Pay.UK Application for an exemption for exceptional circumstances under Specific Directions 2 and 3

August 2020

pay.uk

EXECUTIVE SUMMARY

1. **This document is an application for an exemption from Pay.UK's duty to comply with the obligations set out under paragraphs 2.1 and 2.2 of the Payment System Regulator's (PSR's) Specific Directions 2 and 3 (SD2 and SD3) to competitively procure the central infrastructure contracts for Bacs and FPS. This application is based on the 'exemption for exceptional circumstances' provision that is included in both SD2 and SD3.**
2. The Covid-19 pandemic has created unprecedented and disruptive economic conditions for the UK economy and for Pay.UK's New Payment Architecture (NPA) programme. This has increased the risk in the programme as a whole to an unacceptable level. The materialisation of these risks, particularly transition risk, would have severe and harmful consequences for the UK economy and service-users. Pay.UK has undertaken a review of its available options to reduce these risks to an acceptable level, in line with its obligations as a recognised payment system operator under the Banking Act 2009.
3. Given the unforeseen nature of the Covid-19 pandemic, the totality of risks faced by Pay.UK and the payments industry in delivering the NPA Programme were not, and could not have been, fully understood at the time of the Infrastructure Market Review (IMR) remedies.
4. The exemption requested in this application would, if granted by the PSR, enable Pay.UK to cancel the current competitive procurement approach and instead use the existing supply relationship (with Vocalink, the incumbent infrastructure provider for FPS and Bacs) for the build and run of the New Payment Architecture's (NPA) core clearing and settlement layer. The infrastructure provider will play a critical role in the delivery and safe transition to the NPA.
5. Based on the current information available to it and having examined other options, Pay.UK considers this approach to offer the least harmful way of reducing risks in the project to an acceptable level. This more flexible approach provides a positive way through the unprecedented economic challenges in a way that keeps risks at an acceptable level, maximises stakeholder support, and supports the timely delivery of the NPA - which will ultimately benefit end users and the real economy.

Context

6. The NPA Programme is enabling a vision for the future development of the UK's retail payment infrastructure. It is a significant undertaking for which an equivalent, in terms of scope and scale, has not been delivered elsewhere in the world. It will deliver a replacement for the existing FPS and Bacs payment systems on a phased basis. The core clearing and settlement layer of the NPA will provide a robust and resilient retail payment system and will enable competition and innovation in the wider retail payments ecosystem, ultimately benefiting end users and the broader economy.
7. The NPA Programme has already delivered tangible benefits for end users. The implementation of phase 1 of the 'Confirmation of Payee' service is providing end-users with greater assurance that they are sending their payments to the intended recipient. In addition, as the new 'Request to Pay' service is rolled out, billers will have the ability to request payment for a bill, rather than simply sending an invoice, providing a flexible new way for bills to be settled.

8. However, as acknowledged by the ambition of Payments Strategy Forum (PSF) in 2017, delivering the NPA Programme was always expected to be challenging. Through Pay.UK's own experience - including via an independent review undertaken by the Berkeley Partnership in 2019, followed by a programme reset - we have learnt more about the scale of the challenge and how to face in to it.
9. A key lesson in the programme to date has concerned the demands placed on Pay.UK following our creation. As a new company, Pay.UK has needed to consolidate four companies into one (BPSL, FPSL, C&CCCL, alongside UK Payments Administration), create a new corporate culture, procedures and policies, and has needed to manage staff turnover and recruitment to support its new objectives. This has been achieved while ensuring the safe operation of our payment systems, delivering the ICS Programme and growing the number of direct participants in each scheme. Creating and establishing Pay.UK has been a success but has naturally required significant leadership focus. Taking on the delivery of the PSF vision, and seeking to meet SD2 and SD3 over the same time period has led to significant management and leadership stretch.
10. In addition, we now also recognise that our service user engagement strategy was not sufficiently developed prior to 2020. Ultimately, in order for the NPA to be successful, it is imperative that Pay.UK creates a proposition delivery plan and implementation approach that works for our current and future participants, as we are dependent on securing participant commitment to fund, deliver and safely transition to the NPA, and ultimately to reach end users. In response to this, in early 2020, Pay.UK established the Strategic Participant Group (SPG) to provide a forum for participants to advise Pay.UK and make recommendations on the NPA Programme directly to the independent Pay.UK Board to consider alongside other evidence.
11. The SPG's creation is important in helping Pay.UK to ensure that the NPA will meet participant needs and, through this, maintain support for the programme. Ultimately this support will help enable delivery of the NPA in a way which is consistent with the ambition of the PSF and therefore support the needs of end users and the broader economy. It will also support us in achieving a safe transition of the £7trn of payments that are currently supported on today's payment rails. While we need to achieve support from a wide pool of participants, the SPG allows us to test our approach and gather feedback from a senior and representative group of participants. The UK Finance Payment Product Strategy Board nominated representatives by engaging with its members to ensure SPG members were a representative sample of participants, inclusive of larger and smaller banks and non-bank PSPs. As well as being representative of the industry, the institutions that attend the SPG reflect around 92% of FPS payment volumes and 99% of Bacs payment volumes.

Facing unprecedented challenges

12. Through Pay.UK's own experience and from service user engagement, the scale of the challenge in delivering the NPA Programme has become increasingly clear and has been compounded by the Covid-19 crisis.
13. As a *Recognised Payment Systems Operator*,[1] managing risk is at the core of what Pay.UK does, and it is imperative that we do not undertake activity that puts robustness and resilience at risk [✂]. While Pay.UK's commitment to deliver the PSF vision for the NPA remains, there are

[1] Under the Banking Act 2009.

multiple layers of risk that we now face in delivering the NPA in the current climate. The totality of these risks put the current delivery approach outside of our risk appetite:

- **Baseline risks associated with the NPA transition**: First, the transition to the NPA is in itself a hugely significant undertaking, and involves inherent risk irrespective of the chosen infrastructure provider.
- **Additional risks associated with the existing delivery approach:** Second, layered on to this, we now have a stronger understanding of the additional risks that would arise in the event of using a new supplier for the NPA, [✂].
- **Impact of Covid-19:** A third layer of risk and challenge, caused by the Covid-19 crisis, is new. It not only adds new risks, but also exacerbates the first two layers of risk.

14. Pay.UK is concerned about these risks for a broad range of reasons including the operational resilience of live payment systems, overall time and cost of the programme, and the potential for service users (and ultimately the real economy) to miss out on the significant benefits that are attached to the NPA.
15. [✂]. As well as this being critically important for us from an overall operational and programme risk management perspective, we also need to find ways to minimise the level of risk (and associated cost) that we require our participants to underwrite in support of this programme. This is important from a delivery perspective, because our ownership model and the focus of our regulatory obligations mean that we will need to ask participants to make an upfront user commitment in order to finance the programme. Minimising the programme's risk and uncertainty is an important driver in securing this financial commitment from participants.
16. The Covid-19 crisis is an exceptional circumstance that has exacerbated the totality of risk faced by Pay.UK in delivering the NPA Programme. The economic impact of the pandemic is profound and there remains significant uncertainty about its duration and future impact. However, it appears that the effects of Covid-19 are leading to a 'pandemic financial crisis', causing material damage to the UK economy including the financial sector.
17. In the months and years ahead, there will likely be significant expectations placed on the financial sector to support the recovery of the UK economy, at a time when costs and aggregate risks in those businesses will be higher. This is important context when considering the NPA programme and the risk identified in this paper. It is Pay.UK's view that the pandemic's impact on costs, resultant budget constraints and aggregate risk profiles means that there is a material risk that participants might not be able to underwrite the totality of risk now faced by the programme. In addition, our experience with previous programmes (for example, cheque imaging) demonstrates that industry wide costs are an order of magnitude higher than central costs.
18. As such we have considered how alternative delivery approaches could reduce our overall level of risk to an acceptable level. This application proposes a way forward which we consider lowers our overall risk and correspondingly reduces a risk of an impasse (which could arise should participants be unable to support the NPA with their own programmes, and/or fund Pay.UK in meeting our regulatory obligations).

Our proposed approach

19. In May 2020, the independent Pay.UK Board took the decision to pause the current competitive procurement process and instead explore the opportunity, via engagement with regulators, to

use Pay.UK's existing infrastructure provider to build and run the NPA ("the proposed approach"). The decision to pause was taken because Pay.UK judged that it was unfair vendors to continue to ask vendors to continue to invest in the procurement process during the period that Pay.UK was engaging in discussions with regulators.

20. We are seeking an exemption from the need to comply with SD2 and SD3 for the delivery of the NPA. Given the investment needed in the NPA, we request an exemption for the build and initial run phase of the NPA contract. We anticipate:
    - The end of that contractual period covering build and initial run being the point at which compliance would likely be required by the PSR.
    - That the length of the contract would need to be agreed pre-contract award with the PSR to provide all parties with certainty.
21. The proposed approach would enable Pay.UK to mitigate the totality of risks that is otherwise attached to the NPA Programme to a level that is within our risk appetite, while still delivering the broad PSF ambition. Working with the existing infrastructure provider would: (i) reduce industry wide transition risk and costs (which will be orders of magnitude higher than the costs incurred at the centre) at a time when the industry needs to navigate through the impacts of the pandemic financial crisis; (ii) deliver competition benefits sooner in terms of overlays, between PSPs, and between the NPA and other payment methods); and (iii) enable the innovation outcomes that will benefit end-users and the wider ecosystem.

Work to limit risks and maximise benefit through this approach

22. In proposing this approach, we are cognisant of the potential disadvantages that may come with it, and have made an active trade-off that the benefits of this approach would outweigh the new risks it brings. [✂].
23. To support our response to these challenges in July 2020 the Pay.UK End User Advisory Council (EUAC) was advised of, and discussed, the potential end-user implications of the May Board decision. EUAC subsequently agreed an advice note for the Pay.UK Board which can be found in Annex 5 of this application. While EUAC did not have access to the detailed information provided to the Board, it recognised that minimising transition risk and improving speed to market of the some features of the NPA would be of clear benefit to end users.
24. EUAC recognised that the foreshortening of the competitive process for the core clearing layer could introduce end-user risk of two types if mitigating actions were not identified and taken: (i) around the value for money in the pricing and service that is agreed as part of the contract, which may have an impact on end-users; and (ii) risks relating to the ecosystem development. On this second point EUAC was clear that the value of competition in the ecosystem is immense for end users and EUAC wants to be confident that in arriving at a single provider for the core more quickly, the opportunity to ensure the vendor and Pay.UK are really focussed on proactive ecosystem development to meet end-user needs is not lost.
25. While we agree with EUAC that benefits to participants and end users from competition in procuring the central infrastructure provider would be much more limited than the wider ecosystem competition benefits of the NPA, our approach aims to address any benefits that may be lost due to the cancelation of the procurement process. As well as a number of constraints on the supplier, we are exploring a range of tools that could be deployed to help

ensure that negotiations with a single supplier can deliver a robust contract that will support delivery of the PSF vision, while also achieving value for money.

26. Pay.UK understands that we need to be an ‘intelligent buyer’, regardless of how the procurement is managed, and we are fully committed to being this. This matters for both commercial reasons and also, importantly, for our ability to make decisions that will ensure that the competition and innovation benefits in the wider ecosystem are preserved, and that there can be no advantage around the provision of overlay services accruing to the provider of the core infrastructure. We will retain centralised control of the Programme with tight oversight of the engineering and transition services that the infrastructure provider will supply.

An opportunity to make progress through the current challenges

27. This application is necessarily concerned with the method, and relevant regulatory obligations, of delivering the NPA’s core clearing and settlement infrastructure. This is obviously a critical issue to get right. However, it is important (and extremely welcome) to note that despite the wider economic challenges, there remains, at this time, on-going industry support for delivering the PSF vision, and to achieve the resultant benefits to service users, as soon as is practically possible. There is continued participant support for IS020022 messaging standards, strong central governance, and a phased transition approach with FPS followed by Bacs. In light of current and future service user feedback, the Pay.UK Board has adopted six scope objectives that underpin the NPA, consistent with the PSF ambition.
28. The desired outcome for the industry, end-users, and the broader economy has not changed. Pay.UK, along with the industry, remains fully committed to deliver on the PSF vision, and to deliver the NPA without undue delay, addressing PSF detriments and delivering a competitive and innovative ecosystem that brings material benefits to service users and the broader economy. We consider the approach outlined in this application represents the best option to capture these benefits and deliver for our users without undue delay.
29. The industry commitment to fund the NPA, considering the significant industry costs associated to the program is a key component to its success. With this comes the commitment to implement and deliver as each participant has an important role to play. We believe, with this proposed approach, we have secured industry consensus and alignment, and so the opportunity to maintain industry commitment to NPA. We also believe that this will be delivered in a way that accelerates the key competition benefits for the wider ecosystem, whilst preserving robustness and resilience – all in the face of the pandemic financial crisis – [✂]. We trust the PSR will give this careful consideration and our aim is to ensure that, with the partnership of all relevant stakeholders including our participants and our regulators, the NPA is a success story for “UK Plc” and will deliver the right outcomes for end users.

