

Access and governance report on payment systems: update on progress

June 2019



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1 Executive summary

- 1.1** This report sets out developments in access to payment systems in 2018, including the work that the interbank payment system operators¹, indirect access providers (IAPs), the Payment Systems Regulator (PSR), the Bank of England, the Financial Conduct Authority (FCA) and others have done to improve access to payment systems. Where there have been developments in early 2019, we also comment on those.
- 1.2** It also sets out how interbank payment system operators have taken service-users' views into account in making their decisions over the course of 2018.
- 1.3** These areas are critical in promoting competition and innovation, and the benefits they bring to everyone who uses payment systems.
- 1.4** Since our last report, we have seen a number of improvements in the provision of access to and the governance of payment systems. We have seen new entry across different systems, which ultimately promotes competition and the interests of people and businesses. We have also seen emerging challenges, such as some credit institutions altering their access criteria for payment account services. We have gained new powers and sought to further understand the market.

Access

- 1.5** In 2018 we saw:
- a record number of new direct participants – 12, up from 7 in 2017 – joining Faster Payments Scheme (FPS), Bacs and CHAPS
 - the first non-bank payment service provider (PSP) participants joining these systems, with five non-banks joining directly (TransferWise, Ipagoo, Ebury, Prepay Solutions and CreDec)
 - the first new participants connecting directly to FPS using a sponsor bank for settlement (Ebury and Prepay Solutions)
 - recent new entrants in the indirect access market (ClearBank, Starling Bank and BFC Bank) actively offering services to, and onboarding, PSPs
- 1.6** Pay.UK² became the entity responsible for operating the Bacs, FPS and cheque and credit (C&C) payment systems. Pay.UK also progressed work developing the New Payments Architecture (NPA), including commencing the procurement process for the NPA central infrastructure provider.

¹ Interbank payment systems covered in this report are Bacs, FPS, C&C and CHAPS.

² Pay.UK, formerly known as the New Payment System Operator (NPSO), is the new consolidated body that operates the UK interbank retail payment systems – FPS, Bacs and C&C. It is responsible for developing and delivering the NPA, including a competitive procurement process for the NPA's central infrastructure services.

- 1.7** In January 2018, the Payment Services Regulations 2017 (PSRs 2017) came into effect, placing new obligations, backed up by an enforcement regime, on access providers. These obligations include requirements to treat requests for access in a proportionate, objective and non-discriminatory (POND) way, and for credit institutions to notify the FCA (which provides us with the notification) each time they refuse or withdraw access to a PSP.
- 1.8** In respect of decisions taken in 2018, we received 194 of these notifications for refusal or withdrawal of access to a PSP by a credit institution. This number comprised 34 withdrawals and 160 refusals and concerned 171 separate PSPs (that is, some PSPs had access refused by more than one credit institution).
- 1.9** There remain challenges in the indirect access market. Some established IAPs appear to have a limited appetite for providing services to non-bank PSPs, particularly smaller PSPs and money remitters. Some IAPs have recently altered their access criteria, which means that, despite the entry of new providers, some PSPs still find it difficult to obtain the indirect access arrangements they want, or have been exited from existing arrangements and have had to find alternatives. We will continue to monitor IAPs' treatment of access requests against the PSRs 2017 requirements. Should we suspect that requests are not being treated in a POND manner, we will consider the options available to us, including formal enforcement proceedings.
- 1.10** We have some concerns with how credit institutions are dealing with requests for payment account services under PSRs 2017, including their communication with access seekers and failures to provide required notifications to the FCA.

Governance

- 1.11** In 2018, Pay.UK continued to engage with service-users on aspects of its existing service offerings and plans for new service offerings, including through its stakeholder engagement advisory groups.
- 1.12** Pay.UK's new governance framework became operational from May 2018. Pay.UK implemented its Target Operating Model on 1 March 2019, which includes new capabilities focused on engaging with service-users.
- 1.13** During 2018, we continued our review into our 'day one' Directions to ensure they are fit for purpose and as effective as possible. We released our policy statement in March 2019.

Developments and focus areas in 2019

- 1.14** In our 2018 report, we noted that we expected operators to continue to deliver previous workstreams on non-bank PSP access, and to continue to develop their models to reduce complexity and the cost of direct participation. Beyond this, we did not specify any new focus areas for 2018. This was because we had seen good progress by operators, onboarding new participants had become a business-as-usual activity, and many barriers to direct and indirect access had been brought down due to our work and that of the operators.

Direct access

- 1.15** In 2018, the operators have continued to make good progress in lowering the barriers to obtaining good quality direct access to the interbank payment systems. In turn, this has led to a greater choice of ways to access payment systems than ever before.
- 1.16** 2019 is projected to be another record year for participants joining FPS, although lower numbers are expected for CHAPS and Bacs compared to 2018. As the commencement of the NPA and real-time gross settlement (RTGS) renewal draw closer, we would expect a temporary slowdown in the number of participants joining directly as potential new participants wait for finalisation of the new arrangements to avoid having to go through multiple implementations for different systems in quick succession.
- 1.17** Non-bank PSPs have now been able to gain direct access to interbank payment systems for around a year. We would expect Pay.UK and others involved in onboarding non-bank PSPs to keep their experiences of onboarding under review, and to consider whether there are any enhancements that could be made to improve processes.

Indirect access

- 1.18** Recent entrant IAPs are slowly increasing their market share. Potential new IAPs entering the market in 2019 could provide more options for PSPs seeking indirect access. However, there remain limited options for smaller PSPs, in particular small money remitters. We will continue to undertake monitoring activity in this area and keep the matter under review.
- 1.19** We expect credit institutions to meet all aspects of their obligations under regulation 105 of the PSRs 2017. In particular, we expect credit institutions to improve their practices when considering requests for payment account services by PSPs, and to ensure they have robust processes in place so that all PSPs applying for payment account services get passed through the correct consideration and notification processes. This should reduce instances where we need to request further information, and of notifications not being provided to the FCA when they should be. The relevant threshold for us to open a case into these process issues has not been met so far. However, where we suspect that credit institutions are not complying with their obligations, we will continue to consider all options available to us, including formal enforcement proceedings, having regard to the factors set out in our Administrative Priority Framework (APF).

Governance

- 1.20** Pay.UK is currently implementing its work programme to progress the development of the NPA. As part of this, we expect Pay.UK to continue to focus on its new governance arrangements and engagement with stakeholders, and to understand what the new onboarding demand will be for the NPA.
- 1.21** We expect to finalise changes to our 'day one' Directions later in 2019.

2 Introduction

Structure of this publication

2.1 The structure of this report is as follows:

- **Chapter 1** is the executive summary
- **Chapter 2** is this introduction
- **Chapter 3** focuses on direct access developments
- **Chapter 4** focuses on indirect access developments
- **Chapter 5** focuses on governance developments
- **Chapter 6** covers development areas
- **Chapter 7** is the glossary

Purpose of this paper

2.2 Effective access and well-governed payment systems are critical to promoting competition and innovation in payments, and to promoting more competition in payment services and retail banking.

2.3 We are publishing this report to update stakeholders on developments in access and governance over 2018, including the progress of our work and the related outcomes. Where there have been developments in early 2019, we also comment on those. This is our fourth access and governance report, following previous reports published in December 2015, March 2017 and March 2018.

2.4 We have seen that the choice and quality of access to payment systems have improved significantly since the PSR's creation in 2014. However, this remains a key priority for us because open access to high-quality payment systems is vital for the provision of competitive and innovative payment services to users who participate in the systems.

2.5 This report focuses on the operators of, and access to, the regulated interbank payment systems:

- Bacs, operated by Pay.UK
- Faster Payments Scheme (FPS), operated by Pay.UK
- Cheque and Credit (C&C), operated by Pay.UK
- CHAPS, operated by the Bank of England (the Bank)

2.6 This paper does not cover access to card payment systems or the LINK system, and therefore does not cover our General Direction 3 or regulation 103 of PSRs 2017.

3 While the CHAPS system and most of its participants are within the scope of our regulatory powers, the Bank of England – as operator, infrastructure provider and participant of CHAPS – is not.

Background

Getting access to payment systems

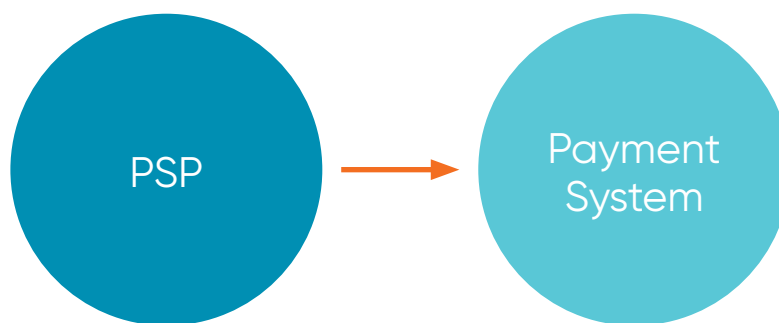
- 2.7** Payment Service Providers (PSPs), such as banks, building societies, credit unions, payment institutions and electronic money institutions, provide services to their customers that often enable the transfer of funds using electronic payment systems. These services include providing payment account services (such as current accounts), issuing electronic money, processing card payments, and money remittance. To be able to transfer funds for their customers, PSPs need access to payment systems.
- 2.8** PSPs can access payment systems in different ways. While models differ across systems, there are generally two fundamental forms of access to the interbank payment systems – direct and indirect.
- 2.9** PSPs with direct access to a payment system are called direct participants. Direct participants process payments through a technical connection to the payment system's central infrastructure, through a bespoke connection, an aggregation service, or a standardised messaging and network service.
- 2.10** PSPs with indirect access go through an indirect access provider (IAP). PSPs with indirect access can be 'agency' or 'non-agency' participants.
- Agency indirect PSPs are provided with one or more unique sort codes by their IAP. An indirect PSP needs to have one or more of its own unique sort codes to provide directly addressable payment accounts. By having a unique sort code, the indirect PSP is able to issue account numbers against that sort code for each of its payment account customers. Each of these sort code and account number combinations will create a unique identifier that is usable in the interbank payment systems.
 - Non-agency indirect PSPs are not provided with a unique sort code and generally provide payment services using the same account number and sort code. For example, a non-agency building society may use roll numbers to differentiate between their customers, and therefore use the same sort code and account number for sending and receiving transactions on behalf of multiple customers.
 - Non-agency indirect access can be supplied by an IAP that has direct access to the system, or as part of a 'nested' supply arrangement, where an indirect PSP itself also acts as an IAP.
- 2.11** Whether a PSP chooses to access payment systems directly or indirectly will depend on several factors, including the volume of transactions it expects to have, and its business model.

- 2.12** A settlement account at the Bank is required for a PSP to become a directly settling participant in Bacs, FPS, CHAPS and C&C. Prior to 2018, the ability to get a settlement account was limited to banks and certain other types of firms. Non-bank PSPs, such as e-money institutions and payment institutions, needed a relationship with an IAP to make payments as they could not get access to a Bank settlement account. In July 2017, the Bank announced changes to its settlement account policy, allowing certain FCA-authorised non-bank PSPs to apply for settlement accounts at the Bank so they can gain direct access to payment systems.

Figure 1: The different ways that PSPs can access payment systems

Direct access

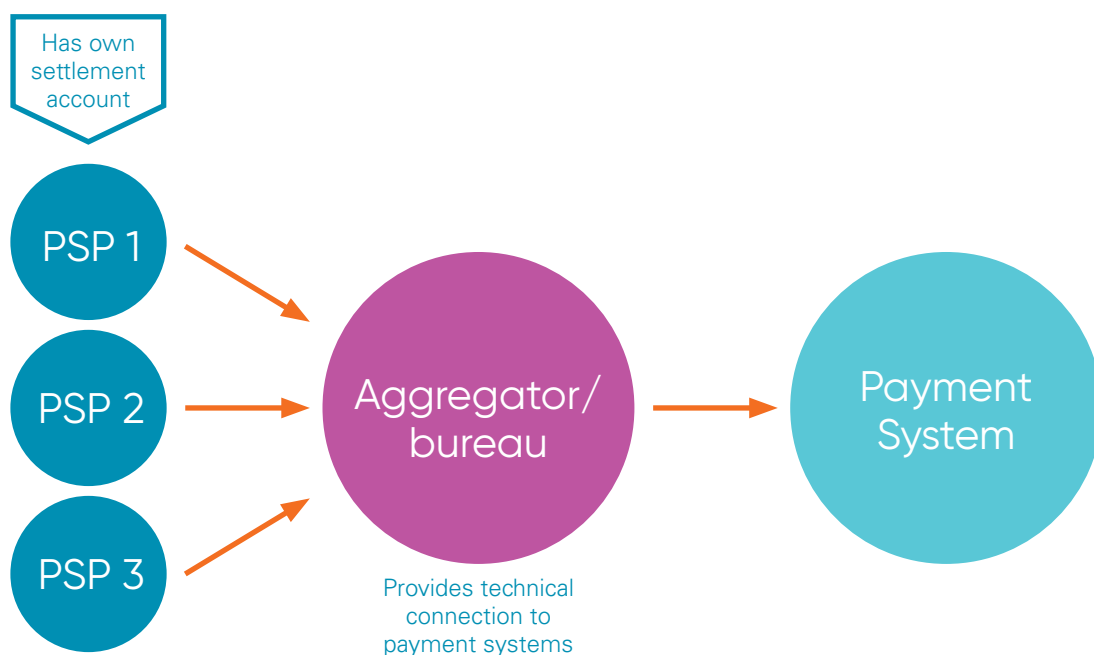
A PSP has a settlement account and its own facility to connect directly to the payment system



