

# Ownership, governance and control of payment systems



This Supporting Paper supports the PSR's Consultation Paper '*A new regulatory framework for payment systems in the UK*'. It specifically outlines our approach to ownership, governance and control of payment systems that forms part of our broader overall framework for the regulation of UK payment systems.

As with all of our proposals in this consultation, they have been designed to further our objectives of promoting competition, innovation and the interests of service-users. This Supporting Paper is designed for those stakeholders who want a more detailed understanding of our proposed approach.

We are asking for comments on this Consultation Paper by 5pm, Monday, 12 January 2015.

You can send your comments and responses to our consultation questions by email to [PSRconsultations@psr.org.uk](mailto:PSRconsultations@psr.org.uk).

You can also respond in writing to the address below (although we ask all respondents to also provide electronic Word and PDF versions of their response).

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Consultation response team  
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We will publish all non-confidential responses to our Consultation Paper along with our final Policy Statement.

We will not regard a standard confidentiality statement in an email message as a request for non-disclosure. Stakeholders who wish to claim commercial confidentiality over specific items in their response should make sure to fill in the cover sheet accordingly, and to identify those specific items which they claim to be commercially confidential by **highlighting them in yellow**.

We may nonetheless be required to disclose all responses which include information marked as confidential, in order to meet legal obligations, in particular if we are asked to disclose a confidential response under the Freedom of Information Act 2000. We will endeavour to consult you in handling such a request. Any decision we make not to disclose a response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Consultation Paper from our website: [www.psr.org.uk](http://www.psr.org.uk)

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# A.

## Introduction

- 3.1 Stakeholders have raised concerns about the ownership and control of payment systems. Important decisions on the way payment systems are operated and developed are made by the boards of Operators. In particular, the control of payment systems by a small group of PSPs is leading, in some cases, to limited openness, innovation and representation of the interests of service-users.
- 3.2 To address these concerns, in the most effective and proportionate manner, we will change the way these systems are controlled and governed, and how decisions are made. This is particularly relevant to not-for-profit interbank Operators whose owners have the ability to control and influence the payment systems' rulebooks. To achieve this, our proposals include the following:
- All Operators will be required to ensure the interests of service-users are appropriately represented in Interbank and Card Operators' decision-making processes
  - Interbank Operators will need to ensure that individuals are not simultaneously a director of both an Interbank Operator and of a Central Infrastructure Provider to that payment system
  - All Operators will be required to publish their board minutes and votes in a timely manner, including a statement of how independent directors have exercised their discretion in relation to public interest matters
  - Operators will be required to report annually on how they have complied with our directions
- 3.3 We expect our proposals to change the dynamics of, and voting on, Operator boards and how control over payment systems is exercised.
- 3.4 We will evaluate both how Operators implement our proposals and also, once implemented, their impact on the control of payment systems. If our proposals do not produce the results we intend, we will take further action, including using our divestment power if appropriate and proportionate.
- 3.5 This Supporting Paper is divided into seven parts:
- **Part A:** this introduction.
  - **Part B:** provides a background on ownership, governance and control of payment systems.
  - **Part C:** sets out the concerns regarding the representation of the interests of service-users, including a summary of the relevant evidence; our assessment of the concerns raised; how those issues impact on our objectives; our proposals; and the costs and benefits of the proposals.

- **Part D:** sets out the concerns relating to actual or potential conflicts of interest arising from the governance arrangements of Interbank Operators, including a summary of the relevant evidence; our assessment of the concerns raised; how those issues impact on our objectives; our proposals; and the costs and benefits of the proposals.
- **Part E:** sets out the concerns regarding transparency and clarity of decision-making, including a summary of the relevant evidence; our assessment of the concerns raised; how those issues impact on our objectives; our proposals; and the costs and benefits of the proposals.
- **Part F:** sets out the concerns regarding the Payments Council's contractual arrangements with the Interbank Operators, and our assessment of the concerns raised.
- **Appendix:** contains a Guidance Checklist of items Operators may wish to consider when carrying out a governance review.

3.6 Expressions and acronyms we use are defined as appropriate in this Supporting Paper and in our *Glossary*. Where expressions are capitalised in the text (e.g. 'Operator'), a more detailed definition is included in our *Glossary*, which is included in *Annex 1* to our Consultation Paper.