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SECTION #1: INTRODUCTION AND BASIS FOR THIS APPLICATION

1. The New Payments Architecture (NPA) Programme is enabling a vision for the future development of the UK's retail payment infrastructure and wider ecosystem. The NPA will enable the retail payments ecosystem to realise new opportunities previously unseen, unlock innovation and competition, and address persisting detriments. Pay.UK's role is to develop an overall conceptual design for the NPA and then implement the core layer and relevant technical overlay services (see Section 3B for details), collectively referred to throughout this document as 'NPA infrastructure', and to set the standards to support this concept.

2. The conceptual design would enable a diverse ecosystem with many actors contributing to the execution of payments over the NPA. Much of the discussion in this application will focus on the method of delivering the NPA's core clearing and settlement layer.

3. The NPA is a significant undertaking, and is a retail payments infrastructure programme for which an equivalent has not been delivered on a similar scope and scale elsewhere in the world. It will ultimately deliver a replacement for the existing FPS and Bacs payment systems on a phased basis. These systems are deeply embedded in the real economy so special care is needed to replace them. The NPA will be based on ISO 20022 messaging standards, with strong central governance and a single set of rules. The NPA payment system will incorporate robustness and resilience, while enabling competition and innovation in the broader retail payments ecosystem.

A. Pay.UK's existing obligations under Specific Directions 2 and 3

4. SD2 and SD3 require the operators of the Bacs and FPS payment systems to procure any future contracts for central infrastructure services in a competitive manner. Additionally, the first central infrastructure contract competitively procured in accordance with the SD2 and SD3 should be capable of receiving and sending all relevant messages (used in the payment system) in the ISO 20022 messaging standard. Although the current procurement obligation explicitly relates to the central infrastructure contract for FPS and Bacs, Pay.UK and its predecessors have proceeded on the basis that the NPA will replace FPS and Bacs. The NPA would, in time, require its own designation under the *Financial Services (Banking reform) Act 2013.*

5. SD2 and SD3 were originally published in June 2017, with compliance deadlines set for December 2020 and 1 July 2020 respectively. Following this, there were several developments that impacted on these obligations:

    - **Compliance deadline change:** The compliance deadlines were extended to 2 December 2023 (SD2) and 30 June 2023 (SD3). This followed applications from Pay.UK to provide time to deliver the NPA Programme.
    - **Ownership changes:** At the point of the remedy decision, Bacs Payment Schemes Ltd (BPSL) and Faster Payments Scheme Ltd (FPSL) were owned and controlled by the group of PSPs that were direct members of the payment systems and funded new developments in those systems directly. As such, the SD2 and SD3 obligations sat, at that point, on the direct participants as a result of their ownership of the PSOs. Subsequently, Pay.UK acquired ownership of BPSL and FPSL at which point

the PSPs ceded ownership and control and Pay.UK took on responsibility for the obligations. An effect of this is that while Pay.UK is responsible for meeting these obligations, it can only do so by ensuring PSP support and willingness to fund the programme to meet those obligations.

6. The competitive procurement obligations in SD2 and SD3 are set out in paragraphs 2.1 and 2.2 and copied below.

2.1 Subject to section 5, the operator of [Bacs/FPS] must take such action as is necessary to ensure that any central infrastructure contract in place on or after [1 July 2020/2 December 2020],[2] or such later date as specified by the Payment Systems Regulator in accordance with section 4 below, has been procured in accordance with paragraph 2.2

2.2 The procurement must include the following steps:

(a) the development of a strategy for the procurement

(b) consultation with service-users, including PSPs and end users, and taking into account the view of service-users expressed in the context of the Forum's work where relevant

(c) fair and transparent engagement with potential providers

(d) development and execution of a transparent and objective process to shortlist potential providers for the competitive tender

(e) development and execution of a competitive tender that is based on transparent and objectively justifiable criteria, and is likely to attract two or more such bids

(f) selection of the central infrastructure provider(s) in accordance with the competitive tender described at (e).

'central infrastructure - Means the whole, or any part of, a package of systems and services, comprising hardware and software, provided under contract to an operator for the purposes of operating [BACS/FPS], including the processing of funds transfers '

'central infrastructure contract - Means a contract between an operator and another person for the provision of central infrastructure'

7. In May 2020, the Pay.UK Board took the decision to pause the current competitive procurement process and instead explore the opportunity, via engagement with Pay.UK's regulators (primarily the PSR),[3] to utilise Pay.UK's current central infrastructure provider for FPS and Bacs to build and run the NPA. The existing provider is Vocalink.

8. Pay.UK judged it to be more appropriate and practical to pause rather than try to engage with the PSR while continuing with the competitive procurement. Further, Pay.UK concluded that it was unfair to continue to ask vendors to invest in the process during the period that Pay.UK was engaging in discussions with regulators.

9. At no time has the Board decided to cancel the procurement and Pay.UK has sought to ensure its compliance with its regulatory obligations at all times. If the PSR were to grant

[2] In 2018, the compliance deadlines were extended to 2 December 2023 (SD2) and 30 June 2023 (SD3).
[3] Pay.UK's other primarily regulator is the Bank of England (given the recognition of Bacs and FPS under the Banking Act 2009). The Bank is a macroprudential regulator with a focus on robustness and resilience.

this application, Pay.UK intends to enter into negotiations with Vocalink (around this delivery approach) to build and run the NPA core infrastructure.

10. The Pay.UK Board took this decision independently, after much deliberation, and based on experience and internal considerations on the Programme to date, alongside consideration of service user views.

Purpose of this document

11. [✂]. In recent months, these challenges have been exacerbated by the Covid-19 situation, and the significant uncertainty this brings going forward. The impact of the Covid-19 pandemic and its effect on the economy have greatly added to the risks in delivering the NPA infrastructure via a competitive procurement.

12. This document is Pay.UK's submission to the PSR on this matter. It constitutes a formal application under Section 5 of SD2 and 3. Pay.UK is seeking an exemption from Pay.UK's duty to comply with SD2 and 3 to enable Pay.UK's utilisation of the existing supply relationship with the current infrastructure provider in the delivery of the NPA Programme.

13. This application explains the new approach proposed to deliver the NPA infrastructure, and why we consider that moving forward with this new approach, while taking steps to mitigate the resulting risks and future potential risks, is reasonable.

14. Following the PSR's consideration of this matter, Pay.UK will, of course, seek to progress the NPA in a way which is consistent with the PSR's decision, through engagement with our participants and other service users. However, in light of the Covid-19 situation, it is Pay.UK's view that there is a material risk of impasse on this matter if our participants are unwilling to fund us in meeting regulatory obligations, and/or complete their own projects to connect to the NPA.

15. We are making this application because Pay.UK, and we believe many of our participants, consider that the proposed approach would mitigate the risks explained in this document and ensure that the benefits of the NPA – to end users, participants, and the economy – are delivered in a timely way that does not increase risks to financial stability.

B. Basis for this application

16. Both SD2 and SD3 provide Pay.UK with a legal right to make an application for exemption from the duty to comply with one or more obligations set out in SD2 and SD3 for exceptional circumstances. This is provided for in Section 5 in each of the Specific Directions (SDs). Section 5.2 provides the PSR with powers to reject or approve such an application, in whole or in part, and to make such approval, subject to conditions.

17. In order to enable Pay.UK to move forward with the NPA Programme through the utilisation of the existing supply relationship, Pay.UK is applying for an exemption from certain obligations under SD2 and SD3, based on the Section 5 provisions. The wording of these provisions is identical (bar the reference to each payment system) in both SDs and is set out below. The SDs require that applications must include the matters set out in sub-paragraphs 5.1 (a) to (c).

‘5.1 The operator of [Bacs/FPS] may apply to the Payment Systems Regulator for an exemption from the duty to comply with one or more of the obligations set out in this [Specific Direction 2/Specific Direction 3]. Such applications must include:

a) the exceptional circumstances which the operator maintains justify the application;

b) the steps which the operator is taking in relation to securing the provision of central infrastructure services absent full compliance with this [Specific Direction 2/Specific Direction 3]; and

c) whether, and when, the operator expects to recommence compliance with all of its obligations under this [Specific Direction 2/Specific Direction 3].

5.2 The Payment Systems Regulator may reject an application or approve it in whole, or in part, and may make such approval subject to compliance with any conditions.

5.3 Where the Payment Systems Regulator has approved an application, the operator must comply with its obligations under this [Specific Direction 2/Specific Direction 3] before such date as the Payment Systems Regulator specifies in the approval of the application.’

18. An initial overview of how the application addresses these requirements is given below – with the rest of this submission and annexes explaining our rationale in detail.

Requirement (a)

19. As a *Recognised Payment Systems Operator*,4 managing risk is at the core of what Pay.UK does, and it is imperative that we do not undertake activity that puts robustness and resilience at risk [we have a zero / close to zero appetite for disruption to our payment systems). While Pay.UK’s commitment to deliver the PSF vision for the NPA remains, there are multiple layers of risk that we now face in delivering the NPA in the current climate. The totality of these risks put the current delivery approach outside of our risk appetite:

- **Baseline risks associated with the NPA transition**: First, the transition to the NPA is in itself a hugely significant undertaking, and involves inherent risk irrespective of the chosen infrastructure provider.
- **Additional risks associated with the existing delivery approach:** Second, layered onto this, we now have a stronger understanding of the additional risks that would arise in the event of using a new supplier for the NPA, [✂].
- **Impact of Covid-19:** A third layer of risk and challenge, caused by the Covid-19 crisis, is new. It not only adds new risks, but also exacerbates the first two layers of risk.

20. Pay.UK is concerned about these risks for a broad range of reasons including the operational resilience of live payment systems, overall time and cost of the programme, and the potential for service users (and ultimately the real economy) to miss out on the significant benefits that are attached to the NPA.

[4] Under the Banking Act 2009.

21. It is this totality of risks, added to and exacerbated by Covid-19, that has led Pay.UK to make this application. **As such, the exceptional circumstance that justifies this application is the disruption, and potential for future disruption, to the NPA Programme caused by the Covid-19 situation and its uncertain future impact.** Given the unforeseen nature of the Covid-19 pandemic, the totality of risks faced by Pay.UK and the payments industry in delivering the NPA Programme were not, and could not have been, fully understood at the time of the Infrastructure Market Review (IMR) remedies.

22. There are a range of risks which are exacerbated by Covid-19, as well as new risks. These are explained in this paper and include the impact on participants, the interaction with the programme on other payment industry initiatives, the readiness of users, additional operational and delivery risks, and transition risks.

23. [✂]. As well as this being critically important for us from an overall operational and programme risk management perspective, we also need to find ways to minimise the level of risk (and associated cost) that we require our participants to underwrite in support of this programme. This is important from a delivery perspective, because our ownership model and the focus of our regulatory obligations mean that we will need to ask participants to make an upfront user commitment in order to finance the programme. Minimising the programme risk and uncertainty is an important driver in securing this financial commitment from participants.

24. The Covid-19 crisis is an exceptional circumstance that has exacerbated the totality of risk faced by Pay.UK in delivering the NPA Programme. The economic impact of the pandemic is profound and there remains significant uncertainty about its duration and future impact. However, it appears that the effects of Covid-19 are leading to a 'pandemic financial crisis', causing material damage to the UK economy including the financial sector.

25. In the months and years ahead, there will likely be significant expectations placed on the financial sector to support the recovery of the UK economy, at a time when costs and aggregate risks in those businesses will be higher. This is important context when considering the NPA programme and the risk identified in this paper. It is Pay.UK's view that the pandemic's impact on costs, resultant budget constraints and aggregate risk profiles means that there is a material risk that participants might not be able to underwrite the totality of risk now faced by the programme. In addition, our experience with previous programmes (for example, cheque imaging) demonstrates that industry wide costs are an order of magnitude higher than central costs.

Requirement (b)

26. We have considered how alternative delivery approaches could reduce our overall level of risk to an acceptable level. This application proposes a way forward which we consider lowers our overall risk [✂].

27. Subject to the PSR granting this application, Pay.UK intends to deliver the central infrastructure by utilising the existing infrastructure provider relationship with Vocalink.

Requirement (c)

28. We are seeking an exemption from the need to comply with SD2 and SD3 for the delivery of the NPA. Given the investment needed in the NPA, we request an exemption for the build and initial run phase of the NPA contract. We anticipate:

    - The end of that contractual period covering build and initial run being the point at which compliance would likely be required by the PSR.

- That the length of the contract would need to be agreed with the PSR to provide all parties with certainty (this could be agreed through the PSR assurance process pre-contract award).

29. It is vital that the regulatory framework is clear before contracts are signed since neither Pay.UK nor the supplier would be willing to sign a contract if there is material uncertainty about whether all of the contractual conditions could be fulfilled.

30. We do not believe that these particular exceptional circumstances (i.e. Covid-19) will remain exceptional at the time that we come to re-tender the NPA core infrastructure. Hence we expect to run a procurement process for central infrastructure at the end of the first contract cycle. However, we would expect any future compliance deadline would need to be set based in a way which could provide flexibility to deal with future market developments.

C. How is the rest of this document organised?

31. **Section 2** of this document provides some high-level background information on the initiation of the NPA Programme.

32. **Section 3** explains the progress made on the NPA Programme to date, and includes a summary of recent events that have contributed to Pay.UK making this application to the PSR.

