PSR report

Access and governance of payment systems: the operators' progress and areas for ongoing focus

15 December 2015

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Executive summary

1.1 This paper is our first annual report on the progress that the operators of the designated payment systems[1] have made towards achieving:

- more open and flexible direct access to payment systems

- inclusive and more transparent governance arrangements

1.2 Open access to payment systems is a vital enabler of the provision of payment services to users who participate in the systems. Part of this expansion of access involves making sure the systems are operated in the interests of all those involved in their use. Well governed and open payments systems create conditions for effective competition and innovation to thrive.

1.3 We have received compliance reports from operators showing how they are complying with measures we introduced aimed at improving direct access and governance[2]. We have used these reports, and previous stakeholder feedback, to inform the analysis in this paper.

1.4 The work the operators have already done in these areas is encouraging. These changes are starting to make a difference. We expect the number of payment service providers (PSPs) who have direct access to payment systems to increase in the coming year, the time to onboard a direct participant to reduce and operators to reflect the needs of service users' views in their decision making.

1.5 This is a good start, but there are areas the operators should continue to focus on. These include:

- further work on access models and their requirements, which could support more proportionate and open access for smaller banks and non-bank PSPs

- streamlining their onboarding processes – to make it quicker and easier for new members to join the schemes

- building on work they have started, to ensure that they are considering all their stakeholders' views in their decision making

1.6 Our access directions have only been in force since June this year, and our full suite of governance directions have only been in place since September. Many of the areas of concern identified through previous consultation remain the areas for the operators to focus on. We expect operators to build quickly on their initial progress in these areas.

1.7 We will continue to monitor the impact of our directions and maintain our open engagement with the operators on access and governance. If further good progress is not made to deal with the issues identified, then we will need to consider taking further action.

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1 We can only use our regulatory powers in relation to payment systems designated by HM Treasury. The designated payment systems are currently: Bacs, C&C, CHAPS, FPS, LINK, MasterCard and Visa.
2 The measure taken on governance (the Governance Directions) do not apply to MasterCard and Visa.

Access

Measures to promote fair and open access to payment systems

1.8   Since our creation in 2014, we've consulted our stakeholders to understand how direct access to payment systems works in the UK. Through this we have identified a range of different issues that could act as barriers to PSPs getting direct access to payment systems. In particular, many stakeholders told us that the requirements operators set were not clear or fair, and may make direct access difficult or impossible for some organisations.

1.9   This was a significant concern for us. Access to payment systems is a vital driver of effective competition and innovation in payments, which in turn benefits the service users who use, rely on and participate in the systems. Promoting access is a priority for us because it's essential to our three statutory objectives – promoting effective competition, innovation and the interests of service users.

1.10   We introduced a number of requirements for the operators through our direct access directions to promote fair, open and transparent access to payment systems. We are currently considering the arrangements for indirect access through our indirect access market review.

The operators' response

1.11   We introduced the access requirements in our March 2015 Policy Statement, and our access directions took effect from 30 June 2015. The operators were required to submit a report to us over the summer setting out how they are complying with them. Our analysis in this paper is based on our review of the operators' reports and our observations of developments in payment systems.

1.12   The operators' progress since we developed our policy proposals has been encouraging. They've made the information available to potential direct participants more comprehensive, and have – in some cases – worked towards making direct access more flexible. We can see the positive impact this is having on the market[3], for example more PSPs are interested in becoming direct participants in payment systems.

1.13   However, there needs to be an enduring focus on current and evolving access issues as markets evolve. There are a number of issues stakeholders previously identified, where more work is needed. We expect the operators to continue making progress on these areas, building on their positive start.

'**So far the most fundamental change I have observed this last year is a change of attitude of the schemes regarding access.**

The schemes now accept they need to facilitate access to new entrants, whether they are credit institutions or authorised payment or electronic money institutions.'

PSR Panel Member

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3 In this document we use the terms 'market' and 'markets' as shorthand for referring to different parts of the payments sector. For the avoidance of doubt, these terms are not intended to describe or suggest the approach that we may take for the purposes of market definition (e.g. in competition law investigations).

Governance

Measures to promote fair and transparent governance of operators

1.14   Our consultations also brought out issues concerning the transparency and workings of the operators' governance arrangements. We identified that a small number of banks and building societies have the ability to exercise control over interbank operators. Many stakeholders felt that the systems were being operated for the benefit of the major banks, and that it was unclear how the operators' boards made important decisions about the systems' operation.

1.15   This was a concern for us. Payment systems must work in the interests of all service users, and confidence in this is essential if participation in the systems is to widen. In particular we are keen to ensure that service users, who are not direct participants of payment systems, can easily engage with the operators and make proposals about the way systems are operated (for example, changes to systems' rules). We want to ensure that those proposals are properly considered and that service users have a feedback mechanism to understand the basis of the operators' decisions.

1.16   We decided to make the decision-making process of the operators of the interbank systems more transparent by requiring them to publish the minutes of their main governing bodies. We also wanted these operators to ensure that the members of those bodies have no potentially damaging conflicts of interest. Finally, we introduced a rule requiring the operators to consider service users' needs in their decision making. As part of this, the operators have to tell us how they've considered service users' needs in the way they operate their systems.

1.17   We expect our directions to change the dynamics of operators' boards and how control over payment systems is exercised. Increased transparency will create the opportunity for stakeholders to understand the outcomes of the decision-making process. This can build confidence in the operators' decision-making processes but also gives stakeholders the opportunity to raise concerns about decisions that are made. If we identify further concerns – for instance, if we are made aware of decisions which don't appear to reflect service users' needs adequately – we will consider whether further steps are needed.

1.18   We introduced the governance requirements in our March 2015 policy statement. The operators had to confirm by 30 April that none of their board directors were also directors on the board of a major infrastructure supplier. They also had to publish minutes of their governing bodies as soon as was reasonably practicable. Lastly, they had to submit a report to us by the end of October, setting out how they were representing the interests of service users in their governing bodies' decision-making processes.

The operators' response

1.19   So far the operators' progress on governance has been encouraging. None of the operators' board members have directorships on major infrastructure suppliers. They have also all put in place procedures to publish minutes of their board meetings. And all operators have told us in detail about their efforts to operate their systems in the interests of all service users.

1.20   However, operators need to continue their work on improving a number of aspects of their service-user representation to complement the improvements they are making in direct access. We expect the operators to continue making progress in these areas.

Developing a process to improve access and governance

1.21   To ensure the effectiveness of our directions, we will continue to collect and assess a range of information about the state of access and governance. We will evaluate the effect on the market and continue to consider whether we need to take any further action.

1.22   We think it's important to be able to highlight ongoing issues to the operators. Each year we will collate the relevant access and governance information, report publicly on the operators' progress and highlight any '**focus areas**' that we think need more attention. This paper is the first of these reports.

1.23   The aim of this process is to:

- Provide **clarity to all stakeholders** on the work that is being done to improve access and the governance of payment systems continuously.

- Allow the operators to consider issues further (i.e. the focus areas) and **let them decide how best to deal with issues** (rather than us prescribing an approach to them).

- Create **a dynamic process of change and improvement** to access and governance arrangements – to the benefit of future payment system users.

- Continue to **build a culture of open engagement and no surprises** with our stakeholders. This will allow us to communicate any concerns about access and governance. We encourage and expect operators to engage with us openly on these issues, and others they or we identify.

Focus areas

1.24   Our access directions have only been in force since 30 June this year. While steps have been taken in response to them, many of the areas of concern identified through previous consultation remain the areas for the operators to focus on. We expect operators to build on their initial progress in these areas, but also to initiate new activities where necessary.

1.25   Similarly with governance, we want operators to continue their improvement in ensuring and reporting on the representation of service users in their operations, and we have highlighted how they should do this.

1.26   You can see the list of access and governance focus areas on pages 36 to 39 of this report.

Your views

1.27   We are keen to hear your views on access and the governance of operators. In particular, we'd like you to tell us about any specific views, concerns or information that you consider relevant to any of the issues we've identified in this paper. We will use any contributions we receive in our ongoing consideration of these issues.

1.28   Please send your contributions to contactus@psr.org.uk.

2
Introduction

Purpose of this paper

2.1   This PSR report looks at how payment service providers (PSPs) get **direct access** to payment systems and the **governance arrangements** of the operators who manage the payment systems.

2.2   It explains the work we and the payment system operators are doing in these areas, and our view of the progress being made. This paper describes:

* the background to access and governance arrangements to payment systems in the UK

* the progress that the operators have made in removing barriers to PSPs getting direct access to their payment systems and what they've done to make their governance arrangements fairer and more transparent

* 'focus areas' where we think the operators need to do more work

* our annual process for evaluating operators' progress in these areas and the effectiveness of our access and governance directions

Context

2.3   Since our creation in 2014, we've consulted our stakeholders to understand how direct access to payment systems works in the UK. Many told us that the requirements operators had set were not clear or fair, and may make direct access difficult or impossible for some organisations.

2.4   This is a significant concern for us. Access to payment systems is a vital enabler of effective competition and innovation in payments, which in turn benefits the service users who use, rely on and participate in the systems.

2.5   Stakeholders also raised concerns in these consultations about the ownership and control of payment systems. Important decisions on the way payment systems are operated and developed are made by the operators' boards.

2.6   We identified a concern that the control of payment systems by a small group of PSPs could lead to conflicts of interest, a lack of transparency in operators' governance and decision-making processes, and limited representation of the service users' interests.

2.7   In our policy statement PS15/1, *A new regulatory framework for payment systems in the UK* (March 2015), we set out our initial policies and directions aimed at addressing these concerns about access and governance. Since then we have been working with the operators to implement these directions.

2.8   We're also working with the Bank of England, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) to coordinate our approaches to access issues where our respective roles and responsibilities overlap.

