Call for Input: Competition and Innovation in the UK's New Payments Architecture

Stakeholder submissions to Call for Input

February 2021

Contents

Names of individuals and information that may indirectly identify individuals have been redacted.

Barclays

Payment Systems Regulator (PSR) consultation on competition and innovation in the UK's New Payments Architecture (NPA) – CP20/02: Barclays response

1. About Barclays

1.1. Barclays is a British universal bank. We are diversified by business, by different types of customers and clients, and by geography. Our businesses include consumer banking and payments operations around the world, as well as a top-tier, full service, global corporate and investment bank, all of which are supported by our service company which provides technology, operations and functional services across the Group.

2. Overview

2.1. We welcome the opportunity to comment on the Payment Systems Regulator's (PSR) consultation on competition and innovation in the UK's New Payments Architecture (NPA). We think it is vital that the financial services industry, regulators, and the Bank of England are involved in shaping the future of UK retail interbank payments. It is also crucial to include the end-users of UK retail interbank payments: businesses, Government and consumers, in that debate.

2.2. We agree with many of the observations made by PSR in the consultation. The risks identified by PSR to competition in the provision of the infrastructure that will power the NPA appear plausible, and the mitigations proposed appear, in theory, appropriate to address the risks identified. However, we would suggest that given the current position of the NPA programme, it is difficult to reach any meaningful conclusions in respect of the competition issues highlighted. Instead, we encourage PSR to work closely with Pay.UK and industry to develop a credible and achievable plan to attain the ambitions of NPA.

2.3. Barclays supports the vision of the NPA. Barclays' wants a UK retail interbank payment system that *"provides flexibility and choice for customers. That is easy for PSPs* [Payment Services Providers] *to access; is designed in a scalable, modular and futuristic way; is supportive of FinTech innovations; and, provides maximum opportunity for competition and differentiation between PSPs."*[1] However, and as we pointed out in our response to the Payment Strategy Forum's blueprint document, more work was needed to re-evaluate the proposed NPA.

2.4. The Payment Strategy Forum (PSF) proposed that NPA would replace the interbank payment systems of Bacs and Faster Payments (and, in the fullness of time, the Cheque Image Clearing System). The PSF expected and based its benefits case on the implementation of NPA at the beginning of 2021, with a defined and reasonably short period of parallel running before the existing schemes close. Bacs and Faster Payments would close down by the end of 2023.[2] We noted at the time that the assumptions that informed the timeline were optimistic and questioned whether it was realistic, and this has proven to be the case.[3]

2.5. One of the critical challenges of the NPA is the migration of Government and business payments and collections from the Bacs payment system to the NPA. These users often submit their payments and collections directly to the central infrastructure rather than via a channel provided by their bank. The Bacs payment system is responsible for over 70% of the volume and value of payments of the planned NPA.[4]

---

[1] Paragraph 3.3, Barclays (September 2017), *Blueprint for the future of UK payments – A Barclays response*, <https://implementation.paymentsforum.uk/consultation-responses-0> [accessed May 2020]
[2] Page 11, Payments Strategy Forum (December 2017), *NPA Implementation plan: Blueprint*, <https://implementation.paymentsforum.uk/sites/default/files/documents/Implementation%20Plan%20Blueprint.pdf> [accessed May 2020]
[3] Paragraphs 5.2 to 5.3, Barclays (September 2017)
[4] Bacs 2019 total volume was 6.5 billion payments with a total value of £5 trillion, Faster Payments 2019 total volume was 2.4 billion with a total value was £1.9 trillion, and in 2019 there were 260 million cheque payments worth a total of £391 million.

2.6. Considering these challenges, we believe that Pay.UK, the industry and regulators, including PSR, need to work together to make the right decisions for the UK economy, consumers and businesses on the future direction of the NPA. We think NPA should prioritise areas where it will make the most positive difference for UK consumers and businesses. Supporting this activity should be PSR's priority.

2.7. We want an NPA that is resilient and cost-effective. It must offer services and features that help foster competition and innovation in the market for payment services and other adjacent services. We believe that for the NPA to achieve those objectives, it is crucial to ensure that Pay.UK has appropriate and independent governance arrangements in place to determine the features, services, rules and operation of NPA. The agreements Pay.UK reaches with organisations that will provide the central infrastructure services (CIS) for the NPA must secure competition and innovation in the market for payment services. Also, and as starkly demonstrated by recent events, the resiliency of Pay.UK and NPA is paramount. The NPA must be able to continue to operate regardless of any issues affecting underlying service providers to NPA.

3. Questions related to competition and innovation

Question 1: We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?

Question 2: How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?

Question 3: For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected.

3.1. The hypothesis proposed by PSR on how the provider of the central infrastructure for NPA could harm competition appear plausible, and there are no apparent others that seem missing. The critical question is the likelihood of these harms materialising. We do not believe that it is very likely that these harms will occur.

3.2. Pay.UK is an independent organisation, and it is responsible for designing NPA and for procuring any central infrastructure required to support the NPA. Both the Bank of England and PSR regulate Pay.UK. Therefore, we fail to understand why the central infrastructure provider would be given the freedom to act in the way envisaged by PSR's hypothesis. For instance, we would expect the agreement between Pay.UK and the NPA CIS provider(s) to limit the latter's ability to use and exploit the data it receives in the provision of NPA services. We would also expect Pay.UK to set access criteria and access costs, and be able to determine the introduction of any new NPA features or services. Indeed, this is the current position for the exiting payment systems operated by Pay.UK. We see no reason why NPA would be any different.

3.3. Our most significant concern regarding NPA and competition relates to the current programme. PSR observes: "*A well-designed and executed procurement process, could, in principle, mitigate the* [monopoly] *risks. However, any changes to design or capability after contract award would be more difficult to mitigate through actions taken in the procurement.*"[5] Pay.UK continues its NPA procurement process despite material uncertainty over the exact detail of the services NPA will provide. Pay.UK does not yet know the required capabilities needed from any central infrastructure provider. So Pay.UK is not able to guarantee that there will not be changes to the

---

Source: Pay.UK table of payments data for 2019, <https://www.wearepay.uk/wp-content/uploads/2020/02/2019-in-Payments-table.pdf> [accessed May 2020]

[5] Paragraph 2.20, Payment Systems Regulator (January 2020), CP20/2 – Call for input: Competition and innovation in the UK's New Payments Architecture, <https://www.psr.org.uk/psr-publications/consultations/new-payments-architecture-call-for-input> [accessed May 2020]

design or capability of NPA. Pressure on Pay.UK to continue at pace with the procurement must cease, and Pay.UK given time to plot the right way forward for the NPA.

4. Questions related to potential mitigations

Question 4: Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.

Question 5: Are any of the types of mitigation we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?

Question 6: Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.

Question 7: Are any mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

4.1. The mitigations proposed by PSR appear plausible at addressing the potential harms that PSR has identified. There are also potential additional benefits from the mitigations over and above the theories of harm identified by PSR. For instance, the adoption of common standards, where appropriate, could increase resiliency of UK payments as a whole as well as providing the opportunity to interact with international payments systems should there be a future requirement or desire to do so.

4.2. Similarly, proper governance is a prerequisite for the critical national infrastructure that the NPA will be. We believe that the independent Pay.UK, rather than the CIS provider, should make decisions on all aspects of the NPA service. Those decisions must be informed by the views of participants and be taken in the broader interests of the UK economy, businesses and consumers.

4.3. A number of the mitigations proposed by PSR seek to remove or reduce the economic interest of the supplier in overlay markets or competing payment systems through varying degrees of structural or economic separation. Such separation will inevitably impose additional costs on any organisation providing central infrastructure services that already operates in adjacent markets or plans to do so. In the event of a competitive procurement exercise, such requirements may reduce the attractiveness of bidding for the service. These requirements may render competitive procurement exercises moot as too few organisations are willing to compete to provide the service.

4.4. Further, any additional costs imposed by mandatory structural or economic separation will increase the fees that PSPs pay to access NPA services, and those fees will ultimately be paid for by the end-users of those services directly or indirectly. Therefore, we believe that there should be clear evidence of actual harms occurring or being likely to occur before PSR contemplates such remedies.

4.5. However, the need for resiliency may be a more compelling argument for the structural or economic separation of the central infrastructure suppliers to NPA. We recommend PSR working with Bank of England to evaluate whether the resiliency benefits, along with addressing risks to competition, make some form of separation attractive.

British Retail Consortium

From: [redacted]
To: PSR NPA
Subject: BRC response, PSR call for input on competition and innovation in the UK's New Payments Architecture
Date: 25 February 2020 10:16:02
Attachments: [redacted]

To whom it may concern,

With apologies for not quite managing to get this to you yesterday, please see below and attached the British Retail Consortium (BRC) response to the PSR call for input on competition issues that could arise in the UK's New Payments Architecture (NPA).

The PSR is asking how to mitigate the competition issues caused by Mastercard's ownership of Vocalink. Attached is the 2017 BRC submission to the CMA and Treasury Select Committee on the Mastercard/Vocalink merger, which we believe stands today for this PSR consultation. Most of the BRC's 2017 concerns about the Mastercard/Vocalink merger have now been borne out, especially given the outcome of the LINK/Vocalink infrastructure tender process and what we know about the NPA tender process so far.

The BRC suggest that the best way to address the competition issues identified in the PSR consultation is for the PSR to use it powers to require Mastercard to divest Vocalink. The suitable buyer could be any body that is not a UK scheme operator (e.g. Mastercard or Visa) and not a major UK PSP (i.e. issuer or acquirer), but could be another payment system infrastructure operator (e.g. Accenture, Capita, Equens, IBM etc) or another trade buyer or investor.

I would welcome the opportunity to discuss this with you further.

Kind regards,

[redacted]

[redacted]
www.brc.org.uk

ClearBank

Clear.Bank®

23 March 2020

PSR Pay.UK / NPA Project Team
Payment Systems Regulator
12 Endeavour Square
London, E20 1JN

Email only: PSRNPA@psr.org.uk

RE: Competition and Innovation in the UK's New Payments Architecture ("NPA") – Call for Input

General Remarks

We appreciate the opportunity to respond to the Call for Input and the overall objectives that the NPA is trying to achieve.

We note that the PSR is seeking input from all stakeholders in the NPA which includes direct and indirect payment system participants, payment service providers that will look to provide overlay services underpinned by the NPA, and bidders in the NPA procurement to ensure all business models are taken into consideration and catered for in the decision-making process, which we applaud. If the PSR has not done so, we would encourage it to also seek responses from prospective stakeholders, in part as issues such as barriers to entry would impact their entry to participate in the NPA.

We believe it is important for all participants to be kept informed of the progress with the procurement process in a transparent manner. There may not be a one size fits all answer and therefore it is critical that decisions are not made in isolation from all those who will ultimately be leveraging the NPA.

Please note that we have responded on a best endeavours basis but feel at this point it is not possible to comment substantially, as we consider that key aspects and example NPA are required in order to provide a well-informed and appropriate response.

In addition to responding to the specific questions, we have considered the hypotheses and mitigations provided in this Call for Input carefully and our overarching observations and request for further information in respect of this Call for Input are:

1. We believe there is a fine balance to be struck between removing or reducing the economic interest of the NPA CIS provider in overlay services or competing payment systems and ensuring that there is a strong pool of potential providers as the NPA presents an attractive proposition.

2. We do not believe that any measures/mitigations to reduce anti-competitive behaviour should be to the detriment of the quality of the NPA solution.

3. We would be interested to understand if it has been considered if the NPA CIS could be set up as a cooperative / membership asssociation, similar to that of SWIFT's governance and oversight model in which participants are shareholders and the shareholders elect the board. This model would limit anti-competitive behaviour as participants would have an interest in the operation of the NPA CIS and retain neutrality in delivery of the NPA.

4. We believe that the key controls around the NPA are the implementation of a robust governance and technical design. In line with the submission from UK Finance on this subject matter, we expect that the NPA will be a payment system designated by HM Treasury for the PSR to regulate and that this will be concurrent to the activities of the Financial Markets Infrastructure Directorate at the Bank of England in this area. The continuance of these activities is considered to be an essential control against an anti-competitive market developing.

5. It is important to note that if the NPA CIS is being defined as a thinner layer which is bolstered by overlay services, then it is imperative that there is interoperability between the NPA CIS and overlay services. There must be sufficient quality control and rigour around the development of the overlay services to ensure resilience and stability but also not stifle competition. The governance of these services as well as how the NPA CIS is managed will be crucial to the competitive and innovative running of the NPA.

6. Further to the point above, we believe that interoperability between schemes inside and outside (i.e. RTGS) of the NPA is critical to achieving a resilient and futureproof payments ecosystem. The interoperable nature of the NPA both internally and externally is key to bolstering resilience in failover scenarios. We recognise that there are use cases today which are strengths of the current setup and we would encourage these to be replicated in the NPA; however would like the NPA to go further including, there being a significant focus on real-time payment processing and intelligent data provisioning. The industry has the opportunity in developing the NPA to provide a more streamlined and futureproofed service, provide better insights and thus enable better decision-making. Doing this would not only drive competition, but would also drive better outcomes for all customers.

7. It is unclear from the Call for Input documentation on the contractual arrangements, besides the NPA CIS entering into an agreement with Pay.UK as its provider. We would request further information in respect of the contractual structure particularly what participants would be expected to sign up to. If participants are only to sign up with Pay.UK we see a risk arising in that any benefits/parameters derived from this Call for Input process will provide for the contractual arrangement between Pay.UK and the NPA CIS, but how can participants be sure that such requirements would be passed on to participants (i.e. pricing, pricing reviews, service levels etc.). If participants were not privy to a contract with the NPA CIS, there would need to be transparency as to what is being captured as between the NPA CIS to Pay.UK and properly backed-to-backed in the participants contract with Pay.UK to ensure any issues regarding competition and innovation cover all parties involved in the NPA.

In our unique position and with a differing business model to traditional payment service provider models, we would emphasize the importance of models outside the norm being considered and would welcome ongoing engagement in this topic.

Questions related to competition and innovation:

***Question 1**: We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?*

We agree with the hypotheses raised by the PSR about how the ownership of the NPA CIS may affect competition and innovation and do not have any further scenarios or hypotheses to add. We believe further information is necessary in order for stakeholders to fully understand and be assured that the matters addressed and agreements reached during the procurement of the NPA CIS provider will be implemented upon the commencement of the NPA on a business as usual basis. This further information could include but should not be limited to detail of the controls and mechanisms in place to manage the NPA CIS on an ongoing basis.
***Question 2**: How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?*
We believe the governance and technical standards developed by Pay.UK to enable the NPA will be the key mitigating factors to stop the materialisation of these hypotheses. This governance needs to be transparent and agile. We would encourage openness, collaboration and robust standards/measures to ensure the NPA is fit for purpose from implementation and an ongoing basis.
***Question 3:** For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?*
All hypotheses made by the PSR will reduce the level of competition within the market and we are therefore supportive of the focus on the importance of avoiding/mitigating against the hypotheses occurring as each could cause significant harm to the payments industry .
Questions related to potential mitigations:
***Question 4:** Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.*
We believe that the current structure of bodies - with HM Treasury, the PSR, FMID and Bank of England is a key control in and of itself. This must be retained to ensure sufficient oversight, review and challenge. It is also important that the PSR and Pay.UK work closely to manage the NPA CIS provider for the benefit and safeguarding of the industry. It will be critical to the ongoing management of the NPA and the promotion of competition and innovation that the NPA CIS provider is required to be transparent in respect of performance, internal governance processes, complaints and roadmap for development. The same scrutiny will need to be considered in respect of any overlay services and the providers of those services. As previously stated, our view is that that the technical and governance design will be a key mitigant for competition and innovation in the NPA and therefore needs to be given the appropriate attention and focus whilst balancing the financial stability of the industry and the stakeholders.
***Question 5**: Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?*

We re-iterate that we consider the most effective mitigations outlined by the PSR are those around the governance and technical design of the NPA (of which should include any overlay services).
***Question 6**: Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.*
We are unable to articulate a considered response to this at this time as there are many contributing factors which would influence the response including who the selected vendor would be, the proposed mitigation and who would bear the costs of any mitigation.
***Question 7:** Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.*
PSR and Bank of England's FMID monitoring of payment services has been proven to be an effective control, this must continue in the NPA. The existing separation between the provider of CIS services from Pay.UK, who operate as an appropriate management oversight of this provider, is also an important boundary that should be maintained in the future development of the NPA.

Electronic Money Association

Electronic Money Association
[redacted]
Telephone: [redacted]
Facsimile: [redacted]
www.e-ma.org

Chris Hemsley
Managing Director
Payment Systems Regulator
12 Endeavour Square
London E20 1JN

Email to: PSRNPA@psr.org.uk

27 April 2020

Dear Chris

Re: EMA response to PSR CP 20/2 Call for input: Competition and Innovation in the UK's New Payments Architecture

The EMA is the EU trade body representing electronic money issuers and alternative payment service providers. Our members include leading payments and e-commerce businesses worldwide that provide online payments, card-based products, electronic vouchers and mobile payment instruments. They also include a large number of smaller Payment Service Providers, including startups. The majority of EMA members are authorized in the UK, and operate across the EU, most frequently on a cross-border basis. A list of current EMA members is provided at the end of this document.

We welcome the opportunity to respond to the PSR's Call for input on competition and innovation in the UK's New Payments Architecture. We have not addressed the specific questions in the Call for Input, but instead taken the opportunity to raise a number of points about the importance of ensuring the technical design of the NPA does not perpetuate the competition risks inherent in FPS and BACS.

I would be grateful for your consideration of our concerns.

Yours sincerely

[redacted]

[redacted]
Electronic Money Association

EMA response to the Call for Input

The EMA welcomes the opportunity to respond to the PSR's call for input at an early stage of policy development on the future regulation of the New Payments Architecture (NPA). We agree with the competition scenarios in relation to the NPA Central Infrastructure Provider (CIP) as set out in the Call for Input and support the proposed mitigating actions.

We would also like to suggest that the PSR consider a couple of additional broader competition risks in relation to the development of the NPA and the selection of the NPA CIP as follows.

As set out in the PSF Strategy (2017) and the PSR's 2017 Direction to Pay.UK, the replacement of the BACS and Faster Payments (FPS) clearing and settlement layer is at the heart of the NPA. However, the scale and complexity of upgrading these payment schemes means there is significant risk that the scope of the NPA is reduced over time due to time and cost pressures for incumbent scheme participants. The two-tier payments infrastructure this would inevitably create, with Faster Payments using the NPA and BACS on legacy systems, will restrict the speed and scale of innovation in the UK payments market.

Curtailing the scope of the NCA would also likely increase the risk that the NPA becomes a like-for-like replacement of BACS/FPS functionality which may introduce legacy competition issues into the NPA ecosystem. For example, connectivity options to FPS currently attract significant setup and on-going operational costs for participants who are required to establish a direct physical connection to the FPS CIP or route via an intermediary.

In addition, currently the FPS CIP requires that participants access, and pay for, transaction data as an ancillary service to core transaction processing, via a separate technical connection. Transactional data is a fundamental part of performing payment reconciliations and all FPS participants are therefore compelled to use this extra service at additional costs.

The above examples illustrate that historical technical design decisions made regarding FPS and implemented by the FPS CIP have led to down-stream competition issues by placing cost barriers for smaller payment providers entering and participating in the ecosystem.

To mitigate against the risk that the NPA, and its operation by the CIP, perpetuates these competition risks we urge the PSR to consider the mechanisms that will be put in place to ensure that the NPA CIP, and NPA technical scope and design, will create a payments architecture that is open, fit for purpose, and drives competition and innovation in the UK payments market.

List of EMA members as of April 2020:

AAVE LIMITED
Airbnb Inc
Airwallex (UK) Limited
Allegro Group
American Express
Azimo Limited
Bitstamp
BlaBla Connect UK Ltd
Blackhawk Network Ltd
Boku Inc
CashFlows
Ceevo
Circle
Citadel Commerce UK Ltd
Coinbase
Contis
Corner Banca SA
Curve
eBay Sarl
Em@ney Plc
ePayments Systems Limited
Euronet Worldwide Inc
Facebook Payments International Ltd
First Rate Exchange Services
Flex-e-card
Flywire
Gemini
GoCardless Ltd
Google Payment Ltd
IDT Financial Services Limited
Imagor SA
Intuit Inc
Ixaris Systems Ltd
Modulr FS Europe Limited
Moneyhub Financial Technology Ltd
MuchBetter
myPOS Europe Limited
Nvayo Limited
One Money Mail Ltd
OpenPayd
Optal
Own Solutions
Park Card Services Limited
Paybase Limited
Paydoo Payments UAB
Payoneer
PayPal Europe Ltd
Paysafe Group
PPRO Financial Ltd
PPS
QIX Ltd
Remitly
Revolut
SafeCharge UK Limited
Securiclick Limited
Skrill Limited
Soldo Financial Services Ireland DAC
Stripe
SumUp Limited
Syspay Ltd
Token io
Transact Payments Limited
TransferMate Global Payments
TransferWise Ltd
TrueLayer Limited
Trustly Group AB
Uber BV
Valitor
Vitesse PSP Ltd
Viva Payments SA
WEX Europe UK Limited
Wirecard AG
Wirex Limited
WorldFirst
Worldpay UK Limited
WorldRemit

Emerging Payments Association

Emerging Payments Association response to PSR Consultation CP20/2

General comments

The Emerging Payments Association welcomes the PSR's consultation on the topic of competition in provision of the payment services which clear the majority of the value of UK payments for consumer and business payment service users. It is clear from the consultation that the PSR recognises the importance of competition to achieve the goals of the New Payments Architecture especially innovation, efficiency and customer focus.

The EPA recognises that the contract to deliver the central infrastructure for the NPA is a significant commitment and there are likely to be few organisations which can do this efficiently, based on previous experience. The EPA further notes that, as the PSR has recognised, these organisations generally have other commercial services either supporting other payment mechanisms or could be "overlay services" under the NPA, either in prospect or being supplied today.

The EPA would also like to point out that there are commercial products other than those specifically provided as NPA "overlay services" which may cause competition issues in markets indirectly related to the NPA ecosystem. As an example, and referencing the point about data access in 2.11.5, the ability to provide invoice reconciliation services outside, but as an adjunct to, the NPA ecosystem would be easier to provide and more effective; it is not clear that this would be required to be an overlay service as defined and therefore could be outside the scope of governance or competition supervision.

This response has been produced using expertise within the EPA community and from some of its members, which come from across the payments value chain. As such it does not claim to totally represent the views of all its 140+ members. However, it has been produced with reference to the EPA's three considerations of promoting innovation, protecting consumers and encouraging competition.

4.2 Questions related to competition and innovation:

1. We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?

Not all competition concerns are around payment services or overlay services provided via the NPA. Other services which could be provided by the NPA CIS Provider (or a related business) could also be in scope, for example those related to 2.11.5: "Abusing access to and use of NPA payments data to its advantage". In general these could be grouped together as services outside the NPA ecosystem, but using NPA data or systems.

We therefore propose that a missing scenario might be:

Scenario A: The NPA CIS provider also (either directly or indirectly through commercial interests in other businesses) provides services outside the NPA ecosystem that rely on data or systems within the NPA ecosystem.

The EPA believes that these should be within scope of competition consideration too. EPA's analysis suggests vertical issues V1-V4, H1-H2, M3-4 are all relevant to Scenario A in reference to all broad competition risks 2.11 1-6.

2. How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?

Scenario 1 seems likely to occur in practice as the decision-making criteria for procurement will almost certainly include experience in the industry, which will include operation of a clearing system, and:

- the incumbent currently provides at least one "overlay service", or
- another provider is likely to provide a related service for other payment services.

Scenario 2 also seems almost certain to occur because the provider selected will be based on experience of running such a system. This means selecting either:

- the incumbent, which already operates other payment systems
- another provider, which would be required to demonstrate relevant expertise most likely running other payment systems.

For Scenario A, the risk is high in that it appears to exist to some degree in the provision of transaction analytics for Bacs and Faster Payments, as the incumbent provider was chosen to provide the data analytics capability identified by the Payment Strategy Forum's Financial Crime, Data and Security working group based on access to data and costs of evaluation.

The EPA's view is that any supplier selected to provide the NPA CIS is very likely to have other commercial operations which fall into Scenario 1, 2 or A. As examples of potential suppliers, organisations such as Visa, Mastercard (including Vocalink, NETS) , SIA and equensWorldline all match one or more of these scenarios, underlining the need for good competition management during and after the procurement activity. EPA strongly believes that competition based on equal access will deliver the goals of the PSR and Pay.UK for the United Kingdom's payments infrastructure.

The factor which could affect whether these harms materialise would be based on ensuring a level playing field between external providers and those internal to the NPA CIS Provider (either directly or indirectly in businesses in which the NPA CIS provider has commercial interests).

One mitigating or acerbating factor is the hygiene with which information is handled within the NPA CIS Provider (or related businesses). If, for example, the NPA CIS Provider is operated as a separate entity and it is treated as an external provide would be, this would reduce some of the day-to-day concerns, especially if this interaction is subject to audit. Whilst this would not rule out internal anti-competitive behaviour, it might be clearer where the standard channels had not been used,

As an example of a rule to ensure independence, it would be reasonable to ensure that no individual had a role in both the NPA CIS and a competitive service, overlay or otherwise, with the exception of shared corporate functions such as HR, Payroll etc. In essence, this would "ring fence" the NPA CIS business from other commercial services of the NPA CIS Provider. This is noted in the section 3.11 of the consultation but is underlined here as an important principle.

Another factor which should be considered is the representation to regional or global industry or standards bodies. IF the NPA CIS provider supplies the technical or managerial staff to liaise with these bodies globally, there is a potential for the needs of the NPA to be poorly or under-represented if not in the direct interest of the NPA CIS provider's other commercial interests. It is therefore vital for the governance of the NPA to either allocate resource to perform this role, or to monitor this function closely.

3. For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?

The EPA believes that the horizontal, vertical and monopolistic, potential detriments outlined in the paper are defined well and all are relevant. In addition, there are issues around innovation in markets outside the NPA ecosystem which could also be impacted, for example risk analytics to detect and/or prevent financial crime of many types.

Scenario 1 is likely to cause appreciable harm because it could distort the selection criteria for competing services and could place unfair impediments to developing new overlay services, leading to a lack of innovation, one of the goals of NPA, and a dependence upon a single provider in the market, making the NPA CIS Provider overly relied-upon.

Scenario 2 is likely to cause appreciable harm because of the potential commercial conflicts within the NPA CIS provider to developing or supporting new services for NPA users and undermining innovation, cost-effectiveness and capability in the NPA.

4.3 Questions related to potential mitigations:

4. Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.

Detailed Technical Design of NPA

In addition to the rules and standards being available to appropriate PSP and non-PSP businesses, it is important that specifications including APIs are also available. In the past, keeping technical specifications within the central infrastructure provider and its direct customers has prevented or hampered entry to the market by other providers. As an example, implementing ISO20022 XML as a payment message standard is a sensible approach but the differences between banks on the specific fields required and the formats of those fields in each of their implementations have caused problems both for (corporate) payment service users and their enterprise software vendors.

It is therefore vital that access to detailed specifications should be available for all customer-facing interfaces and, upon justified request, for specified details of core processing.

Separate entity providing access for potential competitors

While it is important that competitors are provided with the correct and up to date information related to NPA design and operations, it would be possible to engage a separate entity to provide the competitor engagement component of the NPA ecosystem. This would give competitors a responsible body to go to for access, ancillary services (such as testing and accreditation), and to enquire and raise issues. This body, contracted to Pay.UK could be an existing entity or trade body which would facilitate competition within and related to the NPA ecosystem and would be in a position to demand services from the NPA CIS Provider. Having the NPA CIS Provider providing this service as well as consuming it through a hidden route is not an ideal situation and transparency here would be helpful.

5. Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?

3.11c) appears to be an effective balance between benefits of separation and cost (to the NPA CIS Provider and therefore by extension Pay.UK). Most of detriments focus on hidden, internal discussions, plans or strategies within the NPA CIS Provider and so exposing these by ensuring more dealings are transparent will help whilst not significantly affecting the structure and therefore the costs of the NPA CIS Provider.

6. Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.

3.11a) and b) are likely to incur significant costs or reduce competition (potentially increasing costs as well). Changing corporate structure to create a new legal entity is not an insignificant cost, purely in terms of headcount, regulatory compliance and supporting services such as banking. At one extreme, it may mean than there are no benefits in not setting up a new company to provide NPA CIS at an appropriate size – this would be risky to the organisation bidding and might put the potential provider off entirely.

7. Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

3.12c) appears to be ineffective, at least in the recent past. The issue of a service provided by the infrastructure provide to certify entrants to the market of which it is itself an entrant demonstrates a conflict of interest at least which could be mitigated by separation of duties. Similarly there are historical examples of commercial provision of telecoms services by the infrastructure provider which appeared to be at a premium in comparison with market rates.

FIS

Competition and Innovation in the NPA

FIS response to PSR Call for Input

4 May 2020

Non-confidential version

1. Executive Summary

1.1 We welcome the Payment System Regulator's ("**PSR**") call for views and input on the New Payments Architecture ("**NPA"**). Ensuring that the **NPA is a success is key to the UK building out its payments sector and retaining its position as a global payments leader**. Described by the PSR as a "*generational change in UK payments*",[1] the NPA will underpin the processing of more than £6.7 trillion transactions and will support the future of real-time payments and many other innovative new products and services.

1.2 **We would encourage the PSR to adopt a more forward-looking approach to the NPA**. The UK payments industry has undergone significant and rapid change over the last few years. From the introduction of Open Banking, to the renewal of the Real Time Gross Settlement ("**RTGS"**) system, to the introduction of PSD2, policymakers have adopted policies that promote competition and innovation in payments. The industry has itself also innovated and changed significantly, including through Mastercard's acquisition of Vocalink. The competition issues that the PSR seeks to address in this Call for Input must now be considered in light of the significant and ongoing regulatory and industry changes that have taken place over the period since the PSF deliberated. The vision and objectives of the NPA needs to meet this changing landscape.

