

The Payments System Regulator Protecting us from the storm?



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Introduction

Innovation comes in all shapes and sizes, but its source is in a new way of thinking about problems and how to solve them.

The Emerging Payments Association represents companies in financial services that think differently. They think differently about the channels through which they serve customers. About the set of needs they satisfy; the technology they use and in the way they apply this technology; the way their services and products are delivered and marketed; and the business models they use to extract value for their stakeholders.

One of the EPA's goals, in its mission to establish the UK as the global hotspot for payments innovation, is to remove the obstacles which prevent such innovation and which also cuts off competition. This approach is consistent with the recently created Payments Systems Regulator (PSR), which itself, somewhat uniquely, is aiming to work with the industry to create a favourable climate for innovation and foster competition in payments.

The EPA was at the forefront of responding to the PSR's call for input from industry in seeking to formulate its approach to its supervision. The EPA's response was positive as we see clearly that change is necessary if innovation and competition are to be promoted. And we think the regulator has a pivotal role to play in ensuring that this happens

This paper summarises the EPA's views on where the problems are in the UK's payments infrastructure and what changes a courageous regulator needs to ensure the framework within which we all work has real innovation and competition at its core.

Thank you to our Advisory Board for their contribution, and especially to Mike Smith of Raphael's Bank for leading the development of this paper.



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Contents

- Introduction from EPA Chairman, Frank Lambe 2
- Is the PSR protecting us from the storm? 4
- The Regulator’s Approach 4
- Payments Strategy Forum 5
- Missing infrastructure-related themes 7
- Ownership, governance, control and representation 7
- Access to payments systems 8
- What this means 12
- Appendix: About the Emerging Payments Association 13



› 1. Is the PSR protecting us from the storm?

The UK is fortunate that, uniquely in the world of payments, it has a dedicated regulatory authority to promote innovation, protect customers and enable competition.

And it is equally fortunate that, uniquely in our experience, the regulator has chosen to take a highly consultative approach to understanding the complexities of our industry and to designing a regulatory regime that is truly 'fit for purpose'. However, the challenge is enormous. Powerful vested interests are at play. Change is rapid. Consumers are both increasingly fearful and demanding. Competition is rife.

So how well is this approach working? Inevitably, to different degrees depending on where you sit in the morass that is the payments ecosystem. But what about for the companies leading the field in innovation? Those pushing the boundaries to come up with new, better, more cost effective ways of solving payments problems for consumers, governments and companies?

The voice of this disparate but determined group is spoken through the Emerging Payments Association (EPA). The EPA the new alternative to yesterday's trade associations representing tomorrow's payments industry for progressive and innovative payments companies. 70 companies – and growing - across the emerging payments spectrum are collaborating to help shape the future of the payments industry landscape.

The EPA's mission is to establish a global hotspot for payments innovation by attracting investment capital, creating a hospitable regulatory environment for innovators, new entrants and disruptors and promoting collaboration within the payments community. It is led by an Advisory Board of senior executives from ten innovative payments companies including Prepay Solutions, Payment Card Technologies, Advanced Payment Solutions, Raphael's Bank, Sodexo Motivation Solutions, The Bancorp, Ensygnia, Ukash and Optimal Payments. The EPA's first Benefactors are MasterCard, The Bancorp and Stored Value Solutions.

The EPA sets out to be a catalyst for change by speaking with a common voice through dialogue with regulators, lobbying and C-level networking. This White Paper explains how the EPA is views the regulator's approach, and explains how well the hand-in-hand approach is working for its members.

› 2. The Regulator's Approach

In principle, the EPA supports the approach taken by the Payment Systems Regulator (PSR).

But the use of its powers in practice will determine its effectiveness.

EPA members are at the forefront of innovation and change in payments and many are struggling not only with access to payment systems issues but also with the availability of bank accounts, KYC/AML, account number portability and the lack of understanding of payments within many FinTech companies.

At various consultation meetings the PSR has indicated that availability of bank accounts is a FCA matter (or possibly CMA if a competition aspect can be shown). However this issue is so closely linked with the innovation and competition objectives that the PSR now has, that we believe it needs positive regulatory coordination. Whilst its proposed modus operandi talks at length about inter-regulator coordination, we believe this must be proactive in addressing such issues rather than reactive on a case by case basis or when approached.