## B. Background

- 3.7 Ownership and governance of the Operators ultimately determines how **control** is exercised over the payment systems in terms of their operation, access and development. We must be sure that appropriate governance measures are in place so that the extent and manner in which control is exercised over the Operators of payment systems does not adversely impact on our ability to further our objectives of competition, innovation and the interests of service-users.
- 3.8 The ownership, governance and control of UK payment systems has developed to incorporate various recommendations from:
- The Child Report (1984), which recommended the creation of individual clearing companies (the Operators) limited by shares, where the control and ownership of the companies was to be in the hands of all participating member institutions rather than just the major clearing banks and building societies.<sup>1</sup>
  - The Cruickshank Report (2000), which identified various issues, noting that in some other 'shared utility' industries there had been a trend away from mutual governance arrangements.<sup>2</sup>
  - The Bank, having regard to the Principles for Financial Market Infrastructures published by CPSS-IOSCO in April 2012 (CPSS-IOSCO Principles). The Bank adopted these Principles under section 188 of the Banking Act 2009 for payment systems recognised by the Treasury for oversight by the Bank (i.e. Bacs, CHAPS and FPS). This includes in particular the CPSS-IOSCO Principles for governance and transparency, including the appointment of independent directors and chairs, which state that Operators should have "*governance arrangements that are clear and transparent...and support...public interest considerations, and the objectives of relevant stakeholders*".
- 3.9 A Task Force established in 2004 by the OFT to consider concerns raised by the Cruickshank Report launched a revised governance model for the UK payments industry in 2007. This resulted in the creation of the Payments Council, a "*new, high-level, body with responsibility for governance across the payment systems market*".<sup>3</sup> See *Supporting Paper 2: Payments industry strategy and areas for collaboration* which examines the role of the Payments Council

1 The earliest banks to join after these changes were Citibank and Standard Chartered who joined CHAPS in 1985 and Halifax and Abbey National who joined Bacs in 1987. Payment Clearing Systems, Review of Organisations, Membership and Control (1984), see '*Recent developments in UK payment clearing systems*' published in the Bank's Quarterly Bulletin (1987). <http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/1987/qb87q3392394.pdf>.

2 Specifically, it noted that while the mutual governance arrangements had some benefits they also involved some inherent drawbacks and that "*the main problem is that schemes are run in the interests of the banks that own them. This produces inefficient outcomes when the interests of the controlling banks diverge from the public interest. And payment systems have other stakeholders whose interests are not directly represented in decisions about their development. These include personal consumers, business customers, government and potential new entrants.*" See the Cruickshank Report, formally titled '*Competition in UK Banking: A Report to the Chancellor of the Exchequer*' (March 2000) – paragraph 3.61, p68, available at <http://webarchive.nationalarchives.gov.uk/20050301195359/http://hm-treasury.gov.uk/media/805/C0/BankReviewChaptthree.pdf>

3 See Final report of the Payment Systems Task Force, foreword at [http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.ofg.gov.uk/shared\\_ofg/reports/financial\\_products/oft901.pdf](http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.ofg.gov.uk/shared_ofg/reports/financial_products/oft901.pdf)

in more detail. In relation to MasterCard and Visa, the OFT concluded that it no longer felt the governance arrangements for card payment systems were a priority area and that it did not plan further work at that time.<sup>4</sup>

- 3.10 This Supporting Paper looks at ownership, governance and control of payment systems.

### Operation of the payment systems

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- 3.11 In the UK, payment systems are managed by companies (such as BPSL and FPSL) or, in the case of the LINK payment system, the LINK Scheme, which we refer to as Operators. For each Interbank Operator there is a relatively small executive with responsibility for the day-to-day operation of the payment system. Responsibilities typically include:

- on-boarding new participants to the payment system in line with Access Requirements (namely, the rules (including criteria), terms or conditions (including fees and charges), policies or procedures governing access to or participation in a regulated payment system)
- managing the common rules to enable the transfer of funds
- making arrangements for the provision of the infrastructure needed to operate the payment system.