1.3 In particular, **the emergence of new interbank payment services provides an opportunity to for the NPA to create an interbank payments system that competes more directly with existing card payment systems**. While the issues identified by the PSR in this Call for Input are relevant considerations to competition and innovation *within* account-to-account payments, they cannot (and should not) be assessed independently of competition with traditional card payments which will arise as a result of the NPA.

1.4 The PSR has flagged in its consultation a number of theoretical competition concerns that could emerge in relation to the operation of the NPA and it is obviously important for the PSR to be forewarned of potential competition issues before they arise. However, **trying to pre-empt and prevent all possible competition outcomes *ex ante*, irrespective of the likelihood of those concerns arising, is potentially damaging to business and will deter innovation** in this sector.[2]

1.5 **We encourage the PSR to instead consider alternative approaches to achieving greater competition. I**t would be more appropriate for the PSR to introduce measures that increase both competition *between schemes* and the ability for *competing providers* of CIS to emerge. By doing so, the PSR will mitigate the likelihood of many of the competition issues arising, whilst also increasing competition and innovation.

1.6 Finally, the COVID-19 pandemic is currently adversely impacting stakeholders across the payments value chain, with the outlook for a return to normalcy remaining uncertain. Maintaining the resilience and stability of payment systems is critical and must form a key part of any PSR proposals for the NPA. However, there is perhaps a heightened emphasis on resilience at present due to the additional COVID-19 related pressures currently being faced by both individuals and businesses. In considering the future of the NPA, it is important that the PSR carefully balance the need to make progress with the NPA programme (including due to the increased demand for electronic payments relating to COVID-19) against the risks of a significant infrastructure project at a time of heighted economic stress and uncertainty.

[1] First letter from Hannah Nixon, Managing Director at PSR to Mr Paul Horlock, CEO of NPSO Limited dated 18 January 2020, page 1 <https://www.psr.org.uk/sites/default/files/media/PDF/NPSO-open-letter-18-01-18.pdf>.

[2] In addition to its statutory duty to promote effective competition, the PSR has a statutory duty to promote the development of, and innovation in, payments systems in the interest of users with a view to improving the quality, efficiency and economy of payment systems.

2. The importance of the NPA to the UK economy

2.1 As a global hub for financial services, the UK has been at the forefront of payments innovation and was one of the first countries to launch a successful real-time retail interbank system (Faster Payments). However, with the pace of change and innovation only accelerating, the UK cannot afford to be complacent and must take steps to ensure it retains its position as a global leader in this space. The sector overall needs to continue to grow and operate on an efficient and sustainable basis.

2.2 Following the UK's departure from the European Union, the UK government will begin to pursue and implement an independent international trade policy. Given the importance of the financial services sector – including fintech and payment services – to the UK economy, it is important that the NPA's central infrastructure services ("**CIS**"), and in particular the PSR's approach to the NPA, does not inhibit UK competitiveness on the world stage.

2.3 Over the last few years consumers have increasingly moved away from the use of cash and towards digital payment methods. This has made the UK one of the most digital societies in the world, with 70% of all transactions happening in the absence of physical cash.[3] Crucial to supporting the efficient decline in cash is ensuring wider access to, and use of, digital payments and encouraging the greater use and acceptance of digital forms of payments, which will benefit consumers (through reduced fraud, frictionless account onboarding and quicker transaction times). Again, the development of the NPA will impact on how well the decline in cash is managed.

2.4 We welcome the Bank of England's progress in developing the next generation of the RTGS infrastructure to support future innovation in payments. These reforms will improve innovation and increase competition in payments, positioning the UK well and helping to ensure the UK does not fall behind other advanced economies. The UK now requires the retail payments infrastructure to work at the same pace as the wholesale infrastructure to ensure that the transformation in the payments landscape takes place across the board.

2.5 [✂].

3. The importance of the NPA in promoting competition with cards

3.1 The emergence of new interbank payment services through the NPA provides an opportunity to create an interbank payments system that competes directly with existing card payment systems (as Worldpay (now FIS) has explained to the PSR in the context of its market review into the supply of card-acquiring services). This is recognised in the Call for Input, which states that "*the ambition underpinning the NPA is to enable competition between existing and new payment services*".[4] This is also consistent with the objectives of PSD2, which include creating competition in the provision of account-to-account payments, which ultimately should promote competition between the interbank payments system and card payment systems.

3.2 In this regard, we note that it is important to adopt a forward-looking approach, both with respect to the PSR's future regulatory policy for the NPA, and for its ongoing work on the card-acquiring market review. In particular, whilst the issues identified by the PSR in this Call for Input are relevant considerations to competition and innovation *within* account-to-account payments, they cannot (and should not) be assessed independently of competition with

3 Whilst the use of cash will continue to decline, it is important that policymakers and industry continue to find ways to ensure that it can still be accessed for those who rely on it. Current initiatives from the UK government, UK Finance and the PSR to ensure this access to cash is maintained are welcome.

4 Call for Input, paragraph 1.3.

traditional card payments which will arise as a result of the NPA. However, it does not appear that Pay.UK considers this to be one of its core objectives, nor has this objective been built into the design for the NPA.

3.3 This is particularly relevant where likely participants operating within different layers of the NPA system are also active in the provision of card payment services and related activities that, from the perspective of users, will become increasingly interchangeable methods of payment in the future. The extent to which the same owner operates key parts of the supply chain for *both* card payments and account-to-account payments is therefore likely to be a key consideration for the PSR. In particular, it may need to weigh up the potential detrimental impact on competition in the short run with the potential significant benefits to the market and competition in the future (see paragraphs 6.17-6.19 below).

3.4 The development of the NPA should be a catalyst for innovation and competition in the payments market, which will impact on the development of payments policies across the landscape more generally. A recent study for the European Commission has identified the potential competitive constraints of account-to-account payments to the card payment system.[5] The PSR needs to consider both the need to deliver a solution quickly so as to not deter investment and innovation, whilst designing a future-proof state that truly promotes competition between card payments and account-to-account payments across the different layers in the system.

4. Regulatory and industry background

Earlier regulatory initiatives did not fully consider the role of card payments

4.1 Although FIS welcomes the PSR's decision to launch a Call for Input on competition and innovation in the NPA, we are concerned about both the timing of the consultation and the issues that are raised in it that are neither new nor unforeseeable.

4.2 When the PSR launched the Payment Strategy Forum ("**PSF**") and consulted on the future of UK payments in 2015-17, it did so under the stated objective of designing a "*blueprint*" for the implementation of the NPA that would "*take into account all relevant industry initiatives*".[6] At the time, those initiatives included the PSR's market review into the ownership and competitiveness of infrastructure provision, the Bank of England's strategic review of RTGS, the CMA's open banking remedies, and the implementation of PSD2.

4.3 Since 2017, it is clear that there have been further industry developments, including initiatives undertaken by regulators, as well as material changes to the structure of payment markets. As a result, it is inevitable that the state of competition and innovation will have evolved since the PSF's original consultation on the Blueprint for the NPA in 2017.

4.4 Some of the potential competition issues raised by the PSR in this Call for Input have previously been considered by the PSR and/or other regulators, but without sufficient regard

5 See EY, "Study on the application of the Interchange Fee Regulation – Final Report" published 11 March 2020, page 78 <https://ec.europa.eu/competition/publications/reports/kd0120161enn.pdf> ("[o]*ne of the potential competitive constraint*[s] *to the card payment system is represented by recent developments in instant payment solutions for account-based transfers as well as new pan-European infrastructures initiatives to process SEPA Instant Credit Transfer (SCT Inst) such as the TARGET Instant Payment Settlement (TIPS)*") (emphasis added).

6 PSF, "Phase 2 Terms of Reference" published 30 January 2017, page 3 <https://implementation.paymentsforum.uk/sites/default/files/documents/The%20Forums%20Terms%20of%20Reference.pdf>.

to the competitive landscape that would be brought about by the NPA (e.g. by taking a sufficiently forward-looking approach). For example, the PSR's proposed divestment remedy during the market review into the ownership and competitiveness of infrastructure provision was a catalyst for the sale of Vocalink to Mastercard, which is also active in the provision of card payments.

4.5 In particular, the PSR concluded in the market review that there was "*no effective competition in the market for the provision of central infrastructure services for Bacs, FPS and LINK*"[7]. As a result, the PSR concluded that the previous ownership of Vocalink (by a consortium of retail banks) led to incentives to restrict competition for the provision of services to Bacs, FPS and Link, without any regard to the competitive dynamics between card payments and account-to-account payments that are likely to emerge in the future. The CMA also considered the acquisition of Vocalink by Mastercard and cleared the transaction.

4.6 [✄].[8]

4.7 Since then, the PSR (and Pay.UK) has also identified and considered the competition issues identified in this Call for Input on a number of occasions in the past. In particular:

(a) the PSR's first open letter dated 18 January 2018 (the "**First Letter**"), set out a number of issues that the PSR wanted Pay.UK to consider, which included an assurance that it had minimised the risk of the winning bidder being able to use its market power to affect competition in related markets (e.g. for overlay services). Given the concerns set out in this Call for Input, it is not clear that such concerns have yet been addressed; and

(b) the PSR's second open letter 29 May 2019 (the "**Second Letter**"), identified two scenarios which could give rise to competition issues. Scenario 1 related to competition issues as a result of the NPA CIS provider also (either directly or indirectly) providing overlay services in the NPA (vertical issues), and scenario 2 related to the NPA CIS provider also providing other payment services outside of the interbank payment system (horizontal issues). As these issues are being consulted on in this Call for Input, it is clear that these issues have not been sufficiently addressed.

4.8 The creation of Pay.UK, through the consolidation of Bacs, FPS and C&CC, has also resulted in a seismic shift in the already complex landscape within which interbank payment systems operate. These systems, which the PSR/CMA found did not materially compete with each other, will in the future compete – as a system – with other payment systems, including card payments. Therefore, some of the competition issues that are now raised by the PSR in the Call for Input could be addressed by promoting competition between schemes.

4.9 In particular, in addition to considering competition and innovation on an intra-system basis, the PSR should also consider inter-system competition as alternative payment methods converge. We note that this is recognised at paragraph 2.6 of the Call for Input, which states: "*In addition to the NPA, the wider payments landscape is changing in other ways. For example, the second Payment Services Directive (PSD2) and Open Banking will facilitate the emergence of new services which could make competition between separate*

7 Paragraph 1.9. Market review into the ownership and competitiveness of infrastructure provision, Final Report, MR15/2.3.

8 [✄].

infrastructure/service combinations increasingly possible by making them more substitutable from the perspective of payers and payees." [9, 10]

Our concerns on the delivery of the NPA

4.10 FIS remains fully supportive of the NPA programme, but there are growing concerns around the significant degree of uncertainty over the delivery of an ambitious renewal programme on time and at value, particularly whilst continuing to deliver other industry initiatives.[11] As we explained above, the speed and efficiency with which Pay.UK can deliver this infrastructure will influence not just domestic policies and developments, but will also impact on the UK's international competitiveness and its position on the world stage.

4.11 The original timetable for Pay.UK to tender for a long-term strategic partner in August 2017 and announce a winner in Q3 2018 – for NPA delivery in 2021 – has been subject to numerous and significant delays. The latest updates from Pay.UK suggest migration will now be completed in 2025 (although this timeline is also disputed and some industry stakeholders now anticipate that delivery before 2029/30 is unlikely).

4.12 FIS has significant concerns about the delay to the delivery of the NPA, which will have a direct impact on its business. With the timescale for the development of the NPA running well into the current decade, the UK risks falling behind other advanced economies in deployment of the next generation in payments infrastructure. This is likely to result in innovation and new technologies being developed in other markets and overseas.

4.13 Furthermore, FIS has concerns around costs that have been incurred by Pay.UK and will continue to be incurred, even though we have no further clarity on the scope, design or timetable for the NPA.[12] Despite these significant costs, which will be borne by industry and, ultimately, consumers, there is also still no clear indication of how those costs will be recovered. Unless the programme can be delivered efficiently, the economics will not allow it to effectively compete with card payment systems.

The PSR should adopt a forward-looking approach to this consultation

4.14 The competition issues that the PSR seeks to address in this Call for Input must now be considered in light of the significant regulatory and industry changes that have taken place.

4.15 In addition, the vision for the NPA should not be bound by legacy issues or by current technology, and the design should be open and flexible to ensure that other models can emerge in the future. We discuss this further below in section 6.

---

9 Call for Input, paragraph 2.6.

10 A support study by EY on the application of the Interchange Fee Regulation has recently made this very observation, finding that "*the growth in digital payments* […] *is affecting the development of card transactions in two opposite directions. The adoption of digital wallets that are currently mostly based on card scheme networks indirectly fosters card payments, <u>while the concomitant growth of alternative account-based bank transfers exercise competitive pressure on them</u>*" (emphasis added). See EY, "Study on the application of the Interchange Fee Regulation – Final Report" published 11 March 2020, page 40 <https://ec.europa.eu/competition/publications/reports/kd0120161enn.pdf>.

11 In particular, in addition to its role to deliver the NPA, Pay.UK must continue to operate and, ultimately, decommission the legacy retail interbank payment systems that are currently still in operation.

12 PSF, "*Blueprint for the Future of UK Payments – a Consultation Paper*" dated July 2017, pages 54-55 <https://implementation.paymentsforum.uk/sites/default/files/Consultation%20Document.pdf>. The projected cost for delivering the NPA was approximately £852 million in 2017, but this cost was overshadowed by the significant additional cost of approximately £1.9 billion - £2.3 billion to run the existing legacy payment systems in parallel until 2021.

4.16 This consultation allows the PSR to be more forward-looking, and now properly consider these dynamics and the changes that have occurred to ensure we can progress with the development of the NPA.

5. The current approach and mitigants

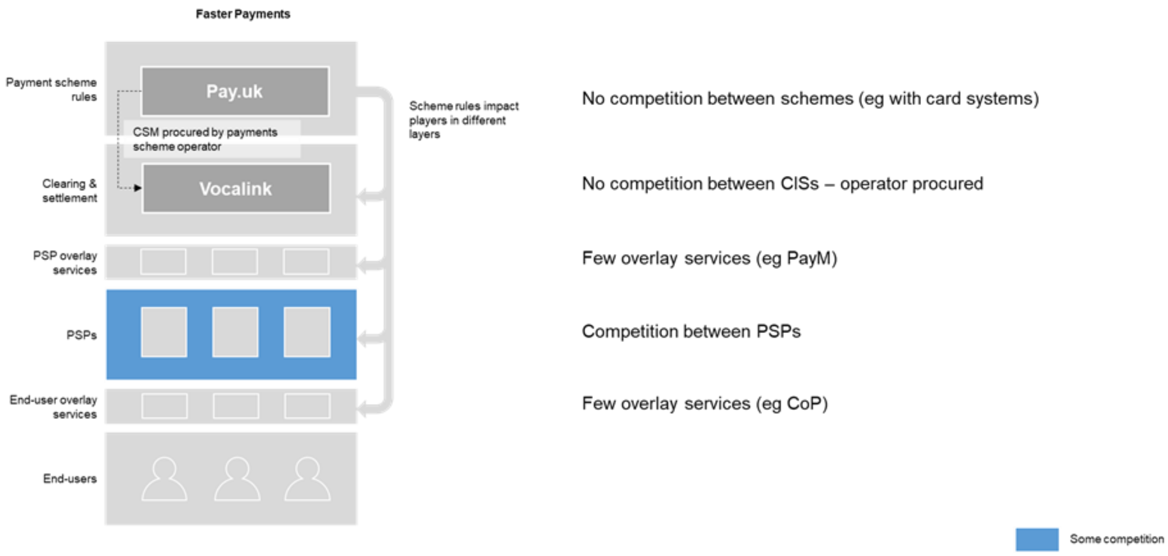
5.1 The current proposed model for the NPA envisages a framework in which:

(a) Pay.UK is seen as a payment systems operator (that sets payment scheme rules) with no immediate competitors, i.e. it envisages no effective competition between interbank and card schemes; and

(b) the NPA is delivered by only one CIS under a contract procured by Pay.UK (described as competition for the market).

5.2 Hence, the proposed model, as set out in Figure 1, creates a 'monopolistic structure' that has the potential to give rise to the range of competition issues described by the PSR in this Call for Input. Except for effective competition between PSPs, there is no effective competition between schemes or CIS providers (and limited competition between overlay services because of its infancy).

1. State of competition under the current framework



5.3 During the PSF's consultation in 2015-17, a centralised model for clearing and settlement services with a single vendor deployment approach was proposed. This was despite having accepted that a potential negative implication of such a centralised model would be that "*competition in the clearing and settlement layers will be 'for the market' only*", whereas one of the benefits of a distributed model included the capability for multiple suppliers to provide competing services.[13] As a consequence, the single vendor deployment approach effectively

[13] PSF, "*Blueprint for the Future of UK Payments – a Consultation Paper*" dated July 2017, page 19 <https://implementation.paymentsforum.uk/sites/default/files/Consultation%20Document.pdf>.

transfers a monopolistic market position to the winning bidder, which may ultimately give rise to the horizontal, vertical and monopolistic concerns set out in the Call for Input.

5.4 In such situations, competition *for the* market is unlikely to be as effective as competition *in the* market (e.g. as the rail franchising model in the UK has demonstrated). Competition *for the* market generally requires all the various aspects of competition to be specified in the tender and/or regulated by the PSR in order to avoid the winning bidder being able to exploit the market power transferred from winning the bid.

5.5 [✂].[14] [✂].[15]

5.6 If the PSR adopts an approach (as currently proposed in the original Blueprint) that results in a single NPA CIS provider, the PSR will need to use its regulatory powers to ensure that:

(a) competition with card payments is indeed promoted ([✂]);

(b) that the operator of the NPA CIS does not have an incentive to restrict competition in relation to other related overlay services (i.e. which will rely on access to the NPA infrastructure); and

(c) that the operator of the NPA CIS does not charge excessive prices for access to the NPA infrastructure, which will deter innovation and impact on its ability to compete against card payments.

5.7 In light of the regulatory and industry developments noted above, including the PSR's First Letter, Second Letter and this Call for Input, it is necessary to consider whether the PSR's original Blueprint is still the appropriate vision for the NPA in 2020 and beyond. In particular, the PSR's Call for Input *only* considers the framework set out in Figure 1 above, which ultimately results in the range of potential competition issues set out in the consultation document, and not alternative market structures which may address these issues.

5.8 One of the key features of the NPA was the adoption of a "*layered approach, with a 'thin' collaborative infrastructure to enable competition and innovation*".[16] One of the main perceived benefits of the layered approach was to establish defined functions within the payment value chain, in order to make it easier for innovation to occur at a quicker pace. However, as the PSR correctly identified in its First Letter, "*for the NPA to be successful …* [t]*here needs to be <u>effective competition</u> across all layers of the NPA, with low entry barriers for PSPs and other service providers*" (emphasis original).[17] We would go even further and encourage the PSR to consider competition across all layers in the *<u>system</u>*.

5.9 Therefore, rather than implementing mitigation to address potential competition issues that might arise from the current model proposed, it would be more appropriate for the PSR to introduce measures that increase both competition between schemes and the *<u>ability</u>* for competing providers of CIS to emerge. By doing so, the PSR will mitigate the likelihood of many of the competition issues arising, whilst also increasing competition and innovation.

---

14 [✂].

15 [✂].

16 PSF, "Blueprint for the Future of UK Payments – a Consultation Paper" dated July 2017, page 5 <https://implementation.paymentsforum.uk/sites/default/files/Consultation%20Document.pdf>.

17 First letter from Hannah Nixon, Managing Director at PSR to Mr Paul Horlock, CEO of NPSO Limited dated 18 January 2020, page 2 <https://www.psr.org.uk/sites/default/files/media/PDF/NPSO-open-letter-18-01-18.pdf>.

5.10 We consider a few alternative frameworks or mitigants below.

6. An alternative approach and mitigants

6.1 The Call for Input notes that potential mitigation to address the competition issues identified:

> "*… can take many forms ranging from, for example, ensuring appropriate technical design of the NPA and/or implementing strong governance arrangements (enforced through contractual provisions where appropriate) to removing or reducing the economic interest of the NPA CIS provider in overlay markets or competing payment systems through a form of separation*".

6.2 Whilst we note that the PSR has a range of regulatory tools at its disposal, which may be appropriate to address specific harms arising from competition issues in particular circumstances, it is important that the introduction of any preventative mitigations does not come at the expense of chilling future innovation or delaying the launch of the NPA. As noted above, attempting to predict and prevent all possible competition issues *ex ante*, in a new and unknown market where an innovation race is anticipated, would risk potentially damaging business and deterring innovation in the sector as a whole.

6.3 However failing to promote effective competition might mean regulatory intervention might be necessary in the future.

6.4 Instead of adopting the current approach set out above, there are alternative measures that would achieve and better serve the PSR's statutory objectives of promoting effective competition and innovation across all layers in the *system*. As illustrated in Figure 2 below, there are **short term considerations** that could improve competition under the current framework include the PSR providing further direction on Pay.UK's role in the NPA system. However, in **the long run,** as set out in Figure 3, the emergence of competition between CIS providers should be considered.

Short term considerations

Pay.UK's role in increasing competition between interbank and card schemes

6.5 The status of Pay.UK as a public interest body should be considered in light of its fundamental economic role within a fast-moving and competitive market. In the future, Pay.UK will directly compete against other payments systems, in particular Visa and Mastercard. The PSR should therefore ensure that Pay.UK is subject to the appropriate duties in its constitution, governance, and organisation strategy to deliver on expectations around promoting effective competition and innovation across the system and between alternative systems.

6.6 Furthermore, it is imperative that the roles and responsibilities of Pay.UK are not conflated with the operational functions envisaged by the NPA CIS. Pay.UK should refrain from assuming an 'operational role' in the delivery of the NPA. This could potentially risks increasing costs, reducing efficiency and chilling innovation at the CIS layer.

6.7 Pay.UK should therefore adopt a role focussed on the delivery of rules and standards, particularly for the provision of central infrastructure and overlay services, through continuous stakeholder engagement to ensure that interbank payment systems match the pace of innovation and efficiency of other payment systems. FIS looks forward to engaging with the PSR on the development of Pay.UK's rules and standards in the future.

Developing the right objectives for the design and delivery of the NPA

6.8 To successfully deliver the NPA, Pay.UK must have the right objectives for its design.

6.9 In its First Letter, the PSR set out the targets that it considers would need to be met for the NPA to be successful. These targets included:

(a) increased innovation in the payments industry;

(b) effective competition across all layers of the NPA, with low entry barriers for PSPs and other service providers;

(c) the delivery of the NPA in a timely manner, with support and engagement from all stakeholders; and

(d) technical robustness and resilience of the NPA.

6.10 However, we would additionally include the following targets against which the success of the NPA should be measured, which were adopted by the Bank of England for the blueprint for the renewed RTGS service. The blueprint required that the Bank of England would adopt options that are:

(a) simple (to develop, operate and use);

(b) flexible (in response to changing future demands); and

(c) cost effective (both for the Bank of England and the wider market).

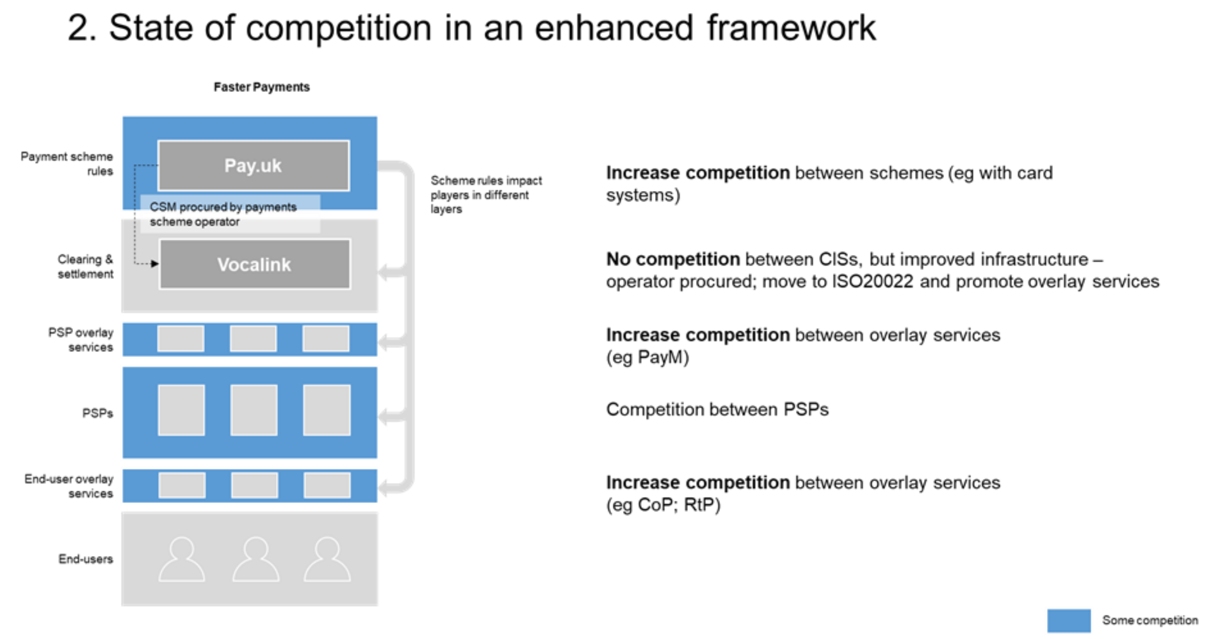
6.11 The addition of (c) is particularly important if it were to successfully compete with card payment systems in the future.

6.12 It would be beneficial for the NPA to adopt the same strategic objectives as part of its future mandate. It is not only important that the NPA and the Bank of England are strategically aligned, but that the NPA should be designed to enable delivery of a payment system that competes with cards both in terms of innovation and price.

Enhancing (not replacing) the CIS

6.13 Instead of replacing the CIS provider, the PSR and Pay.UK should consider enhancing the capabilities of the CIS provider (i.e. Vocalink) in the short term, whilst considering the longer-term structure of the industry (see further below).

6.14 This should include adopting ISO 20022 in the short term so that, over time, capabilities and functions will enable the CIS to evolve into a more competitive environment for the provision of CIS services and overlay services.

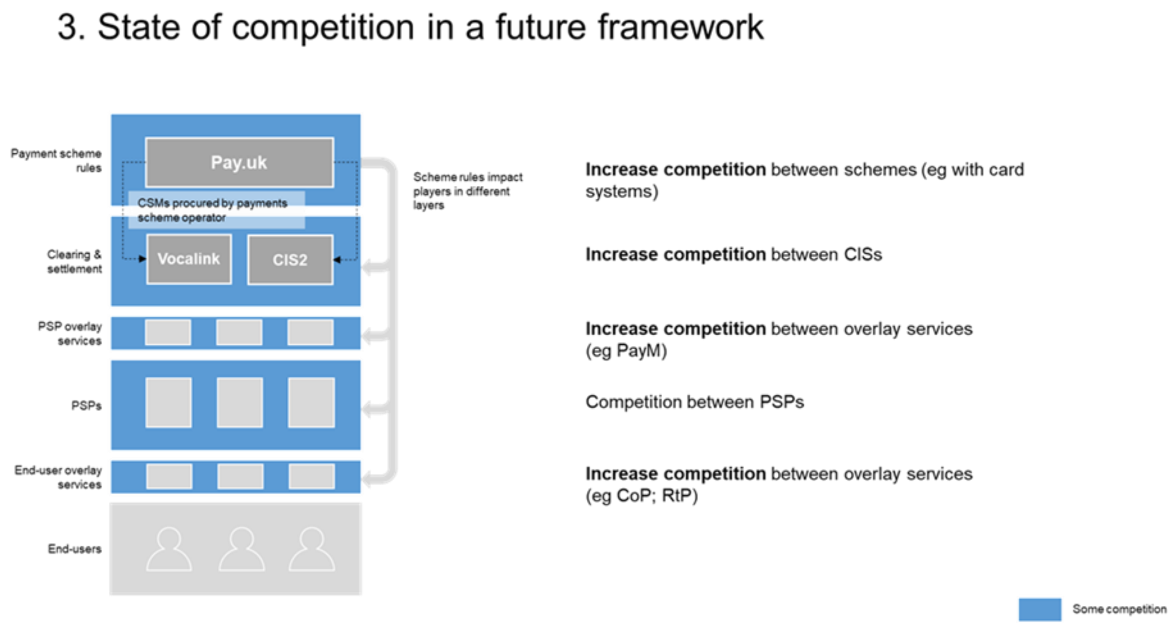


Long term considerations

Enabling the market entry of multiple CIS providers

6.15 As explained above, many of the potential competition issues that the PSR has identified are commonplace where 'monopolistic' structures are created within a value chain. However, rather than seeking to regulate a monopolistic structure as set out above, the PSR should aim to increase competition by enabling rival firms to provide CIS services in the future. Several concerns set out in the consultation document would largely fall away if a model that promotes competition between providers of the CIS in the market is followed.

6.16 The current Blueprint to the NPA does not envisage the emergence of an alternative framework in which there are multiple CIS providers, although it is unclear why this should continue to remain the case. Once the design of the NPA has been agreed then, in the longer term, the current CIS provider, or any other potential CIS providers, should have the opportunity to develop the necessary requirements and capabilities to provide CIS to Pay.UK, as set out in Figure 3 below.



6.17 The vision for the NPA should not be bound by legacy issues or by current technology, and the design should be open and flexible to ensure that other models can emerge in the future. In particular, future technology may allow PSPs and CIS providers to process payments more cost effectively and efficiently because:

(a) payments may become system agnostic, i.e. payments may not be described as either card or interbank payments, but just as "payments". PSPs and CIS providers could consequently route transactions across the most efficient or appropriate system;

(b) the growth in digital payments may result in a market with economies of scale to accommodate effective competition in the market for the provision of CIS; and

(c) technology could allow for interoperability between CIS providers using common standards and interfaces. This is already envisaged in the European system. Interoperability, common standards, and the management of liquidity would certainly be important considerations, but should not be considered barriers to this competition emerging.