33. **Section 4** goes into detail on the three layers of risk discussed above and explains why Covid-19 is an exceptional circumstance that reduces the likelihood of a successful delivery of the NPA Programme should we move ahead with the existing competitive procurement approach. This section therefore provides the rationale for this application, addressing requirement 5A of the SDs in detail. Section 4 also discusses the benefits of adopting an alternative delivery approach, and includes some tools and techniques for how Pay.UK can achieve value for money in the absence of a competitive procurement.

34. **Section 5** provides an explanation of how Pay.UK will ensure it has the capability to act effectively as an intelligent buyer under the proposed new delivery approach, explains plans for delivering the next stages of the Programme under the proposed approach, and discusses the steps being taken by Pay.UK to put itself in a strong position to restart the competitive procurement if that course of action is required following the PSR's decision on this application. It thereby addresses requirement 5B of the SDs.

35. In addition to this application, Pay.UK is submitting six supporting annexes to the PSR.

36. **Annex 1 - Economic impact assessment** provides a more detailed assessment of the costs and benefits of different delivery options.

37. **Annex 2 - Risk assessment** provides a comparison between the risk profiles of moving forward with the existing infrastructure provider (in the event that the PSR grants the application) versus moving ahead with a different supplier following a competitive procurement.

38. **Annex 3 - Procurement overview** provides detail on the procurement process including scoring at the Request for Information (RFI) phase, and explains why the RFI phase was not about picking a winner.

39. **Annex 4 - SPG advice note to Pay.UK Board in May** is provided as context to the main application. This document has been shared with the PSR previously.

40. **Annex 5 - End-User Advisory Council (EUAC) advice note to the Pay.UK Board** was provided following two meetings of Pay.UK's EUAC which discussed the impact of the proposed approach on end-users. Following these meetings, this advice note was provided to the Pay.UK Board meeting in August.

41. **Annex 6 - PSR evidential requirements** provides references to where in the main application or annexes we have addressed the PSR's evidential requirements (as set out in the PSR letter of 26 June).

D. Evidence that has informed this document

42. Pay.UK has sought be provide comprehensive evidence throughout this document and its annexes to: (i) support the case for the application; and (ii) address the requirements set out by the PSR in its letter of 26 June 2020. The evidence is informed by our experience over the last two years of the NPA Programme and through insights gathered from service users, including participants and the EUAC.

43. However, there are some limitations on the evidence that it is feasible to gather at this stage in the NPA Programme. First, while we have engaged with a limited set of stakeholders on a confidential basis, we have not been able to engage widely as we do not wish to prejudice the ability to restart the competitive procurement if that is deemed necessary following this application. Second, on the evidence itself, there are challenges in assigning probabilities and impact values to the market disruptions that could result from the crystallisation of the transition risks described in this document. We have sought evidence from a representative group of participants and provided arguments and supporting evidence to the best of our ability.

44. We note that the PSR may seek further evidence through the public consultation that we understand is likely to follow on this matter.

SECTION #2: BACKGROUND ON THE NPA PROGRAMME

46. This section provides some background information on the initiation of the NPA Programme.

47. In 2015 the PSR created the Payments Strategy Forum (PSF), which was tasked with developing a strategy for UK interbank payment systems. The PSF was independently chaired and made up of a mix of service user and payment service provider (PSP) representatives. The PSF published its strategy in November 2016, which included a vision for meeting the needs of current and future generations of payments service users. As well as setting out a range of detriments that should be addressed, the strategy also envisaged the creation of the NPA and the consolidation of the operators of the interbank payment systems: BPSL; FPSL; and the Cheque and Credit Clearing Company Limited (C&CCCL).

48. Following publication of its strategy, the PSF was asked by the PSR to develop a Blueprint to enable the delivery of that strategy. In parallel, the PSR and Bank of England created the Payment System Operator Delivery Group (PSODG) which was tasked with considering key issues relating to the consolidation of the three payment system operators. Ultimately the PSODG report[5] led to the incorporation of Pay.UK (formerly NPSO Ltd) in July 2017 under a new ownership and governance model which was reviewed by the PSR and Bank of England.[6]

49. In December 2017 the PSF published its final Blueprint, with Pay.UK then being asked to take forward detailed work on design and implementation of a range of initiatives. The final Blueprint proposed work including:

   - **A new architecture for payments:** The PSF envisaged the design and delivery of a layered model for payments processing with security and resilience a key principle. The new architecture would be built on common messaging standards, allow for open access APIs and API governance. Importantly, flexibility in the design should support a range of existing and new overlay services (which would provide opportunities for enhanced competition and innovation in downstream services).
   - **Responding to end user needs**: The PSF specified some solutions to address current and future end-user needs, such as implementing Request to Pay and Confirmation of Payee, and providing greater assurances and enhanced data on users' payments.
   - **Simplifying access to promote competition**: The PSF specified some solutions to simplify access and enable participation in the market for PSPs in order to foster competition and innovation. These solutions included simplifying access to sort codes, settlement accounts and aggregators, establishing common PSO participation models and rules, and moving the UK to a common messaging standard.

50. Prior to the conclusion of the PSF process, the PSR had run its Infrastructure Market Review (IMR). As the interim and final IMR reports were published in February and July 2016 respectively, and the remedies decision in June 2017, this process predated the PSF Blueprint and subsequent developments.

[5] https://www.psr.org.uk/sites/default/files/media/PDF/PSODG-Report-2017.pdf
[6] https://www.psr.org.uk/sites/default/files/media/PDF/joint-statement-on-PSODG-report-from-PSR-and-Bank.pdf

51. The IMR was a market review into the ownership and competitiveness of infrastructure that supports three major UK payment systems, namely Bacs, FPS, and LINK. The PSR's findings in the IMR can be summarised as follows:

- There is no effective competition for the provision of UK payments infrastructure for the three main interbank payment systems (Bacs, FPS, and LINK).
- The lack of competitive procurement exercises by the operators is a barrier to entry that prevents potential providers from competing.
- The UK payment systems' bespoke messaging standards are acting as a barrier to entry for new infrastructure providers into the UK market.
- At the time of the PSR's decision, the joint control that the four largest shareholder PSPs exercised over both the operators and Vocalink meant that the ownership and governance arrangements were at that point considered likely to reduce the level of competition.

52. The PSR consulted on a range of remedies in light of the findings of the IMR.[7] Subsequently, the PSR issued SD2 and SD3 (these reference the anticipated NPA). In addition, the PSR proposed a potential remedy to require divestment of ownership by Vocalink's four largest shareholders. Following this, Mastercard acquired a majority stake in Vocalink from the then owners. At the time the PSR indicated that it believed that Mastercard's acquisition of Vocalink would address the competition issues around ownership originally identified, meaning there was no longer a requirement for a divestment remedy.

[7] During the course of the IMR Vocalink was acquired by Mastercard, which the PSR determined addressed the ownership-related problems it had identified in its review (Vocalink previously had a similar group of owners as the PSOs and PSPs it served).

SECTION #3: MARKET DEVELOPMENTS, PROGRESS ON THE NPA PROGRAMME, AND RECENT PROGRAMME EVENTS

53. This section summarises key market developments following the PSF and the progress made on the NPA Programme to date by Pay.UK. It also includes a summary of recent events that have contributed to Pay.UK making this application to the PSR.

A. Market Developments

54. We think it is important context to note that the payments industry has moved on in a positive way since the PSF Strategy and Blueprint. This progress reflects good work by the PSOs, participants, and policy makers to address (at least in part) some of the detriments identified by the PSF. For example:

- There has been a significant increase in direct participation in the payment systems that Pay.UK operates. Since the publication of the PSF strategy in November 2016, the number of direct participants in FPS has increased from 11 to 33. Over the same period, the number of direct participants in Bacs has increased from 16 to 27. This reflected significant work by the operators of FPS and Bacs.
- Open Banking has launched and the ecosystem is now growing rapidly, with innovation and speed to market working well for end users.
- In 2019, Pay.UK completed the transition to the Image Clearing System (ICS). At the start of 2019, two cheque clearing systems (paper and image) were running in parallel. In August 2019 the banking industry completed its migration to full usage of the ICS, which meant that the paper clearing system could then be decommissioned.
- The ‘Confirmation of Payee’ and ‘Request to Pay’ services have both been launched. These are discussed in more detail below.
- Since 2016, the payments industry has tactically delivered competitive solutions to address financial crime detriments, with banks continually investing in their own solutions. Pay.UK has been engaging with key industry representatives to establish how the industry can be supported in the development of ‘Transaction Data Analytics’, and the possibility of alignment to external financial crime initiatives that are currently underway is also being explored. Pay.UK has also successfully delivered ‘Mule Insights Tactical Solution’ for FPS and Bacs via Vocalink.

55. While some of the detriments identified by the Forum have been addressed, the industry recognises the need, and is committed to deliver much more through the NPA.

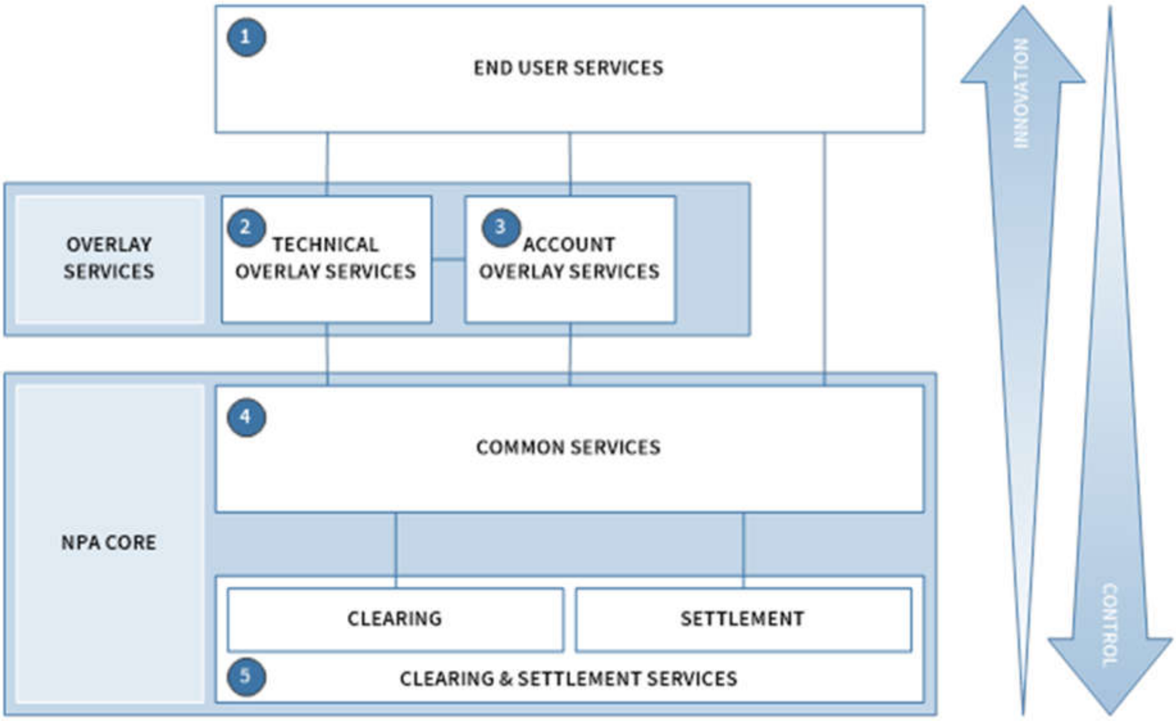
B. NPA Programme progress to date

56. While NPSO Ltd was incorporated in July 2017, the process of consolidating the three PSOs into what is now Pay.UK took considerable time and effort to complete. The consolidation process was finalised with the full integration of C&CCCL into Pay.UK in September 2019.

57. Alongside this, and as expected by the PSR and PSF Blueprint, Pay.UK mobilised the NPA Programme in early 2018.[8]

Layered model

58. In validating the PSF Blueprint, Pay.UK has concluded that the NPA ecosystem will comprise three separate layers, as illustrated by the diagram below.



59. **Pay.UK is tasked with designing and implementing the core clearing layer of the NPA.** The core will be built and run by the selected central infrastructure provider. It will consist of clearing and settlement services (labelled 5 in the diagram) which will provide payment clearing and the instruction/reporting of settlement in central bank money at the Bank of England and common services (labelled 4) which are services that are deemed critical and need to be available for all NPA services, such as message and product rule validation and reference data.

60. Following transition to the NPA, delivery of innovation at the core (i.e. change to facilitate innovation in the ecosystem) would be driven by service user need and depend on the agreement of Pay.UK. We have always sought to utilise a single strategic partner to deliver the core, with this partner being used to build and run the core. Build and run are grouped together because: (i) it creates the right incentives – if a supplier is required to run a service, it will be built in a way that makes the run as effective as possible; (ii) it avoids the risk of switching from a 'build' supplier to a new 'run' supplier at the start of the NPA run phase and the need for that new 'run' supplier to fully understand how the service works before it is operational; and (iii) it can help smooth cost recovery, especially when the cost of build is so substantial.

[8] The first NPA Committee meeting was held in March 2018.

61. **The middle layer will consist of overlays.** There will be two broad types of overlay in the NPA.

