

Responses to draft terms of reference PSR MR15/1 – Market review into the supply of indirect access to payment systems

Respondents

Respondent (<i>non-confidential responses</i>)
Bacs Payment Schemes Limited
Bank of New York Mellon
Barclays Bank
CHAPS Co
Faster Payments Scheme Limited
HSBC Bank
Lloyds Banking Group
Nationwide Building Society
Payments Council
Positive Money
Santander UK
Virgin Money

Bacs Payment Schemes Limited

Indirect Access Review Team
Payment Systems Regulator (15th Floor)
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Via email: iamr@psr.org.uk

23 April 2015

Ref: PSR MR15/1

PSR MR 15/1 MARKET REVIEW INTO THE SUPPLY OF INDIRECT ACCESS TO PAYMENT SYSTEMS DRAFT TERMS OF REFERENCE

Bacs Payment Schemes Limited (Bacs) is pleased to be able to provide feedback on the PSR's draft Terms of Reference 'Market Review into the supply of Indirect Access to Payment Systems' (MR15/1). Founded in 1968 Bacs is a not-for-profit, membership based body and is responsible for the schemes behind the clearing and settlement of automated payments in the UK including Direct Debit and Direct Credit. Bacs has been maintaining the integrity of payment related services for over 45 years.

The Government acknowledges that the Bacs payment system is of critical national importance to the UK financial system and has confirmed that it meets the recognition criteria set out in the Banking Act 2009. Bacs is, therefore, regarded as a FMI, recognised as systemically important by HM Treasury and is overseen by the Bank of England. HM Treasury has also designated Bacs under the provisions of the Financial Services (Banking Reform) Act 2013 and the result of such designation decision makes Bacs a regulated payment system, falling under the powers of the new Payment Systems Regulator.

We believe that it is Bacs' role to provide fair, open and transparent participation in the range of schemes and services we offer to financial institutions. This approach ensures that Bacs can contribute to the ability of providers of banking services to create a competitive market place and deliver real end user benefit. Although Bacs is keen to see new members join the company and participate directly in the Direct Credit and Direct Debit schemes we are also keen to see a vibrant and competitive market place for indirect participants requiring Bacs functionality. In the region of 300 indirect participants currently connect to Bacs either directly or indirectly for the submission or receipt of transactions. If Bacs is approached for advice regarding the most appropriate model of participation, the institution is encouraged to consider a number of participation models based on their own situation by analysing their current or anticipated transaction volumes / values, strategic aspirations and technical / operating environment.

A number of levels of participation in Bacs represent a 'pathway' to full membership in Bacs, with indirect banks choosing to progress through or limit their participation within Bacs as dictated either by their operational or strategic desires. For those institutions that choose not to become a direct scheme member it is our view that the existing scheme members can often facilitate competition from new entrants in the payments market as the Bacs indirect access model can provide new entrants with the opportunity to exploit the financial, technical and operational investments made by the existing direct members to improve speed to market of their own offering.

It is important to note that where an institution chooses to access Bacs via an indirect access arrangement there is a dependency on the institution providing access to ensure it acts as an effective conduit for engaging on Bacs issues. We also note a reference in paragraph 2.9 to less formal indirect access arrangements existing in the market place, given the objectives of the Market Review it is important that all existing arrangements are viewed through the same critical lens to ensure any required improvements in the market can be achieved consistently.

To ensure open access to all market participants Bacs has adopted an approach where any market participant can access the appropriate service directly and on equitable terms regardless of whether or not the institution is a member of Bacs or any other payment scheme. An example of the direct participation model we have adopted for these new services is with our Cash ISA Transfer service where 49 brands have joined the scheme under a direct access model including a number who have no other direct link with Bacs or any other scheme. This direct, open access model is also being used with the Current Account Switch (CASS) service, with 40 brands participating, representing in excess of 99% of the market place.

In response to the three questions detailed in paragraph 3.1, we agree:

- That the draft Terms of Reference appropriately identifies the key questions and issues on which the review should focus.
- That the review should focus on the interbank payment systems identified in the draft Terms of Reference.
- That the review should focus on the services provided by Sponsor Banks to Indirect PSPs.

Once the Market Review formally commences Bacs would be pleased to engage with the PSR on the supply of indirect access to the services Bacs offers.

Yours sincerely



Michael Chambers
Chief Executive

Bank of New York Mellon



BNY MELLON

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United Kingdom

23 April 2015

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Payment Services Regulator
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Re: Market Review into the supply of Indirect Access to payment systems – Draft Terms of Reference (PSR MR 15/1)

Introduction

BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. As one of the world's largest investment services and investment management firms, BNY Mellon welcomes the opportunity to respond to the PSR MR 15/1 ("CP") in respect of Market Review into the supply of Indirect Access to payment systems.

BNY Mellon operates in Europe through: (i) branches of The Bank of New York Mellon (a New York incorporated financial institution) and (ii) directly established and duly authorised subsidiaries established in several EU jurisdictions and branches of those entities operating in most of the core EU member states. It provides services to clients and end-users of financial services globally.

Responses to Specific Questions

Our responses are contained in this document in Annex 1 below.

BNY Mellon looks forward to further engagement with the Payment Systems Regulator in the months ahead in regard to the market review.

David O'Brien
Compliance Director
EMEA Head of Policy, Regulatory Reform and Governance
Compliance & Ethics
BNY Mellon

ANNEX 1 – Responses to Specific Questions

Do you agree with the key questions and issues on which we propose to focus the review?

BNY Mellon agrees with the key questions and issues on which the PSR propose to focus the review. BNY Mellon believe that question number II – ‘what factors may limit the number of Sponsor Banks offering Indirect Access to payment systems’ should be expanded to include ‘and what may incentivise organisations to become Sponsor Banks’ may yield a wider scope of information.

Do you agree that the review should focus on the main interbank payment systems: Bacs, CHAPS, FPS, LINK and C&C?

BNY Mellon agrees that the review should focus on the main interbank payment systems as mentioned in the terms of reference. We note the exemption of international correspondent banking relationships from the review. We would respectfully request that the PSR include a definition of international correspondent banking and advise if there will be an intention to include this type of relationship into the review at a future date.

Do you agree that the review should focus on the services provided by Sponsor Banks to Indirect PSPs?

BNY Mellon agrees that the review should focus on the services provided by Sponsor Banks to Indirect PSPs, with the exception of custody cash clearing and settlement services. In our view, custody cash clearing and settlement services should be excluded from the review, as it is not the main objective of Indirect PSPs to gain access to cash clearing systems when appointing custodians or sub-custodians. In addition to services provided by Sponsor Banks, we suggest that the review gathers feedback on services that are not generally made available to indirect PSPs, but which indirect PSPs believe would add value, if provided.

Barclays Bank

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www.barclays.com

Email to: iamr@psr.org.uk

24 April 2015

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Dear Sir or Madam,

Payment Systems Regulator - Draft Terms of Reference MR15/1 – the supply of indirect access to payment systems

On behalf of Barclays I would like to thank you for sharing the draft Terms of Reference.

We are supportive of the market review and note the areas where concerns have been raised. In part, some of those concerns are being addressed by the development of a Sponsor Bank Code of Conduct. However, this Review will provide an opportunity to look more widely at the economics of the supply of Indirect Access more generally. We would welcome and be supportive of more direct participation in the schemes and also a greater number of banks offering sponsorship into the schemes for indirect participants.