### Governance of the Operators

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- 3.12 For each Operator, the executive reports to a corporate board, or in the case of the LINK Scheme, a Network Members Council (NMC). The boards (or the NMC) make decisions and ratify recommendations, for example, relating to changes to the way that the payment systems are managed and operated (e.g. budgets, staffing levels, supplier contracts) and the systems' rules (e.g. Access Requirements).

- 3.13 The boards act and make decisions within a governance framework constrained by legislation, the constitution of the Operator (the Memorandum and/or Articles of Association or equivalent constitutional document of a company, organisation or association) and any applicable regulatory requirements.<sup>5</sup>

- 3.14 For each Operator (excluding the Operators of LINK and MasterCard), the boards are made up of directors who are appointed by the Direct PSPs who participate in the relevant payment systems, alongside one or more independent, and in some cases executive, directors. LINK Scheme has an arrangement where all PSPs that participate in the LINK payment system are represented on the NMC. MasterCard's participants do not appoint directors to its board.

- 3.15 We set out below our understanding of the governance arrangements of each of the Operators:

#### **a. Bacs Payment Schemes Ltd (BPSL)**

- BPSL is a membership-based, not-for-profit company, limited by guarantee.
- BPSL operates the Bacs payment system that processes payments through two principal electronic payment schemes: Direct Debit and Bacs Direct Credit.

<sup>4</sup> See OFT press release, 22 February 2007 at <http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.of.gov.uk/news-and-updates/press/2007/31-07>

<sup>5</sup> E.g. Part 10, Chapter 2, Companies Act 2006 (General Duties of Directors); Section 175 imposes an obligation on directors to avoid conflicts of interest with the interests of the company. <http://www.legislation.gov.uk/ukpga/2006/46/contents>



- Each member of BPSL (i.e. Direct PSPs) appoints a director. There are two independent directors (including the chair) and an executive director. Each Direct PSP may also appoint an alternate director. Votes of Direct PSP-appointed directors are based on transaction volumes. Independent directors have the power to block certain proposals in order to protect the public interest.<sup>6</sup>

**b. Belfast Bankers' Clearing Company Ltd (BBCCL)**

- BBCCL is a membership-based, not-for-profit company, limited by shares.
- BBCCL operates the NICC payment system that processes cheques and other paper instruments in Northern Ireland.<sup>7</sup>
- Each of the four Northern Irish banks which are members (Direct PSPs) appoints a director and an alternate director. There are three independent directors (including the chair).

**c. Cheque and Credit Clearing Company Ltd (C&CCCL)**

- C&CCCL is a membership-based, not-for-profit company, limited by shares.
- C&CCCL operates the C&CC payment system that processes cheques and other paper instruments in England, Wales and Scotland.
- Each member (Direct PSP) is entitled to appoint a director, and an alternate director. There are three independent directors (including the chair) and an executive director. Independent directors have the power to block certain proposals in order to protect the public interest.

**d. CHAPS Clearing Company Ltd (CHAPS Co)**

- CHAPS Co is a membership-based, not-for-profit company, limited by shares.
- CHAPS Co operates the CHAPS payment system, which is the UK's real-time, high-value sterling payment system.
- Each member (Direct PSP) appoints a director. There are three independent directors (including the chair) and an executive director. Independent directors have the power to block certain proposals in order to protect the public interest.

**e. Faster Payments Scheme Ltd (FPSL)**

- FPSL is a membership-based, not-for-profit company, limited by guarantee.
- FPSL operates the FPS payment system that provides near real-time payments as well as Standing Orders.
- Each member (Direct PSP) appoints a director and an alternate director. There are three independent directors (including the chair) and an executive director. Independent directors have the power to block certain proposals in order to protect the public interest.

**f. The LINK Scheme**

- The LINK Scheme is an operating division of Vocalink<sup>8</sup> and operates the LINK payment system that enables end-users to take cash out of their accounts (amongst other activities) using the network of ATMs in the UK.

<sup>6</sup> The existing test set out in the Articles of Association of BPSL, C&CCCL, CHAPS Co and FPSL defines a Public Interest matter as: "... [a matter concerning the system operator, the payment system it operates] and the payments industry for the long term benefit of the UK, its citizens and businesses as a whole, with particular emphasis on customer needs, competition, innovation, reducing barriers to entry in the payments industry and limiting systemic risk".