Has own settlement account and technical connection to the payment system

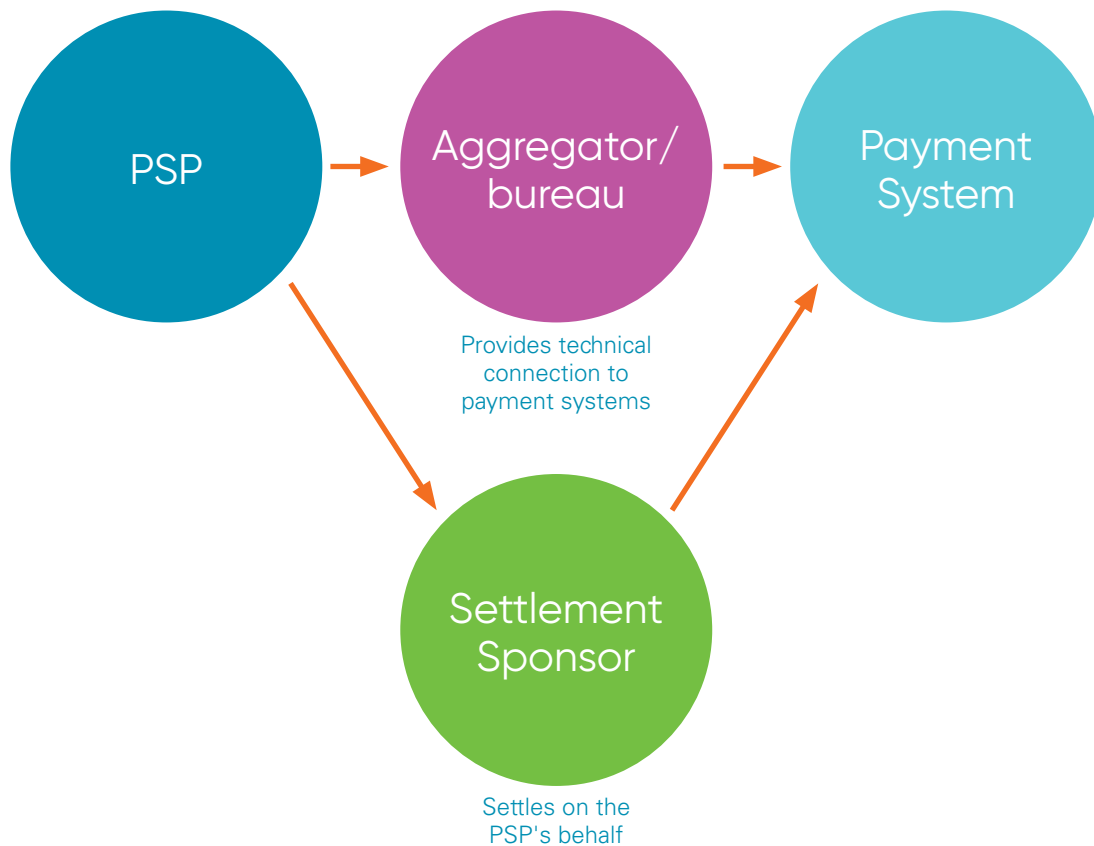
Direct technical access – directly connected settling participants (DCSPs)

A PSP has a settlement account and connects directly to the payment system through an aggregator or bureau



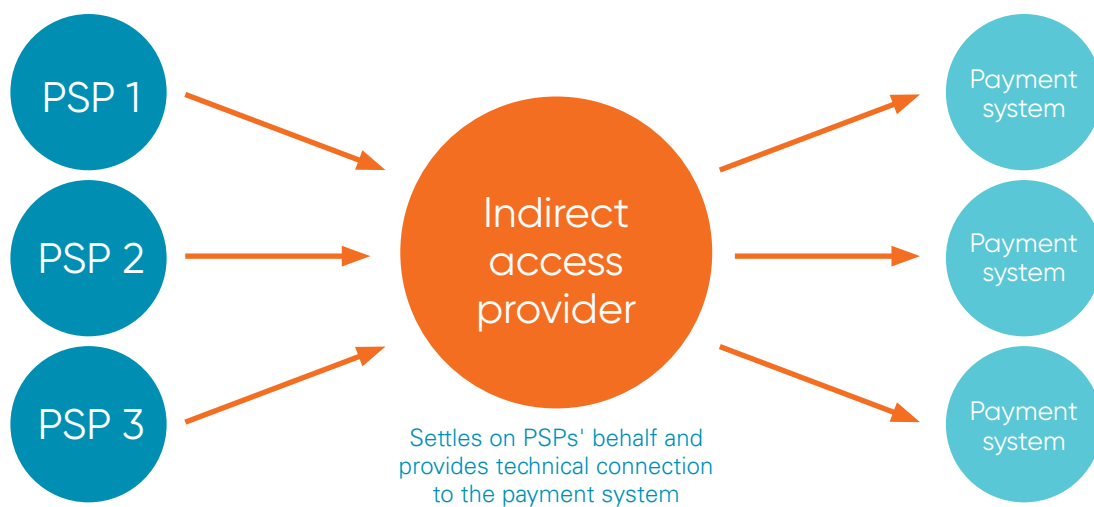
Direct technical access – directly connected non-settling participants (DCNSPs)

A PSP uses a sponsor bank for settlement and either connects directly to the payment system or connects through an aggregator or bureau



Indirect access

A PSP uses a sponsor for settlement and indirect access to the payment system



The PSR's work to date

- 2.13** We started our work on access in 2014, before the PSR became fully operational.
- 2.14** Stakeholders were generally concerned that operators' access requirements were not clear and provided some barriers, and that this may have made direct access difficult or impossible for some PSPs. For indirect access, stakeholders raised a range of concerns including lack of choice of access provider, difficulties accessing and assessing information about different indirect access options, and the risk that providers may discontinue the supply of indirect access without a reasonable notice period.
- 2.15** Only a small number of big banks were participants in all of the interbank payment systems. No new banks had joined FPS since it went live in 2008, and only a handful of banks had joined Bacs. Only four banks offered indirect access – Barclays, HSBC, Lloyds and RBS.
- 2.16** In response to these concerns, we took several steps to examine direct and indirect access and to remove, or encourage the removal of, barriers to PSPs getting access to payment systems:
- We issued General and Specific Directions to help improve access to and governance of payment systems. We worked with the operators to implement these Directions and open up access to more participants.
 - We worked with the industry in its efforts to establish a voluntary code of conduct for the provision of indirect access. The Code was published in September 2015, with updated versions published in September 2016 and March 2018.
 - In our review of indirect access to payment systems, we considered how competitive the market was. We published our findings in July 2016.
 - We worked with other regulators and the operators of the payment systems to lower the barriers to entry and encourage more competition in the access market.
- 2.17** We have published annual access and governance reports in December 2015, March 2017 and March 2018.
- 2.18** We continue to focus on improving the access market.

Recent structural and regulatory changes in access

- 2.19** In November 2017, responsibility for operating the CHAPS payment system transferred to the Bank. While the CHAPS system and most of its participants are still within the scope of our regulatory powers, the Bank – as operator, infrastructure provider and participant of CHAPS – is not. Our General Directions therefore no longer apply to the operator of CHAPS.
- 2.20** In 2018, the operators of Bacs, FPS and C&C consolidated into Pay.UK, previously known as the New Payment System Operator (NPSO). Pay.UK is required to comply with our existing directions and meet the requirements that previously applied to these systems.

- 2.21** We recently reviewed our ‘day one’ Directions, including those mentioned above, to ensure they remain fit for purpose. We issued our policy statement in March 2019, which sets out that we will make some changes to ensure that the Directions remain relevant and proportionate, and to tailor our requirements to market realities, legislative changes and expected future developments. These changes include a principles-based General Direction (GD) 4 requiring the interbank payment system operators to focus on service users and make transparent decisions, and an expansion of Specific Direction (SD) 1 to encourage IAPs to focus on their engagement with access seekers. See paragraphs 4.114 to 4.124 and 5.34 to 5.56 for further details.
- 2.22** The second EU Payment Services Directive (PSD2) came into effect on 13 January 2018 and gave us powers to ensure access rules and conditions are proportionate, objective and non-discriminatory. We have powers under regulations 61, 103, 104 and 105 of PSRs 2017. Regulations 104 and 105 are relevant to this report as they relate to access to interbank payment systems (both directly and indirectly). We are co-competent with the FCA for regulation 105. Where we have powers in relation to PSRs 2017, we no longer have powers under the Financial Services (Banking Reform) Act 2013 (FSBRA). We further consider our PSRs 2017 powers and remaining FSBRA powers in chapter 4.
- 2.23** Under the ring-fencing requirements brought in by the government to strengthen the financial system following the financial crisis that began in 2007, the largest UK banks were required by UK law to separate core retail banking services from their investment and international banking activities by 1 January 2019. The four main IAPs – RBS Group, HSBC Group, Barclays plc and Lloyds Banking Group – have now each split into multiple entities. This has, in some cases, affected which entity within the IAP group provides indirect access services. In some cases, this has meant that different types of customers are serviced by different units within the group, and has changed the processes for PSPs seeking access.

3 Direct access developments

2018 highlights – direct access

This was another record year for new participants joining the interbank payment systems – CHAPS, FPS and Bacs.

2018 saw the first non-bank participants joining directly, and the first directly connected non-settling participants (DCNSP) in FPS.

Aggregator models continued to develop, with PSPs now joining directly through a shared gateway, simplifying the process.

This means that non-bank PSPs can now access interbank systems directly, either as a full settlement participant or using a sponsor PSP to carry out the settling element of the process if they cannot or do not wish to have a settlement account with the Bank of England (the Bank). New direct participants can either connect using their own bespoke connection or use an aggregator to assist and simplify the onboarding process.

Previously, direct non-bank participants were required to prefund their positions in FPS and Bacs using their own funds and not those of clients. However, from 2019 non-bank PSPs will also be able to use the 'client funds' model of prefunding.

Pay.UK became the entity responsible for managing Bacs, FPS and C&C, and commenced the procurement process for the New Payments Architecture (NPA).

This chapter sets out these developments in more detail.

State of the market

3.1 2018 was another record year for new participants joining the interbank payment systems – CHAPS, FPS and Bacs.

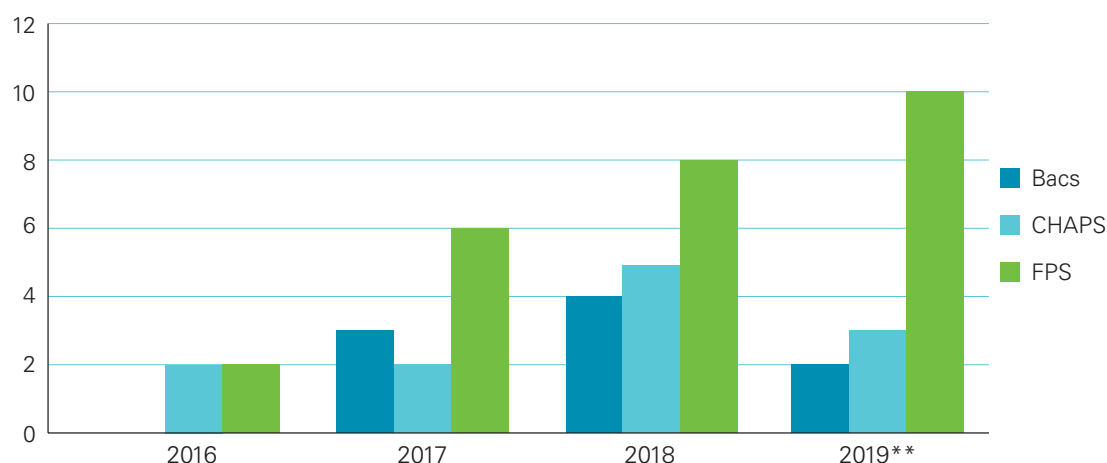
Table 1: New participant numbers by year⁴

	New participants in 2017	New participants in 2018	Expected new participants in 2019 ⁵
Bacs	3	4	2
CHAPS	2	5	3
FPS	6	8 [^]	10
Total	11	17	15
Of which were 'unique'⁶ users	7	12	13

[^] While there were nine new participants in FPS, one had an agreement with an existing participant to replace its position.

All numbers exclude multiple memberships from ring-fenced banks.

Figure 2: History and projection of new participants in the interbank payment systems by year



**estimated

4 Covering the period 1 January to 31 December.

5 Based on projections from the operators in Q2 2019, and subject to change.

6 This removes repeats for PSPs who joined more than one system.

- 3.2** A number of banks joined one or more of FPS, CHAPS and Bacs in 2018. They include:
- BFC Bank
 - The Access Bank
 - ING
 - Atom
 - Virgin Money
 - Elavon
 - Starling Bank
- 3.3** For the first time, a number of non-bank PSPs also joined one or more of FPS, CHAPS and Bacs directly. These were:
- Ebury (as a DCNSP in FPS)
 - TransferWise
 - Ipagoo
 - PrePay Solutions (as a DCNSP in FPS)
 - CreDec
- 3.4** In addition, one financial market infrastructure also joined CHAPS:
- LCH Ltd
- 3.5** At the end of 2018, FPS had 26 participants, Bacs had 23 and CHAPS 30.
- 3.6** The operators have told us there is a strong line-up of PSPs expected to become direct participants in 2019. The projections suggest that 2019 will see a continuing trend of increasing numbers of new participants for FPS as the market is continuing to react to the reduced complexities and costs of direct participation. There are ten participants expected to join FPS in 2019, which is an increase on the number of new participants who joined in 2018.
- 3.7** There is likely to be a temporary decline in the demand for direct access as the development and implementation of the NPA and RTGS renewal approach, with new participants waiting for the new system rather than investing in building connections to the pre-existing system. Pay.UK is currently tendering for parts of the NPA.