Clearly defining the scope of the Review will be key. We understand that the industry working group has engaged with the PSR around the scope for the Sponsor Bank Code of Conduct. We suggest that the PSR either adopts this same definition for the Market Review, or if a different scope is required, considers very carefully how the definition may be changed so as not to include corporate customers and/or correspondent banking relationships since we agree these should be out of scope.

Consideration also needs to be given to the exposure of sponsor banks to the risks associated with their agency customers' potential failure to comply with regulations (e.g. non-compliance with anti-money laundering requirements). In order to ensure a balanced approach to the Review, we suggest equal weight be given to factors in both the demand and supply of indirect access e.g. one of the key questions to be explored might be why indirect participants choose indirect access over direct access and what due diligence they undertake.

Finally, the draft TOR proposes an investigation into the quality and pricing of indirect access services. One consideration to bear in mind is that infrastructure costs may be difficult to apportion where shared across a suite of different products and services.

We look forward to working with you on the review.

Yours sincerely

Simon Chatterton
Head of Payment Schemes, Industry and Innovation

The response contains views which Barclays has not made public to date. We therefore request that if the FCA intends to publish or otherwise disclose the contents of this response that the FCA notify Barclays prior to doing so and take into account any representations that Barclays may make

CHAPS Co

By Email: iamr@psr.org.uk

CHAPS Co

01 May 2015

Enquiries regarding this document can be sent to:
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To Indirect Access Review Team
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From CHAPS Co, Legal & Regulatory Affairs

PSR MR15/1: MARKET REVIEW INTO THE SUPPLY OF INDIRECT ACCESS TO PAYMENT SYSTEMS – DRAFT TERMS OF REFERENCE

CHAPS Clearing Company Ltd (hereinafter “CHAPS Co” or “the Company”) welcomes the opportunity to respond to the above PSR Market Review.

CHAPS Co is the UK electronic Payment System for high value and systemically important transactions which settle across the Bank of England’s Real Time Gross Settlement (RTGS) system, thereby achieving irrevocable finality at the point of settlement.¹ Daily average settlement values exceed £280 billion with a direct participant base of twenty-one major financial institutions whom, in turn, service over 5,000 other financial institutions on an indirect basis (primarily via international Correspondent Banking relationships).

The CHAPS System is a central bank money settlement system and wholesale payments system. As such it processes 93% of the value of all Sterling payments, but only 0.04% of the volume of all Sterling payments. Whilst the major volumes of Sterling payments are predominantly processed by the retail payment and bulk payment clearing systems, there are no prohibitions to CHAPS Co being used for retail transactions. Additionally, because it removes settlement risk from payments, it is the preferred mechanism within the house conveyancing market.

¹ Finality of settlement is underpinned by CHAPS’ designation as a “system” by the Bank of England, as the relevant designating authority under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (the “SFRs”), which implement the EU Settlement Finality Directive 98/26/EC in the United Kingdom.

CHAPS Co is a Recognised System under the 2009 Banking Act² and is thereby supervised by the Bank of England in its statutory supervision capacity.

Since 1 April 2015, CHAPS Co is also supervised by the Payment Systems Regulator (PSR) by virtue of HMT's Designation Order of 19 March 2015.

At a governance level, CHAPS Co operates as a standalone Company which is limited by shares. These are issued on an equal basis to each of the financial institutions which directly participate in the CHAPS system. CHAPS Co's Board is comprised of an Independent Chairman, two Independent Directors, an Executive Director (CEO) and Participant Directors nominated by their respective shareholding institution (having first been considered by the Appointments and Remuneration Committee which is Chaired by an Independent Director).

Response to Questions raised in the Market Review.

Q1: Do you agree with the key questions and issues on which we propose to focus in the review?

CHAPS Co broadly agrees with the key issues on which the PSR intends to focus in the context of this market review.

However, we would like to draw attention to the following two points:

1. The PSR needs to take into account the effects that are expected to derive from upcoming regulation, e.g. ring-fencing, in order to avoid adopting measures that may conflict with the obligations that will derive from it.
2. In general, any measures that may be adopted as a result of this market review must be future-proof in order to avoid market interventions that may:
 - Impose unnecessary regulatory burden on the market;
 - Be superseded by or disincentivise market developments and innovation; and/or
 - Need to be replaced within a very short period of time and as such generate market uncertainty and instability.

In order to avoid such effects, the PSR may want to consider establishing formal regular communication channels with the market regarding indirect access, e.g. either with the establishment of specific working groups or within the remit of the Payments Strategy Forum.

Also, the PSR may want to consider whether this review will be static or dynamic – in other words, will it be an ongoing review or will further review only take place if there has been a material change in market conditions or regulation.

² Recognition Order issued by HM Treasury on 5th January 2010.

Q2: Do you agree that the review should focus on the main interbank payment systems: Bacs, CHAPS, FPS, LINK and C&C?

CHAPS Co broadly agrees that it is appropriate that the review should consider the interbank payment systems as identified above. That said, we strongly believe that no market monitoring responsibilities should be imposed on them, primarily since the providers of indirect access, i.e. the Sponsor Banks are independent entities, individually setting the terms under which they provide indirect access. As such, only the PSR is able to intervene and question the fairness of those terms and/or their compliance with competition law.

Finally, we would add that as an open and transparent payments system, CHAPS CO already has in place mechanisms to facilitate and address any relevant concerns that potential participants may wish to raise and openly publishes its joining criteria on its public website at http://www.chapsco.co.uk/participation/joining_chaps/ (also http://www.chapsco.co.uk/chaps_services/chaps_affiliate_group/).

Q3: Do you agree that the review should focus on the services provided by Sponsor Banks to Indirect PSPs?

CHAPS Co strongly agrees that the **main** focus of this review should be on the services provided by the Sponsor Banks to Indirect PSPs (and, in particular, the terms under which they provide those services).

Similar to our suggestion at Q1, we believe that the PSR's review would be further enhanced in this respect by the establishment of formal regular communication channels with the market and, at a minimum, that this review will take place if and when market conditions will call for it.

Faster Payments Scheme Limited



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23rd April 2015

RESPONSE TO DRAFT ToRs PSR MR15/1 – INDIRECT ACCESS

Faster Payments Scheme Limited (FPSL), as a designated Payment Systems Operator under the Financial Services (Banking Reform) Act 2013, wishes to provide the following comments concerning the draft terms of reference for the market review into the supply of Indirect Access to payment systems.

We are generally content with the scope of the review. We do not consider that there are any other issues that need to be included in the terms of reference at the current time.

There are however a number of points of context that we believe the review team should be sensitive to:

- Considering the market today, direct participation is an option for many customers that already hold settlement accounts as the Bank of England, and for these customers needs to be considered as one of the market offerings alongside Indirect Access.
- In the future, greater access to settlement accounts for non-traditional players may further increase the availability and attractiveness of this direct option.
- As the FPSL new access model develops and comes to market, the concept of Indirect Access will need to be redefined to include two distinct, and potentially separately purchased and provided offerings: technical access (from one of a number of new technical aggregators) and settlement services (either, self-provided for PSPs with settlement accounts, or for those PSPs without a settlement account from an existing sponsor bank, or from potentially new banks that wish to enter the market and provide this distinct banking service to other PSPs).

In due course the team will need to ensure that any remedies considered necessary from the current market structure do not undermine the development of these important market enhancing changes.

