity. A high level assessment by each of the electronic schemes of the technical feasibility of migration to ISO20022 has also been completed.

The Payments Council Board has agreed to prioritise a robust analysis of costs and benefits delivered by the standard for different customer sectors. This will include looking at potential scenarios and considering what role the standard could play in each one for the benefit of the UK market. For customers and the wider economy to be able to benefit from ISO20022, substantial investment may be needed in central payments and banking systems, and the systems of government and businesses. Understanding the impact on the key stakeholder groups and different parts of the industry is therefore critical. We will work to understand the costs and benefits of a wider take up of ISO20022 across the payments system, including the risks that would be involved in its implementation and likely timeframes.

In taking this work forward, we are of the view that any subsequent implementation would need to be undertaken in a way that recognises the following broad objectives:

- to have a positive overall impact on end-users, who can be broadly grouped as consumers, businesses (from micro businesses up to larger corporates), charity and voluntary organisations, and government.

- to maintain, as a minimum, the current levels of integrity of the payments infrastructure;
- to help reduce barriers to entry for new market entrants (challenger banks, TPPs, etc.) and infrastructure suppliers and solution provider vendors;
- to minimise risks during any period of migration; and
- to learn from the experiences of other implementations of the ISO20022 standard in a payments context.

To achieve a detailed and thorough understanding of the benefits and risks, the Payments Council will be working to deliver a consensus industry position on the impact of ISO20022 by the end of June. This will involve wide stakeholder engagement to understand customer, policy and regulatory impacts and requirements; it will also include seeking the views of the FCA and PSR, along with HM Treasury and the Bank of England.

Innovation

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).
Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?
Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.
Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

The UK already has one of the most advanced and innovative payments markets in the world based on a number of collaborative payment systems and services as well as unilateral services.

FPS is one of only a handful of systems in the world that provides real-time payments. Paym, unlike the competitive mobile payment offerings that already exist, is the first with the ubiquity and potential to link up every current account in the UK with a customer's mobile number. And in regards to CASS, although other countries around the world offer switching services, we are not aware of any other that offers a package as comprehensive as the UK service and with a customer guarantee.

Collaborative projects also provide a foundation from which further innovation and competition can flourish. Implementing innovation at the centre provides a stable interbank infrastructure with easy access for a wide range of competing PSPs beyond inter-bank scheme membership who can then themselves develop innovative services and business models. For example, CASS not only benefits the customers by making it easy to switch accounts, it also encourages banks and building societies to develop better current account products to entice new customers or retain their existing base. Faster Payments is used to route payments for Paym, the new mobile payments service; Paym provides interoperability meaning that potentially any PSP can plug in to it and use it as a platform to provide their own mobile payments innovations such as apps, interface, security features and service.

While a well implemented PSR will have a positive impact on the scope for innovation, there needs to be consideration given to the risk of a heavy regulatory burden impairing innovation. The more regulatory requirements that are placed on the industry, the more limiting the scope is to innovate, both in terms of flexibility and the resource available to do the 'voluntary extras'. The key focus needs to be on innovative services delivered for the benefit of the consumer and increasing competition; regulation needs to avoid any unintended consequences.

Another requirement of the PSR in approaching this objective will be to understand what innovation is already happening in the different parts of the industry and be clear on the outcomes it wishes the industry to deliver. Solutions can best be developed when there is a clear problem statement and a cost benefit study undertaken to understand the investment needed and the impacts it would have – the cost for implementation may well be wider than the industry when considering action required on the part of retailers and other types of merchants to upgrade their systems to accommodate new ways of paying or different processes.

Although collaborative innovation at the centre does run the risk of going at the speed of the slowest, it allows the involvement of smaller institutions who may not normally have the resources available to deliver innovation unilaterally. New collaborative services can also be implemented via a staggered roll-out to provide those participants unable to be ready at launch with the opportunity to join in a subsequent phase, such as the approach being taken with Paym.

Effective regulatory drivers in collaboration with the industry can negate the risk of moving at the speed of the slowest in delivering these projects. Having a robust governance structure in place with an independent voice as is currently the case for collaborative developments is important to ensure inclusivity. A very recent example of how this has worked well is the programme to implement CASS. A key feature of the governance structure was that every participant had an equal voice in its development and implementation regardless of institution size or customer base.

Future focus needs to remain on customer experience. Projects currently being delivered as collective innovation include the safe delegation of payments, a common process for handling misdirected payments and setting an industry-wide process for re-trying payments. We will also continue to work on issues such as common standards and consistent customer information on payment methods and what to expect. Innovation does not need to be ‘big bang’ to have a significant and positive impact on customers.

Closing questions

Question 24: Do you have any other comments or concerns you would like to highlight?

The Payments Council has no further comments or concerns to highlight.

Question 25: What, if any, are the significant benefits you see regulation bringing?

We believe that well-implemented economic regulation can support a vibrant industry and the delivery of world-leading innovation, with benefits felt by UK consumers, businesses and the economy as a whole. Well targeted regulation will positively contribute to the delivery of competition, innovation and improving the customer experience and in doing so help to encourage an accessible and competitive industry.

The PSR should bring significant benefits in identifying and undertaking action to prevent market failures, and providing a regulatory driver to speed up the delivery of some decision-making. It can also give a regulatory drive to the timely delivery of innovative solutions, both collaborative and unilateral.

The clarity a regulator can provide to the industry on key objectives and requirements that need to be met, will mean the industry can prepare and plan for delivery against them. This clarity of regulatory objectives also gives certainty in terms of the developments over a 3-5 year horizon (again improving planning, prioritisation and investment of PSPs and therefore efficiency) rather than frequent calls to react to short term initiatives which are unco-ordinated, *ad hoc* and may actually have a detrimental impact in the longer term.

Another benefit a regulator can bring with it is increased customer, policy maker and wider stakeholder confidence in an industry.
A regulator that recognises the importance and role of co-operation to harness network benefits will deliver meaningful change for the benefit of customers and a competitive industry.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Regulation of the payment systems and industry is not new and there are already several regulatory bodies (e.g. Bank of England, FCA) with specific remits in regulating the payment systems. Therefore, there is a risk of regulatory duplication if there is ineffective co-ordination and working relationships between the different regulators and the PSR. This clarity is also important from the perspective of the regulated entities in understanding how to resource their compliance functions efficiently.

It is also important that the PSR has a sound understanding of how the industry works and the differences between the various sectors. For example, the interbank payment systems are very different in nature to the international card schemes; regulatory intervention taken to resolve an issue in one area but applied across the board could have detrimental unintended consequences to other parts of the industry.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Payments Council has no comments to this question.

PayPal

PAYPAL (EUROPE) SÀRL ET CIE, SCA

17 April 2014

Financial Conduct Authority
25 The North Collonade
Canary Wharf
London
E14 5HS

Re: Payment Systems Regulation – Call for Inputs

Dear Sirs,

PayPal welcomes the Call for Inputs on the regulatory approach and early priorities for action by the new Payment Systems Regulator. We believe that both the FCA and the PSR have important roles to play in ensuring that the UK's payment systems support innovation and competition within the wider financial sector.

Please find below PayPal's response. Rather than address each question separately, we have answered them together in sections. We would welcome the opportunity to discuss these subjects in detail and to assist the FCA and the PSR as they consider these matters further.

Introduction

Founded in December 1998, PayPal enables individuals and businesses to pay and get paid online, with mobile devices, and in stores. We enable people to pay for things or send money without sharing their financial information, and with the flexibility to fund the transaction with their account balances, bank accounts, credit cards or promotional financing. With 143 million active accounts in 193 markets and 26 currencies around the world, PayPal enables global commerce, processing almost 8 million payments every day. The PayPal service is offered within the EU by

Telephone +352 26 63 91 00
Fax +352 26 63 92 50
www.paypal.co.uk
R.C.S. Luxembourg B 118 349
Registered office: 22-24 Boulevard Royal, L-2449 Luxembourg

PayPal Europe S.à.r.l. et Cie S.C.A., a credit institution regulated by the Luxembourg Commission de Surveillance du Secteur Financier (CSSF). PayPal has passported its CSSF license to the other 28 EU Member States.

Under EU legislation, PayPal's product qualifies as electronic money or e-money. In practice, it works like a digital or e-wallet. To fund transactions made with a PayPal account, the user purchases electronic money via a funding source (i.e. credit card, debit card or bank account) from PayPal. PayPal then sends this online payment to the intended recipient. Each time a user requests PayPal to send money, PayPal debits the chosen amount from the user's default funding source (bank account, debit card or credit card). PayPal therefore "creates" electronic money and credits it immediately on the receiver's account, even if in practice it may take several days for the settlement by the card acquirer.

As a payment service provider which relies on existing UK payment systems in providing its services, we believe it is essential that these systems support the interests of consumers and businesses as well as promoting greater competition and innovation in payments.

Payment systems in the UK

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We believe that those payment systems highlighted by HM Treasury in its 2013 consultation should be designated for regulation by the PSR: CHAPS, Bacs, FPS, LINK, Cheque and Credit and the main card schemes.

PayPal does not consider itself to be a payment system in the sense of the legislation. Rather, we are a payment service provider which makes use of existing payment systems in providing its service.

PayPal is not a card or bank funds transfer scheme. Instead, PayPal uses card schemes like MasterCard and Visa, and bank funds transfer schemes like Bacs and FPS to provide its payment solutions. PayPal complements the existing financial payment networks – including card and bank funds schemes – by leveraging the payments infrastructure to deliver innovative digital wallet solutions worldwide. As noted above, PayPal is registered as a credit institution in Luxembourg - and as such, regulated by the relevant Luxembourg authorities to ensure our compliance across all EU countries with EU law (such as the E-Money Directive, the Payment Services Directive, ECB Internet/Mobile Security Recommendations, and the Anti-Money Laundering Directive) based upon the "Home State" principle.

We note that the FCA's statement that 'smaller and less systemic payment systems or services, such as mobile payment systems and other proprietary payment card systems, may not initially be designated for regulation', and that as new payment systems develop and grow, '…they may at a later stage be considered for inclusion in the new regulatory regime.' We would welcome more clarity around the criteria which might be used to designate such systems in the future.

Competition in payment systems

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Question 4: What are the main factors impeding more effective competition at each level?

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

As the OFT pointed out in its July 2013 paper 'UK Payment Systems', UK payment systems tend to share a number of characteristics that may limit competition: "These characteristics include high fixed costs and economies of scale in the infrastructure that enables electronic payment systems, as well as network effects, where the value of a payment system is dependent on the number of users it attracts."[1]

Collaboration may in some areas be essential to *deliver* innovation. But fundamentally, competition *drives* innovation. As such, collaboration needs to be scrutinized to preserve the impetus to innovate and deliver the experiences and services that customers will want and need. Specific areas where we believe that collaboration can benefit the UK payment systems include:

> *Tackling Fraud:* Increasingly sophisticated fraud attacks ultimately undermine consumer confidence in payments. Addressing these in a collaborative manner is good for consumers and the industry as a whole.
>
> *Compliance.* Each scheme has level of audit/attestation. Aligning and passporting applicable parts would help in reducing costs and burdens on the payments industry, therefore enabling more participants and innovation.

However, collaboration between established incumbents can lead to arrangements which have the practical – and perhaps not entirely unforeseen – effect of raising barriers to entry and frustrating innovative and alternative business models which could create substantial benefits for British consumers.

Also, we believe that it is more important to focus not only on competition between UK payment systems but also on the competition between the payment service providers that use them as these are likely to drive innovation within the payment systems themselves. For example, we believe that innovation on the part of PayPal and other providers in mobile payments has encouraged the Payments Council to

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[1] 'UK Payment Systems - How regulation of UK payment systems could enhance competition and innovation', July 2013, OFT 1498, para 1.4

develop the new Mobile Payments Service as an additional solution alongside other providers.

Ownership

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

The current ownership structure concentrates control in small number of established incumbents. We note that the regulator would have the power to impose ownership changes on licensed organisations, with the power to require disposal of interest in payment systems, subject to the satisfaction of certain pre-conditions and subject to HM Treasury's approval. However, even if the payment system companies and underlying infrastructure were no longer owned by the major retail banks, these banks would ultimately still retain control over them through their large combined membership. Furthermore, these banks are also the main users or customers of these systems and would retain some degree of buyer power over them.

We therefore agree with the OFT and HM Treasury that there is not a clear cut case for seeking to impose changes in ownership at this time. We would recommend instead focusing attention on governance issues (see below) which would not necessarily require the dismantling of the ownership structure but address competition concerns.

Governance

Question 8: Do you have any concerns about the current governance of UK payment systems?

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

As noted above, the largest users of any scheme will continue to have the greatest influence over investment priorities, due to their buying power, whether they own the schemes or not.

We are therefore concerned that the current governance structure of the major payment systems remains dominated by the large retail banks and that insufficient weight is given to other service users. At the moment, providers accessing a particular payment system indirectly via an agency bank may have much less influence over investment priorities than direct members, despite the fact that they may still be using it to process large volumes of payments. We would recommend that the PSR reviews the governance structures of the major payment systems to ensure that decisions about investment priorities more adequately reflect the interests of its users.

This desire for greater end user influence in the governance of payment systems is also currently under review within the European Payments Council (EPC) through the introduction of the European Retail Payments Board (ERPB) which will have a more balanced governance and oversight by both financial institutions, PSPs as well as retailer end-users. We believe that a similar review, coordinated with the EPC, would be appropriate to address the introduction of a more balanced structure in the UK as well.

Access

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Question 16: Do you have any other comments regarding access?

We currently access UK payment systems indirectly through an agency relationship with a member bank. We have an agreement in place with Barclays Bank to provide our access to the Faster Payments system, and with Vocalink as the processing partner. We also use JPMC for our standard BACS transfers. For card network access, we leverage WorldPay and Global Payments for all card-related transactions to fund our wallet in the UK.

Competition

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

With the introduction of the SEPA bank transfer formats, almost every EU banking system adopted ISO 20022 standards. The UK still uses national schemes. With the required adoption of SEPA in Oct 2016, UK banks will need to be able to process SEPA, i.e. ISO 20022, standards. In essence, banks will need to run two payment schemes. PayPal decided many years back to implement only ISO 20022 where possible. Thus from a PayPal perspective the move of the UK to ISO 20022 standards completely would make a good deal of sense. PayPal believes the move to ISO 20022 for the UK payments systems would a) align the UK payments systems with the broader EU developments generating greater harmonization; b) would make business more cost effective for all stakeholders (banks, PSPs and end users) operating in both the UK and the rest of Europe; and c) would keep UK payment systems competitive as continental Europe and many regions of the world (e.g. Asia) are moving towards XML, i.e. ISO 20022, standards.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

UK payment systems have many components which enable a number of innovative customer focused payment offers to be made. To fully realise these benefits, we believe that the payment schemes need to be more customer focused, and operate in the manner that customers expect. For example, there is no reason that BACS cannot run 7 days a week, or consider multiple file submissions a day, therefore reducing the time between collection and returns. We believe that achieving a better balance in the governance of UK payments systems between financial institutions and end payment system users could go a long way to addressing the current lack of customer focus in the payment systems.

Innovation

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

As a general matter, we believe that there are incentives to innovate in UK payments to provide better payment services in response to competition between service users and clear customer demands. For example, we believe that the innovation of PayPal and other providers in mobile payments has encouraged the Payments Council to develop the new Mobile Payments Service as an additional solution alongside other providers.

Closing Questions

Question 24: Do you have any other comments or concerns you would like to highlight?

Question 25: What, if any, are the significant benefits you see regulation bringing?

Question 26: What, if any, are the risks arising from regulation of payment systems?

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Please see our responses above.

We look forward to assisting the FCA and the PSR as they continue to consider these matters. Should you wish to discuss any of the issues raised in this response in greater detail, please do not hesitate to contact me at amcgowan@ebay.com.

Yours faithfully,

Alasdair McGowan

Director, Government Relations (UK & Ireland)

eBay Inc

Annex 1: Cover sheet

Basic information		
Consultation title:	**Payment Systems Regulation – Call for Input**	
Name of respondent:	**PayPoint Plc**	
Contact at respondent:	Name:	**Anne M Conaty**
	Email:	anneconaty@paypoint.co.uk
	Address:	**PayPoint** London Office 1 Finsbury Square London, EC2A 1AE

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	✓
Indirect participant in payment system(s)	✓
Service-user	✓
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	✓
Trade / Government / Regulatory body	
Other Please specify:	

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		✓
If 'Yes', please submit both confidential and non-confidential responses.		

Response to Payment Systems Regulator's Call for Evidence

Due for Submission to PSR on 15th April 2014.

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We believe the payment systems listed above being CHAPS, BACS, FPS, LINK, Cheque and Credit, and the main three and four party card schemes should fall within the designation. In addition, the regulator should consider emerging payment options where they are owned by the banks or their monopoly infrastructure companies, including mobile phone linked payments.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

PayPoint has successfully delivered innovation and new competitive services in areas which have been of low interest for banks (for example, over the counter cash payments). We would welcome the opportunity to similarly innovate across a broader payments spectrum. However, we are denied first tier access to many schemes that would be relevant to our business, including BACS, CHAPS and faster payments.

Where membership is available, such as being an independent ATM deployer within LINK, the voting structures are such that we have no influence over policy or commercial structure, which remain under the voting control of the major banks. Some of the major banks have also distorted the economics of LINK by denying third party ATM access to basic banking customers. This is also to the detriment of these more challenged customers.

We have also been unable to compete in some instances where banks have bundled payment processing into their pricing, effectively cutting out dedicated processing companies from acting as intermediaries.

It is essential that there is a level playing field. At present organisations providing the same service may do so under different regimes or, in some instances, different legislation. The regime applied to a service should not give any one organisation an advantage over another organisation simply because they function under different regimes.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Competition has the ability to create benefits to service users in terms of costs, quality and innovation. Costs are often given a bundled description of "processing costs" but the processing costs only provide part of the total costs involved in a payment transaction. The MIF Regulations are due to address the question of interchange fees in relation to the payments. However, competition also involves creating a pricing structure that enables other payment options to be supported, not just the more profitable standard payments. So, for example, banks may be able to charge consumers for their cards and have the additional revenue source associated with the business. An independent ATM operator, in contrast, will not have the same revenue opportunities and may be dependent upon a different financial dynamic. Innovative products may not be created due to the costs to the existing service or a concern that the new products will cannibalise existing payment products rather than generate new business. Competition should enable a variety of operators to participate and provide different services.

Competition would also enhance the operation of the services. At the moment a number of payment systems use single suppliers for the infrastructure (for example, LINK uses Vocalink). The ownership structure remains principally with the major banks; this in conjunction with the influence of their legacy systems has the consequence of limiting the user experience and inhibiting innovation.

Competition would also improve the availability of services to consumers. At present major issuers in the UK can arbitrarily switching off LINK scheme access to basic account card holders (Lloyds and RBS has taken this step in recent times). The payment systems do not have a universal service concept similar to those applied in the telecommunication sector. The regulator may wish to consider if something along those lines can be applied to payment systems.

Question 4: What are the main factors impeding more effective competition at each level?

- *Regulatory controls originating under the Payment Services Directive.*
- *Restricted access to payment systems.*
- *The dominance of the card schemes in relation to particular products and services. An example being Visa's dominance in the debit card market and MasterCard in the credit card market*
- *Bundled commercial terms that cut out independent intermediaries*

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

The standards and minimum technology requirements need to be set by a central body. It is important that these standards are consistent across the EU to give the opportunity for new entrants across a wider market.

Collaborative approaches should also be encouraged for developing payment systems. In this context the existing payment services regulation acts as an effective barrier to consumer access. A risk based rather than legislative approach to regulation would help lift some of these barriers.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Governance and ownership arrangements especially where processing entities and payments systems have the same ownership create an anti-competitive environment. This is especially the case in the card schemes where the very fact that certain processors are owned by the schemes adds credibility even though the standards required of that organisation are no different to those imposed on other processing organisations.

There is also an issue that technology developments are applied to smaller operators without them having due recourse to input into the proposed changes. Traditional committee and consultation processes within payment systems give greater control of such matters to the full participants who are frequently restricted to credit institutions (i.e. banks).

The fact the ownership of the major payment systems still rests with the bank is also a bar to competition.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

- *Diversification of co-ownership structures (processing and governance).*
- *Participation linked to diversity of networks rather than high volume (access to services for all consumers is an essential part of competition).*
- *Eligibility for membership of payment systems widened to include more non-bank entities.*

Question 8: Do you have any concerns about the current governance of UK payment systems?

Please see question 6.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

We feel that it is essential that the payment systems should have a robust and dynamic environment in which to operate. We support the creation of a regulator who is knowledgeable in this area and able to address the need to support services and systems beyond those favoured by existing banking infrastructure and services.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

We are members of LINK and pay annual membership fees which are generally the same for all members as they are capped. We then earn interchange from transaction activity at our ATMs. Sometimes the consumer pays a surcharge, in which case there is no interchange. Interchange rates have a direct bearing on the attractiveness of placing free machines for the benefit of consumers.

We are denied access to other bank owned schemes except through sponsoring banks or merchant acquirers. This inevitably means we cannot attract sufficiently attractive rates to make meaningful competitive plays with services that use these payments as building blocks.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

See question 10. We appreciate that first tier status should come with responsibilities and liabilities but where membership is denied, this cannot be fair and reasonable but it would be no better if the conditions of membership, when schemes are opened up, are such that they deter non-banks from joining.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes, in certain instances participation via sponsoring banks creates a waterfall of costs that mean third party service providers cannot provide the service at a price which is competitive with the sponsoring bank. One solution would be to have a category of sponsor that only performed that function enabling resale costs for payments to be reduced as the sponsoring entity is not competing in the same way as in existing sponsoring arrangements.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

In our experience, the choice of sponsoring bank is extremely limited even for an organisation with considerable payment expertise – essentially we are largely tied to our main clearers. Direct access would be considered by us, if available, provided it is accompanied by the ability to influence decisions and commercial terms.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?

No.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

We are interested in top table participation but would consider any options made available to us according to our priorities at the time.

Question 16: Do you have any other comments regarding access?

We would be happy to meet to discuss any more specific detail.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

We believe that many of the building blocks of the payment systems are strong and are a good basis for service innovation. The constraints are often more commercial than technical or infrastructure based.

As an example, LINK rules do not allow for manned cash withdrawals, effectively forcing the installation of an expensive ATM when a terminal based solution could be more cost effective and would work technically just as well. Ultimately, the consumer picks up the system cost and loses the opportunity for wider availability of free cash withdrawals.

Another example is that BACS rules protect banks and consumers with a direct debit indemnity but leave business customers open to fraud, with no recourse at all. Again the scheme could operate differently, with the same level of consumer protection, but the rules of the banks to protect themselves, prevent it from being improved

It is also the case that new payment adoption is usually constrained by pricing more than capability and often with the desire to protect an existing charging model. For example, faster payments are priced far higher than 3 day BACS payments making them unattractive for volume payments, but the marginal cost of these automated transactions must be very low.

Similarly, contactless card schemes are more constrained by their pricing than by infrastructure or technology.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

ISO20022 as a standard would need to be open enough to be relevant to the widening complexities within financial services and payments, but sufficiently defined to ensure integrations to acquiring banks and financial schemes can be reused without significant development. Any changes would need to be managed between 12-36 months in order to give enough time for organisations to plan and adopt the relevant changes.

ISO8583 fails to give any guarantees on what should be expected when carrying out integration activities. This causes delay and barriers to inclusion for new businesses operating at a rapid pace. PayPoint currently experiences less than 20% commonality between its ISO8583 interfaces across its European connections.

Any area of concern with the continued growth of card not present is the lack of defined standards for card security and in particular tokenisation. Any updates should look to reflect the need to ensure those who purchase goods online are protected and those trading online can process with multiple providers without compromising the protection of cardholders' information.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

The existing regulatory structure may prohibit the development of agency functions as envisaged by this question.

We would be interested in participating in competitions to provide infrastructure.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

The existing regulatory structure (PSR and EMD) may prohibit the development of innovative payment products as envisaged by this question. See also our response to question 17.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Please see Question 20.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Greater non-discriminatory access, relaxation of rules designed to protect the status quo and fairer, cost reflective, commercial terms as referred to throughout this response, such as in question 17.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

We would see a place for both but have generally been focused on our own competitive position which usually precludes collaboration. We would be concerned where collaboration delivers a low common denominator and does not allow for service differentiation.

Question 24: Do you have any other comments or concerns you would like to highlight?

No

Question 25: What, if any, are the significant benefits you see regulation bringing?

If applied appropriately and in a proportionate manner, greater access to services and markets.

Question 26: What, if any, are the risks arising from regulation of payment systems?

There is a risk that rather than creating an open and innovative environment the regulation acts to bolster the position of a small number of participants. This is often the incumbent owners of the payment system. The consequence of any such actions is difficult to assess but priority should be given to ensuring that consumer choice and access to services are not diminished. See also question 23.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Regulation has the ability to open, restrict or even prohibit participation in UK payment systems and its impact could be fundamental to our future strategy.

PETER MAIR: SUBMISSION TO UK PAYMENTS SYSTEMS REGULATOR

RESPONSE TO CALL FOR INPUTS

A formal inquiry into Australia's financial system is presently underway – fsi.gov.au: a range of submissions deal with payments system policy issues and mine does so almost exclusively.Ideally, those advising the Australian panel will have an opportunity to discuss UK developments directly with you.

I briefly recast three familiar themes in a way that fits into the '27 questions' format.

-- destructive tax-free bartering of 'free deposits' for 'free services'

My interest in relevant issues in the UK started in the 1960s – in particular a mid-sixties report of a 'Monopolies Commission' and, later, a similar report of a 'Competition Policy Commission'. What stayed with me was a keen appreciation of a so-called 'endowment' effect identified by those initial inquiries – the 'endowment' of an almost overwhelming competitive advantage to the 'clearers' arising in the non-payment of interest on transaction account deposits with banks. More recently an undercurrent of this 'endowment' coloured the Cruickshank criticism of the BOE implicitly indulging the 'big banks' in return for 'cooperation'.

Whatever, the endowment is rarely mentioned these days – save possibly for the central banks in Finland and Norway who made much of it before their payment policy role was subordinated into centralised European policy agencies. The published work of both these central banks in the mid-1990s remains a useful conceptual framework.

Whatever, again, in most countries the 'endowment effect' remains very relevant to the typical dominance of a few retail banks and the typical absence of any credible new entrants.

As you may read in my various submissions, it is about time the 'endowment' was moderated – possibly by ensuring bank customers are 'deemed' to have received a market-rate of taxable interest-income paid on the daily deposit balances in transaction accounts on which no material interest is now paid. Not to correct this anomaly legitimises a destructive form of tax-avoiding barter where bank customers get 'free services' for 'free deposits' – but bank conglomerates holding an entrenched advantage are also able to use the endowment to 'compete' in other markets.

I would be pleased to see the UK pick up this 'endowment' ball and take it away so the playing field for competitive retail banking is more level.

In the meantime there is no force more destructive of competition in retail banking.

-- ad-valorem transaction fees: the credit card racket

A few moments of insightful reflection will reveal, to most minds, that the essential nature of the global credit card schemes is a racket. An illusion of 'free credit' for 55 days is parlayed into an arrangement where the card users believe the transactions are 'free' as is the 'credit' taken before paying the account in full by the due date -- using funds already on deposit in a transaction account on which no interest is paid.

Card users have no incentive to save merchants from paying excessive ‘scheme’ fees’ and ‘interchange fees’ levied as a % of purchase values.

The credit card is, frankly, now a redundant product being misused to exploit both card users and merchants negotiating with what many regard as, de facto, an international cartel. There is no good reason why a user-pays line of credit could not be added to a debit card account.

Looking forward, the credit card product is now playing an embryonic, loss-leader role in developing ‘tap-and-go’ payments arrangements conducive to the displacement of cash – a latter day Mondex if you like.

I suggest two policy initiatives – first, the proscription of all ‘ad valorem’ transaction fees, especially those known as merchant-service and interchange fees and, second, the deeming, as taxable income in the hands of card users, of any ‘free credit’ taken all calculated at the interest rate applied to credit rolled over. Alone or together, those steps would stop the rot.

It is disappointing that the EU has gone down a track of allowing ad-valorem fees of 20/30 basis-points for debit card and credit card transactions – but, hopefully, that is a short-term compromise.

-- no need for large denomination currency notes

In Australia a combination of means-tested entitlements to age pensions and the usual hiding of cash sales income has resulted in a grossly-inflated and hoarded currency note issue from a Reserve Bank ‘dependent’ on the seigniorage from the note issue to fund its operations and capital base.

[This ‘seigniorage’ is, of course, the counterpart of the abovementioned ‘endowment’ commercial banks enjoy from similarly issuing deposit liabilities on which no interest is paid.]

The situation in Australia has degenerated into a farce where the central bank is, effectively, issuing zero-coupon bearer bonds on demand – disguised as banknotes – that are hoarded for the purpose of facilitating assaults on the public purse of its owner, the government. The associated ‘losses’ from the public purse do, of course, greatly exceed the ‘profit’ on the note issue flowing to the central bank.

This nonsense aside, there is another line of attack based on the sense of withdrawing large denomination currency notes to foster the development of EFT payment systems and otherwise facilitate the management of tax-evasion associated with cash dealing and hoarding.

The policy issues about currency notes now coming into sharp relief may not be easily dealt with – including in Australia – but it is surely about time they were given some exposure so the community is on notice of an emerging case for reform.

Peter Mair /10 April 2014

Further to your request for input we wish to submit the following response which are the main issues for the Petrol Retailers Association.

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.
Yes Fuel Cards.

Fuel cards are an important payment method for fuel retailers delivering circa 20% of all transactions at an average forecourt. The Petrol Retailers Association who represent the views of the independently owned forecourts (Dealers) in the UK are concerned as follows:-

1. For some Oil Co branded fuel cards acceptance of these cards can be mandated as part of the fuel supply agreement. However the PRA is concerned that some of the cards commissions derived from transactions made on these cards may not to be up for negotiation nor has materially changed since the inception of these cards some 30 years ago. Income derived from fuel cards now does not cover the marginal cost of acceptance. However it was always pointed out that fuel cards generate footfall and card holders are likely to make private non fuel purchases in the shop. Some PRA members have conducted their own research into this and found that non fuel purchases made by fuel card holders are very small in monetary terms.

A further concern is that for individual Dealers or small Dealer Groups who may have a direct relationship with Allstar (owned by FleetCor) for Allstar card acceptance are priced at a far higher and un-economic rate compared to other companies. Whilst we accept that there should be a discount for volume we believe that the spread between the highest rate and the lowest rate is un-fair.

2. We are also concerned by the recent announcement from FleetCor who enjoy a substantial market share in both the Fleet and Commercial fuel card market segments that they are now offering "Pay as you go" Bunker cards into the Fleet sector. FleetCor has recently launched their Allstar “Premier Programme” which encourages existing Allstar fleet customers to also use a KeyFuels card. When the card holder fuels at a site which takes both cards the driver is encouraged to use their Keyfuels card. This customer offer is predicated on lower priced diesel for the card customer and data from both cards is combined on the one invoice. However by doing this it will mean a substantially lower margin for the site operator. This could be interpreted as to be contrary to the points FleetCor made to the Office of Fair Trading when the transaction to purchase Allstar was reviewed and approved.

Question 10:
How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Many of the PRA members access payment systems via equipment provided to them by their fuel supplier. The Merchant Service Fee’s (MSF) can be negotiated centrally by the Fuel provider the MSF for credit and debit cards is charged to the Dealers as part of the price for wholesale fuel. In the likely event that MSF's are reduced the PRA is seeking assurance that full rate reductions are passed back to the Dealers.

Question 11:
For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

The areas that concern Fuel Retailers are as follows:-

1. The UK should move to a "Fuel" MSF as per Germany and Australia which is fair and reflects the high tax element of the price of fuel and low margins associated with selling it.

2. Under the "honour all cards" rule Dealers are compelled to accept "Premium rate" cards. Rates associated with these cards can wipe out the majority or all of the gross margin. Dealers cannot surcharge for these cards and the point of sale equipment is not able to identify which cards carry inflated costs. The PRA has lobbied for these cards to be outlawed.

Regards
Gordon

Basic Information	
Consultation title:	Payment Systems Regulation – Call for Inputs
Name of respondent:	Prepaid International Forum
Contact at respondent:	Name: Diane Brocklebank
	Email: diane.brocklebank@prepaidforum.org
	Address: 4th Floor, Chapel House 18 Hatton Place London EC1N 8RU

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government /Regulatory body	Yes
Other Please specify:	

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential		X
If 'Yes', please submit both confidential and non-confidential responses		

Prepaid International Forum

Payment Systems Regulator
25 The North Colonnade
Canary Wharf
London
E14 5HS

14 April 2014

Dear Sirs

Payment Systems Regulation

We are writing in response to the **Call for Inputs** initiated by the Financial Conduct Authority in its document: **Payment Systems Regulation** (March 2014).

Prepaid International Forum (PIF)
PIF is a not-for-profit trade body established in 2007 to represent providers of e-money and prepaid payment instruments. PIF acts as principal point of liaison between the industry and government agencies, regulators, consumer bodies and the media to promote the benefits and attributes of e-money and prepaid products.

General Comments on Payment Systems Regulator (PSR)

We had some general comments on the PSR, which we set out below. We have provided our views on some of the questions raised in the Call for Inputs document in the **Appendix** to this letter.

We warmly welcome the statutory objectives that the PSR will have to promote innovation, effective competition and open access in UK payments on the basis that they will drive the creation a level playing field for all payment providers and remedy the issues facing our industry, namely:

- **Innovation** – new and alternative payment services, such as prepaid and e-money are dismissed too readily, too often. There is a general misconception that these products increase the risk of financial crime which is an inaccurate portrayal of a highly regulated sector, providing payment services responsibly and in the interests of consumers and end-users.

- **Competition and Open Access** – actions taken by the UK banking sector has resulted in some of our members being unable to provide their regulated services to existing customers. If allowed to continue, competition in the market could be significantly reduced resulting in fewer, if any, alternative payment solutions for minority groups such as the financially excluded.

We believe that the Payment Systems Regulator has the potential to make a really positive difference to opening up UK Payments and we look forward to helping shape its development for the benefit of all stakeholders.

Finally, we should add that the views stated in our response are those of PIF and do not necessarily reflect the views of all of our members.

If you would like to discuss this response with us, we would be pleased to do so.

Yours faithfully,

Prepaid International Forum

Annex

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

For continuity the new regulator might consider including closed loop card programmes and treat them in the same manner as scheme branded programmes. It is very much in the consumer's interest to do so as well as harmonisation of regulations.

A regulatory view on 'Bitcoin' type services for clarity and security. Other jurisdictions are now announcing their treatment of 'Bitcoin' type services. Clarity from our own regulator would be most welcome.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

The current competition regime is focused on major competitive issues. It does not deal with issues that affect the ability of innovative new players to enter the payments space. From our perspective there is a need for a regime that enables complaints that are of a competitive nature in this regard to be reviewed.

Question 4: What are the main factors impeding more effective competition at each level?

We would reiterate our response to the Government's consultation 'Opening up UK payments' where we highlighted the fact that many players in our industry have experienced real difficulty in gaining or retaining banking partners for their prepaid and associated services. The options available to them are limited and to date, there has been has been little appetite for change. Systems they liaise with do understand but all too often are immovable or slow in approach. There are always 'answers' but no 'solution' or 'easy adaptation' of the current regime.

We believe that a more competitive playing field can be achieved by allowing other, fully fledged and authorised entities to enter the clearing system. There are several reasons why the smaller players would be welcome such as bringing about greater choice, competitive pricing, more efficient services and the provision of specialist facilities in line with market forces and innovative practices.

Question 16: Do you have any other comments regarding access?

Access to the Faster Payments system is currently very difficult for anyone other than the larger payment services providers. Our view is that the system should be opened up and made accessible by smaller financial and payment institutions.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

We believe that the only way to do this is to dismantle some of the structures which are too big and too interdependent to be able to bring anything to market quickly.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

One of the benefits of collaboration might be better interoperability. However, if collaboration takes place on the basis that it is driven by the major players (and that route is followed by the smaller players for innovation) then it could only work if it is properly monitored. The inevitable outcome of universal collaboration would be standardisation, which would stifle innovation. An element of standardisation could only work if it allows for innovation and competition further down the line and that there are certain controls, e.g. around fee setting.

Question 24: Do you have any other comments or concerns you would like to highlight?

On becoming fully operational we recommend that the PSR establishes a permanent stakeholder liaison group to address any concerns as they arise rather than having to go through a complaints or consultation process.

Question 25: What, if any, are the significant benefits you see regulation bringing?

Providing definition and governance to new products thus minimising the non-desirable elements from creeping in.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Over complication and lack of clarity leading to stifling of innovation and small company expansion.

Question 27: How do you think regulation might affect your business and participation in UK payment systems?

By providing clarity, breaking strangleholds on market sectors leading to innovation, cost effective product offerings and, in turn, serving the consumer community in a far better way.

Basic information	
Consultation title:	Payment Systems Regulation: Call for Inputs
Name of respondent:	R. Raphael & Sons PLC
Contact at respondent:	Name: Michael Smith
	Email: mike.smith@raphael.co.uk
	Address: 19-21 Shaftesbury Avenue London W1D 7ED

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	Yes
Indirect participant in payment system(s)	Yes
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?		X
If 'Yes', please submit both confidential and non-confidential responses.		

Response to Payment Systems Regulation – Call for Inputs

From: R. Raphael & Sons PLC (Raphaels Bank)

Nature of Response

We respond in three parts, firstly a general note about Raphaels' activities to put our comments into context, then an exposition of the major issues that we have encountered and our views on them and finally responses specifically to some of the Inputs questions.

We take this approach as some of the issues impact on several questions and in our view, sit together more appropriately as higher level issues rather than specific question responses.

Background

Raphaels is a UK Credit Institution, authorised by the PRA and regulated by the FCA and the PRA. Raphaels' activities concerning payment systems are as follows (in relation to this exercise):

1. Raphaels is a member of Visa Europe, MasterCard International and Link.
2. Raphaels has an estate of 321 ATMs in the UK which as well as dispensing sterling and providing balance enquiries in the standard way, also offer Dynamic Currency Conversion (DCC) when dispensing sterling to certain overseas cardholders and also offering € (and in a few cases $) currency dispensing.
3. Raphaels issues e-money on prepaid cards, currently 3.2m cards in total of which the large majority are issued in the UK with the rest issued in the EU (11 countries) through passporting regulation; these are issued in partnership with third parties, for example card programme managers such as Access Prepaid Worldwide (a MasterCard subsidiary) which manages travel card programmes for Travelex, Thomas Cook and others in £ and several other currencies. Our current total prepaid balances are £202m (£ equivalent). In carrying out this activity, Raphaels is effectively a sponsor of other parties' card programmes, giving access to Visa and MasterCard through its memberships of them. Raphaels remains the card issuer in all cases and is named as such in the cardholder's terms and conditions and on the back of the card, although if you were to ask a Travelex cardholder who issued their card, we believe they would answer MasterCard or Travelex rather than Raphaels. Raphaels holds the funds and settles with the Card Schemes and remains responsible for regulatory and Card Scheme compliance which it oversees through outsourced partners through an extensive compliance monitoring programme. The processing platforms for this activity are owned and managed by companies such as Fidelity Information Systems, MasterCard and TSYS. As such Raphaels does not operate its own account management systems in respect of card issuance.
4. Raphaels does not have its own current account product or customers, however it is working with a few partners on integrating prepaid cards with the UK clearing system. Prepaid MasterCard or Visa accounts running on the processing systems described above are linked to the clearing system using third party middleware which links to a clearing bank and generates faster payments and accepts direct debits through an agency relationship which dedicates a sort code per programme to Raphaels. To date most of this activity is being focussed on the "underserved" & Government market.

5. In respect of these activities and in order to stay within its regulatory large exposure limits, Raphaels keeps cardholder funds in accounts with 14 banks, money market funds and in various governments' securities.

Exposition of Principal Issues Impacting Raphaels

In order for Raphaels to thrive and prosper in the activities outlined above, the following are needed:

- Guaranteed long term access to payment infrastructure;
- Pricing set at a reasonable level with no subsequent discontinuities;
- No inappropriate policy changes without due consultation (taking in the views of all stakeholders) and notice from regulators, card schemes or banks.

Without these, the products we are building and distributing with our partners, already proving to be very attractive to niche markets and growing at 40% per annum in volume, are built on sand.

Raphaels does not want to become a technology company, our interest is in niche markets where we can add value through flexibility, consistency and support for our partners' innovations through providing well-managed fund-holding and compliant access to licences. Likewise, most of our partners do not want to become regulated entities.

As such, we would prefer not to go down the route of building our own technology to implement direct access to payment systems, although if we had to we would certainly look at it carefully. More attractive to us is a model where we link into the established infrastructure of a third party:

- In the case of Visa and MasterCard we achieve this through processing companies such as FIS (mentioned earlier) who maintain compliant and up to date real time processing systems used by many prepaid issuers and which are integrated to the card schemes;
- In the case of faster payments and direct debits we achieve this through a clearing bank agency arrangement and third party provided, clearing bank approved middleware;
- In the case of Link we achieve this through an industry standard switching platform "Postilion" provided by ACI with key bespoke developments and hosted and managed by TNS.

Whilst we have a choice between Visa and MasterCard as a scheme to use, we are reliant on them continuing to support prepaid products. We have no reason to believe they will not, however there is no doubt that they are very susceptible to regulatory pressure and there is always a danger that the well-run part of the industry might be caught up in negative issues arising from the less well run part. This raises the interesting question as to whose responsibility it is to ensure that industry players are well run. In this respect, as a small bank whose balance sheet clearly reflects the fact that this business is a major strategy of ours, we are happy that our own governance procedures combined with the level of regulatory attention we receive as a Credit Institution, is adequate. We are much less clear that the governance, operations and oversight of E-Money Institutions and Payment Institutions is sufficient and certainly not sufficiently co-ordinated, consequently we feel there are accidents waiting to happen in the industry. We are members of, and fully support the work of, the Prepaid International Forum and the Electronic Money Association; however their membership is voluntary and tends to be made up of those companies that want to operate "properly".

This absence of assurance has been reflected in the past few years, and in well-publicised moves last year, by clearing banks closing the accounts of MSBs, PIs and EMIs. Regardless of access to payment systems, there is a basic requirement for these businesses to have access to a bank account. We do understand the concerns of clearing banks in this respect as reflected in the previous paragraph, however for a regulated entity not to be able to open a bank account at a major transmission clearing bank suggests that there is something fundamentally wrong with the market.