62. The first types of overlay are **Technical Overlay Services** (labelled 2). Technical Overlays are used by PSPs to ensure that they are able to support all their expected payment flow outcomes. As such Technical Overlays will often interact directly with services in the NPA Core, though that is not always the case.

63. To date, Pay.UK has focused on identifying those Technical Overlays that participants will need to have in place for day one (for example, bulk/de-bulk is an overlay service that deals with Bacs-type outcomes) enabling only single push payments to be fed into the core for processing (this is a significant change to the construct of current 'pull' payment types). The services we have focused on are those that ensure that current payment outcomes can be replicated safely in the new NPA layered model. Because of the criticality of these services and the obvious impact on service users if current payment outcomes cannot be met, Pay.UK is (in the first instance) looking to contract these services from the central infrastructure provider on day one (and for a period of five years) so that we can transition from today's payment types (this remains Pay.UK's position regardless of the approach taken to appoint an infrastructure provider).

64. However, Pay.UK recognises that as time passes and the market evolves, these services could be open to innovation and competition with potentially multiple service providers offering similar services on a competitive basis (hence, why the contract for the Technical Overlays will not be the same length as the possible 10-year run contract expected for the core). Pay.UK is currently assessing (and will continue to assess) the opportunities for opening up these services to competition.

65. Pay.UK will also work with the market (with initial working groups starting in August) to understand other Technical Overlay Services that could be provided by the wider market from day one. A capability to assist in combating financial crime is an example of a Technical Overlay Service that will be key to the NPA and could potentially be provided by a third party provider. We recognise that both our regulators will need assurance over the decision making framework for opening up overlays to competition, and how Pay.UK would appropriately manage risks and accountabilities.

66. The second types are **Account Overlay Services** (labelled 3 in the diagram above).[9] These are services that do not need to connect into the core. Confirmation of Payee and Request to Pay (discussed below) are examples of live account overlay services. As we develop the NPA, the industry may identify additional services to support payments that could be developed as Account Overlay Services.

67. Account Overlay Services would be open to competition including potentially competition 'in' the market with different providers offering competing overlays which provide similar benefits. Depending on the specific service Pay.UK may take a role in facilitating this development (such as writing rules and standards) or it may not be involved at all.

68. Pay.UK is cognisant of the vertical competition risk in this area, should an appointed infrastructure provider seek to monopolise certain services, perhaps by raising barriers to others from delivering these services. Pay.UK would mitigate this risk through governance decisions such as where Pay.UK, rather than the infrastructure provider, has responsibility and control of issues (such as setting standards, rules, and appropriate terms and

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[9] These were referred to as end-user overlays in the PSF Blueprint.

conditions of access). We covered our views on these risks in more detail in our response to the PSR's Call for Input on competition and innovation in the NPA.

69. **End-User Services** (labelled 1) will consist of end-user channels and services that support end-user propositions. Typically these services include mobile apps, browser-based applications (for example, online banking), point of sale, and business-to-business services. PSPs, rather than Pay.UK, will provide these services to customers. This layer represents the majority of the payments value chain (and the majority of the cost), which is where the majority of (in the market) competition and innovation has happened in recent years bringing benefits to end-users, and is where most of the competition and innovation can be expected in the future.

70. Pay.UK's role in this layer is focussed on setting the rules and standards for the ecosystem as a whole which PSPs have to adhere to. As such, we will help to facilitate competition and innovation in this space such as by moving towards the use of the enhanced data fields within the ISO 20022 messages (it is therefore necessary that the core layer operates in a robust and resilient manner, in order to enable these end-user benefits).

71. Alongside developments in the NPA, we expect competition in the wider payments industry to continue to evolve.

Confirmation of Payee and Request to Pay

72. Alongside progress with the wider NPA Programme, Pay.UK has undertaken activity in addressing end-user detriments, and has delivered two material benefits to service users of the existing retail payment systems: (i) Confirmation of Payee; and (ii) Request to Pay.

73. **Confirmation of Payee (CoP)** is a way of giving end-users of payment systems greater assurance that they are sending their payments to the intended recipient. It is, in essence, an account name checking service that can help avoid payments being accidentally misdirected. CoP addresses certain types of Authorised Push Payment fraud, by introducing another hurdle for fraudsters, and giving effective warnings to customers about the risks of sending payments to an account where the name did not match.

74. In Phase 1, all six directed PSPs[10] have implemented or are implementing CoP and further payment service providers are expected to deliver CoP in 2020 H2. At the end of July 2020, approximately 8.2 million CoP requests per week were being reported (up to 9.8 million if 'on-us' transactions are included). [✂].

75. **Request to Pay (RtP)** is a messaging service that has been created to complement existing payments infrastructure, and gives billers the ability to request payment for a bill, rather than simply sending an invoice, providing a flexible new way for bills to be settled between customers and businesses. For each 'request', customers are able to pay in full, pay in part, ask for more time, communicate with the biller, or decline to pay. The service will sit alongside Direct Debit and other existing bill payment methods to give consumers and businesses additional choice when managing their finances.

76. The service commenced on 29 May with a 'soft' launch, given Covid-19. Pay.UK advised the industry and all those who have shown interest in RtP that the final documents are now available on the Pay.UK website, and that they can now enrol to it. Since then, Pay.UK has

[10] As specified by PSR's Specific Direction 10, the directed PSPs are: (i) Barclays; (ii) HSBC; (iii) Lloyds Banking Group; (iv) Nationwide Building Society; (v) RBS Group; and (vi) Santander.

seen a good level of interest from organisations wanting to register to the framework. There are two levels of participation: (i) service providers (who provide the service to the end user) and technical providers (who build software solutions which the service providers can use). Within the first three weeks following launch, we saw five organisations register.

C. Progress on the competitive procurement approach

77. In accordance with the obligations set out in the SDs, Pay.UK commenced a competitive procurement process, intended to select a supplier to build and then run the new NPA infrastructure. The first stage of this was to publish a Pre-Qualifying Questionnaire (PQQ) to find possible bidders. The purpose of the PQQ phase was to understand from the market the appetite to engage with Pay.UK in the delivery and operation of a technology solution for the core clearing layer of the NPA. Pay.UK received almost 20 responses to the PQQ phase, and Pay.UK down-selected to a smaller number, in accordance with its sourcing approach.

78. Pay.UK then issued a Request for Information (RFI) Notice in May 2019 to those bidders. Pay.UK then completed a down-selection exercise in February 2020, selecting a small number of bidders to go forward. As part of the down-select, Pay.UK applied hurdles focussing on bidder ability to design and build the technology solution.

79. In accordance with industry practice, the RFI phase was not designed to select a single supplier. Rather, the RFI phase was designed to elicit a high-level solution design and rough order of magnitude pricing in order to confirm the credibility of each bidder's proposal. As Pay.UK's thinking and requirements have evolved between the RFI and now, Pay.UK could not seek to rely on bidder RFI responses nor was that the intention at point of RFI issuance. Put simply, the RFI phase was to test which bids were credible, and which bidders could be capable of delivering the NPA, and removing those bidders that Pay.UK concluded would be unable to deliver the NPA. The RFI stage was never intended to assess what was the best bid or to choose a preferred bidder, and the evaluation undertaken at the RFI stage was not the rationale for the proposed delivery approach which this application seeks to enable.

80. At the point that the competitive procurement process was paused in mid-June, the small number of bidders remaining in the process had all demonstrated, at a high-level, the capability to deliver the NPA. If the competitive procurement tender were to proceed, the next milestone in the process would be the issuance of the Request for Proposal (RFP) notice. The purpose of the RFP phase is for Pay.UK to issue, to the remaining bidders, its further developed thinking, translated into outcome oriented business requirements supported by a Master Services Agreement (MSA) and associated schedules. The RFP would be designed to elicit solution designs (and an implementation roadmap) from the bidders supported by a contract and binding price envelope. The design produced at the RFP stage is intended to be sufficient for the bidder to provide firm pricing.

81. [✂].

D. Lessons learned, key programme developments, and stakeholder engagement

82. The lessons learned and developments explained below are a factual description, and are important for understanding the context in which Pay.UK has taken the decision to explore the new delivery approach. The rationale for the decision is, for the avoidance of doubt, explained in Section #4.

Key lessons learned on delivery of the NPA Programme to date

83. Pay.UK has learned a great deal about what is needed to deliver the NPA Programme since the PSF Blueprint was handed over in late 2017, and specifically over the past 12 months.

84. A key lesson (which was also identified by the Berkeley Partnership report, see below for detail)[11] has concerned the demands placed on Pay.UK. As a new company, Pay.UK has needed to consolidate four companies into one (BPSL, FPSL, C&CCCL, alongside UK Payments Administration), create a new corporate culture, procedures and policies, and has needed to manage staff turnover and recruitment to support its new objectives. This has been achieved while ensuring the safe operation of our payment systems, delivering the ICS Programme and growing the number of direct participants in each scheme. Creating and establishing Pay.UK has been a success but has naturally required significant leadership focus. Taking on the delivery of the PSF vision, and seeking to meet the two SDs over the same time period has led to significant management and leadership stretch.

85. Recently, and informed by the Berkeley Partnership report and our engagement with participants, Pay.UK has been aware of, and increasingly concerned about, overall Programme time and cost, transition risk, and the importance of securing participant commitment. The scale of the challenge in delivering the NPA Programme has become increasingly clear. First, the transition to the NPA (which is a pioneering vision for interbank payments) is in itself very challenging, and is a process which has inherent risk irrespective of the chosen infrastructure provider. Second, layered onto this, there are a number of additional risks that would arise in the event of using a new supplier for the NPA. [✂]. A third layer of risk and challenge, caused by the exceptional circumstances created by the Covid-19 crisis, is new and has exacerbated the totality of risk faced by Pay.UK and the payments industry in delivering the NPA Programme to a level which is beyond our risk appetite, and which mean the NPA Programme is less likely to be successful if the existing delivery approach is maintained. These risks are discussed in more detail in Section 4.

86. We have also learned what a realistic plan would require (and how long it would take) to deliver the degree of specifications needed to complete a full competitive procurement. While we will still need to be an 'intelligent buyer' under the proposed approach, as we will need to contract at the same level of detail and will need to: (i) deliver a robust contract that will support delivery of the PSF vision; while (ii) also achieving value-for-money, it will be more efficient to harness PSP and vendor expertise much earlier in the process, meaning we can arrive at the level of detail faster, and progress engineering work sooner.

[11] The Berkeley Partnership report was presented to, and shared with, the PSR in August 2019.

87. Given the Pay.UK Board's focus on how best to progress what is an ambitious and pioneering vision for the NPA in a timely fashion, in early 2020 (and as part of the discussions held at the time that the Pay.UK took the RFI-to-RFP down selection decision for the existing competitive procurement),[12] it asked the Executive to consider whether there were options to accelerate the delivery approach.

88. We have also developed a much better understanding of transition risk (discussed in more detail below) as the programme has progressed, learning from our own experience and analysis, and gathering insights from stakeholders. We understand this was raised as a concern by some service users in the IMR (where the complexity of the NPA was not fully understood and a like-for-like transition was envisaged by some stakeholders). Our understanding of concerns has been enhanced by a consultation on FPS transition, from engaging with bidders during the RFI phase, and from and SPG discussions (see below).

89. We also recognise, as confirmed by the Berkeley Partnership report, that our service user engagement strategy was not sufficiently developed prior to 2020. Ultimately, in order for the NPA to be successful, it is imperative that Pay.UK creates a proposition delivery plan and implementation approach that works for our participants, as we are dependent on securing participant commitment to fund and deliver the NPA, and ultimately to reach end users. Ensuring sufficient consideration of service users' views in strategic decision making is in line with PSR General Direction 4.

90. We recognise that our regulators also place weight on Pay.UK securing user commitment to fund, adopt, and use the NPA. In its open letter of January 2018, the PSR stated *'Securing user commitment: The NPSO will need to develop an approach to ensuring that there is sufficient commitment from future users of the NPA to allow for efficient financing of the project'* and *'Securing commitment from users is an important part of the procurement process, as it lowers infrastructure vendor risk, which in turn should help encourage an effective procurement competition, secure funding and minimise costs.'*

Independent Berkeley Partnership report and Programme Reset

91. In spring 2019, Pay.UK commissioned an independent programme assurance review, carried out by the Berkeley Partnership. Having completed the consolidation of Bacs and FPS into Pay.UK in May 2019, Pay.UK wanted to use the opportunity to properly reflect on progress made in the NPA Programme.

92. The review identified that the long-term success of the Programme was dependent on establishing strong foundations, relating to gaining certainty and alignment in a timely and sustainable way. The foundations would underpin stable delivery going forward. The findings of the review were that the foundations were not sufficiently strong which in turn led to the 'Reset' of the NPA Programme. This commenced in autumn 2019 and since then the programme team has focussed on developing the foundations of the programme.

93. In delivering these foundations, the NPA Programme required a clear and manageable scope and a clear case for change for the NPA (the business case). Pay.UK has also now mapped out its future operating model, and is in the process of developing requirements and service delineations for the design, build, and test of the solution, which are a key part of Pay.UK being an 'intelligent buyer' of NPA infrastructure.

[12] As captured in the Pay.UK Board minutes for the February 2020 meeting.

94. In addition, a new NPA Director was appointed, and a new NPA Directorate was created within Pay.UK to provide the most effective team structure, resources, and delivery model to deliver the NPA.