Non-bank direct access

- 3.8** On 19 July 2017, the Bank announced it was extending access to settlement accounts in its RTGS system to non-bank PSPs. After legislative changes were made, from early 2018, non-banks have been able to join interbank payment systems directly.
- 3.9** 2018 saw the first non-bank PSP join a payment system directly. In March 2018, Ebury became the first non-bank to join FPS as a DCNSP. TransferWise joined FPS in April 2018 as the first non-bank to directly connect and settle. A further three non-banks joined FPS later in 2018. Ipagoo became the first non-bank to join Bacs in May 2018 and the first non-bank to join CHAPS in August 2018.
- 3.10** While we are aware that there is a process of continuous improvement in onboarding PSPs, we expect Pay.UK and others involved in the onboarding process to particularly consider their experiences in onboarding non-bank PSPs over the past 12 months and see whether there are any enhancements that could be made to improve the onboarding processes.

Prefunding requirements

- 3.11** The operators of Bacs, FPS and C&C⁷ require cash prefunding to allow settlement completion in the event of a shortfall. This removes credit risk associated with any settlement participant failing to have the required cash to settle, and any contagion that could arise from any participants failing to pay their obligations. This can pose a challenge for some non-bank PSPs as, until recently, the model for prefunding meant that they had to use their own funds rather than client funds that they were holding against the risk of a shortfall in liquidity.
- 3.12** However, the Bank and Pay.UK have been working to make changes to allow for 'client funds' prefunding models. This enables non-bank PSPs to participate in FPS or Bacs using client funds that they are already holding instead of using their own funds, while keeping the funds safeguarded. This opens up access further for non-bank PSPs. Since early 2019, non-bank PSPs have been able to join FPS using client funds as their prefunding mechanism, with Bacs to follow shortly.
- 3.13** We expect this model will enable more non-bank PSPs (those that cannot support prefunding using their own funds) to join directly.

⁷ In respect of their image-clearing system only.

Changing models

Directly connected non-settling participants in FPS

- 3.14** 2018 was also the first year that a PSP became a DCNSP in FPS. This model allows PSPs to connect to the FPS central infrastructure directly, but with a sponsor PSP carrying out the settling element of the process. This model is technically equivalent to being a direct participant, but without the need to hold an account at the Bank for settlement.
- 3.15** Joining as a DCNSP was made possible by changes FPS made from the beginning of 2018. FPS changed its rules to incorporate DCNSP participants and to retire its pre-existing direct agency model, which has only ever been used by one PSP. The DCNSP model has been further improved because there are pre-existing aggregators that are able to provide cheaper and quicker direct access.
- 3.16** In 2018, two participants joined FPS under the DCNSP model. FPS expects more PSPs to take advantage of DCNSP models in 2019.

Aggregators

- 3.17** Joining FPS and CHAPS has been simplified in the past few years through the role of technical aggregators. Aggregators are firms that provide a product or managed service that allows PSPs to connect to FPS or CHAPS. Before the introduction of aggregators, PSPs would have had to build a bespoke gateway and link to the central infrastructure.
- 3.18** The technical access solutions offered by aggregators generally reduce the costs of joining a payment system directly. The aggregators are able to offer a service based on sharing the costs of the technical infrastructure required for direct participation – therefore reducing the overall cost of direct access for PSPs. This may make it commercially viable for some PSPs with lower volumes to be able to join directly.
- 3.19** Aggregators therefore improve choice for smaller and mid-sized PSPs as the cost-benefit trade-off between indirect and direct access has changed.
- 3.20** In FPS, aggregators are accredited by Pay.UK, and must pass a number of technical and assurance tests in order to gain accreditation. PSPs can therefore choose an aggregator knowing that they have a proven connection into the main infrastructure. In CHAPS, aggregators are not accredited in the same way – the direct participant retains responsibility, but there are firms that have clients and a proven record of delivering access.
- 3.21** Bacs launched an aggregator model in December 2016, but there has been a continued lack of demand from firms wishing to provide aggregator products. In part, this is because Bacs already has a range of different access models that have lowered the cost and complexity of direct participation, and an active bureau model, which is broadly similar to using an aggregator under FPS for the submission of payments. At the end of 2018, Pay.UK began a review to consider this lack of demand, and to explore options to further evaluate the service, in line with NPA developments. As a result of this review, Pay.UK will suspend its Bacs aggregator model and potential participants will be made aware of the variety of options that are already available to them (such as approved bureaux).

- 3.22** In addition to the bureau model, Bacs participants are able to join directly using one of two methods – a bespoke link with the central infrastructure to submit and receive files, or a secure website solution.
- 3.23** We noted in our 2018 report that we have seen take-up of aggregators for onboarding in FPS, and bureau and simplified access models in Bacs. This has continued in 2018. It is notable that the majority of new direct participants in FPS have opted to join through an aggregator.
- 3.24** 2018 saw the emergence of DCNSPs using aggregators to assist in getting settlement sponsors and technical providers, and to assist in undertaking the assurance work needed to join FPS.
- 3.25** We have yet to see the emergence of aggregators providing direct technical access to multiple payment systems simultaneously. While some aggregators provide a combination of aggregation and bureau services, no aggregator provides a single access point for connecting to all the interbank payment systems. We are not aware of any barriers to such a model being developed if there is demand for it.
- 3.26** There has also been an emergence of ‘onboarding partners’ – firms such as Form3 that aim to simplify the joining (and switching) process for PSPs as well as offering multiple products via a single platform.

Case study: Form3 financial cloud

Form3 offers an onboarding service, assisting PSPs in joining payment systems. It allows the PSP to use the scheme connection model and to choose its own settlement sponsor and aggregator to suit its own needs (as Form3 has relationships with various clearing banks and IAPs), while assisting the PSP through the process.

Form3 provides a platform that participants will integrate with once. From there, the PSP can expand its services and the countries it serves whenever it wants to. The PSP can also switch IAP quickly, easily and cheaply, retaining the same single connection to Form3.

In simple terms, the PSP connects to Form3, and Form3 assists it in connecting to the required systems both in the UK and internationally, providing options and information and assisting throughout the process.

So far, Form3 can provide direct or DCNSP access to FPS, Bacs and the Single Euro Payments Area (SEPA). Form3 also has SWIFT infrastructure.

Changes made by the operators

Consolidation of the interbank systems

- 3.27** 2018 saw the consolidation of the operators of the retail interbank payment systems. Pay.UK took responsibility for the Bacs and FPS operating systems on 1 May 2018.⁸ On 1 July 2018, Pay.UK took over the running and managing of the cheque systems, completing the consolidation.
- 3.28** This consolidation was one of the key recommendations of the Payments Strategy Forum. It will enhance the capability and capacity of the operators, streamline governance arrangements and reduce the complexity and costs of having three separate operators.
- 3.29** Also recommended by the Payments Strategy Forum, the NPA – the model for a new retail payments platform in the UK – aims to deliver greater competition and innovation in the UK retail payments industry.
- 3.30** The NPA will replace the Bacs, FPS and potentially the cheque systems, and is designed to provide simpler access to payment systems for PSPs. It will have a thin clearing and settlement core providing the basic payments infrastructure. There will be a single messaging standard, interoperability, and low barriers to entry, which allow providers of overlay services to compete in the market against each other.
- 3.31** Pay.UK is responsible for delivering the NPA programme of work, whose elements will be delivered in stages.
- 3.32** In December 2018, Pay.UK commenced the competitive procurement process for the new NPA central infrastructure supplier. We expect Pay.UK's procurement of the NPA central infrastructure to conclude during 2020; during the procurement Pay.UK will work with suppliers to determine a safe operational go-live date for the NPA core.
- 3.33** In the longer term, the NPA will deliver common access processes. The NPA is expected to go beyond the current service provisions to enable simpler access and ongoing stability and resilience, which should promote greater innovation, competition, increased adaptability and better security.
- 3.34** We are monitoring Pay.UK to ensure it successfully manages the development of (and transition to) the NPA to deliver the intended benefits.

⁸ On October 2018, NPSO officially rebranded as Pay.UK.

Improved propositions

3.35 As we have noted in previous reports, we have seen significant reductions in the time and complexity of directly joining payment systems since we began our access work. In 2018, we have seen further access models such as DCNSP, and, for direct settling non-bank participants, the ability to prefund with client funds in FPS go live. This has meant greater choice of propositions for PSPs in choosing the model for joining directly.

3.36 In May 2017, Bacs launched a generic technical solution for smaller institutions with low annual transaction volumes, which aims to be cost-effective. PSPs are able to submit and receive their payment files via the Bacs Payment Services website, which can be accessed over the internet at a lower cost than would otherwise be required to use the Enhanced Transmission Service and SwiftNet Transmission Service. The Payment Services website solution offers PSPs reduced costs and shorter onboarding time frames. Four new participants joined Bacs using this solution in 2018.

Transactional limits for FPS

3.37 There is currently a transactional cap of £250,000 for payments made via FPS, meaning participants requiring transactions above £250,000 have to use CHAPS or Bacs depending on the time criticality of the payment. Increasing the FPS transaction limit could offer participants the option of joining a single payment system and reducing the need for them to incur additional fees and complexity.

3.38 Pay.UK has been considering the ability to increase the FPS limit from £250,000 to £20 million, and especially the security, capacity and substitutability implications of such a change. FPS will continue to consider introducing an increased limit during 2019.

Cheque Image Clearing System

3.39 Participants in the new Image Clearing System (ICS) continue to migrate volumes of cheques through the new system and away from the existing paper clearing system. The full migration to ICS is expected before the end of the year, at which time the paper clearing system will be closed.

3.40 As discussed in our 2018 report, ICS has different and increased direct participation to that of the old paper clearing system, and allows for different types of direct membership. A number of potential new ICS participants have been in discussion about joining the new system after migration from the old system is complete.

Our conclusion

- 3.41** Pay.UK has continued to make good progress in lowering the barriers to obtaining good quality direct access to the interbank payment systems. In turn, this has led to a greater choice than ever before of ways to access payment systems.
- 3.42** The Bank's extension of access to settlement accounts in its RTGS system to non-bank PSPs has significantly opened up direct access to more PSPs. In addition, the emergence of settlement facilitators and the continued availability and expansion of aggregator models also allows more options for participants, particularly smaller PSPs, to join directly.
- 3.43** We would expect Pay.UK and others involved in onboarding non-bank PSPs to consider the experiences of onboarding non-bank PSPs over the last 12 months and consider whether there are any enhancements that could be made to improve the onboarding processes.
- 3.44** As the commencement of the NPA draws closer, we would expect a temporary slowdown in joining numbers as potential new participants wait for the new system, rather than investing in building connections to the pre-existing system. While it looks like there will be fewer new direct participants in 2019 than in 2018, the operators are still expecting a high number of new joiners, particularly for FPS.

4 Indirect access developments

2018 highlights – indirect access

The PSRs 2017 came into effect, largely superseding our FSBRA access powers and creating new obligations relating to indirect access.

We have seen new entrants enter the market for providing indirect access to payment systems. These new entrants are actively onboarding PSPs, particularly payment institutions, expanding the access options for the small end of the market, which is where we highlighted a concern in our 2015/16 market review into the supply of indirect access to payment systems. However, some credit institutions have altered their access criteria for PSPs, particularly for money remitters.

To inform our monitoring of indirect access, we issued a formal notice to indirect access providers (IAPs) that are direct participants, requesting information about their indirect access offerings.

We also released a questionnaire on our website, targeted at indirect PSPs, about their indirect access experiences.

This chapter summarises the information we have gathered and sets out these developments in more detail.

State of the indirect access market

Background

- 4.1** Indirect access has been, and will remain, a priority area in our ongoing work programme.
- 4.2** On 13 January 2018, the PSRs 2017 came into effect. We are a competent authority in relation to regulation 104 and a co-competent authority in relation to 105 (with the FCA), with a responsibility to monitor compliance with those regulations, covering indirect access for PSPs. Where we have powers under PSRs 2017, we can no longer use our FSBRA access powers.
- 4.3** We last fully reviewed the market in our 2015/16 market review into the supply of indirect access to payment systems.

How the market is evolving

- 4.4** In 2015, when we conducted our market review, there were only four IAPs: Barclays, HSBC, Lloyds and RBS.
- 4.5** Since then there have been new entrants in the indirect access market, and there has been more investment in indirect offerings. There are currently seven IAPs actively offering indirect access services to PSPs⁹: Barclays, ClearBank, HSBC, Lloyds, RBS and Starling Bank offer agency¹⁰ and non-agency services to various payment systems; BFC Bank offers non-agency access to FPS.
- 4.6** ClearBank and Starling entered the market in 2017, and BFC in 2018.
- ClearBank is a dedicated provider of indirect access to payment systems. Traditional IAPs have a broader range of products, including corporate and retail banking and other financial services. ClearBank's purpose-built platform provides an application programming interface-based real-time payments alternative for PSPs who are focused on providing payment products and services, and who do not need access to advanced corporate banking services (such as access to securities markets, buying and selling of equities, and asset servicing).
 - Starling Bank launched its indirect access offering in May 2017. This UK retail challenger bank offers indirect access to Bacs and FPS. Like ClearBank, it provides a different technical proposition compared to incumbent IAPs, by building an explicit payment product for indirect PSPs incorporating modern application programming interface technology.
 - BFC entered the market in 2018, offering non-agency access to FPS. BFC's focus is on providing indirect access to money remitters and e-money institutions who are unable to get banking services elsewhere – for example, due to recent de-risking by the larger IAPs.
- 4.7** We have also had discussions with other PSPs who are considering entering the market to provide agency indirect access services in the future.