2.9   We discussed our work with the **PSR Panel**.[4] You will see that our paper also incorporates feedback from PSR Panel members, reflecting their independent, expert views on the operators' progress in improving access and governance arrangements. All PSR panel members were given the chance to provide feedback.

Structure of this paper

2.10   The rest of this paper is structured as follows:

- **Chapter 3** gives some background to access and governance and why they are important for us.

- **Chapter 4** describes the initial issues we identified around access and governance in more detail.

- **Chapter 5** sets out what the operators have done in response to our directions. This is primarily based on information provided through their access and governance compliance reports.

- **Chapter 6** explains the areas where we think more work needs to be done.

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4 You can find out more about the PSR Panel here: https://www.psr.org.uk/about-psr/role-psr-panel.

3
Background

Getting access to payment systems is essential for all PSPs. However, different PSPs will get access by different means, depending on the characteristics of their business. It is critical for effective competition in downstream markets (like the retail banking market) that there are no undue barriers to direct access.

The operators' ownership and governance arrangements ultimately determine how payment systems are controlled, in terms of their operation, access and development. Given that most of the operators are owned by a small number of PSPs, we must be sure that appropriate governance measures are in place.

A) Access to payment systems

What is access?

3.1   Access involves a PSP's relationship with a payment system, including the legal and funding arrangements, and the technical access that lets PSPs send and receive the payment messages that allow money to be transferred.

3.2   PSPs can access a payment system in a number of ways, including directly if it provides payment services through an arrangement with a payment system (e.g. Bacs), or indirectly by using an indirect access provider's access (e.g. a sponsor bank).

3.3   Direct access can have a number of benefits for a PSP, including:

- better control over the payment services they provide to their end users

- the ability to manage risks, like indirect access provider (IAP) system failures, more effectively

- being involved in the governance of the payment system

- potentially providing better quality technical access, and earlier notice of issues like disruptions and outages

3.4   There has been significant concern in recent years about whether operators' access requirements are proportionate or risk-based. While appropriate access criteria are essential to protect the stability, security and resilience of payment systems, there is a risk that rules could create unnecessary barriers to direct access for PSPs. We look at these issues in Chapter 4 of this paper.

3.5 Through consultation, PSPs have also raised concerns about indirect access (which is where an organisation uses its direct access to a payment system to process transactions for a PSP that doesn't have direct access). One issue is the limited number of indirect access providers – the 'sponsor banks' and other IAPs who provide this service. If more PSPs have direct access, the number of potential indirect access providers will increase. This could mean more choice for PSPs who want to use indirect access.

How do you get direct access?

3.6 A PSP can get direct access (or direct technical access) by joining a payment system as a participant.[5] Each payment scheme has its own set of access requirements that the PSP needs to meet.

3.7 Access requirements are the rules (including eligibility criteria), terms and conditions (including fees and charges), onboarding procedures and ongoing processes that PSPs must follow to be allowed direct access to a payment system.

Eligibility criteria

3.8 The operators each have their own access models, with some similarities and some differences in their access requirements. Figure 1, below, shows our understanding of the common characteristics of each system and the types of PSPs that can currently get direct access to it. The nature of the requirements means that, for most of the systems, only banks and building societies can get direct access (the exceptions are LINK, MasterCard and Visa).

Figure 1: Operators' access characteristics[6]

Operator	Number of direct PSPs	General access requirements (including external requirements)	Who currently meets the requirements?			
			Banks & building societies	Credit unions	EMIs	PIs
Bacs	16	• Bank settlement account • Authorised credit institution • Technical and operating requirements	✔	✖	✖	✖
C&CCC	11	• Bank settlement account • Authorised credit institution, public authority or publicly guaranteed undertaking • Technical and operating requirements	✔	✖	✖	✖
CHAPS	22	• Bank settlement account • Participant under Financial Markets Insolvency Regulations • Technical and operating requirements	✔	✖	✖	✖
FPSL	10	• Bank settlement account • Authorised PSP under PSD • Technical and operating requirements	✔	✖	✖	✖
LINK	37	• Regulated by appropriate body • Technical and operating requirements	✔	✔	✔	✔
MasterCard	75	• Financial institutions regulated or supervised by an appropriate authority • Technical and operating requirements	✔	✔	✔	✔
Visa	66	• Financial institutions regulated or supervised by an appropriate authority • Technical and operating requirements	✔	✔	✔	✔

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5 We note that the various payment systems operators use a range of terms to describe 'members'. For instance, CHAPS uses 'participants' and MasterCard uses 'customers'. Principal members or licensees in Visa and MasterCard will be considered as direct participants of the card payment systems.

6 Link also provides access for charge card issuers and independent ATM deployers.

Onboarding

3.9   In most cases, to be considered for access to a payment system, a PSP must write a letter of intent to the operator saying they want to join, and explain how they meet the access requirements for that system. The operator will consider whether the PSP should be given access. If access is approved, the PSP must go through a joining process known as 'onboarding' in order to become a direct participant. This can vary in time and complexity, depending on the operator's access requirements and the PSP's capabilities.

3.10   There can be several stages to onboarding. Some are common across operators, but a payment system may also have its own processes and approach (for example, CHAPS allocates a 'shepherd bank' to a joining PSP, which is used as a test partner and gives the joiner guidance on operational processes and procedures).

3.11   Figure 2, below, gives a very high level overview of a typical onboarding process. There are a number of significant and interdependent tasks. If the procedures are not clear and well managed by operators and PSPs, they can be time-consuming and costly – making direct access difficult to achieve for some potential participants.

Figure 2: Representation of onboarding process

1. Prepare and apply
- Look at what's involved in getting access – including costs, technical requirements and the operator's access requirements
- Make a business case and project plan
- Apply to the operator for access

2. Access approved: development time
- Create a detailed project plan
- Develop new technology, operational support and procedures to process payments and meet security requirements
- Prepare and sign contracts and legal documents

3. Testing and launch
- Test new internal developments – PSP demonstrates readiness to join system
- Potentially test on an external system provided by the operator
- **Go live** – PSP can now send and receive payments on the live system
- Launch could be phased so participants can build confidence in the live environment

Are many PSPs interested in getting direct access?

3.12   Our consultations have shown that there is considerable interest in becoming a direct participant in various payment systems. This is supported by evidence we have collected in our ongoing indirect access market review, including our survey of indirect PSPs (IPSP survey[7]). A significant number considered that direct access to an interbank payment system would better suit their business needs.

Figure 3: Response to survey question – will direct access be more beneficial to your business[8]?

Would direct access to any of these payment systems suit the needs of your business better than your current arrangement?
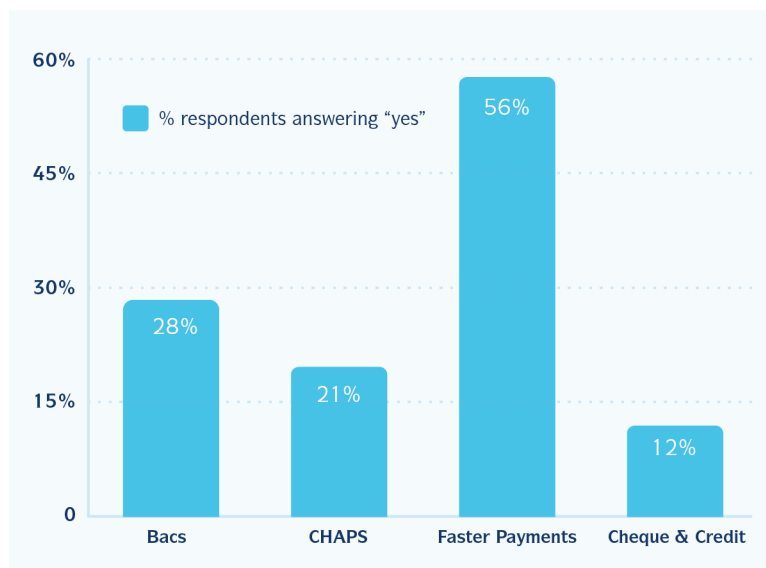
3.13   The operators have given us information about the expressions of interest and letters of intent they've received from PSPs who are interested in becoming direct members (see Figure 11 on page 32). We have used this data and other information[9] to consider the potential demand for direct access. If direct access were open to all types of PSPs, then we consider there could be up to 200 individual PSPs who might consider direct access (to one or more interbank or card systems) to better suit their needs.

Why is promoting access to payment systems a priority for us?

3.14   The payment systems are hugely important to our economy. In 2014, UK payment systems dealt with more than 21 billion transactions, worth around £75 trillion.

3.15   Open and fair access to payment systems has been a persistent concern in payment services markets. From the Cruickshank Review of Banking Services in 2000, to the Treasury's *Opening up UK payments* consultation in 2013, access has remained high among respondents' concerns.

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7 The questions we asked in the survey can be found here: https://www.psr.org.uk/psr-publications/market-reviews/psp-survey-august-2015.
8 Sample sizes – Bacs (N=19), CHAPS (N=14), FP (N=38), Cheque and Credit (N=8).
9 Such as the FCA's The Financial Services Register and the lists of banks and building societies published by the Bank of England.

3.16   Access also has implications for services in other markets. This was highlighted by the recent Competition and Markets Authority (CMA) market studies and market investigation reference into the provision of personal current accounts and the provision of banking services for small and medium-sized enterprises.

3.17   Direct access is important to our stakeholders because of the benefits it holds for PSPs and service users. Figure 4, also based on evidence collected through our IPSP survey, shows the main advantages that PSPs see in getting direct access.

Figure 4: Response to survey question – advantages of direct access

What would the advantage of direct access be?