95. The Reset also included the development and delivery of a strong engagement strategy (and supporting team) to cover all external service users, with an immediate and specific focus on achieving participant commitment to the programme. This is helping to ensure the way in which the NPA is delivered will meet the needs of service users.

96. While some of the recommendations are still being worked on, they were deemed sufficiently progressed for Pay.UK to formally close the Reset in July 2020.

Stakeholder engagement

97. Stakeholder engagement is very important to Pay.UK's delivery of the NPA Programme. Ultimately the NPA needs to deliver a proposition that works for participants and end-users. The views of end user representatives and industry representatives were crucial during the PSF and in formulating the PSF vision (a vision that Pay.UK, and the industry, remains committed to). Since late 2019, Pay.UK has increased its stakeholder engagement, as explained below.

Scope consultation

98. Following on from the Berkeley report, Pay.UK conducted a formal consultation in December 2019[13] to support the finalisation of the NPA Programme scope. The questionnaire was sent to 50 participants (33 direct, 11 indirect, and 6 future participants) and we received 30 responses, with respondents representing 77% of Faster Payments volumes and 76% of Bacs Payments volumes.[14]

99. This service user engagement was aimed at gathering stakeholder insights and testing with current and future participants:

- That demand remains to realise the vision of the PSF Strategy.
- Whether the PSF Blueprint remains the preferred delivery method to achieve the vision set out in the PSF Strategy.
- Whether there are alternative means by which we can achieve the vision set out in the PSF Strategy and whether these should be considered further.

100. This consultation also aimed to help secure and maintain industry support for the Programme. The responses we received were essential for baselining the scope of the NPA Programme which is a key 'foundation stone' for subsequent delivery.

101. Positively, through the consultation, respondents demonstrated strong support for Pay.UK continuing to pursue the outcomes of the vision set out in the PSF Strategy. We found that 95% of respondents continued to support the vision of the PSF Strategy (with more mixed

[13] Over the past year, Pay.UK has also sought feedback on other areas of the NPA Programme, with consultations on FPS transition and the incorporation of ISO 20022 messaging standards for the NPA.

[14] One large PSP did not respond to the consultation which accounts for the significant majority of the remaining Payment's volumes. That PSP has subsequently been involved in the SPG.

support for a single clearing and settlement layer that processes the payment messages for all payment types).

102. In terms of phasing, 86% of respondents agreed with the statement that *'my organisation supports Pay.UK continuing to develop a phased transition approach based on migrating Faster Payments to the NPA followed by Bacs payments'.*

103. However, it is also important to note that there were a range of views on how to best achieve these outcomes and the results also showed that participants require further engagement with Pay.UK on a number of key areas. Further engagement of this sort has been taken forward with the Strategic Participant Group (see immediately below).

Strategic Participant Group

104. In early 2020, Pay.UK established the Strategic Participant Group (SPG) to provide a forum for participants to advise Pay.UK and make recommendations on the NPA Programme. The UK Finance Payment Product Strategy Board nominated representatives by engaging with its members to ensure SPG members were a representative sample of participants, inclusive of larger and smaller banks and non-bank PSPs. To ensure the SPG is sufficiently senior and empowered to delivery industry commitment and consensus, membership was required at Head of Payments or accountable executive seniority. As well as being representative of the industry, the institutions that attend the SPG reflect around 92% of FPS payment volumes and 99% of Bacs payment volumes.

105. The SPG's creation is important in helping Pay.UK to ensure that the NPA will meet participant needs (and ultimately the needs of end users and the broader economy). While we need to achieve support from a wide pool of participants, the SPG allows us to test our approach and gather feedback from a senior and representative group of participants.

106. The findings of the scope consultation noted above were discussed with the SPG, which validated the sentiments, and proposed six scope objectives for the NPA which were consistent with the original PSF vision, and therefore adopted by the Pay.UK Board. These were:

- **Maintaining a robust, resilient and scalable payments platform** remains a pre-eminent objective. In achieving this, the SPG also notes the critical importance of de-risking the migration from the current platforms, noting the lessons learned from recent relevant industry experiences.
- **Adoption of global standards (ISO20022)** on which a wider set of end user services can be offered, for example richer data and payment track / trace, and to facilitate interoperability with non-UK payment systems.
- Development of a **real time payment capability** to enable real-time consumer-business payments but maintaining flexibility / choice for those users who require alternatives.
- Ensure there are **lower barriers to entry and flexibility of access options**, to meet the needs of evolving business models.
- Deliver a **safe and secure environment for all users** by adopting an appropriate security throughout and also including the development of appropriate financial crime solutions.

- Any **efficiencies should benefit participants and users** and not the vendor.

107. In addition, the SPG also recommend that Pay.UK should adopt a heavily phased approach to the NPA. FPS should be transitioned into the NPA first and a sufficient amount of time should be given to consider the safest and most effective approach to migrating Bacs, including for UK Government disbursements and corporates.

108. SPG also had views on the delivery approach to appoint an infrastructure provider, consistent with the approach set out in this application (and discussed in the next section).

End User Advisory Council

109. The scope objectives noted above were supported by Pay.UK's End User Advisory Council (EUAC). In July 2020 EUAC members were advised of, and discussed, the potential end-user implications of the May Board decision. EUAC subsequently agreed an advice note for the Pay.UK Board which can be found in Annex 5.

110. While EUAC did not have access to the detailed information provided to the Board, it recognised that minimising transition risk and improving speed to market of the some features of the NPA would be of clear benefit to end users.

111. EUAC recognised that the foreshortening of the competitive process for the core clearing layer could introduce end-user risk of two types if mitigating actions were not identified and taken: (i) around the value for money in the pricing and service that is agreed as part of the contract, which may have an impact on end-users; and (ii) risks relating to the ecosystem development. On this second point EUAC was clear that the value of competition in the ecosystem is immense for end users and EUAC wants to be confident that in arriving at a single provider for the core more quickly, the opportunity to ensure the vendor and Pay.UK are really focussed on proactive ecosystem development to meet end-user needs is not lost.

112. To support this, EUAC would like to see Pay.UK develop and put in place protections and actions, which bind the vendor and Pay.UK to commit to supporting the development of an ecosystem that continuously meets the needs of end-users in an ever changing environment. It has set out its thinking on this, including some specific recommended actions, in an advice note to the Pay.UK Board.

113. EUAC recommended that Pay.UK continues to engage and further develop the EUAC advice into a set of guiding principles or a framework for innovation that EUAC can monitor progress against. The Board and Executive support this as a course of action.

E. Broad support for PSF vision

114. This document is concerned with the method, and regulatory obligations, for how Pay.UK will select the partner for delivering the NPA infrastructure. This is obviously a critical issue to get right and this is why Pay.UK is submitting this document to the PSR.

115. However, Pay.UK wishes to highlight the bigger picture for the NPA and would like to draw attention to the outcomes that Pay.UK, the industry, and the regulators are all looking to achieve.

116. The enhanced service user engagement since late 2019 has been hugely beneficial in ensuring there is a shared ambition for the NPA Programme. We now have an agreed high-level scope and high-level phased transition approach for the NPA. Generally, the respondents to our consultation, and the SPG, support Pay.UK in continuing to pursue the outcomes of the vision set out in the PSF Strategy. There is continued support for IS020022 messaging standards (further evidenced by Pay.UK's recent consultation), strong central governance with a single set of standards of rules, and a phased transition approach with support for FPS transition into the NPA, followed by Bacs.

117. Pay.UK considers the revalidation of the PSF vision to be a significant achievement in the Covid-19 context (given the impact the crisis has had on the financial services sector) and once delivered, will enable Pay.UK to deliver and enable value to service users. We are pleased to have the industry in support of this goal and we have learned more about our own strategy and relationship with the industry, with an increasing facilitation role in a multi-stakeholder ecosystem. We will continue to engage with service users on a multitude of areas as we progress the NPA Programme.

118. While Pay.UK has sought to gather and then provide comprehensive evidence throughout this document and its annexes, it has not been possible to engage all service users on the issues set out in this paper. As such, we have needed to rely on a smaller, but crucially representative, set of stakeholders for engagement on this particular aspect of the NPA Programme.

F. Covid-19

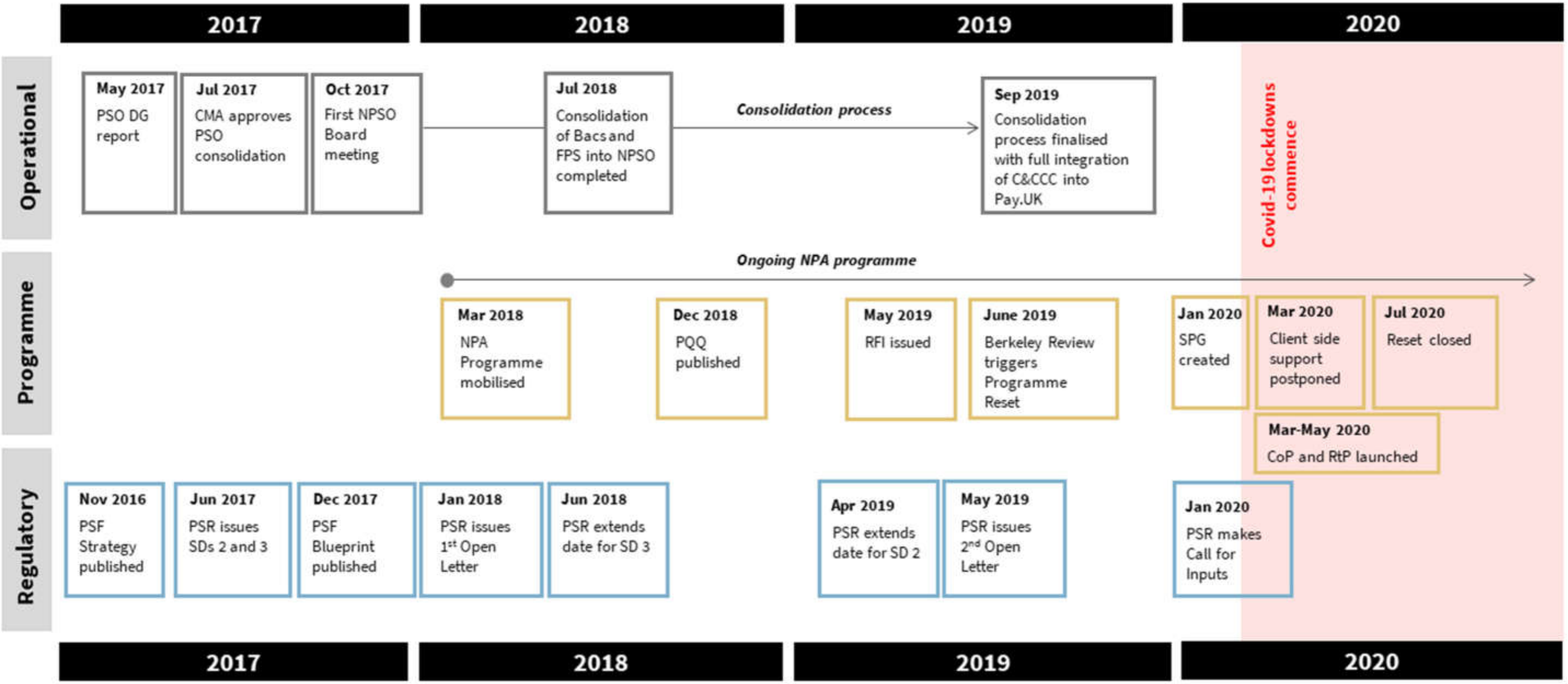
119. More recently of course, the NPA Programme has had to react to the unprecedented and exceptional nature of Covid-19 crisis. In response, the Programme has de-prioritised or paused certain activities pending further assessment of the impact on our plans.

120. However, the possible longer-term implications of Covid-19 remain, and the impact on society, use of electronic payments, and the wider economy is unknown, although it is clear it will be profound. In addition, the nature of the disease and its consequences means that it could alter working patterns for a long time and that sudden changes to plans might be needed at short notice should a second wave (or subsequent waves) break out.

121. In this context, it is important to consider what the impact could be for Pay.UK, suppliers and participants, and what it could mean for the successful delivery of the Programme.

G. Graphical overview

122. This diagram provides an overview of the relative timing of the various developments explained in this section.



SECTION #4: PROPOSED CHANGE IN DELIVERY APPROACH

123. This section explains why we are making an application, based on the 'exceptional circumstances' provision, from the duty to comply with the obligations set out under paragraphs 2.1 and 2.2 of SD2 and SD3 concerning the competitive procurement of the central infrastructure contracts. It also details Pay.UK's proposed change in delivery approach for the NPA Programme.

124. Following the Pay.UK Board's request in early 2020 to consider options for accelerating the delivery of the NPA Programme, the Pay.UK Executive (throughout spring 2020) considered the viability of the existing delivery approach versus alternatives. The Executive undertook internal analysis based on the work of the NPA Programme to date, as well as service user engagement with the SPG.