Yours sincerely,

By email

Craig Tillotson,
Chief Executive

HSBC Bank

HSBC response to the PSR's Draft Terms of Reference for the market review of indirect access to payment systems

1. HSBC welcomes the opportunity to comment on the PSR's draft Terms of Reference for the market review of indirect access to payment systems (the Draft ToR).¹
2. HSBC's comments on the Draft ToR are set out in detail below. The key points can be summarised as follows:
 - a. **Scope of the Draft ToR.** HSBC is broadly supportive of the scope of the PSR's market review, but considers that there would be benefit in clarifying certain terms, in particular what Indirect Access means and what types of PSPs fall under the definition of Sponsor Bank.
 - b. **Key concerns to be addressed in the market review.** The PSR has already taken steps to address a number of concerns identified with regard to Indirect Access, namely a requirement to publish access-related information and the development of a Code of Conduct. In accordance with principles of good regulation and legal certainty, it is important that the PSR allows time for these measures to take effect before embarking on new regulatory initiatives. It is important for the PSR to be explicit about the concerns identified in the consultation which it considers remain unaddressed by the measures already in the process of being implemented. HSBC identifies what it believes are the PSR's outstanding concerns below and comments briefly on each of these issues.
 - c. **PSR's approach must be evidence-based and proportionate.** HSBC would welcome further clarification of what the PSR means by an "economic framework". HSBC considers that any economic analysis which is conducted should take account of the range of forms which Indirect Access may take. Any economic analysis should reflect, in a proportionate manner, the nature of the market review process and the powers which the PSR has to intervene in relation to Indirect Access. In particular, HSBC consider that there is insufficient evidence to warrant a profitability assessment at this early stage of the process. There are more proportionate methods for understanding whether the outcomes, including prices and quality, experienced by service users are consistent with a well-functioning market.
 - d. **PSR's methods of engagement.** HSBC welcomes the PSR's proposal to adopt a variety of methods for the purpose of gathering and analysing information provided by market participants. HSBC considers at this stage of the process, a market participant survey or roundtable discussion would be sensible to define clearly the areas of consensus and/or concern.

Services in scope

3. We agree that correspondent banking should be out of scope of this market review.² We consider that services provided to PSPs which do not involve the use of a UK designated payment system to support transactions from a payer's account in the UK to a beneficiary's account in the UK should also be out of scope.

¹ "Market review into the supply of Indirect Access to payment systems", Draft Terms of Reference, March 2015.

² Paragraph 2.8 of Draft ToR.

4. In the PSR's Policy Statement,³ Indirect Access was defined as "*a contractual arrangement with a Direct PSP...*" (emphasis added).⁴ However, as the PSR acknowledges in its Draft ToR, it is not just Direct PSPs which can provide Indirect Access; some Indirect PSPs themselves can provide Indirect Access.⁵ HSBC agrees with this characterisation of Indirect Access and the proposal in the Draft ToR to define Indirect Access as "*a contractual arrangement with a PSP...*" (emphasis added).⁶
5. The proposed scope of the PSR's review is, therefore, wider than HSBC's agency banking business. HSBC provides its agency banking customers with a unique sort code so that they can gain indirect access to payment systems in order to offer sterling payment solutions to their own clients. The PSR considers that access to payment systems for PSPs who do not have their own sort code should also be within scope. We agree. Indirect Access services which do not require the provision of a separate sort code can be provided by any PSP who already has access (direct or indirect) to payment systems via a bank account.
6. Specifically, we consider that there are two distinct types of Indirect Access, which have very different characteristics:
 - a. **Where the PSP is provided with a unique sort code:** In UK payments industry terms, "Sponsor Banks" are defined as direct participants in payment systems who are equipped to provide PSPs with a unique sort code to enable them to access UK payment systems. Relatively large initial and ongoing investments need to be made by direct participants to become "Sponsor Banks". Indirect PSPs who are provided with their own sort code are known as "agency banks".
 - b. **Where the PSP only needs a bank account:** Any PSP who already has access (direct or indirect) to payment systems can provide another PSP with access to payment systems, by providing them with a bank account. There are relatively few barriers to being able to provide this type of Indirect Access.
7. We set out below how we consider the PSR should take account of these differences in the way it frames its terms of reference.
8. We would also welcome clarity on the definition of Sponsor Bank. As set out in paragraph 6.a above, we consider "Sponsor Bank" to relate only to banks which are able to provide the first type of Indirect Access, i.e. via the provision of a unique sort code. However, the Policy Statement definition of "Sponsor bank services" could be taken to cover both of the above types of service.⁷ Given the wider definition of Indirect Access which has been adopted in the Draft ToR, it would be helpful to clarify the definition of Sponsor Banks at the outset of the market review to avoid confusion.

³ "A new regulatory framework for payment systems in the UK", Policy Statement, March 2015.

⁴ Paragraph 5.24 of Policy Statement.

⁵ Paragraph 2.9 of Draft ToR.

⁶ Paragraph 2.5 of Draft ToR.

⁷ Paragraph 5.26 of the Policy Statement defines "Sponsor Bank services" as "*services provided to a PSP or potential PSP who is not a participant in a particular regulated payment system to enable them to become and continue to be an Indirect PSP using that regulated payment system*".

Issues to be explored

9. In the Draft ToR,⁸ the PSR proposes three questions:
- a. **"What are the implications for competition arising from the structure of the market?"** The PSR says it will develop an "economic framework" for assessing the nature of competition and any access-related concerns this may raise for service users, and will form the basis for the PSR's approach to regulating and intervening in the provision of Indirect Access.
 - b. **"What factors may limit the number of sponsor banks offering indirect access to payment systems?"** The PSR states that it will look at the barriers preventing PSPs from becoming "Sponsor Banks," with a focus on the elements and risks involved in providing services across different categories of Indirect PSPs.
 - c. **"What might a competitive Indirect Access offering look like?"** The PSR proposes to look at outcomes, with reference to quality and prices, as well as the limited degree of choice some Indirect PSPs face when trying to secure Indirect Access.
10. We consider that these questions will cover many of the issues identified to date. However, we have several comments which we make below.

Development of an economic framework

11. We are keen to understand more clearly what the PSR means by an "economic framework". HSBC considers that any economic analysis which is conducted should:
- a. Take account of the range of forms which Indirect Access may take; and
 - b. Reflect, in a proportionate manner, the nature of the market review and the powers which the PSR has to intervene in relation to Indirect Access.
12. First, as noted above, the scope of the review is broader than agency banking as it will cover Indirect Access via Direct and Indirect PSPs. Accordingly, it may not be appropriate or possible to establish a single economic framework for Indirect Access. We would suggest that, as an initial step, further discussions with market participants may be appropriate to clarify the differences between the various types of Indirect Access available, to understand whether a single framework is indeed appropriate.
13. Second, HSBC considers that in developing an economic framework for Indirect Access, the PSR should consider the nature of the market review and the powers which the PSR has to intervene in relation to Indirect Access. In particular, as set out in paragraph 21 below, the current market review is not an in-depth market investigation under the Enterprise Act 2002, nor has the PSR concluded that such a reference would be warranted.
14. As noted in the Draft ToR, the market review will be used to inform the PSR's approach to administrative priority decisions if it receives applications for new access or the variation of existing access arrangements and fees under sections 56 and 57 FSBRA. It is important to recognise that these powers give the PSR the power to intervene in the event of an application by an access-seeker. In exercising similar "back-stop" powers to intervene in access disputes,