6.18 By adopting an approach that enables potential future competition at the CIS layer, a further development might be that PSPs could have greater opportunities to directly contract with CIS providers, as opposed to Pay.UK, further stimulating not only competition between PSPs but, importantly, between CIS providers. We also note that the provision of enhanced competition at the CIS layer is particularly desirable in circumstances where competition for the NPA tender has already been weakened (see paragraph **Error! Reference source not found.** above).

6.19 Moreover, just the *potential* of a competitive structure that enables competition at the NPA CIS layer would reduce the likelihood of any potential competition issues arising, particularly in the shorter term. This, in turn, reduces the risk of any of the competition issues identified in the Call for Input under Scenario 1, Scenario 2 or that arise under conditions of monopoly, and removes the need for any strong forms of *ex ante* regulatory intervention. For example:

(a) Under Scenario 1, the provision of CIS by multiple operators would reduce the likelihood of incumbency advantage or input foreclosure (e.g. through raising access prices or non-price discrimination) because operators would compete for the provision of CIS to providers of overlay services. A CIS operator would have a limited incentive to foreclose providers of overlay services, because this would risk its own market position for the provision of CIS since the overlay service provider could simply choose another CIS provider.

(b) Under Scenario 2, the provision of CIS by multiple operators reduces the likelihood that any one provider would use that position to benefit its economic interest in a competing payment system. A CIS operator would similarly have limited incentives to discriminate against parties requiring access to the NPA CIS, because such parties would remain free to choose another CIS provider.

7. Summary

7.1 As noted above, for FIS, and possibly many other providers in the payments value chain, there are many potential opportunities to provide services at different layers of the payment system. However, if the NPA is not simple, flexible and cost effective, then it risks failing to effectively compete with card payment systems, and losing many of the potential benefits that would otherwise emerge from an increase in digital alternative payment methods for consumers.

7.2 In our view, therefore, the PSR should focus on ensuring that the correct governance arrangements exist between Pay.UK and the provider(s) of the NPA CIS, with a particular focus on establishing clearly defined roles and responsibilities between Pay.UK and the NPA CIS provider(s), designing strategic objectives that are quantifiable, and implementing proportionate monitoring and review mechanisms. This is so that, if any material competition issues arise in the future, the PSR is able to take action at the appropriate time using its regulatory powers where necessary.

7.3 Finally, FIS urges the PSR to provide further guidance to the industry so that the delivery of the NPA can move onto the next stage. In particular, FIS considers that areas where the PSR could assist industry include: (i) a long term vision of the NPA and the outcomes it should achieve, (ii) direction over the role of Pay.UK and the objectives for the design and delivering the NPA, (iii) and the importance of competitiveness of the NPA with other payment systems (including Visa and Mastercard).

HSBC Bank Plc

HSBC BANK PLC

COMPETITION AND INNOVATION IN THE UK'S NEW PAYMENTS ARCHITECTURE

CALL FOR INPUT

RESPONSE TO PSR PAPER OF JANUARY 2020

24 March 2020

COVER SUBMISSION

HSBC Bank plc (HSBC) welcomes the PSR's Call for Input on Competition and Innovation in the UK's New Payments Architecture (NPA). Enabling competition between existing and new payment services, and facilitating innovation in the interests of end users, is fundamental to the ambition of the NPA. It is critical that potential competition issues are identified and mitigated and we therefore support the PSR's focus. We also agree with the PSR that it would useful to set expectations as to these mitigants before the precise design and procurement process for Central Infrastructure Service (CIS) becomes too far advanced.

We echo the PSR's view that it is a critical requirement that the NPA is secure and resilient. Given the importance of the NPA as critical UK infrastructure, in our view resilience and integrity is the most important lens in the selection of the future CIS provider. The existing infrastructure has proven to be highly resilient over the last decade and the future NPA must perform to the same level of stability and integrity.

HSBC recognises the potential competition issues described in the call for input, although, in broad terms, we believe they would be unlikely to arise in the short to medium term. A key question is the extent to which being the supplier of the CIS provides competitive insights and advantages. The precise constitution of the NPA remains unclear both from a governance and technical perspective. Against this nascent position, it is difficult to provide definitive responses to the proposed remedies. Although we understand the precise scope of the CIS is not yet defined, a CIS that is a 'thin' clearing and settlement layer may have more limited opportunities to exploit competitive advantage than is the case for current infrastructure.

Further, we believe that stringent mitigations could risk deterring potential suppliers and impact on the overall competitiveness and vibrancy of the market, particularly restrictions regarding the ability of the CIS provider to tender for overlay services. There is therefore a clear need to keep mitigations proportionate and to ensure that unintended consequences are avoided.

Accordingly, the NPA procurement structure, and any regulatory intervention, should therefore seek to achieve outcomes that:

- Prioritise the resilience and integrity of the future service.
- Achieve access pricing that is fair and at a level that would occur in a competitive market.
- Support an objective procurement process that does not prejudge or presume the existing suppliers to be an acceptable or unacceptable outcome.

- Support a selection of a provider that is financially stable, secure, able to innovate, recognising that supporting commercial incentives in the market is part of achieving this.
- Ensure the technical and governance design principles and controls set out in the Payment Strategy Forum Blueprint are incorporated into any final design.
- Take into account the long-term, past the initial term of the contracts procured.

More broadly, we note that the Bank of England procurement for its Real-Time Gross Settlement (RTGS2) system is underway largely in parallel with the NPA activity. Given that there may be a limited set of potential credible suppliers for such critical payment infrastructure, we reflect on what would happen should the Bank of England and Pay.UK conclude through their separate procurement processes that the same supplier is best placed to deliver both RTGS2 and the NPA. This potentially creates delivery and service concentration risks for users of the two services; however, it also may create other concentration issues in the market from a competition perspective, and may compound some of the potential issues identified by the PSR in the call for input.

For transparency, no HSBC Group company has any commercial interest in any current providers of the NPA CIS. Our views are provided as a major provider of payment services and one of the largest agency banking service providers in the UK.

Questions related to Competition and Innovation

1. **We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?**

1.1 HSBC broadly recognises the hypotheses described about how ownership of the NPA CIS provider might adversely affect competition and innovation.

1.2 In addition to the hypotheses described, we suggest there is a significant risk that the successful NPA CIS establishes an incumbency advantage, limiting competition in the future for infrastructure provision. This could occur by:

- Gaining a clear advantage in a future re-procurement for the NPA CIS through knowledge and track record of providing the NPA CIS, and investments already incurred—this may make it more difficult for other potential providers to offer a competitive package (and so allow an incumbent that anticipates this to charge higher prices for the new term).
- Discriminatory behaviour during a tender or handover period to a new successful provider, such as refusing to respond or being slow to respond to questions about the service, or making it harder for a new provider to prepare a tender or deliver the NPA CIS.
- Intellectual property, other contracts, assets and know-how regarding the central service design and provision which cannot or will not be shared with a new CIS provider. Equally, the CIS should not be incentivised to run-down property/infrastructure that needs to be shared with the new CIS provider.

1.3 A worst-case scenario is that these concerns also deter otherwise viable third parties from even committing the resources to participating in future procurements, putting the incumbent in a position to charge a price significantly above competitive levels.

2. **How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?**

2.1 Broadly speaking, we recognise that each hypothesis described in the call for evidence could in theory materialise. We are, however, somewhat sceptical that the hypotheses would in practice materialise, at least in the initial years of the contract, given that the successful provider will want to establish its credibility and integrity in the market. The provider is also likely to anticipate the regulatory focus and we would expect it to want to avoid exploitation (or the perception of exploitation) of any inherent commercial advantage, as the provider is likely to want to retain the contract for the service, and promote usage of the service, in the long term.

2.2 Beyond this observation of incentives, which of the particular risks listed are more likely to arise largely depends on the particular structure of the CIS procurement that Pay.UK plans to pursue. Our lack of direct sight on the planned structure of the procurement means that it is not possible to provide commentary on likely risks that is specific to the structure planned.

2.3 However, the competition issues that appear most likely to materialise, in our view, are those linked to where the provider seeks to leverage its investment and knowledge into the provision of future overlay services. However, there is a distinction to be drawn between allowing the successful provider to leverage its investment, and preventing unfair exploitation of its position as the monopoly CIS provider. We make the following observations on this distinction:

a. It is critical to balance the attractiveness of the market for CIS provision with the potential disadvantages of prohibitions, to ensure a competitive market of providers. If the provider of CIS services is subject to overly strict restrictions on its ability to provide overlay services (or competing services), this may significantly restrict the (already limited) number of credible providers willing to participate, raising doubts about whether the procurement delivers a competitive price and whether the best overall providers are participating. In particular, if the scope of the CIS services function is defined in a restrictive way, with much of the 'value' instead in overlay services, and the provider of CIS services is prevented from offering these overlay services, potential providers may take the view that they would rather provide the overlay services than mount a highly competitive bid for the CIS services. In short, care is needed to ensure that providers are not dis-incentivised from entering the market for CIS provision and we do not believe that providers who bid for one element should be excluded from providing other services. We consider the potential risks associated with permitting the CIS provider also to provide overlay services can be effectively and proportionately mitigated through regulatory or contractual universal provider/ access requirements as suggested below.

b. Similarly, if the CIS provider is permitted to provide overlay services, but with a strict ring-fence between the CIS and overlay services functions to prevent competitive harm, this may have consequences for innovation and development of know-how/market leading overlay or associated services – with the CIS provider unable to commercialise through overlay or other associated services insights gained from the CIS process, and unable to bring insights from the overlay services to reduce costs or enhance functionality for CIS. A recent example of leveraging insights gained from one service into another is the VocaLink Money Mule Insights developments and proofs of concept, across both retail and wholesale payments. These concerns may be more or less likely depending on the scope of the CIS proposition—for example, if the CIS proposition is extremely narrow, there may be less scope for innovation and cost reduction in CIS in any event, meaning that a strong ring-fence is less likely to present an issue.

2.4 Different approaches may be required for new overlay services in the new Payments Architecture, versus existing managed services that are currently supplied by the central infrastructure provider (e.g. Current Account Switch Service, Cash ISA Transfer Service, Bulk Payment Redirection Service, and PayM). There appear to be clear efficiencies to be gained from core cross-industry services being provided by the central infrastructure provider, and it would not be cost effective to supply these as an overlay service through a separate provider. One good example concerns the future for the Current Account Switching Service (CASS) and the Bulk Payment Redirection Service (BPRS). The co-hosting of the CASS architecture with the current CIS provider of a number of the potential payment types that need to be safeguarded through the account transfer is both efficient and beneficial. An approach where one or more overlay providers are involved in the switching of payments under the CASS or BPRS schemes, is likely to introduce complexity and risk. It also adds potential time delays and costs for firms that are working to deliver payment redirection excellence and to encourage greater competition in the current account market.

2.5 On pricing, we would expect there to be an enforceable standard (either in the service contract (in a form directly enforceable by third parties), or in a regulatory overlay) to guard against discriminatory pricing and to ensure access pricing in particular is fair and proportionate. In particular:

a. If there are material changes proposed to that pricing standard, this should be subject to approval against an objective standard, and regulations should provide for an impact assessment and industry consultation, to ensure transparency.

b. If the design of the procurement anticipates a long-term contract award, then there is much greater potential for cost savings and innovation to be achieved over the term of the contract, in a form that may not be clear at the time of procurement. This makes it unlikely that the price formulation offered in the procurement process will adequately track the savings that can be achieved over the term of the contract or incentivise innovation that benefits users; if so, having the ability (in contract or in a regulatory overlay) for periodic review of prices against an objective metric (for example, based on efficient costs) would be a useful protection. The PSR may find it useful to discuss with the

Government Commercial Function and other sectoral regulators engaged in price regulation (Ofcom, Ofgem, Ofwat, ORR, CAA) potential contractual structures to manage this risk.

2.6 Similarly, we would also expect there to be similar standards (set out either in the service contract or in regulation) to guard against non-price access requirements such as service quality standards and/or performance targets. HSBC advocates that similar consultation processes should apply in the event of any material change to such standards and that effective dispute resolutions processes are established to manage access disputes, including conditions for allocation of liability.

2.7 With reference to the particular risks the PSR has identified:

- **V1**: Without mitigation steps, it seems inevitable that the NPA CIS provider will have access about the capabilities and / or development of the NPA earlier than other overlay services. In the development of the NPA, the chosen NPA CIS supplier will have access to information and, in constructing the clearing and settlement layer, will have industry-leading knowledge of the system.

- **V2**: In our view, the risk of this hypothesis materialising will depend on the design and model chosen for the NPA CIS. Given its incentive to maximise its wider reputation in the payments industry, it can be expected that the NPA CIS provider would have some incentive to offer access to in-house developments, although it is unlikely to charge at the level of marginal costs unless compelled to do so.

- **V3**: This hypothesis could materialise, with the selected NPA CIS provider seeking to obstruct the introduction of services from other overlay providers, or seeking to favour their own in-house developments. We believe that this risk is easily remediated, as set out in paragraph 4.2.

- **V4**: This hypothesis of inappropriate access to competitors' plans is also a genuine risk. Again, we believe that this risk can likewise be easily prevented as explained in paragraph 4.3.

- **H1**: without mitigation steps, there is a risk that the H1 hypothesis could arise. We expect that the NPA CIS provider's incentive would be to maximise the market share and influence of the NPA platform in the payments market overall, which ought to involve encouraging innovation internally and from third parties, rather than limiting the NPA interbank system.

- **H2** and **H3**: We do not believe that these risks are very high. It is unlikely to be in the interests of the NPA CIS provider not to continue to innovate or to downgrade the level of service.

- **M1–M4**: It is important to note that, by its very nature, the provider of the NPA CIS will have a monopoly for the provision of the thin clearing and settlement layer under the anticipated design of the NPA CIS, as defined in the Payment Strategy Forum's Blueprint for the Future of UK Payments.
  - **M1**: we consider this a real risk but that this can be prevented through careful use of appropriate contractual terms by Pay.UK, that control both the initial investment to develop the NPA CIS and the ongoing run costs. As noted at paragraph 4.5, greater care will be needed with this risk if the contract term is likely to be significant and the contract will need to respond to unanticipated upside and downside developments.
  - **M2, M3** and **M4**: while these are theoretical risks, we believe that, with an appropriate Pay.UK contractual framework, such risks can be easily mitigated.

3. **For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?**

3.1 All the vertical, horizontal and monopoly hypotheses set out in the call for input document have the potential to reduce competition.

3.2 Across the three sets of hypotheses, we view the four monopoly risks (**M1**–**M4**) as the issues with greatest potential impact.

3.3 The four monopoly issues have the potential to have an adverse impact on innovation, competition and fair pricing. All four of these risks could adversely impact end users, if they remain unchecked. HSBC believes that these risks can be managed by Pay.UK, with appropriate regulatory supervision, please see paragraph 4.1.

3.4 HSBC is concerned that, should the risks not be managed, we could find ourselves having to manage higher payment transaction costs, reduced operational stability and resilience and / or we miss out on the opportunity for future innovation not just at the moment that the NPA is created but during the lifetime of the NPA. These potential adverse impacts for HSBC all carry the potential for customer detriment.

3.5 However, while HSBC would prefer that these risks be mitigated, it is important to balance this against the potential significant costs of doing so. In particular:

   a. The CIS provider will through necessity have access to design information, data and the potential advantages that this brings, and so be in a better position to innovate or offer additional services. It is not obvious that third parties will have a strong incentive to offer new or competing overlay services, and it would be unfortunate if significant effort is spent to design a regulatory framework that places the CIS provider and third parties in an equal position, only to find that this has removed the ability or the incentive for the CIS provider to innovate, and that few innovative competing services emerge from other providers.

b. Given these potential benefits from regulatory interventions to promote competition are contingent and likely to be relatively limited in nature, HSBC's strong view is that these potential benefits are extremely unlikely to outweigh any increased risk to the stability and operational resilience of the new CIS and any overlay services—as stability and resilience of core payments services carries an extremely high cost, both to direct and indirect users of the system. As a result, the PSR should not accept or encourage interventions to promote competition that lead to any detriment to stability or operational resilience.

Questions related to potential mitigations

4. **Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally?**

4.1 Given the designation of the current BACS and Faster Payments payment systems, HSBC expects that the NPA will be likewise designated by HM Treasury for PSR regulation in parallel with the Financial Markets Infrastructure Directorate (FMID) of the Bank of England supervision. HSBC views this dual supervision as key to safeguard financial stability and to protect against anti-competitive behaviour. It also seems like that the future CIS provider would also be directly supervised by the Bank of England's FMID team.

4.2 The risks identified in **H1** and **V1** relating to the early availability of information are difficult to mitigate. The future CIS provider has to have access to participant data to be able to design and construct the CIS. To help mitigate against the risks, Pay.UK can anonymise as far as possible information provided to the potential CIS provider, including payment volumes, payment values, participants' technical information and payment response and processing times. Furthermore, such information could then be made available to potential providers of overlay services in the interests of mitigating any first mover advantages held by the CIS provider and in the interests of promoting innovation and competition for such services. Such safeguards also serve to protect against the risk identified in **V3** along with our recommendation that non-price standards should be set out in the service contract or regulation.

4.3 The risk identified in **V4** where inappropriate access to competitors' plans can be mitigated through the requirement that only ring-fenced teams will have access to specific competitor information, noting that the ring fencing requirement should not be extended to general CIS data.

4.4 Whilst we understand the concept set out in paragraph 3.9 of the Call for Input, proposing that the NPA CIS provider should not be allowed to bid for or develop overlay services to eliminate competition concerns, HSBC believes that such a remedy would have the potential to restrict innovation. There is a need to develop and maintain a balance between the two competition and innovation imperatives.

4.5 One potential additional mitigant is to introduce a dispute resolution mechanism, so that the NPA CIS contract includes dispute management requirements. We would encourage Pay.UK to develop a dispute resolution mechanism for any overlay or other provider that believes access to the CIS or development of overlay services has been hindered through the restrictive behaviour of the CIS provider. To strengthen the process further, Pay.UK could build in potential recourse to an independent third party, based on an objective standard for resolving such disputes, if the access / development concerns cannot be resolved. For example, the Adjudicator for Broadcast Transmission Services (which applies to Arqiva, as monopoly supplier of the UK's broadcast transmission services) may be a model to explore (www.ota-bts.org.uk). Similarly, Ofcom operates a similar dispute resolution under its Communications (Access to Infrastructure) Regulations 2016.

4.6 As set out in the cover submission, we are concerned at the long term effects of the CIS procurement that may continue after the initial contractual term. As a mitigant, the initial procurement should plan for the end of the initial term and introduce safeguards, including a future pricing framework and the requirement for the CIS provider to support the migration of the service to a new CIS provider at reasonable cost and with full cooperation.

4.7 Additionally, we suggest that the terms of the contractual agreement with the CIS provider should include a provision regarding any change in the provider's incentives, such as a change in ownership or the acquisition of a competitor. This should seek to ensure that any arising conflict of interest is identified and managed, so that incentives remain aligned, with no adverse impact on competition or innovation.

5. **Are any of the types of mitigations we have described likely to be particularly effective of ineffective at alleviating the potential harms, and why?**

5.1 The NPA technical design and strong governance are likely to be the most effective mitigations. Pay.UK can learn from the current CIS arrangements and the design principles set out the in the Payment Strategy Forum Blueprint to inform their future CIS governance model.

5.2 From a governance perspective, we agree that governance arrangements should be set out in the contractual provisions between Pay.UK and the CIS provider as defined in paragraph 3.7. We further suggest that the competitive protections included in the contract with Pay.UK are enforceable by third parties, or by the PSR, rather than just by Pay.UK, who may not have the same incentive to take action to enforce.

6. **Are any of the types of mitigations we describe particularly costly or high risk? If so, please explain why.**

6.1 As explained previously, there is a risk that the proposed mitigations, especially the restrictions on future activities of the party that is awarded the contract, have the potential to affect significantly the commercial attractiveness of the CIS procurement.

6.2 The removal of potential overlay services from the CIS provider carries the significant risk of potentially hampering innovation. As set out in paragraph 3.5 (above), we do not yet know what level of innovation and competition there could be to provide such overlay services. Should the CIS provider be excluded from the development and provision of future services and other providers not choose to develop innovative overlay services, then the UK payments ecosystem and the customers that we serve, will miss out on future enhancements to increase functionality or support the fight against economic crime, along with potential cost or process efficiencies.

6.3 Similarly, an artificial barrier between CIS services and overlay services that sees responsibility for the provision of certain key payment services split between two commercial providers presents significant implementation risks. Poor coordination between the two providers or an inadequate contractual interface may lead to reduced system stability or resilience, which is likely to significantly outweigh any potential for increased competition.

6.4 Considering these risks, we encourage the PSR to provide greater guidance at the outset as to what kind of regulatory regime it will look to put in place, rather than to have this operating as a significant area of regulatory uncertainty during the procurement that has the potential to affect the number of potential bidders and the future level of prices.

7. **Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.**

7.1 The current supervisory framework by the Bank of England's FMID and the PSR is effective today. Both supervisors have complimentary objectives across the financial stability, competition, innovation and end user requirements.

7.2 The pre-NPA CIS ownership remedy from the PSR's Market Review into the ownership and competitiveness of infrastructure provision can also be taken forward into the future procurement exercise. Whilst it is unlikely that any Direct Participants will own any of the firms bidding to be the future NPA CIS provider, to avoid any conflicts of interest, the ownership of the potential supplier should be carefully considered. We would expect that in addition, FMID will carefully consider the potential CID provider's financial and ownership situation.

7.3 The current separation between Pay.UK and the existing provider of the CIS services is an existing mitigation that should be preserved. HSBC notes that different considerations applied in the Bank of England's decision[1] to move to a direct delivery model, where they assumed ownership of CHAPS Co as well as continuing to operate the Real Time Gross Settlement system. Pay.UK as the future NPA Payment System Operator (PSO) does need to be able to assess and manage the full range of risks arising at all points in the system, but through regulatory supervision and their current management of the existing CIS provider, we believe that the existing division between the PSO and the provider of the technical architecture should be continued.

[1] Bank of England - A blueprint for a new RTGS service for the United Kingdom (May 2017)

HSBC UK Bank Plc

HSBC UK BANK PLC

COMPETITION AND INNOVATION IN THE UK'S NEW PAYMENTS ARCHITECTURE

CALL FOR INPUT

RESPONSE TO PSR PAPER OF JANUARY 2020

24 March 2020

COVER SUBMISSION

HSBC UK Bank plc (HSBC UK) welcomes the PSR's Call for Input on Competition and Innovation in the UK's New Payments Architecture (NPA). Enabling competition between existing and new payment services, and facilitating innovation in the interests of end users, is fundamental to the ambition of the NPA. It is critical that potential competition issues are identified and mitigated and we therefore support the PSR's focus. We also agree with the PSR that it would useful to set expectations as to these mitigants before the precise design and procurement process for Central Infrastructure Service (CIS) becomes too far advanced.

We echo the PSR's view that it is a critical requirement that the NPA is secure and resilient. Given the importance of the NPA as critical UK infrastructure, in our view resilience and integrity is the most important lens in the selection of the future CIS provider. The existing infrastructure has proven to be highly resilient over the last decade and the future NPA must perform to the same level of stability and integrity.

HSBC UK recognises the potential competition issues described in the call for input, although, in broad terms, we believe they would be unlikely to arise in the short to medium term. A key question is the extent to which being the supplier of the CIS provides competitive insights and advantages. The precise constitution of the NPA remains unclear both from a governance and technical perspective. Against this nascent position, it is difficult to provide definitive responses to the proposed remedies. Although we understand the precise scope of the CIS is not yet defined, a CIS that is a 'thin' clearing and settlement layer may have more limited opportunities to exploit competitive advantage than is the case for current infrastructure.

Further, we believe that stringent mitigations could risk deterring potential suppliers and impact on the overall competitiveness and vibrancy of the market, particularly restrictions regarding the ability of the CIS provider to tender for overlay services. There is therefore a clear need to keep mitigations proportionate and to ensure that unintended consequences are avoided.

Accordingly, the NPA procurement structure, and any regulatory intervention, should therefore seek to achieve outcomes that:

- Prioritise the resilience and integrity of the future service.
- Achieve access pricing that is fair and at a level that would occur in a competitive market.
- Support an objective procurement process that does not prejudge or presume the existing suppliers to be an acceptable or unacceptable outcome.

- Support a selection of a provider that is financially stable, secure, able to innovate, recognising that supporting commercial incentives in the market is part of achieving this.
- Ensure the technical and governance design principles and controls set out in the Payment Strategy Forum Blueprint are incorporated into any final design.
- Take into account the long-term, past the initial term of the contracts procured.

More broadly, we note that the Bank of England procurement for its Real-Time Gross Settlement (RTGS2) system is underway largely in parallel with the NPA activity. Given that there may be a limited set of potential credible suppliers for such critical payment infrastructure, we reflect on what would happen should the Bank of England and Pay.UK conclude through their separate procurement processes that the same supplier is best placed to deliver both RTGS2 and the NPA. This potentially creates delivery and service concentration risks for users of the two services; however, it also may create other concentration issues in the market from a competition perspective, and may compound some of the potential issues identified by the PSR in the call for input.

For transparency, no HSBC Group company has any commercial interest in any current providers of the NPA CIS. Our views are provided as a major provider of payment services.

Questions related to Competition and Innovation

1. **We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?**

1.1 HSBC UK broadly recognises the hypotheses described about how ownership of the NPA CIS provider might adversely affect competition and innovation.

1.2 In addition to the hypotheses described, we suggest there is a significant risk that the successful NPA CIS establishes an incumbency advantage, limiting competition in the future for infrastructure provision. This could occur by:

- Gaining a clear advantage in a future re-procurement for the NPA CIS through knowledge and track record of providing the NPA CIS, and investments already incurred—this may make it more difficult for other potential providers to offer a competitive package (and so allow an incumbent that anticipates this to charge higher prices for the new term).
- Discriminatory behaviour during a tender or handover period to a new successful provider, such as refusing to respond or being slow to respond to questions about the service, or making it harder for a new provider to prepare a tender or deliver the NPA CIS.
- Intellectual property, other contracts, assets and know-how regarding the central service design and provision which cannot or will not be shared with a new CIS provider. Equally, the CIS should not be incentivised to run-down property/infrastructure that needs to be shared with the new CIS provider.

1.3 A worst-case scenario is that these concerns also deter otherwise viable third parties from even committing the resources to participating in future procurements, putting the incumbent in a position to charge a price significantly above competitive levels.

2. **How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?**

2.1 Broadly speaking, we recognise that each hypothesis described in the call for evidence could in theory materialise. We are, however, somewhat sceptical that the hypotheses would in practice materialise, at least in the initial years of the contract, given that the successful provider will want to establish its credibility and integrity in the market. The provider is also likely to anticipate the regulatory focus and we would expect it to want to avoid exploitation (or the perception of exploitation) of any inherent commercial advantage, as the provider is likely to want to retain the contract for the service, and promote usage of the service, in the long term.

2.2 Beyond this observation of incentives, which of the particular risks listed are more likely to arise largely depends on the particular structure of the CIS procurement that Pay.UK plans to pursue. Our lack of direct sight on the planned structure of the procurement means that it is not possible to provide commentary on likely risks that is specific to the structure planned.

2.3 However, the competition issues that appear most likely to materialise, in our view, are those linked to where the provider seeks to leverage its investment and knowledge into the provision of future overlay services. However, there is a distinction to be drawn between allowing the successful provider to leverage its investment, and preventing unfair exploitation of its position as the monopoly CIS provider. We make the following observations on this distinction:

a. It is critical to balance the attractiveness of the market for CIS provision with the potential disadvantages of prohibitions, to ensure a competitive market of providers. If the provider of CIS services is subject to overly strict restrictions on its ability to provide overlay services (or competing services), this may significantly restrict the (already limited) number of credible providers willing to participate, raising doubts about whether the procurement delivers a competitive price and whether the best overall providers are participating. In particular, if the scope of the CIS services function is defined in a restrictive way, with much of the 'value' instead in overlay services, and the provider of CIS services is prevented from offering these overlay services, potential providers may take the view that they would rather provide the overlay services than mount a highly competitive bid for the CIS services. In short, care is needed to ensure that providers are not dis-incentivised from entering the market for CIS provision and we do not believe that providers who bid for one element should be excluded from providing other services. We consider the potential risks associated with permitting the CIS provider also to provide overlay services can be effectively and proportionately mitigated through regulatory or contractual universal provider/ access requirements as suggested below.

b. Similarly, if the CIS provider is permitted to provide overlay services, but with a strict ring-fence between the CIS and overlay services functions to prevent competitive harm, this may have consequences for innovation and development of know-how/market leading overlay or associated services – with the CIS provider unable to commercialise through overlay or other associated services insights gained from the CIS process, and unable to bring insights from the overlay services to reduce costs or enhance functionality for CIS. A recent example of leveraging insights gained from one service into another is the VocaLink Money Mule Insights developments and proofs of concept, across both retail and wholesale payments. These concerns may be more or less likely depending on the scope of the CIS proposition—for example, if the CIS proposition is extremely narrow, there may be less scope for innovation and cost reduction in CIS in any event, meaning that a strong ring-fence is less likely to present an issue.

2.4 Different approaches may be required for new overlay services in the new Payments Architecture, versus existing managed services that are currently supplied by the central infrastructure provider (e.g. Current Account Switch Service, Cash ISA Transfer Service, Bulk Payment Redirection Service, and PayM). There appear to be clear efficiencies to be gained from core cross-industry services being provided by the central infrastructure provider, and it would not be cost effective to supply these as an overlay service through a separate provider. One good example concerns the future for the Current Account Switching Service (CASS) and the Bulk Payment Redirection Service (BPRS). The co-hosting of the CASS architecture with the current CIS provider of a number of the potential payment types that need to be safeguarded through the account transfer is both efficient and beneficial. An approach where one or more overlay providers are involved in the switching of payments under the CASS or BPRS schemes, is likely to introduce complexity and risk. It also adds potential time delays and costs for firms that are working to deliver payment redirection excellence and to encourage greater competition in the current account market.

