28th March 2018

Dear Hannah

Thank you for your letter dated 18 January 2018. As you point out the creation of the NPSO is an essential step towards a generational change in UK payments. Achieving the ambitions of the Payment System Operator Delivery Group report is our priority. We are building an organisation that will be able to identify and respond to the needs of stakeholders, which can set the conditions for effective competition and, in doing so, drive an increase in innovation across the industry. At the same time we will continue maintaining the reliability and resilience of the systems we operate.

Our Board met for the first time in October 2017. In this short period of time we have made significant progress on the essential steps needed to achieve our ambitions. We have worked with regulators and the existing Payment System Operators to ensure any changes are made seamlessly, with full continuity of service. Our target is to take on the role as the designated operator for the Bacs and Faster Payments systems by May, with Cheques to follow shortly after. We are holding a stakeholder event on 9th May to provide an update.

Our new approach to engagement is taking shape, putting those with an interest in our work at the heart of our decision making process. Since September we have engaged with a significant number of individuals, through a combination of our own events, individual meetings and presentations at conferences. Our new Advisory Councils will ensure the needs of consumers, business and other payment users are formally placed alongside those of industry. The End User Advisory Council is already up and running and recruitment is underway for the Participant Advisory Council. Both will be supported by a voluntary stakeholder community, representing all sectors in our ecosystem. We encourage anyone with an interest in our work to get in touch and join this community.

We believe the New Payments Architecture (NPA) will drive accessibility, competition and innovation. We have established an NPA Programme to progress the work of the Payments Strategy Forum (the Forum). We have prioritised addressing the outstanding questions identified in the Blueprint; in co-ordinating the procurement work underway within Bacs and Faster Payments; and in developing a close alignment between the NPA and the Bank of England's RTGS Renewal Programmes. As we progress the development and implementation of the NPA we are committed to engaging with a range of stakeholders. This has started regarding Confirmation of Payee and Request to Pay. We will share details at the stakeholder event in May on how to get involved with the wider Programme.

Turning to the priorities identified in your letter, these very much align with our own thinking as we see the year ahead as laying the foundations for change. Work is underway and we have summarised our current timelines below. I'm sure you'd agree it is important we do this in the right way, adjusting our thinking as we engage with our stakeholders.

Date	Activity
March 2018	End User Advisory Council established
March 2018	Begin to implement our Risk Framework
May 2018	Standards Framework v1.0 available
May 2018	Implement permanent NPA Programme Board and stakeholder governance structure
June 2018	Establish Participant Advisory Council
End H1 2018	Agree NPSO procurement approach and strategy
August 2018	Develop NPA clearing and settlement layer requirements, sufficiently detailed to enable the next stage of procurement
By end 2018	Develop a process to measure the effectiveness of our Advisory Councils
By end 2018	Consult on and publish Key Performance Indicators
By January 2019	Hold first Guarantors Annual General Meeting
Q1 2019	Publish 2018 status report
By March 2019	The End User Advisory Council produces its first report
By June 2019	The Participant Advisory Council produce its first report
Q1 2020 onwards	Publish a full annual plan, including performance against our KPIs.

Establishing a best-in-class payment system operator

Our strategic objectives will be at the core of how the NPSO operates and are included in the terms of references for our Board, our Board committees and both Advisory Councils. By doing this we can ensure these objectives are embedded in our governance framework. We can also ensure that they are considered each time decisions are taken by our Board and its committees or Councils and they are accountable for upholding the objectives. **In the medium to long term we have an intention to embed the strategic objectives in the NPSO scheme rules being developed as part of the NPA Programme.**

Our aim is to include stakeholders in our deliberations as part of the Board decision-making processes. Our two Advisory Councils will provide a greater understanding of the needs of our community. **The End User Advisory Council has been established and started its work in March. The Participant Advisory Council recruitment process is underway and will meet for the first time in June 2018.** The Councils and the NPSO will be supported by a wider stakeholder community, who we will engage with through a variety of methods to meet individual needs.

Being consistent in the management of the standards and rules of the services we govern will be crucial to our role. They are an enabler of robust, resilient, collaborative retail payment services to meet the evolving needs of, and to benefit, all users. **Our expectation is a Standards Framework v1.0 will be available in time to support the initial development work of the standards and rules for the NPA. Subject to feedback from key stakeholders and Board approval we are hoping the initial delivery will be May 2018. We also anticipate further stakeholder consultation on the Standards Framework v1.0**. To inform our thinking we have considered how other organisations and regulated sectors set their standards and rules.