Information notice

- 4.8** In order to help meet our monitoring obligations and to understand the changes in the indirect access market, in November 2018 we issued a formal notice¹¹ requesting information about indirect access offerings to the IAPs who are direct participants providing indirect access to PSPs (our section 81 notice).
- 4.9** We asked these IAPs to provide us with information, covering the last four years, on the services they provide, including transaction values and volumes, along with information on those PSPs they currently provide services to, those to whom they have refused access, and those who have left or had their access terminated.

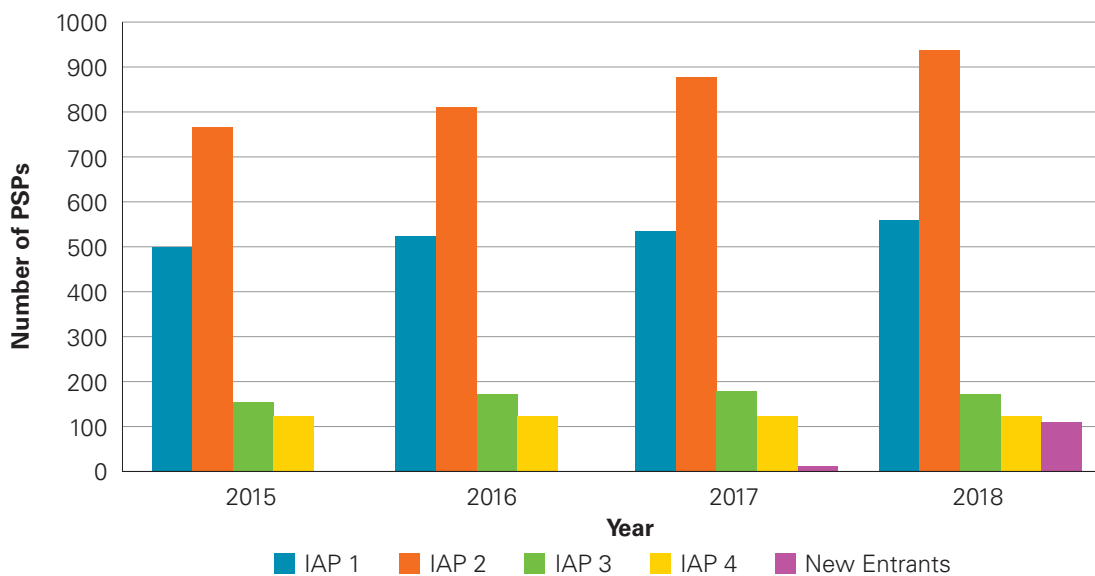
9 As non-agency indirect PSPs do not need their IAP to give them a unique sort code, access can also be supplied as part of a 'nested' supply arrangement, where an indirect PSP itself also acts as an IAP. As such, any provider of payment accounts to business customers can potentially provide a PSP with indirect access. We did not cover the provision of these nested accounts in our section 81 notice as per paragraph 4.8.

10 A subset of indirect access where an indirect PSP utilises a unique sort code in making and receiving transactions.

11 Under section 81 of FSBRA.

- 4.10** This section 81 notice also supports our earlier stated intent to continue monitoring the development of the indirect access market.
- 4.11** The responses received covered 1,901 banking relationships and 1,751 separate PSPs over 2018, indicating that a small number of PSPs have banking arrangements with more than one IAP.
- 4.12** The new entrant IAPs have all been actively taking on PSP customers and are slowly increasing their market share in the indirect access market. The new entrants still represent a small portion of the overall market in terms of PSP numbers, value of transactions and volume of transactions, and the market is still very concentrated towards the main IAPs. This is to be expected given how recently the new suppliers have entered the market. As in most sectors, it sometimes takes new firms time to build brand, resource and capability, and they can at times face technical limits on onboarding rates.
- 4.13** Figure 3 shows the number of PSPs per IAP, per year. We have combined the new entrants into one group in our charts to prevent individual identification of each IAP and to show the cumulative effect of the new entries to date.

Figure 3: Number of PSPs by IAP each year¹²



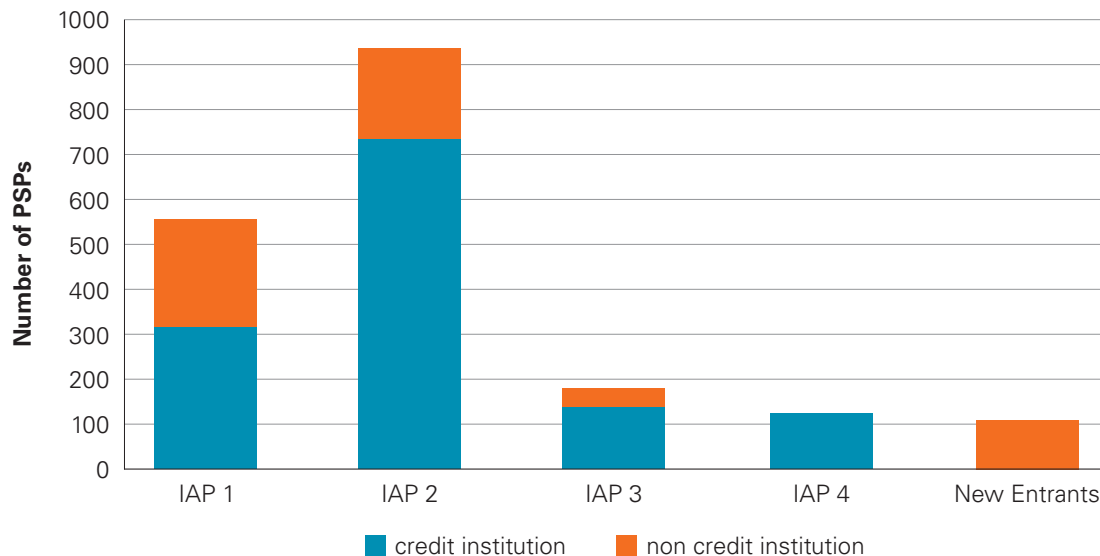
Type of PSP

- 4.14** Many of the customers these new IAPs have been taking on are smaller PSPs, including small money remitters, which have in the past had the most difficulty gaining access.
- 4.15** We noted in the final report of our market review into the supply of indirect access to payment systems that, while the market was generally operating well, there were some specific concerns, including that some small non-agency PSPs have limited or no choice of IAP, constraining their ability to get access, to negotiate on price, or to find an alternative provider if they lose their indirect access, or are not satisfied with the services they receive from their current IAP.

¹² Based on PSP numbers per IAP on 31 December each year, and 31 October for 2018.

- 4.16** While there are still some smaller PSPs who have limited options for gaining access, the entry of new players actively targeting and onboarding non-bank PSPs is a positive development. There are always likely to be some PSPs who find it difficult to gain access to banking on the terms they would like due to the regulatory requirements in the banking sector, which are designed to protect the integrity of the financial system and minimise financial crime. These requirements inevitably create costs – for example, in carrying out due diligence and the ongoing monitoring of transactions, which are likely to create a challenging environment for very small businesses to operate profitably.

Figure 4: Number of PSPs for each IAP (2018)



* IAP 4 does provide payment account services to PSPs who are not credit institutions that allow third-party payments. However, they have not included these in their response.

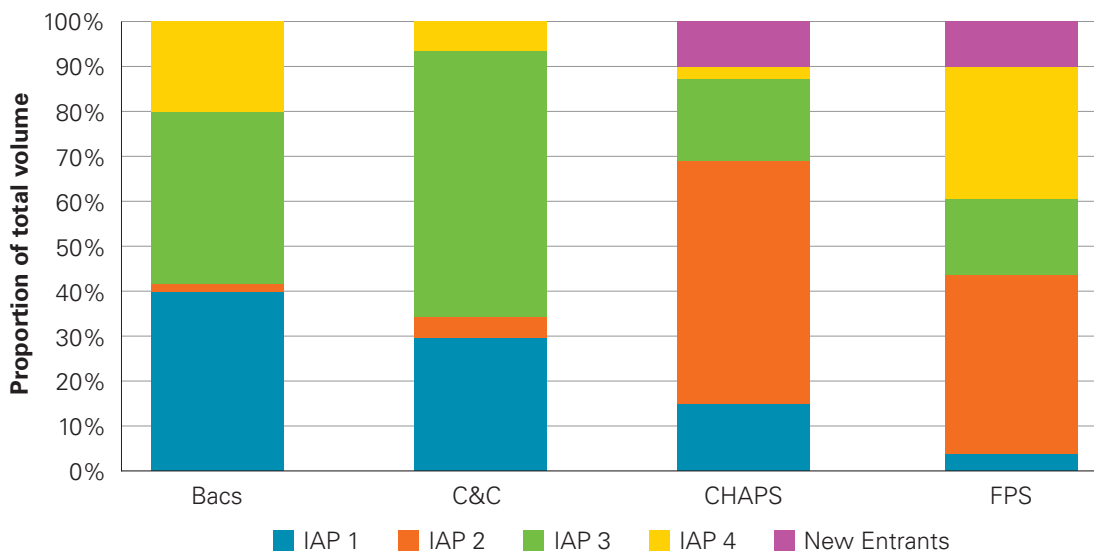
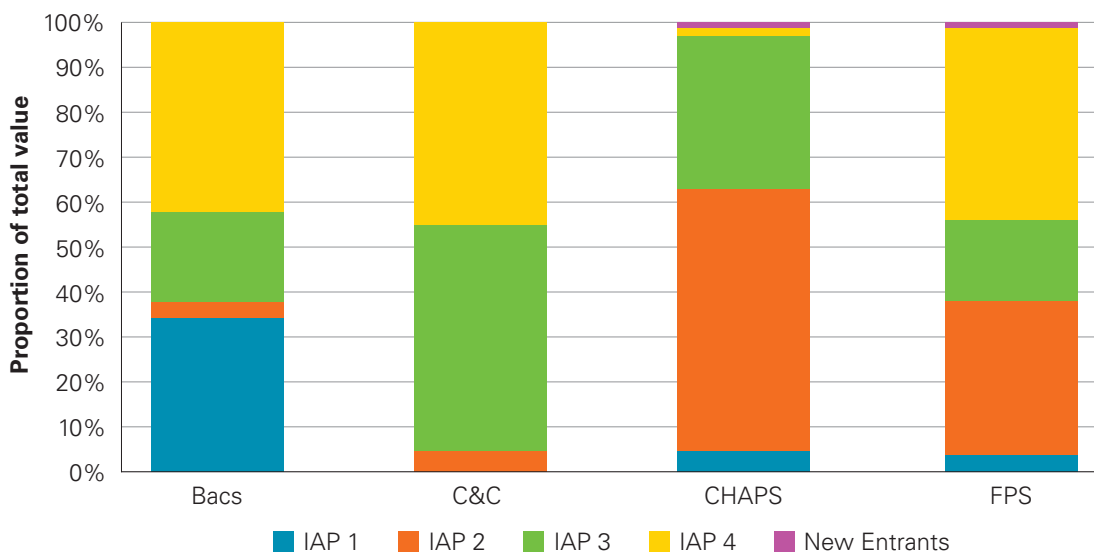
Switching

- 4.17** There is little evidence that PSPs actively switch between IAPs on a regular basis.
- 4.18** In particular, of the PSPs onboarded by the new entrant IAPs, only 3.5% appear to have switched from one of the main four IAPs (that is, the vast majority of these PSPs did not previously have banking arrangements with the main four IAPs that allowed them to make payments on behalf of clients).
- 4.19** While some of the PSPs might be new entrants to the market, it also suggests that the new entrant IAPs are enabling some PSPs to get indirect access from a direct IAP for the first time, where previously they may have been in a nested arrangement (that is, they may have gained access via a PSP that only had indirect access itself) or were operating from an offshore account. This will generally provide more stability, and potentially more favourable costs, for these PSPs.
- 4.20** However, it also suggests that at the smaller end of the market, some barriers to switching or gaining access remain, with PSPs choosing not to, or perhaps not being able to, move to more attractive indirect access terms.

- 4.21** In our indirect access questionnaire (see paragraphs 4.30 to 4.47), 37% of respondents with long-term access arrangements said they had considered switching IAP, but only one PSP had actually switched. Those who had considered switching were mostly seeking more reliability and stability, or better services.
- 4.22** While the majority of respondents who had not considered switching IAP were happy or satisfied with their current provider, some said the reason they had not considered switching was the work involved in such a major undertaking, including the timescales to switch and the barriers to finding another provider. One PSP was considering applying for direct access.
- 4.23** So while we are seeing an expansion in the market in the form of the new players, and some expansion with some of the previous incumbents (in terms of indirect access customer numbers), there is still room for improvement. The continuation of the recent entrants in onboarding PSPs, as well as the potential entry of further players in the future, should further help to improve options for PSPs of various types and sizes.

Access by payment system

- 4.24** The new entrant IAPs all provide access to FPS, with two offering Bacs access and one also offering access to CHAPS. One of the new entrants and all the main four IAPs offer both agency and non-agency access to all interbank payment systems.
- 4.25** By volume, each system had one or two IAPs accounting for the majority of payments, although the IAP with the largest market share differs by payment method, and between volume and value.
- 4.26** Figure 5 shows the volume of payments for each IAP by interbank payment system and Figure 6 shows the value for each system.

