

# Annex 4

## Recommendations from the Strategic Participant Group to the Pay.UK Board

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

August 2020

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# Strategic Participant Group

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Item:	<b>Recommendations to Pay.UK on the NPA Programme</b>
Key Points:	<ul style="list-style-type: none"><li>• This paper has been produced by the SPG secretariat, on behalf of the SPG members. It was discussed at the SPG meeting on 5 May and updated post-meeting to reflect comments.</li><li>• It consolidates discussions from the four SPG meetings held to date into a set of three clearly articulated recommendations, from SPG to the Pay.UK Board, on the NPA programme. Each recommendation is detailed overleaf but in summary:<ul style="list-style-type: none"><li>• <b>Recommendation #1:</b> Pay.UK should incorporate SPG’s six scope objectives for the NPA, which the SPG agree are aligned with the vision of the PSF Blueprint.</li><li>• <b>Recommendation #2:</b> Pay.UK should adopt a phased approach to the NPA - Faster Payments 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 government and corporates.</li><li>• <b>Recommendation #3:</b> Pay.UK should enter regulatory negotiations with a view to cancelling the current competitive procurement process and ultimately engage the incumbent to deliver against the six scope objectives. The SPG understand that this would likely mean that the incumbent would be in place through build and transition (and therefore into the operation of the new core clearing layer) to meet the SPG requirement to minimise transition risk and overall industry costs.</li></ul></li></ul>
Decisions required:	<ul style="list-style-type: none"><li>• Members provided comments on a draft of this paper at the SPG meeting on 5 May.</li></ul>
Next steps	<ul style="list-style-type: none"><li>• This paper will be shared with the Pay.UK Board for consideration at its 13 May meeting alongside Pay.UK’s own analysis.</li></ul>

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## BACKGROUND TO THE RECOMMENDATIONS

- 1 In its first few meetings, SPG has considered a range of issues that have influenced the recommendations it is making to Pay.UK on the NPA programme.
- 2 **Scope archetype work, the PSF blueprint, and recent market developments:** The analysis from the recent scope archetype questionnaire exercise undertaken by Pay.UK has been shared with, and discussed at, SPG. This was discussed alongside the original vision set out in the PSF strategy, and in the context of developments in the payments market since the publication of the blueprint (See Annex A). As set out under recommendation 1, the SPG continues to support the PSF vision to help both address the outstanding detriments, including reducing barriers entry, but also to enable future market competition and innovation to the benefit of users.
- 3 **Impact of Covid-19 on the industry's appetite for change:** The SPG membership is unanimous in its view that both the short and long term impacts of the Covid-19 pandemic (including on the NPA programme) could be profound and warrants careful consideration by the Pay.UK Board. In the short term (which could be many months), most participants will only be focussing on change programmes that directly benefit end users. Over the longer-term, there may be a prolonged impact on economic activity (and the financial sector) which may impact appetite for funding major change programmes. There will therefore be an inevitable impact on participant resourcing and funding available for the NPA programme.
- 4 **De-risking the transition to new services:** Given the critical nature of Bacs and FPS to the UK economy, SPG members are fully cognisant of the need to deliver a safe transition to the NPA.
- 5 **The importance of participant views:** The SPG has discussed, and understands, that the views of the participants are important to both the Pay.UK Board and Pay.UK's regulators. As such, SPG has agreed on the need to provide a clear view on its recommended scope and way forward for the NPA programme to feed into discussions at the Board, and with regulators.
- 6 The SPG is clear that they felt unconstrained in making these recommendations and acknowledged the decision of whether and how to deliver on them is for Pay.UK. The SPG also appreciates that Pay.UK will need to consider the regulatory, legal, and competition implications before these recommendations can be implemented.

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## RECOMMENDATION #1: PAY.UK SHOULD INCORPORATE SPG'S SIX SCOPE OBJECTIVES

7 Between 2015 and 2017, the PSR and the PSF undertook work to identify detriments that existed in the payments value chain, and to identify new solutions and services to be developed to meet the needs of users. SPG analysis (included in the annex) has shown that some of these detriments have been partly addressed. For example:

- There has been a significant increase in direct participation in Pay.UK systems.
- Open Banking has launched and the ecosystem is now growing rapidly, with innovation and speed to market is working well for end users.
- Confirmation of Payee will shortly be implemented and Request to Pay is near launch (both subject to Covid-19 impacts).
- The industry has tactically delivered competitive solutions to address financial crime detriments.