Number of responses
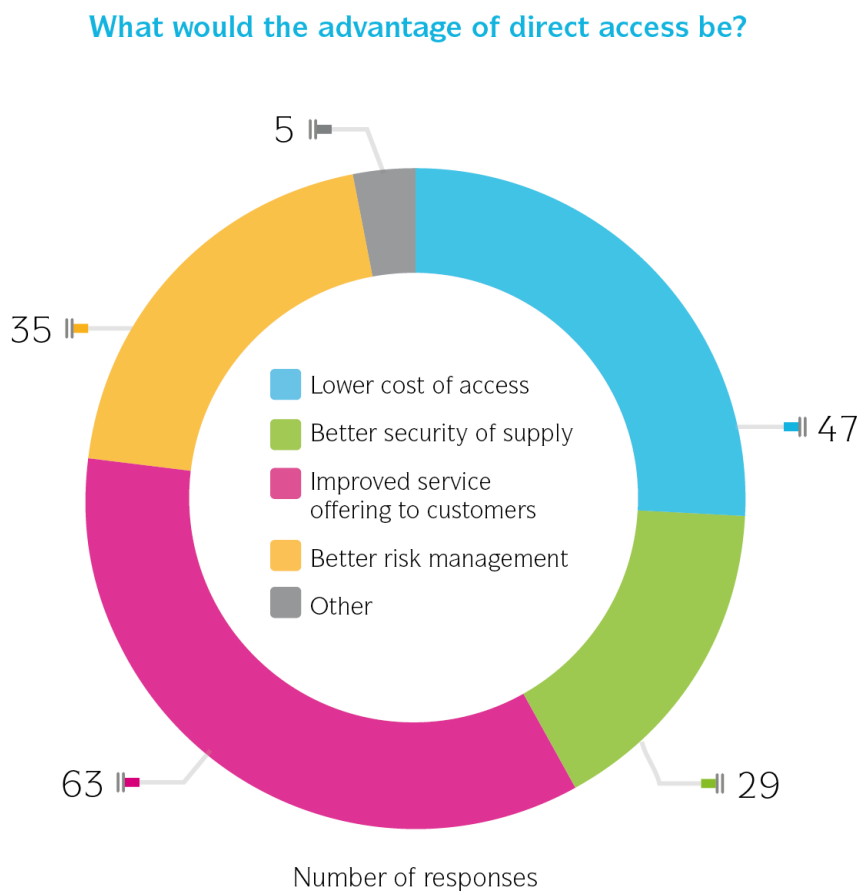
3.18   In summary, the main driver for PSPs is gaining a competitive advantage. A PSP would want direct access if the net benefits are superior to the net benefits of other types of access.

3.19   We would also expect this to have benefits for service users. If PSPs have the best access for their needs, this should lead to more efficient payment services – stimulating innovation to give service users more choice about how they make payments.

B) Governance of payment system operators

Why is governance important in payment systems?

3.20   Governance broadly describes how an organisation is operated: how decisions are made, who makes those decisions, what processes are in place and how responsibility is shared among the different parts of that organisation.

3.21   The payment system operators' governance determines how the systems work, including how access is arranged and how the systems themselves develop. It's important that there are governance arrangements in place to ensure the systems work in the interests of all service users – including those not directly involved in the boards of those systems.

Who are the payment systems' service users?

3.22   Service users are a broader group than the main PSPs forming the direct participants of a system (who usually comprise the majority of the operator's board). For example, the Financial Services (Banking Reform) Act 2013 (FSBRA) defines service users as 'those who use, or are likely to use, services provided by payment systems'. In our own 2014 consultation, we defined service users as 'including both PSPs and customers of PSPs, including government departments, businesses (of all sizes), charities and individual consumers' – i.e. everyone in the 'chain' of a payment being made.

Figure 5: Range of service users

3.23   Different system operators themselves may take a slightly different view of who they define as service users. Most operators have told us that they have a similarly broad definition, which also includes technology vendors, ATM deployers, trade bodies, consumer bodies and training providers. Figure 5 illustrates the range of service users we expect the operators to engage with.

Why is ensuring governance acts for all service users a priority for us?

3.24   Payment systems allow the flow of money that the economy needs to function. As we've stated in the sections of this report dealing with access, opening up these systems has been a concern for some time. Part of this expansion of access involves making sure the systems are operated in the interests of all those involved in their use. Well governed and open payment systems create conditions for effective competition and innovation to thrive across all sectors of the UK economy.

How can operators ensure service users' views are properly collected and considered?

3.25   Operators need to have processes and mechanisms in place to capture, consider and act upon service users' views. In their compliance reports they described the various steps they take to find out about service-user interests, how these interests are represented at board level, and how they communicate decisions or changes to service users. This is summarised in Figure 6.

Figure 6: Process to ensure representation of service users
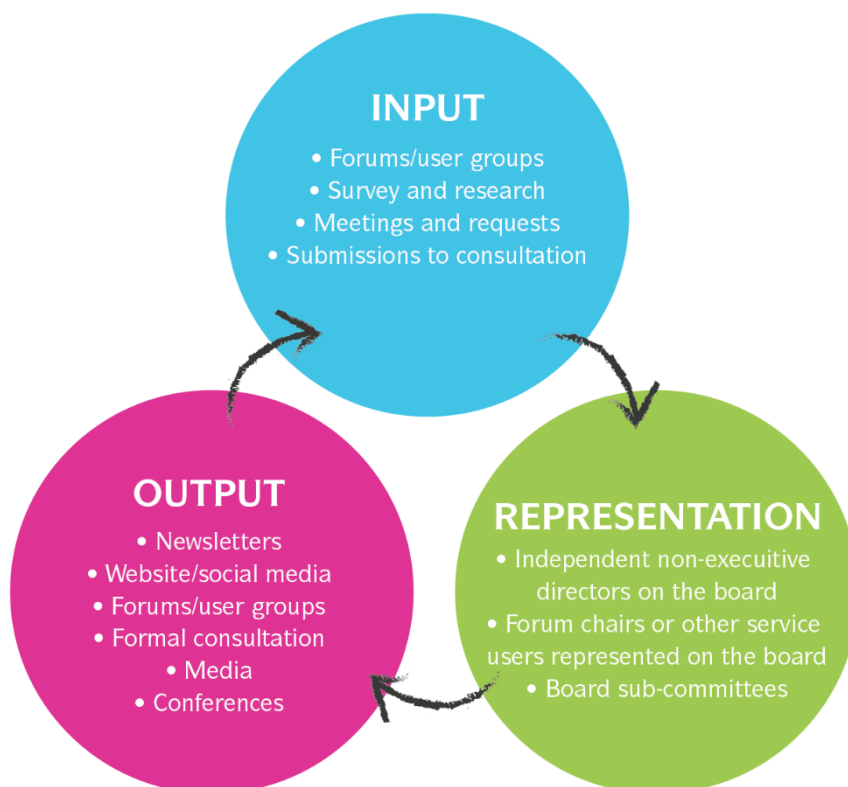
4
Our initial focus

Through extensive consultation we identified a range of different issues that could act as barriers to PSPs gaining direct access to payment systems, or might prevent operators acting in service users' interest.

In response to these issues we introduced obligations on certain operators aimed at ensuring:

- fair and open access to payment systems
- transparency and availability of information about access requirements
- good governance of the operators

Introduction

4.1   We consulted extensively on access and governance issues during 2014, and identified a number of issues that were limiting access to payment systems.

4.2   This chapter summarises the issues, and explains the requirements that we introduced in response.

A) Access

The initial areas of concern

4.3   All the payment systems should have access requirements that give as many PSPs as possible the opportunity to join, while still protecting the system's stability, security and resilience. Our consultations identified several issues that appeared to be restricting new direct participation.

4.4   Some of these issues applied to all the operators, and some to only a few. Figure 7 shows which issues applied to each operator, and highlights some of the comments we made in our November 2014 policy paper.

4.5   For more detailed descriptions of these issues, please see our previous policy statement and associated documents (PS15/1).

Figure 7: Access issues for different payment systems

What's the issue?	Which payment systems does it apply to?						
	Bacs	C&C	CHAPS	FPS	LINK	M'Card	Visa
1. Public disclosure of access requirements **The issue:** A lack of detailed information about operators' access requirements. Stakeholders said: • information was complex and unclear • they weren't given much information unless they signed a non-disclosure agreement **What we said:** There's a need for greater clarity and for access requirements to be made public. This would allow PSPs to evaluate the most suitable way for them to access payment systems.	✔	✔	✔	✔	✔	✔	✔
2. Bank of England settlement account **The issue:** Bacs, C&C, CHAPS and FPS require PSPs to hold a settlement account at the Bank of England (BoE) before they give them direct access. This prevents non-bank PSPs from getting direct access to these systems, as they can't get a settlement account. **What we said:** We asked operators to consider whether a BoE settlement account is really necessary, and if other solutions or settlement models would also be suitable.	✔	✔	✔	✔	✖	✖	✖
3. Regulatory status **The issue:** Each payment system requires its direct participants to have a particular regulatory status. Some systems allow a broad set of PSPs to access their payment systems. **What we said:** The rationale for the differing regulatory status requirements is not obvious. We asked operators to consider how they could accommodate non-banks. Bacs already provided direct technical access to technology providers, corporates and smaller PSPs.	✔	M	✔	✔	✖	✖	✖
4. Technical and operating requirements **The issue:** There were significant concerns about the operators' technical and operating requirements, particularly from smaller or challenger PSPs. **What we said:** Stakeholders were questioning whether the requirements were proportionate to the risk a new PSP introduces to a payment system. We asked the operators to consider: • a more risk-based approach • changes to allow more PSPs to get technical access	✔	✔	✔	✔	M	✔	✔

✔ Yes, the issue applied to this operator	✖ No, the issue did not apply to this operator	M We are monitoring the issue, based on non-specific concerns from stakeholders.