As such we would welcome equivalent transparency to that it is seeking from the industry, from the PSR and its fellow regulators as to the nature of the discussions it is undertaking, relevant minutes and actions etc., together with joint/joined-up guidance on relevant issues. Similarly it would be essential that all of the Regulatory bodies work in a “no surprises” coordinated environment.

› 3. Payments Strategy Forum

The PSR has proposed to set up a Payments Strategy Forum containing a range of representatives of different interest groups. The Forum will have a monitoring role and help the PSR determine the effectiveness of its activities.

The EPA does agree with the PSR’s approach, but with the important caveat that there should be a timetable set at the outset together with some criteria for reviewing the effectiveness of the Forum.

There are many potential pitfalls for such a Forum, including:

- Lack of consensus
- Inability to integrate strategy meaningfully with Operators
- Lack of ownership of any associated business case / spend priorities

No doubt the PSR’s close involvement will give it insight into the Forum’s effectiveness, but participants and the industry in general should buy into what ‘good’ looks like for it, which will help in supporting its success.

The PSR also needs to consider whether, by supporting the Forum, it is effectively standing behind its decisions. This is important in two respects:

- An implicit instruction to industry to work with the Forum in delivering its strategy with the underlying threat of intervention
- Support for Forum outputs even if the PSR does not wholly support them, failure to do this will undermine the point above and render the Forum meaningless

The EPA hopes to participate in the Working Group being set up to design the Payments Strategy Forum. Broad representation is essential and it must also be clear under what capacity members are acting. For example, if members are representing other organisations, they may feel that a consensus of members is required before voting. This will place a very strong emphasis on work between meetings and reduce the impact of the meetings themselves.

The PSR also mentions a requirement for seniority and the ability to commit. However, experience dictates firstly that individuals rarely have the power to make financial commitments on behalf of large organisations without committee discussion and agreement to detail. To get seniority, a trade-off is required against detailed understanding of the issues. A period of time after meetings may be required for ratification, but rigidly set and monitored by the Forum.

It will also be a challenge to set the level at which the Forum's outputs are made. In particular the level of detail around technical changes will need careful thought. Not enough understanding and detail could lead to good recommendations being rejected as unfeasible. And too much will mean that the Forum is necessarily populated by technocrats.

We favour higher level strategies designed to foster competition and innovation to the benefit of end users rather than detailed systems development plans. Indeed through such higher level strategies it may be possible to start fostering some competition between systems rather than being more directional at an individual system/Operator level.

Membership of the Payments Strategy Forum

In term of membership we suggest one representative from each of the following:

- Each designated Payment System
- Academic / visionary
- Major clearing bank payments person (active in agency banking)
- Payments consultant
- Major physical and on-line retailer
- Major non-bank acquirer
- Consumer champion
- SME
- Major corporate
- IAD
- Smaller bank/building society/credit union
- EMI
- PI
- Telco
- On-line payments business
- Banking technology provider
- Member of the EPA Advisory Board

Where possible these should be individuals active in trade/industry bodies and with depth of experience in payments.

Operating policy

Effective governance is everything.

We recommend a 2/3rd majority voting system, which seems a reasonable compromise between getting anything through and allowing any block to gain too much authority.

To us the model proposed by the PSR seems to be struck at too low a level. It focuses on proposals and priorities, which are valid areas for consideration, but there is no mention of strategy, vision or long-term goals.

To us, these would seem to be the start point: begin with the end in mind and work backwards.

There is a real danger that the Forum will become tactical and bogged down in side issues such as account number portability and miss the strategies needed to combine, replace, reinvent or otherwise fundamentally improve the payments systems.

› 4. Missing infrastructure-related themes

The PSR has missed out on several infrastructure-related themes and the EPA thinks these should be addressed by the Payments Strategy Forum.