2.5 On pricing, we would expect there to be an enforceable standard (either in the service contract (in a form directly enforceable by third parties), or in a regulatory overlay) to guard against discriminatory pricing and to ensure access pricing in particular is fair and proportionate. In particular:

a. If there are material changes proposed to that pricing standard, this should be subject to approval against an objective standard, and regulations should provide for an impact assessment and industry consultation, to ensure transparency.

b. If the design of the procurement anticipates a long-term contract award, then there is much greater potential for cost savings and innovation to be achieved over the term of the contract, in a form that may not be clear at the time of procurement. This makes it unlikely that the price formulation offered in the procurement process will adequately track the savings that can be achieved over the term of the contract or incentivise innovation that benefits users; if so, having the ability (in contract or in a regulatory overlay) for periodic review of prices against an objective metric (for example, based on efficient costs) would be a useful protection. The PSR may find it useful to discuss with the

Government Commercial Function and other sectoral regulators engaged in price regulation (Ofcom, Ofgem, Ofwat, ORR, CAA) potential contractual structures to manage this risk.

2.6 Similarly, we would also expect there to be similar standards (set out either in the service contract or in regulation) to guard against non-price access requirements such as service quality standards and/or performance targets. HSBC UK advocates that similar consultation processes should apply in the event of any material change to such standards and that effective dispute resolutions processes are established to manage access disputes, including conditions for allocation of liability.

2.7 With reference to the particular risks the PSR has identified:

- **V1**: Without mitigation steps, it seems inevitable that the NPA CIS provider will have access about the capabilities and / or development of the NPA earlier than other overlay services. In the development of the NPA, the chosen NPA CIS supplier will have access to information and, in constructing the clearing and settlement layer, will have industry-leading knowledge of the system.

- **V2**: In our view, the risk of this hypothesis materialising will depend on the design and model chosen for the NPA CIS. Given its incentive to maximise its wider reputation in the payments industry, it can be expected that the NPA CIS provider would have some incentive to offer access to in-house developments, although it is unlikely to charge at the level of marginal costs unless compelled to do so.

- **V3**: This hypothesis could materialise, with the selected NPA CIS provider seeking to obstruct the introduction of services from other overlay providers, or seeking to favour their own in-house developments. We believe that this risk is easily remediated, as set out in paragraph 4.2.

- **V4**: This hypothesis of inappropriate access to competitors' plans is also a genuine risk. Again, we believe that this risk can likewise be easily prevented as explained in paragraph 4.3.

- **H1**: without mitigation steps, there is a risk that the H1 hypothesis could arise. We expect that the NPA CIS provider's incentive would be to maximise the market share and influence of the NPA platform in the payments market overall, which ought to involve encouraging innovation internally and from third parties, rather than limiting the NPA interbank system.

- **H2** and **H3**: We do not believe that these risks are very high. It is unlikely to be in the interests of the NPA CIS provider not to continue to innovate or to downgrade the level of service.

- **M1–M4**: It is important to note that, by its very nature, the provider of the NPA CIS will have a monopoly for the provision of the thin clearing and settlement layer under the anticipated design of the NPA CIS, as defined in the Payment Strategy Forum's Blueprint for the Future of UK Payments.
    - **M1**: we consider this a real risk but that this can be prevented through careful use of appropriate contractual terms by Pay.UK, that control both the initial investment to develop the NPA CIS and the ongoing run costs. As noted at paragraph 4.5, greater care will be needed with this risk if the contract term is likely to be significant and the contract will need to respond to unanticipated upside and downside developments.
    - **M2, M3** and **M4**: while these are theoretical risks, we believe that, with an appropriate Pay.UK contractual framework, such risks can be easily mitigated.

3. **For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?**

3.1 All the vertical, horizontal and monopoly hypotheses set out in the call for input document have the potential to reduce competition.

3.2 Across the three sets of hypotheses, we view the four monopoly risks (**M1**–**M4**) as the issues with greatest potential impact.

3.3 The four monopoly issues have the potential to have an adverse impact on innovation, competition and fair pricing. All four of these risks could adversely impact end users, if they remain unchecked. HSBC UK believes that these risks can be managed by Pay.UK, with appropriate regulatory supervision, please see paragraph 4.1.

3.4 HSBC UK is concerned that, should the risks not be managed, we could find ourselves having to manage higher payment transaction costs, reduced operational stability and resilience and / or we miss out on the opportunity for future innovation not just at the moment that the NPA is created but during the lifetime of the NPA. These potential adverse impacts for HSBC UK all carry the potential for customer detriment.

3.5 However, while HSBC UK would prefer that these risks be mitigated, it is important to balance this against the potential significant costs of doing so. In particular:

   a. The CIS provider will through necessity have access to design information, data and the potential advantages that this brings, and so be in a better position to innovate or offer additional services. It is not obvious that third parties will have a strong incentive to offer new or competing overlay services, and it would be unfortunate if significant effort is spent to design a regulatory framework that places the CIS provider and third parties in an equal position, only to find that this has removed the ability or the incentive for the CIS provider to innovate, and that few innovative competing services emerge from other providers.

b. Given these potential benefits from regulatory interventions to promote competition are contingent and likely to be relatively limited in nature, HSBC UK's strong view is that these potential benefits are extremely unlikely to outweigh any increased risk to the stability and operational resilience of the new CIS and any overlay services—as stability and resilience of core payments services carries an extremely high cost, both to direct and indirect users of the system. As a result, the PSR should not accept or encourage interventions to promote competition that lead to any detriment to stability or operational resilience.

Questions related to potential mitigations

4. **Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally?**

4.1 Given the designation of the current BACS and Faster Payments payment systems, HSBC UK expects that the NPA will be likewise designated by HM Treasury for PSR regulation in parallel with the Financial Markets Infrastructure Directorate (FMID) of the Bank of England supervision. HSBC UK views this dual supervision as key to safeguard financial stability and to protect against anti-competitive behaviour. It also seems like that the future CIS provider would also be directly supervised by the Bank of England's FMID team.

4.2 The risks identified in **H1** and **V1** relating to the early availability of information are difficult to mitigate. The future CIS provider has to have access to participant data to be able to design and construct the CIS. To help mitigate against the risks, Pay.UK can anonymise as far as possible information provided to the potential CIS provider, including payment volumes, payment values, participants' technical information and payment response and processing times. Furthermore, such information could then be made available to potential providers of overlay services in the interests of mitigating any first mover advantages held by the CIS provider and in the interests of promoting innovation and competition for such services. Such safeguards also serve to protect against the risk identified in **V3** along with our recommendation that non-price standards should be set out in the service contract or regulation.

4.3 The risk identified in **V4** where inappropriate access to competitors' plans can be mitigated through the requirement that only ring-fenced teams will have access to specific competitor information, noting that the ring fencing requirement should not be extended to general CIS data.

4.4 Whilst we understand the concept set out in paragraph 3.9 of the Call for Input, proposing that the NPA CIS provider should not be allowed to bid for or develop overlay services to eliminate competition concerns, HSBC UK believes that such a remedy would have the potential to restrict innovation. There is a need to develop and maintain a balance between the two competition and innovation imperatives.

4.5 One potential additional mitigant is to introduce a dispute resolution mechanism, so that the NPA CIS contract includes dispute management requirements. We would encourage Pay.UK to develop a dispute resolution mechanism for any overlay or other provider that believes access to the CIS or development of overlay services has been hindered through the restrictive behaviour of the CIS provider. To strengthen the process further, Pay.UK could build in potential recourse to an independent third party, based on an objective standard for resolving such disputes, if the access / development concerns cannot be resolved. For example, the Adjudicator for Broadcast Transmission Services (which applies to Arqiva, as monopoly supplier of the UK's broadcast transmission services) may be a model to explore (www.ota-bts.org.uk). Similarly, Ofcom operates a similar dispute resolution under its Communications (Access to Infrastructure) Regulations 2016.

4.6 As set out in the cover submission, we are concerned at the long term effects of the CIS procurement that may continue after the initial contractual term. As a mitigant, the initial procurement should plan for the end of the initial term and introduce safeguards, including a future pricing framework and the requirement for the CIS provider to support the migration of the service to a new CIS provider at reasonable cost and with full cooperation.

4.7 Additionally, we suggest that the terms of the contractual agreement with the CIS provider should include a provision regarding any change in the provider's incentives, such as a change in ownership or the acquisition of a competitor. This should seek to ensure that any arising conflict of interest is identified and managed, so that incentives remain aligned, with no adverse impact on competition or innovation.

5. **Are any of the types of mitigations we have described likely to be particularly effective of ineffective at alleviating the potential harms, and why?**

5.1 The NPA technical design and strong governance are likely to be the most effective mitigations. Pay.UK can learn from the current CIS arrangements and the design principles set out the in the Payment Strategy Forum Blueprint to inform their future CIS governance model.

5.2 From a governance perspective, we agree that governance arrangements should be set out in the contractual provisions between Pay.UK and the CIS provider as defined in paragraph 3.7. We further suggest that the competitive protections included in the contract with Pay.UK are enforceable by third parties, or by the PSR, rather than just by Pay.UK, who may not have the same incentive to take action to enforce.

6. **Are any of the types of mitigations we describe particularly costly or high risk? If so, please explain why.**

6.1 As explained previously, there is a risk that the proposed mitigations, especially the restrictions on future activities of the party that is awarded the contract, have the potential to affect significantly the commercial attractiveness of the CIS procurement.

6.2 The removal of potential overlay services from the CIS provider carries the significant risk of potentially hampering innovation. As set out in paragraph 3.5 (above), we do not yet know what level of innovation and competition there could be to provide such overlay services. Should the CIS provider be excluded from the development and provision of future services and other providers not choose to develop innovative overlay services, then the UK payments ecosystem and the customers that we serve, will miss out on future enhancements to increase functionality or support the fight against economic crime, along with potential cost or process efficiencies.

6.3 Similarly, an artificial barrier between CIS services and overlay services that sees responsibility for the provision of certain key payment services split between two commercial providers presents significant implementation risks. Poor coordination between the two providers or an inadequate contractual interface may lead to reduced system stability or resilience, which is likely to significantly outweigh any potential for increased competition.

6.4 Considering these risks, we encourage the PSR to provide greater guidance at the outset as to what kind of regulatory regime it will look to put in place, rather than to have this operating as a significant area of regulatory uncertainty during the procurement that has the potential to affect the number of potential bidders and the future level of prices.

7. **Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.**

7.1 The current supervisory framework by the Bank of England's FMID and the PSR is effective today. Both supervisors have complimentary objectives across the financial stability, competition, innovation and end user requirements.

7.2 The pre-NPA CIS ownership remedy from the PSR's Market Review into the ownership and competitiveness of infrastructure provision can also be taken forward into the future procurement exercise. Whilst it is unlikely that any Direct Participants will own any of the firms bidding to be the future NPA CIS provider, to avoid any conflicts of interest, the ownership of the potential supplier should be carefully considered. We would expect that in addition, FMID will carefully consider the potential CID provider's financial and ownership situation.

7.3 The current separation between Pay.UK and the existing provider of the CIS services is an existing mitigation that should be preserved. HSBC UK notes that different considerations applied in the Bank of England's decision[1] to move to a direct delivery model, where they assumed ownership of CHAPS Co as well as continuing to operate the Real Time Gross Settlement system. Pay.UK as the future NPA Payment System Operator (PSO) does need to be able to assess and manage the full range of risks arising at all points in the system, but through regulatory supervision and their current management of the existing CIS provider, we believe that the existing division between the PSO and the provider of the technical architecture should be continued.

[1] Bank of England - A blueprint for a new RTGS service for the United Kingdom (May 2017)

Lloyds Banking Group

LLOYDS BANKING GROUP PLC

Response to PSR Consultation Competition and Innovation in the UK's New Payments Architecture: Call for input

24 March 2020

Introductory Comments

Lloyds Banking Group (LBG) is pleased to respond to the Payment Systems Regulator's (PSR) call for input on Competition and Innovation in the New Payments Architecture.

LBG continues to support the four key outcomes identified by the Payment Strategy Forum in 2016 of simpler access, ongoing stability and resilience, encouraging greater innovation, competition, and enhancing adaptability and security. Delivering these should provide an enhanced domestic payments offering that benefits all – participants, retail and business customers.

In an environment increasingly driven by technological developments, our customers expect payments to be made both quickly and safely. Business customers in particular expect to see richer information accompanying the payments they send and receive, and therefore aligning the UK's domestic payment infrastructure with the global ISO 20022 messaging standards is a key objective. The dawn of Open banking has expanded the number and types of payments providers in the market and offers the potential for services that help customers to better track and manage their money.

It is clear though that the payments rails that facilitate our domestic payments would benefit from an upgrade. Delivering the New Payments Architecture (NPA) continues to present the best prospect for the UK to have a robust and flexible domestic payments infrastructure that meets participant and customer needs in the longer term.

As the PSR sets out, it is envisaged that the NPA will be delivered via one core infrastructure, likely to be owned and operated by one central infrastructure services (CIS) provider, with overlay services being provided on a competitive basis. We have considered the range of possible competition issues that the PSR suggests could arise as a result of such an arrangement, as well as the potential mitigations.

Whilst the monopoly provision of NPA could in theory lead to the adverse scenarios the PSR has identified, we consider this is unlikely subject to the effective deployment of the range of mitigations in plan. Pricing of access for overlay services providers is an area arguably most likely to be hampered by information asymmetries, and we would expect Pay.UK to be alert to this, with the PSR providing appropriate regulatory oversight.

In respect of separation of CIS provision from overlay services or other competing payment systems, we can see merit for competition purposes in a degree of separation – such as an operational distinction. However, the stronger options under consideration would give rise to greater costs and so would need to be considered carefully. We can also envisage scenarios where the CIS provider benefits legitimately from economies of scale or expertise to bid for overlay services at a lower price point than its competitors.

Beyond the potential scenarios described by the PSR, LBG envisages scenarios where trade-offs must be made to secure right balance of enabling competition whilst ensuring the safety of the payments system. Such scenarios could give rise to a lack of clarity as to the reasons why a prospective overlay service has been rejected by the CIS provider. We therefore believe Pay.UK should set and govern minimum standards for overlay service providers in relation to safety and soundness.

A key concern for LBG is the potential for a monopoly provider to operate without giving due regard to costs. In our view, Pay.UK must ensure that contract negotiations are conducted in a way that places appropriate emphasis on price efficiency, otherwise participants and ultimately customers could be disadvantaged. In turn, we believe the PSR has a role in holding Pay.UK to account against this objective.

Finally, we believe the potential NPA competition issues outlined could be overcome by Pay.UK reconsidering an alternative model for NPA execution that was reviewed but not taken forward in 2017. This model is the 'Distributed Clearing and Settlement Model' where each participant would connect to the central infrastructure through a chosen infrastructure provider. In our view, such an approach would align to the PSR's competition focus and could result in reduced costs, better participant and customer outcomes whilst also enhancing the safety of the payments system.

Response to Consultation Questions

1. **WE HAVE SET OUT A NUMBER OF HYPOTHESES ABOUT HOW THE OWNERSHIP OF THE NPA CIS PROVIDER MIGHT ADVERSELY AFFECT COMPETITION AND INNOVATION. HAVE WE MISSED ANY?**

1.1 LBG notes the two main scenarios that the PSR has identified in relation to how the winning bidder of the New Payments Architecture might adversely affect competition and innovation. Those are where the NPA CIS provider directly or indirectly provides overlay services in the NPA, and also where the NPA CIS provider directly or indirectly provides other payment services outside the NPA ecosystem that could be substituted for services that will be provided within the NPA ecosystem.

1.2 The PSR has identified six broad ways the CIS provider's behaviour could adversely affect competition: exploiting first mover advantages; overcharging for access; distorting prospective competitors' access to the central infrastructure; gaining unfair commercial advantage through knowledge of competitors' commercial strategies; abusing access to and use of NPA payments data; and discriminating against services provided in the NPA in favour of a (prospectively) substitutable service outside the NPA ecosystem in which it has a commercial interest.

1.3 Having considered the PSR's analysis, we believe it provides a reasonable overview of the potential competition and innovation challenges that could occur in a scenario where there is one provider of core NPA infrastructure. One dimension the PSR could consider further though is how the trade-off between enabling effective competition and ensuring safety and soundness – the cornerstone of the UK's financial services regulatory framework – could play out in practice.

1.4 Bringing this consideration to life, we believe it is undesirable in the interests of safety to have zero barriers to entry for the provision of overlay services. Providers of overlay services will need to demonstrate, amongst other requirements, that they can keep participant and customer data safe and that they have appropriate systems and controls. Pay.UK should therefore set and enforce appropriate threshold conditions in the course of its role as certifier of overlay service providers, with oversight and high-level endorsement from the relevant regulators as required. Pay.UK should also take representations from the CIS provider, participants and others where there are concerns about an incumbent overlay service provider from a safety or customer perspective.

1.5 Further, we note the PSR's outline of the risks that arise due to the monopolistic nature of NPA CIS provision. In our view, the risks around failure to control the costs of initial investment and ongoing operation, failure to keep costs under control for the introduction of new services, and setting prices for accessing the NPA CIS in a way that distorts competition in related markets are live concerns. It is therefore imperative that these are addressed in the procurement process. We note the PSR's comment that it does not plan to concentrate on these issues given that a competitive procurement exercise is underway. However, we strongly believe there is a role for the PSR in holding Pay.UK to account in terms of designing and exercising its procurement process in a way that drives cost efficiencies for participants and ultimately for customers.

2. HOW LIKELY OR UNLIKELY DO YOU THINK IT IS THAT EACH HYPOTHESIS WOULD MATERIALISE IN PRACTICE, AND WHY? WHAT FACTORS COULD AFFECT WHETHER THESE HARMS MATERIALISE?

2.1 LBG's view is that overall the range of horizontal and vertical competition concerns as outlined by the PSR are unlikely to materialise, subject to the effective deployment of the range of mitigations in plan as set out by the Payment Strategy Forum's 2017 blueprint for the NPA. These include the public nature of the specifications that are due to be published, the expected guidance on the provision of overlay services as well as the role of Pay.UK in setting standards and operating an effective governance framework.

2.2 The identified concern that arguably warrants the most consideration is related to the pricing of access for overlay service providers. Fair pricing is an area that can be hampered by information asymmetries, and we would expect Pay.UK to be alert to this, with the PSR providing appropriate regulatory oversight. In our view, the other concerns are perhaps more straightforward to address via strong governance and oversight by Pay.UK.

2.3 There could be situations where a prospective provider of overlay services encounters hurdles to entry, which might be attributed to the CIS provider's monopoly position but from the CIS provider's perspective are rooted in safety considerations. We have seen similar factors at play in the market for banking services for Payment Institutions.

3. FOR THE HYPOTHESES WHICH YOU THINK ARE LIKELY TO MATERIALISE IN PRACTICE, HOW SIGNIFICANT OR HARMFUL WOULD THEY BE TO EFFECTIVE COMPETITION AND INNOVATION IN THE PAYMENTS INDUSTRY, AND WHY? ARE THERE ANY IN PARTICULAR THAT YOU THINK WOULD CAUSE PARTICULARLY SIGNIFICANT HARM? HOW MIGHT YOU OR YOUR BUSINESS BE AFFECTED?

3.1 LBG considers that a situation where access for overlay service providers is priced over and above the CIS provider's costs could negatively affect competition and innovation. By having to factor access costs into overall costs, a prospective provider's bid could be less attractive to participants given that cost will usually be a key consideration.

3.2 In respect of entry considerations, there are likely to be ongoing trade-offs between enabling competition and innovation and ensuring the safety of the payments system. Whilst effective competition can result in market-driven innovation that benefits customers, providers that offer innovative services must not in doing so compromise the cyber and data security of the payments infrastructure. It would be undesirable in the interests of facilitating effective competition to set threshold conditions that are unreasonably stringent, or for reasonable conditions to be interpreted and applied in a way that is unreasonably stringent. Conversely, it would also be detrimental to safety and customer protection to set threshold conditions that are too lax.

4. **ARE THERE ANY TYPES OF MITIGATIONS THAT WOULD HELP ALLEVIATE THE HARM IDENTIFIED THAT WE HAVE NOT DESCRIBED? IN SUGGESTING ANY NEW MITIGATIONS, PLEASE SPECIFY HOW THEY WOULD HELP YOU OR YOUR BUSINESS, OR WHY THEY WOULD FACILITATE COMPETITION AND INNOVATION MORE GENERALLY.**

4.1 Although not a direct consequence of a monopoly CIS provider, LBG believes consideration should be given to the appropriate oversight of any external platforms that are used by overlay service providers in order to secure the appropriate degree of safety, competition and customer protection. It is within the realm of possibility that existing digital app platforms could be used to facilitate usage of overlay services, as they are currently for mobile banking apps. We suggest this consideration is taken forward in the course of the Government's review of payments regulation.

4.2 In relation to the costs to participants and customers of the CIS provider, Pay.UK should ensure that contract negotiations are conducted in a way that places appropriate emphasis on price efficiency. Providing a range of draft contracts, each with a different approach to compensation, could enable the prospective provider to select the contract that is most likely to see it manage its costs effectively. Care will need to be taken if prospective CIS providers offer a package of overlay services in the course of negotiations – in such a scenario, due consideration must be given to the competition and efficiency implications.

4.3 Lastly, LBG is keen that Pay.UK reconsiders an alternative model for NPA execution that was reviewed but not taken forward in 2017 when the NPA blueprint was issued. This model is the 'Distributed Clearing and Settlement Model' where each participant would connect to the central infrastructure through a chosen infrastructure provider. Under this model, Pay.UK would be able to focus on its core strength and expertise in standard setting and monitoring rather than procurement of a core infrastructure provider.

4.4 We have suggested to Pay.UK, in response to its questionnaire on NPA programme ambition, that it reinvestigates this model given developments since 2017. For example, cloud technology is now a more mature proposition for the provision of infrastructure, and regulator knowledge, expertise and frameworks have developed as technology has advanced. We believe the model could deliver the NPA with reduced costs by way of a competition and market-led approach. It could also enhance resilience by way of inherent interoperability, so if one infrastructure provider suffered an outage another could step in.

4.5 In our view, a distributed approach would align to the PSR's competition focus and would not give rise to the competition concerns associated with a monopoly provider as outlined by the PSR in its call for evidence paper. Key factors such as the supervisory and oversight frameworks for these providers would of course need to be worked through carefully. However, we expect the frameworks that will need to be developed in any case for a monopoly CIS provider could be modified with limited extra resource required to do so.

5. ARE ANY OF THE TYPES OF MITIGATIONS WE HAVE DESCRIBED LIKELY TO BE PARTICULARLY EFFECTIVE OR INEFFECTIVE AT ALLEVIATING THE POTENTIAL HARMS, AND WHY?

5.1 LBG has considered the three types of mitigations outlined by the PSR. We agree that effective technical and governance design of the NPA will be vital – the need for them in a well-functioning market is essentially a given. Pay.UK has a positive track record as scheme operator of developing such frameworks. One aspect that could be considered further though is governance in relation to data sharing with overlay service providers. Currently, access to core data requires approval from all participants, which can be a cumbersome process. Making this process more efficient in appropriate circumstances (such as for the purposes of crime prevention, where it would be for the 'common good'), could help to facilitate and speed up innovation.

5.2 We note the PSR's suggestions in relation to removing or reducing the economic interest of the NPA CIS provider in overlay markets or competing payment systems through separation. We are aware that such an approach has had some success in facilitating competition in other markets. In our view, it is important that such measures are only taken in relation to the NPA if the competition benefits to participants and customers are shown to materially outweigh the economic inefficiencies that would be likely to arise.

5.3 We can see some merit, in a scenario where the NPA CIS provider also operates a competing payment system, in an arrangement where there are two legally and operationally separate entities with a common owner. [redacted]

5.4 In respect of the provision of overlay services we can see the benefits of operating two operationally separate entities within the same legal entity (i.e. having two distinct CIS provider and overlay operations), with rules that apply across the boundary. Such an arrangement would enable the sharing of best practice at a high level, whilst limiting the sharing of specific technical details and avoiding the potential for day to day conflicts of interest. It would also be less costly than some of the options under discussion, such as operating as a joint venture or as legally separate entities.

5.5 Currently, Vocalink also operates the peer to peer payments service PayM and the Current Account Switching Service, which are today's domestic payments overlay services. In the NPA, we would anticipate the provision of such services to be open to competitive tendering from other providers, whilst noting the possibility of a package of overlay services offered by the NPA CIS provider as we recognised in our response to question four.

6. **ARE ANY OF THE TYPES OF MITIGATIONS THAT WE DESCRIBE PARTICULARLY COSTLY OR HIGH RISK? IF SO, PLEASE EXPLAIN WHY.**

6.1 Yes, as noted in our response to question five, LBG believes actions to remove or reduce the economic interest of the NPA CIS provider in overlay markets or competing payment systems through separation would require careful consideration. This should include a robust and detailed cost benefit analysis as well as taking learnings from other markets.

6.2 We can envisage scenarios where the NPA CIS provider benefits legitimately from economies of scale or expertise developed over time to bid for overlay services at a lower price point than its competitors. It would be reasonable for participants to hold price efficiency and value for money as key considerations in the appointment of providers of overlay services. As long as costs are not being artificially reduced, there is the potential for participants and end customers to benefit from the efficiencies gained from taking overlay services from the CIS provider.

6.3 We have also considered the concept of a joint venture with another independent entity that has no commercial interests that raise horizontal or vertical competition concerns. Such an arrangement is likely to be costly, and these costs will ultimately be passed onto participants and customers. Specifying a joint venture arrangement as a condition of being the NPA CIS provider could also have the effect of reducing provider focus on participants' core requirement for cost efficiency and value for money. Again, a detailed analysis of the potential competition benefits weighed against the economic implications would be required ahead of any proposal to mandate such an arrangement.

7. **7. ARE ANY EXISTING MITIGATIONS, TO ANY SIMILAR CONCERNS IN TODAY'S PRE-NPA PAYMENTS ECOSYSTEM, PARTICULARLY EFFECTIVE OR INEFFECTIVE IN ALLEVIATING THE POTENTIAL HARMS? IF SO, PLEASE EXPLAIN WHY.**

7.1 [redacted]

7.2 As referenced throughout our response, we are concerned about price efficiency and value for money in the monopoly provision of payments infrastructure, which is a live issue with the incumbent UK domestic schemes – notably the Faster Payments Service (FPS). We are therefore keen that Pay.UK takes learnings from the current scheme infrastructure contracts, particularly the FPS contract, to improve on the current situation. In our view, improving price efficiency will ultimately lead to better outcomes for our customers.

Nationwide

PSR CP20/2 Call For Input – Competition and Innovation in the UK's New Payments Architecture

Response from Nationwide Building Society

About Nationwide
As a Society of nearly 16 million members and a balance sheet of £236 billion Nationwide is a systemic financial institution in the UK. We are focused on retail financial services products. Nationwide is a top three provider of mortgages and savings accounts and has just under 10% of the current account market.

We've closely supported the development of the Payments Systems Regulator and its work over recent years, notably through our contribution to the Payments Strategy Forum and recent efforts to combat Authorised Push Payment scams. We value the emphasis on competition, innovation and service that the PSR sustains and recognising the dynamics of our market, we know it's sometimes hard to reach our ambitions at the pace the PSR and indeed the industry might like.

Questions related to competition and innovation:

1. We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?

Nationwide considers the hypotheses to be focused on the immediate NPA CIS and Overlay ecosystem and thinking does not sufficiently extend into each institution's own competitive payment infrastructures. Primarily, Nationwide suggests this could be achieved with a third scenario of;

The NPA CIS provider also (either directly or indirectly through commercial interests in other businesses) provides payment services to PSPs, outside the NPA ecosystem, upon which PSPs are dependent for interaction with the NPA CIS.

To expand further, should the competition risks be realised, the pool of competing organisations able to offer infrastructure, processing services and/or professional services in support of the continued operation (and competitive enhancement), may be limited. Feasibly, global payment organisations may focus their strategic business development outside of the UK market impacting not just the NPA CIS, but also participants.

An example present in the market today is how start-up organisations have anticipated the UK Retail Payments industry becoming ISO20022 standard. Those who have built entirely ISO20022-native are a technological advantage over the more traditional global suppliers who are undergoing a migration journey from their existing offerings to their new ISO20022 offerings. We question whether some of the traditional larger established suppliers may fall away in this scenario, leading to a smaller pool of suppliers which could be deemed as damaging to competition in the market, negatively affecting general industry pricing for PSPs consuming those services.

Nationwide also suggests a fourth scenario related to competition risk between incumbent PSPs and challenger/fintech PSPs. There is likely to be an opportunity cost for Nationwide (and other PSPs) by having to prioritise the NPA build over other key strategic projects which deliver a clear customer and/or commercial benefit. It could be considered unreasonable for incumbent PSPs to fund costs of building the NPA, in the absence of venture capital and long-term capital funding envisaged by the

PSF Blueprint. New participants, challengers and FinTechs are set to benefit most from the NPA in future, without having to fund any of the build. Could this be deemed anti-competitive, by putting incumbent PSPs at a disadvantage of not being able to focus funding and resource on other innovative payment solutions?

The recent example of the Cheque Image Clearing System (ICS) Programme can be offered. The incumbent sixteen participants were required to fund the build of the new ICS infrastructure, but since go-live another 5-6 participants have onboarded on to the ICS, without having to bear any of the Programme/build. This has opened up barrier free access to Payments systems, but whether this is a reasonable expectation of incumbent PSPs remains.

Whilst the PSR has noted a Joint Venture (JV) hypothesis, consortium appears not to have not been considered.

2. How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?

The PSR has sought views of competition and innovation impacts. Some of the hypothesis will be realised to a degree, limited by any regulation, framework governance or guiding principles. That said, the scenarios outlined may not lead to detrimental outcomes. In Nationwide's view, the PSR should also challenge itself to set risk boundaries, with consideration of mitigating unintended consequences. As an example, restricting the awarded NPA CIS organisation(s) ability to offer overlay services may introduce higher net costs across the full scope of services (in terms of multiple margins, supplier management fees and internal Pay.UK costs), prohibiting access of specialist resource to segments of the NPA and leveraging knowledge of alternative payment scheme solutions.