What's the issue?	Which payment systems does it apply to?						
	Bacs	C&C	CHAPS	FPS	LINK	M'Card	Visa
5. Ongoing fee requirements (including interchange fees) **The issue:** There were some concerns about the level of fees required to join C&C, and the lack of transparency about them. For Link, MasterCard and Visa, stakeholders raised concerns about the respective interchange fee arrangements within these payment schemes. **What we said:** We didn't consider the level of fees to be a significant cause for concern, but we were keen to make information about fees more easily accessible. For C&CC we expected the new clearing model to deal with the issue. We noted the link between access requirements and interchange fees.	✗	✓	✗	✗	✓	✓	✓
6. Requirements to provide a legal opinion **The issue:** Are the legal requirements imposed by Bacs, CHAPS and FPS all relevant or necessary? **What we said:** There may be valid reasons for operators to require PSPs to provide a legal opinion on how they meet the access requirements.	M	M	M	M	✗	✗	✗
7. Risk management **The issue:** Concerns were raised about credit and liquidity risk management criteria for Bacs and FPS – with reference to the loss-sharing agreements they have in place. **What we said:** We will monitor the work these systems are doing to introduce pre-funding.	✓	M	✗	✓	✗	M	M
8. Direct Debit guarantee **The issue:** Stakeholders have raised concerns associated with the DD scheme in Bacs, as collecting organisations potentially face a significant liability for direct debit transactions. This is a potential barrier to entry, particularly for smaller PSPs.	✓	✗	✗	✗	✗	✗	✗

✓ Yes, the issue applied to this operator	✗ No, the issue did not apply to this operator	M We are monitoring the issue, based on non-specific concerns from stakeholders.

Our approach to addressing concerns on access

4.6 As you can see, our consultation identified a range of issues that might limit direct access to payment systems for PSPs.

4.7 Promoting access is a priority for us. Making sure the systems are as open as possible, with objective and risk-based access conditions, is important – it can help ensure that direct access is available and taken up as widely as possible among PSPs. With this and our statutory duties in mind, we developed our policy response to the issues we had identified.

4.8 In April 2015, as set out in our policy statement PS15/1, *A new regulatory framework for payment systems in the UK* (March 2015), we took action in this area by introducing this direction on payment system operators:

- **An Access Rule**[10]: From 30 June 2015, Bacs, C&CCC, CHAPS Co and FPSL have been required to publish fair, open and risk-based criteria for direct access to their payment systems. LINK, MasterCard and Visa have a similar requirement under The Payment Services Regulation. All the operators must report to us each year on what they're doing to make sure access to their system is fair and open. The first of these compliance reports had to be submitted by 31 July 2015.[11]

4.9 We also took these steps to further examine and improve access to payment systems:

- **A sponsor bank information rule**[12]: Each of the current sponsor banks (Barclays, HSBC, Lloyds and RBS) must publish clear and up-to-date information on its indirect access services.

- **The code of conduct**: We proposed that the indirect access providers (IAPs) should create a code of conduct governing their indirect access services. This was put in place in September 2015.[13] It gives indirect PSPs clarity and certainty about their access by formalising the commitments from the sponsor banks.

- **Launched our indirect access market review**: This explores in detail concerns raised by stakeholders during the Financial Conduct Authority's *Payment Systems Regulation Call for Inputs* (March 2014) and the evidence-gathering process that led to our November 2014 consultation paper. We're looking in particular at the limited choice of indirect access providers, and the prices, service and choice available to indirect PSPs.

4.10 This wider set of access measures is intended to help achieve the PSR's statutory objectives of promoting the interests of service users, competition in payments systems markets, and innovation in payment systems, and in doing so to serve the PSR's purpose of making payment systems work well for those who use them. Within this report we will focus on direct access.

B) Governance

The initial areas of concern

4.11 The way that the interbank systems have developed means that a small number of banks and building societies may have the ability to exercise control over the system operators.

4.12 Our policy statement focused on three areas, highlighted in a range of stakeholder feedback, where we believed interbank operators should improve their governance: service-user representation, conflicts of interest and transparency. Figure 8 summarises these areas.

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10 See General Direction 2 (for Bacs, C&C, CHAPS and FPS) and General Direction 3 (for Link, MasterCard and Visa)
11 Please note that there were a set of transitional provisions that limited the scope of information that had to be provided in these first reports.
12 See Specific Direction 1.
13 You can see Payment UK's consultation on the Code of Conduct for Indirect Access providers here: http://www.paymentsuk.org.uk/news-events/news/payments-uk-invites-industry-views-code-conduct-indirect-access-providers.

Figure 8: Governance issues for different payment systems[14]

What's the issue?	Which payment system operators does it apply to?						
	Bacs	C&C	CHAPS	FPSL	LINK	M'Card	Visa
1. Service-user representation **The issue:** Representation of only a narrow and select group of service users can stifle competition and innovation. Stakeholders said that direct PSPs had better information than other service users and more influence over the governance of the payment systems.This is not being adequately addressed by existing service-user forums and groups. **What we said:** Governance processes need to give a meaningful opportunity for service users to influence decision-making that affects them and their needs.	✔	✔	✔	✔	✔	M	M
2. Conflicts of interest **The issue:** Interbank board directors face potential conflicts of interest that may limit effective competition and innovation. **What we said:** Interbank operator's board members must not simultaneously be directors of a central infrastructure provider to that payment system.	✔	✔	✔	✔	✔	✘	✘
3. Transparency **The issue:** There is little transparency in operators' board decisions and how the interests of service-users are taken into account. **What we said:** Interbank operators should publish the minutes of their governing body, including votes.	✔	✔	✔	✔	✔	M	M

✔	Yes, the issue applied to this operator	✘	No, the issue did not apply to this operator	M	We are monitoring the issue, based on non-specific concerns from stakeholders.

4.13   These issues were a concern for us. Payment systems must work in the interests of all service users, and confidence in this is essential if participation in the systems is to widen. In particular we are keen to ensure that service users, who are not direct participants of payment systems, can easily engage with the operators and make proposals about the way systems are operated (for example changes to systems' rules). We want to ensure that those proposals are properly considered and that service users have a feedback mechanism to understand the basis of the operators' decisions.

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14 While our directions on service-user representation and transparency did not apply to the cards systems, they are included in the PSR's programme of work on card payment systems.

Our approach to addressing concerns on governance

4.14   Following consultation, we decided to take these steps to improve transparency and service-user representation:

- **A service user direction**[15]: The operators of Bacs, C&C, CHAPS, FPS and LINK must ensure that service users' interests are appropriately represented in their decision-making processes. They must report annually on how they have complied with this direction. This requirement commenced on 30 September 2015, and the first reports had to be provided by 30 October 2015.

- **A conflicts of interest direction**[16]: The operators of Bacs, C&C, CHAPS, FPS and LINK must take all reasonable steps to ensure that none of their directors is also a director of one of their system's central infrastructure providers. This requirement commenced on 30 April 2015.

- **A board minutes publication direction**[17]: The operators of Bacs, C&C, CHAPS, FPS and LINK are required to publish their board minutes and votes as soon as reasonably practicable, including – where applicable – a statement of how independent directors have exercised their discretion in relation to public interest matters. This requirement commenced on 30 April 2015.

4.15   We expect our directions to change the dynamics of operators' boards and how control over payment systems is exercised. Increased transparency will create the opportunity for stakeholders to understand the outcomes of the decision-making process. This can build confidence in the operators' decision-making processes but also gives stakeholders the opportunity to raise concerns with decisions that are made. If we identify further concerns – for instance, if we are made aware of decisions which don't appear to reflect service users' needs adequately – we may need to consider whether further steps are needed**.**

4.16   The operators had to provide compliance reports on access arrangements in July, and service-user representation in October. These are summarised in the next chapter, highlighting measures the operators have taken and our opinion on how these could be further improved.

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15 See General Direction 4
16 See General Direction 5
17 See General Direction 6

5
Progress to date

Following our policy work and legal directions, the operators have been working towards improving the arrangements for access and governance.

They have all published information relating to their access requirements, and some have started work on projects to evaluate and improve the fairness of their rules. We will monitor and evaluate their progress in this area on an ongoing basis.

Interbank operators have all confirmed that there are no conflicts of interest (with respect to general direction 5) on their boards, and have begun publishing the minutes of their board meetings. They have also put measures in place to ensure service users are represented in their decision-making processes.

A) Access

Introduction

5.1   The access directions we introduced were proposed in November 2014, and took full effect on 30 June 2015. At the core of these obligations are:

   •   the requirement for the operators' to publicly disclose their access requirements

   •   the need for those requirements to permit fair and open access to payment systems

5.2   The obligations also require the operators to submit an annual access compliance report to us by 31 July.

5.3   Since receiving the first reports, we've reviewed them against the access directions and the areas of concern described in Chapter 4. This chapter provides a summary of what we found. It explains the progress the operators reported, and gives our assessment of this against the issues we identified in our November 2014 consultation paper. Although the reports were provided to us in confidence, the operators have each agreed to these summaries being published. Some of the operators have published non-confidential versions of their compliance reports on their websites. We encourage all operators to do this in the future.

5.4   We've also used the reports – and the operators' performance to date – to inform future work that we think is necessary to improve the effectiveness of our directions. This is discussed in Chapter 6.

What have the operators done so far, and what are their future plans?

5.5 The operators' compliance reports are useful in understanding their approaches to meeting their obligations.

5.6 All the operators noted that they had publicly disclosed their access requirements, and went on to explain what they'd been doing to deal with the issues we identified in our previous consultations.

5.7 They also identified the further work they're doing to ensure that their rules and processes promote fair and open access to payment systems.