⁸ Paragraph 2.12 of the Draft ToR.

economic regulators in other sectors have typically taken a "light touch" approach encouraging the parties to engage in commercial negotiations in the first instance. Where intervention is required, economic regulators in other sectors have had reference to market benchmarks or other less interventionist approaches, rather than detailed economic regulation.⁹

15. Given the nature of its powers, it is, therefore, important that the PSR does not pre-judge any application which it may receive under sections 56 and 57 FSBRA in future (if any) and assume that detailed economic regulation will be warranted. Without any evidence to support a need for regulatory intervention in relation to fees (see below), HSBC would encourage the PSR to ensure that the economic framework is developed in a proportionate manner. HSBC would therefore support the PSR's proposal in its Annual Plan and Budget 2014/2015 (Annual Plan) to evaluate a range of different regulators' approaches to economic regulation before developing its own approach to regulation.¹⁰

Identification of concerns not addressed by existing measures

16. As the PSR has noted in the Draft ToR,¹¹ initiatives – especially the Code of Conduct and the information direction - are already underway which will address many of the concerns set out in the PSR's first consultation paper.¹² The PSR will need to allow time for the Code of Conduct and the information direction to be implemented before it can reach a firm view on the effectiveness of these measures. We see it as imperative for the PSR to be explicit about the concerns identified in the consultation which it considers remain unaddressed by the measures already in the process of being implemented.

17. We see four areas of concern that remain outstanding:

- a. Concerns about fees (see paragraphs 19-24 below);
- b. Limited choice of Sponsor Bank (see paragraphs 25-27 below);
- c. Quality and availability of technical access – in particular the asymmetry in the quality of access which Indirect PSPs have relative to Direct PSPs (see paragraphs 28-30 below);
and
- d. The role of regulation in relation to the provision of Indirect Access (see paragraphs 31-32 below).

18. It is apparent that the PSR is keen to explore these issues through the market review. In undertaking its review, the PSR will need to act in accordance with its statutory objectives to promote competition, innovation, and the interests of service users. It will also need to act according to the regulatory principles set out in section 53 of the FSBRA. We urge the PSR to conduct its review in accordance with principles of transparency and proportionality. With these

⁹ For example, in the context of pricing disputes regarding the charges payable by licensees to digital multiplex operators for digital terrestrial television (DTT) for DTT capacity, Ofcom did not adopt a strict price control approach but instead considered it appropriate to develop a benchmark for the price of commercial DTT capacity, using the average of the prices of relevant contracts (see, for example, Ofcom's Determination between Digital 3 & 4 Limited and Channel Five Broadcasting on charges payable for services on DTT Multiplex 2, 28 July 2010).

¹⁰ Page 5 of Annual Plan.

¹¹ Paragraph 1.6 of Draft ToR

¹² "A new regulatory framework for payment systems in the UK", Consultation Paper, November 2014.

general points in mind, we address each of the above areas in turn, in combination with the three questions the PSR poses in its Draft ToR.

(a) Concerns about fees

19. We note that the PSR has stated that it wishes to consider whether the outcomes, including prices and quality, experienced by service users are consistent with a well-functioning market.¹³
20. In terms of prices, we note that only one challenger bank stated that fees charged for access were not consistent with those one would expect in an “*open, well-functioning and competitive market*”.¹⁴ In contrast, several Indirect PSPs noted that fees were not unreasonable.¹⁵ The PSR has noted that concerns about fees do not appear widespread, and that the assessment of fees is complex and requires a significant amount of time and resource to understand accurately.¹⁶
21. The PSR expresses a desire to understand whether “prices are consistent with a competitive market.”¹⁷ There is a range of tools available to the PSR to reach a view on the prices charged in a market. Some tools, for example surveys of indirect PSPs which ask them about the prices they pay and whether they view these as reasonable, are straightforward to use, and would not impose significant burdens on business or the PSR. In contrast, analysis which seeks to assess a firm’s costs of supplying Indirect Access, are very complex and demanding. HSBC is not aware of the OFT or other sectoral regulators having attempted to conduct a detailed profitability assessment during an initial market study (whether under the Enterprise Act 2002 or sector specific powers). This type of profitability analysis has typically been carried out at Phase II of a market investigation by the Competition and Markets Authority (CMA) (and previously the Competition Commission).¹⁸
22. Price does not at this stage appear to be a principal area of concern for PSPs, and other indicators, in particular the amount of innovation taking place in the market, indicate that the market may be working well. We therefore urge the PSR not to embark upon a detailed profitability assessment, before it has a more in-depth understanding of the nature of competition in the market.
23. At this stage, further evidence on pricing and other outcomes can be obtained through more qualitative means. Only if the PSR finds evidence of there being significant issues affecting competition which may ultimately require a form of price control may it be appropriate to refer the market to the CMA for a market investigation.
24. The PSR is a new regulator with no track record on which to rely to set the expectations of market participants. If the PSR launches into detailed profitability assessment exercises at the outset of a market review without considering whether it is necessary or proportionate to do so, this may send the wrong messages to the industry and most importantly, have a chilling effect on innovation, putting the PSR at odds with its own statutory objectives.

¹³ Paragraph 2.12 of Draft ToR

¹⁴ Paragraph 4.228 of Supporting Paper 4 (Access to Payment Systems) to Consultation Paper (Supporting Paper 4).

¹⁵ Paragraph 4.229 of Supporting Paper 4.

¹⁶ Paragraph 4.232 of Supporting Paper 4.

¹⁷ Paragraph 2.12 of the Draft ToR.

¹⁸ See, for example, the recent market studies in relation to payday lending, private healthcare market, statutory audit services market and the energy market, where profitability analyses were not carried out until the case was referred to the CMA for a Phase II market investigation.

(b) Limited choice of Sponsor Bank

25. The PSR appears to be starting from a premise that a choice between four “Sponsor Banks” constitutes a limited degree of choice.¹⁹ We urge the PSR to consider choice in the context of the two different types of Indirect Access we identify above, that is, Indirect Access via Sponsor Banks using unique sort codes (agency banking) and via Direct or Indirect PSPs using bank accounts.
26. As regards agency banking, we consider that the PSR should explore the following issues:
- a. **Whether four providers constitute enough providers:** the PSR should not reach a premature conclusion in this regard. Many other regulated markets function effectively with four or fewer providers. The PSR should use the market review as an opportunity to gather evidence of whether more Sponsor Banks are necessary to facilitate Indirect Access.
 - b. **The costs of switching providers, and whether switching costs are increasing or decreasing in the market:** if switching costs are prohibitive, the number of providers to choose from is largely immaterial. The advent of initiatives such as cheque imaging and implementation of the future clearing model for cheque clearing in 2017 should considerably reduce switching costs for agency banks.
 - c. **How technical changes may facilitate direct technical access for a number of larger agency banks, who would then need to use a Sponsor Bank for settlement services only:** Direct PSPs in payment schemes who do not currently offer agency banking services may find it relatively straightforward to provide settlement services to PSPs who obtain direct technical access to payment systems. We are aware that active consideration of sponsored settlement models is underway in at least two of the designated payment systems in addition to existing arrangements in LINK.
27. As regards the provision of access through a bank account (without a unique sort code), we consider that the PSR should explore the following issues:
- a. What are the limitations, if any, of Direct PSPs (who are not Sponsor Banks) providing Indirect Access to other PSPs?
 - b. Is it possible for any PSP with Indirect Access to provide Indirect Access to another PSP?
 - c. What are the costs, risks and benefits involved in Indirect PSPs providing access to payment systems to other PSPs?