125. Engagement with the SPG (in a series of meetings in spring 2020) covered discussions on the challenges and risks involved with the existing competitive procurement approach (discussed below) and the relative merits of taking an alternative approach, utilising the existing infrastructure provider relationship. SPG made three recommendations in a paper to the May 2020 Pay.UK Board meeting, including that Pay.UK should enter regulatory engagement with a view to cancelling the current competitive procurement process and ultimately engaging the existing infrastructure provider. The SPG membership was unanimous in making these recommendations, which subsequently formed one part of the evidence the Pay.UK Board considered in its review of the viability of the existing approach versus alternatives.[15]

126. To supplement the arguments put forward through SPG discussions and in SPG's paper to Board, Pay.UK asked SPG members to complete a survey so each member could articulate their concerns with the current approach, and to provide justification for those concerns in writing. We refer to this evidence below.

127. As discussed earlier, the NPA Programme has, from its inception, been challenging. We acknowledge that many of these challenges and risks are not new.

128. However, the scale of the challenge and risks in transitioning to the NPA has become increasingly clear as the Programme has progressed. Following the Programme Reset, we have applied much greater focus on the risks relating to the 'foundations' and looking further out on the Programme. Work on key artefacts including the scope archetype, sourcing strategy for the infrastructure provider, requirements and the future operating model, and detailed planning have given us a greater level of certainty in what we are delivering with the NPA, which inevitably also enhanced our understanding of the risks.

129. We have also developed a greater understanding of the risks involved in transitioning to the NPA from our enhanced service user engagement.

130. The onset of the Covid-19 crisis and its impact over the past few months and, crucially, the significant uncertainty this creates for the financial sector over the months and years ahead is creating a pandemic financial crisis. This crisis makes it more challenging for the industry to mitigate the existing challenges that would need to be addressed in delivering the NPA Programme. While we of course hope that rapid and successful progress is made in the

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[15] As part of discussion with the SPG, the Pay.UK Executive also highlighted to SPG members the likely legal and regulatory challenges with this approach.

medical and scientific response to the pandemic, there remains a real risk that the crisis has a long-term impact on the way we can live our lives with a corresponding effect on the real economy, including on the change budgets of PSPs to fund initiatives like the NPA Programme.

131. According to the Bank of England, UK GDP is expected to have been 23% lower in 2020 Q2 relative to 2019 Q4. There is, of course, significant uncertainty around the economic outlook. According to the Bank's 'Decision Maker Panel', three quarters of firms reported that their level of overall economic uncertainty was 'high' or 'very high' in July, compared to around 40% before Covid-19 restrictions were introduced.[16]

132. Even if the economy were to see a rapid improvement in output, it is reasonable to assume (based on available information) that it will be multiple years before the economy recovers from the consequences of what has unfolded over the past six months.

133. Beyond the immediate short-term impact of Covid-19, there are significant expectations being placed on the financial sector to support the recovery in the months and years ahead, at a time when costs and aggregate risk in their businesses will be rising (for example, due to increasing balance sheet pressures). As discussed below, the pandemic financial crisis will impact the resources available and risk appetite of the industry towards the NPA Programme. It is therefore greatly welcomed that despite this level of uncertainty, there remains on-going industry support for delivering the PSF vision (and the benefit to service users that this would provide) as soon as is practically possible.

134. As a Recognised Payment Systems Operator, Pay.UK is supervised by the Bank of England under a framework set out in the *Banking Act 2009* and according to the CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs). In alignment with this framework, managing risk is at the core of what Pay.UK does, and it is imperative that we do not undertake activity that puts the robustness and resilience of our payment systems at risk (we have a zero / close to zero appetite for disruption to our payment systems). Delivering the technical change to enable the NPA will take considerable care and effort, and the complexity of a potential multi-vendor migration adds further challenges to this endeavour. Covid-19 adds further risk and uncertainty, and has exacerbated the totality of risk faced by Pay.UK in delivering the NPA Programme to a level which is beyond our risk appetite, as well as the risks faced by the industry.

135. With robustness and resilience at the forefront of Pay.UK's strategic objectives, and a necessary cornerstone to deliver a competitive and innovative payments ecosystem, Pay.UK concluded that these risks would be best mitigated by delivering the NPA with the existing infrastructure provider. This would best support us in meeting the shared desire (between Pay.UK and service users) to deliver the NPA without undue risk or delay.

136. This approach best allows us to manage and mitigate the totality of risks that is now attached to the Programme in light of: (i) the scale of ambition for the NPA; (ii) the other challenges attached to the current delivery approach, including the scale of transition risk for which we now have a clearer view; and (iii) a global pandemic of this nature. The approach will make it a successful delivery of the NPA Programme more achievable than would be the case if the existing delivery approach were to be maintained.

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[16] https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2020/august/monetary-policy-report-august-2020.pdf?la=en&hash=75D62D3B4C23A8D30D94F9B79FC47249000422FE.

137. This section provides more detail on the main challenges we face and what impact these could have on the delivery of the NPA Programme. While the below provides a narrative explanation of the layers of risk, [✂]. The section is broken down as follows:

A. **Risk associated with the NPA transition.** To start our discussion we explain the baseline level of risk associated with the NPA transition. Delivering the NPA using any approach to appointing an infrastructure provider is very challenging and involves inherent risk irrespective of the parties that are involved in the implementation and transition.

B. **Risk associated with the existing delivery approach**: We then explain the challenges we had been considering ahead of the onset of Covid-19, principally relating to transition risk and speed of delivery.

C. **Impact of Covid-19 on programme delivery**: Next we explain how the impact of Covid-19 will add to and exacerbate the risks discussed in parts A and B.

D. **Proposed delivery approach to mitigate risk:** We then explain the approach we are proposing to take to delivering the NPA should the PSR accept this exemption application, recognising the additional risks this approach brings and how we will manage those risks.

E. **Delivery options considered and discounted**: As part of the process of reaching this proposed approach, Pay.UK challenged itself to consider different options for moving forward and the advantages and disadvantages of each. We explain the alternative options that we have considered in reaching our conclusions.

F. **Interaction with NPA competition issues:** We recognise that our negotiating position may be weakened by the proposed approach. However, there are tools and techniques that could be deployed to help ensure that negotiation with a single supplier leads to effective outcomes.

G. **Conclusion**: We conclude our discussion by explaining the overall basis for concluding that we should move forward with a new delivery approach

A. Baseline risks associated with the NPA transition

138. To start our discussion we summarise the baseline level of risk associated with the NPA transition. Incorporating robustness, resilience, competition and innovation into a new architecture which will replace existing systems, has not been done at equivalent scope and scale elsewhere in the world. Moving to a new platform is inherently a material endeavour with significant technical changes required of participants, regardless of whether a new supplier is engaged or not. We will be transitioning live payment systems that are used daily by individuals, business and government across the entire economy, with current volumes of 200 million transactions per month for FPS and 540 million per month for Bacs.

139. On top of this, the challenge of moving to the NPA is more substantial than a like-for-like transition given the differences already discussed above (such as moving to a new layered model and introducing new messaging standards for payments).

140. Transition is always challenging when moving to a new platform. The complexity comes from: (i) the amount of change including technical changes, testing, and completion of staff testing; and (ii) the number of actors involved including (in the NPA case) Pay.UK, the

infrastructure provider, the Bank of England, regulators, participants (direct and indirect) and intermediaries (such as aggregators). And, of course, these changes need to be introduced while maintaining stable operations. Legacy systems, including those operated by Pay.UK and its participants, have been in place for many years. Over this time they have had numerous changes, meaning increased complexity in understanding and executing what is needed for transition (which would create challenges for both Pay.UK and its participants).

141. In responses to the SPG survey, seven [✂] PSPs (of varying size) referenced compliance and transition with ISO 20022 as a main change, including capturing, displaying and storing enhanced data, and changes to customer channels.

142. Two [✂] PSPs referenced challenges with particular payments types, including the processing of pull payments, mainly Direct Debits, without damaging customer experience, and managing immediate and bulk payments on the same platform.

143. PSPs also noted other changes such as new connectivity and protocols, changes to internal ledgers, and investigative work flow systems.

144. PSPs have commented that expert payment practitioners across the industry are limited, and this small pool will constrain the amount of changes that can be safely managed over a particular period of time. This is within the context of many other changes underway (including RTGS Renewal, Open Banking implementation etc.).

B. Risks to Programme delivery from the existing procurement approach

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C. Impact of Covid-19 on NPA Programme delivery

184. The onset of the Covid-19 crisis has evidently had a profound, unexpected, and immediate impact to society and the economy, and Pay.UK and the payments industry is now working on progressing the NPA Programme under exceptional circumstances. Crucially, the significant uncertainty and challenges that this pandemic financial crisis brings to the economy, and specifically the financial sector, over the medium and longer term brings further risk and challenge for the NPA Programme. This is because the impact of Covid-19: (i) exacerbates the challenges in managing the existing risks discussed in Parts A and B above; and (ii) introduces additional challenges.

185. There remains a real risk that the crisis has a long term impact on the way we can live our lives with a corresponding effect on the economy at large. Furthermore, even with a highly successful medical and scientific response, the impact of the pandemic to date on the UK economy will be profound. It is reasonable to assume (based on available information) that it will be multiple years before the economy recovers from the consequences of what has unfolded over the past six months.

186. This is an exceptional circumstance that could not have been expected or planned for. It has fundamentally altered the payment industry's ability to deliver the NPA Programme.

187. Through the SPG we have been able to work closely with participants to start to understand the impact for their operations and business planning. We do not know exactly how the impact will play out, and we need to consider this uncertainty and the risk created for the NPA programme in our consideration of our delivery approach. In this section we discuss how the delivery of the programme may be impacted by the pandemic.

188. **Participant costs and aggregate risk profiles:** Many participants will be facing new costs and additional risks as a result of the pandemic (i.e. across the whole of their businesses), as well as significant expectations to support the recovery (for example, through lending to businesses). Given this broader increase in cost and aggregate risk, we can expect participants to be less willing or able to accept risk (and the increased cost this brings) around the NPA programme, for example the transition risk that was discussed in the previous section.

189. If the Programme were to proceed in a way that required the transition to a new infrastructure provider, there is a risk that, due to the pandemic's impact on costs and therefore budget constraints, participants would not have sufficient resource to assign to sufficiently help manage the transition risks discussed in Parts A and B above.

190. The impact on costs and resources could mean fewer resources available to manage the ISO20022 change, to work with two suppliers helping to minimise the probability of incidents or respond to incidents, to manage communications, and to deal with the complexity of different transition states. Further, testing, migration, and parallel running would likely take longer, meaning a prolonged period in which incidents could arise. In this sense, the risks that already exist in a two-supplier scenario would face a higher likelihood of crystallisation. One PSP noted that key operational and technical resources would be consumed for many months following Covid-19. It is likely that these same resources would be important in the delivery of the NPA.

191. The representative group of participants we have engaged with via the SPG say their business plans for 2020, and likely beyond, are fundamentally affected by the crisis (and this will not have improved given the recent round of banks' financial results), and that they will need to focus only on those initiatives that offer customer-facing enhancements. The crisis will have a substantial influence on how participant change budgets are spent over the short and medium term. While we are unable to quantify such costs, the SPG has said that this is a key factor for them, and it is widely accepted (given experience through projects such as CASS and ICS) that industry wide costs for an ecosystem like this are orders of magnitude higher than those in the centre.

192. Covid-19 has fuelled uncertainty, and while PSPs are aware that there will be on-going impacts of Covid-19, it is difficult to say what this may be and how long those effects will last for the industry. However, it is clear that one significant impact of Covid-19 is on the resourcing and funding available to participants for change programmes. Six participants (both direct and indirect) cited that Covid-19 had impacted on capacity and capital, meaning less funding is available, they have less appetite for change, and less capacity to manage that change. Even though much of the migration risk will not become 'live' for several years (i.e. until the Programme is ready for participants to transition to the NPA), the long-term uncertainty related to the pandemic financial crisis caused by Covid-19 means that the industry cannot be confident when the impact on the totality of risks will recede to an acceptable level. As seen from the 2008 financial crisis, a short-term economic shock can have a prolonged impact on the financial sector.

193. Despite Covid-19, participants (as represented at the SPG) continue to see the NPA as a key development, albeit that there will be greater focus and prioritisation of change in the next period. Given the lack of capacity and capital cited by many PSPs, it is important to ensure a quick, effective, flexible and low risk route to delivery.

194. It is important to note that while some transition risks would not crystalize for several years (i.e. until the transition from the legacy systems to the NPA is underway), the need to minimise these risks through our delivery approach is a far more immediate consideration for the NPA programme. As well as this being critically important for us from an overall operational and programme risk management perspective, we also need to find ways to minimise the level of risk (and associated cost) that we require our participants to underwrite in support of this programme. This is important from a delivery perspective, because our ownership model and the focus of our regulatory obligations mean that we will need to ask participants to make an upfront user commitment in order to finance the

programme. Minimising the programme risk and uncertainty is an important driver in securing this financial commitment from participants.

195. The Covid-19 crisis is an exceptional circumstance that has exacerbated the totality of risk faced by Pay.UK in delivering the NPA Programme. The economic impact of the pandemic is profound and there remains significant uncertainty about its duration and future impact. [✂].