5.8 The next pages provide a summary of our assessment of the progress the operators have made. This is followed by a summary of what work each operator has done so far and what future work they signposted. This is primarily based on information provided through their compliance reports. We are supportive of this work and we will work with operators to ensure timely progress.

A) Bacs

5.9 Bacs currently has 16 members. Its last new PSP joined in 2011. It said in its compliance report that it is in discussion with a number of potential new direct members. These discussions tend to focus around three key areas: the impact of pre-funding; access to appropriate accounts at the Bank of England (BoE); and whether indirect access is more appropriate in the short to medium term for that institution.

5.10 Bacs identified the following recent developments and future plans in its compliance report:

- It noted that its access requirements have not changed over the past twelve months. Bacs explained that it intends to review its access and participation criteria over the coming months as well as reviewing the technical access channels it offers to both agency PSPs and new entrants.

- It explained that it intended to consult on the Direct Debit (DD) Guarantee scheme in the second half of 2015. The aim of this will be to understand views on the status of the DD Guarantee. Outputs from the consultation and regulatory interaction will determine whether any case for change to the DD Guarantee can be made either as part of a single Guarantee, or possibly with some variations that are more appropriate to specific sectors of the market.

- It started a review of sort codes and bank reference data. These are essential components of access for most participants, but some have reported difficulties in getting a sort code. We believe this review could lead to some of these concerns being addressed.

5.11 We also note that this September, Bacs introduced pre-funding in conjunction with the BoE. This moves away from the loss-sharing arrangements among direct PSPs, which has been cited by some as a barrier to accessing Bacs for smaller PSPs.

Figure 9: Summary of operators' progress against the areas of concern in access

Progress on focus areas	Bacs	C&CC	CHAPS	FPSL	LINK	MasterCard	Visa
Public disclosure of access requirements	Published information	Published information	Published information	Published information	Published information	Published information	Published information
Bank of England settlement account	Needs to consider solutions or settlement models	Needs to consider solutions or settlement models	Needs to consider solutions or settlement models	Started considering solutions or settlement models	N/A	N/A	N/A
Regulatory status	Needs to consider alternative access models	Monitor	Implementing membership categories	Considering different types of membership under new access model	N/A	N/A	N/A
Technical and operating requirements (including sort codes)	Review in 2015/2016	Review under Future Clearing Model	Implementing membership categories	Implementing new access model	Monitor	Considering implications of IFR on operating rules	Considering implications of IFR on operating rules
Fee requirements (including interchange fees)	N/A	Review under Future Clearing Model	N/A	N/A	Planning to review interchange fees	Already taking steps to implement IFR	Already taking steps to implement IFR
Other requirements – legal	Monitor	Monitor	Monitor	Monitor	N/A	N/A	N/A
Other requirements – risk management (pre-funding)	Implemented pre-funding – needs to consider impact on non-banks	Monitor	N/A	Implemented pre-funding – needs to consider impact on non-banks	N/A	Monitor	Monitor
Other requirements – Direct Debit guarantee	Review in 2015/2016	N/A	N/A	N/A	N/A	N/A	N/A

Operator's progress: Colour key

- No change to this area of concern
- Planning undertaken to consider this area of concern, but no action yet
- Work underway to address area this area of concern
- Work completed, or process established, to address this area of concern. Impact under review
- No longer an area of concern based on current information
- Not applicable (N/A) or Monitor

B) C&CCC

5.12   C&CCC currently has 11 direct participants. C&CCC, its members and other stakeholders are currently implementing a transformational project – the Future Clearing Model (FCM) – to replace the current paper-based back office system with image processing (however, end-users will still be able to use paper-based cheques).

5.13   C&CCC identified the following recent developments and future plans in its compliance report:

- The FCM will process sterling cheque and credit payments using imaging technology. The model is currently in development.

- In May 2015, the C&CCC Board completed a gap analysis of their current eligibility criteria against their stated objectives for open access. The following actions were identified to be taken forward through the FCM project:

  o   Technical and operational requirements (rules, procedures, standards) are being re-defined in line with the infrastructure development to support cheque imaging. Requirements are to be built on the fundamentally important principle of open access.

  o   Funding and charging principles should support open, fair and transparent access. These have been proposed and will be reviewed by independent economic assessment to ensure they support these principles.

C) CHAPS

5.14   CHAPS currently has 22 direct participants. Its most recent participating bank joined in July 2015.

5.15   CHAPS identified the following recent developments and future plans in its compliance report:

- It introduced a new funding model in January 2015. Its previous model was based on the volume of processed payments (subject to all participants making a minimum 2% contribution towards total costs). The new model comprises two elements. Firstly, a fixed annual shareholder's charge of c. £30,000 (which is expected to decrease as more shareholders join the scheme). Secondly, a usage charge based upon prior-year volumes. CHAPS considers that the new model will reduce participation fees by around 50% for a low-volume direct participant, significantly lowering a potential barrier for some smaller PSPs.

- Over the last few years, it developed a Participant Categorisation Model (PCM), in which participants will be assigned one of four risk categories based on the systemic and operational risk they bring to the system. A consultation that included the codification of this new model closed in February 2015. CHAPS reports that it is in the final review stages of the draft CHAPS manual, which will reflect these changes. Subject to board approval, it anticipates that the CHAPS manual will go live and be published in Q1 2017.

- It established a Service User Group[18] in 2014, with the aim of helping CHAPS to understand and drive positive change in payments by engaging more broadly with users of the CHAPS system. It sets out on its website that the aims of the groups are to:

  o   explore the customer journey to understand how efficiencies, improvements and further transparency can be achieved, and work together with the Service User Group participants and relevant stakeholders to identify new and compelling products and services that can be introduced and taken to market

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18 The group was initially called the Affiliates group. More information about the group can be found here: http://www.chapsco.co.uk/chaps_services/chaps_service_user_group/.

o   explore how to reduce operational risk and cyber risk threats

o   understand the impact that the new Payment Systems Regulator will have on stakeholders

- More recently, CHAPS informed us that following its November 2015 Service User Group meeting, the payment system will be reviewing the aims of the Group to ensure that they remain fit for purpose and appropriate.

- CHAPS is also conducting work in better supporting current and future onboarding activities.

D) FPSL

5.16   FPSL currently has ten direct participants. FPSL has had one new PSP has joined the system since inception as a direct agency.

5.17   Participants currently gain access by connecting directly via their own dedicated in-house system or indirectly via a sponsor bank. Faster Payments has been encouraging the use of technical aggregators as another way to enable direct connection and access the Faster Payment Service. These new participants would either self-settle, if they hold a BoE settlement account, or seek settlement sponsorship from a BoE settlement account holder. This should mean lower costs (than the PSP would face by connecting directly to the FPS system themselves) and higher quality of service (than could otherwise be achieved through indirect access).

5.18   To date, ten technology companies have signed letters of commitment with FPSL to develop aggregation services through the New Access Model.[19]

5.19   FPSL provided an update on this work in its compliance report. It identified the following recent developments and future plans:

- It is currently reviewing public disclosure of its full costs, and its plan in this area is to publish as much information as possible.

- It is introducing a software accreditation programme for those technical vendor/aggregators who are looking to offer Faster Payments technical access services.

- It has developed a detailed roadmap to rationalise its onboarding processes, identifying the key documents, activities and decisions. The goals of this work are to:

o   provide consistency of approach when dealing with multiple new applicants

o   capture, agree and formalise institutional knowledge

o   make it more cost-effective, quicker and easier to onboard multiple new PSPs

- It is developing a new assurance process, due to be implemented in early 2016, which it says will lead to more focused requirements for new and existing direct participants. This new process will be a more targeted and risk-focused approach, where periodic reviews will be undertaken with their frequency determined by the level of risk brought to the service by the PSP. This should reduce the ongoing burden on some PSPs.

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19 See here:
http://recmgmt.is.fsa.gov.uk/livelink/livelink/36371208/providing%20aggregation%20services%20through%20the%20New%20Access%20Model.

5.20　We also note that this September FPSL introduced pre-funding in conjunction with the BoE. This moves away from the loss-sharing arrangements among direct PSPs, which have been cited as a barrier to accessing FPS for smaller PSPs.

5.21　FPSL set out a comprehensive programme of work in its compliance report. We especially welcome these commitments from FPSL and the work and engagement it has undertaken to date.

> **'Faster Payments seems to be the scheme most actively working to solve the access issues. The other schemes should feel equally concerned.'**
>
> PSR Panel Member

E) LINK

5.22　LINK is a membership organisation with 37 members, made up of the UK's major banks, building societies and independent ATM deployers. Its last member joined in 2014.

5.23　LINK identified the following recent developments and future plans in its compliance report:

- It explained that its access requirements are regularly reviewed in line with regulatory requirements. It said that no changes to its access criteria are envisaged at this time. It noted that collateral requested (if required) is directly proportionate to forecast volumes and settlement risk.

- It noted that its latest governance review may lead to reconsideration of matters such as membership categories to better support innovation and competition.

F) MasterCard

5.24　MasterCard identified the following recent developments and future plans in its compliance report:

- It is of the view that its eligibility criteria are in line with the Payment Services Regulation 2009 and that it was therefore fully compliant.

- It said that it does not plan to undertake any operator review or engagement with PSPs and other interested parties over the following reporting period in relation to its access requirements.

- It explained that Article 6 of the Interchange Fee Regulation (IFR) will require licences for access granted by card schemes to be valid in the 28 EU Member States from 9 December 2015. However, it also said that no change will be required as, since Q4 2014, it has ensured that all licences for participants within the EEA are valid for the 31 EEA Member States.

G) Visa

5.25　Visa identified the following recent developments and future plans in its compliance report:

- It considered itself to be compliant with the requirements of Regulation 97 of the Payment Services Regulation 2009.