In reference to the PSRs concerns with any NPA CIS provider having disproportionate access to the Payment data/M.I. (by virtue of running the NPA), it could be argued that this gives any NPA CIS provider a unique position to provide overlay services. This overlay service may be monetised, but potentially for the benefit of wider society. An example could be the role that VocaLink currently play as Retail Payments infrastructure provider. They've utilised their position in the market to develop a Money Mule detection service, which could greatly reduce criminals benefiting from the proceeds of financial crime. It could be argued that it's not a market advantage being used here but rather VocaLink are using the data they process, which others could use if they sought to (via Pay.UK, and the participant PSPs that own the data, giving their permission).

It is our expectation that the NPA will be designated as a Payment System for the PSR to regulate and therefore seek clarification from the PSR regarding any proposed amendment to the general directions to reflect the new Payment System. Our assumption on this basis is that the CIS to be procured, will be an infrastructure provider as defined in Financial Services Banking Reform Act (FSBRA) 42(2) and so classed as a participant for the purposes of the PSR's General Direction 1 (GD 1). GD 1 requires that participants not only communicate in an open and cooperative manner but disclose to the PSR anything relating to the participant which might materially adversely impact the PSR's advancement of its statutory objectives and duties, specifically relevant here the Competition objective as per FSBRA 50. This is also relevant for Pay.UK as participant in for the form of a Payment Systems Operator (PSO). Additionally, as a PSO, Pay.UK is directed under General Directions 2 and 4.

GD 2 currently requires that in relation to Bacs and FP as designated Payments Systems by HMT, Pay.UK must disclose the access requirements and report compliance to the direction. This reporting includes detail of expressions of interest for access or technical access and the outcomes, as well as any objections to the access procedures received. Also, as part of GD 2 Pay.UK must disclose any material change to access which specifically includes fees and charges. We think this is relevant in considering question 2 and the materialisation and significance of harm that may be posed.

GD 4 requires appropriate representation of Service Users (this includes Payment Service Providers (PSPs) and service providers, retailers and individual customers) in PSOs governing bodies in the interest of decision-making powers. Again, we think this is relevant to not only question 2 and likelihood, but potentially question 3 and whether any harm would be significant. From a transparency point of view, GD 4 also requires publishing of minutes of the governing body which again may act as a mitigant to some of the perceived risks.

As an overarching point, due to the PSRs powers under FSBRA (specifically with the inclusion of the CIS as a 'participant' as per 42 (2)), should any harm materialise, the PSR would be able to set a specific or general direction in order to mitigate against this or take action to cease any activities in an extreme scenario. A cost effective and potentially overlooked mitigant is to remind Pay.UK of their obligations in relation to the above General Directions and how this may play into not only the procurement and contracting, but also their ongoing governance of the CIS. As well as ensuring CIS vendors are aware of the PSRs powers and objectives relating to competition and specifically infrastructure providers such as GD 1 when considering the provision of their services and future development for the NPA.

3. For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?

With both the not-for profit participant funded commercial model of Pay.UK alongside the likely multi-decade term of the supplier relationship, monopolistic issues are, in our view, most likely to be realised. The level of harm any hypothesis would cause are dependent on the level of appropriate regulation, governance and oversight. The anticipated highest likely residual risk to competition is as stated in V1; organisations whom have early access to privileged information may position their products and services ahead of their competitors in the market, limiting the supply chain.

Nationwide's business, but also members, may be materially impacted with higher NPA costs reducing investment funds for change (and therefore products and propositions). In practice, PSPs including Nationwide are looking to new infrastructure technologies as well as being 'ISO20022 ready', replacing legacy technologies. Capacity and concentration risks could persist with common supply chains.

One sub-scenario not considered is post contract at which point Pay.UK have completed their procurement process for the NPA, with a NPA CIS provider selected, but that CIS provider fails to meet their contracted performance and delivery obligations; a scenario realised during the procurement of ICS by C&CCC. The required change in supplier had time, effort and cost to the internal Nationwide programme which in turn has had a competitive impact to Nationwide, against some of our peers in the market.

Questions related to potential mitigations:

4. Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.

We would echo our response to Question 2, in respect of reminding Pay.UK and CIS vendors of their obligations in relation to the aforementioned regulatory powers enforceable by the PSR. We also agree with UK Finance's view that Pay.UK and the PSR will need to work closely to jointly manage the activities of the CIS vendor(s).

Other mitigations that could be considered include;

- Creation of a 'capability and innovation fund' paid into by all NPA contracted parties, with investment into research and development of innovation and enhancements to both the CIS and overlay services.
- The capping at a reasonable and fair level, a baseline profit margin (similar to the MOD's approach to defence contracts).
- Obfuscation and/or providing replica data to all interested industry partners, under strict confidentiality terms.
- Consider Pay.UK's company structure, with mandatory board observer or majority voting rights within the NPA CIS' legal entity.
- Creating an environment of incentive not penalty to innovation.
- Permitting consortium.

Thinking about the business models existent in UK/Global Card payments, a notable difference to UK Retail Electronic payments, is the simple commercial model. With clear pricing (card interchange, etc), but that they also have established consumer protections fundamentally built in (chargebacks, section 75 protections, etc). At present, in UK Retail Electronic payments, there are a range of consumer protections (Direct Debit guarantee, CASS Switching guarantee, Confirmation of Payee, CRM, SCA, etc) issued and administered by different bodies. More consumer protection in UK Retail Electronic payments, equates to greater costs for PSPs and other actors in the payments chain to underpin those consumer protections, and this could become a barrier to new entrants and increased competition/innovation?

5. Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?

The Call-for-Input documentation is too theoretical/conceptual for PSPs to be able to comment on Competition/Innovation concerns fully yet. This echoes comments expressed by UK Finance and other participants at an industry round-table session in late February.

Reflecting on the recent "NPA Programme Ambition Questionnaire" activity (which Nationwide responded to on 14th February), Nationwide stakeholders are concerned about the inherent conservatism of the top six banking groups, who are responsible for approximately 85-90% of money transmission in the UK currently. If conservatism wins out in terms of NPA scope, then the scaled back vision of the NPA could be argued to be anti-competitive for the whole of the UK? Equally, by not currently knowing the defined NPA scope, this means that the PSR Call-for-Input documentation remains very heavy on assumptions and theory, which we acknowledge is out of the PSRs control at this moment.

Specifically, 3.9 where it has been suggested that NPA CIS providers may be eliminated from providing overlay services would potentially reduce the quality of solution available to the industry. Governance for innovation and completion is encouraged, but consideration of efficiency and disadvantageous exclusion is encouraged.

Of the organisational structure mitigation, 3.11c “Operationally separate entities within the same legal entity, with rules that apply across the boundary” would likely be most effective, with lines of responsibility made clear to avoid communication issues into a common supplier.

6. Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.

Joint Ventures pose additional risks that over time, strategic interests diverge, or relationships fail, impacting competitiveness and ability to innovate. Attestation of regulatory compliance across JV boundaries also becomes more complex to evidence with potential for multiple organisations to now be excluded from providing overlay services, further restricting the market.

We recognise that any potential harms may evolve between procurement and delivery of the NPA with contract due diligence remaining critical during this period to mitigate harm. However, we have considered the additional costly mitigant that the PSR may need to direct the NPA CIS to further reduce harms that manifest post-delivery. The possibility exists that any initial directions may not be suitably sufficient, and in time, may require the introduction of supplementary regulation. Either scenario could lead to unnecessary cost for the regulator and potentially PSP’s (as participants and funders of the NPA), PSOs and the CIS and therefore create detriment to service users.

It is important for Nationwide (and other PSPs) to consider the financial/resource costs of reacting to and implementing new PSR regulation relevant to the NPA – and for this reason, we call on whatever action the PSR takes, to be proportionate and rational.

7. Are any existing mitigations, to any similar concerns in today’s pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

The recent formation of the *NPA Strategic Participant Group (SPG)*, with PSPs invited to nominate representatives to attend, gives PSPs like ourselves an opportunity to influence the Pay.UK agenda in relation to the future NPA. At an industry level, we see this as an acknowledgement that participant engagement needed to be stepped up a gear and we welcome the formation of the SPG.

As per our feedback to previous questions, during recent industry deliveries such as the Cheque Image Clearing System for example, the penalties for not meeting regulatory deadlines have not always been as effective as they should be. Creating a culture whereby PSPs/PSOs are incentivised to deliver on time could be more effective.

Contact details:

[redacted]

[redacted]

Natwest

CP 20/02

Call for input: Competition and Innovation in the UK's New Payment Architecture (NPA)

National Westminster Bank Plc Response

March 2020

Introduction

NatWest[1] actively participated in the Payment Strategy Forum (PSF) and is fully supportive of the modernisation of the payments systems to meet the evolving needs of end users and payment service providers. There have been significant changes to the payments ecosystem since the PSF Blueprint document was published, many of which came from PSF proposals. These include the development of Confirmation of Payee and the continuing development of Request to Pay solutions as well as the industry agreement to progress the implementation of ISO20022 within the refreshed RTGS and the NPA importantly sharing a Common Credit Message (CCM). Alongside these are the work by the payment system operators with Bank of England, to extend access to Bank of England settlement accounts for non-bank institutions and widen the provision of payment scheme access to directly connected non-settling institutions,

The changes in the payments market, including the growth in different participant types, and the development of Open Banking and competitive overlay services in recent times, all make clear why the potential impact on competition and innovation in the development of the NPA needs to be considered. NatWest understands that the outcome of the PSR's Call for Input may help shape thinking around the development of the NPA. However, as the PSR is aware, the NPA design still lacks definition and agreement on its scope and timing, and thus we are only able to comment in general terms on the PSR's questions.

The NPA is currently in reset mode and urgently needs to agree requirements and solution design, something that we believe requires significant input from the service users and from the potential vendor(s). Further delays are unhelpful to the short to medium term interests of the industry and its end users.

NatWest believes that the final shape of the NPA will influence many of the factors the PSR is consulting on. For instance, whether there is a single or dual clearing and settlement infrastructure, whether there are both real-time and bulk payments infrastructures and, perhaps most relevant within the context of this Call for Input, whether a single provider or multiple providers are selected to develop and manage the solution. This may introduce additional competition issues for further consideration over time as these factors and workstreams develop.

The design and technical architecture of the NPA, particularly any requirement for interoperability and the provision of resiliency and contingency between real-time and batch services, assuming both are developed as part of the NPA, may have an impact on the pool of vendors willing to bid for the core service. We would encourage common standards (not least of which ISO20022) between real-time and batch solutions to ensure a high degree of compatibility and also to encourage providers to bid for the contract.

It is possible that alternative approaches to meet the PSF Blueprint could lead to different competitive outcomes while still providing the same end-user benefits. One approach may be

[1] NatWest means National Westminster Bank plc responding for itself and its affiliates and subsidiaries. These cover The Royal Bank of Scotland plc, Coutts and Company and Ulster Bank Limited.

to consider the possibility of an upgrade to the existing payments infrastructure rather than a wholesale replacement.

We expect there to be a limited pool of potential vendors for the NPA clearing and settlement infrastructure, with critical in-fill services (for example the provision of the EISCD - the Electronic Sort Code Directory) linked to this potentially provided by others. As with other infrastructure programmes, we think it is reasonable to anticipate that consortia may be formed with a lead partner and specialists to provide in-fill services. Some of these smaller, specialist providers could be classified as Overlay Service Providers so may fulfil this requirement as part of the core contract.

However, the use of joint-ventures and consortia may introduce additional risks to sustainability as such commercial arrangements may not be conducive to long term stability. The current Bacs infrastructure is over 50 years old and Faster Payments in excess of 12 years, some academic studies quote the average life span of a joint-venture between 5-7 years and a failure rate of 50%[2] while others quote life spans of only 3 years.[3]

As a critical part of the national infrastructure, we place high demands on the financial stability as well as operational excellence and technical capability of the potential vendors. It will be important that consideration of competition concerns is balanced against these key performance attributes.

We are not aware that Pay.UK has conducted a risk assessment into changing infrastructure provider. The appetite for operational, commercial and transition risks need to be fully considered along with the end to end costs. The industry and regulators (FMID) need to understand and accept the risks, particularly to settlement services during the during what may be a lengthy migration period.

The significant scale of investment required to replace a piece of critical national infrastructure will need a financial model that takes into account operational stability and resiliency in its commercial terms. Potential vendors will need to exhibit financial strength and stability over the contract term which may limit those qualified to proceed to the RFP stage.

The Pay.UK procurement and contract process will require an economic model to be developed and this will demand strong governance. This economic model should provide participants and end users with certainty of supply and consistency in terms of cost. It must also be accessible for all categories of PSPs, large or small.

NatWest has seen the UK Finance response and largely agrees with its content and direction. The comments made here should be viewed as additional to that response.

---

[2] Harvard Business Review: Your Alliances are too Stable

[3] Deloittes: A Study of Joint Ventures

Questions related to competition and innovation:

1. We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?

No, we do not believe any hypotheses have been missed, however we consider those provided as somewhat theoretical in the absence of a clearly defined NPA scope.

With regard to the specific scenarios the PSR should be cognisant that [redacted] This will depend on the economics of the services provided and the potential payback period.

For scenario 2 (horizontal competition) the organisational complexity and cost of effectively ring-fencing part of the vendor organisation may be a prohibitive factor. We would expect the vendor to be a regulated entity, and if so, this could be monitored and managed without resorting to organisational structural change.

2. How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?

While the hypotheses could materialise, in practice we believe that strong governance, controls and regulatory oversight around the procurement process and contractual terms can be used to ensure that such theoretical concerns can be mitigated against. In any case we would anticipate that the vendor(s) selected to provide the service(s) will themselves be regulated entities and subject to stringent oversight and assurance.

3. For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?

We consider that the possibility of the harms materialising in practice to be very low. It is not in the long term interests of vendors to exert undue influence or try to manipulate outcomes to their own advantage in such ways.

There may be overlay services where the data is closely coupled to the core service and in the case of for instance fraud analytics comprise highly sensitive data. As such the use of this data should be tightly controlled and monitored to prevent a possible breach. Having such services in the hands of a regulated entity may be beneficial. Providing access to firms without adequate controls, security and resources may create unacceptable risks.

Questions related to potential mitigations:

4. Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.

The scope and design of the NPA may materially affect the mitigations required. As previously mentioned, the inclusion of both real-time and batch will be a significant factor as will a single or dual clearing and settlement layer. A single or multiple vendor solution will also greatly impact the competitive landscape, however if multiple vendors are selected contingency and resilience between solutions must be a primary consideration.

5. Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?

We agree that the scope of the NPA and technical architecture design will to some extent determine the best possible outcomes for end users. Strong governance around the procurement process and the contract itself should also prove to be effective controls.

We would expect the successful vendor to provide access on an equal basis to all qualifying PSPs and Overlay Service Providers.

6. Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.

Enforcing structural change on the vendor or requiring a Joint-Venture may be costly and counter-productive, and complex to administer particularly if separate accounting and reporting is required.

7. Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

As with other Payment Services, such as SEPA, clear separation between the rule setting function (EPC) and the operation of the system should be maintained.

----- end of response -----

Pay.UK

The Pay.UK response to the Payment Systems Regulator's Call for Input:

"Competition and Innovation in the UK's New Payments Architecture"

May 2020

Executive Summary

1. Pay.UK is responding to the Payment Systems Regulator's (PSR's) **Call for Input: Competition and Innovation in the UK's New Payment Architecture (NPA)**. Pay.UK is a not for profit company, leading work to deliver the NPA. This includes responsibility for finalising the NPA's design and appointing a Central Infrastructure Services provider (CIS provider).

2. The majority of this response was drafted before the Covid-19 crisis took hold. Therefore its impact has not been fully reflected in this paper, and the effect of Covid-19 on our work on the NPA remains uncertain at the time of submission of this response. Whilst we expect our aims for competition and innovation in the NPA to remain broadly the same, we will of course be keeping our approach under review in light of the significant developments of the last weeks. As part of this we are working closely with Participants to understand the impact of Covid-19 for their operations and business planning. The view we are picking up from these discussions is that the Covid-19 crisis may have a substantial influence on how change budget gets spent over the short and medium term. This has the potential to influence participant requirements for NPA and our approach to the programme. The crisis underlines the critical importance for service users of us maintaining robust and resilient payment systems both in business as usual and through change programmes like the NPA.

3. In 2017, the PSR and the Payments Strategy Forum (PSF) undertook work to identify detriments that existed in the payments value chain and to identify new solutions and services to be developed to meet the needs of users. Since then, Pay.UK and the rest of the payments industry have been working to address these detriments. A number of these have already been addressed, and will contribute to competition in the payments landscape and to better outcomes for users – we have seen a significant increase in direct participation in the systems we operate, Open Banking has launched, Confirmation of Payee will be implemented in the coming months and request to pay is near to being ready to launch. However, there is still more to be done that we currently understand the industry wants to deliver, particularly relating to adopting global standards on which a wider set of services can be offered, ensuring that there are low barriers to entry in various payments markets and seeking to prevent and mitigate financial crime through greater industry collaboration. We anticipate the development of the NPA will form a crucial contribution to these aims.

4. Robustness and resilience are our most critical requirements and having these in place is a key platform on which competition and innovation can then be built. Thus far, we are maintaining not only an ambitious vision, but a pioneering one. Incorporating robustness and resilience, and competition and innovation into a system which will replace existing systems, whilst factoring in competing overlay services, has not been done elsewhere in the world. Ensuring migration from existing systems to the NPA is done in a way that minimises risk will be vital to ensure the NPA's ongoing success.

5. Alongside the critical requirements of robustness and resilience, competition and innovation issues are an essential aspect of the overall considerations that need to be made through the design and procurement of the NPA. We recognise that the structure of various parts of the

payments ecosystem, and the need to coordinate in various areas, creates challenges for competition and innovation. Pay.UK is working to understand and, wherever possible, appropriately manage and mitigate these challenges because we want the NPA to enable competition, innovation and great services for users.

6. Within these considerations of competition and innovation, trade-offs may need to be made throughout the process to ensure that overall outcomes deliver those services that users need at an appropriate cost. There may need to be a balance between encouraging competition in some parts of the value chain compared to the total costs for the system of doing so, including costs associated in ensuring a robust and resilience system. If trade-offs have to be made, we will work to identify any new risks and consider how those can be best mitigated in light of the overall approach. When thinking about these issues, consideration must be given to the significantly greater magnitude of industry-wide cost in comparison to the central costs. The NPA will be designed and governed in such a way to facilitate competition and innovation, whether this is competition that arises from the start of the NPA or competition that can be encouraged as the NPA evolves through its development.

7. We currently anticipate that there will be a single supplier for the NPA's CIS and we are in the midst of running a procurement process to appoint the CIS provider. It is important that this is a robust procurement process that supports effective negotiation on key contractual terms to ensure value for money. Along with the design of the NPA and the procurement process itself, some of these contractual requirements will help to mitigate competition issues that the PSR has identified in its Call for Input (CfI) paper.

8. We will be considering competition and innovation issues throughout our procurement process and contract negotiation. As the PSR has also set out in its CfI paper, many of the potential risks to competition and innovation can be mitigated through the design of the NPA and some risks may be mitigated through governance decisions such as where Pay.UK, rather than the CIS provider, has responsibility and control of issues (for example setting appropriate terms and conditions of access). Other risks can be mitigated through contractual provisions – many such measures under consideration by Pay.UK are in common with the best practice commercial protections that any firm would wish to ensure they have in place when appointing a critical, long-term, single supplier for a strategic outsourcing of this nature.

9. However, it is important to bear in mind that there are some limitations to what can be achieved through ex-ante contractual mechanisms. Ownership arrangements and a firm's position in relevant markets play an important part in considering vertical and horizontal competition issues. Pay.UK's position is to be ownership neutral through our procurement process. We recognise that some suppliers may create specific risks - based on their activities in related markets - which would require particular contractual constraints and ongoing monitoring. We also note that ownership arrangements may change over the course of the contract life. As such, we will seek to have the flexibility to be able to mitigate resulting risks in the future.

10. Overall, we are aiming through our work to develop appropriate arrangements for the NPA – through design (including standards and rules), contracts, and governance – which will facilitate

competition and innovation by the market. We are thinking about competition and innovation questions based on our role and responsibility as a Payment System Operator (PSO) of regulated payment systems and a Financial Market Infrastructure (FMI). As guardian of the NPA ecosystem we will set the framework for the overall approach throughout the NPA ecosystem and we will seek to set this framework in a way which will facilitate competition and innovation.

11. However, we will not have control or power over all aspects of the NPA. We won't have responsibility, oversight or control of every commercial arrangement within the NPA ecosystem, and we recognise that competition issues could arise in services that we don't supply or buy. If there is a reasonable suspicion of anti-competitive behaviour in the NPA ecosystem then regulators or competition authorities can also investigate and, if necessary, take action (and can also use a wider set of powers than those available to Pay.UK).

12. Pay.UK is already assessing the risks to competition and innovation within the parts of the NPA ecosystem that we have responsibility for, and we are examining the various ways in which our NPA design, including adoption of global standards, governance and contractual requirements can mitigate these risks. When contemplating any separate ex-ante regulatory intervention, careful assessment would need to be undertaken by the PSR were it to consist of an upfront constraint on the market – intervention needs to be evidence-based and proportionate to the probability and impact of risks crystallising. In addition, when thinking about potential mitigations to risks to competition and innovation, careful consideration is needed regarding costs, whole system impacts including on robustness and resilience, and the risk of adversely affecting competition and innovation in different parts of the payments ecosystem.

13. Careful thought would need to be given to a response from the PSR which imposed significant restrictions on the CIS provider and the costs this could impose. These costs are met by our Participants, and ultimately their customers. For example, if the CIS provider were to be prevented from providing services downstream, it could be more costly than allowing them to participate (subject to appropriate restrictions on the CIS provider to prevent them from unfairly exploiting their position as the CIS provider) and could lead to a reduction in the very competition and innovation we are seeking to facilitate. There may also be concerns around requirements that would unduly restrict the CIS provider utilising assets from other ventures, particularly if using such assets was a core part of the offering valued by Pay.UK. Our concern would be ensuring that interventions do not undermine the NPA's overall business case and Participant support in the NPA, and the end user benefits the NPA can enable.

14. Throughout the development of the NPA we have been having ongoing communications and dialogue with Participants and stakeholder representatives to inform our decision-making. Their views will be critical to shaping the approach of the NPA to ensure that the interests of all users are at the heart of the NPA design and we continue to meet our strategic objectives in a balanced way.

1) Introduction

15. Pay.UK is responding to the PSR's Call for Input: Competition and Innovation in the UK's New Payment Architecture (NPA). As the body leading the work to deliver the NPA, we are responsible for finalising the NPA's design and appointing a CIS provider.

About Pay.UK

16. Pay.UK was formed in July 2017 (initially under the name New Payment System Operator or NPSO) under the supervision of the Bank of England (the Bank) and the regulation of the Payment Systems Regulator (PSR). We are a not for profit company, with independent governance. Pay.UK currently operates the UK's three interbank retail payment systems: the Faster Payment System (FPS); the Bacs Payment System; and the Image Clearing System (ICS). We also deliver a range of 'managed services' which offer capabilities to enhance the three payments systems, such as Paym and the Current Account Switch Service.

17. FPS and Bacs are both designated as recognised payment systems. As a result, Pay.UK's operation of both Bacs and FPS is subject to supervision by the Bank and specifically, the Financial Market Infrastructure Directorate (FMID). In addition, Bacs, FPS, and the ICS are designated as regulated payment systems and Pay.UK's operation of the systems is subject to regulation by the PSR.

Developing the New Payment Architecture (NPA)

18. Alongside ensuring continued operation of these critical payment systems, Pay.UK is working to deliver the NPA. The NPA is the new conceptual model for the future development of the UK's interbank retail payment infrastructure. The NPA was conceived and recommended by the PSF and documented in its Blueprint published in December 2017 and handed over to Pay.UK for delivery. This followed work by the PSR and PSF to identify detriments that existed in the payments value chain and to identify new services to be developed to meet the needs of users.

19. Since then, Pay.UK and the rest of the payments industry have been working to address these detriments. A number of these have already been addressed, and will contribute to competition in the payments landscape and to better outcomes for users – we have seen a significant increase in direct participation in the systems we operate, Open Banking has launched, Confirmation of Payee will shortly be implemented and request to pay is near to being ready to launch. However, there is still more to be done that we currently understand the industry wants to deliver, particularly relating to: adopting global standards on which a wider set of services can be offered; ensuring that there are low barriers to entry in various payments markets; and seeking to prevent and mitigate financial crime through greater industry collaboration. We anticipate the development of the NPA will form a crucial contribution to these aims.

20. In developing and delivering the NPA, Pay.UK seeks to reflect our strategic objectives including:

- **Robust and resilient** – that payment systems are robust and resilient and that the NPA maintains the ecosystem's trust in the certainty, integrity and security of our payments services;
- **End-user focused** – ensuring the continued relevance, competitiveness and usefulness of the services we provide as part of the UK payments ecosystem;
- **Agile and innovative** - acting as a catalyst for change in the payments industry;
- **Accessible** – promoting competition by supporting new entrants so as to promote a competitive retail payments industry;
- **Efficient** – ensuring that our payment services remain economically efficient and sustainable, while facilitating competition in both upstream and downstream services; and
- **Excellent people** – attracting and retaining talented leaders and people who deliver for stakeholders, consistent with our culture, principles and values.

21. Robustness and resilience is our most critical requirement and having this in place is a key platform on which competition and innovation can then be built. Thus far, we are maintaining not only an ambitious vision, but a pioneering one. Incorporating robustness and resilience, and competition and innovation into a system which will replace existing systems, whilst factoring in competing overlay services, has not been done elsewhere in the world. Ensuring migration from existing systems to the NPA is done in a way that minimises risk will be vital to ensure its ongoing success.

22. Our objectives make clear that competition and innovation issues, including those set out in the PSR's CfI, are an essential aspect of the overall considerations that need to be made through the design and procurement of the NPA. We recognise that the structure of various parts of the payments ecosystem, and the need to coordinate in various areas, creates challenges for competition and innovation. Pay.UK is working to understand and, wherever possible, appropriately manage and mitigate these challenges because we want the NPA to enable competition, innovation and great services for users.

23. Within these considerations of competition and innovation, trade-offs may need to be made throughout the process to ensure that overall outcomes deliver those services that users need at an appropriate cost. There may need to be a balance between encouraging competition in some parts of the value chain compared to the total costs for the system of doing so, including costs associated in ensuring a robust and resilient system. If trade-offs have to be made, we will work to identify any new risks and consider how those can be best mitigated in light of the overall approach. When thinking about these issues, consideration must be given to the significantly greater magnitude of industry wide cost in comparison to the central costs. The NPA will be designed and governed in such a way to facilitate competition and innovation, whether this is competition that arises from the start of the NPA or competition that can be encouraged as the NPA evolves through its development.

Structure of this response

24. The risks set out in the CfI have been considered by Pay.UK, and our current strategy and ongoing approach to the NPA Programme, and procurement, take these into account. Given Pay.UK's role and the importance of these issues, we think it valuable to explain our consideration of these issues and the steps that we can take through our process to support mitigation of these issues. Because of the need to protect the effectiveness of the procurement and negotiation process that we are running, some of our response is kept deliberately at a high level. The structure of this response is as follows:

- **Part 1** is this introduction
- **Part 2** discusses monopoly issues
- **Part 3** discusses horizontal and vertical issues
- **Annex 1** includes our responses to the PSR's specific questions.

2) Monopoly issues

25. The Central Infrastructure (CI) of interbank payment systems are characterised by economies of scale and network externalities, tending to lead to monopoly provision of CI. We currently anticipate that there will be a single supplier for the NPA's CI and are in the process of running a procurement process to appoint the CIS provider. The PSR's Infrastructure Market Review resulted in Specific Directions being imposed which require Pay.UK to competitively procure the replacement for the CI for the current Bacs Payment System and the Faster Payment System)[1].

26. This type of competition "for" the market through a tender process is well established as an alternative to competition "in" the market, where the economics of a particular good or service do not support multiple providers. The benefits of competition for the market can be captured through an effective upfront competition and negotiation process and implemented through an effective contractual framework. Such a framework needs to be flexible enough to adapt to the changing nature of the NPA ecosystem whilst maintaining sufficient protections for those using and providing services over it.

27. We recognise that appointing a single supplier at one point in time can raise challenges when dealing with future change - especially unforeseen change - over time. Pay.UK will be placing considerable emphasis on contractual restraints in a context of future uncertainty. As such, it is important that this is a robust procurement process that supports effective negotiation on key contractual terms to ensure value for money.

Risks

28. There are a number of key risks to competition and innovation that we will be assessing as we develop our contractual arrangements. In particular, we will be considering the risk that once appointed the CIS provider can exploit its position by:

[1] The PSR is monitoring Pay.UK progress with this procurement through formal reporting obligations – through which we are required to submit a compliance report to the PSR on a bimonthly basis. Reporting under this obligation began on 29 September 2017.

- **Not controlling costs (M1)**[2] – Following contract award, and in the absence of appropriate contractual obligations, there may be an incentive for the CIS provider to incur higher costs for both the initial development and the ongoing provision of NPA CI if such costs will be recouped from Participants.

- **Raising prices above levels that reflect costs** – Following contract award, and in the absence of appropriate contractual obligations, there may be an incentive for the CIS provider to seek to increase its prices in the absence of an alternative provider. This may be a particular risk in relation to innovation as described below (M2).

- **Setting prices for access that distort competition (M3)** – If the CIS provider controls the price of access to the NPA, it could seek to set this at a level significantly above costs for all users or for a group of users. These represent a subset of the more general risk that the CIS provider seeks to set all types of prices above cost (the bullet point above).