<sup>7</sup> BBCCL's rules mirror C&CCCL's rules for cheque clearing in Great Britain and work on a "2-4-6" basis. However, NICC has a different operational business model. BBCCL does not play any operational role whereas C&CCCL manages the paper exchange, IBDE network, clearing and settlement through the Bank. An equivalent of the IBDE network does not exist in Northern Ireland; instead there is daily bilateral exchange and net bilateral settlement between the four banks which are Direct PSPs of NICC.

<sup>8</sup> Vocalink is a major supplier of infrastructure services used for the purposes of operating the Bacs, FPS and LINK payment systems, and is a Central Infrastructure Provider as defined within this Consultation Paper (see *Supporting Paper 6: Regulatory tools* under **Part B**).

- The Operator is governed by a NMC consisting of all members (Direct PSPs). The NMC has an independent chair.
- LINK's assets, such as brand and intellectual property rights, are controlled by VocaLink. The LINK Scheme is administered by a ring-fenced group of VocaLink's employees.<sup>9</sup>

**g. MasterCard Inc.**

- MasterCard Inc. is a public company limited by shares and listed on the New York Stock Exchange. Its principal operating subsidiary is MasterCard International and there are various other subsidiaries.
- Participants in the payment system operated by MasterCard do not have a right to appoint board directors: instead, participants are granted licences. Independent directors to the MasterCard Inc. board are appointed by the board (on recommendation of the Nominating and Corporate Governance committee). The board comprises a President/CEO and 11 independent directors.

**h. Visa Europe/Visa UK Limited**

- **Visa Europe** is a private company limited by shares, with all Visa Europe members being shareholders in Visa Europe Limited. The board of **Visa UK Limited** has delegated authority from Visa Europe to operate and develop the Visa business in the UK, including setting certain domestic rules.
- The eight Visa UK members with the highest transaction volumes each appoint a director to the Visa UK board with four or five industry directors elected on a constituency basis from the remaining members of Visa UK. Visa Europe owns a special share that enables it to appoint up to three directors to the Visa UK board. There are two independent directors, including the chair, neither of whom has a veto.
- Visa Europe is a separate company from the US-based **Visa Inc.** However, Visa Europe has a 'put option' that, if exercised, would require Visa Inc. to buy it. Visa Europe pays a licence fee to Visa Inc. for processing services and the use of the brand in Europe.
- For our purposes, we consider that Visa Europe and Visa UK Limited are collectively the Operators of the Visa payment system.

## Ownership and control of Operators

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3.16 The focus of this paper is on the role of governance in determining how the Operators are controlled. However, a crucial related issue is who exercises that control. This is ultimately determined by who owns or has an interest in the Operators.

3.17 This section sets out the current ownership, governance and control arrangements for the Operators of regulated payment systems.

### Interbank Operators (other than the LINK Scheme)

3.18 Under the governance arrangements described above, any PSP with Direct Access to an interbank payment system can appoint a director to the board of the Operator of that system.

3.19 We understand that PSPs who have Direct Access to interbank payment systems (other than LINK) own an interest in the company which manages and operates that payment system,

<sup>9</sup> In this Supporting Paper we refer to the LINK Scheme as an Interbank Operator. It does not have an independent corporate form from VocaLink and is governed by the NMC (rather than a dedicated board of directors). However, the governance directions we make which apply to Interbank Operators apply in equal measure to LINK. We expect the NMC to implement all relevant directions we make which apply to Interbank Operators taking the LINK Scheme's specific circumstances into account.

either by owning shares in it, or, in the case of a company limited by guarantee, providing a guarantee to it.