Whilst we have no reason to believe we are affected at present by these moves, if big banks can change their policies so quickly and issue 60 days' notice to regulated firms to close accounts, how can we be sure that as a small bank we will not be caught in the same line of thinking? It would equally be possible, rather than close accounts, to deny access to payment systems on grounds of risk, or re-price to cover additional real or perceived risk, or ask for additional collateral etc, which could undermine the economic or operational basis of our existing business models.

We have also seen examples of what we believe to be unreasonable charges introduced, without debate, by effective monopolies. For example, in 2013 one of the Card Schemes introduced a DCC monitoring fee in relation to ATM and PoS transactions. This ad valorem fee will cost us €240k this year, a significant hit to the bottom line of this division. We only perform DCC at ATMs (we have no PoS business), the Card Scheme signed off our screen flow and content when we launched the service five years ago and these have not changed since – obviously being system driven the same screens are presented to the customer on every occasion and the system does not suffer the vagaries of a human interaction which can happen with DCC at PoS. As such we do not see that the cost of monitoring our activity amounts to more than £1,000 per annum consisting of a question to us and a couple of test transactions, in other words the fee is simply profiteering. If Card Schemes can introduce such fees at will (not accepting their cards at our ATMs is hardly a viable alternative for us) then again our economic models are continually at risk. Inconsistent policies between Card Schemes also cause inefficiencies and problems, for example MasterCard allows DCC at ATMs on all its cards, Visa only European cards. MasterCard allows FX dispense with conversion as does Link, Visa doesn't.

Regulatory uncertainty is also an issue for us. The draft PSRs have a way to travel before they become law and there are indeed uncertainties around the way in which some of them will be interpreted and implemented, but there is a danger of unintended consequences. For example, in PSD 2 there are proposals about external access of third parties to payment accounts, something which might be designed to allow say Paypal to pull funds on a customer's instruction from a bank account, however this looks a bit different when applied to a prepaid luncheon voucher card. It is conceivable that such unintended consequences could lead to major systems development for smaller, niche products and systems which could be uneconomic or alternatively lead to price hikes or additional collateral requirements from third party payment system providers.

We already live with some issues that we regard as regulatory anomalies, for example, in theory a small bank with capital of £20m can keep at most £20m on deposit with another bank, whereas an EMI with a similar level of capital could keep £1bn with that bank and, to the best of our knowledge, not be subject to any liquidity regime or specific requirements. This in turn exposes smaller banks to the need to have relationships with many correspondent banks which again means that policy decisions in those banks could affect us disproportionately.

We hope this helps set the over-arching position and concerns that we have as a small UK bank, operating uniquely at scale in the ATM and prepaid card markets in the UK. Below we set out some responses to relevant questions, referencing the above as appropriate.

Responses to specific questions

Question 1: *Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.*

In addition to the core systems, we believe there is also a case for looking at those services which are cross industry and are related to the services mooted in the Inputs document, for example PayM as added functionality to Faster Payments.

Question 2: *Where do you believe competition is effective or ineffective within UK payment systems?*

At present, whilst in theory other models exist, there are de facto standards that are so widely adopted that there is no competition. Direct debits for pulled bill payments and BACS for payroll and benefits are two examples of these, which in turn necessitate access to ACH based rather than card-based systems for anyone wishing to provide these critical basic payments.

Question 3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*

We do not see the need to drive increased competition per se between payment systems, for example setting up a second FP service, although it does no harm where it exists. From our perspective, competition arises from product features, benefits, design and service, hence the key issue is consistent and reasonably priced access to the major existing systems rather than additional competition between them. The key in our view is regulation of the providers, not increased competition.

Question 4: *What are the main factors impeding more effective competition at each level?*

No further input, see responses above.

Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

It seems to be inherent in the nature of payments that a high degree of collaboration between industry members is required. This is exacerbated in the case of payments infrastructure which is owned and developed by big players and opened up, by choice or regulation, to smaller players. There is an enormous need for secure, reliable and efficient infrastructure pipes through which payments can pass and that these pipes inter-connect with each other at some point. Unless these pipes are to be nationalised, then collaboration is inherent in maintaining and developing core infrastructure.

Question 6: *Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.*

We see two principal issues with the current ownership structure:

- Developments of shared ownership infrastructure can be delayed to be delivered at the perceived speed of the slowest owner to avoid undue cost or embarrassment to them, hence the need for government intervention in driving FP for example;
- Owners of systems do not need to open them up to third parties and / or can seek to price services at unrealistic levels, for example we received one agency bank quote for £5.00 and another for £2.50 per Faster Payments that we would initiate, an interesting wholesale price where the current retail price in a current account is zero. Longevity of service can also be an issue, see earlier comments re changes in policy.

Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.*

One option might be to continue with existing models but require a standard third-party interface (price and specification) to be made available to regulated third parties with the onus of adequacy of those parties the responsibility of the regulators rather than the system providers.

Question 8: *Do you have any concerns about the current governance of UK payment systems?*

Absolutely. We perceive no serious intent to consider the benefits of payment systems to all stakeholders, only those that the owners deem to be relevant. Despite being the leading issuer of UK prepaid cards we have never once been consulted by a payment system on any question of planning, strategy or development.

Question 9: *What do you believe is the appropriate governance structure for UK payment systems*?

We believe that each system should govern itself, but for each of the designated critical 'regulated' payment systems, the regulator should agree a set of stakeholders and key performance indicators in relation to them and should be sent the minutes of meetings and future plans to which it can object if they are not perceived to be meeting the targets the regulator has set.

Question 10: *How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.*

Please see previous sections.

Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*

We have concerns of the pricing of agency banking transactions such as automated credits, faster payments, direct debits etc. It seems to us that there is a high standard tariff which can then be negotiated down depending on any number of issues. Larger banks seem willing to offer free transactions to their own personal customers but charge significant per click charges to agency banks offering competing products. We believe some form of industry standard ' last mile pricing' could be introduced to put smaller players on an even keel. Link is a reasonable example of this where there is an independent annual cost study which determines the costs of operation which is then applied with a small profit margin as the de facto price for all participants. We are aware that there are incentive deals between Card Schemes and issuing and acquiring members and indeed we have one ourselves, however we have no idea whether these are offered on a fair and even basis as they are negotiated bi-laterally. We have seen evidence of Card Schemes being willing to break their own rules to protect volume.

Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*

See previous point re competition, no particular service-user experience issues.

Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

See previous sections. In the past we have had difficulty in opening bank accounts with major banks where we have Card Scheme rules imposed on us in relation to holding prepaid card balances under Trust Agreements around those accounts, which are simply too much trouble for big banks to bother with. Our earlier comments about inconsistency of policy of agency-providing banks also apply, even if you could persuade another bank to provide the very bespoke service that we use, would their policy team still support this a year later? There is also a considerable amount of bespoke integration work that is required in our case to link prepaid card systems to ACH, the idea of moving to another bank and re-doing all this work at huge cost and in parallel to existing running is impractical.

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:*

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

See previous section. We work with 22 partners in prepaid cards issuing e-money on Visa and MasterCard prepaid products, also credit and debit cards in some cases. Many of these partners themselves run multiple card programmes on behalf of third party brands. This is not quite "providing indirect access" as perhaps envisaged in the question, but it does enable niche players to bring cards to market in a way that would not be feasible if they all had to be regulated and direct members of the Card Schemes.

The partners range from programme managers such as Access Prepaid Worldwide, a wholly owned subsidiary of MasterCard managing multiple prepaid travel card programmes for third party brands, through direct relationships with corporates such as Aviva and Sodexo, through to B2B providers of corporate expense and settlement products.

The major risks in provision of this service are around compliance and business model. Over the 8 years we have been providing these services we have developed extensive knowledge of the compliance regime surrounding prepaid card products and we work very closely with our partners to ensure that products are launched correctly and then run and monitored effectively on an ongoing basis. Settlement risk is very low as we always hold the funds relating to the cards in our own accounts plus sufficient pipeline funds to cover any funds in transit. In terms of business model, there are many prepaid products that have launched and died relatively quickly. Whilst we would not incur a loss from such programmes, nevertheless they consume time and effort and do not lead to profit, hence we apply a number of selection criteria to partners based around the quality of their proposals, their commitment to the project, their experience and their financial strength.

The market for sponsoring banks of prepaid cards in the UK is thin, often the role is provided by niche banks passporting into the UK or by EMIs. The main issues driving this, we believe, are:

- Profits are low in relation to a big bank's £bns of expectation;
- Attention to detail needed is high, effectively you are putting your reputation in the hands of third parties and this requires significant human intervention and management;
- Bigger banks are really only interested in promoting their own brands rather than enabling third parties.

So whilst the technical barriers are low, the economic, experience and strategic issues can be significant.

Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*

See previous sections. We strongly believe that some form of managed access designed to be used by multiple smaller (regulated) players, without the need for sponsorship or oversight from another regulated entity, and with its own specific entry criteria, should be given serious consideration. This applies particularly to the ACH related systems.

Question 16: *Do you have any other comments regarding access?*

See previous sections.

Question 17: *What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?*

History has dictated that infrastructure has been designed for major mass market players. The economics of participation for small, niche players have been largely too challenging. This is reflected by the very poor quality of transmission type products offered outside of the major clearing banks. The way in which infrastructure is developed and managed needs to be cognisant of this and access mechanisms 'designed in' without the need for reliance on the vagaries of sponsorship. It is not feasible to expect small players to bear any costs in relation to the system outside of a reasonable per click fee and their own connectivity costs, anything else is simply a massive barrier to entry.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*

No comment.

Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*

See previous sections. Not being subject to policies and oversight by another regulated entity with potential vested interests is more important than improving technical aspects.

Question 20: *Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).*

See previous section. Discontinuities in fee structures are a major risk to small players. An economic model can be destroyed by such decisions, in the case of a niche player this could effectively end their product and business as they rarely have any or certainly multiple other lines of business to fall back on.

Question 21: *Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?*

See previous sections. Yes, there are many such factors including:

- Cost of access;
- Availability of access;
- Speed of access, integration and development;
- Continuity of service;
- Policy variation and vagaries by sponsors, Card Schemes and regulators.

Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*

The key issues are consistent, open and fairly priced access. With this capability and the issues of product design and distribution in the hands of innovators, there will be plenty of innovation using the existing infrastructure.

In terms of major system developments, removing the requirement of developing at the pace of the slowest participant and regulatory approval of the mid-term plans of all significant systems would be helpful.

Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*

See previous question. The job of the infrastructure should be to keep pace with the major global developments e.g. real time, mobile, capacity, speed, compatibility etc, with the connecting parties able to innovate in terms of product design and service offering. It is not the job of the infrastructure to design service offerings, only to facilitate them.

Question 24: *Do you have any other comments or concerns you would like to highlight?*

No.

Question 25: *What, if any, are the significant benefits you see regulation bringing?*

- Agreement of mid-term plans of major systems to pursue standards, interoperability and global competitiveness agendas;
- Dictating access for regulated entities without oversight by other regulated entities;
- Developing a last mile pricing concept where needed;
- Putting pressure on infrastructure providers who unilaterally change policy or pricing.

Question 26: *What, if any, are the risks arising from regulation of payment systems?*

Making bad decisions, inconsistency, lack of vision or understanding and failure to include all stakeholders could all cause damage. To some extent, over-regulation could hamper the industry if players only ever play to the level set by a regulator rather than try and exceed it.

Question 27: *How do you think regulation might affect your business and your participation in UK payment systems?*

We see the introduction of the new regulator as a very positive step and, over time, expect to see improvements to our business model in terms of consistency of policy and pricing, thereby improving our ability to plan; access improvements removing the need for oversight by another regulated entity; freedom to innovate and work with innovative partners in the knowledge that we can deliver and manage such service offerings for the long term without (potentially unreasonable or inconsistent) external dependencies.

Realex Payments- April 2014
Payment Systems Regulation - Call for Inputs

Basic information
Consultation title:

Name of respondent:	Realex Payments & Realex Financial Services Limited
Contact at respondent:	
Name:	Colm Lyon
Email:	colm.lyon@realexpayments.com
Address:	Realex Payments, London, www.realexpayments.co.uk One King Street, London W6 9HR, United Kingdom Tel: +44 (0)2031785370 Fax: +44 (0)2076917264

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	**Yes**
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other	
Please specify:	
Confidentiality Yes/No	
Do you wish any part of your response to remain confidential?	**No**

If 'Yes', please submit both confidential and non-confidential responses.

Realex Payments- April 2014
Payment Systems Regulation - Call for Inputs

1	Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.	Faster Payments
2	Where do you believe competition is effective or ineffective within UK payment systems?	Competition among banks is not effective when it comes to sponsoring access to faster payments.
3	At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?	If more banks where willing to sponsor access to faster payments, then more applications would be developed to replace cheques, cash etc.
4	What are the main factors impeding more effective competition at each level?	The banks are not incentivised to provide access – it is risky and scheme rules are not friendly.
5	What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?	Very little – rules, access rights and standards mostly. Leave the rest to the players.
6	Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.	Ownership in itself is not an issue, although it can be difficult to determine the different roles played by Vocalink and the scheme.
7	How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.	Should the operators of infrastructure also provide the gateway to access the service?
8	Do you have any concerns about the current governance of UK payment systems?	No. It is well run.
9	What do you believe is the appropriate governance structure for UK payment systems?	
10	How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints	We have (as a Payments Institution) a clearing agency agreement with a bank and to connect our systems we use DCA – a very dated and non real time connection. We tried to use a service, but when the cost of using this and the bank fee was added, our cost of processing was higher than that which banks charge today, so we attempted to connect directly, which is allowed, but no bank would sponsor us. As a consequence we have delayed our product launch for two years (a payment

	you may have in this regard.	account for personal and business users).
11	For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.	No – they basically invalidated our business model and while the Faster Payments say you can connect directly, no bank is willing to sponsor this. We only found one bank willing to sponsor FPMS, a commercial offering from Vocalink, but it was not a runner.
12	Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?	Yes – we have delayed our product launch. And changed our focus.
13	If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?	No – only one bank would sponsor us for FPMS and none for a direct connection. (We have an ISO host that already processes £20bn + per annum). We would like to certify directly to the core infrastructure and offer multiple applications to consumers and businesses alike.
14	Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes: • To whom do you provide indirect access? • What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access? • Are there any barriers to becoming a sponsoring bank?	No.
15	What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?	The risk sharing could be revised to make it easier for banks to sponsor PIs and also the attestation process is very dated.
16	Do you have any other comments regarding access?	It a challenge and while people individually are supportive in vocalink, bank and the scheme it has not happened and in the mean time banks and others have launched their mobile products.
17	What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?	I think you can ring fence the core to protect it, happy to pay for access and we would like to be a gateway to the core that others could connect to us, without the need to complete end to end certification every time someone joins.

18	What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?	The data in FP is very limited and an extended data set would be excellent.
19	What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?	Ask the scheme to revise the attestation process and find some scheme benefit for banks that sponsor PIs. Find out why none will sponsor direct connections.
20	Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).	When you have a sole bank supplier and sole gateway provider we had no commercial meat.
21	Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?	Other than access, no.
22	What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.	We believe that the most powerful way to generate innovation is competition.
23	What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?	I am not a fan of collective innovation as it can sometimes preclude others who are not at the table. Let the customer and the market decide.
24	Do you have any other comments or concerns you would like to highlight?	I would be happy to talk more about this as it has been going on for several years.
25	What, if any, are the significant benefits you see regulation bringing?	Access to FP.
26	What, if any, are the risks arising from regulation of payment systems?	
27	How do you think regulation might affect your business and your participation in UK payment systems?	I think it could help – we don't want to argue our way in, but work with the current players. I think it is important to create a supportive environment where those who wish to invest in payment solutions can do so and the market will pick the winners.

Realex Payments- April 2014
Payment Systems Regulation - Call for Inputs

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14th April 2014

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Payment Systems Regulation – Call for Inputs
Payment Systems Regulator
25 North Colonade
Canary Wharf
London E14 5HS

Dear Sir/Madam,

Payment Systems Regulation: Call For Inputs

I am pleased to attach a copy of the RBS response to the above consultation. We would be very happy to discuss any aspects of our comments with you, if this would be helpful.

Yours sincerely

Kevin Brown
Managing Director

Enc. Cover Sheet & RBS Consultation Response

Cover Sheet

Basic Information	
Consultation Title:	Payment Systems Regulation – Call for Inputs
Name of Respondent:	The Royal Bank of Scotland
Contact at Respondent:	Name: Andy Hamilton
	Email: hamilton.andy@rbs.co.uk
	Address: 7th Floor, 135 Bishopsgate, London EC2M 3UR

Nature of Organisation (select as appropriate)	
Infrastructure Provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	✓
Service-user	
Other payment provider (e.g. ZAPP)	
Third-Party service provider (e.g. ATM Distribution)	
Trade / Government / Regulatory Body	
Other Please Specify:	

Confidentiality	Yes	No
Do you wish any part of your response to remain confidential?		✓
If 'Yes', please submit both confidential and non-confidential responses		

Payment Systems Regulation – Call for Inputs

Response of The Royal Bank of Scotland plc to the Financial Systems Regulator

Introduction

RBS is pleased to have this opportunity to provide input as the PSR considers issues relating to the UK payments industry, and, in particular, competition, access, governance, ownership and innovation.

As one of the UK's largest banks, RBS provides a variety of payment services to personal, business and commercial customers, including agency banks.

The RBS, NatWest and Ulster Bank brands serve some 15 million customers through one of the largest network of branches and ATMs in the UK as well as through telephony, and mobile and internet banking.

We provide a full range of banking products, many of which feature use of payments as part of a wider offering – these include current and savings accounts, debit and credit cards, mortgages, pensions and numerous investment products.

We are members of Payments Council (PC), on whose Board we are represented, the main UK payment schemes (e.g. Bacs, CHAPS, Faster Payments, LINK, and the Cheque & Credit Clearing Company), and the major card schemes.

Our responses to the individual questions in the Call for Inputs appear below, and we will be happy to discuss those responses if it would be helpful. We would, however, emphasise one key point, namely the benefit to be derived from establishing a collaborative body to work with the PSR - bringing together the wide range of participants in the payments industry to take forward those non-competitive activities required to maintain and further enhance the UK's world-leading payments capabilities. As well as facilitating implementation of major projects such as Account Switching, or Mobile Payments, such a body would assist the PSR by providing technical analysis and a point of strategic co-ordination across the industry.

Responses to Individual Questions

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

RBS agrees that the schemes listed (i.e. Bacs, CHAPS, Faster Payments, Cheque & Credit, LINK, and the main three and four party card schemes) should all be considered for designation, thereby ensuring that the PSR has a view of key developments/issues across the UK payments market.

Whilst, in the case of the international card schemes, designation might appear to be less straightforward, we believe that it is to be encouraged – not only to ensure that, as far as possible, there is a level playing field, but also to ensure that scheme rules are aligned to legislation, and to encourage full compliance. In our view, whilst the international nature of some of the card schemes is not always recognised in domestic legislation, this should not present significant issues for the PSR.

It is important that, as and when new payment systems emerge, and gain traction, they are kept under review for possible designation in due course. Those entities which utilise the payments networks, yet operate independently, should also be considered for inclusion – to ensure, for example, that consumer protection (e.g. in areas such as fraud, or disputed transactions) is maximised.

It will be important for the PSR to show flexibility and understanding as it interacts with each particular system, given the distinct features of each – and to recognise that new market entrants (e.g. Third Party Providers) may require new approaches to be developed.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?
Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?
Question 4: What are the main factors impeding more effective competition at each level?

RBS believes that the primary point of competition should be between all types of Payment Services Providers (PSPs) - whether large or small, incumbent or challenger, banks or non-traditional providers – with as level a playing field as possible.

We believe that competition between PSPs generally works well in the UK, with there being little, if any, clear evidence that payment services users in other countries benefit from lower cost/more innovative payment offerings. Furthermore, as PayPal have demonstrated, it is entirely possible for a non-traditional player to enter and significantly grow market share – if new operators can access current/future infrastructure at reasonable cost and without discrimination, the benefits to end users are clear.

The role of simple domestic payment schemes should be to agree and enforce rules and standards, in a transparent manner, and to facilitate interoperability/reach. Competition between such schemes would risk duplication of capability, resulting in higher costs. In areas such as electronic payments, co-ordination at scheme level (e.g. between Bacs, FPS and CHAPS) has resulted in comprehensive, complementary service offerings at a competitive price. This partly reflects the fact that each of the schemes was originally established to meet differing user needs and requirements.

From a customer's perspective, it is not important which scheme is responsible for processing transactions, provided that their payment instructions are carried out accurately, securely and predictably. In fact, customer feedback is generally in favour of simplicity, e.g. favouring one card, which works globally, to a wallet of different items.

RBS also believes that competition between the international card schemes is effective. They each operate with distinct business models (each involving considerably greater complexity than the simple domestic schemes discussed above), but the competition between them promotes innovation with identifiable benefits for consumers, e.g. provision of electronic wallets (such as V.me) or contactless and mobile payments.

Whilst arguably not essential, competition between infrastructure providers is also to be encouraged. However, contracts need to be long enough to avoid discouraging investment in innovation, or in protecting the integrity of the system.

Amongst UK infrastructure providers, Vocalink has a unique role, where its evolution from a not-for-profit collective vehicle established by the industry has resulted in it becoming a critical national infrastructure, under the ownership of a number of banks/building societies. There is, however, little evidence that this has been to the detriment of users, and hence changing the ownership structure is likely to achieve very little. In fact, the presence of shareholders with a key interest in ensuring continuity of service has arguably been beneficial on a number of occasions.

Notwithstanding the OFT's finding (in their 2010 "Review of barriers to entry, expansion and exit in retail banking") that direct and indirect access to payment networks does not appear to raise insurmountable barriers to entry or expansion, RBS acknowledges that there are issues to be addressed around perceived barriers to access. We do believe, however, that in some cases the concerns highlighted by agency/challenger banks are more rooted in lack of clear information and/or understanding than lack of competition. This subject is currently being explored by Payments Council and their work, which we are supporting, is expected to result in a number of ‘quick wins’, and to propose further work to seek solutions where there are more complex issues (e.g. around settlement) which could potentially be a genuine barrier to entry. This is a good example of the industry’s commitment to encouraging competition, and tackling barriers to entry.

Overall, whilst competition should always be encouraged, in principle, it is important that any added regulation does not simply add to the already multi-layered governance structure in the payments industry – we would encourage regulation which seeks to stimulate and incentivise competition, rather than adding bureaucracy and cost.

We are keen also to emphasise the importance of ensuring that any proposed regulatory changes, including those with the aim of increasing competition, are subject to proper cost benefit assessments.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

All regulated network industries need some level of common rules and standards. This is particularly so for the payments industry, which needs an extensive set of rules and technical standards to be in place so that customers of one PSP can make and receive payments to/from a customer of another PSP in an effective and secure way. In order to achieve this level of interoperability and derive positive network effects, participants who otherwise compete strongly with each other need to come together to agree collaboratively on the rules needed to keep payments flowing effectively.

At an individual payment system level, the vehicle for this collaboration is most commonly the individual scheme companies, where, for example, members of the Bacs scheme agree how the Direct Debit Scheme should function in order to provide maximum benefit to corporates and consumers alike, or the LINK scheme, where members agree the basis on which customers of a competitor can use their ATMs.

In addition, it is critical that industry collaboration also takes place within an appropriate centralised body on topics that it would be difficult or inefficient to work on entirely separately within the scheme companies. Examples include the need to develop and debate a common strategic vision for the further development of the UK’s payment systems; the delivery of cross-scheme or cross-platform strategic initiatives (such as CASS and Paym); and the consideration of the case for future common standards (e.g. ISO 20022). A central collaborative industry body also has a key role to play in engaging with end-user representatives to understand their requirements; in representing the UK industry perspective when European regulators are proposing new legislation in the payments space; and in bringing together industry participants to address those issues such as fraud prevention, and cyber-security measures, which will ultimately be of benefit to all participants in the payments market, from infrastructure providers through to end users.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.
Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

RBS does not consider it to be essential to our position as a major player in the UK payments market to be a part-owner of the underlying infrastructure. Whilst (for historical reasons) we are a significant shareholder in Vocalink, we do not own the suppliers who provide our cheque clearing or credit card processing, nor are we shareholders in companies such as Equens, which process our electronic payments in Europe.

That said, very little evidence of real detriment arising from the current ownership structure has been brought forward. Indeed, the presence of shareholders with a strong interest in ensuring continuity of service has arguably been beneficial in the past, i.e. when additional funding has been required.

If there was considered to be a regulatory imperative to require a change of ownership, it would be essential to ensure that the new owners were not able to capitalise on the company's position to hike prices, or reduce service quality. Similarly, any new owners would need to be able demonstrate a long term commitment to future investment.

Additionally, it would arguably be necessary to introduce more competition in terms of infrastructure supply as a precursor to any significant change in current ownership arrangements. The sale of the current operator *per se* would not increase the number of credible competitors.

From a cards schemes perspective, RBS believes that the existing ownership arrangements work well. They provide simplicity and speed to market for Debit Cards and therefore provide benefit to the industry. Visa Europe is not a domestic payment scheme and is owned by the banks across Europe who are members. Visa UK Limited is constituted as a rule and interchange setting body for the domestic market. We do not perceive any problems with the ownership structure of this company as all UK participants have access. MasterCard is a public company incorporated in the United States. Crucially, RBS believes that the existence of the two major schemes ensures that there is competition and choice.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Significant changes have been made to existing UK payment systems governance over the last few years, such as appointing non-executive directors, encouraging participation in initiatives such as CASS, providing additional discussion fora etc. These changes have helped ensure that smaller/challenger/non-traditional players have the opportunity to influence developments.

Whilst acknowledging the need to reflect "public interest" factors, it is important that a balance is maintained, including ensuring that governance bodies also retain sufficient access to technical knowledge/expertise. Additionally, we believe it is also right to take account, from a governance perspective, of the fact that larger institutions meet the majority of the cost of payment systems.

Against this background, RBS believes the current governance arrangements have been largely effective. Whilst arguments are sometimes advanced that the bigger banks may somehow 'dominate' the UK payment systems, and thereby somehow create an uneven playing field, this is seldom supported by concrete evidence. Note, for example that all direct members of Bacs and FP pay the same item rate (however small their volumes), and that customers of LINK members have access to ATMs operated by their competitors, however few machines they operate themselves.

It has also been argued that the current ownership arrangements may result in a lack of innovation, or that developments move 'at the pace of the slowest' – but developments such as Paym and Zapp argue to the contrary. Even acknowledging that there was a degree of regulatory pressure to develop CASS, the participants in this successful/world-leading service include many smaller/challenger banks, some of which are not direct members of the payment schemes or Payments Council.

That said, there have been occasions where the current model has seen the schemes developing along parallel tracks – a situation which might have been avoided through enhanced communication, or a more coordinated UK payment strategy. This is one of the reasons why we are convinced that it is critical that collaboration also continues to take place within an appropriate new centralised industry body going forward.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

Whilst clearly recognising the new regulatory environment which will exist once the PSR is in place, RBS consider that certain key elements of the existing governance approach will remain valid, particularly in terms of the need for a strong collaborative focus.

In this context, we believe that the UK payment schemes continue to have an important role to play in setting scheme rules, managing adherence and changes to these rules, and facilitating and enabling interoperability/reach and competition between banks and other types of PSPs. Whilst supportive of recent moves to strengthen scheme resources, we are keen to avoid the risk of schemes seeking to broaden their remit to the extent that they would start overlapping with each other – as this risks significant duplication of functionality, resulting in higher costs.

In addition to the role of the schemes, it is critical that industry collaboration also takes place within an appropriate new centralised body (a logical successor to the Payments Council) on topics that it would be difficult or inefficient to work on entirely separately within the scheme companies. (See our Answer to Question 5 for examples of the activity areas that we would see taking place within this body.)

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

RBS is a member of all the UK payment systems and accesses these directly.

As a member, RBS owns a share of each scheme management company and contributes proportionally to the ongoing management and development costs of each payment scheme.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Broadly yes – whilst acknowledging that the standards and rules for the different schemes are complex these are important in ensuring the secure and efficient operation of payments.

We would be concerned if well-intentioned moves to ensure a level playing field go too far in the other direction (e.g. so that a vote taken by a majority of smaller players could impose an excessive cost burden on those larger participants who cover the bulk of cost).

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

No.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

N/A

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- To whom do you provide indirect access?
- What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
- Are there any barriers to becoming a sponsoring bank?

We are a major provider of agency services, with c130 customers across the various payment schemes. Those customers range from PSPs wishing to offer a full payments service (e.g. including near real-time payments) to their clients, through to smaller UK Credit Institutions and offices of overseas banks making only occasional payments on behalf of their overseas clients. We are presently in discussion with a number of PSPs about the provision of agency services.

During 2014 our largest CHAPS indirect participants will become CHAPS members, in accordance with the CHAPS Company/Bank of England initiative to reduce tiering and improve financial system stability.

The major risks of providing agency access include:

- Settlement risk - if the indirect participant does not have sufficient liquidity they may be unable to settle their clearing obligations with their sponsor.
- Money laundering – a clearing sponsor is reliant on the indirect participant undertaking robust identity and monitoring activity to identify and tackle potential money laundering activity. Clearing sponsors mitigate this by providing access only to firms with appropriate FCA authorisation, giving assurance that the indirect participant has appropriate AML strategies and processes in place.
- Operational risk
  - Risk of non-compliance with scheme rules, standards etc by the indirect participant. The sponsor bank is responsible for ensuring an indirect participant's compliance but in practice has limited ability to influence.
  - Provision of channels to enable indirect participants to connect to our computer systems to transmit and receive payment messages. Demand for service availability restricts time available for systems maintenance and extends the impact of a system outage.
  - Ensuring that information exchange and settlement happens in a timely manner to ensure that indirect participants can meet their regulatory obligations (e.g. PSRs).
  - Fraud – particularly in the Cheque and Credit Clearing.

Key costs for a sponsoring bank include:

- Development and maintenance costs of providing channels to exchange payment messages and information with indirect participants are substantial.
- The cost of operating a paper clearing service given the overheads involved and rapidly declining cheque usage.

It is worth noting that in addition to fees payable to their sponsor for the provision of access, indirect participants incur significant costs in purchasing/operating payment technology solutions and providing operational support to their customers.

Whilst we do not currently perceive there to be barriers to the provision of agency services, this is a competitive area of the market, and it can be difficult (e.g. in the face of competing, often regulatory-driven, demands) to ensure that service features are kept at the leading edge. Any moves to regulate product features, service standards, or even prices, could be a major disincentive to sponsoring banks.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Not at this stage. The work being undertaken via Payments Council to review the issues raised by agency/challenger banks is expected to provide a number of potential improvements to address issues such as information asymmetry. It remains to be seen whether ideas such as a second membership tier, or development of an "agency bank access" model, are necessary/cost justified.

In due course, it will be appropriate to consider the impact of PSD2, which will, for example, bring Third Party Payment Providers into the scope of payments regulation for the first time.

The Payments Council's Clearing Codes, Rules and Procedures set out the types of institution eligible to participate in the UK clearings. These were revised in 2013 to include all Payment Services Providers as defined in the PSRs as being eligible for membership.

Question 16: Do you have any other comments regarding access?

Access should be based on robust criteria for entry which, whilst being transparent and promoting access to all on an objective and non-discriminatory basis, ultimately need to ensure the integrity and security of the payment systems are protected for the benefit of service users.

Bacs, CHAPS and Faster Payments are designated systems under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 which control access in order to maintain stability in the financial system. This needs to be considered when making potential changes to access.

We believe that the main growth in indirect participation will be via Faster Payments, as a new entrant can use proprietary channels provided by their sponsor to send/receive payment messages, and given the anticipated growth arising from innovations such as mobile payments.

The key barriers to increasing the number of indirect participants are the technology development and maintenance costs a new participant will incur, even if it can link into its sponsor's proprietary systems, and the need for them to ensure compliance with increasingly rigorous regulation. New entrants also need to develop and maintain their own operating model and banking/payments engine.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Whilst it will be appropriate to respond to the findings of studies such as that being undertaken by Payments Council into Access to Payment Systems, there are no fundamental changes, over and above work already in hand, that we would regard as imperative.

Looking further forward, and noting the recent focus on P2P and faster payments there could be a case for the major card schemes to investigate the case for moving to single messaging rather than the concept of authorisation, earmarking and clearing. Given the focus on high value contactless payments there could also be a case for moving in line with Europe in terms of allowing Online PIN to be used at Point of Sale.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Payments Council is currently reviewing, across the whole range of payments system users (Government, regulators, schemes, infrastructure suppliers, PSPs and customers), the potential benefits and disbenefits of making changes to message standards – with particular reference to ISO20022.

Whilst a strong supporter of this review, RBS considers that, before engaging on a major programme to introduce ISO20022, particularly with aggressive timescales, it is important to ensure that potential benefits to some users are not outweighed by unnecessary cost/inconvenience to others.

All other things being equal, migration to international standards would be an enabler of enhanced competition at an infrastructure supply level.

RBS is supporting the work at Payments Council, which is expected to report in June - the conclusions will be shared with HM Treasury and the PSR.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

See responses to Q14/15.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

For a bank such as RBS, there is always a desire to innovate, both to enhance the products we offer, and thereby to meet the expectations of our customers, and to ensure that we remain competitive in comparison with our rivals, including challenger banks, non-traditional providers etc. This is true even in those areas of the market (e.g. personal customers whose accounts are conducted in credit) where innovation may not immediately lead to enhanced income streams.

It is our belief that interchange provides an effective incentive to innovate and to further develop the card payment market collectively for the benefit of all participants, for example in moving to secure technologies both at point of sale and in eCommerce environments.

As events unfold at a European level on interchange fees, innovation in card products and services will likely diminish, unless costs inherent to running card schemes and fund innovation are recouped elsewhere (e.g. annual fees for consumers).

A key consideration needs to be the alignment of the payments services regulatory agenda, to avoid unnecessary costs and unintended impacts on innovation and customer outcomes. Ultimately, the incentive to innovate is driven by market developments and the desire for members to remain competitive in the market place.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

The principal barrier to innovation is often the participants' (both PSPs and infrastructure providers) finite capacity at any point in time to make changes to systems without impacting stability – and the extent to which that capacity is taken up by mandatory changes driven by legal/regulatory requirements.

The risk that collective developments can sometimes end up moving 'at the pace of the slowest' is recognised, albeit that recent initiatives (e.g. Paym) have sought to avoid this by facilitating a phased launch approach.

These are network systems requiring deep co-operation and coordination across many levels for them to work effectively and efficiently. Therefore, it is difficult for individual providers to ensure they can retain the commercial benefit from the high costs of designing and developing unilateral innovation.

In addition, innovation can sometimes be hampered by differences in interpretation of (or implementation against) regulatory requirements. For example, the euro-area migration end-date for SEPA had to be extended recently due to the fact that not all market participants (including many corporates) were ready in time for the original 1/2/2014 end-date.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

RBS would like to see a greater degree of certainty in terms of the 'change' agenda. We would ideally prefer to be able to plan change over a 3/5 year horizon, keeping to a minimum the incidence of urgent additional requirements from regulators (e.g. the cheque imaging announcement made by Government over the Christmas period).

It is highly desirable that future regulatory driven change is accompanied by a more rigorous cost-benefit analysis process, to ensure that uncosted political initiatives do not result in loss of focus on other, potentially more beneficial, innovation.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Collectively driven innovations such as CASS can ensure consistency of customer experience, maximise beneficial network effects, ensure interoperability, and avoid duplication of costs. They also bring the opportunity to launch new services on a co-ordinated basis, avoiding potential confusion from a service user perspective.

It is important to ensure, however, that we continue to avoid 'moving at the pace of the slowest', and encourage innovations such as Zapp and V.me that are supplier (rather than collaborative/buyer) driven.

Whilst keen not to discourage 'unilateral' innovation, it is important to remember that what can appear relatively straightforward (i.e. because there isn't a need to seek agreement from a wide stakeholder group) often has the downside of reduced reach, thereby making success likely to be more difficult to achieve.

It is also worth noting that whilst payment systems and infrastructure may require collaboration, facilitating the customer experience and interaction with the payment system is something that each individual member will need to develop unilaterally in competition with other payment businesses (e.g. as seen with mobile payment initiatives).

Question 24: Do you have any other comments or concerns you would like to highlight?

It would be helpful to understand at an early stage the detailed scope and remit of the PSR, and in particular how the PSR's approach will fit with the broader regulatory landscape in the UK and the EU.

By way of example, it is currently unclear to what extent cross-border / non-Sterling payments, and the specific requirements (e.g. in respect of anti-money laundering regulations) that apply to such payments, will fall within the remit of the PSR.

To this end, it would be very helpful if early clarity could be provided on the key scope aspects of the PSR's Memoranda of Understanding (MoU) with the FCA, the BoE and the PRA (as these are developed). This would greatly help the market in developing an understanding of how the PSR intends to work with other regulators in discharging its core functions.

Question 25: What, if any, are the significant benefits you see regulation bringing?

See response to Q22 re increased certainty around the change agenda, and greater focus on costs/benefits of proposed 'mandated' changes.

Regulators can provide informational and coordination benefits, e.g. by providing the structure and means for making costs and benefits more transparent. They can also encourage change within the system that may be difficult to facilitate unilaterally or collaboratively. Potentially, they could also have a role to play in facilitating payment providers to engage in unilateral innovation. One way to do this is for the regulator to provide a framework or method whereby providers can gain commercial benefit to recoup the cost associated with innovation.

Question 26: What, if any, are the risks arising from regulation of payment systems?

- Unintended consequences – for example if efforts to 'improve' the market for one set of stakeholders results in loss of incentive for others (e.g. provision of agency bank services), or if regulation is too detailed and/or focused on promoting particular technologies, which could have the effect of limiting future opportunities for innovation and market development.
- Competing objectives / conflicts of law – it is important that new payments regulation focused on promoting competition and innovation is consistent and aligned with existing regulatory requirements on other aspects of payments processing e.g. in the areas of AML and sanctions screening.
- Given limited capacity to change payment systems without introducing unacceptable risk, the failure to properly consider opportunity cost (i.e. care is needed to ensure that regulators don't favour 'popular'/short term changes over longer term developments which could ultimately drive greater benefits for users).
- Enforced 'competition' between schemes would add costs, but not necessarily drive commensurate benefits.
- Enforced changes to infrastructure ownership structures may result in reduced access to additional capital, particularly in the event of underperformance.

The payments system is arguably the nation's money supply. Hence for all participants in the payments market, the main objective must be ensuring that the system is secure, stable and convenient. All other considerations, such as innovation, while important, must be secondary to ensuring the system works continuously and efficiently and that customers feel their money is secure. While we see benefit in regulators facilitating information, transparency and coordination, and even in working with providers to build a framework that encourages innovation, it is essential that nothing is done which undermines stability in the payments system as the primary objective of all participants.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

We are, and expect to remain, a major provider of payment services to a full range of UK customers and as such are keen to engage with the PSR in connection with its future activities. It will be important to ensure that the PSR's interventions are calibrated so as to have a positive net effect on the UK payments market, and avoid potential unintended consequences such as reducing the incentive to offer particular products and services to some customer segments on an ongoing basis.

14th April 2014

Santander UK: "Payments Systems Regulation: Call for Inputs"

Santander UK plc (Santander UK) enclose our response to the questions detailed in the '***Payments Systems Regulation: Call for Inputs'*** document, published on 5 March 2014 by the Financial Conduct Authority.

As a **scale challenger** in the UK banking market, Santander UK welcomes measures which improve competition, innovation and the experience of customers. We are therefore supportive of a proportionate and forward looking new regulator of UK payment systems. Regulation will ensure a consistent focus on consumers, access and control, across an integral and sophisticated UK infrastructure.

The Payment Systems Regulator will ensure a consistent focus on consumers, access and control, across an integral and sophisticated UK infrastructure. It should seek to build upon the improvements made in recent years. The UK has one of the most advanced and innovative payment systems in the world, and this is largely due to the industry coming together in collaboration to achieve desired outcomes – whether the driver has been regulatory or otherwise. In the last decade, we estimate the industry has spent over £3 billion on designing and implementing major new services and innovations for UK customers including: the Faster Payments Service; the Mobile Payments Service Paym; and the Current Account Switch Service.

The Faster Payments Service (FPS) is understood to be one of only eight in the world providing real-time payments, meaning that the payment goes from customer to customer in less than a minute. Only five of these countries, including the UK, provide availability of faster payments to customers 24 hours a day, 365 days a year. FPS covers 97% of the UK's retail payment accounts, enabling the majority of customers to benefit from the convenience of this service on a daily basis.

The Mobile Payments Service, Paym, will enable customers to make account to account transfers from April 2014, using only a recipient's mobile phone number instead of their account details - by the end of this year, financial institutions covering 90% of the UK's current account market have committed to being part of the service, with more already in discussions to join at a later stage.

And while other countries offer switching services we are not aware of any that offer a package as comprehensive, fast and consumer friendly as the UK Current Account Switch Service (CASS). Its sophistication is also ahead of other UK industries, such as mobile phone or energy providers, where customers switching may suffer a break in service, or remaining credit for pay as you go customers may be lost. Energy switching can take up to five weeks with the onus on the customer to complete many actions themselves.

Santander UK is a direct participant with a circa 5% share in aggregate across all the different UK payment systems. We do not currently provide agency agreements to other banks seeking access to payment systems due to the complexity required to build a commercial model to support this service line. Smaller firms generally, but not exclusively, go through the big four banks, who each own a greater share of UK payment systems ranging from between 18 and 23%. Santander UK does however act as a sponsor to Corporate clients as part of our standard commercial proposition.

Our response includes three suggestions:

1. We welcome initiatives to improve **access and transparency** of payment systems for smaller banks. This should consider the need to have transparency over the services provided, the cost and the benefits provided by the agency bank in terms of collateral and settlement risk. In terms of open access this should address differences in terms of access to schemes versus integration of systems into the central infrastructure. Any review should take the form of a proportionate approach which recognises significant investment made to date and balances against creating new forms of settlement risk.