We will require tools to decide when and how it is appropriate to intervene in the market to stimulate the development of new payment services and products. **The scope of our market catalyst role is being defined. The capabilities required to fulfil it will be in place when we implement our strategic target state operating model.**

We are committed to promoting a sound and robust payment infrastructure in the UK. To achieve this we will implement a robust Enterprise Risk Management Framework and enhance the risk culture across the organisation. Our Framework has been submitted to the Bank of England. Our ultimate aim is maintaining risk at acceptable levels and avoiding actions that are detrimental to our guarantors, participants, end users, regulators and the industry at large. **Our risk framework is being implemented from March 2018 onwards and the NPA risks identified by the Forum are being integrated within the overall approach.**

Building the future – the New Payments Architecture

Delivering the NPA in a safe and timely manner and, by doing so, creating an environment that increases innovation and competition will be key to us meeting our strategic purpose and objectives. **An interim NPA Programme Board is in place to maintain momentum and is leading on the work assessing and evaluating the Forum's Blueprint. A permanent NPA Programme Board and stakeholder governance structure, to allow a range of interested parties to participate, is expected to be in place by May 2018.**

Engagement has begun on the NPA Programme. As we recognise the importance of this engagement being structured in a way that meets the requirements of a range of stakeholders, a framework is being developed to support the programme. This aligns with the NPSO's strategic objectives. **Version 1.0 of our NPA Stakeholder Governance Framework will be implemented from May 2018 onwards.** We expect the principles of this framework to be adopted for the wider NPSO engagement framework.

The procurement processes being run by Bacs Payment Schemes Limited (BPSL) and Faster Payments Scheme Limited (FPSL) will formally combine at the point we become the responsible operator for both systems. We expect this to be from May 2018. In advance of this we are using the NPA programme to coordinate activities. **We are developing a single NPSO procurement approach and strategy for Board approval by end H1 2018. This approach will be used for the procurement of the NPA clearing and settlement layer.**

Building on the conceptual design work of the Forum, input from the FPSL Request for Information process, the BPSL analysis of unattended payments and through our engagement with the Bank of England's RTGS programme, we have identified a series of design considerations. These include but are not limited to connectivity and security; resilience and hosting; and settlement. **Subject to resolving these considerations we expect to deliver the NPA clearing and settlement layer requirements, sufficiently detailed to enable the next stage of procurement, by August 2018.** To support this we will also document clear rationale for any areas that differ from the Blueprint and evidence of how the needs of users are met.

We have valued our engagement with you and your team as we have considered this response. We are committed to working with the PSR as we progress the activities set out in this response. I believe it is vital that we continue to develop this constructive and collaborative way of working as it will help drive the best outcomes for users and the wider payments ecosystem.

Yours sincerely,

Paul Horlock, CEO – New Payment System Operator

CC:

Melanie Johnson, Chair – New Payment System Operator

Annex: NPSO's response to the initial priorities set out by the Payment Systems Regulator

Target Operating Model

1.1   The New Payment System Operator (NPSO) has been formed to become the responsible body for the retail payment systems operated by Bacs Payment Schemes Limited (BPSL), Faster Payments Scheme Limited (FPSL) and the Cheque & Credit Clearing Company (C&CCC). The recommendations on the proposed structure of the NPSO and its role and responsibilities, as outlined in the final report from the PSO Delivery Group (PSODG) dated 4th May 2017[1], are guiding the development of the NPSO.

1.2   Achieving the ambitions of the PSODG report is our priority. We are developing an operating model and governance framework that will build an organisation that is able to identify and respond to the needs of our stakeholders, which can set the conditions for effective competition and in doing so drive an increase in innovation across the industry. At the same time we will work to ensure that the reliability and resilience of the systems we operate are maintained.

1.3   Version 1.0 of our Target Operating Model (TOM) and governance framework will be operational from May 2018. This is the point we expect to have received non-objection from the Financial Markets Infrastructure Directorate at the Bank of England (the Bank) and we become the responsible operator of the Faster Payments and Bacs systems. We are working with the C&CCC on the target date for becoming the owners and operator of its system. We expect this to follow shortly allowing the C&CCC organisation to be part of TOM 1.0.