Figure 5: Volume of 2018 payments by interbank system by IAP**Figure 6: Value of 2018 payments by interbank system by IAP**

Missing information

- 4.27** In our section 81 notice, we asked the IAPs for information on refusals, withdrawals and voluntary terminations relating to PSPs.
- 4.28** Multiple IAPs were not able to provide any reasons to us for some or all of these categories, as they stated they keep no records once a PSP relationship has been terminated (either forced or voluntary).
- 4.29** We expect IAPs to be able to provide this information to us, and therefore expect IAPs to consider and put in place suitable arrangements for keeping these records in the future. In order to monitor the market effectively, we may need to request this data. Information on reasons for refusal and termination helps us to track PSPs across their banking arrangements and monitor the effectiveness of the market.

PSP experiences

- 4.30** In January 2019, we published a questionnaire on our website, targeted at indirect PSPs, on their experience of obtaining indirect access to UK interbank payment systems.
- 4.31** Forty-three PSPs responded and completed our questionnaire: 29 banks, 4 building societies, 7 authorised payment institutions (APIs) and 1 e-money institution, with 2 PSPs classifying themselves as 'other'. These PSPs banked with a range of different IAPs.
- 4.32** Over 90% of respondents told us they have indirect access to FPS, 88% to Bacs, 84% to CHAPS and 72% to C&C. APIs are more likely to only have access to FPS and Bacs.
- 4.33** Some of the respondents have banking relationships with multiple IAPs, or have different IAP relationships for access to different payment systems.
- 4.34** While the sample is not large enough to provide statistically significant data about the indirect access market overall, we consider the information received to be valuable, particularly when combined with other data, in providing some additional qualitative insight into PSP experiences.

Market satisfaction

- 4.35** On average, respondents rated their satisfaction with their indirect access as 7.5 out of 10. There was no observable correlation between the type of PSP and the rating they gave – some banks and APIs were satisfied with their relationship, some were not.
- 4.36** Positive aspects included:
- good online access and easy-to-use services
 - good range of services
 - reliability of services
 - good service from their IAP, including good response times and regular communications
- 4.37** Areas where respondents noted there was room for improvement included:
- that technical solutions could be improved and processes more automated
 - a need for better relationship management, particularly when things go wrong
 - maintenance windows and downtime need to be reduced
 - a lack of regular updates and early communication of changes, such as the NPA
 - bank charges are too high

4.38 We asked respondents to rate the quality of indirect access provided to them. 95% reported either being satisfied or very satisfied with the quality of their indirect access. Those that were dissatisfied noted technical access and reliability as their primary reasons for their dissatisfaction.

4.39 88% of respondents were either satisfied or very satisfied with their interactions with their main IAP. For the 12% who were not satisfied, reasons included that their IAP was trying to close their account, their IAP was unwilling to assist, or they had concerns regarding ongoing communication with their IAP.

Alternative access options

4.40 For those with longstanding access arrangements, just over a third of entities have considered switching their IAP. However, only one PSP respondent had actually switched.

4.41 For those who had not considered switching, a quarter were happy or satisfied with their current arrangements and see no reason to move IAP. Other reasons provided for not switching included the barriers and timescales involved in switching, the amount of work involved (including the disruption caused) and cost. Some responses provided no reason.

4.42 Those who had considered switching said they were seeking a better service, more stability and reliability, a better price, were being de-banked, or were just seeing what services were available in the market.

4.43 Almost 30% of respondents are dissatisfied or very dissatisfied with the number of IAPs providing indirect access to PSPs in the UK, and almost 40% consider there are not enough IAPs. In contrast, 2.5% of respondents said there were too many options, with the remainder stating there were sufficient options.

4.44 Of those PSPs who had recently joined their IAP, they chose their new/first IAP because of the cost, the easy onboarding process, the speed of onboarding, the technical support provided and the extra financial services offered.

4.45 40% of respondents had considered getting direct access instead of indirect.

4.46 For those who provided reasons, issues that led to respondents choosing indirect access over direct access were:

- availability of detailed and technical information – 3 respondents
- finding an aggregator or other outsourced technical provider – 5 respondents
- infrastructure build – 12 respondents
- changing internal processes – 6 respondents
- assurance process – 3 respondents
- gaining a sort code (if required) – 3 respondents
- credit and liquidity management – 2 respondents
- complex process and high requirements – 12 respondents
- direct access provides no extra benefits compared to indirect access – 3 respondents
- direct access would be more expensive – 11 respondents
- IAPs offer other financial services – 2 respondents
- costs – 12 respondents
- other reasons – 6 respondents (these were not all explained)

4.47 Some PSPs noted that the introduction of the NPA will cause them to reconsider their position on direct access.

PSD2 update

4.48 The PSRs 2017 came into force on 13 January 2018, replacing the Payment Services Regulations 2009. The PSRs 2017 implement provisions of the revised EU Payment Services Directive (PSD2) into UK law. The two sections relevant to this report are regulations 104 and 105. Regulation 104 covers indirect access to designated payment systems and regulation 105 covers access to bank accounts by PSPs (other than credit institutions).

4.49 We are the sole competent authority for monitoring and enforcing compliance with regulation 104, and are the co-competent regulator, with the FCA, for regulation 105.

4.50 We are also the competent authority for regulations 61 and 103 of PSRs 2017. Regulation 61 relates to information provided by independent ATM providers. Regulation 103 relates to the prohibition on restrictive rules on access to Visa, Mastercard, LINK, JCB International, Diners Club International, China Union Pay and American Express. Regulations 61 and 103 do not relate to access to interbank payment systems so are not the focus of this report. We have recently announced that we will expand our General Direction 3 to cover all card payment systems covered by regulation 103.

4.51 Under FSBRA, we have powers to grant an order that provides PSPs access to certain regulated payment systems, or to vary the terms of agreements for access. PSRs 2017 give us powers in addition to those under FSBRA (where we have powers available under regulations 103 and 104 PSRs 2017, we may not exercise our FSBRA powers). The PSRs 2017 require that various operators and access providers meet certain obligations, and have introduced an enforcement regime.

4.52 Currently, we can use our FSBRA powers to:

- consider applications for direct access to SFD-designated payment systems that are also designated by the Treasury under FSBRA: Bacs, C&C, CHAPS, FPS and Northern Ireland Cheque Clearing (FSBRA-designated systems)
- consider any access application or requirement related to a credit union (credit unions are not regulated under the PSRs 2017)
- consider indirect access applications under C&C

Regulation 104

4.53 Regulation 104 imposes certain requirements and prohibitions on the way in which participants in designated payment systems¹³ treat requests from other authorised or registered PSPs for access to those payment systems (i.e. requests for indirect access). Under this regulation, requests for access include new applications and decisions on existing service provision – that is, refusal and withdrawal of access.

4.54 Regulation 104 requires that IAPs:

- treat requests for access in a proportionate, objective and non-discriminatory (POND) manner
- do not prevent, restrict or inhibit access to or participation in the system more than is necessary to safeguard against specific risks or to protect the financial and operational stability of their business or the payment system
- do not discriminate, whether directly or indirectly, between different authorised PSPs or different registered PSPs in relation to their rights, obligations or entitlements in relation to access or participation in the system
- do not impose any restrictions on the basis of the institutional status of a PSP

4.55 Regulation 104 also requires participants to provide full reasons to a PSP if they refuse or withdraw indirect access.

¹³ Bacs, CHAPS, FPS and C&C.

Regulation 105

- 4.56** Regulation 105 applies to the provision of payment accounts services to PSPs (other than credit institutions). In line with the Treasury's interpretation (put forward as part of its consultation on the implementation of PSD2), we consider 'payment accounts services' provided by credit institutions to include the provision of payment accounts used for the purposes of making payment transactions on behalf of clients, safeguarding accounts and operational accounts (accounts used for payments such as salaries and rent).
- 4.57** Regulation 105 requires that credit institutions must grant PSPs access to payment account services on a POND basis. The regulation also requires credit institutions to:
- provide PSPs that enquire about access to payment accounts services with the criteria that the credit institution applies when considering requests for such access
 - maintain arrangements to ensure those criteria are applied in a manner that ensures that access to payment account services is granted on a POND basis
 - ensure that, where access is provided, it is sufficiently extensive to allow the PSP to provide payment services in an unhindered and efficient manner
- 4.58** Regulation 105 requires credit institutions to provide duly motivated reasons to the FCA (which provides them to us) if they refuse or withdraw indirect access.
- 4.59** Our expectations and guidance are set out on our website.¹⁴

¹⁴ psr.org.uk/sites/default/files/media/PDF/PSR-PSD2-Approach-and-PPG-September-2017.pdf

Our work on monitoring indirect access to designated payment systems (regulation 104)

- 4.60** Regulation 104 requires IAPs to provide full reasons for refusal or withdrawal of access to a PSP, but there is no requirement to notify us or the FCA. We primarily monitor compliance via information requests, engagement with IAPs and complaints received from PSPs. We also receive information relating to indirect access under our Directions, specifically GD1 (cooperative relationships with the PSR) and SD1 (indirect access by sponsor banks¹⁵).
- 4.61** To assist in our monitoring obligations under regulation 104, we undertook a significant data collection exercise in late 2018. See paragraphs 4.8 to 4.26 for information on our section 81 notice.

Our work on monitoring access to payment account services (regulation 105)

- 4.62** With the FCA, as co-competent regulators, we have been monitoring whether credit institutions are meeting their obligations under regulation 105.
- 4.63** We have regular meetings with the FCA. As part of these meetings, we consider the notifications received (required when a credit institution refuses or withdraws a PSP's access to a payment account service).
- 4.64** We (together with the FCA) met with the new IAPs following the commencement of PSD2, and we continue to engage with them to check their understanding of the requirements and how they are implementing them.
- 4.65** The larger credit institutions have also all provided their access and risk criteria so that we are in a position to assess whether reasons provided in notifications are consistent with their overall criteria.
- 4.66** In our meetings with the FCA, we consider every notification received from credit institutions. We received 194 notifications of refusal or withdrawal of access to a PSP relating to 2018 decisions¹⁶ – 34 withdrawals and 160 refusals. These covered 171 separate PSPs.
- 4.67** Enough information should be provided in notifications to give evidence of why the individual entity falls outside the risk appetite or access criteria of a credit institution.

¹⁵ A sub-category of IAPs that provide agency indirect access.

¹⁶ Including notifications with a decision date in 2018, received up to 28 February 2019.

4.68 There have been various occasions where we have considered that the initial notification provides insufficient detail. When this has happened, we have followed up with credit institutions about a refusal or withdrawal. To date, we have not considered these potential compliance breaches to reach the relevant threshold for opening a case. Where credit institutions fail to provide notifications or the notifications contain insufficient reasoning, we will continue to consider all our options, including the possibility of enforcement proceedings, having regard to the factors set out in our Administrative Priority Framework (APF).¹⁷

4.69 We may reconsider a notification if further information comes to light (such as a complaint), or if a trend with the notifications emerges that raises concerns.

Reasons for refusal and withdrawal

4.70 The notification requirement in regulation 105 requires credit institutions to provide the FCA with their 'duly motivated reasons' for withdrawing or refusing access to a PSP.

4.71 Our review of notifications shows that, of the 194 notifications of refusal or withdrawal of access to a PSP relating to 2018 decisions, 38 were refusals for products not offered by the credit institution (largely foreign currency safeguarding accounts).

4.72 Common reasons for refusing or terminating PSPs were as follows:

- The credit institution did not offer the requested product (the most common example being safeguarding accounts in foreign currencies)
- The PSP makes transactions through payment corridors that the credit institution considers high-risk (for example, Iran, Nigeria or Pakistan) and these risks cannot be mitigated
- The PSP had inadequate anti-money laundering controls in place, such as having no independent money laundering risk officer
- The PSP has previously been the subject of sanctions
- The PSP has been subject to adverse media (generally a reason only used in conjunction with other factors)
- The PSP operates in a sector outside of a credit institution's risk appetite (for example, cryptocurrency, oil and gas) or has a high-risk customer base (for example, gambling or adult services)
- The PSP is too small or the entity is a micro-enterprise (for example, below a minimum turnover or asset level) to be either profitable or able to use the credit institution's systems (retail versus wholesale)
- The PSP is not regulated in the UK or EEA

¹⁷ www.psr.org.uk/administrative-priority-framework

4.73 For many notifications, the decision to refuse or withdraw access was a cumulative decision resulting in multiple concerns, rather than as the result of any one reason.

4.74 One large credit institution was closed to new money services business (MSB) customers while it undertook a review of its existing customers and considered its access criteria, covering 30 refusal notifications in 2018 (and further notifications in 2019). We have been in communication with this credit institution throughout its review and have requested further information. We note this credit institution is expecting to recommence onboarding MSB customers in the second half of 2019. This credit institution altered its access criteria as a result of its review. We are monitoring the impact of this change as part of our general monitoring of PSRs 2017.

Complaints received and work undertaken

4.75 We monitor complaints from PSPs and notifications from credit institutions that refuse or withdraw access.

4.76 Where we have reason to believe that there may be a compliance failure, we will decide whether to open a case. We will make an assessment having regard to our published APF.

4.77 When we receive a complaint, we usually write to the credit institution or IAP to seek further information to enable us to consider whether there may have been a compliance failure. Where a regulation 105 notification has not been received but should have been, we ask the credit institution in question to submit one, as failure to do so is a compliance failure.

4.78 In 2018, we did not open any cases into potential breaches of the substantive POND test, as we did not identify any instances where the relevant threshold had been met, having regard to our APF.

4.79 However, we have concerns stemming from multiple complaints received in 2018 regarding various credit institutions' communication with, and treatment of, PSPs looking for payment account services. In addition, we received various complaints for which we had not received the corresponding regulation 105 notifications when the complaint was received but one should have been provided. In relation to these process issues, we have not yet identified a matter that reaches the relevant threshold for us to open a case. However, where we identify potential non-compliance, we will continue to consider all options available to us including formal enforcement proceedings, having regard to our APF.

