

# **Simplifying Access to Markets Working Group**

## **Liability in indirect access models sub-group**

### Solution Description:

Accountability of Providers and Participants in  
Indirect Access Models

Draft for Discussion 08/07/16

Approved [date]

***Working group objective is to examine whether and how payment systems can be developed in order to simplify access and participation in the markets for PSPs.***

## Solution Concept Assessment

### SOLUTION NAME: ACCOUNTABILITY OF PROVIDERS AND PARTICIPANTS IN INDIRECT ACCESS

#### PROBLEM STATEMENT:

The solution proposal put forward recognises that in a healthy payments ecosystem, there should be clear criteria for access whether this is direct or indirect, and that all participants should understand their responsibilities and accountabilities, and be aware of any regulatory guidance which impacts them as a participant. Feedback is that this is not always the situation currently.

This solution addresses the lack of clarity for indirect access into a payment system via a direct participant of that system, where the market supply of a bank account to support such indirect access now tighter because of changes to money laundering and terrorist financing risk factors.

The detriments being addressed are:

1. It remains difficult for Indirect PSPs (IPSPs) to obtain bank accounts, and in some cases to retain their bank accounts as the indirect access provider (IAP) withdraws account services;
2. Larger IAPs are constrained by the threat of cross-jurisdictional AML/CTF/Sanctions breaches/Fines; and
3. IAP market remains small but is expected to grow, albeit growth may be slow.

Our more detailed assessment of the detriments is that the heightened financial crime environment has resulted in increased caution by providers, partly as a consequence of complexity in compliance. This extends beyond purely IPSPs, and to other customer groups such as charities and FinTech. The linkage is who and where such organisations receive money from or pay money to.

In term of simplifying access to payment systems, this solution focuses on indirect access and in particular, the need for indirect access PSPs to obtain a bank account with an IAP to support payment system access.

Although lack of a bank account is the manifestation of the detriment, it is not simply a question of market supply. The withdrawal of account services from certain IPSPs, and stronger provider assessment criteria, have created market tensions for certain IPSPs. The emergence of new IAPs presents an opportunity to increase market competition, but not necessarily see all IPSPs able to obtain an account through which to access the payment systems.

There is evidence of IPSPs having been denied access because no indirect access provider will provide account services to them. This may be despite the IPSP considering it has in place clear risk-based criteria for Know Your Customer, Anti-Money Laundering, Sanctions risk and other liability avoidance processes, in the same way as will the IAP. The small number of IAPs, and their similarity of type, has led to similar outcomes for various types of IPSP, and may appear to suggest that the market is insufficiently competitive.

Although the IPSP is an authorised or regulated entity, IAPs remain concerned that they may be liable for an IPSP's shortcomings in meeting its AML/Sanctions checking responsibilities. IAPs with international activity, particularly in the USA, are concerned about action by the US authorities. Money Remitters and small Payment Institutions are on record that they face particular barriers.

The PSR's Interim Indirect Access Review<sup>1</sup> states that it is aware that some non-agency IPSPs face a limited choice of IAPs, and that for some small IPSPs having a bank account is equivalent to having indirect access. A survey conducted by the Association of UK Payment Institutions (AUKPI), shared with PSR in connection with its review,

<sup>1</sup> <https://www.psr.org.uk/psr-publications/market-reviews/MR1512-interim-report-supply-of-indirect-access-payment-systems>

showed that 35 out of 39 applications for bank accounts had been turned down, and 51 out of 71 respondents had had a bank account closed in the past 2½ years. PSR indicated that its own evidence suggests at least 450 access arrangements for non-agency IPSPs have been terminated in recent years.

The core UK IAPs are Barclays, HSBC, Lloyds and RBS. The PSR's interim review noted they have 80% of the SME market and 85% of IAP relationships. This is supplemented by other non-agency IAPs which provide services to IPSPs. Until recently, there has been no evidence that the small number of service providers has impacted the market.