8 However, certain of the more 'long term and strategic solutions' have yet to be delivered, which at the time, the PSF expected the NPA to achieve. On this basis and consistent with emerging analysis from the scope archetype questionnaire, the SPG supports Pay.UK continuing to pursue the outcomes of the vision set out in the PSF Strategy.

9 The SPG's view is that Pay.UK should ensure that the UK continues to offer a 'world leading' payment ecosystem to all its users. **To help frame this aspiration, the SPG recommends that Pay.UK incorporates six high level scope objectives for the NPA programme:**

- ***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 noting the lessons learned from recent industry experience.
- ***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 and appropriate security throughout and also including the development of appropriate financial crime solutions.
- Any ***efficiencies should benefit participants and users*** and not the vendor.

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- 10 The SPG acknowledges there are alternative ways on how to best achieve the outcomes, as covered under SPG recommendations 2 and 3. The SPG is unanimous, however, that robustness and resilience is, and must continue to be, Pay.UK's most critical requirement and having this in place will be a key platform on which competition and innovation can then be built.

## **RECOMMENDATION #2: HEAVILY PHASED TRANSITION OF FPS FOLLOWED BY BACS**

- 11 The delivery of a Faster Payments and Bacs over a single payment rail has been raised as a key area of concern for participants through both the scope archetype questionnaire and in SPG discussions. The SPG also noted how this question had been a challenge for the PSF who did some initial thinking in this area but recognised it was a question for Pay.UK to fully address.
- 12 The SPG has major reservations around how replacing both systems with the NPA could be done efficiently, effectively and safely. Given the complexity of the Bacs ecosystem, SPG feels strongly that any change to Bacs should only be initiated after careful and thorough analysis and consultation with both government and corporates has been undertaken so that the design of a replacement and migration strategy was sufficiently robust. The SPG has been made aware that Pay.UK has heard the same feedback from BACS market participants and also agreed that in making this point they were considering the views of their end users.

### **13 Pay.UK should adopt a phased approach to the NPA. Faster Payments 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 government and corporates.**

- 14 To accommodate this recommendation, the SPG recognise that the new core clearing layer (that will replace Faster Payments first) should be designed (with respect to capability and capacity) and procured in a way that allows a future migration of Bacs volumes.
- 15 The SPG acknowledges that if Pay.UK adopts this recommendation it would be expected to commit to maintaining the current Bacs infrastructure for the foreseeable future. The SPG does not, at this stage, wish to opine on how and when Pay.UK would commence material engagement with industry on the possible future transition of Bacs into the NPA is a decision for Pay.UK. The SPG does acknowledge that industry, including end user, consultation will be required.

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## **RECOMMENDATION #3: PAY.UK SHOULD BRING IN THE INCUMBENT TO PROVIDE VENDOR SUPPORT AND EXPERTISE AS SOON AS PRACTICALLY POSSIBLE**

16 SPG recognises that Pay.UK has, over the past two years, sought to meet the PSR's SD2 and SD3 in good faith. However, at this juncture, the total cost of NPA from procurement through to delivery for the industry is a growing concern for SPG due to anticipated programme delivery costs, timescales, and difficulties arising from migration (especially in the event that a new vendor is selected).

17 In considering its recommendation the SPG recognises the advantages to Pay.UK, and the wider industry, of running a full competitive process as per the current Pay.UK approach. Specifically using competitive pressure to potentially improve the quality, value and services of the central infrastructure provided to Pay.UK. However, the SPG believe this can be mitigated in other ways and against this SPG has considered the following market factors and challenges with running a long competitive process.

18 [X]

### ***De-risking the transition:***

19 As set out elsewhere a core SPG requirement is to operate existing and new services in a robust and resilient way and to de-risk the transitioning to these new services. The risks of outages and service failures are considerable during transition. To support this, SPG is of the view that an incremental transition with the incumbent would be materially lower risk.

20 The SPG considered market examples of migrations that had worked well or caused significant live incidents, and the material impacts these can have on end users – these included:

- Complex migrations in the payments industry that have led to outages; [X]; and
- On those that have worked well the SPG raised, as an example of a recent successful transformation of the core infrastructure, (a) SWIFT's transition to the SWIFT GPI solution, part of the success of this migration was down to it being done "in-house" and (b) the EBA work on the STEP1 to STEP2 migration.