2. **Collaboration** to achieve world leading innovation in payment systems is crucial if we are to build an infrastructure fit for the 21st Century consumer. This should build upon the success of recent significant projects such as Faster Payments; the Current Account Switching Service; and live from 29 April, Paym. These cross industry developments support millions of customers in transferring money or switching bank accounts quickly, efficiently and safely every day, and are unrivalled in other EU or international countries. To reduce complexity and improve efficiency of the governance of the central payments infrastructure we have suggested adjustments to Scheme governance to promote consistency and delivery in para 13.

3. Finally, we note the unique and challenging position of this regulator given its objective regarding **innovation**. This direct mandate differs to other regulators for whom the objective regarding innovation is usually to deliver market conditions which then drive innovation. To this end we suggest the Payment Systems Regulator considers the need in due course for a delivery body to govern and deliver the regulator's vision and engage with schemes on the technical process by which it can do so, as discussed in para 12.

We hope you find our response to the Call for Inputs useful. We have grouped our answers to your questions by topic and would welcome the opportunity to discuss the contents. We will be in touch to arrange a meeting in due course.

Santander UK plc
15 April 2014

Payment Systems in the UK

Question 1: *Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.*

1. We consider all UK payment systems should be designated to maintain consistency and a level playing field. This would include: Bacs; CHAPS; Cheques; Faster Payments; Link. We would also recommend the inclusion of Visa and Mastercard.

Competition in Payment Systems

Question 2: *Where do you believe competition is effective or ineffective within UK payment systems?*
Question 3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*
Question 4: *What are the main factors impeding more effective competition at each level?*
Question 5: *What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?*

2. Significant collaboration at the centre of payment systems supports the creation of a level playing field for all, though the creation of one common tool. Recent, successful examples include the Current Account Switching Service (CASS) or Mobile Payment.

3. There is potential for competition to improve by offering institutions that do not want to participate in the more open market a clear and simple proposition to transact. This could be achieved through greater flexibility in the Faster Payment model.

4. In comparison to overseas markets, the wholesale pricing for direct access to UK payments is competitive. For agencies and corporate a more open and transparent market will support driving onward cost down, with the perception of a poor deal being removed altogether if the core cost is known to participants in the market.

5. In relation to factors impeding competition and collaboration, the current fragmented model by which payment systems operate is preventing rapid, flexible and low cost improvements to support a more competitive environment for end customers.

7. A key risk to mitigate with the development of any additions or changes to the payment systems infrastructure is to ensure a collaborative solution which does not drive fragmentation or unsustainable cost models.

Ownership

Question 6: *Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.*
Question 7: *How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership*

8. The current infrastructure and schemes are critical to the effective operation of UK plc, ensuring the day to day transaction experience is maintained and fit for purpose. Although there is no significant benefit to ownership, the integrity and stability of the central services are well maintained as a result of banks' ownership and each firm having a key stake in the efficient running of the system.

9. While it is possible to move to a different ownership model, the investment required may lead to significant increase in costs for all as any third party ownership would need to generate a profit. There are also risks associated with foreign ownership for example, such as Cyber-Security, and a potential for divergence from collaborative aims or joined up policy making by UK plc.

10. One option which could be considered and which operates internationally would be to look at a Central Bank owned model which functions well – for example, the Bank of Spain manages the Spanish payment systems.

Governance

Question 8: *Do you have any concerns about the current governance of UK payment systems?*
Question 9: *What do you believe is the appropriate governance structure for UK payment systems?*

11. The current stakeholder model governing UK payment systems should be expanded to encourage wider engagement and representation from participants or those who wish to gain or widen access. As with any scope change, it is of fundamental importance for the integrity of the payments systems to be maintained while widening reach and access.

12. The appropriate governance structure should be supported by a delivery body which would govern the implementation of the Payment Systems Regulator's vision and stipulations on the shape of payment systems. Any delivery body

should also have a specific remit to engage with Schemes and firms to define and deliver the complex practicalities which would accompany any tweaks or changes to existing systems. We do not see a future for the Payments Council in this space, but we do see the benefits of a body to facilitate cross industry stakeholder engagement and analysis, on issues ranging from European legislation to the UK regulatory, governmental or legal environment.

13. Santander UK does view it as appropriate to review the industry structure and consider consolidating Schemes into a smaller number. For example, this could include a 'Wholesale' and 'Retail' model to support innovation driven by one MD covering each overall market segment. (At present there are currently MDs for each of Bacs, Faster Payments, CHAPS and Cheques, who have competing interests and by nature support a silo-approach.) This would simplify the structure and enhance cooperation and consistency across the different systems.

Access

Question 10: *How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.*
Question 11: *For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.*
Question 12: *Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?*
Question 13: *If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?*

14. Santander UK is a direct participant in the UK payment systems. The costs are appropriate to support the current infrastructure, and are absorbed as an essential and basic cost of doing business in the UK. We have no fundamental issues with direct access terms and conditions.

15. We have not historically provided a fully fledged agency service (given our position as a challenger bank). At this point in time this does not support our existing strategy and would require a diversion away from our core proposition.

Access (continued)

Question 14: *Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:*
• To whom do you provide indirect access?
• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?
• Are there any barriers to becoming a sponsoring bank?
Question 15: *What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?*
Question 16: *Do you have any other comments regarding access?*

17. Santander UK sponsors our Corporate clients into Bacs. The underwriting of risk for corporate businesses to access the Direct Debit Scheme, provides customers with significant benefits whilst reducing systemic risk albeit the bank takes responsibility for these risks, e.g if a Corporate client becomes bankrupt, the sponsor covers the liability of Direct Debit indemnity claims. This level of risk needs to be factored into pricing arrangements.

19. In relation to other comments, we would emphasise that Santander UK agrees access needs to be more open, but responses to this Call for Inputs need to be very carefully considered, as the integrity, stability and risk considerations for widening access should underpin any final decisions.

Infrastructure

Question 17: *What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?*
Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*
Question 19: *What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?*

20. Improvements to the existing infrastructure would be for Schemes to function in a collaborative manner. This could be achieved through the governance suggestion set out in para 13, which we believe would support a coordinated

and consistent approach to the delivery of UK payment systems which operate in the interest of all users and end consumers.

21. Improving choice of access for smaller banks could also be of benefit. A simplified model for smaller banks would increase transparency and support a level playing field. It would additionally aid service consolidation, however, we would stress this suggestion may not be a silver bullet. It would potentially mean a significant cost and a fast delivery would not be possible.

Innovation

Question 20: *Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).*
Question 21: *Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?*
Question 22: *What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.*
Question 23: *What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?*

22. Balancing innovation against a sustainable business case is challenging in the complex payment infrastructure environment and the need to ensure maximum reach and a level playing field. For example the delivery of recent innovative projects such as the Current Account Switching Service required an investment of circa £750 million.

23. Costs to change central processes/infrastructure by their nature are significant to ensure all accesses and participants needs are taken into account.

24. The UK payment systems infrastructure is profoundly important to UK plc. The complexity of financial systems cannot be likened to other sectors or infrastructures. In this space a collective approach to innovation and implementation is vital so that the level is consistently being raised across the board, leading ultimately to better customer outcomes. Consumers need an infrastructure which is joined up and functions faultlessly no matter where and what their purchase.

25. There is space for both collaborative models (such as PayM) and individual models (such as Zapp), which provide examples of each approach in the same marketplace. Further competitors are entering into this innovative arena such as PayPal, Google, and Amazon. We consider this is the most appropriate way of meeting the needs of a 21st Century consumer.

Conclusion

Question 24: *Do you have any other comments or concerns you would like to highlight?*
Question 25: *What, if any, are the significant benefits you see regulation bringing?*
Question 26: *What, if any, are the risks arising from regulation of payment systems?*
Question 27: *How do you think regulation might affect your business and your participation in UK payment systems?*

26. We welcome the open manner with which the Payment Systems Regulator is engaging with the industry. It is important that responses from all stakeholders across the board are considered and the UK's world leading payments landscape is not disrupted to meet the interests of the few. It is important to ensure that changes generate economically fair and/or efficient outcomes for all stakeholders.

27. Regulation should ensure a consistent focus on consumers, access, control and provide an open and transparent view of payment services. This approach should be underpinned by proportionality and an appreciation that controls are in place to maintain the integrity of the system.

28. It is also critical that at this juncture in the development of the UK's overarching regulatory architecture, the Payment Systems Regulator works in a joined up manner with the Bank of England, Prudential Regulation Authority, Financial Conduct Authority, Competition and Markets Authority – and with HM Treasury (the latter in relation to future policy proposals). The level of regulatory change is considerable and increasing with an associated requirement for increased investment and allocation of resource and management time. While we support proportionate, forward looking regulation that underpins good customer service and a healthy economy – demands on firms must not become so extreme and far reaching that they compromise economic growth and innovation.

[ENDS]

SWIFT Response

Payments Systems Regulation

Call for Inputs

15 April 2014

Foreword

SWIFT thanks the Financial Conduct Authority for the opportunity to respond to the Call for Inputs.

SWIFT is a member-owned, cooperative society headquartered in Belgium. SWIFT is organised under Belgian law and is owned and controlled by its shareholding Users, comprising over 2,300 financial institutions. We connect over 10,500 connected firms, across more than 210 territories. A fundamental tenet of SWIFT's governance is to continually reduce costs and eliminate risks and frictions from industry processes.

SWIFT provides market infrastructures (including UK payments market infrastructures), banking, securities, and other regulated financial organisations, as well as corporates, with a comprehensive suite of messaging products and services. We support a range of financial functions, including payments, securities settlement, reporting, and treasury operations. SWIFT also has a proven track record of bringing the financial community together to work collaboratively, to shape market practice, define formal standards and debate issues of mutual interest.

We thank the Authority again for the opportunity to comment. Please do not hesitate to contact us should you wish to discuss this further.

Natasha de Terán

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Detailed Comments

Data Standardisation

SWIFT's comments relate to the issue of messaging standards, which are raised in Question 18 of the Call for Inputs.

Question 18: *What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO 20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?*

We set out below some of our perspectives on ISO 20022, and its adoption, which we believe might be useful to bear in mind when considering how UK payments might wish to further leverage this standard for messaging.

- ISO 20022 is an open standard, which can be freely implemented, which has an open governance process and which no single entity controls it. It has an established process for maintenance and evolution;
- ISO 20022 covers all payment instruments (credit transfer, direct debit, e-mandates, etc.), with a full end-to-end message set, including: payment initiation, status reporting and account reporting between parties in the payment chain. It can cater for additional functionalities such as: enhanced remittance information and regulatory reporting components. Information included in ISO 2022 messages is highly structured;
- ISO 20022 is widely adopted in the financial industry. Central banks and market infrastructures across the world are increasingly using the standard, with around 70 payments and securities clearing and settlement systems adopting ISO 20022 today;
- ISO 20022 is the standard used for messaging in strategic initiatives such as the Single Euro Payments Area (SEPA), and from 2015 in the ECB Target 2 Securities initiative;
- ISO 20022 adoption enables greater transparency, as well as alignment between payments systems, a consideration that is particularly pertinent given the increased adoption of ISO 20022 for payments (e.g. T2/Euro1 in Europe, the Swiss payment systems, and payments systems in Canada, Australia, Japan, etc.). Greater adoption of ISO 20022 will provide the opportunity to further enhance data consistency and transparency across payments systems;
- ISO 20022 covers all business areas, including: securities, payments, cards, etc. enabling higher levels of automation and interoperability, reducing overall industry costs and lowering barriers to entry for scheme participants;
- ISO 20022 applications include high and low value schemes, as well as domestic and cross-border schemes; increased adoption of ISO 20022 will facilitate more interoperability between all such schemes, as well as facilitate switching for consumers.

Overall we believe that ISO 20022 offers a valuable common process and model for defining and structuring financial data, and an open governance process that ensures a level playing field for standardisers and users. It also offers expert international scrutiny of submitted content. The adoption of ISO 20022 for payments messaging, particularly by payments market infrastructures, is now being seen in a growing number of markets, with consequent opportunities for increased automation and interoperability.

As a final note, we would observe that migrating a community to ISO 20022 can take a significant amount of time. Such a migration should therefore be carefully planned, including by setting clearly communicated milestones.

All of the above should, we trust, provide useful background when considering how the UK payments markets could evolve in terms of any future adoption of ISO 20022.

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techUK submission
FCA Call for Input
Payment Systems Regulation

Basic information	
Consultation title:	Payments Systems Regulation, Call for Inputs
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Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	Trade association

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		✓
If 'Yes', please submit both confidential and non-confidential responses.		

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techUK submission
FCA Call for Input
Payment Systems Regulation

24 March, 2014

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About techUK

techUK represents the companies and technologies that are defining today the world that we will live in tomorrow. More than 850 companies are members of techUK. Collectively they employ more than 500,000 people, about half of all tech sector jobs in the UK. These companies range from leading FTSE 100 companies to new innovative start-ups. The majority of our members are small and medium sized businesses. For more information about Intellect please visit: www.techuk.org

Introduction

techUK welcomes the opportunity to reply to the FCA 'Call for Inputs' on Payment Systems Regulation

techUK's Financial Services Programme provides a neutral forum for stakeholders across the financial ecosystem – from technology innovators to banks, academia and regulators - to consider the technological and operational realities of the financial system. The purpose is to ensure that evolution and reform across the financial system is informed by an appreciation of the technological 'art of the possible' – to the benefit of the banks, their customers and the wider economy.

techUK's response to the FCA 'Call for Inputs' is based on the experience and expertise that its members bring to the payments sector. Much of the technology that underpins the UK's payments infrastructure and that which underpins the banks that operate within it – and indeed the payments mechanisms that allow end users to conduct transactions – is provided by techUK's members.

Technology plays a fundamental role across the UK, and indeed global, payments system – that is a given. However, techUK believes that in designing a future regulatory approach, there needs to be a consideration of both the constantly changing possibilities that technology brings to the payments system but also, significantly, the limitations that current technology infrastructure has brought to bear. In developing the regulatory approach and design of the Payments Systems Regulator (PSR), and indentifying early priorities for action, it is crucial that technology remains a key consideration in terms of the remit of the regulatory authorities, the expertise that it employs and the resource that it can call upon.

Questions

PAYMENT SYSTEMS IN THE UK

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other that the UK payment systems listed above, please explain why.

techUK broadly agrees with the listed payment schemes to be designated for regulation by the PSR (CHAPS, Bacs, Faster Payments [FPS], LINK ATM Network, Cheque and Credit Clearing Company [C&CCC], three and four party card schemes). However techUK believes the PSR should closely monitor the usage of new and emerging payment systems and services, and review their impact on competition, innovation and service-users when considering whether to expand the scope of regulation.

A delicate balance must be struck between regulation and innovation. Too much regulation threatens to stifle innovation and open accessibility, as the owners of the schemes would have less funds available to improve the service offerings, and maintain pace with changing payment value chains. However, as usage of new and emerging payments services grow, it may well be necessary to adapt existing environments to support them and ensure ease of access.

The soon to be launched faster payments mobile proxy service (Paym) provides one such example. This will be the first truly mobile banking facility launched in the UK that has significant reach – offering the ability to transfer funds between 90% of UK bank accounts by using a mobile phone number as a proxy. As mobile communications continues to grow, the mobile proxy service has the potential to revolutionise end-user behaviour, with far reaching impact on the payments value chain. However, this will depend on the gradual increase in its usage.

techUK believes it is important that the PSR is sufficiently equipped to take an agile evidence based approach in assessing which aspects of the UK payments industry should be considered for designation. It is also important that there are plans in place to ensure central systems remain non-competitive yet evolve to keep pace with the changing payments landscape.

COMPETITION IN PAYMENT SYSTEMS

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

The current approach has been effective to the extent that the UK has invested in centralised services for non-competitive payments processes (Faster Payments, Paym). However a challenge remains in how these services can be made available to new entrants in a cost effective and timely manner.

Competition has not been effective in providing Tier 2 and 3 banks and building societies access to payments infrastructure. Although Tier 1 banks adhere to current regulations, the level of service enabled to customers of smaller banks can be below that of larger banks due to access restrictions. This hinders innovation in payments.

Direct access to FPS, or a more transparent and fungible service from Tier 1 banks to indirect participants could rebalance this. However, this requires consideration of how FPS infrastructure can be made affordable to smaller financial organisations.

It is important to resolve these challenges if the UK is to remain at the forefront of driving innovation within the payments market.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Competition can drive benefits for service users across multiple levels. However, an element of caution is needed to ensure that appropriate investment remains in centralised services for non-competitive payment processes.

The relationship between direct and indirect participants requires particular attention, as outlined in question 2.

The channel layer is particularly important in driving benefits to service-users. Current and emerging technologies can make it easier for service users to access the payments environment and make purchases or move money. There are significant opportunities to further extend the services associated with retail purchases, both in store and through digital channels, point of sale (POS), and simplified and more cost effective card payment mechanisms.

Question 4: What are the main factors impeding more effective competition at each level?

Many of the factors impeding effective competition at each level relate to the current technology framework, and how new entrants and in some cases existing users, gain access to the payment system. As outlined in response to question 6, the ownership structure is a major impediment to competition.

Functionality of the payments system is delivered to meet the needs of its key funders or owners. Once this functionality is delivered, there is no or little appetite to invest further to provide access and functionality for other service users. Change is extremely difficult, costly and, given the mission critical nature of the payment systems, is widely considered too high a risk.

However, much of the technology infrastructure that underpins the payments systems was not designed to support the newer, more agile, mobile orientated, environment, which makes it difficult to innovate and deliver a robust mainstream solution that will be attractive to the majority of service users. This has restricted the functionality that new entrants can offer to their customers, which can impact negatively on their competitiveness

Question 5: What functions do you think need to be performed collaboratively in the industry? How can this best be achieved.

techUK believes that a collaborative approach is necessary to address longer term shared infrastructure challenges that negatively impact upon consumers and the wider economy. Examples are noted below.

<u>Digital Modernisation Strategy:</u>
The technology platforms that support every function within financial institutions have in many cases stopped being a competitive advantage and are now widely acknowledged to be a burden – restricting financial intuitions' ability to meet the expectations of their customers, the regulators and contribute fully to an increasingly digital economy.

As outlined in a recent techUK paper[1], this is the result of a technology infrastructure that is inefficient, overly complex, opaque, and as such, is a barrier for cost effective and efficient business change.

<u>This is the single biggest hindrance to the delivery of innovative products and services across financial services, including payments, and a significant cause of operational risk.</u>

Integrating the technology that enables new services into an existing infrastructure is a major challenge that can pose significant operational risk, and has resulted in wide scale systems outages (often impacting on the UKs payments systems). As a result, new services tend to be 'bolted on', adding further to the complexity, delaying the delivery of new innovative services, and further increasing operational risk. Renewing this infrastructure by 'ripping and replacing' systems is a costly and complex challenge, and given the mission critical nature of many financial services, such as payments, is not a viable option. This along with the mission critical nature of many financial services, such as payments, means that 'rip and replace' is not a viable option.

The technology industry itself has undergone something of a paradigm shift in recent years and now presents new opportunities to address the complex challenge posed by financial infrastructure renewal. 'Everything as a service', the cloud and existing e-infrastructure in the UK may offer an opportunity to 're-orientate' the structure of the financial system without having to 'rip and replace' core systems.

This necessary progression, however, will not happen under the financial services industry's own volition and demands a collaborative approach from all key stakeholders. techUK therefore believes that there is now a need for a 'Digital Modernisation Strategy', ideally led by the banks themselves with the support of policy makers, all financial regulators (FCA, PSR, BoE, PRA), and the technology industry – which can provide a platform for the positive evolution of the industry and enable the timely delivery of new innovative products and services to meet the needs of service-users and the wider economy.

<u>Overcoming the infrastructure challenge faced by many financial institutions is central to enabling the long term evolution, innovation and resilience in payments and across financial services.</u>

Please see Annex for further information.

<u>ID & authentication:</u>
techUK believes there is need for collaboration in addressing the current fragmented approach to identity authentication in financial services.

The process of authenticating identity to financial services providers is often inefficient, frustrating and expensive both for end-users and financial services providers. Customers are required to remember multiple passwords and PINs, backed up by multiple security questions and answers when engaging with their bank through multiple channels. Taking out new services often requires consumers to produce documentation and disclose information that their bank already holds and which cannot always be verified. This places strain not only on the service user, who is faced with the difficult task of managing and remembering a host of multiple documents and passwords – but also on the financial institution, which facilitates duplication of process and a drain on resource.

[1] techUK, "Towards a 'New Financial Services'", Jan 2014.

Despite this effort by both financial institutions and service users, fraud is continuing to rise. According to CIFAS, the UK's Fraud Protection Service, identity crimes now account for 66% of all frauds, with marked increases in fraud directed at plastic card accounts and loan products. The cost of this fraud tends to be absorbed by banks in order to ensure the continued functioning of a modern financial system. However, the cost of doing this is becoming increasing onerous.

techUK believes that there is a strong case for collaboration in re-evaluating the current approach to ID authentication in financial services, to better serve an increasingly digital economy.

In a recently published paper[2], techUK explored the concept of a "financial services passport": a standard sector-wide identity that can be securely authenticated in order for consumers to access and take up different accounts and services across the financial system. Building on this, techUK will be publishing a technology roadmap towards a financial services passport and its feasibility.

Other opportunities for collaboration:

- Collaborative AML and security processing.
- Centralised repository of raw payments data. Raw data could be a commodity and the value-added services developed by the payment services participants should be based on their unique insights and industry or consumer relations.

OWNERSHIP

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

techUK believes the current ownership structure does create problems in driving competition and improved service. Ownership of the payments system operators by Tier 1 banks, with direct access, decreases the ability for the indirect participants to compete at the same level. As mentioned in response to question 1, the level of service available to customers of smaller banks, without direct access, can be lower than that of customers of bigger banks with direct access to payment systems.

As touched on in response to question 4, there is a challenge in that the initial functionality of payment systems is always driven to suit the owners and those who fund the infrastructure, placing new entrants at a disadvantage. Once this functionality is delivered, there is no or little appetite to invest further to provide access and functionality for other service users. This has restricted the functionality that new entrants can offer to their customers, which can impact negatively on their competitiveness. As payment processes are driven more and more from mobile devices and non-traditional means, it is important that these issues are addressed in order for the UK to remain competitive.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

N/A

[2] techUK, "Towards a 'New Financial Services'", Jan 2014.

GOVERNANCE

Question 8: Do you have any concerns about the current governance of UK payment systems?

N/A

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

N/A

ACCESS

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

N/A

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

N/A

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

N/A

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

N/A

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- **To whom do you provide indirect access?**
- **What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?**
- **Are there any barriers to becoming a sponsoring bank?**

N/A

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

N/A

Question 16: Do you have any other comments regarding access?

N/A

Infrastructure

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

N/A

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

techUK is of the view that messaging standardisation would yield substantial benefit for all service end users. ISO20022 could offer the necessary standardisation, provided there is only one standard for the UK and this is consistently implemented across all banks, central processes, and other financial institutions.

ISO20022 could enable access to all parties and support some of the initiatives around data movement that are currently difficult and costly to introduce. This could make payment systems more accessible to service users, increase innovation and reduce the costs associated with delivering a service to all parties.

However, lessons should be learnt from the challenges that were identified with SEPA in Europe.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

N/A

Innovation

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

techUK does not believe that incentives to innovate are clear under current arrangements due to the current ownership structure – as outlined above.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

N/A

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

techUK believes it is important that innovation is able to come from within and beyond traditional banking and payments system providers. To enable this, new players need to be able to gain access to the market quickly. This entails changing the ownership structure inherent in the UK payments system.

Access to central infrastructures needs to be straightforward, not limited to being through a major bank, and cost effective. This will enable new entrants to deliver the services that are required to support an increase in innovation across the payments value chain.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Innovation needs to be both unilateral, collective and a combination of the two - depending on the innovation in question. Unilateral innovation can be faster and more radical; however it is unlikely to secure the traction necessary to succeed. Conversely, collective innovation can be slower, less radical yet has a greater chance of success.

<u>Closing questions:</u>

Question 24: Do you have any other comments or concerns you would like to highlight?

See Annex –"The need for digital modernisation"

Question 25: What, if any, are the significant benefits you see regulation bringing?

N/A

Question 26: What, if any, are the risks arising from regulation of payment systems?

N/A

Annex – The need for digital modernisation

The financial services industry as a whole has now reached an inflection point where 'old ways of working' are no longer compatible with financial institutions' changing business models. The technology platforms that support every function within financial institutions have in many cases stopped being a competitive advantage and are now widely acknowledged to be a burden – restricting financial intuitions' ability to meet the expectations of their customers, the regulators and contribute fully to an increasingly digital economy.

As outlined in a recent techUK paper[3], this is the result of legacy systems that are inefficient, overly complex, opaque, and as such, are a barrier for cost effective and efficient business change.

It is the deficiencies in these legacy systems that have been directly attributable to instances of money laundering and rogue trading, to high-profile systems failures that have impacted upon customers and the broader economy and which will only become more prevalent. Similarly they have played a significant role in banks being unable to bring new products to market and make affordable finance available to small companies. Regulators cannot hope to extract actionable information from the data they require from financial institutions in the time frame they require it, if the information silos across banks – a product of these legacy systems - remain in place. Yet, it is these systems that provide the foundation upon which every function within every financial institution sits upon and the provision of economically critical banking services is reliant on, including the processing of transactions.

<u>This is the single biggest hindrance to the delivery of innovative products and services across financial services, including payments, and a significant cause of operational risk.</u>

Integrating the technology that enables new services into existing legacy systems is a major challenge that can pose significant operational risk, and has resulted in wide scale systems outages (often impacting on the UKs payments systems). As a result, new services tend to be 'bolted on', adding further to the complexity, delaying the delivery of new innovative services, and further increasing operational risk. Renewing this infrastructure by 'ripping and replacing' systems is a long term, costly and complex challenge. This along with the mission critical nature of many financial services, such as payments, means that 'rip and replace' is not a viable option.

The technology industry is itself undergoing something of a paradigm shift. The trajectory of rapid technological development means that the challenges faced by the financial services industry can be approached in less costly and disruptive ways than was the case two or three years ago – the key reason why many financial institutions feel they are unable to address this issue. 'Everything as a service', the cloud and existing e-infrastructure in the UK may offer an opportunity to 're-orientate' the structure of the financial system to the advantage of financial institutions and their customers. Much of what banks need to replace in the centre of their legacy systems is duplicated across other banks – it is increasingly accepted across the financial system that their technology is not the competitive advantage that it once was. It now merely performs the same tasks as inefficiently as the next. Therefore what is the point of each individual financial institution unilaterally addressing very similar expensive problems?

The market will eventually move towards this same conclusion – it is already starting to do so in some areas of the US financial system – but it will take a significant amount of

[3] techUK, "Towards a 'New Financial Services'", Jan 2014.

time before any tangible change will take place, to the continued detriment of the industry itself, its customers and the wider economy.

It is apparent to many in the industry – and techUK's members – that there needs to be some catalyst to enable the industry to break its technological catch 22 situation. The importance of technology to the future of the financial services industry is now, hopefully, a drum that the technology industry no longer needs to beat. Whilst it is unfortunate that the magnitude of technology's role should have to be demonstrated through instances of its failure, what remains is an opportunity for all stakeholders to work together to address the fundamental challenges. techUK therefore believes that there is now a need for a 'Digital Modernisation Strategy', ideally led by the banks themselves with the support of policy makers, all financial regulators (FCA, PSR, BoE, PRA), and the technology industry – which can provide a platform for the positive evolution of the industry and enable the timely delivery of new innovative products and services to meet the needs of service-users and the wider economy.

Overcoming the infrastructure challenge faced by many financial institutions is central to enabling long term evolution, innovation and resilience in payments and across financial services.

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17 April 2014

Dear Sir/Madam,

PAYMENT SYSTEMS REGULATION – TESCO BANK RESPONSE TO CALL FOR INPUTS

Executive summary

1. Tesco Bank welcomes the consultative approach adopted by the Financial Conduct Authority (FCA) and the Payments Systems Regulator (PSR) in developing the future regulatory approach of the PSR. It is our view that the creation of the PSR represents a seminal moment to address some of key challenges financial services providers face.

2. We believe that any future reform of payments systems must focus on enabling consumer betterment and should protect against disruption to critical payments services. The UK payments network is one of the most sophisticated in the world and it is encouraging that the vital role it plays in the UK economy has been recognised[1]. It offers a safe and stable way of moving money for customers and institutions, something which must be protected.

3. Tesco Bank supports the core objectives identified by the PSR which focus on; competition, innovation, and service-users. We believe that reform based on this set of principles should enable customer betterment in the form of reduced cost, smarter products and more choice.

4. To achieve this it is our view that the design, priorities and reforms of the PSR, should be informed by robust economic analysis of payments systems in other international markets and sectors which have faced similar challenges. To ensure that the consumer is at the heart of decision making, research should seek to determine the impact of a variety of potential models or solutions on the PSR's core objectives.

5. In our response we focus on sharing our experience as a growing retail bank, detailing the challenges and opportunities payments systems create while competing for customers' business. These challenges and opportunities are:

[1] FCA, Payment Systems Regulation Call for Inputs 5 March 2014, page 3

Competition, ownership and governance

- To create a level playing field we support the designation of UK interbank payment systems and card schemes under the PSR
- A one-size-fits-all approach to reform should be avoided given the differing levels of competition across the schemes
- Cards schemes compete fiercely and are delivering positive outcomes for customers
- The consolidated ownership and governance of the UK interbank payment systems has lead to the creation of complementary, rather than competing payment systems
- A robust economic analysis into the lack of competition in the UK interbank payment systems should be undertaken.

Access and infrastructure

- The PSR should ensure that how providers access domestic UK interbank payment systems does not reduce the range or functionality of services available to consumers
- Potential cost reductions could be delivered and passed through to customers by some simplification and standardisation of the UK interbank payments systems
- Competition between sponsor banks could be increased if agency bank mobility was improved – removing complex processes which tie them
- The cost of directly accessing all of the UK interbank payment systems is prohibitively expensive.

Innovation

- Innovation within the cards industry is generally strong
- Unilateral innovation within the UK interbank systems is historically slow, however mandated developments have delivered positive outcomes for consumers.

Tesco Bank

6. Tesco started out as a grocery retailer and has successfully branched into new markets. It is a great innovator and has a proven track record of entering retail services markets, such as banking and telecoms, bringing more competition but also simplicity, transparency and great value which encapsulate the Tesco brand.

7. Tesco Personal Finance (TPF) was formed in 1997 as a joint venture between Tesco and the Royal Bank of Scotland and is evidence of this record. TPF was renamed Tesco Bank in 2008 when Tesco took full ownership of the business. Since then we have become a growing player in the financial services market.

8. We have over seven million customer accounts and offer a range of personal banking and insurance products. Our growth has been achieved by aiming to be the bank for Tesco customers by rewarding their loyalty and earning their trust. Later this year, we will offer our customers a complete suite of personal retail banking products by launching a current account.

9. Tesco Bank is an agency bank and a full member of the Payments Council. We are a major provider of credit card services in the UK, utilising the Visa and MasterCard networks, to offer customers attractive products, which consistently feature in the best buy tables. There are also circa 3,500 ATMs at Tesco stores, which are operated for Tesco Stores Limited by the Royal Bank of Scotland plc.

Competition, ownership and governance

Designation

10. We recognise the challenge the PSR has in indentifying which payments systems to designate given the differing levels of competition, ownership and governance structure present across the industry. Our own experience of payments systems reflects this complex picture and has varied widely. However, it is our view that in the interest of creating a level playing field, all interbank and card schemes operating in the UK should be considered for designation. Designation should not result in one size fits all remedies. The differences between payments systems and their unique set of challenges and benefits must be recognised to ensure that innovation and competition are not inhibited as an unintended consequence.

11. Designation should include existing UK interbank payments systems; CHAPS, Bacs, FPS, LINK, Cheque and Credit Clearing Company, and the main three and four party card schemes. The payments system is invisible to customers in many ways; they trust their bank to enable them to move their money in a secure way, how and when they want to. It would be of a concern if this relationship of trust was damaged by a new payment system entering the market who failed to meet the standards of the existing providers. Therefore, it is our view that new payments systems should also be regulated by the PSR to protect consumers.

Competition

12. Robust competition for customers amongst payment services providers (banks and building societies) is clearly desirable to drive benefits for the end users. It is our view that more competition at the payments systems level has the potential to support innovation, cost reductions and improve the quality of customer-facing financial services through the passing on of consequential improvements to the financial infrastructure chain. In our experience competition is currently lacking in the certain elements of the payments systems network and we support the PSR objective 'to promote effective' competition.

13. We do not subscribe to the view that the presence of lots of competitors is evidence of a competitive market and that the converse is true of a concentrated market. For example a market can be concentrated yet highly competitive. The grocery market is evidence of this and the consumer benefits are well documented.

Cards schemes

14. Looking to payments systems, while there are a small number of card schemes in operation, our experience is that they vigorously compete for business and offer competitive alternatives, which have ultimately been to the benefit of our customers. We believe there is strong competition in the card issuing market, with over 30 providers competing to offer customers credit card products. We are not aware of any problems created by the current ownership structure of the card schemes, with the Visa, Mastercard; and LINK schemes competing with each other in the market.

15. By utilising card schemes we have been able to successfully enter the credit card market and offer competitive products to our customers. Over 12% of UK credit card transactions are now made on a Tesco Bank credit card[2]. However, for mobile payments, competitive forces have potentially slowed innovation with the card schemes unable to agree the common technical standards required to allow card issuers and retailers to develop customer propositions such as digital wallets that rely on these standards.

[2] By volume, as of April 2013

The challenges of the UK interbank payment schemes

16. In contrast, our experience is that the UK interbank payment schemes largely provide complementary services. These services are necessary functions to enable retail banks to meet their customers' payment needs. There is no real alternative offered in the market and this has limited consumer betterment. However, they do predominantly enable reliable and secure payments, a feature of the system which must endure alongside any reform.

17. The scheme structure includes a number of scheme companies (CHAPS, Bacs, FPS, C&CCC and LINK) with infrastructure provided separately, primarily by Vocalink. We believe the OFT correctly identified that one of key barriers to competition is that the same established financial services organisations own and govern all of these payments schemes and Vocalink: *"As the main members and owners of payment systems, large retail banks have a strong position and an ability to control the decisions made by the payment systems".*

18. The table 1, illustrates this challenge, highlighting the consolidated governance of domestic UK interbank payment systems. The same seven financial institutions are represented on the board of every domestic UK interbank payment scheme, the Payments Council Board and the Vocalink Board. Collectively these institutions control around 84% of the personal current account market[3]. This offers little incentive for competition between the various methods of payment - as these schemes and their owners would not expect to see a net benefit from moving payments between different systems that they own and control[4].

Table 1 – Governance of domestic UK interbank payment systems

Institution	BACS Board	FPS Board	CHAPS Board	C&CCCo Board	Vocalink Board	Payments Council Board
AIB	✓					
BOA			✓			
BOI						✓
Barclays	✓	✓	✓	✓	✓	✓
Citibank	✓	✓	✓			✓
Co-op	✓	✓	✓			✓
Danske	✓	✓	✓			
Deutsche Bank			✓			
HSBC	✓	✓	✓	✓	✓	✓
JPMC			✓			✓
Lloyds	✓	✓	✓	✓	✓	✓
NAG	✓	✓	✓	✓	✓	✓
Nationwide	✓	✓	✓	✓	✓	✓
RBS Group	✓	✓	✓	✓	✓	✓
Santander	✓	✓	✓	✓	✓	✓
Standard Chartered			✓			
Virgin Money	✓					
UBS			✓			

[3] OFT – Review of the Personal Current Account Market, January 2013
[4] OFT – How regulation of UK payment systems could enhance competition and innovation, July 2013

19. Without addressing this challenge it is our view that any consumer benefit derived from the regulation of payments systems is likely to be inhibited. Our view is that the regulator should prioritise analysis into the vertical integration, ownership and governance of domestic UK interbank payment systems and its associated infrastructure.

20. We believe that analysis carried out by the PSR should seek to identify how challenges of this nature have been addressed in other countries and sectors. The output of this analysis should in turn inform regulatory action in order to improve transparency and drive competition to deliver customer benefit. Potential options include reform of scheme ownership, separating schemes from processors, putting into place a commercial relationship or framework, and systems standardisation. The potential outcome would aim to create a market and attract new entrants as the schemes put their infrastructure contracts out for commercial tender.

<u>Collaboration</u>

21. We recognise the benefits of the collaborative approach taken to deliver the Current Account Switching Service (CASS). The CASS set up a distinct project group to deliver its industry wide service for customers, which included all interested financial institutions, large and small, ensuring that agency banks' requirements were not secondary and that our customers received the same standard of service as the large clearing banks' customers.

22. However, while the objective of the CASS is to promote competition, we found that this was not central to the decision-making process regarding its implementation. An example of this was the initial funding mechanism proposed, which was agreed by the Payments Council Board whose membership we outlined in table 1. Our view is that this would have created another barrier to competition in the current account market.

23. In view of this, Tesco Bank commissioned a study which examined the approach taken in other sectors to the funding models. Ultimately, HM Treasury, the Parliamentary Commission on Banking Standards (PCBS) and the OFT felt it necessary to challenge decisions made to address this imbalance – without their intervention we believe CASS would have reinforced the built in advantages of the incumbent banks.

24. The work undertaken by the UK Cards Association in combating fraud provides an example of how effective collaboration can deliver benefits for customers. From a peak of £609.9m per annum in 2008, plastic card fraud reduced to £388.0m in 2012[5]. However, the case for particular functions in the collaborative space needs to be assessed in the context of the overall industry structure.

Access and infrastructure

<u>Approaches to access and infrastructure</u>

25. Reliable access to payment systems is a pre-requisite for any bank or building society wishing to compete in retail banking. New entrants can choose to join these systems directly, or, request indirect (agency) access from one of the providers who have direct access. We are an indirect member of the interbank payments schemes and a direct member of the card schemes we utilise (VISA and Mastercard).

26. As described previously, it is our view that the cards market is serving customers in a competitive manner and is delivering the right outcomes in terms of innovation and product differentiation. However, we believe that a key objective of the new payments regulator should be to ensure that the connectivity model (direct or agency) for the domestic UK interbank payment systems does not reduce the range or functionality of services available to customers, regardless of how their financial service provider connects into the payments network.

[5] UK Cards Association

27. This requirement would help enable all banks to compete for customers on more equal terms. It is a concern that connectivity of the interbank payment schemes is subject to the willingness of incumbent banks to provide access to a potential rival. As a consequence, there is the very real possibility of a conflict of interest between service user and service provider.

28. To address this concern, Tesco Bank would support reform which reduces transactional costs for new entrants and smaller players, which will facilitate additional investment in customer propositions leading to a more competitive market and driving innovation. This could include:
    - Simplifying and standardising technical connectivity across all UK interbank payment systems, with only one connection required for all schemes
    - Simplifying and standardising the settlement requirements
    - Mitigating the current 'lock in' to sponsor banks which makes migrating away from agency arrangements so complex to achieve, particularly in the area of cheque sort-codes and Head Office Collection Accounts (HOCAs).

Cards systems

29. The international card schemes have developed a common set of rules, systems and processes governed through a global self-regulatory standard (EMV). These create the conditions to facilitate the use of card payments and to standardise the entry criteria for new market entrants. Tesco Bank has successfully grown its share of the credit card market and we do not view access to infrastructure as a barrier to competition. As outlined we believe there is strong competition in the card issuing market, with over 30 providers competing to offer customers credit card products.

UK Interbank payment systems

30. By contrast, the UK interbank payment systems have each evolved separate technical and settlement arrangements. This is despite the fact that the underlying processing infrastructure is provided by a single organisation – Vocalink. In addition to the complementary, rather than competing services, we believe that this is likely to inflate the cost of utilising these payments systems, which will ultimately be paid by the consumer.

31. As an agency bank, our ability to offer the same level of service as banks directly accessing the domestic UK interbank payment systems can be limited. In practice, connecting to the UK interbank payment systems through a competitor means that the payments services we offer customers can be no better than our sponsor bank, and as, we have experienced a lesser offering in a number of instances.

32. For example, while the introduction of faster payments has been beneficial for customers, agency banks are unable to process payments in real-time 24x7, making them less responsive to customers' needs than banks with direct access to the payments networks. This situation is exacerbated by the development of additional 'overlay' services utilising the faster payments infrastructure – such as Paym – which further exploits the asymmetry in real time payments processing capability between agency banks and those accessing the UK interbank payment systems directly. More straightforward examples include the lack of timely notification to agency banks when things go wrong in the wider environment, reducing the ability to mitigate customer detriment.

33. We recognise that with any relationship of this nature there will always be challenges and we would not want to see the removal of agency relationships under the proposed payments regulatory regime. This may unintentionally create a barrier to market entry or impede smaller financial institutions' ability to serve their customers, unless other more effective access mechanisms were fully developed.

34. However, the current the alternative of achieving direct access by becoming a full member of all desired payment schemes is not a commercially viable option for a new market entrant. The most cost effective way to access a suite of payments is through a sponsor bank. The number of sponsor banks offering these services is small, but we believe that the access terms and conditions through our sponsor represent the best commercial rates available from the limited number of providers offering these services.

Learning from the European experience

35. The introduction of SEPA across the Euro zone; replaced a number of separate, domestic direct debit and credit schemes with a single scheme, utilising the ISO20022 standard. For any major reengineering of the UK payment systems, a sensible approach would be to use a recognised international standard (such as ISO20022). However, while standardisation could improve processing interoperability and reduce costs in the long run, we do not see a case for reengineering the UK payment systems solely in order to introduce ISO20022.

Innovation

UK interbank payment systems

36. The track record of unilateral innovation is generally poor. The nature of the governance arrangements within the UK interbank payment systems requires several parties to cooperate to deliver any new service proposition for consumers. Non-cooperation can currently be used as a competitive lever to restrict/delay competitor and market developments. It is for this reason that we believe that the vast majority of customer centric innovation in domestic UK interbank payment systems has been driven by external stakeholders including the OFT, FSA and HMT.

37. By way of example, the only unilateral, scheme-wide customer innovation emerging from the LINK ATM scheme in the last 10 years is Charitable Giving, which resulted from the Government's Big Society initiative. While the service was mandated for all UK card issuers in 2012, only ATMs operated by Royal Bank of Scotland (this includes Tesco) and Cashzone (an independent operator) currently offer the service to UK consumers.

38. In spite of this, there are some good examples of innovation through the collaborative delivery of 'mandated' changes across the UK interbank payment systems. For example, for the implementation of the CASS. It was designed to enable direct access for participants, reducing smaller banks reliance on agency relationships and has addressed a key barrier to customers switching provider.