(c) Quality and availability of technical access

28. Many Indirect PSPs have indicated that they would like to see improvements in technical access solutions which make it easier for them to connect to payment systems.
29. The PSR notes in its Policy Statement²⁰ that the industry is best placed to design and develop technical access solutions which will meet the needs of PSPs and end users. We agree. We also

¹⁹ Paragraph 2.12 of Draft ToR.

²⁰ Paragraph 5.108 of Policy Statement.

consider that markets are more likely to deliver innovative new services when they have predictable and stable regulatory environments.

30. We encourage the PSR to ensure that the development of technical access solutions fall within the scope of its market review. Consideration of innovations and developments in the provision of both direct and indirect access solutions have a fundamental bearing on the nature of competition.

(d) The role of regulation in the market for the provision of indirect access

31. The PSR states in its consultation documents²¹ that it will engage with other relevant authorities to promote awareness of the adverse impacts that the implementation of AML regulation may have on choice of Sponsor Bank for some PSPs.
32. We encourage the PSR to be more explicit in the market review about the nature of its engagement with regulators in this regard. More legal certainty for (i) the providers of indirect access to agency banks, and (ii) agency banks who provide indirect access to PSPs, would likely reduce the risks inherent in providing indirect access to payment systems.

Methods of engagement and next steps

33. As indicated above, there are a number of areas where HSBC considers it will be beneficial for the PSR to discuss with market participants prior to finalising the Terms of Reference. HSBC would welcome a roundtable and/or an interview format as an efficient way to establish clear parameters of the review moving forward, and to discuss the PSR's thinking in relation to its timetable more broadly.

²¹ See, for example, paragraph 4.209 of Supporting Paper 4.

Lloyds Banking Group



PSR Market Review into the Supply of Indirect Access to Payment Systems: Draft Terms of Reference

Lloyds Banking Group response

24 April 2015

Executive Summary

Lloyds Banking Group (LBG) welcomes the opportunity to comment on the draft terms of the reference for the Payment Systems Regulator's (PSR) market review into Indirect Access.

The UK payments industry is a fundamental part of the UK economy, and the provision of Indirect Access enables many Payment Service Providers (PSPs) to access UK interbank payment systems for the purpose of providing payment services, for their customers, through a choice of providers and different services.

Whilst there are a number of Indirect Access providers in the UK, there are currently four Banks providing traditional agency banking arrangements defined as "Sponsor Banks. [REDACTED] Recognising both the importance of Indirect Access in the payments industry and the considerable demand for these services, we are committed to a significant investment programme to expand and improve our service, enabling us to compete more effectively in the market. Investment will deliver an enhanced choice of access methods, the ability to support all sort codes (facilitating transfer of indirect access from other providers without impact to a PSP's customers) and enhance our Faster Payments proposition. Our investment aligns with our vision to help Britain prosper by being the best bank for customers, enabling us to meet the needs of existing and future Payment Service Provider clients and in turn their clients.

We note that some PSPs have raised concern about access to payment systems during the PSR's consultations, but we believe the Indirect Access service is and will remain a cost effective and straightforward alternative to Direct Access demanded by many PSPs. This view underpins our significant planned investment. We welcome proposals to extend services available to PSPs (and end-users), however, we request that the PSR gives due consideration to the impact that any regulatory intervention may have on this market affecting the incentives to invest by current and potential providers.

Response to Specific Questions

Q1: Do you agree with the key questions and issues on which we propose to focus the review?

We agree that the key questions and issues identified by the PSR are relevant to its review. We also note that the role of existing and anticipated regulation, while not specifically mentioned in the draft Terms of Reference, has a significant impact on competition in this market and on how it is likely to develop in future. If the PSR is to reach a full understanding of how competition works in the market, any factors limiting the ability to supply Indirect Access, and the likely future direction of the market, we believe that it will be crucial for it

also to review the role of existing regulation in its widest context, including Anti Money Laundering regulation and the significant impact expected from new regulation such as the upcoming Payment Services Directive II and initiatives under consideration such as account number portability.

We agree that establishing what a competitive Indirect Access offering would look like is an important question for this review. However, to produce robust conclusions, it is crucial that this represents a realistic and feasible view of how the market could be improved for the benefit of end-users. This will ensure that any interventions have their intended effect, without disincentivising investment by existing providers or new entrants and give due consideration to the need to maintain the stability and integrity of the interbank payment systems.

Q2: Do you agree that the review should focus on the main interbank payment systems; Bacs, CHAPS, FPS, LINK and C&CC?

We agree that Bacs, CHAPS, FPS and LINK should be in scope but request that the PSR reconsider its intention to include C&CC given the potential impacts from the Future Cheque Clearing Model (FCM). The existing C&CC will be superseded by FCM which one of its core aims is to enhance participant access and may be delivered before the PSR market review concludes. Any assessment based on the existing model is likely to have limited value for understanding how C&CC will operate in future. For this reason, we believe that it would be more appropriate to focus on Bacs, CHAPS, FPS and LINK, and take C&CC out of scope for the review.

If C&CC remains in scope we would support Northern Ireland Cheque Clearing (NICC) being added based on our understanding that FCM covers the whole UK. We would also ask the PSR to ensure there are no unintentional consequences for FCM as a result of C&CC remaining in scope for the market review.

Q3: Do you agree that the review should focus on the services provided by Sponsor Banks to PSPs?

Sponsor Bank services have a very specific (and narrow) definition within the UK payments industry. These services refer to the provision of Indirect Access to qualifying PSPs who have one or more sort codes (currently provided by just us, Barclays, HSBC and RBS).

Agency Banking arrangements is just one way a PSP can gain Indirect Access to the primary UK interbank payment systems. Indirect Access services can be provided under normal commercial banking arrangements by the four Sponsor Banks above and by other PSPs.

We understand from the PSR's Policy Statement and the draft Terms of Reference for this market review that its intended scope goes beyond services offered by Agency Banking (i.e. the scope of the market review will cover all PSPs who indirectly access the UK interbank payment systems). Accordingly, we would suggest clarifying the use of Sponsor Bank terminology in the final Terms of Reference.

In addition, we note that it may be challenging for the PSR and for participants in the market review to identify all indirect PSPs. PSPs using Agency Banking arrangements are easy to determine, but this is not the case where business activity is not solely for the purpose of providing payment services or where PSPs are not appropriately registered with the Financial Conduct Authority (FCA). We therefore suggest that the PSR restrict the scope to

PSPs registered with the FCA (i.e. under regulatory supervision) and are therefore within Payment Services Regulations, Anti-Money Laundering Regulation, and other relevant regulatory requirements.

A handwritten signature in black ink, appearing to read "Russell", with a horizontal line underneath the name.

Russell Saunders
Managing Director, Global Payments

Nationwide Building Society

Nationwide House
Pipers Way
Swindon SN38 1NW
Wiltshire

24th April 2015

Indirect Access Review Team
Payment Systems Regulator (15th floor)
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Sirs

I am pleased to provide you with the Nationwide comments on the draft Terms of Reference for the Market Review on Indirect Access. If you have any questions please do not hesitate to get in touch with me.