Fig 1: NPSO Governance Framework
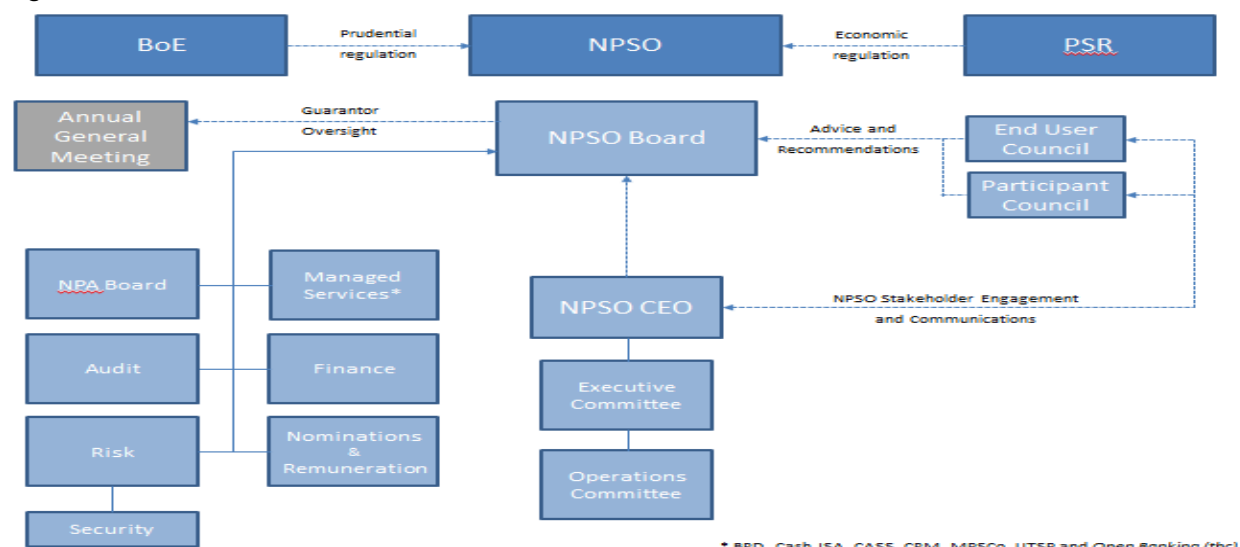
1.4   From June 2018 we will begin to steadily implement our strategic target state operating model. It will include the consolidation of key functions and technologies, embedding one culture and making any required operational restructuring. It will be an iterative and ongoing process with its core being maintaining operational stability of the combined enterprise. It will also set the foundation for the implementation of the New Payments Architecture (NPA).

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[1] https://www.psr.org.uk/sites/default/files/media/PDF/PSODG-Report-2017.pdf

Stakeholder Engagement

1.5   Our aim is to include stakeholders in our deliberations as part of the Board decision-making processes. The method for doing so must be right for the stakeholders concerned and will include, but not be limited to, written public consultations, research, bilateral dialogue and larger decision making groups.

1.6   We began our stakeholder engagement programme in September 2017 and have held a series of events, bilateral meetings and presented at external conferences. These have included a range of stakeholders including consumers, businesses, FinTechs, vendors and Payment Service Providers. Our focus has been on building our stakeholder community, introducing the NPSO and our work programme (including the NPA), establishing the two Independent Advisory Councils (the Councils), and seeking feedback on how stakeholders wish to engage with us and on what topics.

1.7   The Councils will represent the interests of end users and participants, establishing a dialogue between those who use payment services and those who provide them. The Councils are integral to our governance framework (see Fig. 1) and will provide a mechanism for the NPSO to receive advice and recommendations from a range of stakeholders. The Councils and the NPSO will be supported by the wider stakeholder community we are establishing.

1.8   The End User Advisory Council met for the first time on 15th March 2018. We held a participant event in January and have established our participant community. Recruitment for the Participant Council is underway and we are holding a workshop for prospective members in April. We expect the Participant Council to meet for the first time in June 2018. Both will be led by NPSO independent non-executive directors.

1.9   Both Councils will produce reports that will be made available to our Board and publicly via our website. These will be produced within a year of their first meetings. They will set out the work done by each Council and the extent to which the NPSO has addressed end-user and participant needs. We want to ensure that the Councils remain effective and we are developing an approach to assess this. We expect this approach to be defined by end 2018.