Cards

39. Our experience of the card schemes suggests that a competitive environment is more fertile for innovation. All card issuers have the ability to choose the products and services they offer to consumers from any scheme which they choose, but no one player, or group, has the power to influence what the other providers can choose to do.

Conclusion

40. We hope that by sharing Tesco Bank's experience with the PSR and FCA that we have helped build the understanding of the challenges growing retail banks face and how they could be overcome.

41. If you would like to discuss this further please don't hesitate to contact me.

Yours faithfully,

L Johnston

Louise Johnston
Head of Compliance

TURKISH BANK (UK) LTD.

Payments Systems Regulator
C/O Financial Conduct Authority

By email to paymentsystems@fca.org.uk

DIS/PSR

15 April 2014

Dear Sir / Madam

We are submitting our response to your "call for inputs" request.

At the BBA breakfast briefing held on April 8th we were pleased to note that the interim MD of the Payment Service Regulator (PSR) stated that one of their key concerns was the issue of access to the infrastructure. We would like to emphasis our agreement that this is one of the key issues that the PSR should consider in establishing its priorities both from the grounds of competition and also in the interests of the protection of the consumer.

As a community bank serving in particular an area of the market which is not well served by our larger competitors, Turkish Bank fills a niche in providing banking services to people of Turkish origin and those UK residents speaking Turkish. The majority of our staff also speak Turkish.

The Bank is a strong supporter of SME businesses in this sector, an area which we continued to support and lend to during the recession, contrary to some of the larger banks if press reports are to be believed. The Bank has been faced with a severe risk to its business model and current method of operation because last year our clearing bank gave us notice to transfer our clearing business to another bank. The explanation was that their group strategy had changed and they were rationalising their business by concentrating on a small number of key relationships, and due to our small size, we were not considered as a strategic partner.

It has proved to be extremely difficult to transfer our clearing services elsewhere and, whilst we at the highest level, have talked in depth to a number of other clearers, there does not appear to be an appetite amongst the larger banks to provide this service and this is particularly true of the agency element. We have made some limited progress with one other clearing bank, but for their own internal resource reasons they are unable to even consider migration of our cheque clearing for at least two years. In the meantime our existing clearing bank has been very helpful and has withdrawn the notice, but indicated they would like us to continue to seek an alternative supplier.

Whilst this may be possible in the case of electronic clearing services, it is not easy in respect of cheque and cash clearing (agency) services product offerings which this Bank's customers consider to be most desirable. In addition one of the issues raised initially by the FSA in 2004, and echoed by the PRA, is that, the bank should have a second clearer as a back-up for business continuity purposes, a condition we cannot at present fulfil in the case of cheque clearing despite our strenuous efforts.

We would therefore encourage the PSR to consider access to the basic infrastructure as one of the key issues in ensuring that there is competition, and, ultimately, that the interests of our customers are protected.

TURKISH BANK (UK) LTD.

Smaller banks are in many ways helpless against strategic decisions taken at high level in the banks providing clearing services as they may not see the provision of agency banking services as either strategically important or cost effective in terms of resource and risk and capital requirements.

The agency bank concept has worked well in the past allowing international banks to quickly establish a presence in London, often for the benefit of the banking sector in general. To ensure this continues in the future, availability and price are critical. Whether the agency (indirect banking) concept survives or is replaced by a single tier access, along the lines of the Visa and MasterCard model, may be determined by the approach of the Regulator and the willingness to either enforce access to the central infrastructure, or arrange for this to be devolved to an organisation such as VocaLink.

In summary we would submit that a strong and competitive banking system does require the ability for new or niche banks, or other counterparties, to enter and remain in the sector, at a reasonable price in the best interests of competition, innovation and the consumer and, ultimately, the position of London as a leading financial centre.

Yours faithfully

David I Stewart
Managing Director

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Authorised by the Prudential Regulatory Authority and regulated by the Financial Conduct Authority and the Prudential Regulatory Authority

Tusmor

Banking Matters

Response to Call for Inputs

Payment Systems Regulator

Version: V1.00
Date: April 2014

Contents

Question 1.

Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We agree with the listed payment schemes and believe at the present time this is a sufficiently comprehensive for the UK alone.

We suggest that consideration be given to SWIFT which is the primary messaging system for cross-border payments.

Question 2.

Where do you believe competition is effective or ineffective within UK payment systems?

Competition is ineffective across the payment schemes and payment card networks because they all have the same structure whereby small FS providers are forced to engage via the Clearing Banks and, in the case of Card Payments, Sponsor Banks. This adds a level of cost to each transaction that is not justified in terms of consumer or small business benefit.

Compounding the cost and complexity is the common requirement that indirect access to the schemes and card networks has to be via approved infrastructure providers who then pass on the payments transactions to the Clearing or Sponsor Bank. This cost is again ultimately borne by either the customer directly, or absorbed by the Agency Bank, neither of whom gain any benefit.

Additionally, all providers who are not deemed as a Bank or Building Society are commonly not allocated a Sort Code and have to add additional processing to be able to allocate customer payments to the right customer within their own systems. This means Credit Unions, CFDIs and Payment Institutions have a whole extra layer of internal processing which could be simplified by equal access to Sort Codes with Banks and Building Societies.

Care must be taken to ensure the consultation includes understanding of how Settlement Accounts are made available to payment providers at the Bank of England and the primary Card Payments schemes. We believe at present the settlement facility is only available to Banks and Building Societies and further that the daily process of settlement is backed by liquidity provision by the Bank of England which may not be available to smaller providers.

Question 3.

At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Tusmor believes that service-users would benefit from a technology based payment processing hub which replaces the poor quality technology currently provided by the Clearing Banks and their approved infrastructure providers. This hub would connect directly to the payment schemes and card schemes for multiple small payments providers thus spreading the cost of the infrastructure and removing the two and three additional layers of unnecessary processing already identified. Whilst technically entirely feasible this solution would require the schemes and the Bank of England to modify their rules of engagement and to some extent their operations. However, these changes could be minimised as we have explained in our accompanying short design specification.

Question 4.

What are the main factors impeding more effective competition at each level?

We suggest it is simply a lack of understanding that payments nowadays are essentially technology driven but the decision makers are bankers who focus on complex risk models rather than simplification. If all payment authorisations were required to check not only that the customer had sufficient funds to make the payment, but that also that the payment provider had sufficient liquidity in its settlement account, there would be no need for inter-bank indebtedness to build up over the banking day as the payment would be rejected. If no intra-day payment risk could be created then many complex risk management procedures could be removed.

Question 5.

What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

The collaborative functions are those of intra-bank (or more correctly payment provider) net-clearing and net-settlement. Net-clearing is performed in stages; a) at the Clearing Banks then b) at the Payment and Card Schemes. Net-settlement is performed at the Bank of England and at the Card Schemes. Historically this has been through batch processing which, today, is only valid for paper based payment tools.

Question 6.

Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

The payment and card schemes (except MasterCard) operate under structures where the larger banks set the strategy and the smaller ones can only be associates. Since the investment for the Clearing and Sponsor banks would be large it is in their best interest to avoid change.

Vocalink is the monopoly infrastructure provider for the UK schemes and is owned by the larger banks. Therefore they have the ability to control end-to-end access and keep the smaller providers as second-class providers.

The Bank of England is in fact a settlement monopoly and so also has a vested interest in sweating existing assets rather than investing in better, cheaper, more widely available access for small providers.

Question 7.

How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

We believe Chaps is already showing the way, supported by the Bank of England. They are very transparent in their offering. It appears this is a result of a speech given by Chris Salmon in 2012 we have attached the transcript with this submission.

Question 8.

Do you have any concerns about the current governance of UK payment systems?

It is opaque and appears to be primarily banker led. We would recommend that consideration be given to changing it to make consumer, small bank and technologists voices heard.

Question 9.

What do you believe is the appropriate governance structure for UK payment systems?

We believe in competition and so would actively encourage such between the payments systems themselves. Fundamentally, with the exception of paper payments, a payment is simply moving a number from the sending account to the recipient account at both the customer (clearing) level and the payment institution (settlement) level. There is only a historical justification for the plethora of electronic payment schemes overseen by the Payments Council with common infrastructure provider by VocaLink all further constrained by access to settlement accounts at the Bank of England.

We suggest that ownership and governance could be separated, as indeed they are at the commercial banks. The existing owners could be deemed shareholders and the schemes separated into individual commercially run operations. This would make the current Payments Council surplus to requirements and enable the schemes to be masters of their own infrastructure. All payment institutions would become customers with more equal voices and the less efficient schemes would have to improve on both cost and product offerings.

Question 10.

How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Tusmor has spent three years understanding the payments systems from the purview of the small and challenger banking sector and is a champion of change for opening access to the payments sector to benefit consumers and businesses.

Question 11.

For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Evidencing fees is a very difficult task as they are firmly tied up in the commercial contracts between the various organisations.

We attach a previous submission we made which does provide an insight for Credit Union costs, a letter to the TSC from Lloyds explaining their estimated costs of provisioning a basic bank account and this link to a PCBS session where Andrea Leadsom evidences a 3p per transaction charge for Clearing Banks (at 15.46)

We reproduce below (with permission) information provided to us by

Andrew Breese
Chief Executive Officer
moneywise credit union ltd

> “Fiona, in response to request for information:
>
> As credit unions grow and offer a wider and more diverse product for its membership shaking off the perceptions and antiquated methods of operating its business becomes more important.
>
> When describing our service we appear amateurish to those unaware of credit unions:
>
> 'you deposit money with us, we bank it amongst all our cash funds with a major bank. When you want your money we ask our bank to send you your funds or we give you a cheque that you then walk to a high street bank we have an arrangement with who will give you the cash. We can send your funds via faster payment but only if our bank receives our instruction before 3:00pm.'
>
> The whole relationship between credit unions and banks has changed over the years. Our main bank, Unity Trust Bank, has introduced a pricing model that is proving too expensive to operate. The Cooperative bank restricts the amount of cash withdrawal. Lloyds recent split to create TSB is seeing closure of bank outlets. All of the main banks provide automated processes but in their

own fashion and with their own systems and IT platforms making reconciliation complicated and difficult.

Add to this the fact our members deposits are protected up to £85,000 by the FSCS, our own funds on deposit with banks and building societies are not protected above £85,000. This has led to credit unions opening several bank accounts simply to protect their members assets.

The DWP recently announced Universal Credit (UC) payments can be deposited into credit unions but only where a unique sort code and account number exists for the claimant. We have invested a large amount of time into considering UC accounts but if this becomes policy we will have missed the opportunity to support UC.

Within our business we now use four main banks for our business.

Unity Trust for standing order and direct debits

Barclays for merchant services debit card payments

Lloyds for cash withdrawal

Cooperative for automated member withdrawals from our website

All these banks with the exception of Lloyds charge monthly and transactional fees meaning as we develop new initiatives we are mindful of the costs to be incurred.

As an example of costs; we offer a web transfer facility for our members. The service allows members to register to a secure server where they can view their accounts and perform ad hoc transfers to a nominated bank account. For the member they see a real time transfer on their account. for the credit union this is stored to holding account and a file uploaded to Cooperative Bank's FDOnline service. The transfer is then performed by back office staff and reconciled. The process flow described means there are costs to the web system supplier, Cooperative Bank and accounts software supplier. Because there is no limit to the amount of withdrawals this has potential for numerous transaction costs. There are too many organisations in the chain which makes it expensive.

Our credit union is currently facing charges for cash withdrawals, online transfers, PDQ payment processes, pre paid debit cards, Direct Debits. Without our own solution we just become at the mercy of the banks

Question 12.

Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

See response to Q12

Question 13.

If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

See response to Q12

Question 14.

Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

Not applicable

Question 15.

What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

As stated we are currently consulting with a variety of players the provision of a Payments Hub to be operated for second tier players to bypass the current Clearing and Sponsor bank provision and go directly to the schemes.

Question 16.

Do you have any other comments regarding access?

We believe that without direct access to the schemes the present concentration of current accounts will remain with the large Clearing Banks leaving millions of people without access to electronic and online payments and SMEs paying very high costs per transaction which must then be passed to the consumer.

Question 17.

What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

We have already designed the approach we believe will minimise cost for implementation at a systemic level. We are unable to share our own proprietary costings estimates at this time.

Question 18.

What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

The implementation of a UK wide version of the ISO20022 standards would remove a significant amount of unnecessary data transformation through the processing lifecycle and support the opening of payments systems on the UK.

Question 19.

What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

As explained in the attached Access to Payments document we are currently working with many organisations who are currently forced to use poor quality agency banking services but our success will be predicated on the changes at the schemes and the Bank of England we have already explained.

Question 20.

Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

The payments providers we work with are more concerned about obtaining fair access as their first innovation. Subsequent to that the implementation of mobile payments and other such innovations will be relatively simple. However, if the core inequalities to access remain then only the Clearing Banks will be able to innovate and so will deepen their exclusive ownership of new models such as ZAPP and PINGIT. These two innovations also serve to increase the size of monopoly that VocaLink holds.

Question 21.

Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

As already stated, the current payment systems exclude an entire sector of the banking systems from fair and equal access to payment systems.

Question 22.

What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

1. Access to payment systems for a new technology hub that will clear for its members and then submit net to the schemes

2. Constitution of the hub as a Financial Markets Institution (or some similar form) at the Bank of England for access to settlement

3. Access to a sort code for all payment providers not just Banks and Building Societies

Question 23.

What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Since clearing and settlement require collaboration and small institutions cannot individually afford the infrastructure required we can only see collectively driven innovation as being achievable.

Question 24.

Do you have any other comments or concerns you would like to highlight?

Since the resources of the incumbents are far greater than those of the smaller and more dispersed payment providers the weight of lobbying capability will always rest with those players with most to gain by not innovating.

Question 25.

What, if any, are the significant benefits you see regulation bringing?

Levelling the playing field for small players and forcing transparency, both technical and financial, upon the incumbents.

Question 26.

What, if any, are the risks arising from regulation of payment systems?

The potential for misunderstanding issues is a risk if insufficiently experienced technologists are not a key component in the mix.

Question 27.

How do you think regulation might affect your business and your participation in UK payment systems?

Effectively and quickly implemented changes would be critical to enabling us to help our payment institutions to both enter and compete.

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Financial Conduct Authority: Payment Systems Regulator '*Call for Inputs*'

Response from The UK Cards Association

15 April 2014

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Authors: Duncan McEwen
Briony Krikorian-Slade

THE UKCARDS ASSOCIATION

The UK Cards Association (UK Cards) is the leading trade association for the cards industry in the UK. Its members account for the vast majority of debit and credit cards in the UK, issuing in excess of 55 million credit cards and 86 million debit cards, and cover the whole of the payment card acquiring market. UK Cards promotes co-operation between industry participants in order to progress non-competitive matters and seeks to inform and engage with stakeholders to advance the industry for the ultimate benefit of its members' consumer and retail customers.

Executive Summary

- The UK's card market is dynamic and mature and the biggest in the EU. UK consumers represent 31% of the overall card market and 73% of the credit card market, with over 25 card providers issuing cards and around 10 companies acquiring services on behalf of merchants. The UK market is also world-leading in collaborating in the interests of the consumer and merchants – with national initiatives such as chip & PIN and the rollout of contactless cards on various transit networks being admired and emulated globally. This collaboration happens between the different players – issuing and acquiring banks, card schemes and merchants – working through non-competitive forums such as the UK Cards Association.

- As a proactive trade association, we seek to work closely with regulators across the card payments arena to ensure they have the data and information they need to make proportionate and evidence-based decisions. UK banks and card companies are subject to regulation from a number of UK and European regulators – including the Financial Conduct Authority, Prudential Regulation Authority, Bank of England, the Treasury, and now the Competition Markets Authority and the Payments Systems Regulator (PSR) - which can result in a fragmented approach. We therefore welcome the opportunity to inform the regulatory approach and design of the PSR.

- We believe that within the UK/EU regulatory framework the PSR can help payment providers, merchants and consumers by providing a focused and impartial view in how the payment system network should operate across the UK. Our main request is that, in taking any action, the regulator considers how components operate as a whole, rather than looking at different parts in silo, and recognises that changes will have consequences across the wider payment system. We would also look for any resulting regulation to support and be flexible enough to allow for the fast-moving innovation in this area. We would urge the regulator to conduct in-depth and quantifiable analysis of the payments landscape – in terms of competition, innovation and consumer outcomes - as it shapes its policy approach over time. A UK regulator will also need to consider the ability for the UK market to compete internationally and have the resources to be able to invest in and enhance its competitive features and future infrastructure.

We have grouped our responses to the list of questions based on common themes to provide a more general view of the market.

Competition - Q(s) 1 – 4

(1) Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

(2) Where do you believe competition is effective or ineffective within UK payment systems?

(3) At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

(4) What are the main factors impeding more effective competition at each level?

- We believe that competition in the UK cards market is healthy, and both fosters and is bolstered by a high level of innovation to the benefit of consumers. This is chiefly because the cards industry relies on leveraging a joint product serving the differing needs of two complementary groups - consumers and merchants – and competition and relevant incentivisation are required to ensure both groups continue to partake in this two-sided market.

Consumer choice

- At a basic level, a good level of competition is demonstrated by the variety of products and availability of choice provided to consumers. UK Cards has 25 members issuing debit, credit and charge cards and are aware of a number of other card issuers who operate in the UK. The level of 'churn' in the market - the percentage of people changing their card issuer - is 20% per year, a high level compared to a number of other utility-style markets such as electricity (17%), gas (15%) and mobile (11%).

- Not only are there several different providers of cards to choose from, there are different types of card and 'card-like' products on offer. These demonstrate how the industry has evolved in line with the changing spending habits and purchasing value of its customers. Products include:
    - Debit
    - Credit
    - Charge
    - Commercial
    - Pre-paid
    - Store
    - Affinity

- Moreover, it is clear that consumer preferences can be followed with relative ease in this market. Since their large-scale introduction in the UK in 1988 (through Switch), debit cards have outgrown credit card usage and allowed for the migration of payment from cash. Card payments now represent 74% of all UK retail sales.

- Finally, there is also a wide array of environments where use of card payments is now commonplace. This includes traditional 'card-present' transactions (otherwise known as Face2Face) and a variety of 'card-not-present' mediums including Mail Order & Telephone Order (MOTO), online and mobile.

Market players and competition

- Competition can also be seen in the different layers of the card payment system. At the widest level, competition exists between the overarching network systems which are built on different business models and provide different network offerings:
  - Different network models - 3-party (*Diners Club*, *American Express*) versus 4-party (*Visa and MasterCard)*
  - Within the 4-party models, there are alternate business models - member-owned (*Visa Europe*) and publically listed corporations (*MasterCard Inc)*
  - A growing number of alternative international card networks seeking and/or wishing to continue to expand their presence in the UK (*JCB*, *Discover*, *Diners Club* and *China UnionPay)*

- Competition is also a natural result of the various relationships required between the different players of any given retail transaction. For example, between:
  - Terminal vendor and Terminal Service Manager (TSM) provider
  - Merchant and acquirer
  - Acquirer and network scheme
  - Network scheme and issuer
  - Third party provider (like an account information service or payment initiation service) and issuer

- The dynamic nature of the market is also reflected in the differentiation in price structures that have evolved by different payment schemes. These are often successfully used to incentivise and encourage the adoption of levels of higher security by retailers. These pricing structures take different forms:
  - Scheme established
  - Domestic rates as set through bilateral agreements
  - Cross-border payment arrangements
  - Card-present and card-not-present transactions

- Within this dynamic market, barriers to entry are low, as found by the Independent Commission on Banking in 2010: '*over a ten year period* (2001-10)*, new entrants failed to make any significant impression in any retail banking market apart from credit cards*'. In particular, the card-not-present model has provided a platform for new entrants into the payments market (e.g. *PayPal*) and generated a plethora of online retailers (e.g. *Amazon*), who have been able to monetise their retail offerings because of the widespread use of card payments and the statutory and product-specific protections offered to consumers.

- The competitive nature of the card payments industry is only likely to increase as the technological landscape changes:
  - Traditional card payments are being displaced by newly emerging technologies at the point-of-sale;

- o Alternative and closed-loop proprietary payment systems are being offered by the retail community either through consortium-led initiatives (e.g. *MCX* in the US) and/or independent retail outlets (e.g. *Starbucks*).

Collaboration – Q (5)

(5) What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

- Collaboration is a core component of a two-sided market, with schemes, issuers, acquirers and merchants all having to collaborate to meet changing consumer needs. Indeed, supporting collaborative projects is one of the core aims of trade bodies like UK Cards in a highly dynamic and fast moving payments ecosystem. We can act as a non-competitive facilitator for issues such as contactless limits and standards development, and can coordinate messaging without having to be concerned with branding. This is particularly true as the lines between different markets, such as payments and telecommunications, become less distinct and the number of players in this arena correspondingly expands to include the mobile network operators, *over-the-top* providers (e.g. *Google*, *Facebook*) and a host of technology start-ups. Moreover, collaborative work increasingly has to take into account the need for a consistent consumer experience globally – whether the payment is taking place in person or virtually.

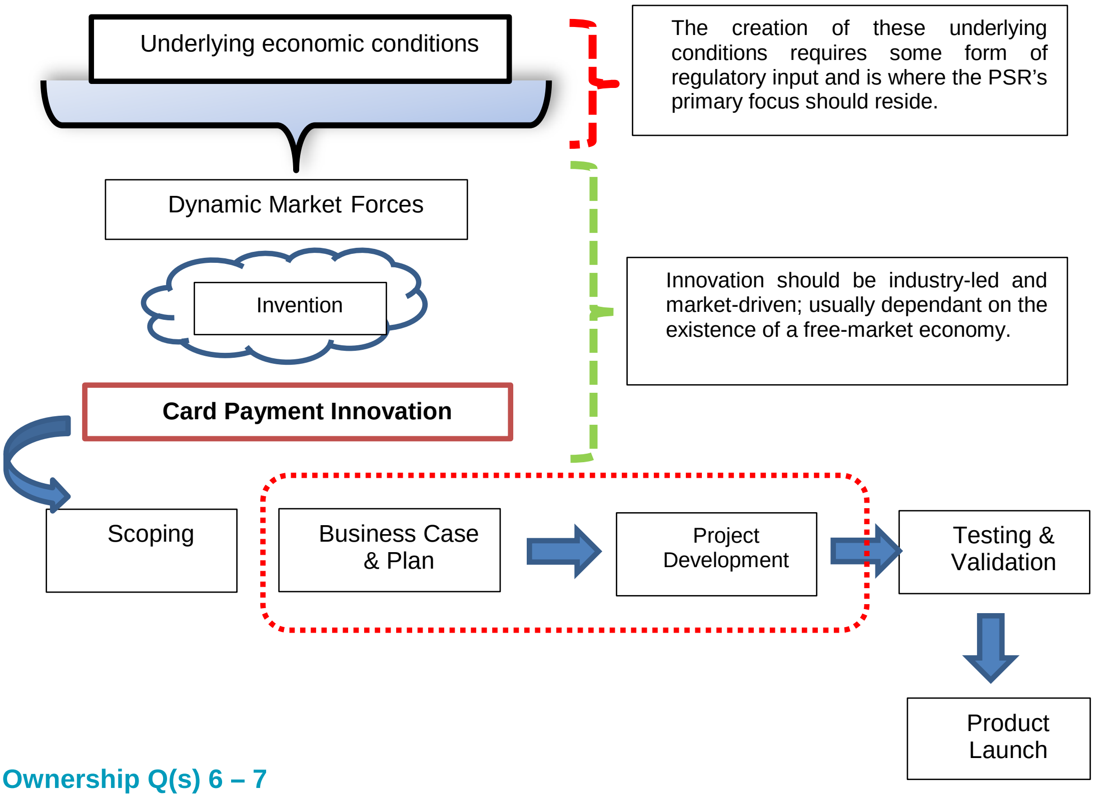
- Some examples of where UK Cards has been able to foster collaborative projects include:
  - o Chip & PIN – (see appendix [1] for an overview of the programme).
  - o Current account switching programme (CASS) with the Payments Council, addressing debit card issues and requiring involvement of the card schemes.
  - o Collaboration with Transport for London to rollout contactless payment cards on the London transit network. This has required common messaging to consumers, and agreed processes for avoiding fraud and managing refunds.

- However, where members have opted to take a competitive stance in delivering innovative products (*3-D Secure, Contactless*), it is arguable that the industry would have benefitted through earlier co-operation. Conceivably, on certain non-competitive issues (consistent messaging, agreed value transaction limits etc.) an independent regulatory body such as the PSR could call for a more collaborative stance to be taken for the benefit of all. A good example might be in leading a cross-industry initiative around the future deployment of a particular payment technology (e.g. Near Field Communication [NFC] payments).

- UK Cards would welcome working with the regulator to identify the ‘pinch-points’ that exist in the collaborative space, where regulatory involvement could help overcome certain commercial hurdles, while helping guard against disproportionate regulatory interventions.

- The following diagram demonstrates where these ‘pinch-points’ might exist, illustrated by the perforated red lines, and where regulatory involvement could be effective.

The potential for regulatory involvement



Ownership Q(s) 6 – 7

(6) Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

(7) How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

- The card payments market is comprised of differing styles of ownership. For example, international four-party schemes can be member-owned or publically listed. In the UK, the four-party schemes were historically structured to encourage banks and building societies to join as members or licensees. These schemes are built around a practical separation of ownership, from the ownership of the scheme itself, to how the processing elements (i.e. the clearing and settlement of payment card transactions) are operated in practice. Alternative international card networks operate on the basis of different structures e.g. global three-party proprietary closed loop card networks which may partner – at arm's length – with a small number of carefully selected licensees, to complement the proprietary and acquiring business. Such licensees have no role in the governance or ownership of the network.

- The international four-party card schemes – often referred to as the 'rails' of the industry - are broadly interoperable. An example is the use of EMV as a cross-scheme, interoperable standard for face-to-face payments. This is key to create the conditions and protocols to facilitate the widespread and internationally accepted use of card payments at a technical level of application.

- The operation and commercial objectives of card payments generally differ to those of the arrangements of the UK interbank schemes *(Faster Payments Services [FPS], LINK, BACS, CHAPS)*. The UK interbank schemes are mainly aimed at being the transfer mechanisms to support different payment types. For example, FPS supports the new PayM application which allows direct mobile to mobile payment. These UK interbank schemes are therefore not generally in direct competition with each other, but support a competitive environment.

Governance Q(s) 8 – 9

(8) Do you have any concerns about the current governance of UK payment systems?

(9) What do you believe is the appropriate governance structure for UK payment systems?

- The role of the international four-party card schemes depends on the efficiencies created by the economies-of-scale and volume of transactions generated by having an interoperable global network. These are not solely UK payment systems.

- With regard to purely UK payment systems, a more informed opinion will be given by the respective UK interbank schemes and the Payments Council.

- A potential area of focus for the UK regulator could be leading discussions arising as a result of European legislation and providing agreement on interpretation – such as relates to the multilateral interchange fee (MIF). The PSR would be well placed to protect and act on behalf of the UK card payments industry to determine what an appropriate scope and commercially acceptable MIF rate might prove to be, given the complexities of the UK cards market compared to equivalent markets. [See our answer to questions 20-23 on 'Innovation' below.]

Access to payment systems Q(s) 10 – 16

(10) How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payments systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

(11) For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

(12) Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

(13) If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

(14)Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes;

- *To whom do you provide indirect access?*
- *What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?*
- *Are there any barriers to becoming a sponsoring bank?*

(15) What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

(16) Do you have any other comments regarding access?

- Our view is that the membership rules and prudential requirements that the international four-party schemes impose are sufficiently structured to allow for open, fair and direct access for any eligible payment service provider (PSP) to join. These four-party card schemes take a graduated approach to membership to encourage as many members as possible – with differing styles, separate tiers and class-of-membership being offered to any PSP.

- Visa and MasterCard, for example, indicate that their payment networks are comprised of over 3000 European PSPs and approximately 15,000 global financial institutions. There is no evidence that these are not being made accessible to PSPs of every conceivable description.

- A good example of the dynamism of the schemes is shown in MasterCard's commercial structure as a publically listed corporation. The interests of its shareholders leads to a commercially driven agenda, aimed at generating the volume of transactions needed to increase the profitability and its share price as a commercial entity. Encouraging new participants into its network supports this strategy.

- Three-party proprietary closed loop schemes, like that underpinning American Express, are exempt from open access requirements under Article 28 of the Payment Services Directive and corresponding UK Regulations.

Infrastructure Q(s) 17 – 18

(17)What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

(18)What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or

improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

- For question 17, see also our answer to answer to 'Innovation' questions 20-23.

- Messaging infrastructure is vital to financial institutions which need to exchange massive amounts of information with their customers, and between themselves. In the UK, ISO8583 standard provides the basis for the card industry's own messaging infrastructure. This accommodates the diversity and full range of card product types (credit, debit, store, prepaid), but also provides the underpinning platform by which future payment innovation can occur (e.g. tokenisation). Standard 70 meanwhile provides a basis for messaging from the merchant to acquirer.

- There is currently an initiative by the European Central Bank and European Commission to support the implementation of a single standard - ISO20022 - to help achieve its aim of a unified Single Euro Payment Area. However, we believe the desire to create a single European standard is too simplistic given the complexities of the card payment ecosystem, and the needs of retailers and of other stakeholders. There is no guarantee that bank-to-bank messaging would encompass the multiple and differing variants being developed, as has proven to be the case for the existing ISO8583 standard.

- A payment-specific UK regulator could help to represent the UK market's concerns on security standards at a European level, for example through the European Central Bank's subcommittee, SecuRE Pay.

(19)What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

- A more informed opinion would be better given by the views of the respective UK interbank schemes and the Payments Council.

Innovation Q(s) 20 – 23

(20)Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

(21)Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

(22)What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

(23)What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

- As discussed above under the 'Collaboration' question 5, we believe that innovation is being driven forward by the card payments market at some pace. The range of schemes and PSPs in the card payments, and more generally retail POS market, drive innovation as they compete to offer a range of products that satisfy consumer demand while delivering commercial profitability. This is increasingly true as an unprecedented number of new players and forms of payment come into the market.

- As mentioned above, there is a role for supportive regulation but the challenge will be in enabling the currently diverse and fast-moving market activity to continue. Ultimately, it should be consumers who continue to decide what works well for them and demonstrate this with their purchasing decisions. In the main, we believe that innovation should be left to the dynamic forces of the market with the primary role of any regulator focussed on ensuring that the underlying economic conditions are present for innovation and competition to thrive.

- One area in which the regulator could help to provide the underlying conditions for innovation is in setting interchange fees, as mentioned under the 'Governance' questions 8-9 above. Interchange fees have played a vital role in the development and expansion of four-party schemes in the payment sector and are an invaluable funding mechanism for innovation by these schemes. However, there has been increasing regulatory scrutiny on the level of interchange as card payments have become the preferred payment mechanism for retail payments. The European Commission has now introduced proposed caps for the level of cross-border and domestic interchange rates.

- The European Commission's proposals could prove hugely disruptive and damaging to the card payment industry because:
    - It will dampen its appetite and ability to invest in future innovation;
    - The proposed interchange rates are arbitrary and not based on a comprehensive economic analysis;
    - The proposed rates are based on a 'one-size-fits-all' approach and do not reflect the very significant differences between Member States' markets.

- We believe that there is a substantial role for the PSR to play in determining the scope and optimal level of interchange regulation in the UK market, balancing the needs of the participants and the need to fund innovation. This should be based on a robust study of the impact of these rates in the UK market.

Miscellaneous – The future role of regulation Q(s) 24 – 27

(24) Do you have any other comments or concerns you would like to highlight?

(25) What, if any, are the significant benefits you see regulation bringing?

(26) What, if any, are the risks arising from regulation of payment systems?

(27) How do you think regulation might affect your business and your participation in UK payment systems?

- We believe the PSR can have a strong role, given its apolitical position, in influencing the regulatory proposals being delivered out of Europe principally from the European Commission and European Central Bank. The PSR can help ensure the underlying conditions of competition and innovation are being safeguarded in the UK, guaranteeing the success and longevity of the card industry here.

- Our primary concern is that the creation of the PSR should not create a set of domestic regulatory requirements that would fragment and undermine the global interoperability of how card payments work. This is particularly important in a regulatory environment that is becoming more complex on the UK level - with the FCA, BoE, HMT, PRA and CMA all having a perspective on how banks and card companies operate.

- Payment regulation on this scale is untested and will be exposed to the scale and pace of technological convergence. The onus will be on ensuring that any regulation is outcome-focused and sufficiently flexible to accommodate innovation.

- We hope to work with the PSR to develop a regulator that is evidence-based and analytical, and that produces regulation that is proportionate and relevant in design. This includes a thorough examination of the competition and innovation within the industry, balanced with the need for interoperability. We look to play a leading, pivotal and co-ordinating role in delivering this on behalf of the industry.

New payment systems regulator – consultation input from UKMTA

April 2014

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

We recognise the need for and benefit of payments schemes being designated. However, in general we believe that designation should be avoided where possible, as it raises barriers to entry.

The effect for some of our members where designation has been applied has been to increase the barrier to entry (cost of technology, lack of choice between providers of that technology) to a level that was untenable for them. Any API is, by definition, smaller than a bank, as the scope of their business is limited by regulation.

Where our members have bank account (which is a separate but very important connected issue considered elsewhere in this response), they access Faster Payments as an indirect participant, which means their transactional prices are higher, and the service levels lower, than those which are offered by direct members to their direct customers. Though we appreciate that costs must be spread in some equitable manner, the effect is to inhibit competitiveness, which was one of the aims of the PSD, since smaller firms cannot provide a functional service level to their customers which is comparable with the service level a direct participant offers to its customers.

We therefore recommend that, when schemes become designated, consideration be given to the rights of access and cost of gaining access to regulated non-banks, such as authorised payment institutions.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Competition largely works well for direct customers of member banks but it breaks down at the boundaries, in areas where banks choose not to offer services; such as remote communities and ethnic communities, for example.

True competition between banks and API's (for example) is difficult in an environment where, over recent years, banks have withdrawn accounts from many APIs, particularly those API's which deal in money remittance type services. The final and largest UK banking provider exited the market in September last year, leaving 150 API's without a bank account. We believe that only between 15/20 API's dealing in remittance services now have money transfer bank accounts, and it is the smaller, community based money transfer companies which have lost accounts. This means that consumers are losing out, and are paying disproportionately large fees as a result of the loss of competition. On many sending corridors, there is now a choice between only two, large international providers and an oligopoly is created. This point his reiterated by a recent (16th April) ODI report, which says that remittance fees to countries in Sub-Saharan Africa are at a level of 12%, when the World Bank target is 5%. A few large payment companies are doing very well commercially out of the decision of the banks to stop providing bank accounts to the many smaller (often corridor specific) API firms who want them and can no longer access them. In our view, the issue of access to bank accounts cannot be detached from the issue of broadening access to payment systems and should be a key issue for the regulator to address.

Whilst undoubtedly individual banks have the right to make such decisions, if market or regulatory forces act such that all banks withdraw services, those API firms become financially excluded – despite having invested in technology and training to reduce their risk, and without any specific contraventions identified. Their employees jobs are at risk; and their clients are left with less and, in some cases, no choice. The risk-based approach recommended by FATF (AML/CTF measures and Financial Inclusion: FATF Guidance 2013) isn't working in practice, because the end-to-end business process requires all actors in a transactional chain to cooperate, and if all actors in any one role choose not to, the chain breaks down.

We recommend that the end-to-end model for any payments service, including each of clearing, settlement, and compliance in turn, be reviewed to ascertain whether there are any bottlenecks which might inhibit competition.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Costs: the G8, of which the UK is a participant, has sought through its 5x5 initiative to reduce the fees charged by Diasporas to send money home (e.g. money remittances). Reducing fees has been shown to increase private sector funds going to developing countries by a sum comparable with the national aid budget. The UK has many regulated and community based payment service providers (PI's) whose price point is substantially lower than the current approximate 9% fee charged to senders. However several such PSPs are inhibited from providing services to UK senders because they lack bank accounts; and others could improve distribution of the service if banks were to adopt them as delivery channels. Compliance is the major burden; guidance around the acceptability of simplified KYC for lower-value transactions, and the establishment of easily-verifiable electronic identity would help.

Quality: UK APIs offer transparency and predictability in international payments which today is rarely offered by banks and which could serve to encourage import and export and the UK's position as a trading nation generally. The new Regulator could help to showcase the breadth of services available from all regulated providers; the Payments Council has appeared to favour the banks, and it has, in practice, been impossible for the UKMTA, (on behalf of regulated PI's) to take any role in forming payment policy via the Payments Council. We have, effectively, been excluded. We remain hopeful that the PSR will be more able to take our views on board.

Innovation: There is considerable potential for benefits for retail and corporate-service-users if the information flow around service fees and FX rates provided was improved. The new Regulator could help to showcase the breadth of services available from all regulated providers. This is, however, difficult to do, although price comparison websites such as moneymove.org are a step in the right direction (although hardly comprehensive).

Question 4: What are the main factors impeding more effective competition at each level?

Banks have been slow to bring payment services to market, and to make available access and information to enable others to do so. This is a particular problem if the banks have decided not to provide certain types of services (e.g. migrant money remittance services) but further adopt policies which exclude other providers (e.g. API's) from providing these services. This a major problem, since the UK government estimates the size of the UK remittances market to be GBP 15 billion annually. That represents a lot of consumers who need cost effective payment services, but who, at the moment, are largely unable to access them.

Whilst the UKMTA campaigns on this issue at all levels, as a representative of the API sector, our experience has been that it has been difficult in the past to engage at policy level with the Payments Council on this matter.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Without doubt the management of schemes, and to a large extent policy, should be done collaboratively. Furthermore the UK has an admirable track record of building, maintaining and operating the clearings. We urge the regulator to continue to place experts (i.e. bankers) at the heart of scheme management.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

The current structure favours the organisations which fund and manage the schemes and the Payments Council. The new mandate should encompass and provide fair access to all stakeholders, including APIs and consumers.

Question 7: How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternative model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternative ownership models.

The regulator might like to consider a new industry utility which would act as an entry point for appropriate regulated entities (e.g. APIs), giving them access on equal functional terms (timing of transactions etc) and reachability as direct members. Cost of establishing and operating such model to be determined and thus options for its funding need to be defined. Of course, the issue of access to the payment systems cannot be detached from the more fundamental issue as how regulated API's can be provided with cost effective banking services (e.g. bank accounts) in an environment where commercial banking providers are withdrawing from providing these services to many API's. In the absence of alternatives, is it possible for the regulator to explore whether the Bank of England might be in a position to provide banking services to API's?

Question 8: Do you have any concerns about the current governance of UK payment systems?

International scope: Governance has historically focused on UK domestic schemes. We think the role of the new regulator should expand to encompass and encourage international trade, and, additionally to recognise that international payments (especially money remittances) are the most cost effective alternative to the UK aid budget. Would there be scope for the regulator to support schemes which seek to encourage migrants in the UK to send even more money remittances back to the country of origin, particularly where developmental benefits are identified? Would it be possible to make such money sends 'tax deductible' in some way, assuming the sender is a UK tax payer?

Rather than identifying issues and barriers, we see an opportunity for the Regulator to inform and encourage. It might consider adopting, as one of its missions, making the UK the most efficient e-economy in the world.

Though international transactions are a very small percentage of total transactions by volume, they are disproportionately valuable economically. The UK has a unique position in international financial services and trade, yet the Payments Council's mandate has been domestic-only. For example, the Payments Council does not gather and publish statistics on international transactions. We recommend the new Regulator's mandate have a global perspective, especially around the innovation and growth elements to its purpose.

Seek forgiveness not permission: innovation is inhibited through the need to operate within the current regulatory framework (a de facto requirement since any innovator needs a bank account; and banks frequently decline to provide accounts to firms which are innovating close to the edge of current regulations, or in uncharted territory.) Inevitably, technology and solutions develop ahead of regulations; MPesa in Kenya (a largely UK-driven innovation, with involvement from DFID, Vodafone and Consult Hyperion) being one such example. We should like to see the new regulator encourage such innovation within the UK, perhaps by providing 'safe harbour' for experimental services.

We mention that the UK Government is already seeking to encourage innovation in payment services through initiatives like the 'safer corridors' project, which is been developed under the aegis of the (recently founded) Cross Border Remittances Working Group (chaired by Sir Brian Pomeroy); the 'safer corridors' project is looking to find a new methodology for UK clients to send money to Somalia, which is a country particularly dependent on money remittances but which is seen as particularly high risk by the banks. The 'safer corridors' pilot is being lead by DFID and the World bank, but a range of other partners, including money transfer companies, are also involved. How can the new regulator be involved in pioneering new solutions in payments?

One other comment on governance – UK PI's are already regulated by the FCA as payment firms and by HMRC under the MLR. The PSR needs to explain how the role they fill will complement existing regulators – indeed, we hope that the new regulator will make the point that it will not be issuing new 'rules to follow' but instead using its powers to make the market work better, so it is easier for PI's to operate.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

The management and operation of the payments systems has been done well and safely for many years, by experienced bankers; that should continue. We recognise that maintaining the integrity and reputation of the UK payments system is fundamental – but also believe the the model should be broadened to encompass all stakeholders more directly and to encompass a global element, as outlined above. We believe that transparency (around issues such as pricing, for example) should be the default assumption – so that, as much as possible and feasible, an agenda which encourage competition for the benefit of end users should be the clear objective.

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

UK PI's access the UK payments systems indirectly, through relationships with direct members. Clearly, firms would be able to offer our customers a better service level if they had direct access but clearly such access would have to be contingent on the basis that systems, security and compliance functions are equal to bank grade. However the cost of access is prohibitive for most API's. The most realistic next step is for a direct provider (or a new industry utility?) to be mandated or established which would act as an entry point for appropriately regulated entities such as APIs, giving them access on equal functional terms (timing of transactions etc) and reach ability as direct members. And not forgetting providing them with bank account facilities, if needed.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

We appreciate that costs must be apportioned in a fair manner. However it is unclear what the real costs are, and the methodology for apportionment. It is not therefore possible to answer this question.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Yes; for example the speed at which API's are able to settle a £ transaction via Faster Payments is much slower than a direct member can achieve.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

There is effectively no choice in access for API firms offering money remittance services, predominantly because all UK banks have elected not to support firms offering this type of business model (see above); there may be marginally more choice for existing API firms which specialise in FX services rather than remittances, but even here, the banks are generally closed to FX start ups. Unless and until there is a fundamental change in policy by the banks towards PI's, there will never be the true diversity of PSP's, and the consequent level competition which can ensure the needs of end users are properly met.