Euro payments – increasingly the UK is involved in credits and debits to the Euro Zone and within the UK, yet the infrastructure around these remains fragmented and patchy. For example, direct debits barely exist. With the growth of currency cards, overseas home ownership, relatives living in the EU and retirement abroad, this aspect of our infrastructure is shamefully poor.

Settlement processes – the way we settle payments requires a radical re-think. With Faster Payments, payments can now be sent and received in seconds but over a bank holiday weekend settlement can take 5 days. This in turn leads to concerns around access and collateral requirements for smaller payments operators which prevents innovation and competition.

Sort Codes - within the subject of messaging we should look at the necessity for sort codes and the whole basis of the domestic infrastructure. Arguably a numbering system designed around cheques is not fit for purpose for electronic payments in the 21st century.

› 5. Ownership, governance, control and representation

The EPA's view is that the PSR's approach to who owns, runs and controls payments systems is spot on. It also supports its approach to requiring all Interbank and Card Operators to ensure that there is appropriate representation of the interests of service-users in discussions and decision-making at board level. However, the EPA believes the PSR could better define the timescale and criteria for assessing compliance of the Operators with the PSR's direction, perhaps adding more detail of the process that this will involve and an undertaking to make public your discussions and review findings.

Avoidance of conflicts of interest with Interbank Operators

The PSR proposes to require the Interbank Operator to take all reasonable steps to ensure that any individual acting as a director of that Operator must not simultaneously act as a director of an actual or potential Central Infrastructure Provider to that payment system.

This approach has a number of limitations. Whilst there is undoubtedly merit in ensuring that no individual sits on Boards which de facto creates a conflict of interest, the issue around organisational conflict, where Direct PSPs effectively control all the systems is not addressed.

It is entirely conceivable that the representatives of the big banks on the various Boards will all work in the same division of that bank, possibly with direct reporting lines amongst them. Supposing a “Chinese Wall” around conflicts of interest generated by this is a big supposition. Indeed the lack of this has been a perceived weakness in the operation of the Payments Council.

However, combined with the need to publish minutes and ensure independent service user representation, it should be possible to monitor behaviour and this will be the key to successful implementation rather than direction, which is supported by the EPA.

Publication of board minutes

The PSR is to require all Operators to publish board minutes in a timely manner, including for the published minutes to include a record of votes and reasons for decisions made.

The EPA believes this is a good move, as this will be a key measure of behaviour of Operators and their owners. Of course the minutes will need careful review and interpretation by the PSR.

› 6. Access to payments systems

Too little, too late

The EPA has strong views on the PSR’s access proposals.

Its strong view, particularly from talking with a number of smaller payments players, is that a piecemeal approach to improving access rules will not deliver the results required.

Gaining the necessary permissions, delivering a range of different technical requirements across multiple operators and addressing different sets of collateral and other settlement issues will be daunting and far too complex for many players within the industry.

The EPA strongly believes that what is needed is an institution (under current rules this would need to be a credit institution) which has a significant business focus (i.e. probably its major *raison d’être*) on providing payment services to the Financial Services industry.

This should not be an existing major clearing bank or owned by one (or several); they have too much baggage, too many overseas interests and too many competing claims on their resources, brand equity and competitive position. This has been exemplified by your view of the failure of the Payments Council to deliver change at the pace that is needed and the issues arising around sponsorship and indirect access.

There is a significant role for the PSR to proactively encourage and actively engage in such a development. The EPA is currently strongly considering starting such a process via RFI / RFP to the payments infrastructure players and this would be greatly enhanced by proactive involvement from the PSR, as opposed to the approach currently proposed which we summarise as ‘tweak the rules and see what happens’.

Whilst the proposed market review is not a bad idea, the length of time it will take and the fact that it intends to review the impact of the other measures the PSR is introducing, which in turn will take time to have an impact and thereby delay any firm conclusions, will mean one thing. That this country will waste another 18 months in reaching the conclusion which our part of the industry has already reached, which is that the indirect access model is fatally flawed and requires a radical alternative approach (such an approach is outlined above).