Introduction

Nationwide Building Society welcomes the opportunity to respond to the Payment Systems Regulator (PSR) and its Terms of Reference on the Market Review into the supply of Indirect Access to payment systems (PSR MR 15/1).

Nationwide is a direct member of the mainstream payment systems within the scope of the review, i.e. Bacs, Faster Payments, LINK and Cheque & Credit Clearing and have Indirect Access to CHAPS through a sponsorship by HSBC. We also have representation on both UK and European Visa Boards. As Nationwide does not offer indirect access to these card schemes, we are not clear the evidence supports their exclusion from this review. Having the assessment and evidence to support this conclusion would help to narrow the scope of this review.

We fully support the Regulator's objective to determine whether current Indirect Access arrangements deliver a good outcome for service users. We agree that the market review is an appropriate mechanism through which to make this assessment and look forward to contributing to that work later in the year.

Scope

We agree with the scope of the Market Review however we have a question as to the definition or use of the words 'service users' in Issue III when the scope (section 2.7) includes all types of PSP and not the end customer, e.g. the corporate customers etc.

Issues to be explored

I. What are the implications for competition arising from the structure of the market?

The structure of the market is well defined in having a number of sponsors enabling Indirect Access to all types of PSPs. Each of the payment systems has clearly defined requirements for Direct Access and it is through the Direct Access PSPs that Indirect Access is obtained through contractual arrangements and Ts&Cs. As a Direct PSP in the main payment systems we have no specific views on these; however, we are an Indirect PSP for CHAPS obtaining our services from HSBC. Over the years we have considered the offerings from alternative providers and have not pursued them for various reasons.

II. What factors may limit the number of Sponsor Banks offering Indirect Access to payments systems?

Whether or not a Direct PSP becomes a Sponsor has to be based on the business case for that PSP. There are contractual terms etc. that need to be in place, a competitive pricing proposition and more importantly the access arrangements in terms of connectivity to the network carrying payment files or individual items. To manage these, the Direct PSP needs to have adequate relationship management capabilities to support Indirect Access. The fact that there are only four prime sponsors, these being the 'Big Four' on the high street, would suggest that the associated costs and arrangements required are significant and could be a barrier to smaller Direct PSPs entering into the Sponsorship market.

III. What might a competitive Indirect Access offering look like?

The purpose of this review and the scope is supposedly looking at PSPs and does not go into service users (see section 2.7); if the review is to investigate the provision of services by the Indirect PSPs then this should be clearly stated. A competitive offering would obviously have a number of Direct PSPs being approached by potential Indirect clearers who have the opportunity to take up services at a reasonable cost, with clearly defined SLAs, good relationship management and also the ability to be released from contract with ease so that alternative supply can be procured at reasonable cost, effort and timescales.

Feedback

- We agree in principle with the key questions and issues to focus on, however noting that this should be confined to Direct and Indirect PSPs only as suggested in section 2.7 and not include service users in its widest sense as suggested in Issue III.
- We also agree that the review should focus on the main payment systems as stated.
- The review should focus on services provided by Sponsor Banks and also investigate what Indirect PSPs really require from their Sponsor so that we have a full analysis of the market and conditions within.

Yours faithfully



PAUL HORLOCK

Head of Payments

Payments Council

Note



24 April 2015

To Payment Systems Regulator

DRAFT TERMS OF REFERENCE - PSR MARKET REVIEW INTO THE SUPPLY OF INDIRECT ACCESS TO PAYMENT SYSTEMS (PSR MR15/1) - PAYMENTS COUNCIL RESPONSE

1 INTRODUCTION

The Payments Council welcomes the opportunity to provide feedback on the Payment Systems Regulator's Draft Terms of Reference for its planned *'Market Review into the supply of Indirect Access to payment systems (PSR MR 15/1)'*.

The Payments Council is supportive of the new economic regulator and what it aims to achieve for the industry and its customers. The UK is already a world-leader in its payment systems and services and the Payment Systems Regulator (PSR) can play a positive role in helping the industry to maintain and enhance that position.

We are broadly supportive of the purpose and scope of the Market Review and would be pleased to provide input to the PSR, if required, once the Market Review commences.

We are pleased to note that the draft Terms of Reference highlights the work that the Payments Council has already undertaken to create an information hub (www.accesstopaymentsystems.co.uk). It was set up to help financial providers wanting to access payment systems, and was developed after analysis we undertook identified a lack of transparency on information regarding access.

www.access.paymentsystems.co.uk was developed to help organisations such as banks, building societies or other payment service providers, who need access to the UK's payment systems. It provides these organisations with an information resource setting out their options for connecting to payments systems, including information on both direct and indirect access, and directs them to the relevant payment scheme's website. The



information provided is, we believe, particularly helpful to new entrants to banking who need to provide one or more payment services as part of their customer product offering.

The draft ToRs also reference the Sponsor Bank Code of Conduct. The Sponsor Banks have now created a draft Code and the Payments Council will help facilitate the process of getting the final text agreed and approved by the PSR as soon as possible in readiness for having it in place by the deadline of 30 June 2015. The Code of Conduct will be hosted on www.accesstopaymentsystems.co.uk. We will continue to work closely with the PSR as the Code of Conduct is developed to ensure that it meets the PSR's expectations of scope and implementation.

One aspect of the discussions we have been having with PSR colleagues on the Code of Conduct is around the scope, particularly the PSR's view that the term 'Sponsor Bank' may apply to more than the four¹ banks that currently provide indirect access on an advertised commercial basis. A few parts of the draft Terms of Reference could be read to imply that it is only focused on the four Sponsor Banks providing access on an 'advertised commercial basis'. However, we do note that on page 5, section 2.9 this is clarified and aligns the market review scope with the Code of Conduct scope i.e. the review includes the four Primary Sponsor Banks, "other banks" who may be direct PSPs and are providing indirect access and also Indirect PSPs who are considered to be providing indirect access. We think it will be helpful to keep the scope of the Code of Conduct and the Market Review broadly aligned.

2 RESPONSES TO QUESTIONS

Please find below some comments in relation to the specific questions put forward in the Draft Terms of Reference.

2.1 Do you agree with the key questions?

We broadly agree with the scope of the Market Review and the key questions proposed. However, as noted in section 2.3 below, we also believe that the dynamics of the market in Indirect Access go wider than the Sponsor Bank / Agency Bank relationship. As such, we believe that it would be beneficial for the PSR to consider the broader regulatory environment with regards to payments and indirect access to payment schemes and not focus solely on access.

¹ The number is currently five, but one will soon be exiting the Sponsor Bank market.



For the second market review question (What factors may limit the numbers of Sponsor Banks offering Indirect Access to payment systems?) the PSR is proposing to ask what prevents more PSPs becoming Sponsor Banks. Going back to the scope comments made earlier in our response, the fact that the review (and the Code of Conduct) scope effectively classes any direct or indirect PSP providing indirect access as a “Sponsor Bank” by default this may then become quite confusing. The scope section (2.9) of the draft terms of Reference refers to “all Sponsor Banks” as distinct from the “primary Sponsor Banks”, so by definition, there are a lot of banks who are actually considered by the PSR to be Sponsor Banks over and above the primary four. Therefore, perhaps the PSR might consider exploring what prevents more PSPs offering indirect access on an ‘advertised commercial basis’ – as only four organisations (the primary Sponsor Banks) do that currently, hence the view that there is limited supply of indirect access services.