PSR's interim review confirmed awareness of at least four PSPs planning to become IAPs in the short term, and that it considers their entry and expansion to be likely, swift enough and sufficient in scale to address many of the concerns it has raised around indirect access. It is anticipated that these additional IAPs will both introduce competition to incumbent IAPs and potentially, because of their proposed services offering, be more likely to service smaller and newer types of PSP, and thus broaden service supply in the more recently impacted sectors. This should potentially address the market issue and PSR is expected to wish to monitor this as part of its continuing review of indirect access provision.

The closure of bank accounts both by banks in the UK and globally, together with the withdrawal of services to customers associated with higher money laundering risk is referred to as 'de-risking'. The World Bank Group<sup>2</sup> at the request of the G20 and the Financial Stability Board (FSB), and with the support of the Committee on Payments and Market Infrastructures (CPMI), undertook fact-finding work on this in late 2015. Their analytical work focused on two areas – restriction or termination of correspondent banking relationships and account closures of money transfer operators. Countries, including Australia, Canada, France, Germany, Italy, Mexico, the UK, and the US, are all stated as ones where money transfer operator accounts have been closed.

In the UK, the separately commissioned FCA research into the drivers and impacts of de-risking found that, faced with higher capital requirements and higher liquidity thresholds, as well as greater enforcement by regulators and prosecutors, banks had reduced debt exposure. A consequence of banks' strategic reviews is their frequent choice to focus on their 'core' business. In doing this, certain sectors have been more impacted e.g. money transmission services, pawnbrokers, FinTech companies, and charities operating in geographical areas perceived to present greater money laundering terrorist financing risks.

The FCA (Howell) report on the 'Drivers & Impacts of Derisking'<sup>3</sup> concludes that banks take their de-risking issues seriously, and are mindful of obligations to treat customers fairly and of the financial inclusion agenda. It noted that policies and procedures are still developing. Countering this however, was the conclusion that de-risked customers suffer disruption and cost impact, often accompanied by distress and frustration.

In terms therefore of access to payment systems, the problem impacts a relatively small number of participants, but the view is that this masks a bigger issue on how account closure/withdrawal is impacting across other customer sectors. The challenges are much broader and more complex than the simple non-opening or closure of bank accounts, and we are of the view that continued review by Government, regulators and industry should seek to work towards an accepted approach to these issues in terms of outcomes and performance monitoring.

One key area of clarity required is, when a breach of rules/procedures is caused by an IPSP, what risks and liabilities an IAP is responsible for, so that more are encouraged to offer this service and to a wider range of PSPs. We consider this most sensibly sits with the industry, potentially co-ordinated through the auspices of the Joint Money Laundering Steering Group.

There was a general acceptance of the principle that the 'polluter pays' for any breach.

### **CURRENT STATUS OF INTERESTED PARTIES**

Preliminary research carried out by the sub group drew out the following observations:

- Most IAPs operate both within and outside the UK and are subject to global regulations which means that implementing uniform policy standards is difficult without global consensus among regulators;

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<sup>2</sup> <http://www.worldbank.org/en/topic/financialmarketintegrity/publication/world-bank-group-surveys-probe-derisking-practices>

<sup>3</sup> <https://www.fca.org.uk/news/fca-research-into-the-issue-of-derisking>

- It was generally agreed that for any individual IAP, the potential benefit from servicing an IPSP was small in regards to the IAP's overall commercial operations, whereas the risk in servicing the IPSP (due to potential AML/KYC breaches) was virtually unlimited. Therefore, even though the possibility of damage from servicing any one IPSP might be tiny, the unbounded potential reputational risk incurred means that IAPs are less likely to provide services to IPSPs, and there is evidence that services continue to be withdrawn from some IPSPs;
- Both IAPs and IPSPs accepted the principle of accountability for their own actions and liabilities, and are seeking clarity around examples across the transaction chain; and
- A number of concerns around liability may be more immediately mitigated by the growth of IAPs that are domestic businesses, supported by the provision of simplified direct access and unified standards.

The PSR in its Indirect Access Market Review Interim report MR15/1.2 set out two relevant findings under its Finding 6:

7.23 Financial crime regulation is a market characteristic that has an important influence on IAP behaviour. Some IAPs apply minimum revenue thresholds for new IPSP customers and have introduced de-risking policies for existing IPSPs – where they terminate access for customers perceived to be higher risk – in order to mitigate the perceived risks and costs associated with financial crime (chiefly money laundering and terrorist financing). This has particularly affected small non-agency IPSPs.