- **Setting other price and non-price terms of access that distort competition (M4)** – If the CIS provider controls other aspects surrounding the conditions of access, it could seek to set these in ways that limit, or raise prices to, some or all providers seeking access.

- **Degrading quality of service** – Following contract award, and in the absence of appropriate contractual obligations, there may be an incentive for the CIS provider to lower the quality of service that it provides across a range of functions in order to reduce its operating costs and make higher profits.

- **Making insufficient investment over time** – Following contract award, and in the absence of appropriate contractual obligations, there may be an incentive for the CIS provider to delay or defer planned capital investments to reduce its costs and maximise profits.

- **Not supporting innovation over time (M2)** – Following contract award, and in the absence of appropriate contractual obligations, there may be an incentive for the CIS provider to not support innovation and to not control costs surrounding innovation and new services.

- **Selling services beyond the scope of its contract** – The opportunity may arise through the period of the contract for the CIS provider to offer new services which are outside of the scope of the initial contract, which only it can provide because of its position as CIS provider. When considering this risk we are also mindful of the innovation benefits that may arise from the CIS provider being able to benefit from expanding the scope of its service in certain circumstances.

- **Putting in place barriers to transition** – The CIS provider may have the incentive to make it practically difficult or costly to change to an alternative CIS provider at the end of the contract period.

[2] Letters and numbers in brackets reference the PSR's various hypotheses in the CfI.

29. We note that while each of the risks described above may arise simply from having a single provider, some of these risks could be exacerbated by some of the vertical and horizontal issues (described below) which arise from the particular characteristics of the CIS provider. For example, the CIS provider may have a greater incentive to exploit some of these issues described above if it is active in other markets in the NPA ecosystem (vertical risks) or if it is active in the provision of other payment systems (horizontal risks).

30. We also note that the monopoly risks (M1-M4) identified by the PSR in its CfI paper do not include the risks identified above on quality of service (other than in relation to horizontal risks) nor on contract transition.

Potential mitigations

31. We will be considering all of the risks described above through our procurement process and contract negotiation. As the PSR has also set out, many of these potential risks to competition and innovation can be mitigated through the design of the NPA and some risks may be mitigated through governance decisions such as where Pay.UK, rather than the CIS provider, has responsibility and control of issues (such as setting standards, rules, and appropriate terms and conditions of access).

32. There are a range of contractual measures that can be considered to mitigate these types of risk. Many of these measures are in common with the best practice commercial protections that any firm would wish to ensure they have in place when appointing a critical, long-term single supplier for a strategic outsourcing of this nature.

33. Pay.UK plans to develop its proposed Master Services Agreement, for inclusion at the next stage of the procurement process, with these risks in mind. As part of developing these arrangements we are informed by the contractual arrangements and experience that we have with our current CIS provider. We are mindful of course that those arrangements were developed in a different ownership context and incentives for particular stakeholders have changed somewhat (with a number of Payment Service Providers (PSPs) previously being shareholders in the Payment System Operator (PSO), shareholders in the infrastructure provider and service users of the payment systems). New arrangements will therefore need to reflect a more arms-length commercial relationship.

3) Horizontal and vertical issues

34. The CfI explains that the PSR is also concerned about two other groups of potential competition effects:

    - Vertical effects, which occur in different parts of the value chain. In the case of the NPA these types of effects could arise most notably where other services are provided by the CIS provider.

- Horizontal effects, which occur in the same market. An example could be a product linked to interbank payments competing with debit/credit cards at the point of sale.

Risks

35. The key questions in both situations are whether being the CIS provider brings advantages, or changes incentives, in other connected markets. The risks we see are:

    - Being the CIS provider brings advantages in the NPA ecosystem that means there is not a level playing field between the CIS provider and other suppliers in those markets.

    - Being active in other markets changes the incentives for the CIS provider to deliver the best service for Pay.UK and its Participants.

36. The ownership of the CIS provider and the activities of both it, and related group companies in closely connected markets, can play an important part in considering vertical and horizontal competition issues. Pay.UK's position is to be ownership neutral through our procurement process. We recognise that some suppliers could create specific risks - based on their activities in related markets - which would require particular contractual constraints and on-going monitoring.

37. We also note that ownership arrangements may change over the course of the contract life (for instance, the ownership of our current CIS provider has changed in recent years). As such, we will seek to be able to have the contractual flexibility to be able to address such changes in the future.

Potential mitigations

38. In terms of mitigations in these areas, a number of the provisions highlighted in the monopoly mitigations section above are also relevant to dealing with vertical and horizontal competition issues – with clear service level agreements and other contractual requirements being particularly important.

39. For example, clear contractual requirements regarding the need to support and deliver innovation in response to Pay.UK's direction (itself in response to service user needs – such as for new services or enhancements to existing ones) helps to address this issue whether the root cause is that of a monopoly CIS provider that does not support innovation (M2), a CIS provider seeking to slow the innovation of third party service providers it competes against elsewhere in the value chain (V3), or a CIS provider seeking to prevent competition against an alternative payment system it has a commercial interest in (H2).

40. As well as this, there are some measures that Pay.UK will consider through our work that may mitigate potential horizontal and vertical competition issues:

    - **Control of the design of the NPA**. As a key part of the NPA Programme, Pay.UK is in the process of assessing key aspects of the design of the NPA (see also 'Setting Rules and

Standards' below). Whilst Pay.UK will be seeking to gather information from a range of stakeholders about important design decisions, it is Pay.UK that will make the overall design decisions and not the CIS provider. In doing so, we will aim to make decisions that, as well as ensuring robustness and resilience, facilitate competition and innovation across the payments ecosystem. Where possible we will seek to make decisions that rely on standards and technical requirements that will not be unduly costly (either to all firms or to types of firms). Keeping barriers to entry low for all providers will limit the extent to which the CIS provider can exploit its position elsewhere in the NPA value chain. While low barriers to entry are of benefit to all providers, we are particularly aware of the importance of ensuring low barriers to entry for smaller firms.

- **Setting Rules and Standards**. We are the guardian of the NPA payments ecosystem and will, in some situations, be facilitating innovation in our market catalyst role. Setting and maintaining standards and rules is the basis of defining the services to be delivered to the users of the NPA. To support this we have established the Standards Authority – which will have responsibility for enabling change to these standards over time. We will require the CIS provider to adhere to these standards. We will finalise our governance arrangements (standards framework) later in the year and, in line with our desire to have openness and transparency on the development of standards and rules, we are already consulting on how we expect to utilise standards as an opportunity to make UK payment systems work better for everyone.[3] We will continue to work closely with the Bank (in its role as operator of CHAPS) to help ensure that the introduction of ISO 20022 enables benefits to be realised throughout the economy.

- **Control of interactions in value chain with rest with Pay.UK**. As the PSR has recognised, governance arrangements and questions of who controls decision-making can help to constrain the behaviour of the CIS provider, simply by ensuring that they do not have free-reign to act in a way that would cause risks to competition and innovation. Clearly, we will be appointing a CIS Provider with significant expertise that we will wish to benefit from. However, we anticipate that as far as is possible it will be Pay.UK that will have control and decision-making responsibility, with the CIS provider acting under our direction. Hence it will be Pay.UK, and not the CIS provider, that has control of issues such as the cost of access to the NPA or the testing process that needs to be followed. This will help to mitigate the risk of access conditions being used to distort competition between the CIS provider when competing in other markets. Similarly, it will be Pay.UK, and not the CIS provider, that will govern decisions about changes to the CIS services so that the CIS provider cannot favour ideas that would benefit other parts of its business.

- **Confidentiality of information between different parts of a supplier**. Pay.UK will require effective handling and protection of confidential information as part of the contract with the CIS provider. Such provisions will limit the extent to which information flows between different parts of the CIS provider – even if it is a standalone provider with no commercial interests elsewhere in the NPA ecosystem or in (potentially) competing systems. In other

[3] https://www.wearepay.uk/next-generation-standard-for-uk-retail-payments/

cases, in order to facilitate competition in new services, we will ensure transparency of critical information to a range of suppliers in a way that effectively addresses any advantage that the CIS provider would otherwise have. In some cases, this might involve communicating key decisions about the capabilities and development of the NPA to all Participants in the ecosystem so as to ensure that there is no informational advantage for the CIS provider to benefit from.

- **Business separation**. We recognise that potential CIS providers will be structured in different ways and we will need to consider this issue in respect of all of our objectives including those surrounding competition and innovation. Some potential CIS providers may already have some form of separation in place within their wider group company, and others may make proposals regarding structural arrangements that we will need to assess to assure ourselves that our requirements (including the need to mitigate risks to competition and innovation) will be met.

Annex 1 - Pay.UK's responses to the PSR's consultation questions

In addition to discussion of monopoly, horizontal and vertical issues as set out above, answers to each of the PSR's specific questions can be found below. As with Parts 2 and 3, because of the need to protect the effectiveness of the procurement and negotiation process that we are running, some of our response is kept deliberately at a high level.

Questions related to competition and innovation risks

1) We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?

Response

42. We broadly agree with the PSR's overall high-level hypotheses. As the PSR is aware, we are looking at risks to competition and innovation in the NPA in detail as we work through the NPA Programme. Through our consideration of these risks, we have identified additional hypotheses that are not contained with the PSR's monopoly risks (M1-M4):

- **Quality of service**: We have identified a risk that the CIS provider degrades the quality of service in order to save itself money. Without relevant contractual provisions, the CIS provider could decide not to invest or put effort into ensuring service quality, so as to save itself money, and therefore the quality of service could degrade over time. There are relevant contractual provisions, explored in Question 4, which can mitigate this risk. Although the PSR has identified a similar issue in respect of horizontal issues (H3), we believe that this issue also represents a standalone risk irrespective of whether the CIS provider is active in payment systems that compete, or have the potential to compete, with the NPA.

2) How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?

Response

43. The likelihood of the various hypotheses materialising in practice will be lessened by a robust procurement process that supports effective negotiation on key contractual terms. These contractual terms will set a basis for the provision of the CIS, as well as setting a basis for a competitive environment for the provision of other services in the NPA ecosystem. Pay.UK is therefore actively considering the necessary contractual provisions that we will require to be in place as part of our planning and work towards the next stage of the procurement process. The desirability of harnessing the benefits of competition and innovation for the NPA ecosystem as a whole will be a key determining factor in the contractual provisions as well as the design of the NPA itself.

44. We believe that reputational risk will also lessen (although not remove) the likelihood of competition risks being realised. The behaviour of the CIS provider will be constrained somewhat by the threat of reputational risk, both domestically and internationally. As stated in

our response to Question 1, the CIS provider is likely to want to win the contract again after the initial contract ends, so will want to behave in such a way that will make this more likely. The CIS provider will also likely want to maintain a good reputation outside of Pay.UK, for example with PSPs and the rest of the industry, and also internationally, where they may provide other services. Such reputational reasons should help to constrain the behaviour of the CIS provider and instead should encourage the CIS provider to act in a way that would enhance and maintain their reputation.

3) For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?

Response

45. Risks to competition and innovation have the potential to be harmful without the relevant mitigations. As stated in our response to Question 2, and in the main body of this paper, there are a number of categories of contractual provision which would help to lessen the impact of any risks to competition and innovation. For example, SLAs will ensure certain aspects of quality are maintained which helps to mitigate the risk to quality irrespective of who the CIS provider is, but as such also helps to mitigate the ability to degrade overall system quality because of horizontal competition issues.

46. Alongside the procurement process, Pay.UK's aim is to mitigate any risk as much as possible through the design of the NPA incorporating both technical and governance issues, as well as strong and enforceable provisions within the contract.

47. The likelihood of some hypotheses arising in practice will also depend on the position of the CIS provider in other relevant markets. This is something we will take into account, particularly through the contract and related negotiations, to ensure that we have provisions to recognise this both at the start of the contract and also in the future should changes in ownership increase the likelihood of particular risks arising.

48. In the Faster Payment System, the current CIS provider, Vocalink, provides PayPort, a managed service gateway that offers direct access to FPS. Other providers also supply gateway services to facilitate access to FPS for their customers. Vocalink has not been able to monopolise gateway services simply because it is also the CIS provider for FPS. Such a competitive outcome has resulted from the appropriate governance arrangements that Pay.UK and its predecessor organisations have had in place to mitigate the various vertical competition risks. We anticipate that we would take similar steps in relation to governance and the control of decision-making to help to mitigate equivalent risks to distorting competition in the NPA.

Questions related to potential mitigations

4) Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.

Response

49. Pay.UK governance will act not only to prevent restrictions or distortions of competition and innovation, but will also actively seek to facilitate competition and innovation throughout the NPA ecosystem.

50. Decisions regarding the approach taken to the NPA will be made on the basis of evidence gathered from the stakeholders involved in the NPA ecosystem. The overall governance process should ensure that the views and interests of all PSPs and end users are represented throughout the NPA Programme and ongoing life of the NPA, for example through the newly formed NPA Strategic Participant Group, Participant Advisory Council, Participant Engagement Forum and End User Advisory Council. Other aspects of Pay.UK governance, such as Pay.UK control of governance processes, and overall decision-making power, will also add to the mitigation of risks to competition and innovation. The independence of Pay.UK's Board is also an important element of ensuring the mechanisms mentioned here are effective.

51. For the additional risks presented in answer to Question 1, we are considering what approaches would most effectively help to mitigate these risks. Mitigations being considered in respect of the risks to the quality of service hypothesis are likely to include:

- design requirements relating to the robustness and resilience of the provision of the CIS;

- clear contractual provisions, such as Service Level Agreements, setting out expectations of the level of quality required for key performance indicators; and

- governance procedures including Pay.UK's control of processes on aspects of the NPA operation.

52. Mitigations being considered in relation to the future risks to the contract transitioning to an alternative CIS provider at the end of the contract period include contractual provisions allowing:

- Pay.UK to have access to key people, intellectual property, documents and assets registers; and

- Transfer of assets at a fair market value to the new provider, if needed.

5) Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?

Response

53. As the PSR is aware, Pay.UK is actively assessing the mitigations to risks to competition and innovation in the NPA that could be put in place and we will be considering these throughout both the procurement process and the ongoing development and operation of the NPA. As previously commented, a robust procurement process that supports effective negotiation on key contractual terms will enable contractual provisions that act as effective mitigations for future competition risk, for example around quality of service. The design of the NPA, including standards and rules, will act as an effective mitigation for some risks, such as ensuring fair and easy access to the payment systems. Any mitigations Pay.UK puts in place will be strong and enforceable.

54. As well as ensuring the initial design and delivery of the NPA helps to mitigate potential risks to competition and innovation, we recognise that as the PSO for the NPA we will have an ongoing responsibility to facilitate competition and innovation over the lifetime of the NPA. As is clear from the fact that four out of our six strategic objectives explicitly mention competition and/or innovation, these ongoing objectives will also help to design and govern approaches that encourage competition and innovation over time.

6) Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.

Response

55. The cost of some mitigations will be dependent on the CIS provider. The position in relevant markets and ownership of the CIS provider would play a part in this. We will be reviewing this throughout our procurement process to consider the cost that mitigating risks to competition and innovation could present, and the most efficient way of doing so.

56. We are considering how the design of the NPA may affect competition and innovation at different parts of the value chain, and between different providers or different types of PSPs. For example, in general we believe that it is appropriate for the CIS to be relatively "thin" so that the majority of the value chain can face ongoing competition between a variety of suppliers. However, it is nonetheless important that we consider whether making the CIS unduly thin could disadvantage certain types of PSPs such as small PSPs. It may be the case that excluding some services from the core CIS provision may simply make it costly for small PSPs to provide, or obtain, these services for themselves. Pay.UK will think carefully about the requirements of the CIS and what will sit inside and outside of the tender, ensuring it does not create unnecessary burdens or cost for particular PSPs.

57. Significant thought would need to be given to a response from the PSR which imposed strict requirements on the CIS provider and which materiality affected the attractiveness of the proposition and the cost this could impose. If, for example, the CIS provider were to be

prevented from providing services downstream, this could be more costly than having them in the market with appropriate restrictions to prevent them from unfairly exploiting their position as the CIS provider (i.e. there may be an efficiency saving if the CIS provider were able to take part in the market). We also have concerns around requirements that would unduly restrict the CIS provider utilising assets and intellectual property from other ventures, particularly if using such assets was a core part of the offering valued by Pay.UK in the procurement process.

58. As the PSR is aware, any form of structural mitigation in respect of risks to competition and innovation is likely to be a more costly form of intervention compared to mitigations that focus on behavioural requirements. Separation is costly, particularly where structural separation is required. It may be the case that some potential CIS providers already have some form of separation in place within their wider group company, but for others this may not be the case. Imposing structural separation requirements would have to be considered with caution, particularly before seeing any harm arise.

59. As far as possible we will be seeking to be neutral in our requirements regarding the ownership and legal structure of the CIS provider as long as we are able to assure ourselves that the full range of our requirements (including the need to mitigate risks to competition and innovation) will be met. We retain the ability to choose an alternative provider right up until the point that the contract is signed, should the contractual provisions that we consider to be commercially necessary, and required to mitigate the full range of risks, not be agreed.

60. We also recognise that the nature of the risks to competition and innovation may change as new products and services arise over time, and also as ownership arrangements may change in the future making some risks more or less significant over the lifetime of the initial CIS provider contract and over the lifetime of the NPA. As far as possible we will therefore seek to have the flexibility to mitigate risks as different issues arise.

7) Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

Response

61. As explained in answer to Question 3, one of the ways in which we currently mitigate certain types of competition risk is through governance and control arrangements. For example, in the case of Vocalink providing PayPort as a managed service gateway that offers direct access to FPS alongside other competitors offering similar gateway services, Pay.UK, and not Vocalink, retains control of the processes surrounding access. We would anticipate that similar mitigations to prevent the CIS provider from exploiting its position would be appropriate in the NPA.

62. Contractual obligations and Pay.UK's governance processes already provide significant mitigations against potential harm both in terms of the behaviour of the CIS provider and also through the wider value chain. Contractual requirements already help to address issues such as the control of costs, the need for continual improvements, investment and innovation. Governance processes already help to prevent distortions arising between different firms.

Specific functions such as our aim to be a catalyst of innovation will also help to ensure that ongoing innovation is facilitated.

63. The change in ownership of Vocalink also provides an illustration of the importance of recognising that the nature of competition risks can change over time. Previously there may have been more concern surrounding vertical arrangements leading to risks to competition at the PSP level because the, mainly large, PSPs that owned Vocalink also competed against other PSPs downstream. However, the change to majority ownership by Mastercard increased the risk of horizontal competition issues arising.

64. Irrespective of who is appointed to be the CIS provider, change in ownership or a change in other aspects of their activities, such as entering a new market or withdrawing from a market will alter the extent to which particular types of risks to competition and innovation are likely to be of most concern. We will therefore seek to be able to have the flexibility in place now to be able to address such changes in future.

Revolut

Revolut

[redacted]

01 May 2020

Response to CP20/2 - Call for input: Competition and Innovation in the UK's New Payments Architecture

4.2 Questions related to competition and innovation:

1. **We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?**

We feel that the vertical and competition issues cover the potential impact on competition and innovation sufficiently. A central common NPA infrastructure which allows for other suppliers to offer overlay services would be positive for competition in the payments industry and could facilitate the creation of more innovative models.

2. **How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?**

<u>Scenario 1: vertical competition issues</u>

There could be a risk of unfair competition if the NPA CIS provider provides overlay services itself. This is primarily because the NPA CIS will have access to information about the progress of the NPA that is not available to other potential providers, which will only have a negative impact on those other providers' ability to offer new services in the market. This could also result in less innovation as potential providers may feel they cannot compete with the NPA CIS.

Scenario 2: Horizontal Competition Issues

We feel there are less competition issues with the horizontal model though appreciate that the NPA CIS may still have some influence over which providers participate and ultimately provide overlay services. Using commercial information gained from operating the NPA CIS to design new services (H1), and degrading the service of the NPA infrastructure to give alternative systems an advantage (H2) are considerable risks. Revolut is of the view that these risks are unlikely to materialise within the existance of a properly-functioning governance structure within NPA CIS that imposes appropriate controls on the process for onboarding overlay service providers.

Monopoly issues

The identified monopoly issues are in line with those Revolut considers high-risk in this scenario. Despite this, we understand these risks will be mitigated via a well-designed and executed procurement process. This would also help mitigate some of the vertical and horizontal risks as long as there are appropriate controls.

1. **For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?**

We feel that the vertical competition issues would be most harmful to the payments industry. Revolut supports a centralised NPA CIS structure that encourages the procurement of strong OSPs, and encourages innovative models. We hope that Pay.UK will strongly consider pricing more appropriately in light of COVID-19 to allow PSPs to and OSPs to access the NPA CIS, and to minimise the impact on competition and innovation longer term.

4. 3 Questions related to potential mitigations:

1. **Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.**

If Pay.UK creates an appropriate governance structure for the NPA CIS with controls around pricing and procurement, this should help mitigate the potential vertical and horizontal competition issues highlighted in the consultation paper.

Revolut Ltd, [redacted]

2. **Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?**

Pay.UK should consider a proper tender process for OSPs to encourage them to apply to provide overlay services. We support the idea of creating rules around when decisions can be made to alter the technical specifications for the NPA CIS, and the opportunity for parties other than the decision maker to engage. Revolut also supports the implementation of an API to allow OSPs and PSPs to use the system efficiently.

3. **Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.**

It could be damaging to mandate that the NPA CIS provider cannot have any economic interest in the market for NPA overlay services or any other payment system that could compete with NPA services. We do not support this option as it could shut off potential providers from engaging with the model where those providers may be best in the market.

4. **Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.**

No comments.

Santander

Santander UK response to PSR CP 20/2

Call for input: Competition and Innovation in the UK's New Payments Architecture (NPA)

Overview

a) Santander UK (hereafter Santander) welcomes the opportunity to contribute to the PSR's call for input into the competition and Innovation in the UK's New Payments Architecture (NPA).

b) Santander continues to support the need to evolve the Bacs and Faster payment systems, in particular the capability to send and receive all relevant messages (used in the payment system) in the ISO 20022 messaging standard. However, it does not support any material change to the central 'rail-tracks' (i.e. Bacs and FPS) currently operated by Vocalink (either by re-tender or wholesale change to its structure) and rather suggests that any attempt to bring competition into the eco-system is in the layer that sits above this e.g. through allowing trusted parties access to usable, available data.

c) However, we consider that risk appetite has changed since the original requirements under PSR General Directions 2 and 3 were agreed. The overall landscape around access and competition has materially changed, with considerably more participants and connected entities in place now, and the scale of collaborative and competitive innovation has evolved considerably as the digital footprint for consumers has increased.

d) The NPA scope encompasses Critical National Infrastructure and change to any or all of the service needs to be carefully considered, with a clear business case for the change, balancing this against the possible negative impact on stability and resilience that could materialise as a result.

Santander Responses:

1. ***We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?***

   We do not consider that there are any additional hypotheses to flag. Whilst encouraging competitive innovation and unlocking new business opportunities are important, we would emphasise here the paramount importance of

   a) non-competition related factors, such as sustainability, operational resilience and ensuring payments are safe and secure and

   b) considering this project in the context of the wider payments landscape and changes currently underway. Procompetitive collaboration across payments has been a consistent benefit to end consumers and to the evolution of the ecosystem into one of the world's best services. We believe the efficiencies generated in achieving these aims far outweigh the possible harm likely to arise from the hypotheses identified by the PSR, provided that the safeguards discussed below are applied.

The wider payment landscape is changing already, with SWIFT, CHAPS and Open Banking roadmaps already in play, and many others planned – this in addition to the need for regular maintenance, Scheme mandated changes, and the ongoing need to innovate and plan for the future. Alignment of any new architecture to those Standards will help with bringing more standardisation across payments and remains essential to the simplification agenda as set out in the Payment Strategy Forum vision. Bacs and Faster Payments services are part of the Critical National Infrastructure and provide the ability to move money in real-time or timely batch processes for the majority of transactional needs in the UK between bank accounts. Service reliability and stability is an essential feature of this model. In this context, there are very real and material risks that will be generated by introducing too much change into this complex landscape. Any proposed change needs to be assessed carefully and the risks fully understood. This is not to say that change should be delayed or deferred, but we would emphasise the importance of incremental change, utilising the skills and experience already within the system.

In particular:

- we are firmly of the view that the NPA CIS needs to be operated by a single provider (as it is today) – which in turn means that the NPA CIS is likely to be owned by a single entity. This generates some obvious competition concerns. However, by way of an illustrative example, we consider that the central infrastructure used today works well; Vocalink have the experience and scale required to operate it. In the past, the Industry has suffered at the hands of new, inexperienced scale suppliers, for example in the case of the Cheque Image Clearing Service (ICS); and
- we consider that the complexity of change could be simplified to focus on the central infrastructure, 'rail tracks' service, being maintained as-is, with the layer around that delivering the innovation and additional services. Innovation for example can be stimulated from a better use of the available data, more concisely accessed and available to trusted parties, this in itself does not need a whole new infrastructure; ISO20022 will bring richer data and structure to support this. Any request to bring competition into the 'rail tracks' space (either by way of tendering a new single supplier or an attempt to introduce multiple suppliers) needs to be carefully considered and the scale of risk to change needs to be well understood and accepted given the potential impacts to the critical infrastructure. In short, we consider that the real 'value-add' isn't on the 'rail tracks' but on the layer on top.

So our position is: continue with a single central "rail-track" provider; introducing competition in the overlay service, ensuring access to the transactions data is carefully controlled, but available to regulated entities that can provide supporting services, such as Fraud & Financial Crime controls. The perceived need for competition in everything payments should not over-position the need to manage a stable and cost-efficient payment service, which delivers efficiencies that benefit consumers.

If there is a position that can agree the "rail-tracks" remain as is, with a surrounding layer open to competition, this could be delivered more quickly, and with greater benefit for the wider ecosystem and consumers: on the other hand, a lengthy procurement process, time to embed a new (or many) supplier(s) and deliver the migrations will most likely be a lengthy and costly process, with no or limited gains to consumers.

2. ***How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?***

As noted above, we do not support any material changes to the current 'rail-track' service. We do, however, support a re-evaluation of the commercial parameters of the existing offering. We also provide our views on the competition hypotheses and mitigants for completeness.

Whether the Industry would benefit from a full procurement process needs to be carefully considered; the time and effort, including costs, required could be considerable, and the wanted benefits are unlikely to materialise. A better solution may be to drive a more transparent current supplier approach, akin to an "open-book" accounting model with an agreed margin, with value in procurement driven from those overlay services that can be effectively separated out – whether the incumbent can tender for those services needs to be considered. What is essential is the process ensures everyone is comfortable with what is being proposed.

The wider ecosystem is likely to receive a more immediate benefit from delivering a renewed plan focused on a single supplier, with clear direction to move to an ISO20022 migration roadmap over an extended window, enabling access to data and services, and stimulating competition in the overlay service space.

However, in the event that a full procurement process is run:

- In relation to the monopoly issues flagged in the consultation paper, we share the PSR's view that a well-built, competitive procurement process run by Pay.UK will adequately address any competition concerns. As explained above, it is of paramount importance that any attempt to mitigate the competition issues identified in the consultation paper does not impinge upon the 'efficiency-enhancing' core functionality, reliability, security and resilience of the system.

- As regards the other vertical and horizontal competition issues, we understand that there may be possible hypotheses driven by Vocalink's ownership by Mastercard, with the latter's wider role in the payments sector and its possible incentive to leverage any position as NPA supplier into its existing or new markets. [redacted] In any event, should Vocalink win a competitive procurement process (as best candidate), we consider that any possible concerns could be addressed through separation structures or 'ring-fencing' to address potential conflicts of interest. Our expectation is that any minimum form of ring-fencing should ensure access to all services (such as test environments, consultancy), intellectual property and opportunity for all participants to collaborate and influence the product roadmap. We reflect on the original position that the CMA took when reviewing the MasterCard purchase of Vocalink and believe this remains a valid assessment.

3. ***For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?***

As noted above, we need a stable 'rail-track' for the central payments infrastructure to run on. Operational resilience and stability should be the primary priority – this is the key feature consumers of these services need. We do not consider that any of the hypotheses identified present concerns that would outweigh this primary objective.

The original Strategy Forum output considered many detriments existed, but we feel the vast majority of these have evolved. As already mentioned, we believe the scale of competition and innovation in payments has exponentially increased since that report, as well as the evolution of Open Banking which has created an additional enabling space for Third Parties to consume and enhance payment services. A push to continually change and to try to find small enhancements to stimulate pockets of growth can have a detrimental effect on the ability of many to innovate; where significant cost is incurred for marginal benefits, the wider customer population will not benefit from the scale opportunities that could exist. We would caution that a rapid scale change with NPA would have a material impact on this.

4. ***Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.***

As noted above, we need a stable 'rail-track' for the central payments infrastructure to run on. Operational resilience and stability should be the primary priority – this is the key feature end consumers of these services need. We do not consider that any of the hypotheses identified present concerns that outweigh this primary objective.

The original Strategy Forum output considered that many detriments existed, but we feel the vast majority of these have evolved and have actually decreased or disappeared. As already mentioned, we believe the scale of competition and innovation in payments has exponentially increased since that report, as well as the evolution of Open Banking which has created an additional enabling space for Third Parties to consume and enhance payment services. A push to continually change and to try to find small enhancements to stimulate pockets of growth can have a detrimental effect on the ability of many to innovate; where significant cost is incurred for marginal benefits, the wider customer population will not benefit from the scale opportunities that could exist. We would caution that a rapid scale change with NPA would have a material impact on this.

5. **Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?**

We consider the use of appropriate governance arrangements and operational separation or ring-fencing as effective mitigants to alleviate the potential harms. We consider the implementation of a "utility-type" model as an effective structure that would address competition concerns.

The Bank of England effectively oversees the current supplier, and it remains key that this governance remains to ensure the stability of the supplier and services.

It is essential that NPA considers the wider landscape changes, in particular around ISO20022 and the commonality this brings, with a need for consistency in both message services and delivery strategy. Careful planning and phasing is essential, with clear guidance provided on both the long term strategy (e.g. migrations completed by x date to new standards) and the shorter term flexibility to enable new services in the competition space (for example the ability for many to consume central data services to provide data analytics for Financial Crime and Fraud prevention). A lot of time has been taken to consider the widest needs of the payments landscape but taking a more conservative and logical approach to the core services would enable a more controlled review and quicker decision-making process.