1.10   We aim to bring together the interests of our stakeholders to articulate a comprehensive but appropriately differentiated, well-evidenced view of how the NPSO can help meet users' needs, not just now, but in the future. This forward look is perhaps one of the most challenging elements of our work. Helping to design a stakeholder engagement and insight programme will therefore be an early focus of the Councils' work.

1.11   Engagement has begun on the NPA Programme. Recognising the importance of this engagement being structured in a way that meets the requirements of a range of stakeholders, a framework is being developed that aligns with the NPSO's objectives. V1.0 of the NPA stakeholder governance framework will be implemented from May 2018 onwards. We expect that the principles of this framework will be adopted by the broader NPSO engagement framework.

Strategy-setting and decision making

1.12   Our purpose has been clearly articulated and embedded into NPSO's Articles of Association, which are publicly available and lodged with the Companies Registrar at Companies House. It is to **'support a vibrant UK economy enabling a globally competitive payments industry through the provision of robust, resilient, collaborative retail payments services, rules and standards for the benefit and meeting the evolving needs, of all users'.** This purpose is supported by six strategic objectives:

1. **Robust and Resilient**; maintaining trust in the certainty, integrity and security of its payment services as operators of systemically important financial market infrastructures.
2. **End-User Focused**; ensuring the continued relevance, competitiveness and usefulness of the services we provide as part of the UK payments ecosystem.
3. **Agile and Innovative**; acting as a catalyst for change in the payments industry – realising opportunities; addressing threats; and supporting industry wide initiatives.
4. **Accessible**; promoting competition by supporting new entrants through comprehensive and consistent application and on-boarding processes.
5. **Efficient**; ensuring that its payment services remain economically efficient and sustainable, while facilitating competition in both upstream and downstream services.
6. **Excellent People**; attracting and retaining talented leaders and people who deliver for stakeholders, consistent with our culture, principle and values.

1.13   These objectives will be at the core of how we operate and we will ensure we are publicly accountable for meeting them. Any changes to them will be appropriately consulted on with stakeholders, including the PSR**.**

1.14   Rather than include the objectives in our Articles we believe the most efficient and effective way to achieve this is to include them in the Terms of Reference for the NPSO Board, the Board Committees and the two Councils. This will ensure the objectives are built into our governance framework. We can also ensure they are considered each time decisions are taken by our Board and its committees or Councils and they are accountable for upholding the objectives. Before approving any changes we will consult with a range of stakeholders, this will include our Advisory Councils (which will determine how to engage the wider community), the Bank and the PSR. The rationale for any changes will ultimately be documented in our Board minutes and published on our website.

1.15   In the medium to long term we have an intention to embed the objectives in the NPSO Scheme rules (which are being developed as part of the NPA Programme). This is an approach we have identified as working well in other sectors. We discuss our approach to managing these rules later.

1.16   We fully support the need for our actions to be transparent and accountable. To support this we intend to host the first Annual General Meeting for our Guarantors before January 2019. As described earlier the End User Advisory Council is established and we are making good progress in establishing our Participant Advisory Council.

1.17 We have considered the scope and requirements of an annual plan and associated Key Performance Indicators (KPIs). We are aligned with this recommendation and will:

- Publish a 2018 status report in Q1 2019. At that stage the KPIs we will measure ourselves against will be derived from our 2018 milestone plan.
- Develop a comprehensive set of KPIs for agreement by our Board by the end of 2018. We will begin to measure ourselves against these in 2019.
- Publish our first annual plan, covering 2019 and our performance against our KPIs, in Q1 2020.

1.18 As we develop our KPIs we will discuss these with the Bank and the PSR, seek advice from both Councils and provide an opportunity for other interested stakeholders to provide feedback via our website. Our Board will be asked to sign off based on an assessment of this feedback. The Board's decision making process and the discussions that lead to its rationale will be included in the minutes and posted on our website. Once agreed the KPIs will also be posted on our website.

Competitive procurement of central infrastructure for the New Payments Architecture

Programme Set-up

1.19 Prior to the Payments Strategy Forum handing over its Blueprint our programme team received all relevant NPA documentation and undertook a number of knowledge transfer activities. This knowledge transfer process included, amongst other handover and shadowing activities, retention of a number of contractors now being utilised to support the 'assessment and evaluation' of the Blueprint. Since the handover, a number of steps have been taken to bring together a team from the NPSO along with BPSL, FPSL and the C&CCC into one NPSO programme.