Direct participation in the clearing systems requires a settlement account; if the member banks won't provide such an account, direct access to the clearings is of no value.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

Not applicable

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Please see response to Q7

Question 16: Do you have any other comments regarding access?

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

We fully recognise the economically critical nature of the UK's payments systems and that the fundamentals of reliability, resilience and security are paramount. We do, however, believe that regulated non-bank providers are willing and able to operate to the necessarily high standards. Indeed, new entrants may well use more modern technology which, if designed correctly, may provide higher levels of security and resilience than the systems operated by some banks.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

The adoption of ISO20022 would provide a welcome platform for innovation especially in interbank communication and services. However, it should not be the sole focus; standards, like regulation, often follow rather than precede innovation; their adoption should not act in such a way as to stifle it.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Please see response to Q8 and Q18.

Regulation is typically associated with adjectives such as control, restraint. We recommend the Regulator should also take an active role in encouraging innovation. We recommend that it should have a vision statement which might echo that of the Lisbon Agenda – 'Make the UK the most efficient e-economy in the world'. Such a framework would attract and encourage innovation in financial services (of which payments is a necessary but in some ways relatively unimportant component) whilst encompassing safety, security, resilience, and rights of all stakeholders.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Question 24: Do you have any other comments or concerns you would like to highlight?

Question 25: What, if any, are the significant benefits you see regulation bringing?

In our experience, the Payments Services Regulations have acted to legitimise an established innovative small business, which in turn has helped us grow. However, there has been a fundamental failure by policy makers at all levels (right up to FATF/World Bank) to establish principals for payments services which can allow them to be developed and flourish to the benefit of consumers in an environment where there are strong counter-veiling (and often contradictory) pressures on all players to put in place sufficiently strong systems and safeguards to protect against risks associated with money laundering, terrorism finance and other forms of financial crime. At the moment, the negative attitude of the banks towards payment firms means that they are preventing PI's from being allowed to develop and implement the innovative services which consumers need. The suspicion of the banks towards payments firms in relation to their AML controls is often unjustified and is based on a lack of understanding (or a lack of willingness to understand, given that banks may seek PI's as competitors as much as collaborators?) but policy makers need to break the log jam and encourage a common transparency around AML/CTF so that there is a shared understand of both the risks and the necessary remediation at all levels of the payment chain (i.e consumers, PI's and banks) and amongst policy makers and legislators at national, regional and international level. Unless we make progress on this issue to develop a better and more effective regulatory structure, an efficient international payment system which truly meets the needs of consumers will fail to emerge.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Two major risks are

- Inhibiting innovation
- A temporary but nonetheless significant planning blight

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Annex 1: Cover sheet

Basic information		
Consultation title:	Payment Systems Regulation – Call for Inputs	
Name of respondent:	Vendorcom Limited	
Contact at respondent:	Name:	Amanda Faul
	Email:	amanda.faul@vendorcom.com
	Address: 2nd Floor, Elizabeth House 39 York Road London SE1 7NQ	

Nature of organisation (select as appropriate)	
Infrastructure provider (e.g. Vocalink)	
Payment system operator	
Direct member of payment system(s)	
Indirect participant in payment system(s)	
Service-user	
Other payment provider (e.g. ZAPP)	
Third-party service provider (e.g. ATM distribution)	
Trade / Government / Regulatory body	
Other Please specify:	X – Business Community

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential?		X
If 'Yes', please submit both confidential and non-confidential responses.		

Payment Systems Regulation – Call for Inputs (Vendorcom response)

Introduction

Vendorcom is a membership organisation which connects the key stakeholders in the consumer payments industry in Europe. Its primary aims are to promote innovation, create a platform for thought leadership, provide a forum for knowledge sharing and issues resolution for its members and encourage capability development in both individuals and companies as well as across the entire consumer payments ecosystem.

Since its inception in 2003, Vendorcom has supported the cards & payments industry by providing a coherent and representative voice and by acting as a single point of authoritative and credible information for its members. In addition, it ensures that decisions made by industry influencers take into account the issues and concerns of solution providers who, in turn, collaborate constructively with existing working bodies in the cards & payments industry. Some members of Vendorcom are also Associate members of the Payments Council.

Vendorcom, the cards & payments community is a membership organisation which represents key stakeholders in the merchant payments industry in Europe. Vendorcom's membership includes card schemes, issuing and acquiring banks, payment service providers, processors, solutions providers, systems vendors, systems integrators, security solutions providers, etc. and we have a wider reach that sees us have regular contact with a further c. 2000 organisations within the merchant payments sector.

Vendorcom has strong collaborative credentials and as such has strong relationships with a number of other associations including UK Payments, European Payments Council, Digital Policy Alliance and the PCI Security Standards Council.

At Vendorcom, we are committed to bringing the expertise of both our core team and our members to the table in support of the Payment Systems Regulator's (PSR's) strategic aims, vision and values to ensure that any future regulation of the UK Payment Systems is: well-reasoned, based on a solid knowledge and understanding of these payment systems, fair and equitable to all parties, protects the trust in and integrity of the systems, meets the needs of the service users and avoids the pitfalls of unintended consequences.

It should be noted that, as our focus is on merchant payments, the following response to the 'call for inputs' has this focus at its heart and as such, our comments relate predominantly to three and four party card schemes and other payment schemes only where they touch merchant payments (for example, the use of faster payments in the development of mobile payment applications such as Paym, Pingit, Zapp, etc.) or have potential to be used for merchant payments in the future. We will not, for example, be making any significant volume of comments relating specifically to CHAPS, Bacs, and ACH etc.

General Comments

Whilst we will go on in this document to respond to the specific questions asked, we would like to begin by making a number of key points about the overall document and the establishment of the PSR.

- As a general point, and one that was very apparent in the 10th April 2014 Stakeholder Event, there is a distinct difference between interbank schemes and merchant payment schemes and it would seem wise that the regulatory framework be constructed to recognise this whilst allowing for some convergence of systems and the need for cross-pollination between the two regulatory streams.

- Whilst, as stated above, it is our intention to provide whatever support we can to the PSR, we do still have questions regarding the problems that the PSR has been created to solve. We fully support the objectives of 'promoting effective competition', promoting '…the development of, and innovation in, payment systems…' and ensuring '…that payment systems are operated… in the interest of service-users…', yet we don't feel that, at any stage, substantive evidence has been produced that there are currently significant failures in these areas that cannot be addressed through self-regulation/market demand. Rather we see the use of terms such as 'many people feel…' and 'it has been expressed that…' which at best reflect hearsay and opinion. It appears (as evidenced in the language of HMT's consultation) that the need for regulation is being tied closely to the failures of the banks, and this linkage is both unhelpful and confusing, particularly to the merchant payments sector where the provision of many consumer focused payment innovations have little to do with core banking functions. It would make our role in supporting the PSR much easier if concrete examples as to current problem areas could be provided. This would also make the PSR's task in prioritising its activities much simpler. Additionally, it would be valuable to all concerned to understand the success criteria for any regulation of the UK payments system.

- It is essential in looking at the various payment systems to be governed by the PSR, that a 'one size fits all' approach is avoided. For example, whilst CHAPS, Bacs, ACH and Faster Payments can be seen as largely domestic systems (today) and as such suitable for domestic regulation, this is not the case of the three and four party card schemes and many of the emerging, non-card based merchant payment systems . These operate on a global basis and, therefore, are already subject to significant regulation, such as the PSD and proposed PSDII, which, for example, already provide rules relating to access to the schemes, which by means of the Directive, are applicable in the UK as they are in the rest of Europe. We are concerned that the PSD/PSDII are largely excluded from the remit of the PSR, which, given their impact upon the three and four party card schemes (and their participants/associated service providers) would appear to leave potential for confusion at best and regulatory chaos at worst. An early example of this is the definition of 'payment service provider', which does not correspond with that included in the PSD/PSDII. Perhaps the question is how the PSR will engage with the regulator responsible for applying PSDII?

- A view has also been expressed that what appears to be missing from the current UK and pan-European regulatory frameworks is an arbitrator to oversee and mediate on the implementation of that regulation, and to perform an ombudsman type function where irregularities and unfairness are seen.

- Where the payment systems are not confined to UK borders, the PSR must ensure that it is working with the regulators in other jurisdictions to ensure that any regulation it develops does not have the effect of making the UK a less attractive market in which to do business. Should this be the case, this could lead to organisations avoiding designation in the UK by basing themselves in another European jurisdiction and using the provision for 'passporting' within the PSD/PSDII to provide services into the UK market.

- It would be interesting to understand what, if any, role the PSR will have in representing the interests of UK payment systems (including the three and four party card schemes) at a European level as Brussels seeks to implement further regulation.

- From a 'UK plc' point of view, it may also be beneficial to see if any of the currently UK domestic payment schemes could expand beyond our borders.

- In addition to our interest in understanding what influence the PSR may seek to exert in Brussels, it would also be interesting to understand what, if any, influence will the PSR have with other regulating bodies within the UK? For example, improving the reach and capacity of the broadband service within the UK, so that it is on a par with other geographies would have significant positive impact on the ability of payment systems to deliver a greater level of innovation to market. Will the PSR be able to add positive value by lobbying for change that will enable greater competition, innovation and better delivery to service-users? The PSR must not operate in isolation and focus purely on the payments systems themselves, as this belies the complexity of payments. Importantly the PSR must encourage competition between payment mechanisms as much as between providers. Also in this regard, is there a risk that with HM Treasury retaining regulation of some types of payment system and the PSR being a secondary regulator, the regulatory landscape will become very confused and confusing?

- We do not feel there is sufficient attention given over in the Call for Inputs document to the requirement that the PSR deliver its objectives whilst having regard to the importance of '…maintaining the stability of, and confidence in, the UK financial system' (Banking Reform Act, s.49 (3)). It is imperative that the integrity and security of the current systems is maintained and that any steps taken to provider greater access to, competition with/between and innovation in our payment systems are taken in this context.

- In seeking to encourage competition and innovation, the PSR must be careful to do so with purpose, rather than doing so for the sake of competition and innovation in and of themselves (innovation for innovation's sake benefits nobody). We should not, for example, be looking to force the creation of a further payments system, but rather, should be creating an environment where, if there is a market need/desire, a new payment system can develop and flourish, whilst focusing greater attention on ensuring the we're making the most of the systems we currently have by looking at how they can be used in new and innovative ways (e.g. Paym's use of Faster Payments), by addressing issues relating to access, interoperability etc. Care should be taken, particularly when taking decisions regarding the designation of players, not to effectively 'positively discriminate' in favour of new entrants, by subjecting them to a lesser level of regulation than that applicable to existing, proven providers.

Question Responses

Q1 – Do you have any views on which payments systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

- There needs to be a considerable level of detail around how designation is going to be managed: Who will make the decisions? What criteria will be used (e.g. consumer protection, protection of the integrity of the payment systems)? It's essential that a clear framework is set, which applies to everyone, but acknowledges different stages of development and grows with the organisations. For example, with the PCI DSS, we see different levels of requirement dependent upon the size of an organisation; we would suggest that a similar model be applied. Providing such a framework, with all players required to recognise a tiered 'designation' structure, does not just protect incumbent players, but also protects new entrants to the market who, having established a business, which then grows, finds that it needs to be reengineered at a point in time when it falls within the PSR's designation criteria. A tiered approach would encourage them instead to consider the designation criteria from day one.

- There is a very strong risk in not applying such a designation to smaller, less systemic payment systems/services – for example, mobile payments operators. These organisations may lack experience and make mistakes, causing vulnerabilities in existing payment systems, etc. Not designating smaller players may also play to organisations remaining small, niche players and thus not delivering the level of competition that the regulator is seeking to create.

- Thought must be given to how the 'passporting' provisions of the PSDII may enable organisations to get around designation (where these payment systems fall under the governance of the PSDII).

- It is also important to differentiate between regulation of the payments products offered to PSPs and those offered to PSUs. Whilst one has an effect on the other, it is not clear that both the inter-PSP and PSP-PSU market can be regulated with the same mechanisms or the same success criteria.

Q2 – Where do you believe competition is effective and ineffective within UK payments systems?

- In relation to competition between the various payments systems, in some cases this is simply a case of timing. For example, the development of applications such as Paym, Pingit, and Zapp etc. in the mobile space now provides the opportunity for faster payments to compete with three and four party card schemes in the merchant payments space. This evolution of faster payments as a competitor to cards has taken time because of the necessity firstly for the infrastructure to bed in and achieve sufficient level of adoption and secondly for the smartphone market to reach an appropriate level of maturity.

- Where we do see issues relating to competition in merchant payments, is in relation to those technology providers who are seeking to work to integrate with the payments schemes (either directly or as part of the wider ecosystem). For example, where mPOS providers are seeking to provide e-commerce solutions for their merchants, the cost in terms of both time and money to integrate with the acquirers can be prohibitive. The result of this is that the customers of these mPOS providers are effectively denied access to the payment systems through their existing acquirer relationship and have to seek access through alternative routes, such as PayPal or payleven. Similarly, whilst we recognise their importance in ensuring interoperability and maintaining the integrity of the UK merchant payments infrastructure, national standards such as the APACS standards, continue to make it very difficult for new market entrants, especially given the time taken for certifications/accreditation. A more universal approach to standard setting, such as that advocated by SEPA may allow for greater competition. Whilst the regulator must have in mind UK payment service users, it is not clear that this is best achieved by specific UK variants of standards.

- There are concerns that the vertical expansion that is currently being seen in the market may lead to lack of effective competition. For example, where the schemes are buying other players in the payment ecosystem, such as payment processors, and taking shares in new providers (such as iZettle, Square, etc.). Areas such as this should be reviewed by the divestment board within the PSR to ensure competition remains effective. Other areas, however, such as the use of the Faster Payments System to provide mobile and internet payments do demonstrate the ability of some payment service providers to offer competitive solutions.

- The payments systems operators are not solely responsible for ineffective competition around payments, for example in the merchant payments space, Independent Sales Organisations (ISOs) have a significant part to play in whether competition can be effective or ineffective, as they act as intermediaries between acquirers and merchants. Will the PSR have the power to regulate wider third party players in the payments space?

- There is a view that the current VocaLink infrastructure is not sufficiently open and should be reviewed. For example, it is interesting to note that VocaLink used the faster payments network to develop Zapp prior to the creation of PayM (essentially the same proposition) and then sought to divest itself of the former, for financial gain. Is this an example of an organisation taking advantage of its position and only providing wider access once it has done so? There is also a view that concentrating the entire UK infrastructure in one, bank-owned, commercial managed company does not lead to resilience and integrity. There is a counter argument that the Payments Infrastructure could be a Public service managed and operated within the Public sector. The concept of fairness and competition where this is a commercially operated service seems somewhat contradictory. There is a risk that to open the VocaLink service up to competition could intrinsically damage the integrity of the system as it currently operates.

Q3 - At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

- It depends what 'levels' are being referred to her, e.g. does it relate to the diagram in figure 1?

- Assuming that the term 'levels' does indeed refer to the 9 groups represented in the diagram in figure 1, there is potential for competition to drive benefits to service-users at all levels – it's not limited and it shouldn't be limited. However, the areas where we are seeing the greatest levels of competition, particularly in terms of innovation at present are in the organisations covered by 7. (Other Payment Providers) and 8. (Third-Party Service Providers) where it's the point of interaction with the consumer in merchant payments systems which is the subject of the greatest level of innovation.

- Innovation is and will continue to come from both within and without the payments systems, with MNOs, tech start-ups, opportunities created by Bluetooth, Wi-Fi, NFC, schemes, infrastructure providers all driving change and thus providing greater competition in the wider merchant payments market. Even in the merchant payments area, most of this innovation comes in the interface between payment service users and payment service providers with little innovation happening in the inter-PSP space. Separating regulation of schemes from PSOP offerings to PSUs will make this distinction.

- Specifically in relation to competition in the area of payments systems (in merchant payments), we should be looking to see what will come out of Amazon, Apple, Google, Facebook, etc. who have the potential to be the payment systems operators of the future – and also to the architecture behind crypto-currencies such as Bitcoin, which also offer potential to replace both merchant payment scheme- and interbank-scheme infrastructure.

Q4 – What are the main factors impeding more effective competition at each level?

- We must ensure that where action is being taken to secure the infrastructures, there is transparency such that these actions are not regarded as anti-competitive either from a perception or legislative point of view.

- Existing regulations impede both competition and innovation as the costs in terms of time and money to bring new solutions to market are prohibitive e.g. the cost and time taken to obtain certifications and other approvals. As a result, much of today's innovation is taking place outside of the regulations by 'geeks in their grandma's basements' who are delivering solutions which are not covered by the current rules because documented regulations aren't keeping up with market demand, especially in the mobile arena.

- Innovation in the ACH payments industry is also stifled by existing regulations and the significant investment required ensuring compliance. This therefore increases the costs of new developments for existing and new players, such as new mobile services, and increases the maintenance costs of existing systems, leading to the lack of development on some core payment systems within PSPs. A good example of this is the delay in rolling out Faster Payments services to corporates which took in some cases years after the launch of FPS.

- The outcome of current regulatory processes is that the cheapest, compliant solutions become viewed as best (e.g. the minimising of card interchange fees); we should instead be focusing on the delivery of value added services based on agreed inter-PSP standards.

- What is the FCA view on where competition is being impeded at the moment? Is this a reference to the fact that Visa Debit is the predominant player at present? Is it the bank dominance in ACH payment transactions by retail and corporate customers? Or is it simply that the focus of the Call of Inputs is on retail banking and interbank schemes?

Q5 – What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

- We have seen significant success and benefit to all stakeholders where the payments industry has worked together. For example, the Chip & PIN rollout in the UK was a strongly collaborative effort and should be held up as a shining example of how working together delivers benefit for all. By contrast, the rollout of contactless payments in the UK was seen as a purely competitive opportunity and thus we have seen a fragmented, confused merchant and consumer message and a very slow level of adoption.

- Collaboration works best in the inter-PSP space as long as it can deliver to the PSU significant value.

- The provision of SEPA-compliant Credit Transfer and Direct Debit services to businesses in the UK and the collaboration in the development of standards for euro payment initiation and clearing has been a good example of collaboration in the inter-PSP space, whilst the mobile payments scheme Paym is a good example of cooperation to provide PSUs with a common service.

- In essence, open collaboration should be allowed and encouraged wherever possible as it will lead faster, more robust innovation. There is a significant difference between collaboration and collusion and what constitutes the latter should be clearly defined and guarded against by the regulator, whilst the former should be largely be left to be governed by the players and the merchant-consumer market.

Q6 – Do you think the current ownership structures create problems? If so, please explain your concerns with the current structure.

- The predominantly US ownership of the current incumbents (in relation to three and four party card schemes) leads to a very heavily skewed system, which sees audit programmes, rules, etc. set up to meet very US centric requirements (e.g. US protectionism around tobacco, gambling) and the introduction of standards (such as PCI DSS) aimed to protect against risks which do not exist within the UK (and Europe) in the same way – e.g. the risk presented by the continued use of magstripe and signature as an authentication method. The result is that all participants (direct or otherwise) in the card scheme are burdened with unnecessary costs in relation to payment security (in the customer present space).

- Current card schemes are also issuer centric organisations and as such, if they decide they are going to change the fines to the acquirers, there's very little to stop them. Acquirers can now sit at the table, but they are often unable to say anything and if they do, then they're not listened to. Things are changing, the acquirers are working to have a collective voice, but the current structure does lead to various players being disadvantaged. For example, there are costs attached for vendors to access the Visa Europe/MasterCard vendor websites.

- The card schemes have bought companies recently who compete with their member banks – this does bring more competition however, it is interesting to look at whether this does or should constitute a conflict of interest? Will this be something that the PSR seeks to review, perhaps paying particular attention as to any potential advantages being given to those companies which are under card scheme ownership?

- When looking at the current ownership and how it might potentially need to change, it would be wise to do this whilst looking at the impact on the players. In particular, if we're putting in rules that are UK specific, the PSR must keep in mind that, in relation to card schemes in particular, these are global businesses and give due consideration to how any changes impact globally.

- Some members have expressed concern over VocaLink's – ownership of LINK/Faster Payments//Bacs/Paym networks. It has been great to see a good level of innovation here, but it isn't open to everyone and, as mentioned in answer to Question 2 above. They could potentially use these networks to seek competitive advantage through the development of new solutions on these networks (e.g. Zapp). Should they be making the networks more open and available to others (via licence) to ensure a more level playing field? It is also clear that VocaLink's ownership by large banks can mean that the solutions they propose to industry problems are in the interest of their owners. More open solutions, which may be less attractive to the high-street banks, are side-lined. It is also clear that there should be strong information segregation between those designing an open system and those implementing it.

Q7 – How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternative model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership

- See above

- Starting from the current position, there are no good solutions: with multinational providers, the UK can be only a minority interest; with share infrastructure operators owned by a small proportion of the PSPs, some of whom re-sell those inter-PSP products to other PSPs, it is not clear how that operator can be made more accountable to other PSPs without being clear how the operator of critical national infrastructure should be responsible to its board, its owners and the citizens through governmental or regulatory oversight.

Q8 - Do you have any concerns about the current governance of UK payment systems?

- Control is currently weak, very bank-centric and relatively closed (UK Cards Association/UK Payments Council) and achieving compliance/accreditation can be slow, costly and burdensome, resulting in significant barriers to both new entrants and innovations from existing providers. A governance system which allows for greater representation and collaboration in the development of frameworks/standards and facilitates greater openness would be beneficial. It is not clear how developments which may be in the interest of a large number of users, such as harmonising the Direct Debit recall period for sterling transactions with that of those in euro in the UK, can be discussed and implemented across the industry; without the key frameworks, it is difficult to achieve consensus.

- Lack of consistency in the enforcement of existing governance structures (card scheme rules, standards etc.) is a cause of some concern as it can mean that companies who ‘play by the book’ and seek to comply to the various rules/standards are disadvantaged by doing so. One example of this, as provided by our members, is the Visa Merchant Agent Programme. Where organisations have signed up, the cost has been not insignificant and the understanding was that any organisation not signed up before the end of the first year would be unable to take on new payment business through the acquirers; to date there is no evidence of this being the case. Members have also referenced the fact that similar listings with MasterCard are free of charge.

- We are seeing innovators regularly introducing new products, or competing products, often at prices far below those that incumbent providers are able to offer, simply because they are ignorant of, or choose to ignore, existing rules/standards/regulations, and there always seems to be at least one card scheme and/or acquirer that is prepared to support these businesses. It would be interesting for the PSR to consider its role in ensuring the consistent application of these current rules/standards/regulations.

- As mentioned in the ‘general comments’ section of this response, in relation to merchant payments, where the three and four party card schemes are concerned, we must not make the mistake of considering these to be ‘UK payment systems’. If the PSR is to consider governance in this area, then great care should be taken to ensure it works effectively alongside existing governance structures, such as those coming out of Europe and does not result in creating ‘Fortress UK’ and preventing competition from organisations coming in from outside the UK as well as interoperability issues for UK organisations seeking to expand their businesses beyond UK shores.

- As previously mentioned, great care should be taken to ensure that any fresh governance in the UK doesn’t force organisations offshore, which then use the PSDII provisions to passport their solutions into the UK; if the response was then to restrict the ability of EU-based organisations to enter the UK payments market, this would surely be against the competition the regulator is there to engender and protect. It may be that the key concern of payment systems providers in the inter-PSP space is not payment service users or innovation, but integrity, reliability and resilience.

Q9 - What do you believe is the appropriate governance structure for UK payment systems?

- An objectives-based governance structure, which sets a framework but which leaves organisations free to compete around how they achieve those objectives is the most appropriate governance structure.

- Any governance structure must take account of, reference and interact with existing governance structures, for example, PSDII, PCI DSS.

Q10 – How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or restraints you have in this regard.

- Across our membership we have a number of different players accessing payment systems in either directly or indirectly and have encouraged members to respond directly to these questions as to how they are affected, however, there are a couple of general points that can be made.

- The concept and nature of 'access' is one area of significant difference between interbank schemes and merchant payment schemes and where the regulatory structure should be tailored accordingly. We will focus our comments particularly on merchant payment systems.

- Current merchant payment systems have been built over a considerable period of time by the incumbent players, with significant investment and great attention paid to ensuring that they are secure and inspire trust and confidence by not only merchants and consumers but also those organisations who would seek to build innovative solutions based on those systems. As a result of the above, it is reasonable that there are conditions, requirements and fees associated with access to ensure that those accessing the system do so in a way that has no negative impact (e.g. by having lax security) and provide a level of financial recognition of the value of the service provided to their business. However, these conditions, requirements and fees should be appropriate and based around ensuring appropriate security levels (proportionate to the assessed risk) and delivering a reasonable level of return on investment and must at all times be both justifiable and transparent. There may be a role for the regulator in acting as an independent reviewer of the conditions, requirements and fees to ensure that they are proportionate, justifiable and transparent and to provide advice/guidance where behaviour has swung away from this.

- Over the course of the last seven years, the fees charged by card schemes (merchant payments) have been subject to an intense level of review, criticism and debate and, after numerous court battles, are currently subject to proposed legislation as part of the PSDII package. The current proposals relating to the capping of interchange fees relating to credit and debit card payments provides, as well as changes to business practices and rules, relating in particular to surcharging and the honour all cards rule. Without wanting to get into the detail of the interchange debate here, the PSR would do well to look at this in detail, as it provides an example of a piece of regulation ostensibly aimed at ensuring better value for service-users, particularly through reduced costs, but where, in geographies where caps are already in place, there is little evidence to suggest this is being delivered. Instead, in geographies such as Australia, Poland and Spain, we've seen costs increase in other areas, new costs being introduced and no evidence of any savings being passed on to consumers. As well as failing to deliver benefit, we would also suggest that the cap on interchange fees is unlikely to increase competition (in the UK we've already seen issuers such as MBNA look to sell their book and exit the market due the market being an unprofitable one) and could have the effect of reducing investment in both maintaining the infrastructure and seeking to innovate. Whilst we will have to wait and see what the impact will be once the new regulation is in force, it is a good example of the risk of unintended consequences.

Q11 – For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

- See above

Q12 – Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

- See above

Q13 – If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

- See above. In the structure of this question, it could be inferred that only access to interbank schemes is of importance.

Q15 – What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

- Again we are applying a wider understanding to the narrowed definition of 'payment systems' that is implied by this question.

- Within merchant payments there is currently a specific problem with the Account Updater System, with acquirers only providing access to organisations using their gateway and not providing access to third-party PSPs. However, there is a different fee structure in place for organisations that don't use the Acquirer Updater System. This appears to suggest a level of restrictive practice which should at the very least be subject to review.

- Providing access rules and conditions are transparent and justifiable based on assessment of risk, cost associated with delivering the system, etc. (as mentioned in answer to Q10 above), then no action should be taken.

Q16 – Do you have any other comments regarding access?

- The PSR's definition of access should be widely discussed and agreed, specifically recognising the varying considerations for access in the distinct ecosystems of interbank and merchant payments. The facilitation of the Access session in the 10-04-2014 Stakeholder event was poor and belied a lack of understanding by the facilitators of the merchant payments ecosystem.

- As a specific, it appears that, whilst the systems have been designed to allow participants directly in ACH payment systems (such as ETS access to Bacs), the costs of access (levied by the operator which is typically owned by their handling bank) can be prohibitive, forcing them to rely on payment services from their handling bank.

Q17 – What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payment systems?

- In merchant payments, there is a need for global rather than national standards, in order to ensure greater competition; attracting new players to the UK market and enabling UK organisations to compete more effectively across international borders. Common platforms and common standards ensure greater interoperability. Any consideration of a national standard which differs in any way from the common standard should be given the upmost thought prior to agreement.

- Standards/regulations need to be developed in a more 'agile' manner, to enable them to better keep up with market developments, ensure they don't delay/discourage innovation and that they remain relevant rather than quickly becoming obsolete.

- More broadly, the UK payments systems would be better served by improvements to UK broadband, through the introduction of super-fast wireless, greater reliability of our 3G/4G networks, adoption of a common framework for mobile payments and similar, not directly 'payments-initiated' developments. To place the responsibility for the perceived lack of innovation in payments largely on payment systems providers would be naïve and ultimately unproductive.

- Harmonisation between regulators and regulation/legislation/standards is key. There must be an alignment between regulations and it must be clear which standards/regulations/legislation take precedence in any given environment. For example, what will be the impact of the Network and Internet Services Directive when it comes into force later this year? What will be the outcome of the current European Data Protection Regulation discussions? – can we achieve harmonisation across Europe in any meaningful way?

Q18 – What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

- We are leaving our members to deal with this question directly in their own response documents.

Q19 – What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems?

- Again, the term' agency banks' belies a lack of appreciation of the merchant payments sector and an implied narrowing of the definition of 'payments systems'. The PSR should seek more informed advice on merchant payments and look to map the distinct relationships and interactions in both merchant payments and interbank scheme systems.

Q20 – Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

- There is a risk that with the change in the interchange fees, organisations will be actively discouraged from innovating, and that continued investment in the existing payment infrastructure will reduce. This may have a disproportionate impact in the UK market, given the predominance of card payments. It would be interesting for the PSR to consider whether the reduction in the interchange fee reduces the ability of the card schemes to compete effectively, in the future, with other payment systems (e.g. faster payments, direct from bank account payments (such as Sofort)). Given that the passing of the

European legislation on interchange fees will now be delayed by the coming elections, it may be the case that there is still the opportunity for the PSR to involve itself in this discussion (which we would certainly advocate), however, it would be coming to the discussions very late in the day.

- Part of the difficulty today is that organisations (current players) are so busy trying to keep up with regulatory change (for example the proposed changes to interchange fees) that there is not time to innovate. The inherent complexity in current standards/regulation/legislation is stifling innovation. Anecdotal evidence suggests that 75% of bank spending is currently associated with compliance in merchant payments (e.g. having to replace PINpads/Payment Terminals)

Q21 – Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

- The new regulator should look to encourage good behaviour in PSPs and PSUs by allowing charges for transactions and relationships to be related to the true-cost. For example, the provision to consumers of free cheque clearing (which is estimated to cost at least £1.20 per cheque as opposed to £0.01 for an electronic transaction) puts a significant cost hurdle in the way of a PSP offering a service to replace cheques for consumers; if the services were priced based on the true cost, many consumers would switch to the innovative scheme to avoid incurring additional cost.

Q22 – What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

- There is a huge amount of innovation going on in the merchant payments space today – perhaps not at the infrastructure level, however, new and innovative ways of using the payments systems are springing up on an almost daily basis, albeit, in many cases they are evolutionary rather than revolutionary. Other than ensuring that rules/conditions/fees are set to reflect the need to protect the systems/reward their developers rather than to deliberately restrict access, the industry should be allowed to continue to innovate at its own pace – where innovation is slower than we may like, consideration should be paid to the risks associated with rushing things.

- It is likely that charging consumers based on their usage of payment methods would provide both the incentive and investment to move to innovative schemes and payment mechanisms. By allowing consumers choice, it is likely to reduce the cost of legacy payments and facilitate a move to more cost-effective methods.

Q23 – What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

- In mass market systems, a collaborative approach is best in almost every case, particularly in terms of open access, ease of market adoption, education of consumers, time taken to achieve critical mass, cost to deliver, the ability to ensure interoperability, maintaining a clear upgrade/development route map, ensuring core integrity and blocking external attacks from fraudsters; the list of potential benefits is almost limitless! The only exception would be where a sole innovator has such a novel or radical innovation and ability to demonstrate leadership and execute that they can go it alone. Even here, the need to bring others on board at an early stage should be recognised but this can usually be achieved if the originator understands the need for an inclusive approach in order to ensure that the full market potential of their solution is to be realised.

- Clearly collectively driven innovation can be fraught with excessive delays if the objectives and terms of reference are not clearly defined at the outset. An example of this is SEPA for Cards which has been effectively stalled for the past eight years in terms of delivering any meaningful market benefits or achieving the European Commission's political objectives for an open European cards market.
- Purely unilateral innovation is usually confined to narrow, distinct niches and may be appropriate in the extreme consumer fringes of payments where a merchant or bank might choose a particular interface or technology that reflects their brand or customer demographic.
- In general, collective innovation, international standards and a strongly collaborative approach has been the basis for all great merchant payments innovations and developments, e.g. card standardisation, global interoperable networks, EMV, and PCI.

Q24 – Do you have any other comments or concerns you would like to highlight?

- Not at this stage

Q25 – What, if any, are the significant benefits you see regulation bringing?

- Unsure at this stage as still unclear as to the facts behind the problems that regulation is looking to solve. We welcome the open approach being taken by the PSR to date and look forward to hearing more about the development of its strategic aims, vision and values and the approaches it will be taking to deliver these.

Q26 – What, if any, are the risks arising from regulation of payment systems?

- As mentioned in the general comments at the beginning of this document, the varying payment systems (particularly giving regard to those which are domestic versus those which have a global reach) cannot be regulated with a one size fits all approach. Where payments systems such as the card schemes are already subject to governance from Europe and more widely, little, if any, additional regulation should be considered.
- Where regulation is considered to be necessary, it should take the form of providing a broad framework and/or a set of objectives, leaving organisations free to choose how they operate within the confines of the framework or how they choose to meet the objectives.
- Light touch, agile governance/regulation is essential to avoid the unintended consequences of making the market less attractive and thus less competitive and reducing the incentive to innovate.
- The lack of distinction between interbank scheme based payment systems and merchant payment systems is a very significant concern as it could result in wholly inappropriate and misaligned regulatory structures.

Q27 – How do you think regulation might affect your business and your participation in UK payment systems?

- Given that we do not yet have any real understanding of what any future regulation might look like, it's too early to comment on this, however as a general rule of thumb, providing any regulation is at a framework/objective setting level and only seeks to intervene in a more prescriptive way where practices develop which are unfair and unjustifiable, we would hope that the effect would be positive for the industry as a whole.

- For the Vendorcom Community, the development of payment systems regulation presents another area where we can work with merchant payments sector influencers and our members to build connections and relationships that are beneficial to the overall merchant payments ecosystem. Promoting innovation, ensuring collaboration, creating the basis for greater, more effective competition in the market and resolving issues between the leading stakeholders has been the primary objective of the Vendorcom Community in Europe for over 10 years. We are committed to the UK payments market within the context of the wider European and global merchant payments ecosystem. The Vendorcom team is at the disposal of the PSR as it seeks to understand and interact with the wider merchant payments community.

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Ms M Stark
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

16 April 2014

Dear Ms Stark,

Payment Systems Regulation: Call for Inputs

Virgin Money is supportive of the Government's decision to introduce a new Payment Systems Regulator which will have powers over UK payment systems and their direct members.

In previous submissions to the OFT, Treasury Committee and the Parliamentary Commission on Banking Standards, we have expressed concern about the effective oligopoly of large banks and the barriers to entry and expansion in retail banking, particularly in the personal current account market. These barriers are particularly evident in the domestic payment systems, where the large banks are not only the principal users of the systems, but also co-operate as principal owners and have the ability to impose barriers to entry through membership requirements, agency banking arrangements and interchange fees.

One theme of our attached response to the questions is that competition has an important role to play in driving down costs and delivering pro-consumer innovation. The scope for competition will, of course, differ across payment systems, and we identify those areas where we believe that the introduction of greater competition could yield significant benefits to users of payment systems and, in addition, those areas where the scope for greater competition is more limited. That said, any attempts to increase competition in this area must take place against the backdrop of the priority to maintain the continuity of payment services and ensure that financial stability is maintained. The new Payment Systems Regulator should not take any action – including in the competition sphere – that could compromise this core objective.

We believe that the Payment Systems Regulator should examine the following issues because they have the potential to help level the playing field between the large incumbent banks and banks such as ourselves and deliver value to consumers:

- Assess the case for reducing the requirements for direct entry to the major payment schemes;
- Examine ways in which information asymmetries in agency relationships could be reduced, including through greater transparency;

- Ensure that indirect members of payment systems and schemes and, in particular, C&CCC are not disadvantaged by having to change sort codes when changing from one agency bank to another.

The new Payment Systems Regulator has the potential to make a real and tangible difference to the landscape of retail banking in the UK. The Payment Systems Regulator has the opportunity to address deep-seated problems in the UK payments system, many of which were first identified by Sir Donald Cruickshank almost 15 years ago, but which still remain to be fully addressed.

We believe that the issues outlined in our response to the questions should be seriously examined by the Payment Systems Regulator and that, if they were addressed, would go a long way towards creating a more dynamic payments system, which will help deliver real benefits to consumers and place the UK at the cutting edge of payments.

Yours sincerely,

Jayne-Anne Gadhia
Chief Executive Officer
Virgin Money

Payment systems in the UK

1. **Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why?**

We agree that the cheque clearing system (C&CCC), automated payment systems (CHAPS, Bacs and Faster Payments) and the LINK ATM network should be brought within the scope of regulation.

Additionally, we believe that the main three and four party card schemes —such as Visa and MasterCard— should also be brought within the scope of regulation. This is because the major card schemes account for a large, and growing, proportion of total payments and because such schemes can display strong network effects, with the consequent tendency for one or a small group of operators to dominate the market. A failure to bring such schemes into the scope of regulation would introduce a regulatory gap into the system, with the consequent risk that such schemes would gain important competitive advantages vis-à-vis those that fall under regulation. However, whilst the card schemes should come under the new Payment Systems Regulator, it must ensure that the regulation of card schemes will be consistent with EU regulation, including Payment Services Directive 2.

Competition in payment systems

2. **Where do you believe competition is effective or ineffective within UK payment systems?**

3. **At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?**

4. **What are the main factors impeding more effective competition at each level?**

5. **What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?**

We believe that the Payments Systems Regulator should strike an appropriate balance between regulation and competition in delivering innovation and good consumer outcomes. Over the last decade, the UK payments system has been slow in proactively delivering pro-consumer innovation. To a large extent this reflects the lack of competitive forces in the delivery of payment services.

We therefore believe that the Payment Systems Regulator should view competition as an important mechanism for ensuring that the UK payment systems deliver payment services that meet the current and future needs of personal and business customers and can support economic growth. We favour a process of change that is gradual and evolutionary, and most importantly, that does not put at risk the reliability and stability of payment systems, or the willingness of large banks to invest in them. We also recognise the importance of collaboration in driving forward improvements to payment systems. We discuss the role of collaboration and an industry-wide payment strategy in greater detail later in our submission.

In meeting the needs of personal and business customers in a rapidly-changing and increasingly-online environment, we believe that a key objective must be to encourage innovation, partly through the use of new technologies that are lower cost and more flexible, provided that they are sufficiently reliable. This is feasible and possible as the planned introduction of cheque imaging and mobile payments both demonstrate.

While we support the establishment of a Payment Systems Regulator, we believe that the key objective of delivering innovation in payment services will often be better delivered by encouraging greater competition in payments, where this does not compromise reliability and continuity of service and/or financial stability. To this end, the Payments Regulator will have a crucial role in setting and monitoring the framework within which effective competition takes place.

Regulation by contrast has an important role to play in ensuring access to payment systems on 'fair and reasonable' terms for smaller banks and other market participants and in ensuring firms cannot take advantage of dominant market positions, where these are a natural by-product of economies of scale, high fixed costs and network effects. However, we believe that measures such as price controls should be used only as a last resort and where it does not appear possible to achieve effective competition or where there is evidence that market dominance exists. Such an approach would be consistent with the BIS's *Principles for Economic Regulation*.

The FCA asks about the scope for increasing competition from three vantage points, arguing that "competition is or could in theory be present between:

- Payment services offered over existing schemes
- The schemes themselves, including payment card networks
- Infrastructure providers".

We agree with the FCA's approach of looking at the payments business at each of these three levels, which we have called payments services, payments systems and payments infrastructure, and considering what, if anything, could be done at each level to increase competition and innovation and reduce costs. We believe that there is potential for greater competition at each of the three levels, although far less in payments systems, because of the benefits to consumers of large networks that may be close to natural monopolies. We consider the scope for greater competition between payment systems or in infrastructure provision in greater detail later in our submission.

One way to increase competition in payment services would be to address the cross-subsidies which are an inherent feature of the 'free-in-credit' banking model. We believe that the new Payment Systems Regulator should give serious consideration to the way in which 'free-in-credit' banking, including cross-subsidies between different consumer groups, and associated 'free payments' serve to reduce innovation and competition in payment services and the personal current account market. This is because, while banks face costs from consumers and businesses making payments, they do not charge consumers directly for individual transactions, and so customer behaviour is not influenced by price differences reflecting different underlying costs. We believe that greater use of price signals would encourage consumers to make more active choices (as in using Paypal rather than a card or using a debit rather than a credit card) and would help drive down costs.

Ownership and governance

6. **Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure?**

7. **How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model,**

might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models?

8. **Do you have any concerns about the current governance of UK payment systems?**

9. **What do you believe is the appropriate governance structure for UK payment systems?**

The Payment Systems Regulator should consider the ownership of the payments system by the large incumbent banks and, in particular, whether divestment would act as a catalyst for greater competition between schemes as well as increased innovation. We remain to be convinced that a change in ownership would bring these benefits, given that the large banks would continue to wield significant power as the principal users of payments systems. Such divestment could, at the margins, promote greater competition between schemes, but the scope for greater competition in this area will inevitably be limited by economies of scale combined with the existence of strong network effects in payment systems, which will tend to lead to the dominance of one scheme for each class of payment. Any consideration of ownership changes should, however, take place in the broader context of ensuring such changes do not put at risk the reliability and stability of payment systems, or the willingness of large banks to invest in them.

Some scope may also exist to increase competition between existing payment systems as well as between payment systems and payment card schemes, both of which are areas where competition is at present limited. To this end, we would support the gradual removal of limitations on the scope of the activities of payment systems, and encourage payment systems to compete with each other (e.g. Bacs with Faster Payments, LINK with cards). However, any steps to introduce greater competition in this area must take full account of the implications for the reliability and continuity of payment services and the broader impact on financial stability.

Access

10. **How do you access UK payment systems?**

11. **For the access you described above, are the access terms and conditions (including fees) fair and reasonable? If not, please provide details?**

12. **Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?**

13. **If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?**

14. **Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)?**

15. **What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?**

16. **Do you have any other comments regarding access?**

We access the major payment schemes both directly and indirectly. We are direct members of both LINK and Bacs, but indirect members of CHAPS, Faster Payments and C&CCC.