- It noted that it undertakes, at least annually, a review of its Member Risk Policy to ensure that the policy remains fit for purpose, and is fair, proportionate, and non-discriminatory. It also

explained that its access requirements may vary, but are proportionate to the level of risk an applicant is deemed to pose if it can't meet its settlement obligations.

- It explained that it will be required to update its access requirements in light of the IFR.

- It said that it is proposing changes to its Account Information Security programme. These changes will simplify and reduce the reporting requirements associated with this programme – allowing acquirers to take a more risk-based approach to monitoring their exposure.

5.26 We also note that Visa has improved the information it makes available to prospective members. Information on the different categories of membership, the application process and Visa Europe's Operating Regulations are now available on the Visa Europe website.

B) Governance

Introduction

5.27 We first proposed our governance directions relating to Bacs, C&CCC, CHAPS, FPSL and LINK in November 2014, and confirmed them in our policy statement PS15/1.

General direction 4, which requires operators to ensure appropriate representation of service users' interests in their governing body's decision-making processes, came into force on 30 September, with a compliance report required by 31 October.

General direction 5, concerning conflicts of interest on operator boards, took effect on 30 April. It requires the operators to take all reasonable steps to ensure that their directors are not also acting as a director of a central infrastructure provider to that regulated payment system.

General direction 6, requiring the publication of operator board minutes, took effect for board meetings held on or after 30 April. In practice, schemes have observed this as different times – reflecting their schedule of board meeting dates and then publication of minutes after the meeting 'as soon as reasonably practicable'.

5.28 At the core of these obligations are the requirements for operators to act in the interests of their service users, and to be transparent in how they do this. We asked operators to tell us how they represent their service users' interests according to the following elements:

- **Input:** How does the operator and its board find out about service users' interests in general (including their needs and behaviours), and in relation to specific proposals?

- **Representation**: How are the service users' interests represented at board level (including the structures and processes that make this happen)?

- **Output**: How does the board communicate their decisions and any changes to the system's operation to service users?

- **Appropriateness:** How does the operator assess how appropriate its arrangements for representing service users are?

5.29 We have received and reviewed the first reports. Below is a summary of what we found. It explains the progress the operators reported, and our assessment of this against the issues we identified in our November 2014 consultation paper.

5.30 We've also used the reports – and the operators' performance to date – to inform future work that we think is necessary to improve the effectiveness of our directions. This is discussed in Chapter 6.

What have the operators done so far, and what are their future plans?

5.31 All five operators have confirmed that there are no conflicts of interest of the type described in general direction 5 on their boards. They've all also started publishing the minutes of their board meetings.

5.32 The operators' compliance reports for general direction 4 have been useful in understanding their approaches to meeting their service-user obligation. All the operators explained what they have been doing to deal with the issues identified through our previous consultations, and identified the further work they're planning to do to improve this representation.

5.33 The section provides a summary of our assessment of the progress the operators have made (an overview is at Figure 10).

Figure 10: Summary of operators' progress against the areas of concern in governance

Focus areas	Bacs	C&CCC	CHAPS	FPSL	LINK	MasterCard	Visa
Service user representation	See 6.30	See 6.30	See 6.30	See 6.30	See 6.30	N/A	N/A
Conflicts of interest	No conflicts regarding GD 5	No conflicts regarding GD 5	No conflicts regarding GD 5	No conflicts regarding GD 5	No conflicts regarding GD 5	N/A	N/A
Publication of minutes	Published board minutes	Published board minutes	Published board minutes	Published board minutes	Published board minutes	N/A	N/A

Operator's progress: Colour key

No change to this area of concern	Planning undertaken to consider this area of concern, but no action yet	Work underway to address area this area of concern	Work completed, or process established, to address this area of concern. Impact under review	No longer an area of concern based on current information	Not applicable (N/A) or Monitor

A) Bacs

5.34 Bacs confirmed that it doesn't have any conflicts of interest on its board (relating to general direction 5). It has also published the minutes of its 25 June 2015 board meeting on its website.

5.35 Bacs conducts market research (for example through institutions such as the University of Bristol) and surveys to collect evidence and views on service users' interests. It engages directly with payment originators (e.g. corporate members, government, SMEs, charities), both in groups and individually. It also runs an Electronic Affiliate Interest Group that meets quarterly, in conjunction with FPSL, to engage with payment originators, bureaux, agency banks and other suppliers. The chair of this group, currently Richard Thomas of MBNA (a user and affiliate, but not a member of either Bacs or FPSL), may attend board meetings on an agenda-driven basis.

5.36 Bacs considers proposals for change, recommendations and service-user views through various committees under the wider governance model of Bacs. The Bacs Board has two Independent Non-

Executive Directors (INEDs), one of whom is the Board Chair. The INEDs have a duty to safeguard the public interest.

5.37   Bacs communicates and feeds information back to service users through direct engagement, affiliate groups, other interest groups, information campaigns, website, newsletters and social media. It continues to seek ways to improve the effectiveness of its engagement with stakeholders and service users.

5.38   Bacs also plans to review its governance arrangements in the light of potential new direct members.

B) CHAPS

5.39   CHAPS confirmed that it doesn't have any conflicts of interest on its boards (relating to general direction 5). It has also published the minutes of the 16 July 2015 meeting of its board on its website.

5.40   CHAPS has an Affiliates Group, now called the Service User Group (SUG). The SUG meets on a biannual basis and has a direct reporting line into the Business and Strategy Committee, which is one of seven CHAPS board committees. The board of CHAPS has three INEDs, one of whom is the board chair. CHAPS is considering recruiting a fourth INED with the specific remit of chairing the SUG.[20] In the future, the CHAPS board will have a standing agenda item to consider input and views from SUG.

5.41   CHAPS communicates decisions or changes that are part of its ongoing service-user engagement including through the SUG, website and newsletters.

C) C&CCC

5.42   C&CCC confirmed that it has no conflicts of interest on its boards (relating to general direction 5). It published the minutes of the May, June and July meetings of its board on its website, and has also published the minutes of the Senior Sponsors Group (SSG) for its FCM project.

5.43   C&CCC has several service-user forums and groups that it engages – for example the Cheque Printer Accreditation Scheme (CPAS), a Cheque User Forum, a Vendor Forum, agency workshops and the FCM SSG. The SSG is also open to representation by stakeholders who are not current direct scheme members, such as trade associations. C&CCC also conducts surveys following each Vendor Forum, to assess views on content.

5.44   The C&CCC board has two INEDs, including the chair, with a public interest remit. The C&CCC Governance and Stakeholder Management Committee (GSM) is responsible for managing service-user relationships. The GSM is chaired by an INED. The views of agency PSPs are represented at board level by directors appointed by sponsor banks drawing on their expertise.

5.45   C&CCC is considering developing further communication tools to engage with service users (such as webinars). It currently communicates with service users primarily through newsletters, its website and its forums and groups.

D) FPSL

5.46   FPSL confirmed that it doesn't have any conflicts of interest on its boards (relating to general direction 5) and has incorporated this restriction into its Articles of Association. It has published the minutes of the 24 March and 11 June meetings of its board on its website.

5.47   FPSL also runs a number of engagements to take into account the representation of service users. For example, it has an access programme that engages with wider service users to broaden access

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20 Following their compliance report, CHAPS updated us that a decision has now been made to recruit a fourth Independent Director.

to different types of participants and aggregators. FPSL also plans to recruit a service-user engagement manager in 2016 to provide additional capacity for this. The operator's onboarding manager provides introductory information to prospective new participants, and its product manager leads service-user engagement in product design and development.

5.48   FPSL recently developed a set of service-user principles (which it aims to publish) that will be the driver in FPSL's longer-term commitment to continue to engage effectively with a full spectrum of service users.

5.49   FPSL appointed three INEDs in 2013, with a specific responsibility to 'understand and represent the needs of service users'. These INEDs are Chairs of several key committees: the FPSL Board, Rules and Governance, Risk, Audit and Finance, Remuneration and Appointments, and Assessment. INEDs are also allocated to organisations planning to participate in the system, to give them a point of escalation and a voice at the board before joining. FPSL also runs a development committee, reporting into the board, which explicitly considers new ideas and change requests from service users.

5.50   FPSL participates in the Electronic Affiliate Interest Group in conjunction with Bacs. Information from these discussions is fed into the appropriate committee. FPSL's and Bacs's INEDs are reviewing this group's effectiveness.

5.51   Through FPSL's specific engagement with Vendercom to explain the access programme, Vendercom has recently set up a Special Interest Group (SIG) around Faster Payments, which FPSL attends. This SIG gives vendors a forum to discuss opportunities to expand the use of the Faster Payments system into innovative areas.

5.52   FPSL provides feedback to service users through various means, including publications on their website, a dedicated email address that allows prospective participants and participants of the scheme and service users to contact FPSL if they have a query or complaint, and an ongoing programme of work.

E) LINK

5.53   LINK confirmed that it doesn't have any conflicts of interest on its board (relating to general direction 5). It has published the minutes of the March to September meetings of the Link Scheme Limited (LSL)[21] board on its website. They also publish the minutes of their Network Member Council (NMC).

5.54   LINK has developed a set of consumer engagement and communication tools that allows rapid feedback and continuous engagement with service users. This includes research into consumer needs and preferences (according to age, income groups and deprivation, for example) as well as other consumer matters such as demand for ATMs in under-served areas.

5.55   The LINK Scheme has a Consumer Council to engage with service users, which includes representatives from consumer organisations and PSPs. LINK agrees an annual score card with the Network Members Council (NMC) that rates the strategic approach of the scheme, and places the interest of service users at the heart of the scheme. LINK also operates a governance and performance committee that has a mandate to consider service-user interests. The LINK scheme board has an independent Chair.