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- 21 Based on these examples and their broader market knowledge, the SPG discussed how the payments industry has learnt that modernising and transforming the core for market infrastructures and banks should be approached differently. [X].

## ***Addressing remaining PSF detriments without undue delay:***

- 22 Amongst the SPG membership, there is a desire to both address the remaining PSF detriments and to develop a competitive, innovative and end user focussed market (outside of the central infrastructure layer). The SPG also want to achieve this on a faster timetable than the current NPA Programme and its competitive procurement timeline will likely achieve.
- 23 A long delay in implementing ISO 20022 will put UK institutions at a competitive disadvantage compared to other markets like the USA, Europe, and Asia where message size is being expanded much faster. This will harm the business lines provided by UK banks (including, for example, correspondent banking) and, in part, is driving the desire of the SPG to move quickly.
- 24 The SPG understands that appointing the incumbent now could compromise Pay.UK's ability to benefit from competition for the provision of the core clearing layer. However, SPG considers: (a) that a non-competitive arrangement at this layer is unlikely to lead to end user detriment; (b) that the industry can accelerate delivery of wider ecosystem competition benefit by compromising on competition for the core clearing layer; [X].
- 25 [X]. This approach should also lead to an earlier and easier transition, thereby accelerating the delivery of end user benefits. Put another way, moving away from a competitive approach for a small part of the ecosystem will accelerate competition benefits over the much wider part.

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## ***Greater market focus on competition and innovation in the ecosystem rather than the core:***

26 Changes underway in the payments market are leading to a greater focus on competition in the broader ecosystem rather than at the central infrastructure layer (where the focus should rightly remain on robustness and resilience). The SPG notes relevant examples from other regulated sectors – telecoms; rail; energy – which aren't required to competitively procure. The SPG has questioned why this is necessary for the payments industry, especially when balanced against the likely transition risks. The SPG is aware however that those regulators seek to address this through other interventions such as price control. Overall, the SPG view is that the wider ecosystem competition benefits would best be delivered by not competing for the central infrastructure procurement, in particular because this one small part of the ecosystem is unlikely to cause an end user detriment. The SPG notes that the change of ownership of the incumbent has already dealt with many of the issues in this space.

## ***Impact of Covid-19:***

27 The above concerns over cost, migration risk, and the need to address the remaining PSF detriments in a timely way are only exacerbated by the economic issues arising from Covid-19 on ecosystem players.

28 In light of Covid-19, SPG noted that the financial and resource capacity of the ecosystem (particularly corporates users and government) will be weakened. In the short-term, the SPG recognises that running a long competitive procurement is costly and these central Programme costs would be saved by on-boarding the incumbent quicker. In the medium term, SPG is also mindful of the important distinction between central costs (incurred by Pay.UK) and industry wide costs (incurred by Pay.UK, participants and other actors in the payments ecosystem) that will result from the programme, with the latter bring orders of magnitude greater. Historically a formula of 10 (industry costs) to 1 (central costs) has been the baseline but due to the embedded nature of Bacs and the complexity of its migration some have suggested a factor of between 20 and 50.

29 More broadly, the SPG is concerned about potentially reducing resilience (during migration) for a post-Covid world. The payments systems continue to operate in a robust and resilient way and therefore it would be unwise to jeopardise this stability at this time.

## ***SPG recommendation on procurement approach***

30 Weighing the upsides and the downsides has led SPG to conclude that the downsides of the current procurement process greatly outweigh the potential benefits. **Pay.UK should enter regulatory negotiations with a view to cancelling the current competitive procurement process and ultimately engage the incumbent to deliver against the six scope objectives. The SPG understand that this would likely mean that the incumbent would be in place through build and transition (and therefore into the operation of the new core clearing layer) to meet the SPG requirement to minimise transition risk and overall industry costs.**