Whilst Virgin Money is, generally satisfied with the price, terms and conditions on which we indirectly gain access to Faster Payments, CHAPS and C&CCC, we understand that some smaller banks and building societies may have problems accessing the system on fair and reasonable terms. Additionally, they may lack the expertise to negotiate effectively with the sponsor banks.

The Payment Systems Regulator should, as a priority, examine the extent to which the large incumbent banks have, or could, create barriers to entry and expansion through their membership requirements for the major payment systems or through the terms and conditions on which they offer indirect access to those systems. The OFT in *UK Payment systems* noted that "given the high concentration in the retail banking markets...it would not necessarily expect competition among these large providers to lead to competitive and efficient outcomes in the provision of access to payment systems".

With respect to payment systems, we believe that the Regulator should:

- Assess the case for reducing the requirements for direct entry to the major payment schemes;
- Examine whether smaller banks using agency banking arrangements get inferior levels of service or face disproportionately high charges;
- Examine ways in which information asymmetries in agency relationships could be reduced, including through greater transparency;
- Look at the case for establishing a single interface through which smaller banks and new entrants could gain access to some or all payment systems they wish to access indirectly;
- Ensure that the requirements for handling payments and settlement accounts at the Bank of England do not create unnecessary barriers to direct membership of payment schemes for smaller retail banks;
- Ensure that interchange fees are broadly cost-reflective in total and fairly spread between different banks (incumbents, smaller banks and new entrants) and retailers.
- Examine the extent to which indirect members of the Faster Payments scheme are not disadvantaged (e.g. in Paym) by slower settlement and confirmation of payments and, if so, how this could best be remedied;
- Ensure that indirect members of payment systems and schemes and, in particular, C&CCC are not disadvantaged by having to change sort codes when changing from one agency bank to another.

Infrastructure and innovation

17. **What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?**

18. **What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and**

considerations would need to be taken into account in adopting new standards?

19. **What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?**

20. **Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees.)**

21. **Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?**

22. **What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments?**

23. **What do you believe are the benefits and limitations of collectively driven innovation versus unilateral innovation?**

We believe that consideration should be given to the scope for greater competition between payments infrastructure providers which could help enhance innovation in payment services and would also help drive down costs. However, any steps to introduce greater competition in the provision of payments infrastructure must take full account of any implications for the reliability of payment services and financial stability.

At present the infrastructure supporting many of the key payment systems —Bacs, Faster Payments and LINK — are owned and run by VocaLink which is itself owned by largely the same group of banks which operate and own the payment schemes, including the three listed above. We believe that the Payment Systems Regulator should examine:

- The extent to which ownership of VocaLink by the large banks has served to reduce the scope for new infrastructure providers to enter the market as well as the extent to which divestment of their ownership of VocaLink would stimulate greater competition and innovation in infrastructure provision;
- What kind of ownership structure for payments infrastructure would most likely support innovation, and the financial stability implications of such changes;
- Whether the parts of VocaLink that support Bacs, Faster Payments and LINK should have a greater degree of separation from each other and whether this would increase competition between payment systems.

Closing questions

24. **Do you have any other comments or concerns you would like to highlight?**

25. **What, if any, are the significant benefits you see regulation bringing?**

26. **What, if any, are the risks arising from regulation of payment systems?**

27. **How do you think regulation might affect your business and your participation in UK payment systems?**

Payment strategy

We strongly support the establishment of a payments strategy that meets the current and future needs of personal and business customers and that is achievable. However, it will be necessary to ensure that such a strategy is supported by the large banks and, most importantly, that they are willing to make the necessary investments.

We strongly support the establishment of a payments strategy that meets the current and future needs of personal and business customers and that is achievable. However, it will be necessary to ensure that such a strategy is supported by the large banks and, most importantly, that they are willing to make the necessary investments.

Responsibility for devising a payments strategy should sit with the industry and the individual schemes, but, as envisaged, with the Payment Systems Regulator approving strategy and ensuring that the strategy is joined-up and coherent. To this end, we believe that there could be merit in establishing a new industry body (which might be a reconstituted Payments Council) to work with individual payment scheme companies and the Payment Systems Regulator on matters that require industry-wide collaboration, such as the formation of strategy and the implementation of initiatives. Such an approach would recognise that, whilst competition will often be the driver of innovation in payment services, collaboration also has an important role to play, especially in delivering initiatives that require industry-wide participation. That said, collaboration on industry-wide initiatives must not be allowed to impede competition or cut across innovation in payments by individual banks.

Accountability and expertise of the Payment Systems Regulator

The new Payment Systems Regulator will have a demanding job. The sheer range of issues requiring consideration and action suggests that the Payment Systems Regulator and their team should have knowledge and experience of:

- all the designated payment systems, the infrastructure that supports them, and related matters in banking (such as current accounts and credit cards);
- utility-style regulation, including the ability to drive forward a pro-competition agenda;
- use of concurrent competition powers;
- forming strategy and getting buy-in for this strategy from a wide-range of stakeholders, including consumer groups, banks, payment systems and infrastructure providers amongst others; and crucially
- challenging the self interest of the large banks and dominant infrastructure providers, when necessary and where they oppose change.

On 7 April 2014 the FCA announced the membership of the Payment Systems Regulator Board. We note that the Board, as currently constituted, consists solely of FCA executives and non-executives. We believe that consideration should be given to having some external representation on the Board (as is the case for example with the Bank of England's MPC and FPC), augmenting the skills of the announced members with individuals with experience and knowledge, for example, of utility-style regulation and introducing greater competition in such markets as well as individuals with industry-specific IT expertise.

We also believe that, given the important role the Payment Systems Regulator will play in driving competition and innovation in payments, consideration should be given to how to ensure accountability of the new body. As a first step, we believe that the Payment System Regulator should be accountable for its strategy to Parliament, via the Treasury Committee.

Financial Conduct Authority: Payment Systems Regulation Call for Inputs

Response from Visa Europe

15 April 2014

INTRODUCTION

Visa Europe welcomes this opportunity to provide input to the FCA process to determine the regulatory approach, rules and priorities for the Payment Systems Regulator (PSR) in time for 1 April 2015.

Visa Europe is a membership association, owned and operated by over 3,000 banks, financial institutions and payment service providers – large and small – in a territory that comprises 37 countries across Europe and beyond. As a dedicated European payment system, we are designed to specifically respond to the needs of European 'service-users'. We exist and operate as an entirely separate organisation to Visa Inc., but work closely together to enable the global interoperability of Visa payments anywhere in the world.

We recognise this Call for Inputs is the first step in a series of market engagement activities over Spring and Summer 2014, which commenced with the 10 April 2014 Stakeholder Engagement Day. Visa Europe commends the FCA's stated approach of working via close dialogue with the payments industry, in order to gain a comprehensive understanding of the industry's complex operation. We welcome the possibility of further engagement – such as a Visa Europe hosted 'masterclass' on 'internationally-capable merchant payments' – and are happy to provide any information or input that would assist the PSR's development into an independent, economic regulator with clearly-defined objectives, appropriate priorities and a practical rulebook.

Our comments in this Call for Inputs response are based on over 50 years of experience of running a payments system that enables a consumer shopper or corporate purchaser to make a payment via a Visa debit, credit, commercial or prepaid card to a 'merchant' (including retailers, airlines, utility provider, small businesses, charities, etc), regardless of whether these are based in the same country, or in over 200 other countries around the world. We refer to this as 'internationally-capable merchant payments'.

Throughout this response we refer to ourselves as an internationally-capable 'card' system, in order to explain the type of payments we deliver compared to other payment systems. Cards can be used to pay 'face-to-face' with the merchant via Chip and PIN, contactless, or in some markets, magnetic stripe. Cards can also be used in the 'card not present' e-commerce environment (currently 25% of Visa transactions in the UK and growing). In practice however Visa Europe is a broadly based payments business whose innovations will increasingly not just involve a physical plastic card nor necessarily just 'merchant payments'. Operating in an increasingly competitive international marketplace with fast-changing technology, Visa Europe has and will develop other ways of making it possible to shop or transfer money between two parties via the Visa network using any secure device or any channel.

STRUCTURE

Visa Europe's response to the Call for Inputs is structured as follows:

- **Section A** provides a short summary of Visa Europe's response to the Call for Inputs. An overview of Visa Europe's payment system is also provided.
- **Section B** sets out Visa Europe's response to the specific questions asked. As requested by the FCA and stressed on the 10 April 2014 stakeholder event, this section includes evidence, information and detail.

SECTION A – OVERALL COMMENTS

Visa Europe strongly supports the vision of an open, dynamic, efficient and secure world-class payments industry in the UK in which innovation and competition respond to the payment needs of end users. We would like to make a number of overall points and recommendations regarding how the PSR can best achieve its aims.

- **Payment systems in the UK are highly diverse. The primary distinctions are between 'merchant payments' and 'inter-bank payments'; and between payments systems which operate internationally or just in the UK.** The payment systems active in the UK are each complex and very different from each other in terms of purpose, strategy, governance, access, competition and innovation (see answer to Q2). It is imperative that the PSR gains a strong understanding of these differences and can evaluate each individually.

- **The payments market is rapidly changing with fast-moving technology and new market entry.** There should be a strong emphasis, as already intended by HM Treasury, on 'future proofing' the PSR's rulebook and regulatory decisions. This should ensure oversight of all significant players and maintain effective functioning of this highly competitive and fast-changing international market.

- **All payment entities with significant impact on end-users should be designated to ensure a level playing field.** In addition to the list of payment systems currently intended by HM Treasury for designation, other payment systems (whether they define themselves as such or not) warrant consideration for designation from day-one as well (see Q1 answer). E.g. PayPal has over 18m UK account holders and has expanded beyond eBay and e-commerce into 'face-to-face' payments. When launched, Zapp will also be available to over 18m UK current account holders with backing from several significant high street banks.

- **Be proportionate and measured – not 'one size fits all'.** The diversity and complexity of payment systems active in the UK requires a proportionate, cost-effective and measured approach – a 'one size fits all' approach could be extremely disruptive and potentially destructive for the industry. Market intervention should only be considered when there has been clear end-user detriment, and solutions should be reached via robust cost-benefit analysis.

- **Focus on identified, evidence-based problems**. Visa Europe understands that the main concerns of HM Treasury are related to the domestic inter-bank payment systems and that no significant concerns have been raised in relation to Visa Europe. Any concerns expressed by HMT regarding domestic payment systems should not be seen to automatically apply to 'card' payment systems such as Visa Europe, given their fundamentally different characteristics.

- **Take account of the international implications of UK decisions.** Payments is a scale business. Many payment systems operate beyond just the UK on the basis of pan-European or international governance structures, strategies, standards and interoperability of products. UK-focused regulatory interventions could create challenges for internationally-capable systems or could slow down innovation delivery if changes were required in the UK alone without reference to the wider international picture.

- **Work within the context of existing European payments regulation (interchange, PSD2), other relevant regulation (data protection, etc.).** The cards industry in the UK has been regulated for many years at the European level. The PSR should ensure that it does not create a framework in the UK that is more restrictive than European regulation, which would thereby put UK based payment systems at a competitive disadvantage. Any direct conflicts would also lead to significant confusion and complications.

- **Work within the context of applicable UK regulation.** The PSR will be joining the current activities of the FCA, CMA and Bank of England. It is imperative that there is clear jurisdiction between these regulators for their respective remits, responsibilities and powers. Failure to clarify and establish this could stifle innovation, cause level playing field problems, place payment systems in the UK at a competitive disadvantage and frustrate intended regulatory outcomes.

- **Be aware of unintended consequences.** There are numerous examples where well intended regulatory intervention in the cards payment market has resulted in detrimental consequences. Following regulatory intervention on interchange in Spain in 2004, Spanish consumers paid €2.35 billion more in annual card fees between 2005 and 2010. As a result, there was a marked slowing down of growth in card usage in favour of cash. Market players, who lose revenue as a result of regulatory intervention, are always likely to look for new revenue sources in other ways, potentially to the detriment of consumers.

- **Trust in payments is of the utmost importance.** Any significant loss in trust by consumers in one payment system could affect trust in electronic payments overall. Maintaining trust should be a major driver of any new regulation.

- **Internationally-capable merchant payment systems are not a utility.** The characteristics of a utility typically refer to natural monopolies that produce a homogenous product. In UK payments, there are multiple ‘rails’ that reflect multiple requirements, and the competition between the rails and the innovation delivered on the multiple rails is strongly to the benefit of the service-user. The PSR should take clear account of this in the way in which it regulates.

- **The PSR should act as an independent, economic regulator.** For the PSR to work effectively it will need to have a clear sense of purpose as an independent, economic regulator. Given its relationship to the Financial Conduct Authority, and that the PSR board is entirely comprised of FCA senior figures, there is a concern that there could be mission creep, with the PSR trying to address conduct, leading to both functions being delivered poorly.

- **Consumers should be able to ‘reverse’ a payment if necessary.** It is inevitable that payment systems will be required by ‘participants’ to ‘reverse’ a ‘merchant payment’ (e.g. if the wrong amount is sent due to payer/merchant error, if the goods/services were faulty/not received by the payer, etc). Such functionality is essential in maintaining end-users’ trust and confidence in electronic payments, but the experience varies significantly according to the different systems. For card payments in the UK, Section 75 of the Consumer Credit Act already covers payments over £100 on credit cards, and Visa Europe's chargeback framework already goes further than this by applying to all Visa cards for all transaction amounts. It is important that equivalent functionality is offered by other payment systems active in the UK (e.g. PayPal; Zapp; etc), otherwise it will place other payment systems who continue to invest in and prioritise consumer protection at a competitive disadvantage.

- **Be very clear and consistent with definitions and industry terminology.** Across the payments industry, there are a variety of meanings for the same phrase or item of industry terminology – e.g. 'infrastructure', 'retail payments', etc. This can create potentially-damaging confusion.

Visa Europe would also like to provide its response as a payment system intended for designation to the three objectives of the PSR from the perspective of an internationally-capable 'card' payment system:

- **Competition.** There is clear and vigorous competition between 'card' payment systems at the inter-system (payment system), intra-system (payment service providers) and infrastructure levels (authorisation, clearing and settlement) layers. The fast-moving international market is also seeing intense competition, not just between established 'card' payment systems but from processors and non-traditional technology companies seeking to enter the payments market (e.g. mobile phone operators, search engines, social networks, etc). See answers to Q1-Q4.

- **Innovation.** Strong competition in 'card' payments is apparent from the rapid pace and scale of change. Visa Europe has invested over €1 billion in new technology and infrastructure over the last six years, and continues to spend over €100 million each year in creating faster, safer and more convenient ways to pay. International 'card' payment systems such as Visa Europe are not a 'cost centre' for the banks and financial institutions. There are strong commercial reasons to innovate. Our latest innovation includes the digital wallet, V.me by Visa; contactless card and mobile payments; mPOS acceptance, and mobile personal payments. For more information, see answers to Q20-Q23.

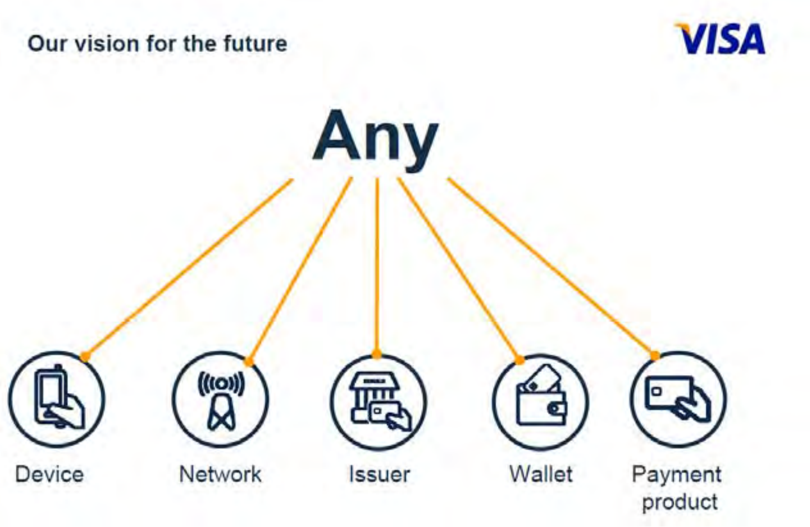
- **Access. '**Card' payment systems require scale and therefore it is in Visa Europe's interest to work with as many 'participants' as possible (our membership includes traditional high street banks and non-bank owned acquirers to building societies and credit unions, the payment arms of retailers, eMoney licensees, payment institutions and mobile phone operators), to reach the widest number of consumers and merchants who can use our products via any device or any channel. Visa Europe's interests in promoting access accords with the position under the Payment Services Directive (PSD). Visa Europe has over 3,000 members – large and small – across 37 countries, of which over 100 are in the UK. Over the last 12 months, nine new members have joined in the UK.

VISA EUROPE

No longer just a 'card' company

Visa Europe is a payments business, working at the forefront of technology to introduce new, easier, and more secure payment options for people to pay and be paid. For the last 50 years, we have enabled consumers, retailers and other merchants, and banks to do business together via the use of a plastic card. There are currently over 500 million Visa cards across Europe, and the future of our business will involve extending Visa technology to make it possible to shop or transfer money via a mobile phone and/or on the internet.

Throughout this document we refer to ourselves as a 'card' system, for the ease of clarifying the type of payments we deliver compared to other payment systems. Yet the rapidly evolving character of our business beyond just physical payments 'face-to-face' with a plastic card is a key theme in Visa Europe's response to the FCA's Call for Inputs outlined below.



Use of our payment system

There are 500m Visa cards across Europe, and €1 in every €6.50 spent in Europe is on a Visa card. In the year to September 2013, total expenditure on Visa cards reached €2 trillion, while point-of-sale spend increased by 8.5% to €1.4 trillion. Annual e-commerce spending on Visa cards continues to grow (20% year-on-year) and now stands at €240bn.

In the UK, more than £1 in every £3 spent by consumers each year is on a Visa card, with Visa debit cards accounting for over 80% of this. In the year to September 2013, total expenditure on almost 125m UK Visa cards increased 9.2% to £445 billion, while e-commerce spending increased 18% to £110 billion.

Our membership association structure

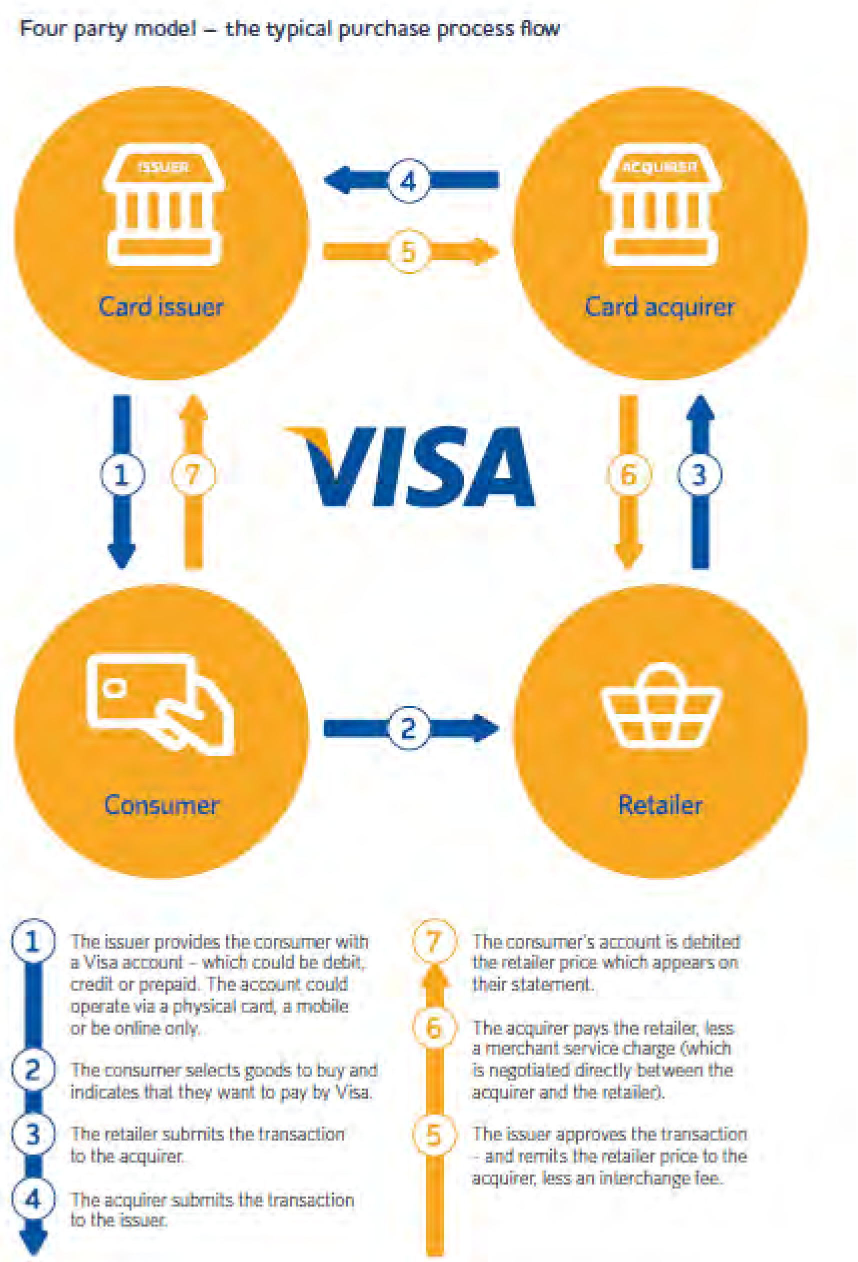
Visa Europe is a membership association, owned and operated by over 3,000 banks, financial institutions and payment service providers – large and small – operating in a territory that comprises 37 countries across Europe. We work closely with Visa Inc to enable the interoperability of Visa payments anywhere in the world, but exist and operate as an entirely separate organisation. We have an exclusive, irrevocable and perpetual licence from

Visa Inc to provide Visa branded products and services in our territory. We are headquartered in the UK.

As a membership association, we reinvest our free cash flows back into making our system more efficient, and in new innovative payment methods and platforms after supporting our capital base (in line with Basel norms).

<u>How our payment system works</u>

We provide the brand, systems, services, and rules that help make electronic payments happen between millions of European consumers, retailers (and other merchants), businesses and governments. We are part of one of the biggest communications networks in the world. That same technology provides the platform to keep every transaction safe, to support new and innovative ways to pay, to speed up transaction times even as volume grows and, above all, to ensure paying by Visa works, wherever in the world the Visa cardholder currently is.



We operate this via the ‘four party model’, which is explained in the diagram above. Visa has a direct relationship with issuers and acquirers via our membership structure. Whilst we do not have a direct relationship with consumers or retailers, we continually conduct research and market analysis to ensure we understand their needs and are able to work with members to deliver payment products and solutions that meet their needs.

The blueprint for the operation of the Visa system is set out in our operating regulations which govern the relationship between the participants in the Visa payments business. These operating regulations provide for an equitable balance between the rights and obligations of all involved. They also ensure the inter-operability and end-to-end quality of the services and platforms and provide end users with the required level of trust in the product and the brand that they use or accept.

In addition to operating the Visa ‘scheme’ (brands, products, services, rules), we have also invested €0.5 billion in recent years in order to create our world-leading processing infrastructure. We have the fastest, most reliable, robust and secure authorisation, clearing and settlement system in Europe. Year-on-year, our authorisation delivers 100% availability and 99.999% service quality, with complete multicurrency capability. In the 12 months ended March 2014, we processed in excess of 15.4 billion transactions (clearing & settlement), which is an average of more than 42 million per day. In the run up to Christmas 2013 the peak volumes though the Visa Europe Authorisation Service reached 1,580 transactions per second.

As a processor, we compete with more than 20 other processors in Europe. Visa Europe’s issuers and acquirers are completely free to choose their processor and network of choice for authorisation, clearing and settlement. As a result of the highly competitive processing market in Europe, our processing system only processes less than half (46%) of all Visa transactions in the Visa Europe territory.

In terms of processing, Visa Europe only plays a role in part of the value chain. We engage in bank switching, clearing and settlement of transactions, but we do not carry out for example issuer or acquirer processing. It interconnects with numerous domestic and independent processors including LINK, Atos Worldwide, First Data, EuroConnex, and Total Systems.

SECTION B – REPSONSE TO QUESTIONS

PAYMENT SYSTEMS IN THE UK

Q1: ***Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.***

Having reviewed HM Treasury's approach to designation made clear in the HM Treasury October 2013 'response to consultation' (p.9-10.), and subsequently in Part 5 of the Financial Services (Banking Reform) Act 2013, we have provided our viewpoints on the stated approach below. Visa Europe will also share its views directly with HM Treasury when the official consultation on PSR designation is issued later this year.

HM Treasury designation decisions – with Visa Europe's comments

- **Competitive neutrality.** Visa Europe agrees it is essential that there is a level playing field amongst 'merchant payments' in the UK – defined as payments being made by a consumer or corporate payer to a retailer, merchant or business recipient. It is important to ensure systems do not gain a competitive advantage because they are not designated, versus those that are. Clearly such an outcome would be perverse, and would ultimately be to the detriment of end users.
- **Future-proofing.** The payments industry in the UK and elsewhere is currently experiencing an unprecedented level of change in terms of scale and speed. This is driven in large measure by technology, which is facilitating market entry by a range of new entrants, as well as the development and launch of new products. HM Treasury has rightly built into the designation criteria the number, value and nature of transactions the system presently processes, or "has the potential to process in the future". The development and growth of emerging payment systems should be closely monitored by HM Treasury so as to provide for designation before their size led to any deficiency or disruption which had serious consequences for service-users.
- **Regular review and flexibility.** HM Treasury has acknowledged designation needs to be appropriate and be kept under review to "have the flexibility to bring emerging payment schemes and participants into scope, as and when they meet the threshold for designation"
- **Proportionality.** HM Treasury has made clear there will be no 'blanket demands' across all the designated systems. Instead the PSR will be under a duty of proportionality in its actions, curbing the risk of demands that are irrelevant or inappropriate for particular areas of the payments market. Visa Europe strongly supports this approach, which would allow resources to be focused on addressing identified evidence-based problems and priorities, without subjecting all systems to the burden of regulation which was not specifically targeted at identified issues that warranted intervention.
- **Assessment by potential impact on service-user.** It is essential that consumers, businesses, retailers and other merchants, and governments continue to trust electronic payments and have choice between payment systems according to what best meets their payment needs. Therefore Visa Europe agrees that designation must be assessed from the perspective of whether there will be any serious consequences for service-users if there was a disruption to the payment system's operation. In this context, consideration should also be given not just to those entities which define themselves as a 'payment system' but also those who exhibit similar functionality and whose activities could significantly impact the consumer.

- **All ‘merchant’ payment systems active in the UK within potential scope of designation.** HM Treasury has decided that for reasons of competitive neutrality and future-proofing, all ‘merchant’ systems active in the UK should be evaluated to consider against the criteria for designation, including ‘no-party’ schemes, which Visa Europe would interpret as covering entities such as PayPal.

Payment systems warranting consideration for designation

Determining which entities will be designated, and how the criteria for designation are applied, will be a critical question for HM Treasury.

Visa Europe understands that HM Treasury currently intends in the first instance to designate the main domestic automated inter-bank schemes (Bacs, CHAPS, Faster Payments); the cheque clearing systems; the LINK ATM network; and the international ‘card’ schemes (three party schemes such as American Express and four party schemes such as Visa Europe and MasterCard).

Given that HM Treasury currently intends to designate international ‘card’ schemes, Visa Europe believes there are also other payment entities active in the UK which have a significant impact on the experience of service-users, and large enough, to be considered for designation in the first instance as well. Visa Europe suggests consideration should be given to the following payment systems:

- **PayPal**. The number, value and nature of transactions warrant consideration for designation as a significant payment system active in the UK. PayPal has over 146m account holders worldwide, of which 18m are in the UK, which is its second largest market after the US. Setting this in context, American Express has 4.1m UK cards and MasterCard 40m UK cards (both are payment systems intended for designation).

  Created in 1999 to service eBay, over 70% of PayPal’s payment volume now comes from outside eBay. Its share of total global e-commerce payments was estimated at 18% in 2010[1]. PayPal payments totalled $27bn in 2013. More recently, PayPal has also expanded from e-commerce payments into a full service offering including ‘face-to-face’ payments. For example, PayPal can today be used to pay via mobile phone at over 2,000 retailers including Snow+Rock, Thomas Pink, Karen Millen, Warehouse, Oasis and Cycle Surgery, plus restaurant chains Pizza Express and Prezzo. ‘PayPal Here’ has also been launched allowing small businesses, via an iPad or smartphone, to accept payments from customers PayPal accounts. Whilst there is no established definition for this kind of payment entity, Visa Europe notes that in its 2012 response to the European Commission’s Green Paper, PayPal referred to itself as a “three-party payment scheme”. PayPal President David Marcus also referred to PayPal as a “payment system” in a February 2014 interview with the Daily Telegraph[2].

- **Zapp.** Zapp is an example of an upcoming UK payment system which seeks to compete directly with cards at the point at which consumers decide how to make a payment to a retailer. Whilst it will not launch until Autumn 2014, it has publicly announced[3] its scale will be immediately significant from the outset given that it will be available to 18m UK current account holders across five banks (HSBC, First

[1] Source: eBay analyst day 2011
[2] http://www.telegraph.co.uk/finance/newsbysector/supportservices/10612216/PayPal-fends-off-calls-for-demerge-from-eBay.html
[3] http://www.theguardian.com/business/2014/jan/15/zapp-app-millions-shoppers-pay-smartphone

Direct, Nationwide, Santander and Metro Bank). It initially will be available for online purchases, and will be enabled for at least one in five face-to-face payments to retailers from late 2015. Zapp is being developed by Vocalink, which is owned by a consortium of 18 banks and building societies, many of which are also members of Visa Europe. This is also another example of how the overlapping ownership of payment systems has not deterred investment in innovations and competing systems in the merchant 'shopping' end of the UK payments industry.

- **Other payment systems.** A range of other competing systems are currently active in the UK, in relation to e-commerce or face-to-face payments (or both). As a basic premise, designation considerations should concentrate on ensuring that custodians of a consumer or business payment have specific responsibilities and are accountable for the successful, timely and cost effective completion of that payment, whether in the face to face or online environment.

  In this context, those organisations, such as Visa Europe, which bear the cost and burden of supplying and maintaining payment networks should not be deprived of the opportunity to compete effectively with emergent payment providers that benefit from this infrastructure (e.g. Amazon 'one click; iTunes card-on-file) and who do not necessarily share the investments that are required to support it. The following chart illustrates the number and diversity of players which could reach a scale where impact to the service-user would be significant enough for consideration of designation.

<u>Chart to illustrate number and diversity of players in UK payments of relevant to the service-user (consumer, small business, retailer, etc)</u>

Source: Information sourced by Visa Europe from the public domain and correct at 31 March 2014
Graphic is not exhaustive and is to demonstrate key player positioning in UK payments

COMPETITON

Q2: *Where do you believe competition is effective or ineffective within UK payment systems?*

By way of background, Visa Europe considers it would be helpful to outline its view of the UK payments industry, and to explain specifically why it considers that the functions and operations of the domestic inter-bank systems are so different to that from the international 'card' payment systems.

<u>Definition of the UK payments industry</u>

The Call for Inputs attempts to group 'participants' in regulated payment systems into three groups: payment system operators, infrastructure providers and payment service providers.

There is however a degree of complexity concealed by each label, and we would recommend focusing on from an end-user's perspective. What is each payment system designed to do? Who does it compete with in that space? Who is delivering that service in the UK?

Traditionally, different payment systems have focused on very different kinds of transaction, with different requirements:

- Business to business (regular, cyclical payments like invoicing etc.)
- Shopping in retail and travel (ad-hoc, unpredictable – any consumer, any retailer, at any location, at any time)
- Regular payments i.e. utility bills (regular, cyclical, predictable)
- Large scale transactions i.e. house purchase (one-off but very significant)

The degree of competition between payment systems in these different areas has varied; however, new technology is creating the opportunity for increased competition across and between the different areas, as well as allowing new forms of competition from other players not previously involved directly in payments (e.g. Mobile Network Operators).

Taking these developments into account it is possible to offer the following transaction categories. The definition of each category brings out the broad distinctions between the different payment systems active in the UK:

- **Electronic payments from UK payer to a merchant based outside the UK.** In this category, the electronic payment is typically conducted via the use of a plastic card (debit, credit, prepaid or commercial card) and facilitated by the international 'card' schemes of Visa, MasterCard and American Express. A 'merchant' includes a retailer, a travel merchant (e.g. hotel, airline), a small business, a charity, etc. The cross-border transaction can take place 'face-to-face' when the UK payer is travelling (for holiday or on business), or via an ecommerce transaction on the internet. For the last, other payment systems become relevant for international payments, such as PayPal.

- **Electronic payments from a UK payer to a merchant based inside the UK.**
  - **Ad hoc payments**. In this category, the payment system used is typically the same as listed in the above example. New innovations have also bought other options to market, such as the upcoming UK launch of Zapp.
  - **Cyclical / predictable payments**. When paying a utility bill (gas, electric, mobile phone) or subscription, the UK consumer can either make the

predictable payment each time via a card. They can also set up a 'recurring transaction' (or continuous payment authority) via a card payment system, or initiate a direct debit (via a domestic inter-bank system). New innovations in this space also include Pingit from Barclays.

- **Electronic payments from a UK consumer to another UK consumer.** In this category, the electronic payment is typically conducted via a bank account using Faster Payments, or another domestic inter-bank system. There is also a great deal of innovation and new products being launched in this space, such as the upcoming launch of Paym. The 'Visa Personal Payments' functionality was also launched in Spring 2013 which consumers can access via participating Visa member banks, and can transfer money to another of Visa cardholder in Europe. 3.1m UK consumers have already downloaded the RBS app with Visa Personal Payments functionality.

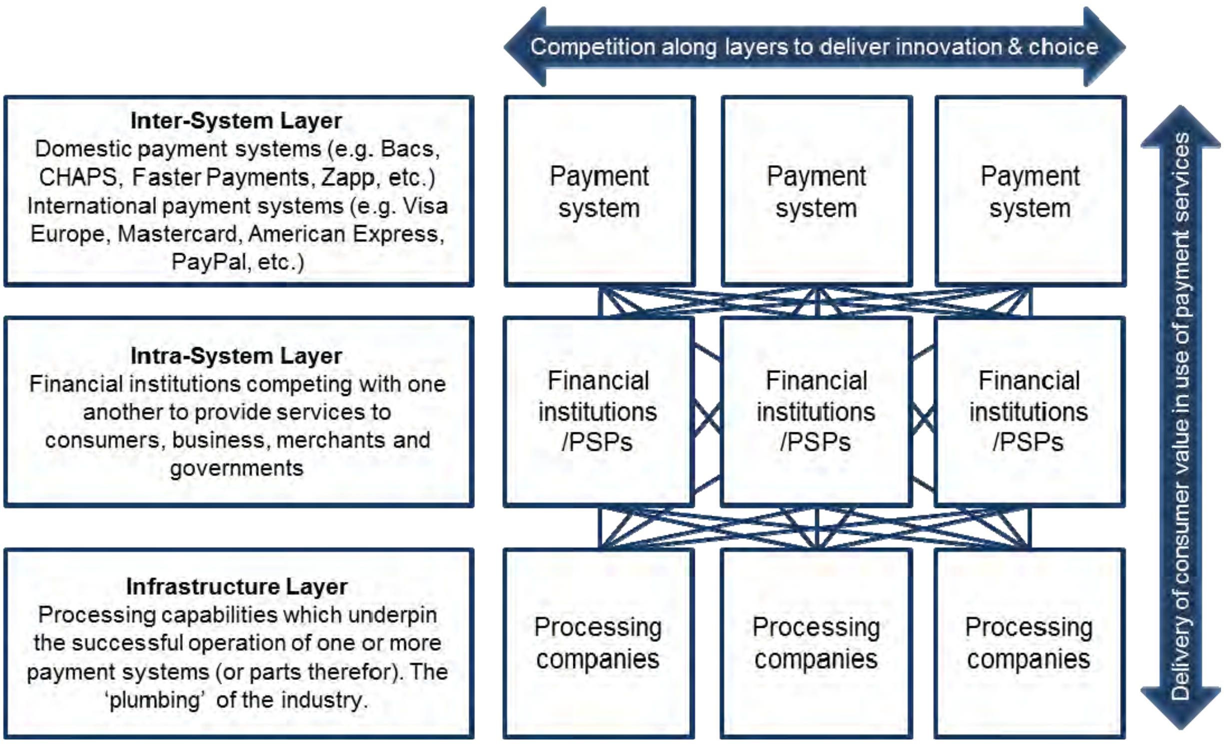
- **Electronic payments from a UK consumer to another consumer outside the UK.** In this category, payments can be made via services such as Western Union and MoneyGram, or by bank transfer. International 'person-to-person' payments can also be made by Visa Personal Payments, which can be sent to any other Visa card in Europe, across multiple currencies.

- **Electronic payments from a UK employer to a UK employee.** In this category, payment functionality is available via the domestic inter-bank systems.

- **Large value electronic payments within the UK.** In this category, payment functionality is available via the domestic inter-bank systems.

- **Electronic transaction to access cash.** In this category, payment functionality is available at ATMs via the LINK network, primarily processed by Vocalink.

As noted above, Visa Europe believes competition should be viewed from the perspective of the payments experience of a consumer (or other 'end-user') in the UK. This echoes HM Treasury's stated approach towards the principles of designation and requires account to be taken of ALL payment systems which are active in the UK and not just the 'UK payment systems' (traditionally regarded as Faster Payments, Bacs, CHAPS, etc). On this basis, competition in UK payments takes place at three different, but interconnected, levels, as reflected in the diagram below.



In this definition, Visa Europe exists both as a payment system ('the scheme') and as an infrastructure provider ('the processor').

Competition

Visa Europe's comments are based on over 50 years of experience of running a payments system where a consumer or corporate payer can make a payment via a Visa debit, credit, commercial or prepaid card to a 'merchant' (including retailers, airlines, small businesses, charities, etc) based in the same country, or based in over 200 other countries around the world. We refer to this as 'internationally-capable merchant payments'. In this context, Visa Europe believes that in relation to the 'card' payment systems competition is highly effective at the inter-system, intra-system and infrastructure levels.

Competition in the inter-system layer – 'card' payment systems

- Duality of membership between Visa Europe and other international schemes such as MasterCard is common and has resulted in vigorous competition by the internationally-capable payment schemes. This competition drives innovation in products and systems (see response to Q20 for examples).
- There have been an increasing number of new entrants competing with internationally-capable payment systems over recent years as illustrated by the 'key player positioning' chart in the answer to Q1. The card payments business has relatively few barriers to entry and many of the global players seek a position in the UK where they believe they can offer differentiated products and services.

Competition in the intra-system layer – participants of 'card' payment systems

- Issuers in international four-party scheme compete with each other to attract customers which can lead to more rapid network expansion and innovation, for the benefit of both merchants and consumers.
- There are currently over 30 acquirers active in the UK market (for both ecommerce and/or face-to-face payments) leading to significant competition for acquiring business and high levels of churn among merchants in relation to acquiring in the UK. A number of large merchants are also acquired by more than one acquirer. Moreover, the extent of cross-border acquiring into the UK has continued to grow year on year, and the UK is one of the most important markets for "inward" cross-border acquiring within Visa Europe's territory. Visa Europe's latest 'commitments' agreement with the European Commission[4] and the proposed interchange regulation will drive further competition in cross-border acquiring to the benefit of consumers and merchants.
- The proliferation of payment services being offered and the emergence of new payment technologies, such as e-payments and m-payments, is a strong indication that competition is effective between payment providers. Furthermore, there has been a proliferation of new payment providers[5] in recent years. Clearly, new technologies are providing new avenues for companies to enter the payments sector. The general implication of these developments is that, for the first time, there is a possibility that innovation in payment system technology will no longer only be driven

[4] European Commission press release, 26 February 2014. http://europa.eu/rapid/press-release_IP-14-197_en.htm

[5] Payments within the UK is currently characterised by the entry of a large number of new players, some of whom will seek to compete by building on existing payment channels, while others will provide non-payment card solutions. It will also involve existing players which have hitherto operated in one channel providing payments through other channels. Examples of companies that will seek to build (at least in part) on existing channels include Google, PayPal, and Amazon, and those entering the market with non-card related propositions include VocaLink and Ericsson.

by banks and card payment networks but also by other players. This will undeniably provide a new impetus and generate growth in a market where there have been previously concerns about the pace of innovation.

Competition in the infrastructure layer – processors of 'card' payment systems

- Internationally-capable payment systems generally have to have their own infrastructure providers (referred to as 'processors'), to underpin the successful operation of the payment system. Visa Europe does not mandate the use of its infrastructure and indeed a wide range of commercial companies compete for business in this space. The level of competition is exemplified by the fact that 54% of Visa transactions in Europe are not processed by Visa. In the UK, the percentage is much higher for 'point-of-sale' (POS) transactions due to the nature of the UK acquiring market being mainly comprised of non-bank institutions (e.g. WorldPay, Eleavon, Global Pay, First Data) who have sought to simplify their processing arrangements by processing via one destination – Visa Europe. Visa Europe only processes 1% of ATM transactions on Visa cards in the UK.

Competition in the payments industry has become more intense in recent years as a result of innovations, with new technology attracting further new entrants in the digital/mobile arenas. This trend is expected to continue and accelerate as existing and new payment providers use a variety of new technologies to compete with existing international four-party and three-party 'card' payment systems.

Q3: *At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?*

Visa Europe believes that there are strong competitive forces in play at each of the inter-system; intra-system and infrastructure levels referred to above in relation to 'card' payments. In order to drive further benefits for service-users, Visa Europe will be required to continue responding rapidly to market and technological developments, and in this regard continued innovation will become even more critical in the coming years. Appropriate regulatory conditions are required in order to support and encourage such innovation and ensure no steps are taken to undermine it.

The importance of security and consumer adoption should also be considered in assessing the role that collaboration has to play in delivering this. In this respect competition at any cost will not work. For example, the collaborative (multi-billion) investment across the card payments industry in Chip and PIN (quantified to a few billions) has helped bring fraud down to 0.045% fraud-to-sales ratio (4.5p lost to fraud for every £100 spent) on Visa cards across Europe and fostered consumer confidence in the use of those payment systems involved.