5.56   LINK has recently reviewed its governance arrangements through an independent review, in response to the changing and developing nature of its membership. This is likely to affect the future governance and operational structure of LINK.

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21 LSL is a new corporate entity, incorporated in December 2014, which is the operator of the LINK Scheme for the purposes of the Financial Services (Banking Reform) Act 2013.

5.57   LINK noted that it will do more consumer-focused work over the next year, including work on financial inclusion and interchange fees. It communicates with service users through the council, communication tools, website, etc.

C) The impact of what the operators have done so far

5.58   While it's important to understand the changes the operators are making (as described above), we also intend to monitor their impact in the markets. In particular, we want to see if PSPs are finding it easier to get direct access to payment systems and will consider the impact on:

- **Demand for direct access:** Whether there is an increasing demand from PSPs to gain direct access and how operators are opening up their systems to a more diverse set of PSPs.

- **Cost of direct access:** Whether more proportionate and risk-based access requirements are reducing the initial and ongoing cost of getting direct access.

- **Time it takes to gain direct access:** Whether the support and guidance provided by operations around onboarding procedures and processing are reducing the time it takes to gain direct access.

- **Open engagement:** Whether PSPs feel they can genuinely influence decision making that affects them and their needs, and whether operators are actually considering their interests when taking decisions.

Demand for direct access

5.59   The operator's changes appear to have led to a growing demand for direct access, with more expressions of interest and letters of intent being sent.

5.60   Some of this new demand follows work the operators have done to review their access requirements to ensure open, fair and proportionate access. For example, FPSL is implementing a new access model to accommodate smaller PSPs through enhanced technical access solutions provided by aggregators. FPSL anticipates 3–6 new direct participants in 2016.

Figure 11: Indication of current and future demand for direct access (as at 30 June 2015)

Operator	Expressions of interest	Letters of intent to participate	New DPSPs	Total DPSPs
Bacs	8	0	0	16
C&CCC	2	0	0	11
CHAPS	10	4	0	22
FPSL	30	2	0	10
Link	7	2	0	37
MasterCard	5 open applications		9	75
Visa	1 open applications		7	66

Cost of direct access

5.61   Evidence we have gathered from PSPs suggests that the upfront costs of gaining direct membership can be significant. We understand that it could cost in the order of £2.5m–£4m.

5.62   The payback of such investment could be expected to be around three to five years, although the payback time will be driven by both the cost of joining (which will depend on the status of the PSP) and the volume of payments processed.

Time it takes to gain direct access

5.63   On average it takes 12 to 18 months to become a direct participant in a payment system. The time and costs vary significantly depending on factors such as whether the PSP is an existing indirect participant, and the number of institutions joining at the same time.

5.64   However, some operators appear to be reducing the onboarding time. For example, FPS confirmed that it can now potentially onboard a new direct participant in as little as nine months if necessary, provided the participant has made the relevant preparations.

Open engagement

5.65   Although our policies have only been in place since April, we've received positive feedback from a range of stakeholders about the operators' improved engagement and processes. For example, we are aware that over recent months there have been some examples of changes being made to the operation of systems following proposals by service users.

5.66   In future we expect to include more detailed analysis of the impact of changes the operators are making to take service users' input and needs into account. This might include more clarity on access requirements, choice of access options, supportive joining process and time taken for new members to join.

5.67   We will also consider the quality of board minutes and the timeliness of their publication, and whether more needs to be done to build awareness and interest from service users.

5.68   We will consider which measures are most appropriate, and may request additional information from operators as part of future compliance reports to support this assessment.

> **'In summary, it's a good start and there are demonstrable market improvements, but there is scope to do more to lower the hurdles faced by new entrants.'**
>
> PSR Panel Member

6
Further work

> While the operators have made some progress since we developed our policy proposals, they need to continue focusing on these issues to ensure open and fair access to their payment systems, and transparent governance that service users can have confidence in. We are setting out in this chapter the process that we will follow to monitor and evaluate:
>
> • the effectiveness of our directions
>
> • the areas we believe the operators need to focus on to ensure progress

Introduction

6.1 The operators' progress since we developed our policy proposals has been encouraging. They've made the information available to potential direct participants more comprehensive, and have – in some cases - worked towards making direct access more flexible. We can see the positive impact this is having.

6.2 However, there needs to be an enduring focus on current and evolving access issues as markets evolve. As the analysis in the previous section shows, there are a range of issues that stakeholders have previously identified where more work is needed. We expect the operators to continue making good progress on these areas, building on their positive start.

6.3 We will monitor the operators' work and compliance with our access directions. We will evaluate the effect it has on the market and continue to consider whether we need to take any further action.

A) The process

Developing a process to improve access and governance

6.4 Operators must comply with our directions and also report annually on how they're achieving compliance. In doing this, it will be important to reflect on the principles-based nature of the obligations that we've put in place. Compliance is not achieved through box-ticking; there is a broader obligation on the operators to do all they can to meet the spirit of our directions. Our aim in taking this approach is to foster a culture and environment in which the payments industry rises to the challenge itself.

6.5 To ensure the effectiveness of our directions, we will continue to collect and evaluate a range of information about the state of access. This will include:

• **Operators' compliance with our directions:** We will assess the operators' compliance with their obligations under our access and governance directions on an ongoing basis.

- **Operators' compliance reports and evidence:** We will expect the operators' annual compliance reports to provide evidence that access to each of their payment systems is fair and open and that they adequately consider service-user needs. We will also take into account how the operators are developing this evidence – for example, if they have committed to review certain aspects of their access requirements by an appropriate date. We expect evidence to relate specifically to the issues that we or stakeholders have identified (such as those described in this paper).

- **Stakeholders' views:** As part of their reporting obligation (under our direction), the operators must tell us how they've considered interested parties' views on the operation of their systems. **We expect a greater focus on this in future reports**.[22] We expect to see proper evidence of consultation with stakeholders and consideration of how their needs can be addressed.

- **The evolving nature of markets:** We expect to see evidence that the operators are considering the dynamic and evolving nature of markets (and the needs of stakeholders as these markets evolve). We will expect to see access arrangements evolve in response to changing needs and will evaluate the impact this has on the market.

6.6 We will also engage with our stakeholders and consider any views and concerns they bring to us.

6.7 After considering this information, we want to be able to highlight ongoing issues to the operators. So, on an annual basis we will collate the relevant access information, report on the operators' progress and highlight any areas which we think need more attention ('**focus areas**'). This paper is the first of these reports.

6.8 This process has several aims:

- Provide **clarity to all stakeholders** on the work that is being done to improve access and governance of payment systems continuously.

- Allow the operators to consider issues of concern further and **let the operators decide how best to deal with issues** (rather than us prescribing an approach to them).

- Create **a dynamic process of changes and improvements** to access and governance arrangements, to the benefit of all payment system users.

- Continue to **build a culture of open engagement and no surprises** with our stakeholders. This will allow us to communicate any concerns about operators' access and governance requirements. We encourage and expect operators to engage with us openly on these issues, and others they or we identify.

Potential further action

6.9 We will continue to monitor the impact of our directions and maintain our open engagement with the operators on access and governance. If further good progress is not made to deal with the issues identified, then we will need to consider taking further action.

Other

6.10 The next sections set out the issues we think require further consideration by the operators. We will work with the operators to consider the extent to which these issues affect their particular system, and also expect them to continue to exercise their judgement about meeting the requirements of our directions.

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22 This was one of the areas that operators were not required to report on under the Transitional provisions.

6.11   In addition to the focus areas, we'd like to make a general point for the next reporting period about gathering stakeholders' views and evidence. While operators were not obliged to report on these topics in 2015 (under the PSR's transitional provisions), they will have to in future. They will need to collect more evidence and views from stakeholder to support their future compliance reports and demonstrate progress at improving direct access. In particular we would like to see:

- evidence that there has been consultation with stakeholder on operators' future plans

- operators clearly demonstrating to us that they collect and actively consider views and evidence from the broad range of service users

B) Access

Focus areas

6.12   Our access directions have only been in force since 30 June this year. While steps have been taken in response to these, many of the areas of concern identified through consultation should still be areas to focus on. We expect operators to build on their initial progress in these areas, but also to initiate new activities where necessary. The areas are set out below. The right-hand heading indicates the type of impact this work could have (see paragraph 5.58).

1) Public disclosure of access requirements   *open engagement*

6.13   Operators have improved the information they make available to potential members. However, some information is only available on signing an Non-Disclosure Agreement (NDA). While this is understandable for some information, we'd like operators to make as much information as possible available without an NDA, and only use a NDA when this is reasonably justified.

2) Bank of England settlement account   *demand for direct access*

6.14   Some stakeholders noted that access to a Bank of England settlement account can still restrict some PSP's ability to gain direct access.[23] We're continuing our work with the Bank of England to support their review of what types of institutions can hold a settlement account with the Bank.

6.15   We expect operators to engage with the Bank where necessary, and to continue to consider alternative solutions or settlement models.

3) Regulatory status   *demand for direct access*

6.16   Operators should continue to consider changes to their access models that could support more proportionate and open access for smaller banks and non-bank PSPs, such as different membership categories. We recognise that the need for progress in this area may vary significantly across payment systems.

4) Technical and operating requirements   *cost of direct access*
time it takes to gain direct access

> **'Access costs and technical difficulties still do not reflect the desired risk-based proportionality that should be the norm.'**
>
>   PSR Panel Member

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23 PSR Panel Member's comments.

6.17 Operators should continue to evaluate the proportionality of their access requirements, particularly their technical requirements. While this is an issue that all operators need to consider, there are some specific areas that we think require further consideration:

- The processes of allocating sort codes and managing the related data remain a barrier to access. Bacs is conducting a review of these processes to consider ongoing concerns. We expect Bacs to make progress in this regard, and consult with relevant stakeholders and other operators during the next reporting period.