196. In the months and years ahead, there will likely be significant expectations placed on the financial sector to support the recovery of the UK economy, at a time when costs and aggregate risks in those businesses will be higher. This is important context when considering the NPA programme and the risk identified in this paper. It is Pay.UK's view that the pandemic's impact on costs, resultant budget constraints and aggregate risk profiles means that there is a material risk that participants might not be able to underwrite the totality of risk now faced by the programme. In addition, our experience with previous programmes (for example, cheque imaging) demonstrates that industry wide costs are an order of magnitude higher than central costs.

197. **Interaction with other payment industry initiatives:** We are also cognisant that Covid-19 may impact other industry initiatives, such as RTGS Renewal. Given the phasing between the two programmes (RTGS Renewal followed by NPA), we will need to manage how the existing FPS and Bacs payment systems interface with RTGS, which may involve early development of NPA capabilities to act as the gateway between FPS and Bacs and the new RTGS infrastructure. Moving forward with the existing infrastructure provider, rather than a new supplier (and the more rigid timetable and migration approach this would involve), would likely make it much easier to be flexible, reducing risk for Pay.UK's interaction with RTGS Renewal. Possible changes to timetables on other payments industry initiatives (for example, SWIFT and TARGET2 would also impact participants' capacity to manage change).

198. **Readiness of end-users:** A significant number of small businesses and corporates have been severely impacted by Covid-19. As such, they need to focus on their immediate business and serving customer needs. They are unlikely to have the capacity or budget available to devote to complex change. Whilst direct participants will insulate end users as far as possible from change, the introduction of ISO 20022, needs to be as simple and low cost as possible and this may be made easier for end users through the re-use of existing infrastructure. Reducing the level of complexity for direct participants will enable them to focus more on end users.

199. **Increased operational and delivery risk**: Covid-19 creates a number of more practical challenges around the delivery of the NPA. For example, some of the activities that would normally be conducted in an RFP stage could be impacted by social distancing and travel restrictions (for example due diligence is often undertaken at client delivery centres or datacentres, and client reference site visits are undertaken).

200. **Managing the risk of delay**: [✂]. However, the overlay of Covid-19 makes this challenge a magnitude harder. The uncertainty created by Covid-19 is especially challenging. We are unable to identify when the impact of the crisis will be over, and therefore the option of simply delaying the current competitive procurement approach leads to an open-ended timeline for the NPA (and if we were to restart the procurement, further delay could be introduced in the event of a second wave of Covid-19). As noted previously, both Pay.UK and the industry want to achieve the benefits of the NPA (which will benefit all service users), swiftly and without incurring unnecessary transition risks.

201. Depending on its timing, the potential for a second wave in the pandemic could also create significant difficulties for delivery, especially if a second wave were to hit after the current infrastructure provider had served notice on the current contracts and before a new supplier was fully on boarded. Managing delays and needing to re-plan on the back of unexpected events will be significantly more challenging if two suppliers are involved.

D. Proposed delivery approach to move forward

202. In light of the challenges noted above, the Pay.UK Board considered three options (at its May 2020 Board meeting) for moving forward with the NPA programme.

203. The selected option was to pause the current competitive procurement process, and commence regulatory engagement in order to explore the opportunity to use Pay.UK's existing infrastructure provider. If the PSR were to grant this application, Pay.UK would enter into a negotiation with Vocalink around this delivery approach.

204. The Pay.UK Board considered the difficult trade-offs between this option and the existing competitive procurement approach, reflecting differences in cost, risk profile, alignment with current regulatory obligations, participant commitment and deliverability, and importantly the additional risks that Covid-19 brings to the Programme's delivery.

205. In addition to Pay.UK's own considerations, the option was consistent with the recommendations that were made to the Pay.UK Board by the SPG, given the SPG's concerns over migration risk, speed of delivery, a focus on robustness and resilience at the core, and the impact of Covid-19. While the Pay.UK Board carefully considered the views of the SPG, it made its decision independently.

206. We have made an active trade-off between different risks in pursuing this approach. In coming to its decision, the Board was aware of the potential disadvantages of moving away from the competitive procurement process at this stage both in terms of ceding competitive tension but also the other benefits that may have emerged for Pay.UK from another provider. Recognising this, the Board also remains keen to explore alternative mechanisms to support the commercial drivers of Pay.UK and our customers, as well as the PSR's policy objectives. As such we are considering the tools and techniques that could be used in negotiation of any future contract for the NPA (were this application to be granted by the PSR). This consideration is discussed further in Part F below.

207. It is important to note that Pay.UK has only paused the procurement at this stage whilst this application is considered by the PSR.

E. Delivery options considered and discounted

208. As part of coming to a decision on its preferred approach, Pay.UK considered whether to continue with the competitive procurement process as one of the options. In this option Pay.UK would appoint a supplier following the conclusion of the in-flight competitive procurement process. The supplier would be awarded a contract against a set of detailed contractual requirements developed by Pay.UK.

209. At its May 2020 meeting, the Pay.UK Board had significant concerns with a continuation of this approach, especially in light of recent developments and Covid-19's potential impact on the economy. Primarily, the Pay.UK Board was concerned with a prolonged timetable and cost for delivery [✂] – both of which are exacerbated by Covid-19.

210. Given the complexity of what needs to be achieved, and the objective (shared with the industry) of delivering the NPA and addressing remaining PSF detriments (even in a payments industry impacted by the effects of Covid-19), the Board judged that a way needed to be found to bring the strategic partner on-board sooner if possible (with the agreement of the regulators) to de-risk the programme, and to ensure participant support to continue to fund the NPA Programme.

211. As such, Pay.UK considered whether it would be possible to accelerate the competitive procurement (which would enable Pay.UK to continue to meet its regulatory obligations under SD2 and SD3). In this option the supplier would need to be appointed against higher level criteria and commercials than previously planned. In order to remain compliant with its current requirements, accelerating the procurement would still require detailed requirements and lengthy processes requiring a large and appropriately resourced team at Pay.UK. Pay.UK concluded that this option would not be able to deliver any real benefit, since it would not achieve the competition benefits that the original procurement approach would, and it would only gain a small amount of time (which could be easily eroded in the context of Covid-19).

212. [✂]

213. [✂]

214. [✂]

F. Achieving value for money through the proposed approach

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216. We recognise that our negotiation position could be weaker in the absence of a full competitive procurement process and therefore our ability to mitigate some of the risks may be somewhat weaker. [✂]

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Regulatory requirements

229. [✂], it is also important to recognise that the NPA will be subject to significant regulatory scrutiny from both the Bank of England and the PSR.

230. Our *Banking Act 2009* and *CPMI-IOSCO PFMI* obligations means that certain quality features of our infrastructure are of critical importance, but also that regulatory requirements will necessarily prevent quality from falling below these standards. For example, Service Level Agreements and certain contractual provisions will have to be designed to exceed regulatory minimum standards.

231. Similarly, the PSR retains its competition powers which can always be deployed ex post such as if there is evidence of a breach of competition law.

232. With reference to the PSR's broader regulatory requirements, clearly the regulatory framework is not something that Pay.UK has control of but rather this is something that the PSR could put in place, if so required. Pay.UK believes that it is possible that a fair contract (for Pay.UK, PSPs, and end-users) can be negotiated that negates the need for additional regulatory requirements to be in place. Given that this depends on a multitude of factors in relation to a system that has yet to be designed, one cannot be certain in this regard.

233. If the PSR had particular requirements that could be reflected in the contracts in order to mitigate particular risks, then an early discussion of these would be helpful. Of course, any additional contractual requirements would need to be negotiated with the infrastructure provider.

234. In addition, we also note the assurance process that the PSR has put in place for the NPA Programme. We recognise that the staging (i.e. the timing) of that assurance approach would need to change were the approach set out in this application to be taken forward.

235. We anticipate that one of the PSR's assurance stages would be shortly ahead of the NPA contract award stage. We also recognise that the scope of the assurance that the PSR requires through the different stages of the programme would also change, potentially to reflect some of the issues discussed in this section. For instance, we appreciate that the PSR may seek Pay.UK assurance that the terms of the contract meet participant expectations (including any outputs/requirements set by the PSR in light of this approach) prior to the contract being finalised.

Alternative approaches to procurement and the NPA

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242. [✂]

G. Conclusion

243. Incorporating robustness, resilience, competition and innovation into a new architecture which will replace existing systems, has not been done at equivalent scope and scale elsewhere in the world. Pay.UK's commitment to deliver the PSF vision for the NPA remains under the proposed new delivery approach. However, as discussed in Parts A, B, and C above, there are multiple layers of risk that we now face in delivering the NPA in the current climate:

- **Baseline risks associated with the NPA transition**: The transition to the NPA is in itself very challenging. We are planning to undertake a process which has inherent risk irrespective of who the chosen infrastructure provider is. It is in this context that consideration of the following incremental risks should be made.
- **Additional risks associated with the existing delivery approach:** There are a number of additional risks that would arise in the event of using a new supplier for the NPA. [✂]
- **Impact of Covid-19: The emergence of Covid-19 across the world is unprecedented and Pay.UK and the payments industry are now operating under exceptional circumstances.** There remains significant uncertainty about the length of the pandemic and the short and long-term impacts on the economy. Due to the pandemic's impact on costs and therefore budget constraints, there is a material risk that participants would not have sufficient resource to assign to sufficiently help manage the existing layers of risk risks discussed above.

244. Further, Pay.UK judges that, for the NPA, the most end user value sits in the services that will be enabled in the wider ecosystem, while the most significant risk lies around the transition at the core. Pay.UK is keen to deliver the former, while minimising the risks in the latter.

245. The desired outcome for the industry, end-users, and the broader economy has not changed. Pay.UK, along with the industry, remains keen to deliver on the PSF vision, and to deliver the NPA without undue delay, addressing PSF detriments and delivering a competitive and innovative ecosystem that brings material benefits to service users and the broader economy.

246. While the ultimate outcome remains the same, Pay.UK has concluded that part of the delivery method for getting to that outcome requires a revised approach. After considering all the alternatives, Pay.UK is of the view, based on the information it has, that utilising our existing infrastructure provider relationship is the best option for the industry and for end users. Furthermore, this is consistent with the PSR's statutory competition objective, which is to promote effective competition in the relevant markets in the interests of those who use, or are likely to use, services provided by payment systems17.

247. This option meets our most critical requirement of a robust and resilient core infrastructure needed to deliver a competitive and innovative payments ecosystem. In support of this, we think that in the Covid-19 context, a multi-vendor migration poses an unacceptable risk, given the nature of the project and levels of risk already present before the pandemic. [✂] . However, as we have discussed above, there are a number of mitigants that we would use to reduce the impact of this risk – not least because the deal that is negotiated will need to acceptable to participants.

[17] Section 50(1) Financial Services (Banking Reform) Act 2013

SECTION #5: MOVING FORWARD

248. This section provides an explanation of how Pay.UK will ensure it has the capability to effectively act as an intelligent buyer under the proposed new delivery approach, explains plans for delivering the next stages of the Programme under the proposed approach, and discusses the steps being taken by Pay.UK to put itself in a strong position to restart the competitive procurement, if that is required following the PSR's decision on this application.

A. Acting as an intelligent buyer

249. Throughout the selection of, and engagement with, the selected infrastructure provider, it is imperative that Pay.UK is able to act as an 'intelligent buyer' for the build and run of the NPA core clearing layer. Being an 'intelligent buyer' will empower Pay.UK to: (i) ensure the NPA enables the PSF vision including by setting requirements that will ensure that competition and innovation benefits in the wider ecosystem are achieved (and that there can be no advantage around the provision of overlay services accruing to the provider of the core infrastructure); and (ii) ensure commercial readiness, achieving value for money, and to deliver an effective ongoing relationship.

Ensure the NPA enables the PSF vision, setting appropriate requirements

250. Pay.UK needs to retain ownership and accountability for the build and operation of the NPA and the payment services it provides. To commission the build and operation of the NPA, we need to set out what the NPA is, and what the respective roles are of Pay.UK, the infrastructure provider, and others in the ecosystem for delivering and operating it. This detail and clarity is crucial to meeting our responsibilities as a Recognised Payment System Operator and to delivering an NPA that meets the PSF vision (which will enable competition and innovation in the payments ecosystem).

251. The respective roles of Pay.UK and the infrastructure provider during the implementation, transition, and operation of the NPA are very different, and therefore require different knowledge and capabilities. In short, the infrastructure provider will be required to possess the knowledge and capabilities to design, build, test, and operate the new NPA platform to meet Pay.UK's requirements, and use its knowledge and experience to advise Pay.UK on innovative solutions to those requirements. Pay.UK will need sufficient knowledge and relevant capabilities to both define those requirements, maintain oversight and control of the prime during implementation, and ultimately remain accountable for accepting the NPA platform in to live service.

252. The PQQ, RFI, and Pay.UK's own internal processes to date have fed into our design more generally. As well as our requirements and the responses of individual bidders, joint solutioning sessions with bidders allowed us to deep dive into some of the more complex areas (such as transition), which has helped to inform and move our thinking forward, and has helped us develop knowledge of alternative bidders. The information gathered in this overall RFI process has been fed into our design sprints allowing us to further finesse the outcome-based requirements that we will expect to be delivered by the appointed supplier.

253. Regardless of the procurement process followed, we are working towards being in a position by the end of this year where we have agreed clear requirements and conceptual designs for the NPA which will help ensure high quality in the NPA.