Visa Europe's open membership structure has actively assisted in driving competition:

- Smaller players in particular are able to access innovation they would not otherwise be able to offer their customers by themselves, which they can then use to compete with each other.
- Members individually decide whether they want to use Visa Europe's innovation products and services, those of a competitor, develop their own, or indeed a mix of all these.
  - E.g. The mobile person-to-person solution from the Royal Bank of Scotland is a mix of their own platform and the Visa Europe platform. By contrast, Barclays, one of the largest Visa Europe members has opted to develop its own mobile person-to-person solution.

Visa Europe has researched and assessed the needs of UK consumers, retailers and other merchants for many years in a number of different ways. The ongoing success of Visa Europe's payment system is determined by the degree to which we continue to provide innovative payment solutions that directly meet the needs of consumers and merchants alike.

Q4: ***What are the main factors impeding more effective competition at each level?***

Visa Europe believes there is effective inter-system and intra-system competition in relation to internationally-capable merchant payments and that there are no factors impeding competition at these two levels from our experience of operating card payment products and services.

However, effective competition requires a 'level playing field' for all competitors and any developments that undermined this could have a serious impact on competition. There should not be vested interests between the governance of payment systems, and the infrastructure chosen to 'process' the payments from that payment system. If a certain infrastructure supplier is chosen without a comprehensive procurement process that prioritises the right criteria (best value, best service, etc), this can be a significant impediment to competition.

Another factor that may limit competition would be that banks and other incumbents should not be regulated in a disproportionate way that hampers their ability to innovate. Non regulated competitors, with less perceived risk, would be in a position to continue to innovate by trial and error and respond quickly in a flexible way if new products or initiatives are not successful. See answers to innovation questions (Q20) for examples.

COLLABORATION

Q5: ***What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?***

Collaboration between the payment system and its 'participants'

Collaboration is at the heart of Visa Europe's business. Working as a membership association, every day we need to collaborate with our 3,000 members and other players in the broader global merchant payments ecosystem to maintain the effective and secure operation of Visa payments.

Collaboration between different payment systems

When considering collaboration between payment systems, it is essential to understand the UK payments industry is not a homogenised market, and each payment system active in the UK varies widely in terms of the respective capabilities, and the nature of the payments they provide (see description given in Visa's introduction).

Visa Europe fully agrees with the OFT's conclusion (OFT UK Payment Systems report, July 2013) that collaboration should be strictly limited to areas where collaboration, rather than competitive market forces, would be the most efficient manner in which to deliver changes in the 'card' payment sector, and which would generate benefit for the end-user.

Visa Europe believes the following areas benefit from collaboration in the 'card' payments space:

- Standards. In the UK, this is mostly co-ordinated in the UK across the card industry by the UK Cards Association. Globally, Visa Europe has always supported industry-led standardisation, with representation of all relevant stakeholders, in order to ensure the interoperability that is needed to support the growth and efficiency of European payments.
- Security. Collaboration is co-ordinated across cards and point-of-sale terminals for security by EMVCo, and the SEPA Card Standards which include European-wide security requirements. A good example of cross-cards industry collaboration was the creation and roll-out of Chip and PIN.
- Terminology with a view to encouraging transparency to service users
- Contactless limits in order to simplify the merchant and cardholder experience at the point of sale.

For payments in the 'merchant space', there are many benefits to be gained across the four parties – i.e. by consumers and retailers – if payment systems instead are left to compete with each other. This is most relevant for upcoming innovation, such as e- and m-payments. Imposing collaboration measures when the development of a new technology is at embryonic stage would risk stifling innovation.

For new innovation, it is can also be more beneficial to leave the participants of payment systems to use new innovations to compete with each other. One example of this is contactless, where the first bank (Barclaycard) to adopt and deliver contactless cards gained competitive advantage, and this generated momentum and uptake by the other banks and financial institutions. Using the example of Barclaycard, competition for contactless has also led them to innovate further, creating the PayTag contactless sticker for mobile phones.

OWNERSHIP

Q6: ***Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.***

The 2013 HMT 'Opening up UK Payments' consultation document argued that the problems of access and competition flow from the fundamental ownership arrangements for the inter-bank systems, rather than the 'card schemes'. This was echoed in the responses to HMT's consultation and no evidence has been advanced to challenge this view.

<u>Visa Europe's ownership structure</u>

Visa Europe is a membership association of banks and financial institutions in 37 countries across Europe and beyond. It is an open, four-party payment system, whose members compete with one another by issuing cards and acquiring merchants. In most cases an entity cannot issue a card or acquire a merchant unless it first becomes a member of Visa Europe, and to become a member is to become part of the ownership and operation of Visa Europe.

Visa Europe has over 3,000 members, of which over 100 are in the UK (including 'principal' and 'sponsored' members). Membership is very diverse and includes both large and small institutions, ranging from the traditional high street banks and non-bank owned acquirers to building societies and credit unions, the payment arms of retailers, eMoney licensees, payment institutions and mobile phone operators. All institutions (within one of the six

Payment Services Directive categories) have the option to apply for direct 'principal' membership of Visa Europe, but some choose to instead be 'sponsored' – for example Credit Unions – as it better suits their business model. Small institutions are represented at the level of the Visa Europe and Visa UK Boards through the election of Directors who represent the interests of the smaller players.

Please see answers to Q10-Q16 for information on how institutions can become a member of Visa Europe (access).

Visa Europe's ownership structure has supported its investment in innovation, Members who are represented on the Visa UK Board are also investing in new technologies in parallel to Visa Europe. This is well illustrated by the development of mobile person-to-person payments in the UK. Last year Visa Europe launched Visa Personal Payments, (where a Visa cardholder can securely transfer funds to any other Visa cardholder anywhere in Europe using their mobile phone), while its members have already launched their own person-to-person payment apps (e.g. Pingit) or are involved in person-to-person payment services via other UK payment systems (e.g. Paym via Faster Payments and Vocalink). Clearly, this is an area where, rather than acting as a brake on innovation, the common ownership of the card and/or domestic payment systems by UK banks has not discouraged the same banks to invest in innovation and develop their own competing products.

Visa Europe does not find that the considerations and arguments regarding ownership of UK payment systems are aimed at, or relevant to, international 'card' payment systems such as Visa Europe.

Q7: ***How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.***

Visa Europe does not consider that any material issues of concern arise from its ownership structure. On the contrary, it considers that its structure supports its members in innovating and competing with each other vigorously.

Any regulation imposed on Visa Europe's ownership structure in the UK would have wider implications for Visa Europe as it is a European 'card' payment system. Visa Europe encourages the PSR to understand the implications of any of its decisions in the broadest European and/or global impact, especially for the many payment systems which operate both within and beyond the UK.

The European Union is currently considering the proposed Interchange Fee Regulation and revision of the Payment Services Directive. As and when this legislation is enacted it will have a significant impact on 'card' payment systems and, in particular, the level of interchange fees. In the context of this proposed Regulation, the European Commission has already specifically looked at ownership structures of European 'card' payment systems and proposed a separation of scheme and processor. Visa Europe strongly disputes the need for such a step and regards it as "a solution in search of a problem". Further regulatory intervention regarding ownership structures of 'card' payment systems at a national level would appear to be disproportionate, unwarranted, and likely to lead to unnecessary confusion, and potentially inconsistency.

GOVERNANCE

Q8: ***Do you have any concerns about the current governance of UK payment systems?***

Visa Europe has a strong focus on corporate governance. The governance structure provides necessary checks and balances to support the effective operation of a dedicated European ‘card’ payment system and gives us effective decision-making to respond efficiently to the needs of UK and other European banks and service-users.

As a membership association we have a unique system of corporate governance which has been developed and refined over many years. We review our governance model on a regular basis to ensure it is effective in supporting Visa Europe’s operation and feel it currently remains fit for purpose to encourage Visa Europe and its members to compete, innovate and meet service-user needs.

Our governance enables us to guide the development of payments across Europe, invest in the progressive enhancement of the industry infrastructure and, ultimately, bring the optimum mix of benefits to each party in every Visa transaction. Stakeholder consultation and collaboration is formally built into the way we work.

All Visa Europe members have the same stakeholding in the form of a single share. The governance structure applies to all and, regardless of size of entity, each member is allocated a Relationship Manager whose role is to represent Visa Europe to the member and vice versa.

There are numerous examples where the needs of smaller members have been reflected in broader strategy decisions. To use the example of the prepaid card sector, which is typically issued by smaller stakeholders, in the past Visa Europe has set up a dedicated prepaid team to promote, develop and innovate the prepaid business. We have also developed and launched a number of innovations specific for the prepaid market for issuers and acquirers to leverage.

Visa Europe’s smaller members have access to the same services as the larger members, including access to sponsorship assets such as Visa Europe’s sponsorship of London 2012 Olympic and Paralympic Games. Many small banks chose to use the London 2012 sponsorship asset and activate it with their own cardholders to gain business benefit. Also, workshops and member events are often held to the benefit of smaller members, which share best practice examples from around the world that often small and/or single-market members might not be aware of.

Q9: ***What do you believe is the appropriate governance structure for UK payment systems?***

Visa Europe believes that internationally-capable ‘card’ payment systems are strongly distinct to UK payment systems and understands ‘card’ systems are not the focus of this question.

ACCESS

Q10: ***How do you access UK payment systems?***

Q11: ***For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.***

Q12: ***Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?***

Q13: ***If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?***

Q14: ***Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK?***

Q15: ***What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?***

Q16: ***Do you have any other comments regarding access?***

Visa Europe understands that most of questions 10 to 16 are aimed at the domestic inter-bank payment systems and their participants. As outlined in the answer to Q6 (ownership), no criticism – by HMT or respondents to HMT's consultation – has been made against the access to international 'card' payment systems.

The international card payments sector is open and accessible to a very wide range of institutions. The fact there are over 3,000 members of Visa Europe across Europe, and over 100 in the UK, is testament of Visa Europe's open approach to membership. The rise of prepaid products and e-commerce acquiring in recent years alongside the issuing framework of the European Electronic Money Directive and E-Money licensees has seen increasing numbers of smaller, non traditional members join Visa Europe for the purposes of issuing prepaid or acquiring. One example is Raphaels Bank who is one of the UK's largest prepaid issuers, yet one of the UK's smallest banks.

In addition, access to card payment systems is already regulated via Article 28 of the Payment Services Directive for many years. Any company or organisation which falls under one of the six categories defined in the Payment Services Directive (PSD) is eligible to apply for membership of Visa Europe, subject to a risk review. Such risks include settlement risk, operational risk and business risk and are designed to protect the integrity, financial and operational stability of the European and global payment system. Overall, Visa Europe believes that such restrictions on access are objectively based and strictly proportionate.

This framework has operated extremely effectively to date in providing access to the Visa Europe system. Accordingly, no additional regulation is needed regarding access to Visa Europe. In fact, specific UK regulation on this point could make it more difficult for Visa Europe to operate at a European level if, for example, Visa Europe were to have different eligibility criteria and a separate process for access in the UK. Most of the entities which are currently eligible for membership of Visa Europe as per the PSD i.e. banks, e-money institutions and payment institutions, benefit from a European passport and are able to operate anywhere within the EU, including in the UK, either through a physical establishment or by providing services cross-border.

Different access criteria and process in the UK could either disadvantage or provide advantages to UK banks, e-money institutions or payment institutions which could potentially be regarded as discriminatory under EU law. In addition, given that the PSD is predominantly a maximum harmonisation directive it would very difficult for the UK to go over and above the requirements specified in the PSD regarding access.

Visa Europe actively consults with the various countries in which Visa Europe operates, to ensure that our membership structure and associated membership pricing structures are fit for purpose and ensure that it is accessible to all eligible applicants. The process to join Visa Europe is the same across all European markets. At a high level; the process can be divided into eight steps:

1. Initial engagement between the interested party and Visa Europe to establish business requirements/expectations/needs against the Visa Europe eligibility criteria and membership options.
2. Fraud and Compliance reviews
3. Formal application submission
4. Risk and Anti-Money Laundering review
5. Visa Europe Risk Committee review of application
6. Potential conditions (e.g. financial safeguards) fulfilled and deeds signed
7. On-boarding including technical projects and training
8. Go live

During the last 12 months, nine new members in the UK have joined Visa Europe – four payment institutions, four eMoney institutions and one credit institution. There are currently a number of applications for membership under review and a further ‘pipeline’ of entities having expressed preliminary interest in joining Visa Europe to conduct business in the UK.

INFRASTRUCTURE

Q17: ***What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?***

Visa Europe believes that the infrastructure layer (see diagram provided in answer to Q2) should be as open and as competitive as the other layers when taking into account the entire UK payments industry. This is even more important when looking to the future as infrastructure companies are increasingly able to propose innovative new alternatives for payment mechanisms at both the inter and intra system level (e.g. Zapp). There should be no restrictive practices and choices should be made on a commercial basis in order to create the best solutions for consumers, merchants and other participants.

Q18: ***What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?***

Regarding ISO20022, Visa Europe is supportive of this new standard and will progressively adopt it in line with commercial needs and opportunities. Progressive adoption is the right approach for all parties and will bring numerous benefits across the industry, as it will allow the proper exploitation of existing assets in parallel with investment in new assets to support emerging and future needs. Forced adoption at too fast a pace could cause more problems than it solves and would not, in itself, deliver any direct benefits for the end service-users.

Q19: ***What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?***

There are no relevant implications regarding ‘agency banks’ participating in Visa Europe’s payment system as we are open to full ‘principal’ membership for all banks and financial institutions if they wish, or via ‘sponsored’ access if that better suits their business needs (see information provided in answer to Q10-Q16).

INNOVATION

Q20: ***Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).***

Before incentives to innovate are discussed, we would like to outline our interpretation of ‘innovation’ and provide examples of recent innovations which Visa Europe has generated as a payment system and which have been bought to service-users by its members (i.e. participants in the system).

Visa Europe managing fraud through innovation across Europe

Who is driving innovation in 'merchant' payments?

- **The established payments industry (payment systems and banks)**. Innovation in payments was once purely the domain of banks, and driven in the main by the need to increase security and reduce fraud, e.g. magnetic stripes, Chip and PIN, 3-D Secure such as Verified by Visa, etc. As the chart below shows, banks continue to drive a great deal of innovation in the payments industry, leveraging the rapid evolution of mobile and digital technology to better serve their customers. The difference today is that they are not alone.

- **Retailers.** A great deal of payment innovation is now driven by retailers responding to the needs of constantly-connected consumers whose primary desire is convenience. Increasingly retailers see transactional experiences as a way to differentiate their offering. It's important to acknowledge that fundamentally retailers do not want their customers to shop elsewhere – though they want to know what they are buying if they do – and so their primary focus is not necessarily on providing ubiquitous, interoperable, scalable payment solutions. Needless to say, this outlook may differ somewhat from that of payment schemes, who have a responsibility to think about payments from a system perspective, balancing the needs of consumers (rather than customers of a single business), retailers, issuers and acquirers.

- **New market entrants** (e.g. mobile payments start-ups) also increasingly appear to believe they can meet evolving consumer needs and realise associated commercial opportunities, particularly as the advancements in mobile and digital technologies lower the previously prohibitively-high barriers to entry that were a feature of the payments industry.

- **Global technology and platform giants** (e.g. Google, Apple, Facebook), previously disinterested in payments, are now realising the opportunity payments offers as a route to gain primacy over consumer relationships and access to a rich dataset. These new entrants have deep pockets – e.g. For R&D funds, Samsung has US$8.2bn; Google has US$4.8bn, Apple has US$2.5bn, etc.

All of this innovation means an increased variety of ways to pay at merchant 'point of sale' (POS). The below exemplifies the number of ways in which a consumer can pay a merchant, beyond the usual Chip and PIN / contactless terminal.

And while it's interesting to note that in transit – an industry with high transaction volumes – the direction of travel is towards EMV contactless payment card acceptance, these market trends have resulted in a great deal of experimentation with payment experiences, particularly at the physical POS. Many of these new experiences, while closed-loop in terms of acceptance, are underpinned by open-loop systems, i.e. they run on established card payment systems rails via mechanisms such as 'card on file'. We encourage innovation and experimentation in payments and believe it is of the utmost importance to provide the flexibility in our specifications and standards to enable our members and retailers to deliver value-adding transactional experiences to their customers.

<u>Visa Europe's innovations – current and future</u>

We have invested over €1 billion in new technology and infrastructure over the last six years. Moreover, in response to rapidly evolving consumer and merchant demand, we are investing over €100 million each year in faster, safer and more convenient ways to pay.

Current developments, in relation to which the UK market is at the forefront, include:

V.me by Visa	**Visa's digital wallet, V.me by Visa:** This provides for convenient and secure online shopping using a smartphone, tablet, laptop or PC. When a Visa card is used in a V.me by Visa wallet, the same protection and rights will apply as would be the case with any Visa card transaction. V.me was launched in 2013 by the first Visa Europe member in the UK – Nationwide.
	**Visa contactless card and mobile payments:** These enable payment quickly and securely at the point of sale using a card or mobile phone. There are currently 32m contactless cards in the UK, equating to approximately one in every four Visa cards in the UK, and their number continues to grow rapidly with recent month-on-month growth of over 10%. Contactless acceptance reduces the time taken for payment at the point of sale and thereby serves to reduce acceptance costs for a typical merchant. A number of large merchants, including Transport for London, Marks and Spencer and

	Boots, now accept contactless cards. This is of particular value to a range of businesses, including transport systems which rely on small but frequent payments for their revenues.
	**Visa mobile services:** These can involve paying in person using contactless NFC (Near Field Communication) technology, or shopping online using a mobile device. Also, Visa is supporting the development of mobile acceptance devices so that small merchants, particularly in service industries, can turn their smartphone into an acceptance device for Visa Chip and PIN payments.
	**Visa mobile personal payments**: These are designed to help consumers manage their money and transfer funds to any Visa cardholder in Europe using their mobile phone, backed up by the security and expertise of Visa Europe's industry-leading processing systems. This is already live in the UK with multi-currency and immediate payment features. More than 3.1m RBS Group customers have downloaded the Visa Personal Payments-enabled app.

<u>Incentives to innovate – financial</u>

Interchange fees in the 'card' payment space have had (and continue to have) a significant positive impact in the adoption of new technology and fraud prevention measures. The successful introduction and coverage of Chip and PIN anti-fraud technology and recent introduction of contactless payment terminals at merchants point of sale are two examples of how lower interchange fees have been used as an incentive to merchants to invest in new technology for the benefit of consumers. The revenue generated by issuers from interchange has also served as an investment fund for innovation.

As multilateral interchange fees (MIFs) are being reduced and restricted via the Interchange Fee Regulation (IFR) which is currently subject to political scrutiny by the European Union's three executive and legislative branches, there is a strong likelihood that card issuers will rationalise and consolidate their range of products, for example, by reducing the number of point-based reward programs and invest less in R&D and technologies.

Interchange revenues enable issuers to invest in R&D and new technologies, including, for example, contactless / NFC and EMV technology (i.e. Chip and PIN). A reduction in interchange revenues could make it more difficult to realise savings and cost reduction generated by such new technologies. For example, EMV (Chip and PIN), has proven very effective in reducing fraudulent transactions in the UK which may help in lowering costs to issuers, acquirers and merchants (and thus ultimately to result in lower prices for consumers).

Visa Europe believes incentives to innovate are clear under current arrangements and there are relatively few barriers to innovation by internationally-capable 'card' payment systems, albeit that reduced interchange revenues, and ill-thought through and discriminatory regulation, could act as a brake on innovation.

Incentives to innovate – other

In addition to financial incentives via interchange, Visa Europe uses a variety of other incentives to encourage innovation adoption amongst its members. These include:

- **Liability shift**. Retailers and other merchants (via acquiring members of Visa) have been incentivised to accept more secure methods of payment (e.g. Chip and PIN; Verified by Visa) by having the liability shifted away from them regarding the risk if the transaction turns out to be fraudulent.
- **Chargeback.** The chargeback mechanism exists for an issuer to 'chargeback' a transaction on behalf of a Visa cardholder, determined on a case-by-case basis, if there is a problem with the merchant (e.g. merchant ceases trading; goods are faulty or not as ordered; etc). This degree of consumer protection has permitted issuers to gain consumer trust in electronic card payments, which is the most critical factor in the update of new technology. It is also this established consumer protection in the card payment space which will lead consumers to assume they are also protected and can have the same 'chargeback' experience via other payment systems, which is unlikely to be the case. For example, does this exist with PayPal? Zapp? etc. The measure of a responsible payment system is the mechanisms it has in place for when a transaction goes 'wrong' or is made incorrectly.
- **Competition.** Many of Visa Europe's members see the advent of new entrants offering the consumer a different payment experience via a different payment relationship, and this has incentivised banks to innovate in the effort to retain the primary financial relationship with the consumer.
- **New entrants.** The established financial services providers may not be able to generate innovation from scratch but it can use new trends driven by new entrants, and then partner with the newer entrants to deliver the solution to service-users on a mass scale. One example of this is the growth in the UK of MPOS (mobile point of sale). The high street banks have formed partnerships with innovators such as Payleven and Square to provide a channel for the innovations to reach scale.

Q21: ***Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?***

There are no factors which currently limit Visa Europe's ability or incentives to innovate. However, Visa Europe strongly believes that if internationally-capable 'card' payment systems are to be regulated, this would constrain our ability to respond effectively to a rapidly evolving market as well as stifle innovation.

Q22: ***What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.***

Trust is vitally important to the payments business, and to maintain user trust in payments Visa Europe has to carefully balance the requirements of convenience, speed and security, along with technological advances for new payment devices (e.g. via the mobile phone or tablet). When considering the pace of innovation, it is critically important that nothing is brought to market with an inadequate level of security. The timeframe can therefore be longer when innovation is being created from 'scratch', such as for digital wallets.

Technologies are not created and commercialised overnight, and even technologies we today take for granted such as email and mobile phones took between 10 and 20 years to reach mainstream adoption. Consumers can take time to embrace new ways of doing things and build up the necessary confidence and trust.

Payments also need scale to really work. The degree of risk is high, which can affect the pace of innovation delivery. Also, in order to reach scale, collaboration is required amongst many different entities to solve complex delivery challenges to get a safe and secure innovation to consumers. In the example of mobile NFC (Near Field Communication), it has been a challenge to balance the commercial requirements between payment systems, banks and mobile network operators to find the right business case for each entity, which has affected the pace.

Q23: ***What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?***

Visa Europe conducts considerable research into the needs, attitudes and behaviours of consumers, merchants, and other participants in payment systems. Our objective is always to provide innovative solutions to meet their needs in ways that best suit their interests. We regard it as a good thing that other inter-system players are also innovating in this space as this competition between payment systems and participants will ultimately lead to the best products and services being delivered to consumers.

Collectively driven innovation is beneficial, and sometimes essential, to create standards (such as Chip and PIN, tokenisation, etc), which operate at an industry level, and often international level, to protect the consumer from fraud and other criminal activity. There are often scale advantages as well to cross-industry collaboration. The limitations to this collaboration are that often it can take time for a central entity to coordinate agreement across a whole industry, often in multiple regions, and have this end decision implemented globally. Therefore, collective innovation should be viewed and encouraged when it is appropriate and necessary – i.e. when individual stakeholders would be unable to provide such innovation and decisions individually, or it would be inefficient to do so.

CLOSING QUESTIONS

Q24: ***Do you have any other comments or concerns you would like to highlight?***

Please see ‘Section A’ of our response.

Q25: ***What, if any, are the significant benefits you see regulation bringing?***

As an entity with a strong pan-European and global strategy, it is challenging to identify how regulation in a single market can bring benefits to the operation of the Visa Europe payment system.

Visa Europe’s view is that any regulation should be carefully calibrated in particular by reference to the goal of furthering competition and creating the right environment for innovation. To the extent that it is considered that specific measures are required, these should be strictly proportionate to the objective of achieving competitive market outcomes.

Q26: ***What, if any, are the risks arising from regulation of payment systems?***

Visa Europe is concerned that anything more intrusive than proportionate and evidence-based regulation could lead to a wide range of risks and negative consequences for internationally-capable ‘card’ payment systems. The bureaucracy and costs of compliance could slow down innovation creation and delivery in the UK, leading to unregulated competitors being able to gain competitive advantage from the situation.

Also, due to the complexity of the payments industry in the UK and globally, the actions by one player (regulator) in one market can often create a series of unintended consequences for users of that payment system – including financial institutions, consumers and merchants – in other markets.

Finally, competition and innovation can only flourish in an environment in which there is a level playing field between market players, and it is of paramount importance that regulation supports and does not undermine this.

Q27: ***How do you think regulation might affect your business and your participation in UK payment systems?***

The decision to designate Visa Europe under the Payment Systems Regulator has the potential to significantly impact our business. The exact implications of this are not clear at this stage, but regulation in essence necessitates the introduction of a substantial internal administration to ensure compliance.

Given the extent to which card payment systems rely on global interoperability – relating to key issues such as the management of fraud, card design and terminal standards whilst across national borders – anything further than ‘light touch’ regulation at a UK level could risk causing difficulties for the effective operation of the Visa Europe system in Europe, as well as the UK. This would ultimately dampen Visa Europe’s ability to invest in innovation, ultimately to the detriment of UK consumers, small businesses and other users.

Is it also essential that regulation decisions at the national and European level are consistent, in order to create the certainty which is necessary for further investment and innovation.

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Payment Systems Regulator
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15 April 2014

Dear Sirs,
We have pleasure in submitting our views on the UK payments industry in response to the Payment Systems Regulator (PSR) Call for Inputs dated 5 March 2014.

VocaLink sits at the heart of the UK payments industry and is responsible for processing about 10 billion transactions with a value of £5 trillion annually. We operate a UK payment processing hub that makes it possible for all consumers and businesses with a bank account in the UK to transact with each other. Domestically, we are responsible for the development and operation of the infrastructure which provides the Bacs, Faster Payments, LINK ATM, Account Switching services, and the recently launched PAYM mobile proxy database service. Internationally, we process the majority of Sweden's retail electronic payments and also provide the central infrastructure for the recently launched Singapore FAST service[1].

The purpose of a Payment System is to facilitate the movement of funds between households and businesses, conveniently, securely, and efficiently. The UK Payment Systems are some of the most advanced globally, but we recognise that there is scope for further improvement and that changes are required to ensure that UK consumers and businesses continue to benefit from competitive and innovative payment services which will enable them to make payments conveniently and securely.

We believe that the PSR should focus on three key areas that can have a positive impact on innovation: (i) assessing whether current arrangements for participating in Payment Systems and accessing the Infrastructure are sufficient to facilitate innovation; (ii) assessing corporate governance arrangements to ensure that the relevant parties have the right incentives to innovate and introduce new products; and (iii) designing mechanisms to facilitate collaboration between different parties.

[1] FAST (Fast And Secure Transfers) is a new electronic funds transfer service that enables customers of the participating banks to transfer Singapore Dollar funds from one bank to another in Singapore almost instantly http://www.abs.org.sg/fast.php.

VOCALINK

Continuation

The answers to many of the questions raised in the Call for Inputs are heavily inter-related and therefore rather than providing a question by question response, we have considered the themes raised in the Call for and set out our views on each of the themes in the accompanying response.

We hope that you find our responses to the Call for Inputs helpful and we very much welcome the opportunity to discuss the matters raised at your earliest convenience.

Should you have any queries, please do not hesitate to contact me.

Yours faithfully,

Tim Ensor-Clinch
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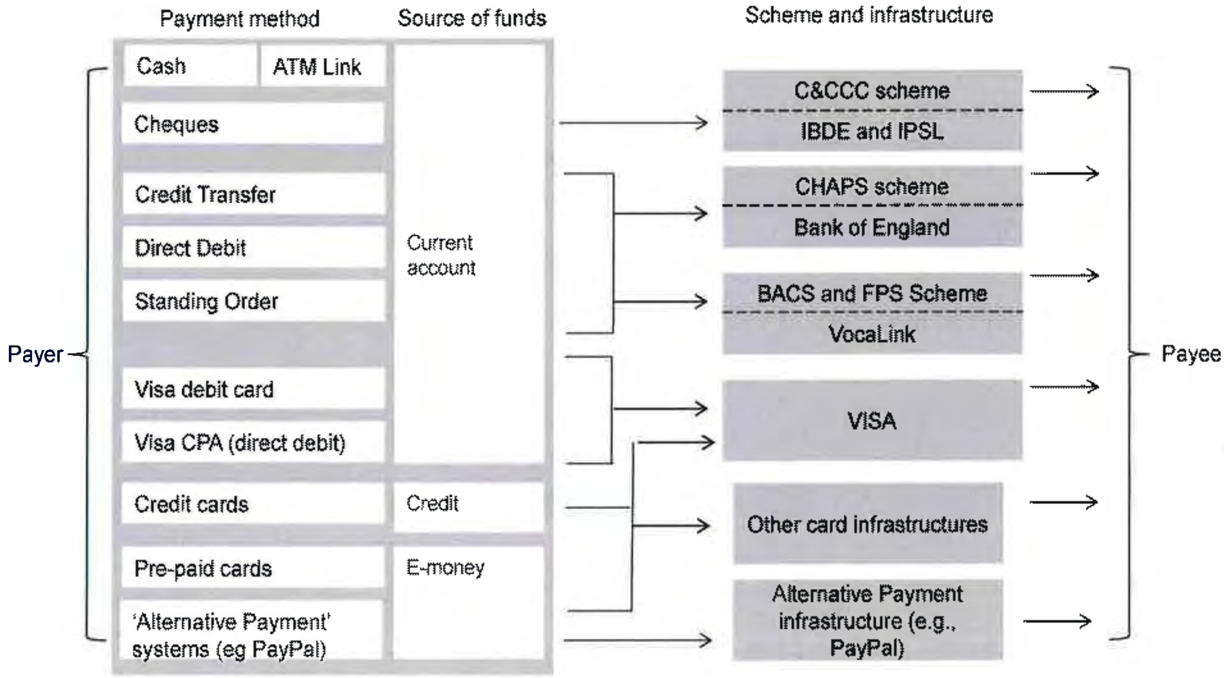
VocaLink Response to Payment Systems Regulator Call for Inputs

Introduction

The UK payment systems are highly complex comprising a multiplicity of service providers offering complementary competing payment services.

Figure 1 shows some of the payment methods that are available to households and corporates to make and receive payments, the source used to fund the payment transaction, the Payment System into which the payment transaction is submitted, and the Infrastructure that processes the payment.[1]

Figure1



Different payment methods will draw on differing sources of funding. For example, some payment products enable the Infrastructures to access the payer's payment account (typically their current account held at a deposit-taking institution), whereas a credit card product relies on credit which is typically repaid by a credit transfer (using FPS), by direct debit (using BACS) or by a cheque (using Cheque &Credit Clearing Company (C&CCC)). Some e-money providers (such as PayPal) are 'closed' where transfers of value take place across the books of the provider, but relies on other payment methods (credit / debits transfers or cards) in order for funds to be transferred into or away from the e-money provider's system.

Consumers can choose from a number of payment methods, depending on the situation they find themselves in. For example:

- for payments in a retail outlet: debit and credit cards, and cash are generally available as payment methods;
- for payments over the Internet: most consumers have access to debit and credit cards and other payment products such as PayPal. Depending on the situation, some people may also consider using Faster Payments or a Pay on Delivery Service offered by companies such as Parcelforce;

[1] Note, the diagram highlights the main payment methods but should not be considered exhaustiv. The diagram also does not include the settlement layer, which in the case of most payment systems ultimately takes place at the Bank of England.

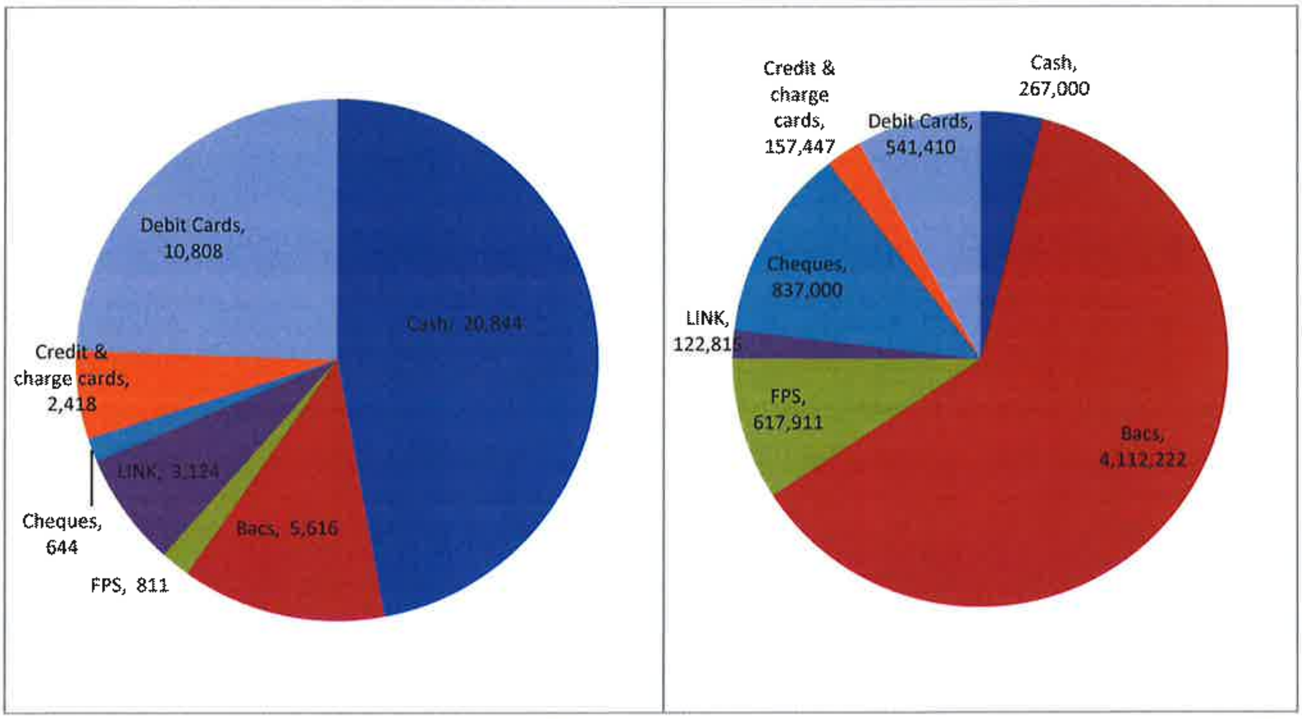
- for transactions at a private property (e.g. paying a plumber): consumers can generally use cash, cheques, debit or credit cards (for example, by calling the office of the service provider and making the payment over the phone), or new mobile payment methods that are being introduced (such as Zapp);
- when paying a bill, such as a utility bill: consumers can use debit or credit cards, direct debit or Faster Payments, cheques, or cash (using a service such as Paypoint).

This demonstrates that the payers (consumers and corporate) and payees (businesses) have access to multiple payment methods which cater for different situations.

The cash economy remains a strong feature in UK retail payments when measured by annual volume of transactions – Figure 2 below highlights the volumes and values for each of the key payment methods.[2] The importance of the debit card market also cannot be overstated. Debit card usage is becoming a very important force in UK retail payments - a market segment where most transactions are processed by a single (combined) Payment System Operator and Infrastructure provider (VISA Europe).[3] Figure 3 highlights the movement in payment volumes between cheques, cards and ACH.

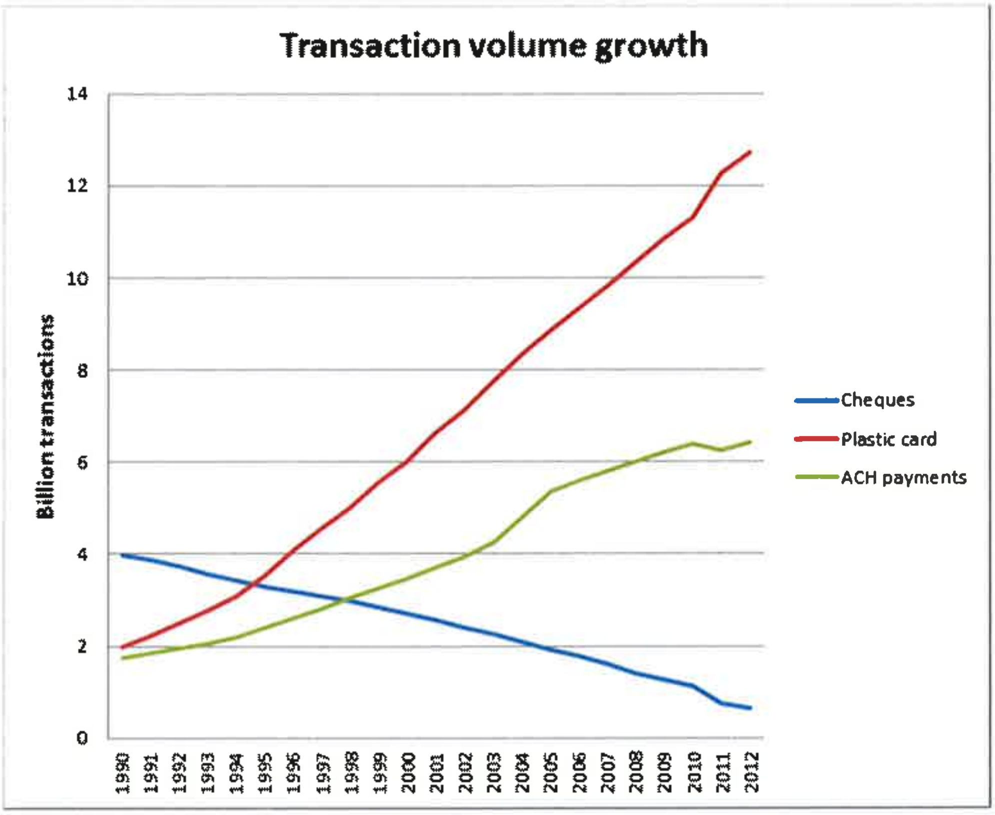
Figure 2[4]

Transaction volumes (2012) - millions **Transaction values (2012) - millions**



[2] Note: the CHAPS system is not included as it is a very low volume / very high value system processing mainly very high value wholesale market transactions.
[3] Although the combined card scheme/ infrastructure model is coming under EC scrutiny through the Regulation of interchange fees for card-based payment transactions (COM(2013) 550 final)
[4] Source: Payments Council, LINK Scheme, BIS Red Book

Figure 3[5]



The payment services value chain is complex and consists of many different functions and a range of different providers. Some of the main functions are shown in Figure 1 and include clearing and netting, settlement, and authentication (the service through which an infrastructure accesses payment accounts at the payment service provider), and (not shown in the diagram) 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 the total costs of these transactions to the Service-user[6].

It is also worth noting, that at each level in the value chain, there are typically a number of different players[7]. For example, there are many payment services providers (banks and payment institutions) and also a number of different infrastructure providers providing similar processing services. VISA's infrastructure is similar to VocaLink's infrastructure in the sense that it provides the clearing of large volumes of retail payments, has direct access to households' and corporates' current accounts (through authentication activities undertaken by the banks) and is used to offer a number of different payment products - in the case of Visa: debit cards and Continuous Payment Authority (CPA) which is akin to a direct debit service, and in the case of VocaLink, credit transfers and debit transfers.

[5] Source: Payments Council
[6] Typically the corporate user as consumers are generally not charged individually for credit / debit transfers with the 'free in credit' banking model.
[7] With the exception of the central bank settlement layer

Payment Systems in the UK (Question 1)

Summary

We agree with the scope of payment systems that HM Treasury is likely to designate[8] subject to the following observation:

- ***The size of the alternative payments market in the UK is becoming more significant and is growing. In particular, in certain sectors (e.g., e-commerce) alternative payment providers (such as PayPal) have a significant market presence and consideration should be given to including such payment service providers within the scope of the initial designation order.***

Background

Some newer Payment Service Providers (such as PayPal) are now responsible for very large payment transaction volumes. Although such systems will typically rely on the underlying clearing and settlement mechanisms (Bacs, FPS and the Cards systems) to enable their Service-users to load or unload funds onto or off their payment account, transactions within these systems may (as in the case on PayPal) be settled within that system. We agree that many smaller 'alternative payment' systems may not initially need to be designated for regulation. However, as the new entrant / alternative payment provider market matures, it is likely that these alternative payment providers may start to account for a more material volume of transactions, bringing them within scope for consideration to be designated and indeed, some alternative payment service providers may already be at this level.

In the case of Bacs, FPS and Chaps, it should be noted that each of these Payment Systems has been 'recognised' as Financial Market Infrastructure[9]. These recognised FMI Payment Systems are sophisticated multilateral systems handling significant transaction volumes and / or values and the safe and efficient functioning of these FMI Payment Systems is key to maintaining confidence in the financial infrastructure. Although not directly linked to each-other these FMI Payment Schemes do serve inter-connected institutions and markets and perform a UK payments 'backbone' role, providing the underlying capability which enables consumer and business (including banks and other Payment Service Providers) payments to be cleared and settled.

Consideration should also be given whether it is necessary to include the LINK ATM cash withdrawal network in the scope of designation. The LINK ATM cash withdrawal network exists as an adjunct to the 'cash economy' and its principal purpose is to enable consumers to withdraw cash from their payment account via an ATM – it is not a Payment System as defined in the Glossary of Terms at Annex 4 of the Call for Inputs.

[8] CHAPS, Bacs, FPS, LINK, C&CCC, and three and four party card schemes
[9] Under Part 5 Banking Act 2009

Competition in Payment Systems (Questions 2 - 5)

Summary

- ***Existing payment methods are, in the main, substitutable, giving the Service-user choice in how he / she wishes to make payment for a given transaction – advances in access and payment technology will serve to provide greater choice and an increase in substitutability for the Service-user;***
- ***The characteristics of the different Payment Systems lead to competition at different layers of the payment market – the characteristics of some Payment Systems (e.g., cards systems) lead to competition between those systems at the Payment System Operator layer, whereas for other Payment Systems (e.g., Bacs, CHAPS and FPS) their characteristics focus competition at the Service-user layer;***
  - ***There is effective competition for the market for the provision of Infrastructure services – the provision of Payment System infrastructure is contestable.***
  - ***Increased downstream competition (at the Service-user interface) will drive innovation and competition upstream.***

Background

We believe that, overall, competition is effective in providing choice and innovation for the Service-user, although a more detailed analysis would be required to assess the exact nature of competition in different payment situations. There is not only competition between the different payment methods (e.g. a debit card competes with a credit card and with credit transfers (e.g., Faster Payments), but also between different brands (e.g. MasterCard competes with American Express) and between different issuers or banks.