7.24 IAPs also have different commercial appetites for attracting new (and retaining existing) IPSP business. Some want to expand their IPSP activities, while others are more selective about which IPSPs they serve. Generally speaking, large agency IPSPs and medium (agency or non-agency) IPSPs are seen as most attractive, while many IAPs have only limited interest in smaller non-agency IPSPs.

Supporting linked action was noted in the FCA 2016 Business Plan which identifies Financial Crime and Anti-Money Laundering as one of its seven priorities. It also signalled its continued intention to work closely with Government and other regulators on regulation e.g. the EU's Fourth Money Laundering Directive (4MLD), which requires UK implementation by mid-2017, and its participation in the Financial Action Task Force (FATF), as the standard setting body to combat such crime and threats.

On 24<sup>th</sup> May 2016, FCA published its research on the issue of 'de-risking,' a term it uses to describe its observations that 'banks are withdrawing or failing to offer banking facilities to customers in greater volumes than before'. There is a perception that this is driven by banks' concerns about the Money Laundering and Terrorist Financing (ML/CTF) risks posed by certain types of customer.

The FCA noted too that the report it commissioned demonstrates that de-risking is the result of a complex set of drivers, with no apparent 'silver bullet' to solve it. It indicated that the report notes that potential pathways to mitigate the issue may lie in balancing costs and risks between banks and high risk sectors, and a better developed understanding of how to measure AML/CTF risk on a 'case by case' basis. We support this as part of our solution proposal to achieve a more normalised market.

In April 2016 the Government released its action plan for anti-money laundering and counter-terrorist finance<sup>4</sup>. One proposal of particular interest which might improve the current state of affairs, where both the IAP and the IPSP have to duplicate and perform AML/CTF work for the same payment, would be the acceptance of a form of Safe Harbour for the IAP, to allow it to rely on the AML/CTF work carried out by the IPSP. Further engagement and liaison is proposed with the Home Office and FCA and industry contacts to understand current developments more clearly before proposing any formal activity, since this priority area for legislators and regulators also covers the WG's area of concern.

Engagement is underway with BBA on its work through the Joint Money Laundering forum, and with the FCA. BBA has confirmed that it has recently reconvened its Remittances Action Group and is interested to engage in linked areas of activity.

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<sup>4</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/517993/6-2118-Action\\_Plan\\_for\\_Anti-Money\\_Laundering\\_\\_print\\_.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517993/6-2118-Action_Plan_for_Anti-Money_Laundering__print_.pdf)

We are aware too of proposals from the Financial Crime, Data and Security working group which if introduced could also alleviate impacts, namely:

1. Technical standards for Identity Verification, Authentication and Risk Assessment of parties to payment transactions;
2. Financial Crime Intelligence Sharing;
3. Enhancement of Sanctions Data Quality

## **SOLUTION DESCRIPTION**

The SAM and Financial Crime, Data and Security WGs agreed the need to ensure a healthy end-to-end payments infrastructure, with clear guidance to all participants and users. This becomes increasingly important as more new types of participant enter the market.

The early solution proposed a mapping exercise and analysis, with the objective of seeking clarity on which party holds the responsibility for such obligations and in doing so identify where a solution needs to be found. We think this could still form a useful part of next stage activity, given lack of clarity expressed, however only as part of an agreed workplan.

Our proposed solution recognises that there is a need - given the range of interested parties and the recent reports and research, particularly into de-risking – that a key first step should be to bring together a multi-stakeholder review group to consider the issues and what is underway that may address them and identify gaps which remain to be filled.

Anticipated attendees would include regulators (FCA, HMRC and potentially PSR), with FCA proposed as the lead organisation, industry (BBA, AUKPI) and other interested parties with understanding of financial crime and access issues. This group should consider the issues and proposals raised in this paper, and supplement them if necessary with related issues, and determine a plan of work.

We consider it likely that certain actions will be capable of being taken forward through existing working groups, with review group to consider this and also to perform a continuing oversight and reporting role of progress.