4.80 We also have concerns from our ongoing consideration of the regulation 105 notifications received. We are considering all options available to us, including enforcement action. These concerns and our expectations are outlined further below.

Detail in the notifications under regulation 105

- 4.81** Regulation 105 requires ‘duly motivated reasons’ for the refusal or the withdrawal of access to be provided to the FCA (which passes them to us). The information provided to us has been of varying quality; therefore, we have sought clarification and further information on many occasions.
- 4.82** We expect sufficient detail on reasons for withdrawal or refusal to be provided to give evidence that an individual assessment has been undertaken. As we state in our approach document, it is not enough to say in a notification that an entity falls outside a credit institution’s risk appetite: we expect information to be provided about why that particular entity’s access has been refused or withdrawn, against the access criteria of the relevant credit institution.
- 4.83** For example, if a PSP operates through a high-risk corridor that is outside of a credit institutions risk appetite, we would expect evidence to be provided in the notification that the individual entity had been considered against the relevant access criteria, and that the entity could not mitigate the risks sufficiently.

Application of access and risk criteria

- 4.84** We expect an individual assessment for each PSP applying for a payment account service.
- 4.85** The majority of credit institutions have certain areas outside their tolerances where they will not provide services to PSPs, such as certain payment corridors or minimum revenue thresholds. Application of these access criteria is only considered POND if an assessment is done that shows why a particular entity falls outside the access criteria, that the assessment complies with the requirements in the regulation, and that the PSP’s particular risks could not be mitigated to the satisfaction of the credit institution.
- 4.86** In addition, the criteria themselves should not contain blanket policies based on restricting access to those services for broad categories of PSPs, without considering the specific risks posed by PSPs and ways in which a PSP might mitigate any risks.
- 4.87** Currently, there appear to be mixed approaches among credit institutions to how they deal with PSPs that immediately fall outside of their application criteria.
- 4.88** We expect a regulation 105 notification to be provided even when an entity initially falls outside a credit institution’s access criteria, and a credit institution cannot refuse to accept an application because the PSP appears to fall outside its criteria. For example, if a credit institution does not provide indirect access to PSPs below a certain turnover threshold, and an entity is below that threshold, we would expect a regulation 105 notification to be provided evidencing that the entity falls below this and why any issues with this could not be mitigated.

Missing regulation 105 notifications

- 4.89** There have been instances where PSPs have made a complaint to us or the FCA that they have been refused a payment account service, but no regulation 105 notification had been received by us relating to that refusal at the time the complaint was made.
- 4.90** Our section 81 notice also highlighted instances where notifications should have been provided upon a refusal but had not been.
- 4.91** It appears this partially stems from inadequate processes and procedures by credit institutions to identify where an applicant is a PSP, and the application for an account has therefore gone through the wrong process. PSPs may approach a bank via a variety of means, such as through a branch, online or through a relationship manager. A PSP may have applied at a branch office and the PSRs 2017 obligation may not have been correctly triggered. Processes need to be robust enough to pick up applications from PSPs regardless of the channel they use to approach the credit institution.
- 4.92** In addition, some notifications have been received much later than the date the PSP was informed of the decision. Our approach document states that we expect notification at the same time as the credit institution informs the PSP of its refusal. Again, in the case of withdrawals, notifications should be sent to us at the same time as the PSP is informed of the decision, to ensure that proper consideration can be given to the matter, even if the PSP has a chance to ask the credit institution to change the termination date with the credit institution.

Communication of reasons to the PSP

- 4.93** We have seen various examples where credit institutions have refused a payment account to a PSP without providing it with the reasons for the refusal. While there is no legal requirement to do so, as we have set out in our approach document, we would expect credit institutions to provide their reasons wherever possible.
- 4.94** We have also seen examples of inconsistent reasons being provided, where PSPs are refused by the same credit institution for the same reason, but some PSPs have been told why where others have not.
- 4.95** Providing refusal reasons to PSPs can assist them in fixing deficient processes or making alterations that may allow them to gain access in the future.
- 4.96** We expect credit institutions to adopt adequate internal processes to allow for the messaging of reasons to PSPs, and to provide opportunities for the PSP to address any risks or concerns identified as part of the application process.

Code of Conduct for Indirect Access Providers

- 4.97** The Code of Conduct for Indirect Access Providers is an industry code setting out a range of measures and commitments to improve indirect access to payment systems.¹⁸
- 4.98** The Code is voluntary and was developed by the subscribing IAPs in consultation with us to address concerns around the commercial access arrangements they provide to PSPs requiring indirect access services to UK payment systems. Current subscribers are Barclays, ClearBank, HSBC, Lloyds and RBS. It launched in 2015 and was updated in March 2018 (in light of the commencement of PSD2).
- 4.99** The Code sets out standards of best practice for key elements of the commercial arrangements between IAPs and indirect PSPs (that is, it applies once a PSP becomes a customer of a subscribing IAP). The Code is designed to meet the requirements of indirect PSPs for:
- clarity on the contractual arrangements that govern the supply of indirect access services that PSPs receive
 - security of the supply of indirect access
 - confidentiality of commercially sensitive information shared with IAPs
 - support in establishing indirect access and in switching between providers
 - appropriate and timely communication between IAPs and PSPs regarding the availability of services and planned changes
- 4.100** The Code Administration (within Pay.UK) has reported a good standard across all IAPs' 2018 annual certification submissions and confirmed the ongoing subscription of all Code subscribers for 2019.
- 4.101** Key activities for 2018 included:
- the proactive work of the IAPs to review and refine the customer base, particularly the split between agency and non-agency relationships where indirect access services are being provided
 - migration of customers onto new IAP contracts/agreements, with positive progress reported for 2018 and work continuing with two IAPs during 2019
- 4.102** We expect IAPs to continue to work to improve the visibility and impact of their Code of Conduct, to consider what could improve PSPs' awareness of, and confidence in, the Code. We also expect the IAPs to continue to address quality-related issues affecting PSPs that choose indirect access.

¹⁸ The central website for the Code is: www.accesstopaymentsystems.co.uk/code-of-conduct

Conclusion

- 4.103** In our 2015/16 market review into the supply of indirect access to payment systems, we identified specific concerns that were limiting competition and innovation in the provision of payment services:
- While large PSPs tend to have a wider choice of access options, many small non-agency PSPs had a limited choice of IAPs, including some that had no choice.
 - PSPs in all categories were facing a number of specific quality-related issues with indirect access, including the quality and availability of technical access, and concerns around access agreements and termination periods.
 - Indirect PSPs in all categories face barriers to switching IAPs, reducing the competitive pressure on IAPs and preventing PSPs from securing the best possible price and quality outcomes.
- 4.104** There are more IAPs in the market that are actively onboarding PSPs than ever before. In particular, the new entrant IAPs have been onboarding smaller PSPs that may not have been able to get access via one of the four main IAPs, which is pro-competitive. All else being equal, this should be increasing the amount of competition in the market, but we note that the level of switching remains relatively low and concentration remains relatively high.¹⁹
- 4.105** The four main IAPs appear to have limited appetite to provide services to particular sectors of the market, as shown by their access criteria. Some have adjusted their criteria in the past couple of years – for example, in light of recent legislative or political changes. So, while there are more IAPs in the market offering indirect access, the structure of the market has changed and there may not be any greater choice for smaller PSPs.
- 4.106** We still hear that a small number of PSPs are struggling to get the access arrangements they would like, generally because they operate through a particular corridor, or in a sector that some IAPs may consider as attracting more risk. There are always likely to be some PSPs who find it difficult to gain access to banking on the terms they would like due to the regulatory requirements in the banking sector that are designed to protect the integrity of the financial system and minimise financial crime. However, we will continue to monitor the market over 2019, including the access criteria for payment account services.
- 4.107** There are new models since our review, and non-bank PSPs can now join payment systems directly, and the introduction of aggregators and onboarding can assist and simplify the onboarding process.

¹⁹ For example, the Herfindahl-Hirschman Index (HHI) for FPS for 2018 was 2,894. This represents a 3% decrease (improvement) compared to 2015.

- 4.108** We have not received any complaints in 2018 about the quality of indirect access received by PSPs. This improvement is backed up by responses to our questionnaire. Positive responses suggest that for those PSPs who are able to get their required indirect access arrangements, the quality of this access, and the relationship with the corresponding IAP, is positive. Of those who answered our questionnaire, 95% reported being satisfied or very satisfied with the quality of their indirect access, while 88% were satisfied or very satisfied with their interactions with their main IAP.
- 4.109** So, while the indirect access market is generally moving in the right direction and is evolving, and there have been recent positive changes with new IAPs entering the market, there is still room for improvement. The embedding of the recent new entrant IAPs, and potential further entrants in the future, should help the market to continue to move in the right direction. We will continue to monitor the market over 2019, including the access criteria for payment account services.

Regulation 105 obligations

- 4.110** In relation to regulation 105 notifications, we expect credit institutions to improve their overall practices in order to fully meet their PSRs 2017 obligations. In particular, the information on reasons provided to us when a credit institution refuses or withdraws access to a payment account needs to be improved, with clearer information provided on why the relevant entity has been refused or withdrawn, against the access criteria of the relevant credit institution.
- 4.111** We also expect credit institutions to have robust processes in place to ensure all PSPs' applications for payment account services are processed appropriately and that the required regulation 105 notification is provided. Evidence from complaints received suggests this is currently not the case.
- 4.112** We have not identified an instance to date where the relevant threshold for us to open a case into process breaches has been met. However, where we identify potential non-compliance by a credit institution, we will consider all our options including the possibility of commencing formal enforcement proceedings having regard to the factors set out in our APF.
- 4.113** Credit institutions should also work to improve their communication with PSPs following the outcome of the decision of whether they will provide a payment account service, keeping them up to date during the consideration process, and providing reasons where possible following a decision.

Other relevant projects

Specific Direction 1

- 4.114** As part of our review of our ‘day one’ General and Specific Directions, we reviewed SD1, relating to indirect access. We have released our policy statement on our position following this review.²⁰
- 4.115** Currently, under SD1, we require the four main IAPs (Barclays, HSBC, Lloyds and RBS²¹) to publish certain information about their indirect access services:
- contact details
 - description of services
 - high-level descriptions of eligibility criteria
- 4.116** SD1 was originally designed to facilitate indirect access by helping PSPs seeking indirect access to make an informed decision about their options.
- 4.117** Following our review, we are making some changes to expand both the scope and coverage of the Direction.
- 4.118** The new Direction will cover all IAPs providing sponsor bank services.²² For those sponsor banks, it will cover all their indirect access services (both agency and non-agency).
- 4.119** We will also expand the scope of the Direction to cover the period where a PSP has put in an application for indirect access with a sponsor bank, and the sponsor bank is considering the application. We will require sponsor banks to provide access seekers with confirmation of receipt of an application and an indicative timeline for its consideration of the application. This information should be updated throughout the process if timelines change.
- 4.120** There is currently no obligation on sponsor banks to provide information on timelines or give access seekers up-to-date information on the status of their application. The Code of Conduct for Indirect Access Providers for sponsor banks only applies from the contractual stage, when an access seeker is accepted for access (and it is also voluntary to subscribe to the Code). We considered the difficulties for those seeking access in understanding the application and decision-making process of the IAP. These difficulties do not appear to have been solved through the competitive tensions in the marketplace.

20 www.psr.org.uk/decision-review-our-day-one-directions-and-cp183-consultation-proposed-directions

21 These were the only IAPs offering sponsor bank services when we put SD1 in place.

22 A sub-category of IAPs that provide agency indirect access.

- 4.121** In various access requests that have been brought to our attention, we have seen instances where sponsor banks have failed to keep an access seeker that has applied for indirect access updated – in some cases even failing to inform the access seeker when it has made a decision about the application. Requiring an updated timeline to be provided should assist in ensuring the process moves forward and that the access seeker knows what to expect in that regard.
- 4.122** We will continue to require that sponsor banks provide on their websites the information required under the current Direction: contact details, a description of the indirect access services and eligibility criteria.
- 4.123** SD1 will automatically expire in three years unless we have made a decision to extend it.
- 4.124** We expect to finalise changes to the Directions in late 2019.

PSD2 and section 56/57 combined guidance

- 4.125** During the last year, we have been developing combined guidance for access applications under sections 56 and 57 of FSBRA and complaints about access to payment systems under PSRs 2017. We intend to launch our consultation on the updated guidance later in 2019.

5 Governance

2018 highlights – governance

Pay.UK continued to engage with service-users on aspects of its existing service offerings and plans for new service offerings, including through new stakeholder engagement advisory groups.

Pay.UK implemented its Target Operating Model on 1 March 2019, which includes new capabilities focused on engaging with service-users.

Pay.UK also progressed work developing the New Payments Architecture (NPA), including commencing the procurement process for the NPA central infrastructure provider.