1.20 To maintain momentum an interim NPA Programme Board has been established that has delegated authority from the NPSO Board. It met for the first time on 8th March 2018 and is chaired by an independent non-executive director with a specialism in this area. In order to ensure a range of stakeholder views are represented the NPSO Board members chairing each of the Councils sit on the NPA Programme Board.

1.21 We recognise the importance of establishing a permanent Programme Board with the right mix of representation, skills and experience. Identifying the correct composition will therefore be an early task of the interim NPA Programme Board. We expect to move to the permanent, fully constituted NPA Programme Board and supporting stakeholder governance structure by May 2018.

Blueprint Assessment and Evaluation

1.22   Building on the conceptual design work of the Forum, input from the FPSL Request for Information process, the BPSL analysis of unattended payments and through our engagement with the Bank's RTGS programme, we have identified a series of design considerations. These include but are not limited to connectivity and security; resilience and hosting; and settlement.   Subject to resolving these considerations we expect to deliver the NPA clearing and settlement layer requirements, sufficiently detailed to enable the next stage of procurement, by August 2018. To support this we will also document clear rationale for any areas that differ from the Blueprint and evidence of how the needs of users are met.

Competitive procurement of the NPA

1.23   Under the overall guidance of the NPA programme, BPSL and FPSL procurement teams are collaborating within an interim governance framework to identify and develop common areas of working. Under this model, resources are being shared across both projects.

1.24   We have been fully briefed by both BPSL and FPSL as they seek any necessary extensions to your competitive procurement remedy. The NPSO will become responsible for, and reporting against, the Infrastructure Market Review (IMR) remedies from the point we receive non-objection from the Financial Markets Infrastructure Directorate at the Bank. This will also be the point the BPSL and FPSL procurement processes will formally combine. As stated earlier we believe this will be from May 2018.

1.25   In advance of this we are developing a single NPSO procurement approach and strategy, under the guidance of an independent non-executive director with a specialism in this area. This approach will be used for the procurement of the NPA clearing and settlement layer. It builds on and takes into account work currently underway in BPSL and FPSL; the IMR remedies and a review of industry best practice. It will also bring together the work   that is underway within the NPA Programme on how we plan to secure user   commitment;   the question of broader competitive dynamics and the flexibility of technical design and contract. It will be taken to the NPSO Board by end H1 2018 for endorsement.

Comprehensive migration planning exercise

1.26   We have adopted the Forum's work on migration planning as our baseline. As we complete the design of the NPA we will test our thinking as part of our wider stakeholder engagement process. As described earlier, potential users will be engaged as part of the NPA Programme stakeholder engagement process. Through this we will actively seek their commitment that they have aligned their own internal plans to the overall migration plan.

Development and management of standards and rules

1.27 Being consistent in the management of the standards and rules of the services we govern will be crucial to our role. We will establish a common capability which we will refer to as the Standards Authority (the Authority). This capability will be housed within the TOM and its purpose is to deliver and maintain best-in-class standards and rules for the benefit of the end users, participants and interested stakeholders. It will be the authoritative source on standards and rules within the scope of the NPSO and will work in accordance with our strategic objectives.

1.28 Work is advancing on the establishment of the Authority and we expect to be able to enhance and grow the capability in line with implementing our strategic target state operating model. As we progress through these stages we expect to be able to consolidate our approach to existing and new standards and rules. The Authority will ultimately become responsible for all standard and rules[2] within the scope of the NPSO.

1.29 At this stage our initial analysis indicates that there are circa 150 existing artefacts that may be relevant to the processes of the Authority. We will work in cooperation with BPSL, the C&CCC and FPSL to go through a discovery phase to be able to quantify and qualify the extent of these artefacts and to inform issues such as consistency, and ease of access, and to consider the appropriate maintenance of these artefacts. We consider that this is an important step towards NPSO consolidation.

1.30 We know that the NPA standards and rules are an important early deliverable and a critical component for the next phase of procurement. We are therefore working in close cooperation with BPSL, the C&CCC and FPSL via a common working group, called the Standards Advisory Group (SAG). This group is supported at CEO level. The Bank also participates for the purposes of establishing interoperability between the standards for NPA and RTGS renewal. This joint approach will support the interoperability objectives of both the Bank of England RTGS renewal programme and the NPA Blueprint.

1.31 The Authority will be fully accountable to our Board and will work via a dedicated Board standards sub-group, where functional responsibilities can be delegated by decision of the Board. The Authority will work in accordance with CPMI-IOSCO principles and enhance the stability of the UK payments infrastructure through transparent and open processes to help safeguard that standards are consistent, aligned and interoperable with the rest of the world. We expect that interoperability will itself enhance resiliency of market infrastructure.