2.2 Do you agree the review should focus on the main interbank payment systems: Bacs, Chaps, FPS, Link, C&C?

Yes.

2.3 Do you agree that the review should focus on the services provided by Sponsor Banks to Indirect PSPs?

While we agree that the services provided by Sponsor Banks are an important aspect of the agency proposition, we also believe that there are other vital elements that should be taken into consideration. We would welcome the PSR broadening this market review to include reviewing the economics and business models behind why participant PSPs chose to join a payment scheme indirectly via a sponsor PSP rather than directly, and the provision of services from PSPs to other PSPs in accessing payment systems. We believe that developing a deeper understanding of the economics of the supply of indirect access generally would be positive.

As we have noted in previous consultation responses, the Payments Council has undertaken work to identify the key issues associated with access and to take forward actions in response. Our focus was on the non-commercial aspects of access and those that are in the collaborative space rather than specific to individual payment schemes.

We sought to engage with both smaller and incumbent financial institutions, payment schemes, infrastructure providers, government and regulators to explore and identify the issues payment service providers have faced (whether perceived or real) in accessing payment systems.



At a high level, we have found that smaller financial institutions face three key considerations when accessing the payment systems:

1. their ability to provide customer propositions in a competitive environment but on a level playing field;
2. how to meet the technical and system requirements to secure access to the full range of payment systems; and
3. how to put settlement and liquidity arrangements into place.

It is these liquidity and collateral requirements, and the need to set up and run their own complex IT systems, that provide the real cost barriers to new and challenger institutions.

Following on from our earlier comments on scope, we also believe it would be useful for the PSR, in this Market Review, to differentiate between a “Sponsor Bank” who is one of the primary four offering indirect access on an advertised commercial service and other direct scheme members who are considered Sponsor Banks by virtue of the PSR’s scope definition, and also indirect PSPs providing indirect access who are also considered Sponsor Banks under the scope definition. This is because the primary four have a set-up that supports the commercial offering – i.e. a department and staff solely dedicated to dealing with their Indirect Access customers and specific agreements for this service – whereas other “Sponsor Banks” who don’t offer a commercial service will likely have a very different set up – especially if they are Indirect PSPs themselves. Those types of “Sponsor Banks” may not even consider themselves as such. We think that the PSR should be mindful of these differences when conducting their research.

Finally, we also support the PSRs objectives around improved technical access provisions. As part of the World Class Payments project, the Payments Council (and the new trade association for the payments industry that will replace it this summer) will be assessing what is required to enable PSPs to have fair and transparent access to payment services with common technical standards, rules and practices, where it isn’t already the case. We recognise that many institutions choose to access the payment systems through other institutions because it suits their business requirements, and the payments landscape must acknowledge and enable that to happen seamlessly.

We also believe that it is helpful that the Market Review on access is being undertaken concurrently with a Review into infrastructure. We believe there are likely to be overlapping points emerging from the two and it is sensible to look holistically across the landscape.

Positive Money

Dear Indirect Access Market Review team,

With regards to the key questions and issues on which you intend to focus this review, we think that more attention should be given to the barriers to PSPs getting direct access (which is usually preferable than indirect access).

In particular:

1. Is it not the case that Indirect Access solutions only exist because there are barriers to entry that prevent PSPs getting Direct Access (their preferred option)? The PSR's 'Access to Payment Systems' paper mentioned hearing from many PSPs that "they want Direct Access, but are unable to become Direct PSPs...and must therefore rely on a Sponsor Bank for Indirect Access".
2. If this is the case, shouldn't the key question be, how can the barriers to Direct Access be removed?
3. The greatest potential for competition in the PSP industry is likely to come from technology firms that register as Electronic Money Issuers (EMIs). However, EMIs are currently forced to go through Indirect Access because they are denied BoE settlement accounts. This is despite the fact that, by any measure, an EMI takes far less risk with its customers' funds than a conventional bank.
4. Therefore, isn't there a strong case for EMIs to be given settlement accounts at the Bank of England?

We would therefore recommend the following question be added to the Terms of Reference:

- Would removing the barriers to Direct Access have a greater impact than efforts to improve the market for Indirect Access services?

We discussed some of these issues with the Competition and Markets Authority when they were considering launching the full review into competition in personal and business current accounts. Our comments to the CMA are reflected in our paper on increasing competition in payment services. Once the final terms of reference are released, we will make a more detailed submission with regards to the provision of settlement accounts by the Bank of England.

Best wishes,

Ben Dyson

Head of Research

Positive Money

0207 253 3235

07986 823361

Santander UK

Santander UK plc
Response to Payment Systems Regulator: Draft Terms of Reference for Market
Reviews
24 April 2015

- 1) Santander UK plc (hereafter Santander) welcomes the opportunity to respond to the Payment Systems Regulator's (PSR) draft terms of reference for its proposed market reviews into i) the ownership and competitiveness of infrastructure provision; and ii) the supply of indirect access to payment systems.
- 2) As a scale challenger in the UK retail banking market, and part owner of UK payment systems with a circa 5% market share, Santander is committed to working with the new PSR to ensure the delivery of world class payments systems, supporting an increasingly digital world and customer.
- 3) Below, we consider both market reviews. However, before turning to our specific comments, we have a number of high level observations relating to:
 - (i) how these market reviews fit into the current payments and banking environment; and
 - (ii) the importance of ensuring that these reviews conclude in a manner which leads to coordinated and improved outcomes for customers and payment systems users.
- 4) The timescales for the reviews, planned to commence circa late May 2015 and run for approximately 12 months, will mean it is of paramount importance that remedies are developed in a transparent and coordinated manner with other regulators currently conducting large scale banking-related structural reform projects and market investigations or market studies.
- 5) For instance:
 - We call for detailed coordination at both senior and working level with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) in relation to the development of Banking Reform, for which final rules are due to be published in H1 2016.
 - We are expecting the Competition and Markets Authority's Retail Banking Market Investigation to conclude in May 2016, potentially introducing significant remedies in the UK banking market.
 - The FCA is working on a number of market studies in relation to credit cards, corporate and investment banking, mortgages (expected) and cash savings (concluded). Each of these may result in remedies required for the banking industry.
- 6) The first half of 2016 is therefore emerging as a key period during which the conclusions, remedies and final rules of a number of these structural and competition-related regulatory reforms will be published. While we support measures which increase competition and choice in retail banking, these measures should not conflict, contradict each other or place additional pressure on bank infrastructure to manage change. In particular, any additional pressure on infrastructure during the

implementation of Banking Reform will risk both the stability of core systems and the quality of service we can provide to our customers.

- 7) Santander is keen to work with regulators to ensure that the long term future of the banking sector is kept front of mind as the array of structural reforms and competition related reviews conclude.

Market review into the ownership and competitiveness of infrastructure provision

- 8) Santander agree with the proposed scope and the issues posed for focus in this market review. In terms of the review's scope, we suggest that the Cheque Company should be brought into the scope of the review to ensure that their direction, both now and in the future, is aligned. We agree that CHAPS does not need to be brought into scope given its distinct nature.
- 9) In relation to other issues relevant to this review which should be included, while we recognise the need for an open and competitive market, it is important to ensure that sensitivity and confidentiality of payments data is maintained.
- 10) We recognise concerns previously expressed about ownership of the System Operators and consider that a market review is a positive opportunity to consider the relationships in a fair and reflective way. As Santander has highlighted in previous consultation responses, we believe the number of Schemes creates further challenges, particularly given the need to compete against each other as individual companies. This reduces the ability to provide a single vision of consolidation and simplification to support the innovation agenda. One single Scheme Company – covering Bacs, Cheques, Faster Payments and Link, which all become services under the single company structure as CASS is today – would simplify this and drive the optimum agenda for innovation. As such, we believe this must be a primary focus of the market review.