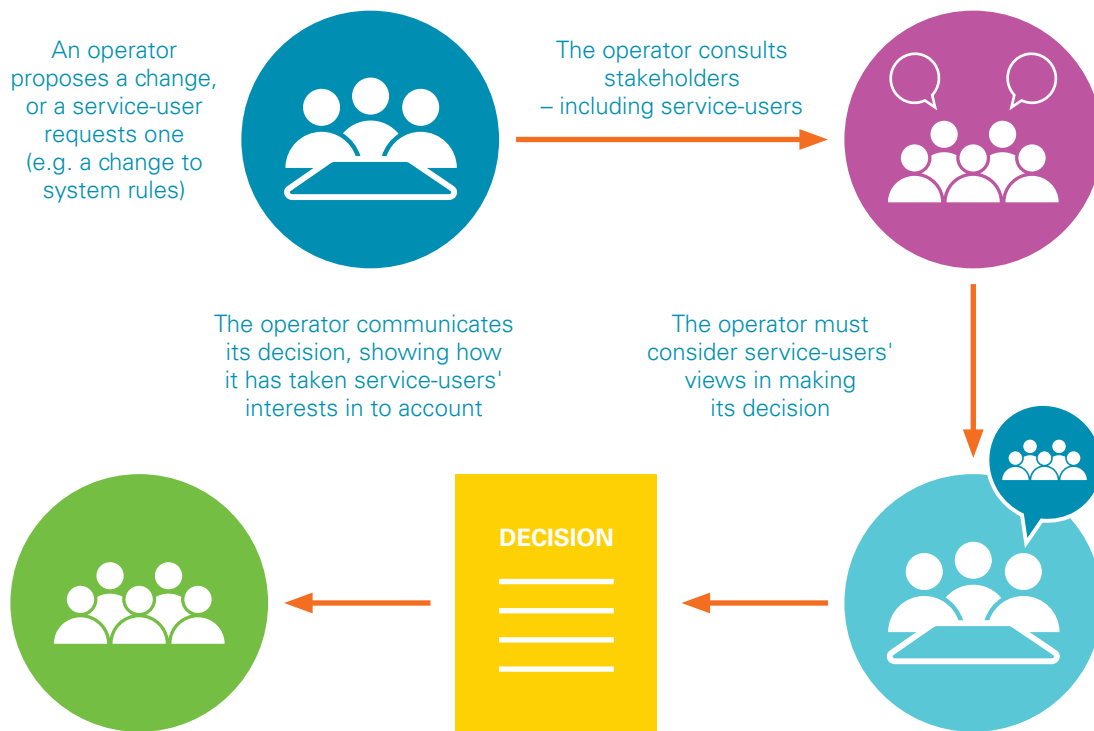
We reviewed our 'day one' General and Specific Directions, mainly relating to access and governance of payment systems.

This chapter sets out these developments in more detail.

Background

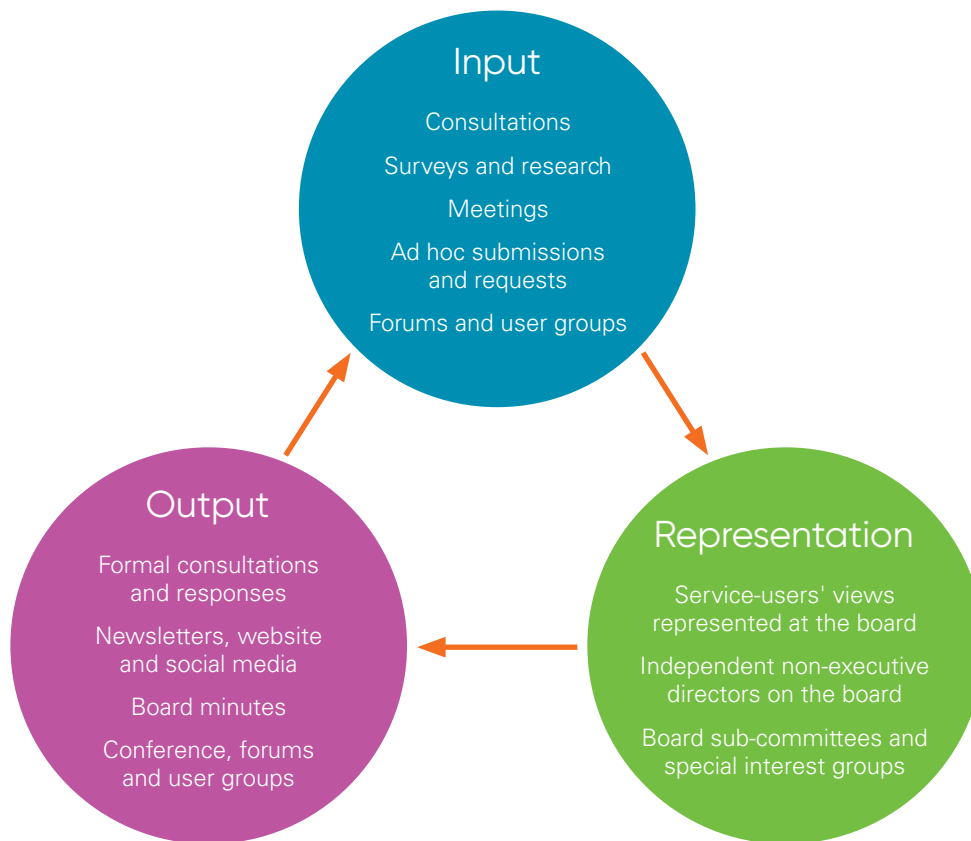
- 5.1** One of our statutory objectives is to promote the interests of those who use, or are likely to use, services provided by payment systems. As part of this, it is important that the views of service-users are taken into account in the governance of payment system operators.
- 5.2** To achieve our objective, in 2015 we issued GD4 and GD6.
- GD4 requires the operators of Bacs, C&C, FPS and LINK to ensure there is appropriate representation of service-users in the decision-making processes of their governing bodies.
 - GD6 requires the same interbank operators to publish the minutes of their governing bodies, and sets out what those published minutes must contain.
- 5.3** We define service-users as comprising both PSPs and customers of PSPs, including (but not exclusively) government departments, businesses (of all sizes), charities and individual consumers. Each payment system will have a variety of users of its products and services. It is important that the operators research and understand the composition of their cohorts of users in order to be able to structure user engagement and consultations appropriately.
- 5.4** We want operators to ensure their governance structure supports engagement with service-users and appropriate representation of service-users' interests and views in decision-making – through the setup of governing bodies and internal processes, and through every stage of decision-making processes (before, during and after a decision is made). This is illustrated in Figure 7.

Figure 7: Incorporating service-users' voices in decision-making



5.5 In the case of a change led by an operator, this means it should consult service-users before making a decision, consider their views when making the decision, and report decisions made and reasons for those decisions.

5.6 Similarly, in the case of service-user requests for change, the process should cover the logging of these requests, their internal handling and consideration, and then appropriately reporting back whether the request has been granted or rejected and the reasons for this decision. Figure 8 presents channels for incorporating service-users' voices in decision-making.

Figure 8: Channels for incorporating service-users' voices in decision-making

Progress and new developments

Changes to Pay.UK governance

- 5.7** Pay.UK is the entity set up to consolidate the operators of the existing retail interbank payment systems. The creation of Pay.UK is designed to facilitate the delivery of an NPA, which is designed to drive competition and innovation in the interests of users.
- 5.8** In 2018, Pay.UK completed the process for consolidating the governance of Bacs Payment Schemes Ltd, Faster Payments Scheme Ltd and Cheque & Credit Clearing Company Ltd, and became responsible for the operation of the Bacs, FPS and cheque clearing payment systems.
- 5.9** This consolidation followed one of the recommendations of the Payments Strategy Forum, aiming to enhance the capability and capacity of the operators, streamline governance arrangements and reduce the complexity and costs of having three separate interbank operators.
- 5.10** As part of its ongoing establishment as an organisation, Pay.UK envisaged a governance framework in which the interest and the perspective of service users were taken into account in the decision-making process. This governance framework became operational from May 2018.

- 5.11** Pay.UK has an independent board, which includes seven independent non-executive directors and guarantors, that acts to hold the Pay.UK board to account for continuing fulfilment of its purpose and the strategic objectives.
- 5.12** Pay.UK has established two independent advisory councils that work on behalf of the end-user and participant communities in the UK:
- an end-user advisory council
 - a participant advisory council
- 5.13** Both councils advise and provide challenge to the Pay.UK board to help ensure that the views of participants are understood and addressed.
- 5.14** It has also created a number of NPA advisory groups that assist with consultation on key aspects of their work, including procurement, request to pay and transaction data analytics. These advisory groups should help improve engagement with service-users, provide a vehicle for consultation and support delivery of the programme.
- 5.15** In September 2018, a new participant engagement forum was also established, open to all direct participants of FPS, Bacs and cheque imaging, where direct participants can provide feedback at a senior level addressing the Pay.UK executive committee and board.
- 5.16** To ensure the Pay.UK board is delivering appropriate governance and oversight of the three payment systems, its chair will oversee a review of the effectiveness of the Pay.UK board after its first year of operating these payment systems. The findings of the review, alongside any proposed improvements, are targeted to be completed by the end of June 2019.

New Payments Architecture programme

- 5.17** In January 2018, the PSR published an open letter²³ to NPSO (now Pay.UK), setting out our initial expectations and priorities for it to consider. This included asking it to consider how it will implement these strategic objectives through its governance and decision-making processes. A key access-related area for consideration is how it will embed its objective for accessibility into the payment system rulebooks, and how it will refer back to its full range of strategic objectives when developing and amending rules. This applies not only for the existing payment systems, but also for the development of the NPA.
- 5.18** Pay.UK has been progressing work to develop and deliver the NPA. Specific stakeholder and service-user engagement for the NPA programme has been conceived by Pay.UK, which announced in September the first set of the NPA advisory groups.
- 5.19** We are monitoring closely the NPA programme and its development to ensure it delivers the intended benefits, including innovation, fair competition, access and security in the interests of users. We expect that end users will directly experience the improvements in payment services through, for example, confirmation of payee and request to pay.

²³ www.psr.org.uk/psr-publications/news-announcements/PSR-open-letter-NPSO

New operating model

- 5.20** Over 2018, Pay.UK developed a new Target Operating Model (TOM), designed to help moving from scheme-centric organisations to one single organisation by amalgamating the expertise and function-driven models of the previous separate schemes. The TOM also includes new capabilities focused on engaging with service-users.
- 5.21** On 1 March 2019, Pay.UK implemented its TOM, fully amalgamating the four companies (Pay.UK, FPS, Bacs and C&C) and staff. This should drive more alignment between the three different payment systems' access requirements and ensure consistent approaches to areas such as risk management and resilience. Pay.UK expects that this structure will further support the agenda of fair and open access, and is working to fully embed the changes.

Stakeholder engagement

Pay.UK

- 5.22** Pay.UK has established a formal stakeholder engagement function within its communications directorate. It has explained that its approach includes a number of forums for end users and participants to engage with Pay.UK and enables it to update and discuss key issues widely with the payment ecosystem.
- 5.23** Pay.UK ran a range of stakeholder events during 2018, including advisory group meetings, round-table discussions in key centres throughout the UK, webinars, outreach and third-party speaker and panel appearances. It has also engaged with stakeholders in various informal ways, including via social media, email bulletins and press releases.
- 5.24** Initially, activity focused on introducing Pay.UK and establishing its new role and strategy. More recently, it has engaged with stakeholder communities on upcoming changes, particularly relating to the NPA programme and overlay services.
- 5.25** Pay.UK will focus on refining and embedding its new engagement mechanisms throughout 2019.

FPS-specific engagement

- 5.26** FPS has introduced its business initiatives approach to enable a more effective process to collect and document service-users' views and engagement, which will likely fit into Pay.UK's service-user engagement framework.
- 5.27** FPS has engaged in various bilateral meetings with existing and potential service-users and representative bodies for information and education purposes, but also to allow service-users to share their views, feedback and concerns about their payment experience of FPS.

Bacs-specific engagement

- 5.28** Bacs facilitated various workshops where the wider payments community had the opportunity to provide views on the NPA as well as Bacs products such as Direct Debit and the current account switch service. The workshops also provided the opportunity to speak about the development of Pay.UK with its CEO.
- 5.29** The Bacs knowledge centre and e-learning hub allows participants to access information and training documents, and to raise issues whose escalation can lead to updating best practices.
- 5.30** Bacs conducts a programme of market research focused on the needs of its service-users in various areas, such as current account market and messaging, to verify that they are correctly identified and targeted in its product developments.

General Directions compliance

- 5.31** Pay.UK provided its compliance reports under GD2 and GD4.
- 5.32** These compliance reports are sent in accordance with the requirements under our General Directions. These provide the detail on how each operator considers it has complied with our relevant access and governance Directions, and highlight key areas of progress for each over the last 12 months.
- 5.33** These compliance reports will be published after this report.

Review of our 'day one' Directions

- 5.34** When the PSR launched in 2015, we issued six General Directions and one Specific Direction under FSBRA (the 'day one' Directions), the majority of which were intended to improve access to, and the governance of, payment systems in the UK.
- 5.35** Since then, there have been various market and legislative changes, so we have reviewed these Directions to ensure they remain relevant and proportionate over time. As part of our review, we ran a public consultation for 12 weeks. During the consultation period, we met with 25 stakeholders through small roundtable discussions and various bilateral meetings. The stakeholders included payment system operators (PSOs), IAPs, PSPs and trade associations.
- 5.36** In March 2019, we set out our policy decisions in our revised Directions CP18/3.²⁴ We expect to make the revised Directions in late 2019.
- 5.37** GD2, GD4, GD5 and GD6 relate to direct access and governance of the interbank payment systems covered by this report, and our policy positions and reasons are summarised below. A summary of the relevant direct access and governance Directions is in Table 2.
- 5.38** SD1 relates to indirect access of interbank payment systems and is summarised in paragraphs 4.114 to 4.124.