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[2] At this stage these are likely to include scheme rules, implementation guides as well as technical standards (data exchange standards or messaging standards, security standards, API standards, data standards, code lists, and reference data).

The founding principles of the Authority are set out below.

Standards Authority foundation principles	Summary outline
Robustness and resiliency	• Ensure a reliable and resilient standards for participants and in support of the PSOs responsibilities • Ensure robust operations that meet or exceed the needs of the existing PSO arrangements • Ensure transparency of operation and tracking of incidents. Have in place robust business continuity and disaster recovery objectives and plans
Low barriers to entry	• Ensure broad stakeholder representation in the rules and standards setting process • Ensure rules and standards are openly available and accessible • Support end users, participants and interested stakeholders to be able to understand and interpret rules and standards
Consultation process for setting and amending standards and rules that is proportionate	• Establish a transparent standards consultation process • Publish results of consultations, including why proposals have and haven't been included • Ensure standards are set in a way that supports access and are proportional for different types of participants
Robust governance for setting and modifying standards and rules	• Establish a clear governance structure for approving new, amendments and deviations to rules and standards • Establish an appropriate appeals process • Include the process for modifying standards and rules in the rules themselves.
Standards and rules are developed with support of stakeholders and they have a clearly defined role in the process	• Identify and engage key stakeholder groups, noting that the Advisory Councils will play a key role in ensuring broad stakeholder representation in the rules and standards setting process • Define a process whereby all stakeholders should have the same possibility of contributing • Build in a public review as part of the decision-making process on rules and standards
Interoperability internationally and with other UK initiatives	• Ensure that the PSR and the Bank are able to be represented in the rules and standards setting process • Ensure the standards setting process is aligned to and informed by key domestic, European and international standards activities

1.32 Our commitment is to describe the detailed aspects of how NPSO develops, maintains and modifies standards and rules within a clear and robust governance framework. This will be known as the Standards Framework which will form the 'rulebook' on all aspects of the standards and rules. In designing this approach we have considered other organisations and regulated sectors, including the Rail Safety and Standards Board (RSSB), Ofgem, IFRS Foundation, ISO and International Accounting Standards.

1.33 The development of the framework is an immediate priority. To ensure alignment with our regulators it will be developed with input from the Bank and the PSR. Our expectation is that the Standards Framework v1.0 will be available in time to support the initial development work of the rules and standards for the NPA. Subject to feedback from key stakeholders and Board approval we are hoping the initial delivery will be in May 2018. We also anticipate further stakeholder consultation on the Standards Framework v1.0.

Market Catalyst Role

1.34   We are defining the market catalyst role, and when it might be appropriate for the NPSO to act in this capacity.   As set out in the Forum's Blueprint a market catalyst could take a number of forms such as:

- **Commission market research:** to understand factors such as customer and market needs and the economics of new services
- **Establish rules and standards:** to define the essential requirements for service offerings
- **Provide test environments:** to stimulate the market by provision of test environments to speed service development cycles
- **Promote services:** to raise awareness and support market adoption
- **Procurement:** to create initial implementations of new services where market forces are insufficiently developed, with clear exit criteria
- **Provide seed funding**: to stimulate market entry where unmet needs are identified.

1.35   We are committed to understanding how our actions can strike the appropriate balance between our strategic objectives. To understand how this balance can best be struck we have started work, supported by external economists, to develop a "market and economic analysis framework". Initially it will be used to inform NPA design decisions but in the longer term will help determine what capabilities the NPSO may require.

1.36   In parallel the scope of our market catalyst role is being defined. The capabilities required to fulfil it will be in place when we implement our strategic target state operating model.   We recognise our potential role as a market catalyst is of interest to you and other key stakeholders so we will engage on this as our thinking develops.

Risk management

1.37   Risk management is an inherent part of our business and service activities. We consider the adoption of a consistent, comprehensive and effective risk management framework as fundamental to meeting our purpose and strategic objectives. This framework will be consistent with and meet the principles and standards of both ISO 31000: 2009 and CPMI-IOSCO risk management, as well as our regulatory requirements. Our risk framework is being implemented from March 2018 onwards and the NPA risks identified by the Payments Strategy Forum are being integrated within the overall approach.