It is not in the interests of UK PLC to postpone action on this agenda, particularly given the impact of PSD2 regulation (in broadening the opportunities for third party processors), the explosive growth in the FinTech sector, the major issues around the availability of services to the remittance market and the difficulty of innovative new competitors in finding bank accounts and payment gateway services. When combined with the increased regulatory requirements on the sponsor banks in terms of capital, liquidity, approved persons, AML legislation and difficult market conditions, very slow progress is predicted.

The EPA believes a much more proactive regulatory approach is required, focussing on creating a viable alternative solution rather than trying to force (at least partially) unwilling existing providers to deliver it.

The PSR's proposed access rule

The PSR's proposed Access Rule is not seen as incorrect. But as outlined above, the EPA believes that trying to solve this problem by improving rules rather than addressing requirements will not produce the results needed to deliver on the PSR's innovation and competition objectives.

In addition, the guidance section may need to be expanded to ensure alignment between the owner, operator and sponsor required to access a payment system, to provide clarity around the application process and any interdependencies. In considering FPS as an example, the scheme itself and its operator may publish access rules which appear acceptable, however if few or no banks are willing to sponsor the access or make it commercially viable to do so, how does this get resolved (see our above point re the need to create a player that wants to do this)? Can access rights and criteria be specified and defined in the context of the status of the institution looking to join – e.g. Credit, Payment or E-money institution?

The PSR's proposed reporting rule

The PSR proposes to bring in a Reporting Rule (on compliance with the access obligations applicable to them) on all relevant pan-GB Operators (i.e. Bacs, C&CC, CHAPS, FPS, LINK, MasterCard and Visa).

The concept of a reporting rule is appropriate. However the PSR will need to clarify the outputs and whether there is a case for penalties for non-conformance. In addition to the requirement to report on compliance with access obligations, operators could be asked to provide KPIs and in time targets on new access volumes. This would show success in terms of new players gaining access to payment systems.

Public disclosure

The PSR proposed to require public disclosure of Access Requirements for Operators subject to Regulation 97 of the PSRs 2009 (i.e. LINK, MasterCard and Visa). The EPA supports the public disclosure of access requirements. However, there is a danger this drives the wrong behaviours i.e. information becomes broad and generic rather than granular and appropriate. The requirements should ideally not be open to interpretation and sufficiently precise such that operators implement the services in a consistent manner.

Publication of information by Sponsor Banks

The PSR is proposing to require Sponsor Banks to publish certain information. And the EPA believes it is critical for Sponsor Banks to publish information on access.

This should be inclusive of all details to successfully engage and access to payment systems. The access related information should include technical access options, risk assessments and requirements, compliance reviews and commitments for continuity of service. Terms of reference for joining the scheme via a sponsor must be clear and the obligations for all parties set out. If there is a requirement from a sponsoring bank for third party auditing, then the scope should be published together with a list of approved third party auditors.

The fact that sponsorship is not a major focus for the current sponsoring banks is reflected in the current situation. The EPA doubts whether information requirement publication will herald a significant shift in the availability of services and may have the opposite effect of taking some players out of an already sparse market.

The PSR Information Hub

Collating all the information about accessing payment systems in one location makes sense. Possibly, the PSR could consider doing this itself rather than expecting industry to do so. Keeping this information up to date and current is important as businesses can spend a lot of time attempting to find the right people to talk to, when seeking access to payment systems.

Code of Conduct

A code of conduct can be helpful. However to join a payment system – such as FPS – a company needs to speak to the scheme, source a technical connection and a sponsor. It is conceivable that all parties will individually conform to the “new world”. But access could still be slow and problematic.

Therefore a code of conduct for all players involved in a payment system might be an effective way to ensure alignment between all parties e.g. for accessing FPS, the scheme, the operator and all settlement / sponsor banks sign up to the same code of conduct document.

The EPA is concerned that some benefits may be lost in execution. It is unlikely that “one size fits all” will be the best model here. The range of services may vary widely and broader relationships between sponsor bank and sponsoree may come into play. As such the code of conduct will need to be very carefully drafted to avoid unintended consequences.

Number of Sponsor Banks

Has the PSR considered what a good number of sponsor banks is? Will pressure be brought to bear on the major banks to participate in this activity if they appear reluctant (in the face of new requirements)? We have received feedback from some members that there is a new round of clearing banks exiting the third party FI market.