6. **Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.**

We consider there are costs and benefits associated with all the approaches.

7. **Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.**

No further comments.

TransferWise

PSR Call for Input – NPA Competition and Innovation

Dear PSR,

We read through the document "Competition and innovation in the UK's New Payments Architecture" and agree with the risks and mitigations proposed. We would like to highlight two additional risks and propose mitigation options.

Connectivity to the NPA

At the moment, if participants wish to get connected to the Faster Payment Service, there is a limited number of options:

(1) You can establish an MPLS connection via BT to Vocalink;

(2) You can establish a connection, either via the Internet or MPLS to a gateway service provider such as Vocalink's PayPort;

(3) You can partner up with intermediary service provider who shields the connectivity layer from the participant and offers an API to which you can connect to over the Internet; or

(4) You can connect to another direct participant using their connectivity mechanisms (SFTP, API, UI etc.).

If competition is the subject, then one key principle should be that access to common infrastructure should not create a competitive advantage to any participant.

Options (2) to (4) are workarounds involving third party intermediaries, whose services add additional costs to the participants. This means that from a cost perspective, participants utilising option (1) will have a competitive advantage over participants using (2) to (4).

Option (1) however is expensive to set up and maintain, creating an entry barrier to smaller and emerging participants. We estimate that up to 70% of setup costs for Option (1) could have been reduced, if alternative direct connection mechanisms (see "Mitigation" below) were available at the time of our connectivity.

Additionally, there are significant costs (including engineers) to maintain the data centers, just because we are required to have an MPLS connection to Vocalink, which could only be used for connecting from physical data centers.

The requirement for a physical connection for the most direct access effectively creates a lock-in for the Central Infrastructure provider. If enough of the volume has been set up on MPLS or any other direct connectivity, there is significant friction introduced to a particular provider, increasing any switching costs noticeably. This in turn creates reluctance for incumbents to switch, while creating an entry barrier or a competitive disadvantage to new joiners and smaller participants.

Mitigation

We propose that for the NPA a diversity of connectivity options is made available. For participants who have physical infrastructure footprints in place and in whose best interest it is to continue using physical connections, then the physical data center and physical connection option should remain at their disposal.

However, an option to connect to the Central Infrastructure over the Internet either using a Virtual Private Network (VPN) or public-private key encryption should be made available. This would not only give participants the choice to set up their payment systems on the cloud, but it would also mitigate any lock-ins to a specific connection mechanism and to all the costs associated with it.

Trust service provider

One core piece of functionality of a Central Infrastructure is for the participants to access their data, mainly for the purposes of reconciling settlement cycles. At the moment, the Faster Payments Central Infrastructure has been built up in a way that to access the data a whole separate connection is required.

The cost optimal way for setting up such a connection is to sign up with the Universal Trust Service Provider (UTSP), a subsidy of Pay.UK.

There is a disproportionately large cost just to access reconciliation data, which is part of the fundamental functionality. The problem stems from the Central Infrastructure provider having set up the access in this particular way.

This specific example could be generalised to a higher level risk where the Central Infrastructure could be offering services in several parts unnecessarily, causing costs to inflate without a clear reason. Note: While UTSP's service strictly isn't offered by the Central Infrastructure provider in this instance, however the need for it does stem from the Central Infrastructure provider.

Mitigation

In this specific example, accessing the infrastructure in order to send and receive payments, and later reconciling the data should not be two separate products. Rather, both features should be made available as part of a single package for facilitating payments, without any additional setups or costs.

This would reduce the complexity for both Pay.UK to manage their portfolio of features as well as the setup complexity for the participants.

From a higher level point of view, we'd suggest having a control mechanism which would critically assess whether what is offered by the Central Infrastructure provider is optimal or not.

Conclusion

In conclusion, we believe that the PSR's approach with regards to the NPA is heading in the right direction. We would suggest adding the aforementioned, perhaps more subtle points to the list of risks regarding competition.

PSR Call for Input – NPA Competition and Innovation

Amendment to response, March 2020

Dear PSR,

In addition to our responses submitted to the Call for Input on February 25, 2020, we wanted to highlight one additional risk point to consider.

Specifically, Competition and Innovation in the UK's New Payments Architecture document mentions the following with point 1.6:

> *Pay.UK proposed to comply with our directions by procuring replacement infrastructure for FPS and Bacs that is consistent with the ambition of the NPA.*

This point implies that the scope of the NPA includes the replacement of Faster Payments as well as Bacs. However, there is a significant risk that the participants of Pay.UK operated schemes may pressure Pay.UK to limit the scope of the NPA to FPS only, in order to cut costs or increase the speed of developing the NPA.

If the scope of the NPA is limited to FPS only, then in the long run Bacs payments will be missing out on all the benefits that a migration to ISO20022 can bring, such as improvements in speed and having richer transaction metadata.

With this short amendment, we suggest the PSR to review risks around Bacs being left out of the scope of the NPA.

TSB

From: [redacted]
To: PSR NPA
Subject: CP20/2 – Call for input on competition issues that could arise in the UK's New Payments Architecture (NPA)
Date: 01 May 2020 14:13:19

Good Afternoon

Please see below for a response from TSB Bank related to the call for input on Competition and Innovation in the UK's New Payments Architecture

Questions related to competition and innovation:

1. We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?
    - The competition risks and impacts identified cover scenarios that could occur . An additional scenario could be if the incumbent were to remain as NPA CIS provider, and has access to existing scheme information that provides them with a competitive advantage in terms of managing customer migration from existing overlays to new ones

2. How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?
    - It is highly likely that incumbent Payments infrastructure providers will apply for the NPA CIS contract given that they will have expertise. The likelihood of anti-competitive behaviour materialising is dependent on how they are regulated, and what services they are able to offer and when , outside of the core clearing processes.
    - If the appointed NPA CIS provider is asked to provide an initial set of overlay services, then that vendor may gain a first mover competitive advantage through no fault of their own.

3. For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?
    - A horizonal competition risk could materialise if point of sale payment innovation was inhibited by a conflict of interest. This could occur if the CIS Provider is also an incumbent PoS payment service provider. Alternatively, they may be incentivised for NPA to succeed if it enables a more efficient payment journey that can be leveraged.

Questions related to potential mitigations:

4. Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.
    - An enforced delay on the provision of overlay services by the CIS Provider would

mitigate any first-mover advantages that could be gained. An overlay market place should exist from Day 1, to avoid concentration into a single provider that then effectively becomes a monopoly, and measures should be taken to ensure that users can switch between providers of overlay services easily.

5. Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why
    - Mitigation 1, 'Technical Design' , could be an effective way to prevent the CIS provider creating barriers to entry in the development of overlay services. Use of common interfaces and standard API's to connect to the core settlement service will create a level playing field for all overlay providers. Early distribution of these standards to industry will also ensure no first mover advantage is gained by the CIS Provider. Further actions to help foster competition are the open provision of sandbox/test facilities to the marketplace, and open monitoring of service performance of all overlay service providers , to ensure the NPA CIS provider is not gaining a performance advantage through co-location of infrastructure
    - Mitigation 2, 'Governance Design' , could provide effective oversight of the CIS Provider if executed by Pay.UK. This could ensure that no unfair advantage is gained by the CIS Provider should they also develop overlay services. This will be an effective check and balance to ensure the CIS Provider is operating in the best interest of service users, given the criticality of the clearing and settlement service to national Payments infrastructure
    - Mitigation 3, 'Reducing economic interest of the NPA CIS provider in overlay markets through separation'. This could help by mandating that operationally separate entities within the same legal entity would be needed where there is intent to provide both clearing & settlement services, and overlay services. This would reduce likelihood of unfair advantage being gained by a single entity having the ability to develop and test overlay services whilst also developing the core service in parallel.
    - A phased and iterative ramp up of NPA, which is desirable in order to reduce risk, would require a degree of parallel running with existing Payments infrastructure. Introducing horizontal constraints to prevent suppliers operating existing and new infrastructure could exclude providers from the selection process, to the detriment of the NPA

6. Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why

    - Any constraints placed around legal entity separation at the point of contract signature are valid, but there is a risk around the ongoing enforcement of such constraints especially in the context of the CIS provider being involved in merger/acquisition activity which may compromise the original separation.

7. Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

    - Measures taken in recent years to improve access to the existing schemes, both in terms of liquidity access at the central bank and also in terms of technical access through aggregators/bureaux, has increased the level of competition and ease of access to the payments ecosystem.

Regards,

[redacted]

[redacted]

UK Finance

Competition and Innovation in the UK's New Payments Architecture

Call for Input

Date: 25 March 2020

Address: PSR Pay.UK/NPA project team
Payment Systems Regulator
12 Endeavour Square
London
E20 1JN

Sent to: PSRNPA@psr.org.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

1. Payments in the UK is a collaborative industry process essential for the functioning of UK society and is enabled by payments providers, payment systems and market participants – all working within the remit of law and regulatory oversight. It is essential that UK consumers and businesses are able to make payments effectively and UK Finance recognises the importance and significance that the New Payments Architecture (NPA) has in promoting competition, enabling innovation and ensuring resilience to the UK's economy.
2. There are many methods that UK consumers and businesses can use to make payments; ranging from Bank of England notes and Royal Mint coin, money service businesses, e-money, cheques, payment initiation services enabled by Open Banking, FPS, Bacs, CHAPS and the facilities of the card schemes.
3. UK Finance notes that the competition risks that the PSR raises are useful to consider. However, at this early stage in the development of the NPA these concerns remain somewhat conceptual as it is not clear how the NPA will finally be constituted, both from a technical and a governance perspective. This makes it somewhat difficult to provide concrete responses to the PSR's suggested remedies and potentially introduces a certain amount of regulatory uncertainty at a time when Pay.UK's NPA procurement process is already underway.
4. In particular, UK Finance and its members wish to highlight the key role that the technical and governance design of the NPA will have on ensuring that these competition risks do not materialise. These were clearly laid out within the Payments Strategy Forum (PSF) blueprint[1] and UK Finance recommend that, as the scope and design of the final NPA become clearer, the PSR and industry assess what design principles outlined within this document have been appropriately implemented within the final design, where additional

[1] https://implementation.paymentsforum.uk/key-documents

[redacted]

controls may have been put in place and whether there are ways that the original design principles must be re-evaluated in light of industry development.

5. Given the controls already proposed by the PSF, UK Finance and its members do not anticipate that any of the scenarios outlined by the PSR will materialise in the short to medium term.
6. This said, whilst Pay.UK has been given clear direction through the letters from the PSR[2] , we agree that there is still a need for the final design and governance of the NPA to evidence how it answers the competition risks raised by the PSR. Such a design must answer these concerns as well as ensure the resilience and reliability of the central infrastructure in order to enable the effective delivery of products and services to UK plc through conventional means and through overlay services. We look forward to engaging with the industry, Pay.UK and the PSR as those designs gain greater clarity.
7. While the PSR note that it has 'set aside' questions regarding current mitigations; it is expected that the NPA will be a payment system designated by HM Treasury for the PSR to regulate[3] and that this will be concurrent to the activities of the Financial Markets Infrastructure Directorate[4] at the Bank of England in this area. The continuance of these activities is considered by UK Finance and its members to be essential controls against an anti-competitive market developing.
8. The mitigations proposed by the PSR to remove or reduce the economic interest of the NPA CIS provider in overlay services or competing payment systems are rational and reasonable approaches to reduce duly evidenced ineffective competition within a market. However, these actions could impact the competitive procurement of a CIS provider, particularly if firms make a decision that the provision of overlay services is potentially more rewarding than providing the central clearing and settlement layer; this could make the procurement less attractive and significantly reduce the pool of potential suppliers. The timing of this consultation does introduce a certain amount of regulatory uncertainty for vendors and UK Finance consider that the PSR should provide clarification before any intervention at this juncture and consult with the industry on the evidenced need for such conditions.
9. Should the PSR consider any of the mitigations it outlines to reduce the economic interest of the vendor of the NPA CIS, UK Finance and its members expect that such action would be duly evidence based and proportionate to the evidenced risk to competition arising – clearly driving towards a desired outcome. UK Finance recommend that this assessment be done in discussion with Pay.UK and wider industry with regards to such a particular concern, rather than prescribed in theory.

1. We have set out a number of hypotheses about how the ownership of the NPA CIS provider might adversely affect competition and innovation. Have we missed any?

UK Finance note the value of the considerations that the PSR has made on the ownership of the NPA CIS; we note that the Bank of England's is currently stepping through a procurement process

---

[2] https://www.psr.org.uk/psrs-open-letter-new-payment-system-operator-npso

https://www.psr.org.uk/psr-publications/news-announcements/psr-open-letter-payuk-may2019

[3] https://www.psr.org.uk/payment-systems/who-we-regulate

[4] https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision

for the renewed RTGS system. It may be worth considering in what way a single supplier providing services for both the NPA and/or overlay services as well as the RTGS would impact the competitive market.

2. How likely or unlikely do you think it is that each hypothesis would materialise in practice, and why? What factors could affect whether these harms materialise?

UK Finance consider that the governance and technical standards developed by Pay.UK to enable the NPA will be the primary factor which could affect whether the harms identified materialise. As the PSF blueprint outlined as core design principles of the NPA; the industry expects Pay.UK to provide 'A single set of standards and rules with strong central governance' and 'End-to-end interoperability (including Application Programming Interfaces and a common messaging standard)'. These design principles also note that Pay.UK should 'be the central body that governs the NPA, including the setting of standards and rules, such as for overlay services and for technical considerations such as security… defining and maintaining the standards for NPA operation.'

These rules, and wider contractual arrangements, should include provisions around access costs (V2), clearly negotiated pricing of services, both for participants of the ecosystem and for any changes required to the CIS (V3, M1, M2, M3, M4), specific service level agreements for all participants in the industry (H3) and provide a clear structure for collaboration on standards to be developed, allowing for appropriate transparency and confidentiality as appropriate (V4). UK Finance expect that the wider governance structure that enables the enhancement of the NPA and any development of its overlay services will involve the clear management of the involvement of the CIS provider, as well as clear expectations as to its development of any necessary functionality (H2, M2).

It should be noted that there are existing controls in place to reduce the potentially disproportionate availability of data to the CIS (V1, H1). Under current arrangements with the infrastructure provider of schemes managed by Pay.UK, there are strict contractual arrangements between scheme participants and the infrastructure provider that mean data collected can only be utilised with explicit approval of participants. Particularly as this relates to, fundamentally, consumer use of payment systems; the data in question is likely to be covered under existing data protection law and the misuse of this data could carry severe penalties if not undertaken with the due permission of the contracting parties and the end-user of the service; particularly as anonymisation and aggregation techniques may not necessarily mean that consumer data can no longer be attributed to specific individuals.[5] Given the use of these similar controls and the wider data privacy concerns, it appears unlikely that these scenarios will arise in practice.

3. For the hypotheses which you think are likely to materialise in practice, how significant or harmful would they be to effective competition and innovation in the payments industry, and why? Are there any in particular that you think would cause particularly significant harm? How might you or your business be affected?

It is considered by UK Finance and its members that the hypotheses made by the PSR will all reduce the level of competition to varying degrees within the market and are supportive of efforts by Pay.UK and the PSR to ensure that there are suitable levels of competition at all levels of the NPA. As per our previous answer, UK Finance and its members believe there are existing industry controls that mitigate the likelihood of these scenarios arising.

---

[5] https://georgetownlawtechreview.org/wp-content/uploads/2017/04/Lubarsky-1-GEO.-L.-TECH.-REV.-202.pdf

4. Are there any types of mitigations that would help alleviate the harm identified that we have not described? In suggesting any new mitigations, please specify how they would help you or your business, or why they would facilitate competition and innovation more generally.

UK Finance reiterate its members' expectations that the NPA will be a payment system designated by HM Treasury for the PSR to regulate and that this will be concurrent to the activities of the Financial Markets Infrastructure Directorate at the Bank of England in this area. The continuance of these activities is considered by UK Finance and its members to be essential controls against an anti-competitive market developing.

Further, we note that there is a key strategic need for the PSR and Pay.UK to work closely together to enable the industry that uses the services of the CIS provider to appropriately manage the activities of the CIS provider. It is in the interests of all participants within the payments ecosystem, and the users of services that they provide, for the vendor of the CIS to be closely managed; UK Finance recommend that Pay.UK and the PSR collaborate effectively in their activities to ensure that the vendor of the CIS competition in the industry continues to be effective and that the industry is appropriately supported in providing vital payment services to UK plc.

5. Are any of the types of mitigations we have described likely to be particularly effective or ineffective at alleviating the potential harms, and why?

UK Finance re-iterates that it considers the most effective mitigations outlined by the PSR are those around the governance and technical design of the NPA. These have already been elucidated in detail. Further, we note the wide range of payment services that operate in competition with an interbank clearing system such as the NPA. These include Bank of England notes and Royal Mint coin, money service businesses, e-money, cheques and services afforded by the card schemes.

6. Are any of the types of mitigations that we describe particularly costly or high risk? If so, please explain why.

UK Finance does not have a view on any particular cost associated with any of the mitigation approaches. It is considered that: the costs associated with any mitigation, the benefits gained through the mitigation and who would bear the cost of any such mitigation; would be dependent upon the specific scenario of a chosen vendor and the mitigation proposed.

7. Are any existing mitigations, to any similar concerns in today's pre-NPA payments ecosystem, particularly effective or ineffective in alleviating the potential harms? If so, please explain why.

UK Finance considers the current monitoring of the payments services by the PSR and the Bank of England's FMID to be particularly effective in alleviating potential harms. The existing separation between the provider of CIS services from Pay.UK, who operate as an appropriate management oversight of this provider, is also an important boundary that should be maintained in the future development of the NPA. We recommend that the PSR consider carefully the outcomes that it wishes to promote in the industry following any intervention it considers

If you have any questions relating to this response, please contact [redacted]

[redacted]

VISA

PSR Pay.UK/NPA project team
Payment Systems Regulator
12 Endeavour Square
Stratford
London E20 1JN

1 May 2020

Dear Sir/Madam,

Re: Call for input on Competition and Innovation in the UK's New Payments Architecture.

Visa Europe Limited (Visa), is pleased to provide a response to the questions outlined by the Payment Systems Regulator (PSR) in its Call for Input on Competition and Innovation in the UK's New Payments Architecture (NPA).

The world of payments is undergoing a period of rapid change, driven by new competitors, innovations, technologies and consumer expectations. Visa recognises the prime importance of standards in building a new ecosystem, especially in providing the secure interoperability that enables seamless customer experience, within a complex, competitive multi-vendor environment.

We therefore welcome the intent of the PSR to provide greater clarity about the nature of regulation that might be applied to NPA, value this opportunity for engagement [redacted]

As this response is being provided during a period of uncertainty in the wider economic and policy environment we would welcome the opportunity to comment further should there be changes to the programme that impact on the issues under consideration.

Visa Response to the PSR Questions regarding Competition and Innovation (Questions 1-3)

Visa recognises the need for the PSR to develop clear policy positions related to the future regulation of NPA. To that end we welcome the stated approach of the PSR, as outlined in paragraph 1.11, that they will work to identify risks that may arise in the development of NPA, before considering what steps may be appropriate to mitigate those risks, depending on their nature and materiality.

Visa also welcomes the PSR's desire, outlined in paragraph 2.7, for delivery of NPA that supports the development of innovation and competition.

Visa is supportive of the open stakeholder engagement approach proposed by the PSR in the introductory sections of the Call for Input as stakeholder views are needed to better identify any risks.

Visa notes that the Call for Input often refers to 'issues' (rather than risks) and we would not want references to specific 'competition issues' to mean that a position had already been taken on how NPA should develop, and further that possible risks were already regarded as actual issues that will arise.

To avoid any risk of predetermination of NPA outcomes we would highlight that the approach to identifying and mitigating risks outlined by the PSR in paragraph 1.11 would be very welcome at this investigative stage of the consultative process; to ensure open consideration of all possible scenarios, frameworks and outcomes.

One such framework proposal, that evidences how sectoral thinking is yet to crystallise, is the belief held by some market participants that competition would be best facilitated through the introduction of NPA that does not rely on a single CIS Provider for clearing and settlement.

We therefore encourage the PSR to remain committed to its open scoping disposition to avoid undue ex-ante approaches and any early introduction of structural remedies that could limit market options and inadvertently introduce a different set of risks to the NPA Programme.

Appropriate design of NPA and the introduction of robust governance from the outset of the project will significantly reduce the likelihood of harms from materialising. This includes the harms envisaged in the PSR hypotheses, particularly the risk that prices to access the NPA Central Infrastructure Service (CIS) are set in a manner that restricts entry and reduces the intensity of competition and innovation.

Outlined below are some further technical design and governance proposals that will act to prevent these harms from the outset.

Visa Response to the PSR Questions regarding Potential Mitigations (Questions 4-7)

Appropriate technical design and robust governance structures to oversee NPA are paramount to ensure the successful introduction of new central infrastructure. As such, we welcome the PSR's focus on both aspects. However, development must start with a foundation appropriate for critical national infrastructure. Consequently, there are two conflicting drivers for success that must be managed:

- Openness vs. Security – NPA must allow third parties to contribute to the overall capability whilst also meeting the rigorous security standards for protecting the system.
- Flexibility vs. Performance – NPA is a long-term provision and must be able to meet day one requirements as well as adapt to future developments.

Technical Design of NPA

[redacted]

This is essential in order to enable good design and subsequently ensure accurate procurement, contracting and development. We also welcome the PSR's view that "the technical design of NPA should facilitate competition and innovation" (paragraph 3.3).

Innovation in NPA design should leverage knowledge from across the ecosystem and explore and evaluate developments in technology and customer behaviour. Innovation opportunities in these sectors include distributed ledger, artificial intelligence, tokenisation, cloud, the internet of things, the migration from cash, bill pay preferences and hidden payments. By keeping a pulse on the latest developments, the CIS Provider will be able to identify key insights that will support the ongoing enhancement of NPA.

Innovation should also be encouraged through a focus on the concept of Open Market Infrastructure (OMI) and by ensuring low barriers of cost and complexity of access provide the conditions to enable innovation on the platform.

Additionally, the CIS Provider, when appointed, must focus on how it will work with Pay.uk to accelerate the speed at which new payments propositions and solutions are brought to market, in order to deliver value to the end-user. In doing so the OMI enables a transparent and level playing field for the introduction of new services with no inherent advantage to the appointed CIS provider.

By focusing on these innovation themes the CIS Provider will enable Pay.Uk to reduce any barriers to entry for new players, reduce the cost to serve participants and align with the PSR's expectation, outlined in paragraph 3.4, that innovation enablers be 'built in' to the functional and technical specifications for the central infrastructure.

The PSR could also consider opening access to innovation on the existing infrastructure. This would provide the opportunity to test approaches ahead of significant architectural change, thereby providing a greater degree of certainty to industry that the correct approach, when chosen, is being carried forward.

We would be happy to arrange a meeting to share more detail regarding our experience of using innovation opportunities to encourage increased participation in the system and to nurture Fintechs, start-ups and challengers to aid them in the development of new payments capabilities and propositions to meet needs of the market.

Good Governance and Transparency

Visa believe that clients' trust needs to be earned. That is why we have a robust governance structure, and we regularly monitor our corporate governance policies and practises to ensure we meet or exceed the requirements of applicable laws, regulations and rules.

A key element required to ensure the necessary control and integrity of a payment ecosystem is a formal governance process to manage both single and multi-supplier environments.

However, a robust governance structure should not simply be viewed as a means to mitigate against to poor behaviour, as set out by the PSR in paragraph 3.1, but is also a means to enable good practice.

The establishment of a strong overarching governance framework at the outset of the NPA Programme, with clarity on responsibilities, accountabilities and consultative requirements for Pay.UK [redacted]

[redacted]

The introduction of good governance from the outset of NPA development will act to fortify the efficacy of the NPA service model and render unlikely the risk of harms, including those hypotheses outlined by the PSR, from materialising in practice.

Of equal importance, is transparency and the provision of contractual clarity relating to relationships within the ecosystem.

The establishment of clear reporting and change management processes during Phase 1 of the NPA Programme will act to facilitate suppliers' competitive provision of 'overlay' services that the PSR envisages in paragraph 2.3 and limit the requirement for future regulatory intervention.

[redacted]

[redacted]

[redacted]

Please let me know if you have any further questions about this response. I can be contacted at [redacted] or on [redacted].

Yours sincerely,

[redacted]

Visa Europe
[redacted]

[redacted]

[redacted]

Vocalink

VOCALINK

Call for input: Competition and Innovation in the UK's New Payments Architecture

Vocalink's response

17 April 2020

1) Executive Summary and General Comments

1. Vocalink welcomes the opportunity to comment on the PSR's Call for Input (CfI).
2. We are surprised that the PSR has chosen to review the structure of the market at this juncture, considering that the existing environment is the result of several previous evidence-based reviews, including:
   - the CMA's in depth examination of the central infrastructure services (CIS) market and clearance of Mastercard's acquisition of Vocalink (October 2016 to April 2017);
   - the PSR's own role in setting up and leading the Payment Strategy Forum (October 2015 to December 2017);
   - the PSR's Infrastructure Market Review (IMR) (March 2015 to July 2017); and
   - the PSR's discussion paper on the use of data in payment systems (June 2018 to September 2019).
3. We note that the competition issues raised in the CfI are hypothetical, and not evidence-based. This represents a fundamental flaw in the approach being taken and is likely to result in hypothetical and conjectural responses.
4. A consideration of the scenarios presented in the CfI demonstrates that each would require numerous conditions to be met, and for no preventative measures to be in place, in order for the hypothetical competition issues to ever materialise. In practice such scenarios are very unlikely and even if they did materialise there are many existing factors which would naturally prevent the hypothetical competition issues arising. These include:
   - strong economic incentives for the CIS provider to make the NPA a success, widen access and encourage the use of overlay services;
   - the risk of reputational damage to the CIS provider in the event that they were to undertake some of the actions suggested by the PSR;
   - a sophisticated buyer (Pay.UK) with strong governance, implementing a thorough procurement process; and
   - robust contractual frameworks, which include best practice 'checks and balances' on the CIS provider including pricing, access, requirements to provide data to third parties, requirements to demonstrate value for money, and benchmarking.
5. Even if the hypothetical competition issues identified by the PSR were likely to arise, a number of the potential 'mitigations' described in the CfI would be extreme and entirely disproportionate, with a high risk of major unintended consequences. They are also completely unnecessary. The technical design and governance enforced by Pay.UK through the procurement and contracting processes will prevent or mitigate any residual competition risk. Any measures targeting the economic interest of the NPA CIS provider in other markets, or involving direct PSR intervention, would be unnecessary, disproportionate, and put the competitive tender process for the NPA CIS at risk.
6. Publication of the CfI is itself already having significant unintended consequences:
   a. The timing of the CfI and the proposed timing for issuing the regulatory policy are deeply unhelpful and damaging to the NPA CIS procurement process, which has been in progress for over a year. The resulting uncertainty in the regulatory environment means that bidders cannot effectively set their bidding strategy. The process of setting regulatory policy and consulting with stakeholders should have been completed prior to the procurement process commencing. However, given that the PSR has chosen to issue the CfI, we believe it is essential that the NPA procurement process is now paused until the PSR's regulatory policy is known and can be taken into account by both Pay.UK and bidders. It is simply not credible to expect potential bidders or Pay.UK to continue the NPA process uninterrupted with such future uncertainty having now been introduced.

b. Additionally, the PSR's decision to issue the CfI is distorting competition and slowing innovation today, and has put Vocalink and other bidders at an unfair competitive disadvantage in the provision of overlay services. This directly contradicts the PSR's objectives to promote competition, innovation and the needs of service users. We are highly concerned at this development, and have added this to our Risk Register. This state of uncertainty will likely continue to distort competition at least until the PSR publishes its Regulatory Policy Statement (and possibly after that, depending on the nature of the final policy). Accordingly, with our legal team, we continue to monitor the PSR's work in developing its regulatory policy and the negative effect it is having on competition and innovation.

7. A regulatory policy is not required in this case and indeed is potentially harmful to competition. However, if the PSR continues with its plan to issue a Regulatory Policy Statement, we note that both the development of the policy and the policy itself will likely supress competition if they, in any way, restrict bidders' ability to participate in the provision of overlay services. Additionally, the PSR should avoid specific or detailed policies as these could harm competition further and would not be future-proof. Rather, if a regulatory policy is issued, it should be generally framed and limited to a set of outcome-based objectives which give appropriate consideration to all three of the PSR's statutory objectives. Furthermore, any regulatory policy should be supported by evidence, be proportionate to the issues identified and, where it is an *ex ante* regulatory policy, based on a robust analysis of the likelihood of the hypothetical issues arising.

8. Competition is currently working well in the provision of overlay services, and it is evolving without the PSR's intervention – examples of this are Request to Pay and Confirmation of Payee, where there are many vendors offering solutions. Any intervention by the PSR in this nascent market, which is not supported by robust evidence, will do more harm than good to competition.

9. We also make the following further general comments:

   - The hypothetical issues raised in the CfI are not based on evidence, nor has the PSR set out any meaningful analysis on which Vocalink can comment. It is therefore not possible to provide a detailed rebuttal to the points raised in the CfI. As a result, this response can only set out Vocalink's key concerns arising from the position of the PSR, and highlight at a general level why the hypothetical issues identified will not arise in practice, and therefore why it would be unreasonable for the PSR to intervene.
   - The PSR has asked whether it has identified all the possible harms linked to competition concerns relating to NPA CIS. One obvious additional issue is the potential impact of the PSR's own actions. The consequence of a policy which, by design or effect, excludes or unduly discriminates against bidders with a track record of delivering and operating payment systems, would be to the detriment of competition, innovation and service users. That is a harm that the PSR needs to avoid.
   - We do not address the 'monopoly issues' identified in the CfI. Although Vocalink disputes that these issues are likely to arise in practice, as the PSR itself states, to the extent these issues could arise they can be addressed in the course of a well-designed and effective procurement process. As far as Vocalink is aware, the PSR has not identified any concerns with the current procurement process that would give rise to concerns in this regard.