Solution issues for further consideration - these are not exhaustive but represent proposals for the group where the existence of such system attributes were seen to be helpful

- a. Whether there exists, or can be developed, a clear mapping of parties in the payment chain and an articulation of regulatory and legal responsibilities for each party and where, if a party accesses a payment system via another party, which of them is considered responsible across the payment end-to-end journey;
- b. Potential to deliver greater transparency at transaction level for an IAP and an IPSP handling the same payment, such that KYC and AML requirements, responsibilities and liabilities are clear and can be carried out sufficiently and reasonably;
- c. Potential to develop clearer defined rules describing what criteria a PSP needs to meet to qualify for a bank account, noting that IAPs will wish to maintain commercial and risk based decision-making ability to allow them to meet their corporate objectives and policies;
- d. Consider the introduction of a simplified and standardised accreditation process of direct and indirect access for smaller payment institutions at the time of their authorisation and periodically, potentially through external accredited audit.
- e. Consider if a safe harbour option can be developed, to provide assurance to IAPs that they can service IPSP payment traffic without undue liability; and
- f. Consider how other players with different risk profile might be encouraged to become IAPs.

Other options considered but not progressed which may be appropriate for the review group to assess:

- Whether there may be commercial solutions, which might link with other solutions e.g. technical aggregators. There is precedent with CLS which performs OFAC scanning centrally for its participants. There may be merit in considering whether a collaborative/competitive solution could be developed for the payment systems.

## PEOPLE INVOLVEMENT AND ACTION

WHO	WHAT
<b>SAM Working Group</b>	<ul style="list-style-type: none"> <li>• Mapping of flows, liabilities, regulatory status and other requirements.</li> </ul>
<b>Liabilities Sub Group</b>	<ul style="list-style-type: none"> <li>• Produce topography of payments participants and how they are affected.</li> </ul>
<b>PSR / Bank of England / FCA</b>	<ul style="list-style-type: none"> <li>• Support discussions and ultimately support changes to legal/regulatory frameworks to clarify liabilities for payments infractions.</li> </ul>
<b>Home Office</b>	<ul style="list-style-type: none"> <li>• Taking forward Government April 2016 Action Plan to examine Safe Harbour service for IPSPs where both parties are handling the same payment.</li> </ul>
<b>BBA</b>	<ul style="list-style-type: none"> <li>• Competent trade association for Anti-Money Laundering and Sanctions compliance guidance<sup>5</sup>.</li> </ul>
<b>FPS</b>	<ul style="list-style-type: none"> <li>• AML report has already been shared with Working Group.</li> </ul>

## LEADERSHIP

Although this remains an access to markets issue, the leadership needed is one which combines understanding of the need to create a simplified and more open payments market, together with the capability to influence the development of future policy and its continued adherence, alongside its adoption and practical application in the market.

This is not a new challenge, but remains an unresolved one which we believe Government, regulators and the industry need to continue to address to deliver clear and consistent guidance and practice which allows both IAPs and IPSPs at the working level to have greater clarity.

The BBA provides a focus on UK, EU and international policy development, engages with the FCA on financial crime matters and seeks to promote reform to the UK legislation for AML. Under its auspices sit key industry groups, including the Joint Money Laundering Steering Group.

We envisage that the initial leadership, as is already happening, will come from Government and regulators, given the need to ensure the UK continues to maintain strong defences against anti-money laundering and financial crime threats.

However, this issue covers two very different problems – difficulties in access to payment systems and the need to ensure that these systems do not facilitate financial crime through the movement of funds.

Divergent views have existed for some time and from this group's review, we are proposing that interested stakeholders, covering regulators, industry bodies, providers and participants come together to agree the key issues to be looked into and a time-bound work plan to address them.

No one expects that there will be a 'silver bullet' solution but potential pathways may support progressive change, linked to existing activity, is possible. Through the Forum's consultation, we will be seeking views on who should lead this initial phase of activity.

<sup>5</sup> <http://www.jmlsg.org.uk/what-is-jmlsg>

## COMMUNICATION

A communications programme will need to be developed as part of any agreed changes to the legal and regulatory framework affecting liabilities, and it will need to be agreed where this is led from for the payments industry. There will be a need to ensure, from the AML, FinCrime and indirect access perspectives, that communications and related activities are aligned to deliver expected outcomes.