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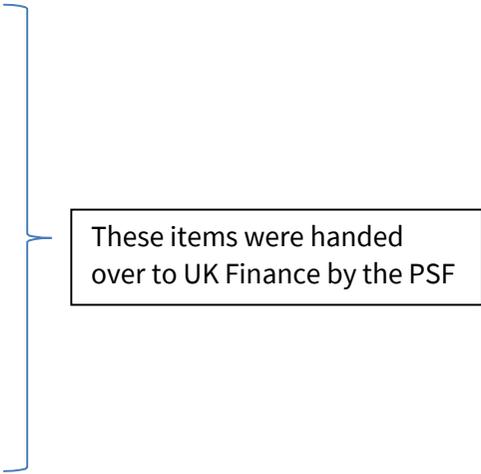
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- 31 SPG understands that the adoption of this recommendation by Pay.UK could result in the pausing of the current competitive procurement process. The SPG membership appreciates that Pay.UK will need to consider the possible regulatory, legal, and competition implications of before it can be implemented.
- 32 SPG considers that any PSR concerns over the final recommendation could be satisfactorily addressed, SPG believes engaging with the incumbent earlier will allow the NPA to be delivered quicker. This would enable outstanding detriments as set out in Annex A to be addressed quicker than the current NPA programme plan indicates. Also, although competition will be lost for the provision of the core clearing layer, the SPG believe that delivering the NPA quicker will facilitate competition in the provision of end user overlay services. The SPG recommends in any 'regulatory negotiations' that Pay.UK leads with these arguments.

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**Annex A: High level assessment of industry progress in meeting PSF Detriments – those that haven't been fully delivered and are expected to be implemented via the current NPA scope are highlighted in yellow.**

Group	Remedy	Implemented or soon to be implemented	Expected to be implemented by current NPA Programme Scope	How was this implemented?
Responding to end user needs	Request to Pay	Soon	-	Rules and standards developed by Pay.UK. Launch imminent ((subject to Covid-19 impacts)
	Assurance Data {now known as Confirmation of Payee)	Soon	-	Rules and standards developed by Pay.UK. Confirmation of Payee has been directed by the PSR and is due to be live in March (subject to Covid-19 impacts)
	Enhanced Data	No	Yes (common messaging standards via ISO20022)	
Improving trust in payments	Payment Transaction Data Sharing & Data Analytics	Yes (tactical via MITs)	Yes (Strategic data feed via NPA)	
	Indirect Access Liability Model	No	No	
	Guidelines for Identity, Verification, Authentication and Risk Assessment	Yes	Yes	
	Financial Crime Intelligence Sharing	Yes	-	
	Trusted KYC Data Sharing	No	No	
	Enhancement of Sanctions Data Quality	Yes	-	
	Customer Awareness & Education	Yes	-	
Simplifying access to promote	Access to Sort Codes	Yes	-	Bacs made available a new utility sort code range for indirect participants. Sort code checkers are available across Bacs and FPS.

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<b>competition</b>	<b>Accessible Settlement Account Options</b>		Yes	-	Bank of England extended access to RTGS accounts to non-bank payment services providers.
	<b>Aggregator Access</b>		Yes	-	Third party providers were allowed to provide PSPs with a technical access solution that enables submission of input and receipt of output from Bacs and FPS services.
	<b>Common PSO Participant Model and Rules</b>		<b>No</b> (A Pay.UK project to implement tactical changes is being initiated)	<b>Yes</b> (through the development of a single clearing layer)	
	<b>Establishing a Single Entity</b>		Yes	-	Creation of Pay.UK
	<b>Moving the UK to a Common Message Standard</b>		<b>No</b>	<b>Yes</b> (common messaging standards via ISO20022)	
<b>A new architecture for payments</b>	<b>Simplified Payments platform</b>	<b>A Layered Model for Payments Processing</b>	<b>In part</b> (e.g. some layering is emerging alongside Open Banking and other Overlay Services)	<b>Yes</b> (it is anticipated the design of the NPA will facilitate more Overlay Services)	
		<b>Common Messaging Standards, Open Access APIs &amp; API Governance</b>	<b>In part</b> (via Open Banking)	<b>Yes</b> (common messaging standards via ISO20022)	
		<b>A Simplified Delivery Mechanism</b>	<b>No</b>	<b>Yes</b> (via the proposed single clearing layer)	
		<b>Overlay Services</b>	<b>In part</b> (e.g. RtP and CoP)	<b>Yes</b> (it is anticipated the design of the NPA will facilitate more Overlay Services)	