The EPA believes the PSR needs to be watchful in the implementation phase that sponsor banks do not use new requirements as an (invalid) excuse to increase prices under a new regulatory regime.

And as outlined above, we have significant reservations that trying to improve the behaviour of current sponsor banks will deliver the required results.

Technical Access Solutions

The PSR proposes to develop Technical Access Solutions. The EPA encourages this as it is part of the opening access agenda. The certification of such technical access gateways or solutions may be completed by the scheme itself, rather than the operator (who is still involved in the certification process). In an ideal scenario, there would be several access gateways each with its own value added services to sell on to others and PSPs seeking to join the payment systems.

But commercially viable models must emerge in support of the competition and innovation objectives. And the EPA has significant reservations that this approach will deliver the results required, as outlined above.

And when determining the benefits and costs, the PSR needs to monitor what happens closely to ensure measures drive the right behaviour. The link between settlement/collateral and technical solutions needs more clarification to ensure full benefits are delivered.

Interchange

Interchange fees are but part of the overall package of fees flowing as a result of a card transaction. They have understandably received the greatest attention as they form the bulk of the issue and the powerful retail lobby has been making its case strongly.

However, we would recommend a thorough detailed review of the pricing practices of Visa and MasterCard, both interchange and issuer charges, as members have brought to our attention significant anomalies in terms of transactions at PoS outside the EU and various other arbitrary and apparently unfair fees charged.

Setting penalties

The PSR's approach to setting penalties makes sense. Experience will dictate whether it is sufficient but the EPA does not see any need for any other system at present.

One thing which is not clear from the documents is the extent to which individuals might be held accountable. This has been the subject of much debate and is currently being consulted on by the FCA.

The PSR should make it clear whether individuals who are not caught by another approved persons regime (e.g. CEO of an infrastructure provider) may be subject to personal accountability.

› 7. What this means

This means the PSR has made a good start. But the journey to transforming the UK's payments infrastructure is a long and complex one.

The Emerging Payments Association is setting out to make London the global hotspot for payments innovation. The PSR has a critical role to play in achieving this goal. Get it right, and the UK can lead the world. Stumble or take the wrong path and innovation, competition and global leadership will elude us.

About the Emerging Payments Association

The Emerging Payments Association (EPA) is a community of C-level market makers set up in 2013 with a common aim: to shape the future of emerging payments. 27 industry leaders are already contributing from four areas: banking, retail, telecommunications and financial services. They would like to be seen as the most influential people in the payments industry.



There are five components of EPA

1 Leadership	2 Governance	3 Activities	4 Outputs	5 Measures
<p>Eight leading CEOs on the Advisory Board</p> <p>20+ other members from across the ecosystem</p>	<p>Ambitious business plan</p> <p>Tight operating methodology</p>	<ul style="list-style-type: none"> ● Education ● Intelligence ● Lobbying ● Sponsorship ● Influence 	<p>More rapid growth in demand for members' services</p> <p>New competitive advantage for members</p>	<p>Tight quarterly financial reporting</p> <p>Review of performance against output targets</p>

Achievements

Influence

- › Project HMT – Public Sector
- › Responding to 'Opening up UK Payments'
- › Working with MasterCard on White Paper
- › Project 'Forum of Forums'
- › Building links between trade associations

Education

- › Sponsored the 'Better Government ICT Procurement' conference
- › Spoke at panel at Pay Expo, Pay 360, Contactless Cards & Payments
- › Sponsored 'Digital Leaders' conference in Westminster
- › Participated on Advisory Board of Digital Leaders in Government
- › Publishing White Paper: Who needs a bank account anyway?
- › Produced Emerging Payments Market Map
- › Published Glossary of Terms for Emerging Payments for seven trade associations in payments
- › Produced website and membership brochures

› Advisory Board members

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Frank Lambe (Chairman),
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Kriya Patel, Managing
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EPA is managed by Gx for its members.

See www.emergingpayments.org

To comment on this White Paper, contact Frank Lambe, Chairman, EPA at frank.lambe@emergingpayments.org