- C&CCC should consider the development of an accreditation process for providers of technical access solutions to the FCM. This could spur on the development of such solutions that may reduce the cost and complexity for connection to the FCM for potential participants.

- We note that CHAPS worked on the PCM in 2013 and is currently projected to complete implementation in Q1 2017. We also encourage CHAPS Co to explore how this new rule framework could be shared with prospective participants once approved by the CHAPS Board in Q1 2016.

- LINK explained in its compliance report that no changes to its access criteria are envisaged at this time. While it is positive that LINK considers that its requirements are appropriate, we think it important that it keeps this under review. We expect LINK to continue to **engage with users** about the appropriateness of the arrangements, and we will look for strong evidence of such engagement and stakeholders' views in its next compliance report.

5) Fee requirements <div align="right">_cost of direct access_</div>

6.18 The Interchange Fee Regulations (IFR) may have an impact on access arrangements and requirements within the card payment systems. We'd like to see card operators carefully consider and report on any impact this may or will have on access arrangements in their next compliance report.

6.19 We understand that LINK is planning to look at its interchange fee calculation in connection with its current governance review.

6) Risk management – pre-funding <div align="right">_demand for direct access_
cost of direct access</div>

6.20 Bacs and FPSL have implemented pre-funding requirements to mitigate settlement risk. Prefunding makes direct access more appealing for many PSPs as they no longer face financial loss in the event that another direct participant defaults. However, this may still pose difficulties for some institutions (such as EMIs). Bacs and FPSL may need to explore options to mitigate this in the future.

7) Direct Debit Guarantee <div align="right">_demand for direct access_
cost of direct access</div>

6.21 We welcome Bacs's commitment to consult on the Direct Debit (DD) Guarantee scheme. We expect Bacs to consider and assess stakeholder concerns (such as those expressed by our panel members) scheme in more detail. Bacs set out in its compliance report that this consultation would take place during the second half of 2015, although we understand this is now expected in 2016. Bacs say this will allow time for engagement with a range of stakeholders (including regulators) to establish the appropriate breadth for the public consultation. We expect to see good progress made in this area during the next reporting period and suggest that Bacs ensure it includes all relevant service users in this consultation.

'The limitless DD Guarantee makes it difficult for non-credit institutions to compete effectively with retail credit institutions in creating a competitive offer.'

PSR Panel Member

New issues

6.22 We've identified a new theme relating to direct access that we encourage operators to address.

8) Onboarding processes   *time it takes to gain direct access*
                                                    cost of direct access

6.23 There is growing demand for direct access. Good onboarding processes can considerably reduce the time it takes for a PSP to become an operational new direct member of a system. Some stakeholders feel that although operators are making good progress in creating a level playing field for PSPs, some of the remaining issues can still unnecessarily delay the process for gaining direct access.[24]

6.24 In order to achieve further improvements in this area, operators need to have clear and well-defined joining processes. Operators also need to identify areas that could be streamlined or made consistent across participants. We recognise that some operators already started making progress towards considering this. Operators should take steps to manage the pipe-line of new joiners, including those entities seeking to join as a result of structural reform legislation, and make provision for any impact on direct access to their systems.

C) Governance

Focus areas

6.25 The operators' progress since we developed our policy proposals on governance has been encouraging. They have told us that they have ensured that there are no conflicts of interest regarding directorships of major infrastructure suppliers amongst their board members. They have also all put in place procedures to publish redacted minutes of their board meetings.

6.26 All the operators have also reported on the measures they have in place, or are putting in place, to improve the representation of the interests of all service users in the decision-making processes of their governing bodies. While progress on this is also encouraging, there are several emerging themes that operators need to work on, to varying degrees.

1) Publication of minutes   *open engagement*

6.27 All operators have published their board minutes. They should continue to meet this requirement and look to publish their minutes as quickly as reasonably possible after a board meeting and with as few redactions as possible.

2) Conflicts of interest   *open engagement*

6.28 No person acting as a director of an operator also acts as a director for a central infrastructure provider.

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24 PSR Panel Member's comments.

6.29　Our market review into the ownership and competitiveness of infrastructure provision will further explore how the governance and ownership arrangements and vertical relationships within payment systems may affect decision making.

3) Service users   *open engagement*

6.30　On governance, this is the area where we expect to see more progress from the operators. There are three areas in particular that we expect them to focus on:

i)　Breadth of engagement

Not all the operators have been engaging with a wide enough range of service users. While some look broadly and engage different groups, others focus narrowly on certain PSPs. We will work with the respective operators to come to view on the service users whose views should be understood and considered as part of the decision making process for their payment systems.

ii)　Representation

We need to be confident that the evidence collected from service users is properly considered by the boards of the operators. Some operators have put more clear representation in place compared to others. So we want operators to demonstrate appropriate representation of these views in board discussions (either through representation on the board (ie through INEDs with dedicated accountability for service users), sub-committees to the board or standing agendas, etc).

iii)　Continuity

We are aware of several operators conducting ongoing reviews of their governance arrangement. We want the operators to engage service users during these reviews to ensure continuing compliance as a result.

D) Next steps

6.31　In addition to publishing this paper, we've written to the operators setting out the issues we think they need to work on. We will continue to meet with them over the coming months to understand their views of the issues and monitor progress and market developments.

6.32　We will require the operators to update us on their progress in evaluating or resolving these issues in their 2016 compliance reports. However, by highlighting this list of issues we aren't limiting the operators' ability to start new projects in a particular area, or to identify further priorities or areas to consider.

6.33　Stakeholders have told us they would prefer the access and governance reporting requirements to have the same annual deadline. We will consider this and may consult on the idea in due course.

Your views

6.34　We are keen to hear your views on access and governance. In particular, we invite you to provide any specific views, concerns or information that you consider relevant to any of the issues identified in this paper. Any contributions would be used to help assist our ongoing consideration of these issues.

6.35　Please provide your contributions to contactus@psr.org.uk.

Interactions with other work

6.36   As our Indirect Access Market Review does not conclude until summer 2016 and the Code of Conduct has only been recently implemented, our focus in this report has been on direct access. However, it may be appropriate for the scope of future reports to be broader and include aspects of indirect access as well.

Glossary

Bacs	The regulated payment system which processes payments through two principal electronic payment schemes: Direct Debit and Bacs Direct Credit. The payment system is operated by Bacs Payment Schemes Limited (BPSL).
C&C (Cheque & Credit)	The regulated payment system in England, Scotland and Wales that processes cheques and other paper instruments. It is operated by Cheque and Credit Clearing Company Limited (C&CC).
CHAPS (Clearing House Automated Payment System)	The UK's real-time, high-value sterling regulated payment system, where payments are settled over the Bank of England's Real time Gross Settlement (RTGS) system. It is operated by CHAPS Co.
direct access	A PSP has direct access to a payment system if the PSP is able to provide services for the purposes of enabling the transfer of funds using the payment system as a result of arrangements made between the PSP and the operator.
Direct Debit	The Bacs scheme for collecting pre-authorised debits on the payer's bank account, which are initiated by the payee.
direct technical access	The manner in which a PSP technically connects directly with either a payment system Infrastructure Provider or an operator in order to enable the transfer of funds.
EMI (Electric Money Institution)	The main business of EMIs is issuing cards which are electronically pre-stored with money, such as travel money cards and some gift cards.
FPS (Faster Payments Scheme)	The regulated payment system that provides near real-time payments as well as Standing Orders. It is operated by Faster Payments Scheme Limited (FPSL).
FSBRA	*Financial Services (Banking Reform) Act 2013.*
indirect access	A PSP has indirect access to a payment system if it has a contractual arrangement with a direct PSP to enable it to provide payment services (for the purposes of enabling the transfer of funds using that payment system) to its customers.
Indirect access provider (or IAP)	A PSP that provides indirect access to a payment system to other PSPs for the purpose of enabling the transfer of funds within the United Kingdom. This is the case whether the IAP does or does not provide the indirect PSP with a unique sort code (i.e. whether or not the indirect PSP is listed as the "owning bank" for a sort code in the Industry Sort Code Directory, with the sponsor bank listed as the "settlement bank").
LINK	The regulated payment system which enables end users to take cash out of their accounts (amongst other activities) using the network of ATMs in the UK. It is operated by LINK Scheme.
MasterCard	The regulated payment systems supporting payments made by cards and operated by MasterCard Inc.

payment service provider (PSP)	A PSP, in relation to a payment system, means any person who provides services to consumers or businesses who are not participants in the system, for the purposes of enabling the transfer of funds using that payment system. This includes direct PSPs and indirect PSPs.
PI (Payment Institution)	A person that has been granted authorisation under a national legislation implementing the PSD or been granted a waiver from full authorisation and been registered in accordance with Article 26 PSD (a 'small PI').
settlement	The discharge of obligations in respect of funds owing between two or more participants in a payment system.
settlement account	An account which is used to settle transactions between participants in some payment systems.
sort code	A six digit number used for the purpose of routing payments in certain payment systems.
sponsor bank	A PSP that has direct access (direct PSP) to a regulated payment system and provides indirect access to that system to other PSPs (indirect PSPs) for the purpose of enabling the transfer of funds within the United Kingdom, including through the provision of sort codes and indirect access for agency banks (for interbank payment systems). Sponsor Banks are a specific type of indirect access provider ('indirect access providers' refers to a broader category of direct PSPs, and includes direct PSPs which do not provide sort codes in interbank payment systems).
technical access	The manner in which a PSP technically connects with either a payment system infrastructure provider, an operator, a provider of indirect access, or a third-party service provider in order to enable the transfer of funds.
Visa (Visa Europe)	The regulated payment systems supporting payments made by cards and operated by Visa Europe and Visa UK Limited.