Price competition in the markets for payment methods for households may be affected by the current *free-if-in-credit* banking model. Although some banks have started moving away from this model, various payment transaction services are not charged for individually, which may affect consumer behaviour.

However, markets for payment services are two-sided - both consumers and retailers make choices about acceptance and usage of payment methods. Retailers are typically charged on a per-transaction basis and may influence their customers' choice of payment methods. For example, they may refuse to accept certain payment methods, offer discounts if paid by direct debit, or surcharge credit card transactions. In the context of the end to end payment value chain, the costs attributable to the central infrastructure processing activity are very small as a proportion of the total cost of making the payment.

Whilst a Service User has choice between using different payment methods, there are reasons why the introduction of new entrants at the Payment System level is not rapid, as any new entrant Payment System needs to provide an attractive offering to both payers and payees to ensure adoption. Launching a new Payment System requires a high degree of collaboration between the Payment System Operator, Payment Service Providers and Service-Users to ensure that the rules and standards that are adopted are feasible and appropriate. These are necessary preconditions for competition at the Payment System level and mean it is not likely that there will frequently be new Payment Systems introduced – however, when a new Payment System is adopted (e.g., FPS) the impact within the market can be transformational and can provide a new underlying infrastructure on which many new and innovative payment methods can be developed. It is more likely that 'dynamic' competition for payment services will be seen within the downstream payment layers (closer to the Service Users) of which services such as Pingit, PayPal, and the (soon to be launched) Zapp service are examples.

We believe that there are three important areas of focus that can affect competition between or within different Payment Systems: information, interfaces with standards, and access.

- Rules and standards - Payment Service Provider competitors need to be given timely and equivalent information on rules, standards and interfaces in order to compete effectively with value-added services provided by Direct Members or by the Infrastructure provider.
- To enhance access to existing Payment Systems, technical standards and interfaces must be made openly available in order to reduce the costs of directly accessing multiple Payment Systems.
- For Indirect Participants to compete with Direct Members, the terms of their access to the Payments Systems needs to be objective and non-discriminatory. There are two aspects to these terms: the commercial terms as agreed with the Direct Member, and the terms upon which Indirect Participants are able to directly access the Infrastructure.

Infrastructure

Given our role, we wish to comment specifically on the Infrastructure element of the value chain.

The provision of infrastructure for the Bacs, FPS and LINK services is contestable and there are alternative infrastructure providers that could bid for these contracts, just as VocaLink bids for other contracts operated by other Payment System Operators. For example VocaLink was successful in a competitive tender for the contract to process the majority of Sweden's retail electronic payments and also to provide the central infrastructure for the recently launched Singapore FAST service. The provision for the central infrastructure for the UK Faster Payments Service was also tendered by the industry on a competitive basis. Furthermore, as explained, the products that run on the Bacs and FPS infrastructure compete in the downstream market with various other methods for making retail payments.

The economies of scale in relation to the provision of the infrastructure for each of the Bacs and FPS schemes are significant and each of these services is therefore provided most efficiently by a single infrastructure provider – as opposed to having multiple infrastructure providers servicing each scheme - A multiple infrastructure model for a single Payment System would inevitably involve a duplication of fixed costs and would require direct participants to maintain multiple connections with each other infrastructure provider. The complexity of introducing change within such a multi-infrastructure provider model should also not be underestimated and changes at the Payment System level would need to be replicated across each Infrastructure provider. In our view, such a complex solution could also lead to risks to the overall stability of the Payment System to the detriment of the Service-users of the Payment System.

In sum, competition is most effective for the market (i.e., at the stage of bidding for contracts) whereas any additional competition that may be achieved through the introduction of interoperability is unlikely to bring any additional benefits that competition for the market does not otherwise achieve.

Ownership and Governance (Questions 6 - 9)

Summary

- ***Changes in governance at the Infrastructure Provider and Payment System Operator layers (e.g., decision making process and Service-user participation) can address concerns about ownership having a negative effect on competition and innovation;***
- ***There is scope for convergence (at a corporate and business level) at the Payment System Operator layer.***

Background

The Call for Input highlights the ownership structure of Payment Systems as a factor that can affect incentives for participants to innovate and compete vigorously.

We recognise that a likely area of regulatory scrutiny with respect to ownership of Payment Systems is the involvement of the banks at many levels of the value chain. The banks own a number of the Scheme Operators, some Infrastructure providers (including VocaLink) and are the access point for Indirect Participants. Ownership and governance are closely related and implementation of good governance principles can be helpful in ensuring that any concerns associated with the current ownership structures are mitigated while preserving some of the beneficial features, including the alignment of risk, ownership and investment responsibility which is inherent in the current ownership structure. The benefits of the owner / user model is evident in other related industries and is seen in organisations such as London Clearing House and CLS.

We recognise that there is strong argument for the Payment Systems to be 'opened up' – providing this is done in a manner which does not introduce an unacceptable level of risk which could impact the stability of the Payment System to the potential detriment of the Participants and Service-users. We believe this should be possible through governance changes, that ensure meaningful participation by Service-users and Indirect Participants at the Payment Scheme Operator level. It is at the Payment System Operator level where key decisions on investment, access, innovation, and changes in membership requirements are 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.

The existing Payment System Operator structure evolved in response to previous reports[10] and 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 both at the infrastructure and Payment System Operator level.

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.

[10] In particular, the Cruickshank report : *'Competition in UK Banking: A Report to the Chancellor of the Exchequer' on 20th March, 2000'*

Access (Questions 10 - 16)

Summary

- ***Indirect access to Payment Systems reduces entry costs for smaller players and may therefore facilitate entry and promote competition;***
- ***Providing broader direct access to the Infrastructure provider should facilitate both competition and innovation in the downstream market.***
- ***Payment System resilience must remain an over-riding factor governing direct access.***

Background

The objective of providing access to the Payment Systems is to support the choices a Service-user (consumer or business) should have when deciding to make a payment.

By mandating access to a given Payment System asset, competition by alternative providers of the related services (which are reliant on that asset) is promoted, because it would be inefficient (or too costly) for each of the downstream providers to build their own (network) asset.

For the Payment Systems there are four levels at which access concerns might potentially arise:

- **Payment System Operator access** – Payment System membership rules are set by the Payment System Operator which, in the case of the systemically important Payment Systems, is overseen by the Bank of England;
- **Payment Infrastructure access** - access to the infrastructure is typically based on terms set by the Payment System Operator that has a service agreement with the Infrastructure provider;
- **Indirect Participant (sponsored) access** – Payment Service Providers that are not Direct Members of the Payment System (which may be for technical or prudential reasons) can participate in the Payment Systems via Direct Members. The indirect access conditions are determined bilaterally between the Indirect Participant and Direct Member - although these conditions will be informed by the access rules to which the Direct Member itself is subject;
- **Third Party Provider (TPP) access** - third-party providers of payment services (e.g., payment institutions, gateway, bureau and other technical providers) including those covered in the draft Second Payment Services Directive, require access to information on the Payment System Operator / Infrastructure standards to enable their products and services to interface with the Payment Systems.

The nature of each of these access points is distinct, and therefore the regulatory approach to access will need to address each level individually. A single approach across the different areas would be unlikely to fully address the issues arising at the different levels of the value chain.

At the Infrastructure provider layer we are fully supportive of the principle of broader access and the development of access solutions that will enable more Payment Service Providers to directly interface with the Infrastructure. The importance of the TPP access layer should not be under-estimated and we expect that there will be a growth in the UK market for payment initiation services (such as Sofort in Germany) which enable a consumer to give a TPP permission to initiate a payment from the consumer's account. We believe that providing secure access and centralised authentication services to such TPP firms is a necessary precursor to the growth of this 'alternative payment' market, which is capable of providing credible competition to the incumbent retail payment methods such as cards.

The extent to which payment providers participate in the Payment Systems as Direct Members or Indirect Participants will largely depend on their appetite (i) for making the back office payment infrastructure investment necessary to be a Direct Member and (ii) for reserving necessary capital to underpin the settlement risk associated with their transactions and other Direct Member transactions from a loss sharing perspective. However, we do believe there is scope for change at the Payment System Operator access level that could drive an increase in Direct Members - increasing the frequency of settlement cycles (thereby reducing any intra-settlement risk) and introducing a pre-funding mechanism (which we understand is being introduced in 2013) are two examples. It should also be noted that increasing Direct Membership of the Payment Systems can assist in creating the conditions necessary to drive competition for Indirect Participant access services – there should be more Direct Members capable of offering indirect access.

Infrastructure (Questions 17 - 19)

Summary

- ***ISO20022 will over time become the de facto standard for payment messages, but there remain entrenched legacy standards.***
- ***The ISO20022 message standard has the capability to act as an enabler to transform existing payment types and underpin new payment and related services by allowing the transaction message to carry a richer dataset.***

Background

ISO20022 standards can provide a number of significant advantages in the banking environment, for example the ability to carry additional data. As a result, there is a trend for new services in the banking sector to be developed using ISO20022 based standards i.e. in the UK: Account Switching, Cash ISA Transfer, and Stocks and Shares ISA Transfer; in Sweden: the real time system (BIR) and the related Mobile system (Swish). ISO20022 is also being adopted by large banks and suppliers of banking software and therefore, over time, is becoming the de facto standard for new products and services.

However, ISO20022 standards have not displaced widely used existing standards (national or otherwise) that are deeply embedded. The only exception to this (to our knowledge) is SEPA, which has required EU regulation to enforce migration.

Although the wholesale replacement of standards in any of the UK Payment Systems may, at this time, be hard to justify in the shorter-term (as it will necessitate re-engineering of legacy IT platforms) the ISO20022 standard would enable significant additional information to accompany the payment message information and could act as a catalyst for much richer payment and related data services to be provided to Service-users, including public sector. An example would be the HMRC Real Time Information service which, if further developed, would use ISO based standards.

<u>Innovation (Questions 20 - 23)</u>

<u>Summary</u>

- ***Unilateral Innovation in the market is generally effective, evidenced by the introduction of services such as Pingit, Zapp and PayPal; however, launching new payment products remains challenging but changes to governance structures and broader access will assist current challenges and help to drive successful innovation.***
- ***Clear regulatory guidance on collective innovation is needed to provide stakeholders with a framework within which collaborative activities can take place;***
- ***Collective innovation in the market has been less effective and is slow to take place (without regulatory impetus) although when implemented, can provide significant new functionality (e.g., FPS) for the benefit of all Service-users;***
- ***Collective innovation will require centralised collaboration - a suitable effective representative forum is necessary to coordinate and manage innovation which requires a critical mass of participants.***

<u>Background</u>

Two types of innovation that occur in the payments sector are mentioned in the consultation: collective innovation and unilateral innovation. The incentives to engage in these two types of innovation and the likely customer benefits, wider consequences and potential regulatory approaches are likely to differ – therefore, each should be considered carefully.

Collective innovation relates to new products or services where the value is realised only when the parties on both sides of the transaction adopt the innovation. The costs of adopting the innovation may fall on one or both of the parties. Examples include, a new Payment System offering a faster payment cycle or a new Payment System offering a new mobile payment product (where parties on both sides need to agree on a new standard).

By contrast, for unilateral innovation the benefits accrue directly to one party and this party will also bear the costs of adopting the innovation. These are most likely to take place outside the core of any payment system - i.e., at the level of the Payment System participants or Service-Users. Examples may include add-on information services that analyse payment flows for a business, and a new mode of access to a given payment Infrastructure.

In principle, the incentives for unilateral innovations to take place should be clear. As there are no external effects, the appropriate incentives of the provider to introduce new products and services are likely to be sufficiently strong. As such, any regulatory regime should ensure that it preserves the freedom for businesses to innovate in this manner, without onerous restrictions.

Where innovation requires coordination and collaboration between payers and payees and their service providers, there needs to be a critical mass of providers and/or customers adopting the new service so that those who join the system have other participants to transact with - in this way, the value from the adoption of the innovative service will be realised. These innovations may therefore not proceed if the critical mass of participants is not reached, even if the innovation would benefit the industry as a whole and/or current or future customers, as the pace of innovation is likely to be determined by the critical number of providers and the slowest participant within that group. Collective innovations that are viable with a relatively small number of participants are therefore more likely to be implemented than innovations that require a large critical mass. For example, the LINK ATM network was initially set up by a relatively small group of banks. As such, collective innovation is likely to be slower where coordination is required between a larger number of stakeholders.

To assist the market in evolving innovatively, there are three types of intervention that could be considered:

- Clear guidance on the type of collaboration that is allowed under competition law. Arguably, there is a risk that these boundaries are (perceived to be) too restrictive, which can discourage innovation. Creating the right financial incentives is important for the launch of any new product, and it is important that the pricing structure for payment services accommodates the necessary financial drivers to incentivise organisations to invest in innovative products.
- Ensuring scheme arrangements only require unanimity of existing members before initiating innovations where it can be shown this is essential to the success of the new payment service. Allowing subgroups of members to implement collective innovations could speed up achieving critical mass where full consensus is not essential to the success of the innovation.
- Design a mechanism that can facilitate collaboration between different parties - there is likely to be scope for the regulator to support a forum or fora to facilitate collaboration. Potentially, Infrastructure providers can play an important role here.

15 April 2014

End.

Payment Systems Regulation : Call for Inputs

Cover Sheet

Basic Information	
Consultation title	Payment Systems Regulation : Call for Inputs
Name of respondent	VocaLink Limited
Contact at respondent	
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	Address: Drake House, Homestead Road, Rickmansworth, Hertfordshire, WD3 1FX.

Nature of organisation (select as appropriate)	
Infrastructure provider	Yes
Payment system operator	No
Direct member of payment system(s)	No
Indirect participant in payment system(s)	No
Service-user	No
Other payment provider	Yes
Third party service provider	Yes
Trade / Government / Regulatory body	No
Other	N/A

Confidentiality	**Yes**	**No**
Do you wish any part of your response to remain confidential		No
If 'Yes', please submit both confidential and non-confidential responses		

FCA Call for Inputs – YBS Response

Question 1: Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above, please explain why.

Answer: We believe that all the UK payment systems listed above (i.e. CHAPS, Bacs, FPS, LINK, C&CCco and all main card schemes) should be designated for regulation – these organisations form the core of the UK payments structure, and their operations and strategies have a major impact on the services that are provided to business users of these schemes, and ultimately to consumers.

Question 2: Where do you believe competition is effective or ineffective within UK payment systems?

Answer: We consider that there is a reasonable level of competition between the different schemes, i.e. they all need to innovate and improve processing efficiencies to ensure that their service proposition encourages use of their payment facility, and avoids users switching to another scheme providing the same payment type, or to an alternative payment method.

In our experience (as an indirect scheme member and agency bank) competition between the individual direct scheme members (and probably between the providers of the infrastructures used by the direct members), when providing scheme access to indirect participants is less effective; we have found service issues (in one form or another) to be present irrespective of the particular direct scheme member used. Therefore while there is clear scope for competition at this and the infrastructure provider level to achieve excellent service levels in all respects, it seems that the scheme providers (and their underlying infrastructure providers) generally don't deliver to this standard.

Question 3: At which level(s) is there potential for competition to drive benefits for service-users, in terms of costs, quality or innovation?

Answer: We believe that competition should drive benefits at all levels, i.e. through the payment services offered by the schemes, through the direct scheme participants themselves and through scheme infrastructure providers, but we consider that currently this is mainly at the payment service level only. There seem to be significant constraints preventing direct scheme members in particular from providing a high-quality service offering to their agency banks; in our experience this observation can be applied to a number of organisations in this category to a greater or lesser extent, i.e. they all have service limitations.

Question 4: What are the main factors impeding more effective competition at each level?

Answer: As mentioned, there is an inherent conflict of interest whenever a direct payment scheme member provides scheme access to an indirect participant/agency bank who will invariably be a competitor for retail banking business. Direct members also have regulatory and other strategic priorities which we consider often results in both financial and technical resources being diverted to other projects, rather than being allocated to improving the service proposition for indirect members. We are also led to believe that direct members do not recoup the true cost of arranging indirect scheme access from agency banks (because many would be unable to pay this cost), meaning that they may be unwilling to invest in improving the service for a nil/marginal return.

Question 5: What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

Answer: To facilitate a 'level playing field', whereby all indirect scheme participants would have the same opportunity to access all payment schemes (and would therefore be able to improve payment services propositions for their own customers) without necessarily having to commit to direct scheme membership, we believe that the industry needs to develop some form of 'common utility' and/or managed service for this group. This utility would need to be capable of routing individual payments and/or payment files to the various schemes, i.e. acting as a single gateway.

Payment facilities would need to be underpinned with standard licensing, service and pricing agreements and a robust system infrastructure, to enable a consistent (high!) level of service to be delivered to all the service users. One approach could be for for all direct members of the various schemes to voluntarily commit resources and to agree to collaborate in developing this system (which could also possibly require a certain level of funding from licensed users), as this would enhance payments industry services as a whole and remove the need for direct members to maintain indirect access facilities themselves – which is achieved with varying degrees of success at the moment, as mentioned above. If direct members are unable to collaborate voluntarily then regulatory intervention may be necessary, as we believe there is an urgent need for the introduction of common standards regarding access to payment schemes for agency banks.

Alternatively, major payment service providers e.g. Swift and Vocalink could be encouraged to develop standard solutions for indirect members.

Question 6: Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Answer: We believe that current scheme ownership structures, whereby strategic decision-making powers, etc., tend to lie with the same few large financial organisations, can hinder the development of innovation and change and may not always result in decisions which are in the best interests of the wider payments industry, or of consumers.

It is apparent that an organisation needs to have achieved a certain size and scale before being in a position to commit the financial sureties and other resources required to gain a share of scheme ownership; we believe that this situation can lead to 'vested interests' influencing decisions regarding issues such as indirect access and use of agency sort codes, etc. On the other hand, scheme members can claim with some justification that they should have a role as key decision-makers, as they provide the investment in scheme developments.

Question 7*:* How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership.

Answer: This is a complex question and it is difficult for us to provide a clear response, in our capacity as an agency bank without direct input to scheme strategies, etc. However, one approach could involve the establishment of an independent body, with a direct reporting line to the regulator and responsibility for reviewing and sanctioning decisions taken by scheme Boards. This should ensure that decisions and overall strategies will benefit all payments industry stakeholders, but would need to avoid an overly-bureaucratic approach so as not to impede the progress of beneficial change.

Question 8: Do you have any concerns about the current governance of UK payment systems?

Answer: As ownership and governance of UK payment systems and schemes appears to overlap, our response to Q.6 applies here also.

Question 9: What do you believe is the appropriate governance structure for UK payment systems?

Answer: As ownership and governance of UK payment systems and schemes appears to overlap, our response to Q.7 applies here also

Question 10: How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc.) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Answer: We access all schemes as an indirect member via several individual clearing banks' sponsorships. The Yorkshire Group pays approximately £2.5m per annum in total to our sponsor banks, the LINK scheme and our card payment acquirers, in transaction, file transmission/submission and connectivity fees relative to the schemes listed in our Q.1 response.

Question 11: For the access you described above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Answer: Our sponsoring banks and other service providers generally supply a reliable and appropriate level of access to the schemes that we use, although on occasions we have to accept unfavourable contract terms and limited commitment to service level agreements in order to receive the services. In our experience our sponsors have been reluctant to support the provision of their payment systems with suitable contract and service support agreements, and regular system performance reviews and reports.

Question 12: Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Answer: We considered early participation in the Current Account Switch Service through our Norwich & Peterborough brand, which provides current account facilities to over 100,000 customers. However our N&P sponsoring bank (Co-op) chose not to enhance the faster payment file format provided to their agency banks, to accommodate entry of the unique reference number which needs to be applied to each account switch payment. Therefore early participation in this service would have required payment routing through a different sponsor bank - for this and other strategic reasons we have decided to delay participation until a future date.

This illustrates how sponsor banks currently can determine how and to what extent their agencies are able to participate in new payment developments, and how agencies' 'freedom of choice' to participate or otherwise can be unreasonably restricted under present access arrangements.

Question 13: If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Answer: We are able to choose between several direct member banks to access all relevant schemes however switching services from one bank to another is time-consuming, resource-intensive and costly for indirect members, and in many cases results in this group accepting mediocre service levels from a direct member rather than undertaking the major work associated with a switch.

Neither is direct access under current arrangements a viable option for most indirect members (including YBS) - in most cases complex and costly technological developments are required to engineer direct interfaces with the payment schemes, scheme fees and financial guarantees can be prohibitive for smaller organisations, and all direct members are invariably mandated to upgrade their systems to reflect scheme enhancements/introduction of new services, again involving substantial costs.

So while there are obvious benefits to direct membership in terms of customer experience, cost levels (and the resource commitment required to fully participate in decision-making, etc., as a direct member) are unacceptable for most indirect members.

Hence our suggestion for the introduction of a common utility, to provide an affordable gateway (with shared costs) into the schemes for indirect participants, with standard pricing, contracts, service agreements and consistent service levels.

Question 14: Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

• To whom do you provide indirect access?

• What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?

• Are there any barriers to becoming a sponsoring bank?

Answer: We do not act as a sponsoring bank.

Question 15: What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Answer: As outlined in our response under Q.13 there are technological and cost barriers to direct access and it is difficult to envisage how second tier membership would overcome these. Such a membership category potentially gives indirect members a greater influence in the determination of scheme strategies and system improvements, but probably only to a minor extent.

Question 16: Do you have any other comments regarding access?

Answer: Without the common utility platform mentioned above, ways need to be found to widen and simplify interface options and reduce the financial/resource burden to encourage greater direct membership.

Question 17: What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Answer: In our experience direct members employ different proprietary systems for accessing central scheme infrastructures, all with varying connectivity methods, file formats and messaging standards – partly we believe because the scheme infrastructures operate in different ways. Not all of these proprietary systems have the same degree of reliability or functionality.

A greater degree of standardisation across scheme infrastructures could improve the performance of individual direct members' systems, result in lower development costs and encourage wider scheme access. However this may not be feasible due to cost constraints, also the scheme infrastructures seem to perform well. Fundamental performance problems seem to exist within the individual system platforms used by the direct members, many of which appear to need upgrading to eradicate sporadic localised/widespread service failures.

Question 18: What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Answer: We believe that adoption of common messaging standards will facilitate the introduction of new payment methods and services and faster improvements in existing services, benefiting service users and consumers alike. It would seem logical for all relevant schemes to adopt the ISO20222 standard for Customer Credit/Debit Transfers and similar transactions, as this should enable new payment methods to be developed and implemented more efficiently through use of a common formats and file structures.

However a timeframe of 3-5 years may well need to be applied to accommodate the extensive system upgrades needed to revert to ISO20022 across the payments industry; we believe that many systems continue to use derivatives of BACS payment formats, which may need to be updated to conform to this standard.

Question 19: What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

Answer: We agree that the development of competing payment gateways/common utilities/managed services options could potentially benefit agency banks in terms of pricing, innovation and access. We believe that several major payment system operators/service providers (e.g. Swift, Vocalink, Bottomline Technologies) should be encouraged to develop compatible solutions for agency banks, to enable organisations like ourselves to be able to offer a range of payment options to our customers that is comparable with those offered by, and that develops at the same pace as those operated by, the direct members.

Question 20: Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Answer: It seems that incentives to innovate are not clear under current arrangements, and that payment services developments mainly tend to occur when direct scheme members are mandated to implement them following governmental pressure, e.g. introduction of faster payments, electronic cash ISA transfers, current account switching and cheque imaging. There is now an opportunity through regulation to ensure that direct members attach the same weighting to innovatory initiatives as to other commercial and strategic priorities, to improve the rate at which changes with potentially industry-wide benefits occur. Financial incentives e.g. additional tax allowances, could also be considered to make innovation more attractive commercially, as fees and set-up costs have to be affordable to encourage take-up.

Question 21: Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Answer: Current limiting factors for our organisation are short to medium-term requirements to upgrade our in-house systems and infrastructure in order to create the capacity to handle growing business volumes, to integrate a major brand acquisition and to complete various mandatory/regulatory projects. All of these initiatives are essential to maintain/improve existing customer service levels and continued operation in the regulatory environment.

Question 22: What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Answer: Innovation is likely to be stimulated through a combination of factors such as those outlined in our responses to Q.17-20, i.e. standardisation of scheme infrastructures, improvements to scheme members' system platforms, development of competing payment scheme gateways for agency banks, and introduction of regulation and financial incentives geared towards this specific objective.

Question 23: What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

Answer: We believe that the principle benefits of collective innovation are potentially lower development costs (resulting from economies of scale created by all participants sharing the cost of developing uniform systems) and distribution of new services to a maximum number of service users and consumers (which may in itself help to defray development and ongoing costs). However this could also lead to a slower pace of change as the collaborative approach needs the agreement of all parties at key stages of the development, which invariably takes time to achieve.

Question 24: Do you have any other comments or concerns you would like to highlight?

Answer: A general observation is that a large number of indirect scheme participants are reliant upon a handful of direct members, all of whom have to juggle a number of competing activities (and often give priority to the needs of their own customers, over the needs of their agencies' customers) during the course of delivering scheme access to the larger group. We consider that this arrangement may place too great an onus on these organisations and is a major factor in relation to the service issues referred to above.

Question 25: What, if any, are the significant benefits you see regulation bringing?

Answer: We anticipate that our payments will be routed more quickly to/from the various schemes, to enable us to reduce payment timescales for our customers and expedite query resolution processes. We also envisage being able to launch new payment services for our customers, in direct competition with scheme members, without the need for excessive investment in new payment technologies.

Question 26: What, if any, are the risks arising from regulation of payment systems?

Answer: While we consider that there is an urgent need for the new regime to ensure schemes pursue strategies which are of greatest benefit to all industry stakeholders, and that access is more readily available to all service users, an appropriate level of governance should be exercised. Over-governance could create an excessive administrative burden on the regulated firms, could bring the regime into conflict with other regulatory bodies e.g. Bank of England and may impede technological developments.

Question 27: How do you think regulation might affect your business and your participation in UK payment systems?

Answer: Regulation should promote a situation whereby we are able to offer the full range of efficient money transmission and payment services to our customers, and are in a position to participate in new payment initiatives at an earlier stage than at present, through improved indirect access facilities. We would also be prepared to consider direct participation/access in/to payment schemes/systems if regulation refined current membership terms, resulting in reduced financial and resource commitments.

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Payment System Regulation – Call for Inputs

YourCash Europe (YCE) welcomes the opportunity to participate in this consultation. YCE currently deploys c.5000 ATMs throughout the UK, Netherlands and Belgium. In 2013, the business handled c.75 million ATM transactions, equating to £2 billion cash dispensed through the UK estate and €1.3 billion in Europe. In the UK over 50% of YCE ATMs are free-to-use, which acquire over 80% of YCE transactions.

YCE welcomes the establishment of a new regulator for payment systems in the UK and strongly supports and recommends that Independent ATM Deployers (IADs) are included in this regulation. The role and responsibilities of IADs in the UK in providing universal access to cash has increased exponentially over the last 13 years, with c50% of the UK's 67,000 cash machines now being owned and operated by the Independents, and an increasing number of Bank's remote fleets being divested to the Independents. It is vitally important for the Regulator to understand the challenges currently facing this industry, to protect the UK ATM eco-system that ensures consumers continue to have easy access to cash in the UK.

Payment systems in the UK

Q1. Do you have any views on which payment systems should be considered for designation? If this includes parties other than the UK payment systems listed above please explain why.

Independent ATM Operators and also their Processors (e.g. Vocalink) should be designated. Both operate or provide infrastructure services as defined by the Banking Reform Act, and both meet the HM Treasury designation criteria with regard to "deficiencies in the design of the system or disruption of its operation would be likely to have serious consequences for users or likely users of the system".

Competition in payment systems

Q2. Where do you believe competition is effective or ineffective within UK payment systems?

Q3. At which level(s) is there potential for competition to drive benefits for service users, in terms of costs, quality or innovation?

Q4. What are the main factors impeding more effective competition at each level?

Q5. What functions do you think need to be performed collaboratively in the industry? How best can this be achieved?

There is a conflict of interest in the current ownership and control structures of the processor Vocalink and the Scheme LiNK. Both are majority owned or controlled by the major banks. This structure stifles innovation and is anti-competitive.

LiNK should become a corporate entity in its own right, separated from Vocalink, and operated on the same governance/control structure as other Schemes such as Mastercard and Visa. LiNK should also have a proper supplier contract and relationship with Vocalink, including transparency of how Member funds are being reinvested by Vocalink into the ATM infrastructure . The supply arrangements should be tendered with competitor processors.

The voting rights of the Members of LiNK should also be reviewed so that the Independent operators have and increased level of voting rights which recognise the distribution network they provide for consumers, many of which *are larger than some of the major Banks – of the top 6 largest ATM networks in the UK, 4 belong to Independent operators.*

Vocalink is owned by the major banks. That ownership should be divested. There are conflicts of interest within the Vocalink shareholders, for example Barclays development of Pingit, and Vocalink's own development of Zapp, as well as with the Members voting rights that they hold at LiNK.

There has been limited innovation at the ATM in the last 40 years, only balance enquiries (declining use) and Mobile Phone Top-Ups which are low in volume. The ATM needs integrating with new technologies, to give end-users interoperability. The current structure of LiNK and Vocalink, and the Interchange methodology, means that there is no business case to invest for innovative propositions.

The LiNK Interchange methodology and the OFT exemption which applies to this has fairness, transparency and collaboration at its centre, but is under immense challenge now due to its constant decline over the last 10+ years which means there is limited or no investment in ATMs, or funds to "pay for the future". A Multi-lateral interchange approach is preferable to both an intricate network of bi-laterals, and indeed the non-transparent and internally controlled method utilised by Mastercard and Visa, but it needs reviewing to ensure sufficient investment is made in the ATM infrastructure going forward in order to drive interoperability between payment channels for consumers and consumer-led innovation.

Ownership

Q6. Do you think the current ownership structure creates problems? If so, please explain your concerns with the current structure.

Q7. How might the regulator address any issues with the current ownership structure? Please explain how any remedy, including any alternate model, might address any or all of the issues you have identified and also highlight any potential concerns associated with such alternate ownership models.

Absolutely this is an issue. Overlapping relationships and common ownership within the payment processor Vocalink and the Scheme LiNK, despite supposed "Chinese walls", is and has been a barrier to competition and innovation.There are multiple examples of these conflicts.

The Banks should divest of their interests in Vocalink which should compete for business on price, service and innovation.

LiNK member voting rights of the major Banks should be re-assessed to ensure more of a level playing field with the independent ATM operators who have fleets larger than most banks and play a crucial role in providing end-users with free or convenient access to cash.

Governance

Q8. Do you have any concerns about the current governance of UK payment systems?

Q9. What do you believe is the appropriate governance structure for UK payment systems?

In relation to the ATM industry it is time now for the current governance structure to be reviewed. The landscape has changed significantly in the last 13 years on several fronts;

- *the entrance of independent ATM deployers who now own and run c33,000 of the UK's 67,000 cash machines*
- *the increasing levels of cash being drawn out from remote cash machines as other access-to-cash channels reduce e.g. bank branches, cash back*
- *the sale of Bank fleets to Independents e.g. 1200 machines from Santander to Notemachine*
- *the significant decline in interchange paid from the Card Issuers to the Card Acquirers, which now threatens a reduction in ATMs where the economic business case is no longer viable*
- *the disproportionate influence that the large Banks have upon the ATM eco-system*
- *the lack of influence that the Independents have upon the ATM eco-system*

The changes that need to be made are as mentioned previously. Separation of LiNK and Vocalink. LiNK to become a private limited company, with ownership fairly allocated across ATM deployers on the proportionate basis that they provide access points-to-cash, rather than transaction volume. Banks to divest of their shares and control over Vocalink. Proper supplier relationship to exist between LiNK and Vocalink, or its chosen (by tender) processing partner.

Access

Q10. How do you access UK payment systems? Please provide details (e.g. direct or indirect, the conditions, fees and requirements for access etc) for each payment system you have access to and any concerns you may have with your current arrangements. If you do not currently have access to UK payment systems, please provide details on how you participate within the UK payment industry, and detail any concerns or constraints you may have in this regard.

Q11. For the access you describe above (in question 10), are the access terms and conditions (including fees) fair and reasonable? If not, please provide details.

Q12. Does the access arrangement you currently have limit your ability to compete or impact on the service-users' experience in any way?

Q13. If you access payment systems indirectly through a sponsoring agreement with a direct member bank, do you have sufficient choice in sponsoring banks? Would you prefer to access payment systems directly? What do you see as the benefits and risks of doing so?

Q14. Do you act as a sponsoring bank, providing indirect access to any payment system participant in the UK (please provide details for each payment system you provide access to)? If yes:

- **To whom do you provide indirect access**
- **What are the major risks and costs associated with providing such indirect access? On what basis do you choose whether to provide indirect access?**
- **Are there any barriers to becoming a sponsoring bank?**

Q15. What changes to access rules and conditions would you like to see? Are there any alternative routes to gain access to payment systems that you believe should be developed (e.g. a second tier membership to payment system operators)?

Q16. Do you have any other comments regarding access?

YourCash's licencing and acquiring infrastructure is as follows:

- *Membership of LiNK*
- *Principal licence with Mastercard*
- *Sub licence with Visa via Vocalink's commercial arrangement with Principal Licence holder Voice Commerce Group*

LiNK

Fees; The membership fees are fair and transparent. However there are other operational fees which are levied by Vocalink but which are negotiated by LiNK which are far less transparent or negotiable. This needs unwinding as part of the governance re-structure.

Additionally, the membership entry requirement to LiNK and ongoing oversight needs strengthening given the history of ATM deployers going into administration and the key role that the 5 remaining non-regulated players have in the market. The annual LiNK Certification process is too operationally focused, and needs to have a Financial Standing and Ongoing Viability assessment, to ensure there is no material risk to a significant proportion of the ATM distribution network. "Too big to fail" springs to mind.

LiNK also needs more empowerment ("teeth") with the Major Banks. Over 2 years ago RBS and Lloyds took the decision to block Basic Bank account holders from universal access to all ATMs, only allowing access at their own ATMs, or some other limited channels such as the post office. This is treating consumers unfairly. In also flies in the face of PSD and Mastercard/Visa regulation of "honour all cards", as Acquirers are required to honour all cards, but some Issuers have chosen to block where they can be used.

Scheme membership (Mastercard and Visa)

We were able to achieve a Principal Licence with Mastercard for ATM acquiring, having met all their stringent entry requirements. We were only the 3rd in the world to achieve this, the 2nd in Europe, the 1st in the UK. This gives us important competitive and innovative advantages.

We have not been able to achieve a Principal licence with Visa Europe due to their different qualifying requirements which include a Payment Institution Licence (PIL). We meet all the standards for a PIL but are caught under an exemption by the FCA's UK member state interpretation of the Payment Services Directive (PSD). PSDII will change this but not be implemented for 18-24 months. Having a sub-licence via a 3rd party has hindered competitive advantage and innovation. The FCA should review its criteria for PIL applications. This also fits with the stronger governance required for LiNK membership. There are limited options to use an alternate sub-licence provider, due to the commercial relationship the Principal licence holder is required to have with Vocalink.

Infrastructure

Q17. What improvements or changes do you believe are required in the provision and use of infrastructure in the UK? We would also be interested in your views on the cost of such changes, for you or for the industry as a whole. What considerations, if any, need to be considered regarding the impact of any changes or improvements on the resilience and reliability of payments systems?

Q18. What changes, if any, are needed regarding messaging standards in the UK? For example, would the adoption of ISO20022 standards alleviate any concerns or improve any constraints you experience? What timeframe and considerations would need to be taken into account in adopting new standards?

Q19. What solutions can be developed to increase competition in the provision of infrastructure and/or managed services to support the technical and operational functions of agency banks participating in UK payment systems? How can this be achieved, and what will the impact and benefits of this be to your business?

There needs to be more choice of payment processors beyond Vocalink to ensure a competitive landscape for those providing acquiring services. However, all potential new entrants are constrained by having to have a collaborative and commercial relationship with Vocalink in order to access the Switch, which routes all the traffic to/from the cardholder bank's to the acquirer and provides the settlement mechanism. The Switch should be owned by LiNK, who can then chose payment processors through a competitive tender.

Vocalink services have been very stable over the years, but their utility-style approach has stifled innovation.

Adoption of ISO20022 would appear to be a positive step for the industry if it raises standards, improves interoperability and reduces constraints.

Q20. Are incentives to innovate clear under current arrangements? Please also include any concerns you may have regarding fee arrangements and the impact of changing fee structures (such as changes to interchange fees).

Q21. Do any factors limit your ability or incentives, either collectively or unilaterally, to innovate within UK payment systems?

Q22. What changes, if any, are needed to facilitate a greater pace of innovation in UK banking and payments? Please refer to your previous answers where relevant.

Q23. What do you believe are the benefits and limitations of collectively driven innovation vs. unilateral innovation?

There are no incentives to innovate. Quite the opposite. LiNK interchange sets innovation transactions at Nil e.g. Barclays Pingit. Also Charity Giving at ATMs is an example of this where there is no payment to the Acquirer for enabling this facility, infact the Acquirer has to carry the processor's costs, so there is no business case for rolling this out extensively. The major banks only did this in response to political pressure. There has been limited promotion and the volumes are tiny.

I had an innovation idea around Pension Giving at the ATM, but the dis-incentivisation put this project in the freezer.

The changes required to facilitate a greater pace of innovation in UK payments are already covered under previous questions.

<u>Closing questions</u>

Q24. Do you have any other comments or concerns you would like to highlight?

Q25. What if any, are the significant benefits you see regulation bringing?

Q26. What, if any, are the risks arising from regulation of payment systems?

Q27. How do you think regulation might affect your business and participation in UK payment systems?

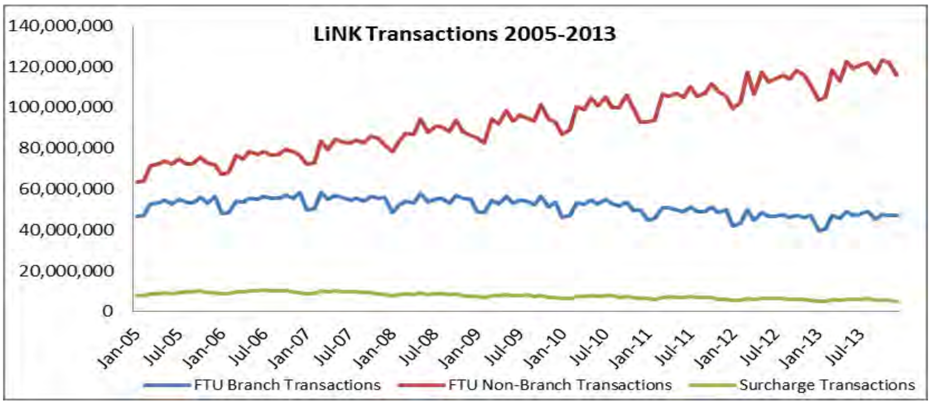
There is a need to educate and inform the politicians and regulators on the role and importance that Pay-to-Use (PTU) ATMs play in the industry. Often derided, but much mis-understood. Key facts;

- *c20,000 PTU machines i.e. 30% of the UK ATM distribution network, but used by consumers as "convenience" and "choice" they only acquire less than 4% of total transactions (steady decline since 2006). There is plenty of alternate FTU machines within reasonable travel distance.*
- *the machine provides an important revenue stream to the hosting merchant, who retains c50-75% of the revenue*
- *in many cases the merchant also places his own cash into the ATM, thus saving on re-banking charges*
- *there are limited opportunities to convert a PTU ATM to a free-to-use (FTU) ATM, as FTU ATM's drive over 3 times as many transactions so the merchant would have insufficient cash to fill the machine, plus a loss of revenue stream as the interchange paid on FTU transactions is insufficient to provide an economic case for the acquirer to share with the merchant*

There is also a need to educate and inform the politicians and regulators on the role and importance that the Independent operators have played and continue to play in providing new access points to end-users, as Banks reduce their fleets.

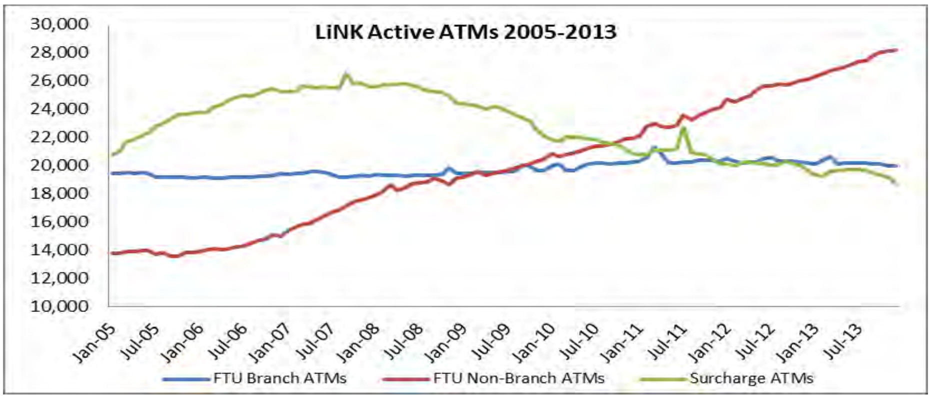
The attached graph shows:

Volumes of transactions increasing at remote FTU ATMs, reducing at Bank branch FTU ATMs, and the minimal volume of PTU transactions



This further graph shows:

The rise of remote FTU ATMs and the decline of PTU ATMs



Benefits of regulation: I believe regulation is now required for the ATM industry for the following reasons:

- *to raise standards and ensure no downside or systemic risk to the 33,000 ATMs provided by the independent operators – we have seen varying levels of financial stability over the years where LiNK has had to intervene previously, but on a non-mandated basis. The players also have material responsibility within the cash provision chain which should receive closer scrutiny.*
- *to create a level playing field between Issuers and Acquirers, and between Schemes (LINK, Mastercard and Visa)thus providing fairness, transparency and driving competition*
- *to stimulate Innovation, through choices of processors and a review of Interchange*

The risks arising from the regulation of payments systems are that the Regulator needs to ensure that the regulation is appropriate and proportionate. Listening and responding to these Call for Inputs is important, as is a continuation of the consultation process.

We hope this helps you to develop specific regulatory options for further formal consultation later this year, and would want to continue to be actively involved in this.

Jenny Campbell, CEO and Chairman

YourCash Europe Limited