²⁴ www.psr.org.uk/psr-publications/news-announcements/PSR-open-letter-NPSO

Table 2: Summary of our policy positions and key changes

Direction	Will apply to...	Summary of new Direction	Key changes to 'day one' Direction
GD2 Interbank access	The operators of FPS, Bacs and C&C	Requirement to: <ul style="list-style-type: none"> • have proportionate, objective and non discriminatory access requirements • disclose publicly these requirements • notify us of updates and changes to their access requirements • provide an annual report containing access information 	<ul style="list-style-type: none"> • Access test wording aligned with PSRs 2017 • Removed application to the operator of CHAPS
GD4 (new Direction) Service-user interests (of interbank systems)	The operators of FPS, Bacs, C&C and LINK	Requirement to: <ul style="list-style-type: none"> • consider service users and make transparent decisions • publish a forward-looking stakeholder report on engagement activities 	<ul style="list-style-type: none"> • Consolidated direction (covering content of previous GD4 and GD6) focusing on service-user interests to help ensure PSO engagement and decision-making is: <ul style="list-style-type: none"> – tailored with service-users across the value chain in mind – based on a clear set of objectives – transparent • Changed focus of the reporting obligation to a public-facing report on stakeholder engagement • Removed application to the operator of CHAPS

Direction	Will apply to...	Summary of new Direction	Key changes to 'day one' Direction
GD5 Conflicts of interest: infrastructure providers and bidders	The operators of FPS, Bacs, C&C and LINK	Requirement to ensure none of their directors are also directors of a central infrastructure provider to their system, or participating in a tendering exercise to supply that system	<ul style="list-style-type: none"> • Clarification to prevent a PSO director also being a director of an infrastructure company bidding to supply the PSO • Removed application to the operator of CHAPS
GD6 (formerly requirement to publish minutes of governing body)	See GD4 above	Direction combined with new GD4	<ul style="list-style-type: none"> • See GD4 above

General Direction 2

- 5.39** The purpose of GD2 is to encourage appropriately open access to interbank payment systems. The Direction is intended to ensure that access requirements are fair across the market and do not discriminate and unduly prevent certain PSPs from getting direct access. Compliance with GD2 also helps us to build knowledge of the direct access market and monitor competition.
- 5.40** We will refine GD2, changing the wording to use the POND test under PSRs 2017. While we consider there is no material difference between the current test and the POND test, consistent language will provide clarity to the interbank PSOs, which are subject to both GD2 and sections 56 and 57 of FSBRA.
- 5.41** We will keep the requirement for the operators of FPS, Bacs and C&C to notify us of any material updates or changes to access requirements to help us stay informed about the interbank access landscape.
- 5.42** We will also continue the formal reporting obligation to report to us annually on compliance with the Direction and we will maintain the requirement that they update us on changes to their access requirements. Receiving this information may alert us to any instances where Pay.UK, the operator of FPS, Bacs and C&C, may be non-compliant.

New General Direction 4

- 5.43** Both GD4 and GD6 were put in place to help ensure that interbank PSOs work in the interests of those who use interbank payment systems.
- 5.44** GD4 currently requires the interbank operators to ensure that service-users' interests are appropriately represented in their governing bodies' decision-making processes. These processes should give service-users a meaningful opportunity to influence decisions that affect them and their needs. It also requires the PSOs to report to us annually on their compliance with the Direction.
- 5.45** GD6 currently requires the same PSOs to publish the minutes of their governing bodies, and sets out what those published minutes must contain. This is to increase transparency about decision-making so that service-users are better able to understand the reasons for decisions that affect them.
- 5.46** We have had concerns about the effectiveness of these requirements. We consider that while the requirements have driven a change of process in PSOs, the change may not necessarily be producing consistent outcomes in the way PSOs engage with service-users across all PSOs.
- 5.47** As such, following consultation, we will revise the Direction, moving away from the input focus of the current Direction. This new Direction will set out the outcomes we expect PSOs to deliver in service-user engagement.
- 5.48** Given that both GD4 and GD6 both deal with aspects of how PSOs take service-users' interests into account, we will combine them into a single revised governance Direction.
- 5.49** Our new GD4 will introduce a single service-user-related Direction, covering the engagement and reporting requirements set out in the former GD4 and GD6, with an outcome-driven approach.
- 5.50** The focus is on service-users' interests, and the new GD4 will promote both stakeholder engagement and transparency across the value chain. Specifically, it will introduce an obligation on PSOs to engage actively with, and consider the views of, service-users through a tailored engagement and communication strategy – for example, via formal consultation processes or dedicated workshops.
- 5.51** To aid in transparency, we will still require publication of board minutes and we will also require the publication of a forward-looking annual stakeholder report on engagement activities.
- 5.52** In addition, we may consider requiring Pay.UK to report against a key performance indicator (KPI) metric reflecting its stakeholder engagement and we may conduct ad hoc monitoring of a PSO's compliance.

General Direction 5

- 5.53** GD5 is designed to prevent conflicts of interest between operators and central infrastructure providers due to cross-directorships.
- 5.54** We will retain this Direction with the purpose unchanged. We will also update it to make it clear that this obligation applies in relation to any party that is bidding to be a central infrastructure supplier to LINK or Pay.UK. Currently this requirement is only in the guidance relating to the Direction rather than the Direction itself.
- 5.55** Given LINK is currently running a re-procurement exercise, and Pay.UK is procuring the NPA, we think it is important to maintain the obligation to support the effectiveness of these processes.
- 5.56** We do not believe the obligation will limit the effectiveness of PSO boards. We have seen no evidence yet from either LINK or Pay.UK to indicate that it has hampered their ability to build an effective board while avoiding conflicts of interest.

Our conclusion

- 5.57** Significant changes have occurred in the governance of Pay.UK during 2018. We expect that these changes will enhance capability and capacity, streamline governance arrangements and reduce the complexity and costs of the interbank systems, compared to having three separate operators.
- 5.58** We have seen a good focus on service-users' interests in the development of both the NPA and TOM. We will continue to look closely at Pay.UK's work in this area to ensure that the intended benefits for service-users are effectively delivered.
- 5.59** We expect Pay.UK to continue to focus on its new governance arrangements and engagement with stakeholders. This will include an annual stakeholder engagement report under our revised GD4 – a public-facing document explaining the key stakeholder engagement over the last 12 months and highlighting issues for engagement with service-users in the year ahead.
- 5.60** We have also noted as part of our policy statement for our revised GD4 that we may consider requiring Pay.UK to report against a KPI metric reflecting its stakeholder engagement.

6 Development areas

There are a number of areas where we think operators, credit institutions and IAPs need to continue their focus, or make further progress.

There are also areas where we will do further work over the coming year.

Direct access

- 6.1** We have been encouraged by the operators' work in opening up direct access, which has led to an increase in direct participation in the interbank payment systems. We expect these improvements to continue, including improvements in models to lower the complexity and cost of direct participation.
- 6.2** We would expect Pay.UK and others involved in onboarding non-bank PSPs to reflect on their experiences of onboarding non-bank PSPs over the last 12 months, and consider whether there are any enhancements that could be made to improve the onboarding processes.
- 6.3** As the commencement of the NPA and RTGS renewal draw closer, we would expect a temporary slowdown in the number of participants joining directly as potential new participants wait for finalisation of the new arrangements to avoid having to go through multiple implementations for different systems in quick succession.
- 6.4** Now that the consolidation of FPS, Bacs and C&C is complete, we expect Pay.UK to consider to what extent it can align its processes across the different systems to make onboarding as frictionless as possible for PSPs.

Indirect access

Work for credit institutions

- 6.5** We expect credit institutions to ensure they provide sufficient reasons for refusals or withdrawals of payment account services to us under regulation 105, giving clear information on why that particular entity has been refused or withdrawn, against the access criteria of the relevant credit institution.
- 6.6** We also expect credit institutions to have robust processes in place to ensure that all PSPs applying for payment account services are passed through the correct consideration and notification processes.
- 6.7** Credit institutions should also work to improve communication of their decisions to PSPs when they inform a PSP whether they will provide them with a payment account service.

Work for IAPs

- 6.8** In our 2018 report, we noted that we had been told informally that there are still a number of issues with the way in which some IAPs deal with prospective indirect customers and, in some cases, existing customers.
- 6.9** Following our recent announcement about our changes to expand SD1, we expect IAPs to improve their practices in dealing with PSPs that have requested indirect access. This includes providing more information to these PSPs about their applications, keeping them more informed on their progress and status, and providing them with estimated timelines.

Governance

- 6.10** Pay.UK is currently working to implement its work programme to progress the development of the NPA.
- 6.11** We expect Pay.UK to continue to focus on its new governance arrangements and engagement with stakeholders. This will include an annual stakeholder engagement report under our revised GD4 – a public-facing document explaining the key stakeholder engagement over the last 12 months and highlighting issues for engagement with service-users in the year ahead.
- 6.12** We have also noted as part of our policy statement for our revised GD4 that we may consider requiring Pay.UK to report against a KPI metric reflecting its stakeholder engagement.

What we will do

- 6.13** We will continue to monitor developments in access to payment systems. In particular, we will continue to monitor Pay.UK's progress to make sure the NPA delivers its intended benefits for banks, businesses and consumers.
- 6.14** We will continue to monitor compliance with PSRs 2017, including credit institutions' compliance with regulation 105, and IAP's access criteria for payment account services.
- 6.15** We will continue to monitor the impact of our Directions.
- 6.16** We will also continue to monitor any effects of the UK's withdrawal from the EU on our access programme of work. The longer-term impacts of Brexit on the overall framework for the regulation of payment systems in the UK will depend, in part, on the relationship that the UK seeks with the EU in the future. We will work closely with the government as it confirms the arrangements for the UK's future relationship with the EU.

7 Glossary

Term or abbreviation	Description
access seeker	A payment service provider (PSP) seeking access (direct or indirect) to a system.
agency indirect PSP	An indirect PSP that has its own sort code provided by its indirect access provider.
aggregator	An organisation providing technical access to a payment system's central infrastructure through a shared gateway.
API	Authorised payment institution.
Bacs	The regulated payment system that processes payments through two principal electronic payment schemes: Direct Debit and Bacs Direct Credit. The payment system is operated by Pay.UK.
the Bank	The Bank of England.
Bank of England settlement account	A settlement account in central bank money, used to transfer funds on the Bank's real-time gross settlement (RTGS) system. An account is required in order to be a direct participant in FPS, Bacs, CHAPS and the cheque systems.
C&C (Cheque and Credit)	The regulated payment system processing cheques and other paper instruments. This encompasses the image clearing system and paper-based system. It is operated by Pay.UK.
CHAPS	The UK's real-time, high-value sterling regulated payment system, where payments are settled over the Bank of England's real-time gross settlement (RTGS) system. It is operated by the Bank of England.
credit institution	Under the PSRs 2017, an undertaking whose business is to take deposits or other repayable funds from the public and to grant credits for its own account.

Term or abbreviation	Description
direct access	A PSP has direct access to a payment system if the PSP is able to provide services for the purposes of enabling the transfer of funds using the payment system as a result of arrangements made between the PSP and the operator.
direct technical access	A technical solution that directly connects a PSP (or other authorised user) with the central infrastructure of a payment system.
FCA	Financial Conduct Authority.
FPS (Faster Payments Scheme)	The regulated payment system that provides near real-time payments as well as standing orders. It is operated by Pay.UK.
FSBRA	Financial Services (Banking Reform) Act 2013.
General Direction (GD)	A Direction we issued under section 54 of FSBRA, section 125 of the PSRs 2017, regulation 4 of the PCIFRs 2015 and https://www.psr.org.uk/how-psr-regulates/regulatory-framework-and-approach/general-directions , as amended from time to time. It applies to all parties of a category specified in the Direction.
indirect access	A PSP has indirect access to a payment system if it has a contractual arrangement with an indirect access provider to enable it to provide payment services (to enable the transfer of funds using that payment system) to its customers.
indirect access provider (IAP)	A PSP that provides indirect access to a payment system to other PSPs for the purpose of enabling the transfer of funds within the UK. This is the case irrespective of whether or not the IAP provides the indirect PSP with a unique sort code (that is, whether or not the indirect PSP is listed as the 'owning bank' for a sort code in the Industry Sort Code Directory, with the IAP listed as the 'settlement bank').
LINK	The regulated payment system that enables end users to take cash out of their accounts (among other activities) using the network of ATMs in the UK. It is operated by LINK Scheme.

Term or abbreviation	Description
non-agency PSP	An indirect PSP that does not have its own unique sort code.
operator (payment system operator)	In relation to a payment system, any person with responsibility under a payment system for managing or operating it. Any reference to the operation of a payment system includes a reference to its management.
Pay.UK	The entity set up to consolidate BPSL (Bacs), FPSL (FPS) and C&CCCL (Cheque and Credit). Formerly the NPSO.
payment service provider (PSP)	A PSP, in relation to a payment system, means any person who provides services to consumers or businesses that are not participants in the system, to enable the transfer of funds using that payment system. This includes direct PSPs and indirect PSPs.
PSD2 (Second EU Payment Services Directive)	Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) 1093/2010, and repealing Directive 2007/64/EC, published in the Official Journal of the EU on 23 December 2015. The UK's obligations are transposed into UK legislation in PSRs 2017.
Payment Services Regulations 2009 (PSRs 2009)	The Payment Services Regulations 2009 (SI 2009/209), which implement the Payment Services Directive (Directive 2007/64/EC) in the UK, as amended from time to time.
Payment Services Regulations 2017 (PSRs 2017)	The Payment Services Regulations 2017 (SI 2017/752), as amended from time to time, which implement the Second EU Payment Services Directive (PSD2).
service-user	Those who use, or are likely to use, services provided by regulated payment systems.
sort code	A six-digit number, usually written as three pairs of digits, used for the purpose of routing payments in certain UK interbank payment systems.
Specific Direction (SD)	A Direction issued by the PSR under section 54 of FSBRA and https://www.psr.org.uk/how-psr-regulates/regulatory-framework-and-approach/general-directions , as amended from time to time. It applies only to persons specified in the Direction, or persons of a specified description.

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12 Endeavour Square
London E20 1JN
Telephone: 0300 456 3677
Website: www.psr.org.uk

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