## SYSTEMS AND PROCESSES

Little direct impact on systems and processes within participants – this is mainly around legal and regulatory compliance /change. However once liabilities have been clarified, changes would result from the likely different operating models that would emerge for IAPs and IPSPs.

## DEPENDENCIES

The solution outlines proposed, although relating to access to payment systems, fall under the broad and complex topic of financial crime, where multiple activity is underway, both in the UK, Europe and globally, some of which may directly benefit or impact both IAPs and IPSPs in respect of what is covered here.

As such we see dependencies on:

- Developing regulation such as the transposition of the Fourth Money Laundering Directive in to UK law;
- Current work underway by the FCA on de-risking;
- On industry financial crime and money-laundering expertise e.g. JMLSG, BBA working groups

There will be a need to seek views during consultation and determine with industry parties on how best to organise to take forward. This may be under existing forums or newly convened ones.

## COST BENEFIT ANALYSIS

The solution proposals are ones which seek to gain clarity on a known access issue, with international dimensions, which those groups that have been considering have made limited progress.

The activity proposed sets out activity which recognises that the entry of new IAPs to the market is progressing, and should deliver good outcomes in the short term. These outcomes will not however necessarily add clarity to the market.

The initial phase of activity i.e. mapping, analysis and engagement is additional activity for those already engaged on such matters to consider and can be phased one off, low cost activity. It will also support the identification and prioritisation of any further activity considered necessary.

Any technical developments, such as potential central OFAC screening, would need formal cost: benefit analysis if a proposal to develop were agreed. This would be considered as a medium-sized industry development.

Cost	Benefit
- Policy development time/resources and cost of any legal and regulatory framework changes to clarify liabilities	- IAPs and IPSPs would have clarity over their respective responsibilities and liabilities.
- Additional cost of regulatory fines and reputational damages for participants when AML / KYC procedures are incorrectly followed	- More IAPs are likely to consider offering services if liabilities and risks are clearly understood.
	- Financial models are clearer for challenger banks and new entrants using indirect access to payment systems via an IAP which will assist business planning and risk management.

## **SECURITY / RESILIENCE**

No direct impact expected on security and resilience. This change could encourage more indirect participants, with potential impact on these topics.

## **EXISTING OR IN-DEVELOPMENT SOLUTIONS**

Current regulator publications now issued which may lead to industry engagement but no known solutions are currently in-development and any this would be a new initiative.

## **INTERNATIONAL INSIGHTS / BENCHMARKS / HORIZON SCANNING**

The paper refers through out to similar issues in multiple international jurisdictions with the same/similar risk/liability issues for access to payment systems.

We are aware that the international card system operators have pre-paid card products which support the international remittance market, where there seem to be fewer issues for the payer. It is unclear whether such a solution will always be of use to beneficiaries.

Equally, we have been advised too that certain IPSPs may wish to make payments from the UK where their needs are better met by having an account in a local jurisdiction. This may need to feature in wider education of the sector.

## **COLLABORATIVE OR COMPETITIVE**

This solution is very much about collaboration to determine the true extent of the issues still and what is currently being considered to mitigate these. The issues are long-standing and known, with regulatory and industry engagement and discussion. However the access concerns remain and the 'solution' is to ensure that a clear understanding is developed of issues to be resolved.

## **QUICK WIN VS SUBSTANTIAL PROJECTS**

The mapping and initial analysis ought to be capable of being completed within months – after which time planning will be required for longer term changes, e.g. changes to regulatory guidance.

## **IMPLEMENTATION APPROACH AND TIMEFRAME (OVERALL)**

As noted above, the initial analysis could be completed within months, although any timetable would need to be set depending on how such work was integrated with existing and related activity/other developments.

## **IMPACT: SUCCESS METRICS**

Success would mean that IAPs and IPSPs would have full clarity of the liabilities they are taking on, what being regulated (e.g. as an Authorised Payment Institution) means in liability terms, and ideally a clear understanding that the principle of 'polluter pays' applies when it comes to regulatory breaches.