254. As part of the 'no regrets' activity that will be completed before we engage an infrastructure provider (discussed in more detail below), Pay.UK will have completed baselined versions of the key artefacts required to fulfil its accountabilities. Collectively these artefacts will be used to: provide a clear and detailed understanding of the detail that underpins Pay.UK's vision for the NPA; provide a robust foundation for the supplier to develop the detailed design, giving clear direction and a platform that can be quickly built upon; ensure that the core clearing layer is not unduly influenced by the supplier's existing platform, and clearly set out the split of service provisions between Pay.UK and the infrastructure provider during implementation, transition and run. The main artefacts are:

- **NPA propositions:** The set of Core and Technical Overlay propositions that will be enabled by NPA for market consumption.
- **Requirements definitions:** The requirements for the 'technology solution' of the NPA. This will cover both outcomes relating to the functionality of the solution and 'non-functional' aspects of the solutions (such as volume and availability requirements). Functional requirements are being derived from defining the conceptual clearing and settlement for the NPA and mapping payment journeys.
- **Proposed transitions states:** Articulation of how Pay.UK envisages moving from the existing FPS and Bacs payments systems to the NPA platform.
- **Future operating model:** The capabilities required to operate the NPA, and how responsibility will be split between Pay.UK and the infrastructure provider.
- **Operational service definition:** Articulation of expectations for the services that will be delivered by the infrastructure provider during the build and run of the NPA.

255. Development of these key artefacts will be completed before an infrastructure provider is appointed, thereby helping to prevent key design decisions being unduly influenced by the infrastructure provider. Pay.UK is developing these artefacts with an appropriately skilled programme team (made up of staff, professional services support and independent contractors). It is carrying out independent assurance, utilising the services of a leading professional services firm. And it is holding participant forums and working groups that will utilise industry expertise to improve the quality and integrity of these artefacts. This work will also help ensure participant buy-in.

Ensure commercial readiness, achieving value for money, and delivering an effective ongoing relationship

256. Pay.UK needs to drive value for money on behalf of our participants (who will fund the NPA), and ultimately end-users and the broader economy. Pay.UK also needs to be able to provide an appropriate level of challenge to the infrastructure supplier, both technically and commercially, and to deliver sufficient scrutiny and manage accountabilities.

257. To enhance our existing capability, Pay.UK will complete a number of preparatory activities prior to engaging with the infrastructure provider (either via the proposed approach, or as part of the competitive procurement process). These activities are producing the following artefacts:

- **Case for Change:** This document will ensure a common understanding across the industry of the business case for the NPA and the commercial implications of building it.
- **Funding Recommendation:** This will enable Pay.UK to seek commitment from the participants on funding and usage of the NPA based on solid estimates of what is required. This will be needed prior to signing the MSA (see below).
- **Short Term Supplier Agreement:** This will be an interim commercial work arrangement required in advance of the MSA being finalised (in either delivery approach). This arrangement reduces the lead-time to supplier onboarding as essential contractual documentation is 'supplier ready'.
- **Master Services Agreement (MSA) Construction:** The MSA will be the contract between Pay.UK and the infrastructure provider covering the build and run of the NPA. We will complete the commercial work required in advance of the MSA being finalised.

258. For options on how NPA competition issues could be managed in the absence of a competitive procurement, please see Section 4.

Expert resources

259. The activities above are being delivered by experienced professionals with sufficient experience in respective areas. External support (e.g. legal and consultancy) is engaged where additional specialist support is required. Further, Pay.UK is deploying third party assurance on key Programme artefacts where appropriate.

B. Next steps in utilising the existing infrastructure provider relationship and time savings

260. Should the PSR grant this application, Pay.UK would seek to move ahead, following appropriate internal governance, with engaging the incumbent infrastructure provider.

261. While the plan for utilising the existing supplier will be defined further in the coming months, we have (for illustrative purposes) included indicative plans in the diagrams below covering activities leading up to signing the Master Services Agreement (MSA) with the infrastructure provider to build and operate the NPA core clearing layer.

262. We compare two options: (i) continuing with the existing competitive procurement; and (ii) moving forward by utilising the incumbent infrastructure provider relationship. Note, we are aware that the PSR has suggested a decision could conceivably take until early 2021 but for indicative planning purposes, we have assumed a final response from the PSR on this application in December 2020. During the period between the submission of this application and a decision on it by the PSR, we remain keen to continue working with the PSR on how its process aligns with the plans set out below.

263. Pay.UK has taken the decision to prioritise 'no regrets' activity for the remaining duration of 2020 (i.e. whilst this application is under consideration). No regrets activity encompasses effort to: (i) mature requirements, design and proposition activity, enabling Pay.UK to engage as an 'intelligent buyer' with a future supplier with regards to having a system built

that can enable the PSF vision; (ii) engage with service users through the SPG and working groups to engender confidence and buy-in to the NPA programme; and (iii) complete procurement preparatory activity (which is agnostic of the delivery approach) to allow Pay.UK to either move forward in utilising the existing supplier relationship or restart the competitive procurement process if necessary. The majority of 'no regrets' activity is planned to be completed by December 2020, though some work will continue into 2021 Q1.

264. Should the PSR grant this application, Pay.UK intends to engage Vocalink within one to three months from the point of the PSR's decision. At this point, a requirements confirmation and 'joint solutioning' phase with Vocalink can commence. Joint solutioning will involve utilising the infrastructure provider's knowledge and experience to help Pay.UK develop its thinking on specific aspects of the requirements.

265. Schedule savings beyond this point will be determined by: (i) the time saved to negotiate and agree the MSA with the supplier; and (ii) any acceleration of the post-MSA activity up until completion of the implementation and transition phases. It should be noted that in both the competitive tender approach, and moving forward with the incumbent supplier, the delivery activity is planned to get to the point of high level architecture completion. Definition of the lowest-level design will occur after the MSA signature in both plan options.

266. The estimated schedule saving of at least 12 months that can be gained once Vocalink is engaged, is made up of on two parts.

267. First, there is a six-month saving in the time taken up to the point of signing the MSA (noted as Major Milestone 3b in the diagram below) under the proposed approach of moving forward with the incumbent supplier when compared to the competitive procurement plan. The rationale for the assumed six-month saving in getting to Major Milestone 3b is as follows:

- Pay.UK requirements will be assessed directly against a single supplier's technical solution, removing ambiguity or gaps and driving the specificity required for an MSA at a faster pace.
- Pay.UK will have a dedicated focus on a single supplier through the proposal process, reducing the total elapsed effort that would otherwise be needed to complete RFP execution, evaluation, and 'best and final offer' processes.
- Working with a single supplier will provide greater confidence on the requirements and solution specification of the NPA, allowing Pay.UK to more readily obtain participant commitment to proceed to the implementation phase.
- There is more opportunity to run activities in parallel through the proposal phase, removing the interlocks between delivery and commercial activity, allowing Pay.UK to more efficiently manage the dependencies into finalising Major Milestone 3b.
- Joint solutioning activity is more targeted, and the required level of quality outputs can be created at a faster pace.

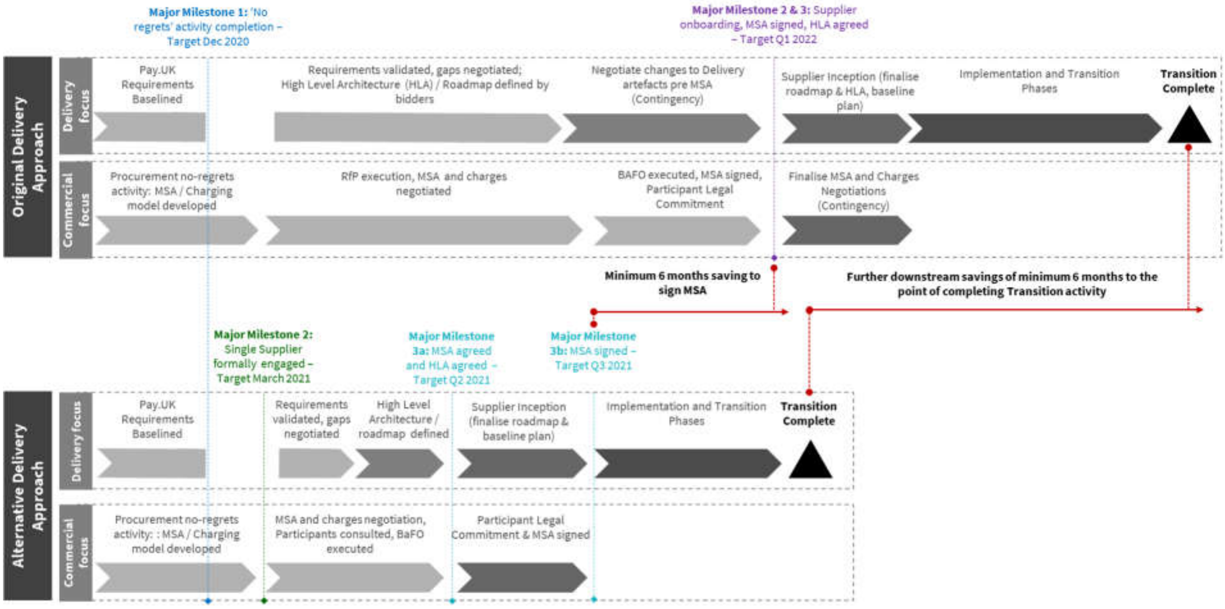
- The supplier may choose to resource a larger team for the requirements and joint solutioning activity, given this will now be a more certain investment, allowing Pay.UK to define more accelerated timescales for the completion of this activity.
- The high level architecture definition and implementation roadmap can be worked on collaboratively by Pay.UK and the supplier, reducing the risk of re-work to address misalignment or the amount of negotiation required to agreeing the proposals.

268. Second, it is envisaged that working directly, and solely with the incumbent supplier for the period of time leading up to the signature of the MSA will result in further schedule savings of at least 6 months over the transition phase. The current high level and work-in-progress view of the end-to-end delivery plan, has a five-year period of transition. Therefore, we expect a minimum 10% reduction in implementation timeline by proceeding directly with the incumbent. This is because: (i) during the time to agree the MSA up until Major Milestone 3b, it is expected that the supplier will be preparing for and giving consideration to more detailed aspects of the design and delivery; and (ii) the incumbent will be able to move at a greater speed given its knowledge of the existing systems. These time savings arise because of the streamlining of the design and build activities by the incumbent which can be accelerated due to the direct relationship between Pay.UK and the supplier and design work being done collaboratively at an early stage. [✂].

269. Importantly though, the indicative time savings outlined above do not take into account the impact of any further Covid-19 measures or implications (including of a second wave) on the Programme.

270. Further, additional time differences between the two approaches (and in favour of the proposed approach) would likely be caused by the additional testing and migration time expected by participants (as identified in the SPG survey)

271. Note, the timing of the milestones above are based on an early view of the planning for a non-competitive procurement process, and are subject to change until a revised programme plan: is (i) fully governed; and (ii) we have engaged the infrastructure provider to agree delivery a methodology and approach. Further, the schedule set out below assumes PSR will grant this application in December 2020, directly following the completion of no regrets activity. Delays beyond this could impact the schedule.



C. Restarting the competitive procurement process if necessary

272. We fully understand that the outcome of this application may be the restart of the competitive procurement process that was paused in June 2020. Following the PSR's consideration of this matter, Pay.UK will of course seek to progress the NPA in a way which is consistent with the PSR's decision, and in line with UK's strategic objectives.

273. We also note that were the PSR to grant this application, Pay.UK would still of course retain the ability to restart a competitive procurement exercise, for example if negotiations with Vocalink failed to secure appropriate terms.

274. Were either of these scenarios to arise, Pay.UK would undertake the remainder of the competitive procurement in line with the objectivity and transparency that has been used in the process to date.

275. As such, it continues to be essential that Pay.UK: (i) mitigates as far as possible the risk of bidders withdrawing from the process before a regulatory decision on this application is taken by the PSR; and (ii) is ready to restart the procurement within a reasonable timeframe after the PSR's decision on this application.

276. We have sought to be as open with bidders as is appropriate given the current challenges. In mid-June, we communicated the pause to the bidders. [✂].

277. Alongside the no regrets activity discussed above, Pay.UK has (to avoid potentially unnecessary costs), paused work that would only be needed in the event of moving forward with a competitive procurement. However, we anticipate that, given progress on work to date, this paused work could be completed in reasonably short order following a PSR decision on this application.

278. A decision on when and how to restart the procurement would sit with the Pay.UK Board. However, this decision would require engagement with the participants to ensure there is an ongoing willingness to fund the NPA Programme through the competitive procurement process.

279. In light of the Covid-19 situation, it is Pay.UK's view that there is a material risk of impasse if our participants are unwilling to fund us in meeting regulatory obligations. Such an impasse would challenge Pay.UK's relationship with its participants, would take up considerable leadership time, and would (in our view) also be a risk to financial stability, via the subsequent risks that: (i) we would not be able to realise the NPA vision; (ii) participants may seek alternative (and less robust) supply or bilateral arrangements; and (iii) damage to the relationship between Pay.UK and its participants could negatively impact existing services and their maintenance. Naturally, Pay.UK, participants, end users and the regulators will want to avoid an impasse.