Market review into the supply of Indirect Access to payment systems

- 11) Santander agrees with the proposed scope and the issues posed for focus in this market review. As the only retail bank involved in ownership of the payment systems but not acting as a sponsor bank, we are uniquely placed to participate in the market.
- 12) In relation to other issues relevant to this review, we believe that it should not prevent or delay the opportunities for banks to improve indirect access to payment systems to other providers. The complexity of systems presented in this area is significant, and at a time when banks will be seeking to implement Banking Reform changes, there will need to be thorough and robust consideration given to how the model is evolved, without overloading the current sponsor banks and System Operators beyond reasonable stresses. This will help ensure that banks like Santander are able to maintain focus on placing customer needs at the heart of our business and on providing a service which is simple, personal and fair.

Virgin Money

Indirect Access Review Team
Payment Systems Regulator (15th Floor)
25 The North Colonnade
Canary Wharf
London
E14 5HS

24 April 2015

Dear Sir/Madam

Financial Conduct Authority (FCA)/Payment Systems Regulator (PSR) Consultation Paper on Market review into the supply of Indirect Access to payment systems: Draft Terms of Reference (PSR MR15/1)

We welcome the market review of Indirect Access to payment systems in the UK and support the proposed Terms of Reference. We include below comments on each of the specific points raised in paragraphs 2.12 and 3.1 in the Draft Terms of Reference, and will be happy to provide responses to questions which arise as the market review proceeds.

I. Market structure

We support the intention of the PSR to develop an economic framework for Indirect Access. We believe that Sponsor Banks should be able to earn a fair return, allowing for their costs and risks associated with the provision of Indirect Access to payment systems - but that they should not gain 'unfair' advantage from the concentration of the supply of Indirect Access in four large banks that, furthermore, are broadly similar to each other.

We recognise that smaller Payment Service Providers (PSPs) can achieve significant benefits from being able to gain Indirect Access rather than having to make the investments, in areas such as building infrastructure and achieving compliance with payment systems' Access Requirements, which would be necessary for them to gain Direct Access. So, while we agree that Direct Access should not be in scope of the review, we think that, as well as developing an economic framework for Indirect Access, the review should consider the relative costs and benefits of Indirect Access versus Direct Access.

We think that consideration should also be given within the review to Technical Access Solutions, such as those set out in paragraph 4.263 of *Access to payment systems* (PSR CP14/1.4), since:

- they could enable Indirect PSPs to become Direct PSPs, or could provide a middle ground between Indirect Access and Direct Access; and
- they could make it easier for PSPs to gain access to multiple payment systems.

II. Sponsor banks

We support the intention to understand better the barriers which are preventing more PSPs from becoming Sponsor Banks and believe that an increase in the number of sponsoring institutions would further drive competition and choice in this particular market, with potential subsequent downward pressures on pricing and an increase in the quality of service.

We note in paragraph 4.201 of CP14/1.4 that Sponsor Banks must have Direct Access to the payment systems, IT systems capable of sending and receiving payment instructions on behalf of Indirect PSPs, and appropriate operating and accounting systems to deliver a service compliant with regulation and to manage a range of risks associated with providing Indirect Access (including ensuring compliance with AML and sanctions regulations).

This list of requirements seems demanding, especially given that the provision of Indirect Access is likely to represent a small part of a banking group's activities.

We regret the withdrawal of Co-operative Bank from the provision of sponsor services, and would welcome the entry into this market of PSPs that are different from the big four banks and that would add to diversity and competition, including for new entrants to payments services that aspire to offer innovative products that bring benefits for consumers. For the prospect of such new entry to be realistic, we think that entry to, and the ongoing provision of Indirect Access, should not be unduly onerous in terms of the costs and risks associated with providing services across different types of Indirect PSPs. That said, we believe the regulatory authorities will need to consider and strike the appropriate balance between making sponsor provision more attractive and not compromising the resilience and financial stability of the payments system.

We note in paragraph 4.239 of PSR CP14/1.4 that some Indirect PSPs have concerns regarding the continuity of the supply of Indirect Access they receive from their Sponsor Banks. The loss of supply would create problems for any Indirect PSP (as recognised in paragraph 4.241), but would be a particular problem for a bank or building society with over £25 billion of retail deposits, which must meet the ring-fencing requirements for continuity of services, but which has only limited activities in payments and so uses Indirect Access. We believe that the review should examine this as part of its work programme.

III. Competitive market

We support the intention to assess whether the provision of Indirect Access to PSPs is consistent with a competitive market, in terms of factors such as the quality of services and pricing. We think that making this assessment in this manner will provide a very useful objective appraisal as to whether the market is competitive, despite the limited number of providers, or whether there are shortcomings that need to be addressed.

We also agree with the intention to assess whether Indirect PSPs have a real choice of Sponsor Bank. We suggest that, as well as assessing the limited choice faced by PSPs when they initially seek to secure Indirect Access, consideration should be given as to whether it is realistic or feasible for PSPs subsequently to switch from one Sponsor Bank to another, given the risks, costs and any other possible constraints.

In assessing whether the market is competitive, we agree with paragraph 1.3 of the Draft Terms of Reference that the review should consider whether current arrangements are delivering good outcomes for consumers and organisations that use payment systems. We assume that the review will consider the outcomes for both PSPs using Indirect Access and for consumers using payment services provided by Indirect PSPs.

Payment systems in scope

We agree that the review should focus on the main interbank systems: Bacs, CHAPS, Faster Payments Scheme (FPS), LINK and Cheque & Credit (C&C), and that it should exclude card payment systems.

Services in scope

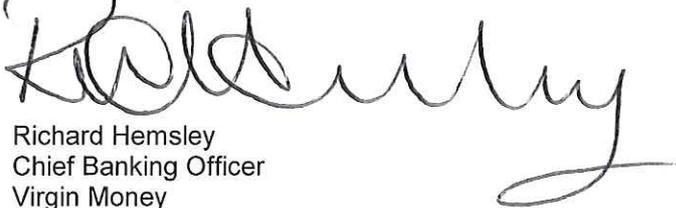
We agree that the review should focus on the services provided by Sponsor Banks to Indirect PSPs. We support the proposals not to include the provision of access to corporate customers such as utilities and retailers, or international correspondent banking relationships.

Other matters

We are pleased to note that the PSR has decided to apply the Direction to publish access-related information to the four primary providers of Indirect Access and require them to comply with the Sponsor Bank Code of Conduct. In connection with this, we are also pleased that the Payments Council is developing the Information Hub website, and that the Sponsor Banks are working on the Code of Conduct.

We would be delighted to support the PSR's ongoing work in this area, and look forward to contributing further to the market review as it progresses. Please do not hesitate to contact me should you wish to discuss our views further prior to the finalisation of the Terms of Reference.

Yours faithfully



Richard Hemsley
Chief Banking Officer
Virgin Money