10. The CfI sets out a series of questions. Our response is not structured in a question-by-question format because we consider:

    - that there are fundamental issues with the CfI which need to be addressed (Sections 2,3, and 4);
    - the questions raise overlapping issues, and therefore our answers are structured by issue (Sections 5, 6 and 7); and

- although we do not think a policy is necessary or advisable, in the final section we set out what we think are some appropriate guiding principles in case the PSR does decide to proceed with developing a policy.

2) The PSR's Open Letters and CfI are harming competition today in existing markets

11. While hypothesising about what could happen in five to ten years' time, the PSR's approach is harming competition today. That harm will perpetuate and stifle innovation, for the reasons set out below.
12. More specifically, the uncertainty created by the PSR's Open Letters and the CfI is slowing innovation and dampening competition today, to the detriment of service users. The manner in which the PSR is developing its regulatory policy is distorting competition in the provision of overlay services more generally. As explained below, it is also having an impact on the NPA procurement process.
13. Developing and offering overlay services for payment systems has been a core critical component of Vocalink's business strategy for some time. We have made multi-million investments in our overlay services, such as financial crime solutions (including Mule Insights Tactical Solution, Confirmation of Payee), Zapp/Pay By Bank App, Request to Pay and other services which are still in development.
14. The PSR's Open Letters, and now the CfI, have created unnecessary uncertainty in relation to the provision of overlay services, with damaging consequences for Vocalink and competition more generally:
    a. As set out below, the uncertainty is having a significant impact on the competitive NPA CIS procurement process.
    b. There is an underlying concern that the PSR might prohibit the winning bidder for the NPA CIS contract from offering overlay services. As one of the organisations bidding for the NPA CIS contract and currently developing and providing overlay services, Vocalink is at a material disadvantage compared to some of our competitors, both in the provision of overlay services and in the NPA tender process. We are deeply concerned that the PSR's approach presents a risk to our business and strategy, to the extent that it has been added to our Risk Register and is being managed accordingly. With our legal team, we continue to monitor the reputational and financial impact the development of the PSR's policy is having on our business.
    c. The impact on our potential customers is also clear, albeit harder for Vocalink to measure, particularly in the current climate. Potential customers of Vocalink's products and services are likely to be unwilling to invest in developing products and services with us if there is a risk that we will be limited in our ability to provide overlay services, were we to win the NPA CIS contract. We also suspect that our competitors will seek to use this to their advantage. This reluctance to work with Vocalink could manifest itself in a number of ways. Some customers might go to a competitor who is not bidding for the NPA CIS, and therefore does not face this risk introduced by the PSR; other customers might simply delay or not proceed with commissioning an overlay service until the situation is clear. In both cases, competition will, through the PSR's intervention, be prevented, restricted or distorted to the detriment of innovation and consumers.
15. The continuing uncertainty is therefore distorting competition today, and may still continue to distort competition at least until the PSR publishes its Regulatory Policy Statement (and possibly after that, depending on the nature of the final Policy).
16. It is good practice for regulators to undertake a cost benefit analysis of a proposed regulatory policy which takes into account the impact of the policy itself and, importantly, the impact of the process for setting the regulatory policy. We would have expected the PSR to have

undertaken such an analysis. However, it appears that the PSR failed to consider the foreseeable impact of its approach on existing competition.

3) The timing of the PSR's CfI process clashes with Pay.UK's NPA procurement process

17. The timing of the PSR's CfI and the proposed timing for issuing its regulatory policy is deeply unhelpful and damaging to the NPA procurement process, and to the bidding strategy of Vocalink (and, no doubt, the strategies of other bidders).

18. We understand that the PSR is seeking to publish its Regulatory Policy Statement relating to the regulation of the NPA by the end of 2020. At the same time, we understand that the next stage of the NPA procurement process is the Request for Proposal (RFP) and, although Pay.UK has not set a deadline, we expect it to be in 2020. It would be almost impossible for us to respond to the RFP in a meaningful way while the PSR's policy, and therefore the environment in which the successful bidder will operate the NPA CIS, remains highly uncertain.

19. This uncertainty is likely to affect individual bidders differently depending on their other business activities. However, the general impact is clear:

    a. If bidders are required to bid in the face of an uncertain regulatory environment, their bid design and pricing will need to reflect this uncertainty – either through explicit risk premia or through additional costs[1] or investments to manage the uncertainty of what will be required or prohibited. Clearly this would be sub-optimal, and would ultimately be to the disadvantage of end consumers.

    b. Depending on its contents, the PSR's regulatory policy could make bidding for the CIS element less attractive, and reduce competition. If bidders thought that winning the NPA CIS contract would preclude them from offering overlay services, then they might choose to revise their commercial strategy and, for example, only decide to provide overlay services. Alternatively, bidders may choose to bid for the NPA CIS with the intention that, if successful, they will not develop overlay services which (irrespective of whether they would win the contract) they could bring to market. The uncertainty created by the PSR in this context will inevitably have an impact on bidders' strategy in response to the RFP, and ultimately profound adverse consequences to the provision of both the NPA CIS and overlay services.

20. Ideally the PSR's regulatory policy would have been known to bidders well in advance of the NPA procurement process starting. However, now that the PSR has issued the CfI and announced its intention to develop such a policy, thereby creating the uncertainty described, we believe it is essential that the NPA procurement process is now paused until the PSR's regulatory policy is known and can be taken into account by both Pay.UK and bidders.

4) The PSR's CfI is inconsistent with recent extensive regulatory reviews of this sector

21. Both the PSR and the CMA have, in recent years, conducted detailed evidence-based reviews (with, in the case of the PSR, extensive stakeholder input) that have framed the current market structure and competitive environment. We therefore find it concerning that the PSR has now chosen to raise hypothetical and unsupported competition concerns, not previously identified by the PSR's and the CMA's recent evidence-based reviews into UK payments. It appears to us that, by so doing, the PSR is implicitly questioning the previous conclusions reached by the PSR itself and by the CMA, but without producing any evidence or analysis to suggest that there has been a material change in circumstances to justify such an approach.

[1] In order to ensure the quality of the NPA CIS: quality cannot be compromised because of the fundamental importance of resilience of the NPA CIS.

PSR market review

22. The PSR's market review into the ownership and competitiveness of payment systems infrastructure provision (the Infrastructure Market Review or IMR) was a multi-year, evidence-based review that considered many issues similar to those that the PSR is raising in its CfI. The IMR examined the market in-depth, and concluded that in some respects competition was not effective and proposed three remedies to address the competition concerns raised.

23. Specifically, the IMR concluded that there were barriers to competition as a result of:

    - the lack of competitive procurement exercises by the operators of payment systems; and
    - the use of bespoke messaging standards.

24. The PSR implemented remedies which have dealt with these issues, and can be seen in action in the form of the design of, and procurement for, the NPA.

25. The PSR also concluded that the then ownership and governance arrangements were likely to reduce the level of competition in the market for the provision of central infrastructure services. However, before the IMR process concluded, Mastercard announced its planned acquisition of Vocalink. In its final report the PSR concluded that the acquisition addressed the ownership-derived competition issues identified in the IMR.

CMA review

26. Mastercard's acquisition of Vocalink was also considered by the CMA for merger review. At the end of its Phase 1 review, the CMA raised one competition concern in respect of a reduction in the number of credible bidders for the LINK contract. Mastercard offered, and the CMA accepted, undertakings in lieu of a reference to Phase 2, which the CMA concluded would adequately address competition concerns relating to LINK. The CMA concluded that the acquisition of Vocalink by Mastercard did not create any competition issues for Bacs, FPS and the NPA. It concluded that there were no vertical or horizontal competition issues of the type that the PSR has raised in the current CfI.

27. We understand that the CMA consulted widely with the industry, including the PSR, in reaching this evidence-based decision. If the CMA and/or the PSR had concerns relating to Vocalink and/or the relationship between Vocalink and Mastercard, then there have been ample opportunities and powers to act.

Payment Strategy Forum

28. Contemporaneous with the IMR, the PSR set up, managed and oversaw the Payment Strategy Forum (PSF). The process included the identification of 'detriments' to users of the existing payments value chain and, although these can be addressed without the NPA, the PSF proceeded to design the NPA blueprint. The NPA is clearly the consequence of regulatory action and the PSR had ample opportunity to shape its design as it was being developed.

29. It is concerning that the PSR is again looking to target the infrastructure market, particularly given the market for payment systems infrastructure is the result of regulatory action and deliberate (and justified) inaction by the PSR and the CMA.

30. The approaches taken in the previous reviews, and the conclusions reached, are in stark contrast to the current position of the PSR.

31. In the CfI, the PSR now raises hypothetical competition concerns with the market structure that it has played a fundamental role in creating. In the following sections we set out why the PSR's hypothetical competition concerns will not materialise. However, before doing so we note that these hypothetical concerns could be avoided altogether if the PSR was to consider facilitating alternative market structures which are capable of delivering effective competition. The two most obvious alternative structures are:

- Competing interbank payment schemes[2]; and
- Direct contracting between infrastructure providers and payment services providers (such as the SEPA model).

32. That being said, we consider that no regulatory action is required from the PSR at this juncture because there is effective competition for the NPA CIS and in overlay services. If the PSR considers that there is a need to alter the competitive dynamic, then it should consider these alternative market structures as a more proportionate and effective response before taking other regulatory action.

5) Many conditions would have to be met in order for the hypothetical issues to materialise

33. The PSR has identified four vertical and three horizontal issues – effectively, theories of harm. The seven issues that the PSR raised have five underlying concerns in terms of what the CIS provider must have the incentive and ability to do. Each concern has numerous conditions which must exist without effective mitigation by the existing characteristics of CIS provision or actions in the remit of Pay.UK, set out in the following sections, for the PSR's hypothetical concerns to materialise.

34. We have summarised these conditions in the following table and summarised some evidence demonstrating why these concerns will not arise in practice.

Concerns may arise if the NPA CIS operator…	The conditions which must all exist for the PSR's hypothetical concern to materialise in reality	Examples of why the conditions will not arise in practice
… has the ability and incentive to limit third party access to information about the NPA CIS. (V1 and H1)	• there is information which the NPA CIS provider has from developing and operating the NPA CIS that would provide a competitive advantage in developing other services; • the NPA CIS provider is able to limit or delay access to this information; and • it would be more profitable for the NPA CIS provider to limit/delay access to this information, rather than not to do so.	• Technical standards will be set by Pay.UK (paragraph 43) • CIS provider will be contractually obliged to provide information within set timeframes (paragraph 50) • Transaction-based revenues incentivise CIS provider to grow volumes and make the NPA a success (paragraphs 47 and 48) • Risk of reputational damage to CIS provider (paragraphs 48 and 59)
… has the ability and incentive to set higher price for third party overlay services (V2).	• the NPA CIS provider can charge a price to third party overlay service providers that is sufficiently higher than the price it charges its own overlay services and that this impacts the competitiveness of third party overlay services; and • it would be more profitable for the NPA CIS provider to charge this higher price for third party overlay services rather than charging a lower price.	• Prices to third parties will be set by contract with Pay.UK (paragraph 46) • The CIS provider doesn't charge third parties – only Pay.UK. No opportunity to price discriminate (paragraph 46) • Transaction-based revenues would incentivise CIS provider to grow volumes and make the scheme a success (paragraph 47) • Risk of reputational damage to CIS provider (paragraphs 48 and 59)
… has the ability and incentive to degrade the	• the NPA CIS provider can degrade the quality of the NPA CIS overall; or	• Rigorous Bank of England supervisory regime (paragraph 60)

[2] Shortly after the NPA blueprint, the PSF proposed a merger of scheme companies for FPS, Bacs and the Cheque & Credit Clearing Company. This merger was referred to, and cleared by, the CMA at Phase 1. The scheme merger, in effect, ruled out the possibility of any competition between retail interbank payment schemes in the near future

Concerns may arise if the NPA CIS operator...	The conditions which must all exist for the PSR's hypothetical concern to materialise in reality	Examples of why the conditions will not arise in practice
quality of the NPA CIS (V3 & H3)	• the NPA CIS provider can degrade the quality of the NPA CIS for specific overlay service providers; and • it would be more profitable for the NPA CIS provider to degrade quality of the NPA CIS than maintaining a high quality of service.	• Service level agreements (and financial incentives) set in contract (paragraph 49) • Service degradation would cause significant reputational damage to CIS provider (paragraphs 48 and 59) • Degraded service would drive volumes to competitors (paragraph 49)
... has the ability and incentive to prevent or delay third party overlay services (V3 & H2)	• the NPA CIS provider can take actions which delay or prevent third party overlay services from being introduced; and • it would be more profitable for the NPA CIS provider to prevent or delay third party overlay services compared to allowing introduction of these.	• CIS provider will be contractually obliged to provide information or to on-board overlay services within set timeframes (paragraph 49) • Transaction-based revenues would incentivise CIS provider to grow volumes and make NPA a success (paragraph 47) • Risk of reputational damage to CIS provider (paragraphs 48 and 59) • Many overlay services will not require access to the NPA CIS (paragraph 55)
... can use third party information to frustrate competitors' services (V4)	• the NPA CIS provider has advance access to competitors' plans, ahead of others in the market; • the NPA CIS provider would be able to use competitors' plans to prevent/delay introduction of competitors' services; or • the NPA CIS provider would be able to use competitors' plans to introduce a similar overlay service faster; and • it would be more profitable for the NPA CIS provider to pre-empt a third party overlay service as per the above than to allow the development of the service unchallenged.	• Only technical information will be shared with CIS provider for the purposes of on-boarding (paragraph 52) • Transaction-based revenues would incentivise CIS provider to grow volumes and make scheme a success (paragraph 47) • Risk of reputational damage to CIS provider (paragraphs 48 and 59)

35. For the PSR to implement a regulatory policy it must demonstrate, with robust evidence, that *all* of the conditions in the second column are satisfied for any corresponding concern to materialise in practice and, if so, that existing mitigations are not in place or are insufficient to address evidence-based concerns. To date, the PSR has failed to do so. At present, the potential theories of harm are based on inferences that each of the above statements may be true, and inferences that no mitigations would be in place. The PSR cannot credibly create a regulatory policy, which would have a direct influence on the market and all stakeholders, based on a tower of inferences that is not grounded in evidence and on which, as a result, the PSR has not provided a meaningful basis for parties to challenge.

6) The hypothetical issues won't arise in practice: procurement, design and contracting

36. It is clear that the inferences on which the hypothetical theories of harm are based, cannot provide a reasonable or rational basis for a regulatory policy, and certainly not a prescriptive or intrusive regulatory policy. As stated, due to the PSR not providing any evidence or meaningful

analysis to support the hypothetical theories of harm put forward in the CfI, it is not possible for Vocalink to provide a detailed response. However, we highlight below a number of key facts and features of the market that demonstrate that the hypothetical theories of harm are not credible.

37. In short, the NPA CIS has not yet been developed and Pay.UK is only part way through the procurement process for the development of the CIS. A well run procurement process and good governance, both of which are already requirements without needing any additional PSR intervention, will avoid the vast majority of the theoretical issues the PSR has suggested.

Procurement and the role of Pay.UK

38. Pay.UK and the banks who would be connected by the NPA are sophisticated buyers. Pay.UK is in a strong negotiating position; the merger of the interbank payment schemes to create Pay.UK has in effect created a monopsony. There is only one buyer of NPA CIS in the UK, but many suppliers (because of the global nature of the supply-side of the market). Furthermore, Pay.UK has strong incentives and the complete ability to ensure no distortions of competition would arise, even if the NPA CIS provider were to in principle have the incentive and ability to restrict competition in the manner suggested by the PSR.

39. Specifically, Pay.UK will set the scheme rules and, based on those rules, will decide who can and cannot be a member of the scheme. Pay.UK will be responsible for the governance of the rules. Pay.UK will also control the on-boarding process, although it will require support from other parties, including the CIS provider, in respect of the assessment of technical on-boarding. The successful bidder will therefore not have the opportunity to engage in behaviours that could be of concern to the PSR.

40. For Vocalink, the UK market is extremely important. It is a market where we have invested and deployed most of our assets. Delivering and operating a successful NPA is critical to Vocalink's credibility in the global market. Our competitors will understand this and will be competing hard to win. Pay.UK will also understand this and therefore have an even stronger negotiating position throughout the procurement and contracting process.

41. As stated, a well-run procurement process (as required by PSR-issued Directions on Pay.UK), and good governance (of the scheme, the scheme company and the procurement including NPA design and contracting) will avoid most of the theoretical issues the PSR has suggested without the need for further intervention from the PSR.

42. We are concerned that the PSR's perception that there is a need for a regulatory policy might suggest that it has insufficient confidence in Pay.UK to run an effective procurement and contracting process. While this is not our view of Pay.UK or the on-going procurement process, it would be helpful to understand whether this is the view of the PSR, and its motivation behind the Open Letters and the CfI for its regulatory policy.

Design

43. Pay.UK is also in control of the technical design of the NPA and will set the technical standards and requirements. Again, that control will mean that the successful bidder will not have the opportunity to engage in behaviours that could be of concern to the PSR:

    a. Pay.UK has built-in incentives to design the NPA CIS and its procurement in a way that avoids creating the barriers to competition that the PSR has suggested, because Pay.UK wants a successful core infrastructure and a thriving overlay market.

    b. The Technical Standards will be defined by Pay.UK, not the CIS provider (e.g. the definition of the Common Credit Message) and NPA bidders are not participating in Pay.UK's standards definition work. This will minimise the risk that the successful NPA bidder will be able to provide a lesser quality service to its downstream competitors, addressing the PSR's vertical issue 3 and horizontal issue 3.

    c. The CIS provider would not be responsible for 'granting access' to the NPA CIS – this would be Pay.UK's responsibility. Pay.UK would also be responsible for setting standards and controlling accreditation. This would eliminate the ability of the successful NPA bidder to delay or block the introduction of third party overlay services, further addressing the PSR's vertical issue 3 and horizontal issue 3.

d. The CIS provider could, if Pay.UK felt it necessary, be contractually obliged to create 'sand box' access for other overlay service providers to have access to information about CIS; this access would be controlled by Pay.UK. This would restrict the ability of the CIS provider to access information about a competitor's services, addressing the PSR's vertical issue 4.

Contracting

44. As a bidding party in active competition across many markets in the UK and globally, it would be inappropriate and commercially harmful for Vocalink to share our views on specific contract terms relevant to the PSR's issues. However, the general point is that contractual terms negotiated all at the same time, and before the contract is awarded, could address many of the PSR's hypothetical issues. Contract terms would cover pricing, quality and data rights amongst other matters.

45. In this context it is also important to note that Pay.UK is under the supervision of the Bank of England because it operates systemically important payment systems. The Bank of England has non-objection rights over material business changes such as the introduction of the NPA. We therefore expect that the Bank will undertake a thorough review of the award of the contract, and ensure that both the process and outcome are sufficiently robust to meet the Bank's exacting expectations.

Pricing

46. As today, the prices that the CIS provider can charge for the provision of its CIS will be contractually agreed with Pay.UK on commercial terms as a result of the competitive procurement process. Rate cards and/or day-rates can also be contractually agreed. The CIS provider will not be able to price discriminate between Participants or between overlay service providers because prices will be set in the contract with Pay.UK. As a result, the CIS provider would not be able to charge itself a lower price than other overlay services providers, addressing the PSR's vertical issue 2.

47. The CIS provider's revenue is also likely to be linked to transaction numbers and a contractual investment programme. Transaction-based revenues would incentivise the CIS provider to make the NPA a success. Contrary to the PSR's hypothetical horizontal issues 1, 2 and 3, the CIS provider would have an economic incentive to help facilitate widespread access by increasing transaction volumes through the central infrastructure. Widespread access might relate to new members joining the scheme or new overlay services (from competitors) driving transaction volumes and revenues. In any event, it is highly unlikely that a CIS provider could influence the decision of consumers to use the NPA or not. If anyone was capable of influencing consumers then it would be those Participants with direct consumer relationships.

48. Any idea that the CIS provider will want to somehow divert transactions to other payment methods is fanciful – not only would it damage its global reputation, it would likely also divert a substantial proportion of transactions to a competitor. For example in the case of LINK ATM transactions in the CMA review of the Vocalink/Mastercard merger, the CMA concluded that most transactions would be diverted to Vocalink/Mastercard's competitors. Consumers are also very well versed in the payment options they have available today.

Quality

49. The NPA CIS contract will include defined Important Business Services and defined levels of Impact Tolerance as required by the Bank of England's forthcoming Operational Resilience Framework. The contract will include the required service levels (including but not limited to those required by the Bank of England's Operation Resilience Framework), with financial incentives to deliver on these service levels. To illustrate the likely scale of these requirements, Vocalink's current contracts with Pay.UK for Bacs and FPS include [✂] service-level agreements (SLAs). Therefore, the CIS provider would be highly unlikely to have the incentive or ability to degrade the quality of the service to divert transactions to other payment systems, addressing the PSR's horizontal issue 3.

50. The design of the NPA CIS is likely to mean that it is not possible to degrade the quality of the service to competing overlay service providers only. Indeed, it would be surprising if the design did not explicitly prevent such an outcome. In addition, the SLAs would also prevent the CIS provider from degrading the quality of the service to specific customers. The SLAs are likely to cover all aspects of the service for example the core switch, technical on-boarding processes, provision of information as directed by Pay.UK. The PSR's vertical issue 3 will therefore simply not arise.

Data rights

51. As per the FPS contract in place today, the NPA contract is very likely to set out the CIS provider's rights (or lack of rights) and obligations over transaction data. All parties will also be subject to general data protection law. The CIS provider could be contractually obliged to make available the data to third parties if requested by Pay.UK, which would address the PSR's vertical issue 1. Similarly, the CIS provider is highly unlikely to be able to use the data without the permission of Pay.UK and/or the participant banks, reducing the risk of horizontal issue 1. In some situations, the participant banks might need to obtain permission from their customers. We note in this context that the PSR's recent working paper on data concluded in September 2019 with no immediate action.

52. The CIS provider would not gain access to sensitive information regarding third parties who are seeking access to the central infrastructure, other than the subset of technical information that is necessary to undertake on-boarding. Internal segregation of teams could also be put in place to provide additional comfort and such requirements could also be captured in the contract, eliminating the risk of vertical issue 4 occurring.

<u>Evidence from the provision of overlay services today does not support the PSR's concerns</u>

53. Vocalink is currently developing or providing overlay services, such as financial crime solutions (including Mule Insights Tactical Solution and Confirmation of Payee), Request to Pay and other services.

54. Vocalink's experience to date is that the provision of overlay services is highly competitive – for example we understand that there are numerous competitors for both Confirmation of Payee services and Request to Pay services. We do not consider that the hypothetical competition concerns raised by the PSR in the overlay space are supported by the evidence from the provision of overlay services today. Absent regulatory intervention, we expect this market will remain highly competitive.

55. Based on the overlay services that we see in the market today (such as Request to Pay) and the NPA design, many future overlay services will not require access to the core infrastructure. Those overlay services that would require direct access to the core infrastructure are likely to affect the whole industry and therefore likely to be subject to Pay.UK consultation and procurement or accreditation. The CIS provider would have very little additional, or advance, knowledge that it could use to its benefit in such situations. We do not consider that the CIS provider could be able to foreclose the market to competitors because of the factors set out above, including the contractual relationship between Pay.UK and the CIS provider and the control Pay.UK has over the technical design, standards and on-boarding.

<u>A comprehensive set of 'mitigations' already exists</u>

56. The PSR's CfI presents hypothetical competition concerns. The concerns are hypothetical because they do not take into account market evidence, including the factors set out in this section of our response. In short, these concerns will simply not arise for the reasons in paragraphs 36 to 55. In addition, a comprehensive set of 'mitigations' already exists (as explained below). Although the PSR might describe these as 'mitigations', we see them as an integral and fundamental part of the market – today and in the future. Any assessment of the effectiveness of competition should not be undertaken in a vacuum, but should instead take into account market evidence and practices of the type that we have highlighted in this response.

57. Intervention by the PSR is not needed because the 'mitigations' that are currently in operation and/or likely to be part of the NPA CIS procurement process are effective. Specifically, the technical design and governance design of the NPA as set by Pay.UK or in the tender process for the NPA CIS contract between Pay.UK and NPA CIS bidders will in effect remove any residual risk of the PSR's concerns arising. Furthermore, any additional intervention by the PSR, or any restriction on economic interest of the NPA CIS provider in the provision of overlay services (whether or not they require access to the NPA CIS) or competing payment systems, is no more likely to be effective than the 'mitigations' that are currently in operation and/or likely to be part of the NPA CIS procurement process, albeit that any PSR intervention would be more intrusive and burdensome. Before intervening, the PSR needs to consider the proportionality of the intervention and the risk that it might have unintended consequences on competition, innovation or consumers.

7) The world is bigger than the NPA, Pay.UK and the PSR

58. The UK is one of the most innovative payment markets in the world and, as such, it is implausible to suggest that any credible CIS provider may choose, or ever be able, to threaten resilience in such a high profile market. The suggestion by the PSR that the NPA CIS provider might choose to degrade the quality and/or the resilience of the service it provides for commercial advantage is entirely unrealistic. To suggest that a CIS provider would deliberately degrade the quality of a service forming part of the UK critical national infrastructure is simply not credible. The implications to a CIS provider of taking such a step would be truly catastrophic, would open the CIS provider to material breach of contract claims and potential regulatory sanctions.

59. Vocalink and Mastercard have built successful global businesses based on providing resilient services. Vocalink and Mastercard seek to sell products and services to participants in many different markets. Seeking to degrade the NPA CIS service in an attempt to move customers and/or payment transactions to other Vocalink or Mastercard services would cause major reputational and commercial damage to our organisation. We would expect the same to be true for the other bidders for the NPA CIS. The reputational damage that the CIS provider would suffer if it were to adopt the behaviours suggested in the CfI represents a serious disincentive to acting as the PSR suggests.

60. Vocalink is a specified service provider (SSP) and is supervised by the Bank of England under the Banking Act 2009 for the services it provides to the Bacs, FPS and LINK payment schemes. Similarly, it is logical that the NPA CIS provider will be supervised by the Bank of England. The Bank of England's objective is to maintain the UK's financial stability. From a payments perspective, this means that specified service providers should be operationally and financially resilient. Bank of England supervision is rigorous and thorough.[3] The Bank requests regular information to provide it with comfort that the risks are being appropriately managed and that resilience is not compromised. The Bank also undertakes regular deep-dives into specific topics. Under Bank supervision it would not be possible to do anything which could materially degrade operations without being in breach of the Bank's expectations for an SSP. Any breach would almost immediately come to the attention of the Bank. The PSR's concerns that the CIS provider would have the incentive and/or ability to reduce resilience suggests that the PSR has either overlooked, or somehow has concerns with, the Bank of England's supervision, which has as its aim the maintenance and improvement of resilience.

[3] https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2018/sfmi-annual-report-2018-annex

8) What would a good policy for the future regulation of the NPA look like?

61. Vocalink believes that a regulatory policy is not required in this case, and indeed would be harmful to competition for the reasons outlined above. The harm to competition resulting from the PSR's Open Letters and the CfI already demonstrate real risk that any intervention by the PSR in this area could have unintended anticompetitive consequences.

62. If the PSR nevertheless does decide to publish a policy:

    a. We consider that an overly specific or prescriptive policy is far more likely to have unintended consequences or might prohibit effective and proportionate solutions. Therefore, any policy should be generally framed, and limited to a set of outcomes-based objectives, focussing on the outcomes the PSR wants to see. It should avoid specific or detailed policies.

    b. A regulatory policy must have longevity. While it is acceptable for a policy to become redundant because competition has become effective, it could be damaging to competition, innovation and service users if the regulatory policy was quickly out-of-date because the market had changed, or because Pay.UK had re-designed the NPA specification or the procurement process. It would also be damaging if the policy was revised on a frequent basis. One of the design principles for any regulatory policy proposed by the PSR in this space should be that it is fit for purpose for at least five years.

    c. Any policy should also be designed so that it does not have the effect of harming current or future competition, for example by removing a key competitor from the market or (directly or indirectly) discriminating against specific competitors / categories of provider.

63. The PSR already has many regulatory tools at its disposal. A policy based on hypothetical concerns, with no evidential base is not the basis for formal intervention. Indeed, any PSR regulatory policy would not have a formal legal status, but rather will set the expectations of how the PSR will use its existing powers:

    a. This reinforces the point that any policy should be principles-based, otherwise it will fetter the PSR's discretion to act in an appropriate manner in due course, if necessary.

    b. Not all market participants will understand the status of any policy. Any policy should make clear that the PSR would have to follow further regulatory processes before it could formally intervene (such processes include the requirements to consult with interested parties, to collect evidence, to analyse potential competition issues and propose and implement remedies). Any proposed regulatory policy should also make clear that the PSR is bound by its statutory objectives, its statutory powers and the processes that it is required to follow to implement changes. Without such information, there may be confusion concerning the policy, and market participants may reasonably form expectations that the policy has a greater legal status than it does, which in turns risks reducing competition for the NPA CIS and overlay services.

64. Consistent with better regulation principles, any proposed regulatory policy should, in any event, be strictly proportionate to any issues identified. In short, the PSR should intervene no more than the minimum necessary, and even then only where the evidence supports intervention and the effectiveness of the proposed solution. This should be a design principle for any proposed regulatory policy relating to the NPA: if two interventions are likely to be equally effective, the PSR must propose the least intrusive one.

65. A final point is that Pay.UK is subject to the IMR remedies in respect of procurement processes and message standards, the purpose of which was to increase competition. We see no reason to consider that greater intervention is required in future compared to today. If anything, less regulatory intervention is required as mitigations are being captured in the NPA design and procurement process, and the establishment of a single, sophisticated buyer – Pay.UK – minimises the concerns identified by the PSR.