- 3.20 In practice, a relatively small number of the Direct PSPs have an interest in all, or most, of the Interbank Operators, thereby giving them the ability to appoint directors to the boards of these Operators. This includes Barclays, HSBC, Lloyds Banking Group, Royal Bank of Scotland Group, Nationwide, Santander and the Co-operative Bank. See the table included under **Part B 'Industry Structure'** in *Supporting Paper 1: The PSR and UK payments industry* which shows these ownership interests.
- 3.21 Their ability to appoint directors to these Operator boards – which are responsible for the management and operation of the systems, including the system rules – gives these large banks (and building societies) the potential to exercise a significant degree of control and influence over the operation and development of these payment systems. The *effective* control that these large banks can exercise over Interbank Operators, through their interests in them, means that there need to be robust measures in place to prevent these payment systems being operated disproportionately in the interests of these PSPs.
- 3.22 We have the power to direct a person who has an interest in an Operator to dispose of all or part of that interest. However, we do not consider that this would be an appropriate and proportionate response to the concerns we have identified at this time for a number of reasons:
- Interbank payment systems have evolved as collaborative networks, run as not-for-profit entities and controlled and owned by the larger PSPs. Because of these relationships, Interbank Operators set charges to only recover costs. Under different ownership, the Operators and Infrastructure Providers may not have this incentive to keep prices low. This is an important factor we have considered in using our powers, and in particular our power to require the divestment of an interest in an Operator.
  - The nature of the interbank payment systems, and the vertical relationships surrounding the interbank payment systems, gives rise to concerns about the degree of control and influence over payment systems which can be exercised by the owners. The rules of many of the payment systems are determined jointly by boards of directors appointed by the owners. The larger Direct PSPs may have the potential to exercise a significant degree of control and influence to design the rules of Operators for their own benefit and against the interests of their competitors or new entrants. The important factor for us is how that control or influence over payment systems is exercised.
- 3.23 As such, we believe that addressing ownership by focussing on the governance of payment systems will be effective at addressing the concerns that arise because of the nature of the interbank payment systems (and the vertical relationships described above surrounding the interbank payment systems). This will ensure that payment systems are operated in the best interests of service-users, including how the interests of service-users are represented in decision-making processes at board level, conflicts of interest and transparency (see **Parts C, D and E** of this Supporting Paper).
- 3.24 However, in the event that our proposals on ownership, governance and control of payment systems do not produce the result we intend, we may examine whether there is a need to consider exercising our power in relation to disposals of interests in Interbank Operators.

### **LINK Scheme**

- 3.25 LINK is an operating division of VocaLink. LINK's assets, such as brand and intellectual property rights, are controlled by VocaLink.
- 3.26 In the case of the LINK Scheme, the NMC (rather than a board of directors) is responsible for the management and operation of the system, including the system rules. All Direct PSPs who access the LINK system are members of the NMC and represent their own interests in decision-making.

- 3.27 Our focus will be on governance and control of the LINK Scheme, specifically, by ensuring that payment systems are operated in the best interests of service-users including how the interests of service-users are represented in decision-making processes at board level, conflicts of interest and transparency (see **Parts C, D and E** of this Supporting Paper).

### Card Operators

- 3.28 MasterCard Inc. is a publicly listed company and the appointment of its directors does not result from participation in the MasterCard payment system.
- 3.29 Visa Europe and Visa UK operate a constituency model for the appointment of directors (see paragraph 3.15(h) above).
- 3.30 We do not intend to make any proposals relating to the ownership (or other interests) which PSPs have in the Card Operators at this time. Rather, we consider it more appropriate to focus on concerns relating to aspects of the governance and control of the Card Operators, specifically, by ensuring that payment systems are operated in the best interests of service-users including how the interests of service-users are represented in decision-making processes at board level and transparency (see **Parts C and E** of this of this Supporting Paper).

### The roles and responsibilities of board directors

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- 3.31 The default position under company law is that directors must act in a way that promotes the interests of the company for the benefit of its members, as a whole.<sup>10</sup> In the case of some Operators, the Articles of Association set out what the purpose, or success, of the company is in more detail given the nature of the company and the payment system it manages and operates.
- 3.32 While directors appointed by Direct PSPs, and any executive directors, are subject to the same duties as other directors, they also bring specialist knowledge and skills to an Operator's board in relation to banking, payments and payment systems.
- 3.33 Executive directors are responsible for the day to day management of the company including the implementation of decisions made by the board.
- 3.34 The role of independent directors, and non-executive directors more generally in terms of corporate governance, is to challenge and counsel the executive while maintaining independence. Independent directors may also bring additional skills to the board such as a background in consumer issues or technology. Independent directors may also chair key sub-committees of the board such as audit or risk committees. In the case of four of the Operators, the independent directors have a veto to protect the public interest (see paragraph 3.36 below).

### Decision-making processes at board level

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- 3.35 In the interbank payment systems, voting is rarely used in practice, with the boards preferring to reach a consensus. Voting is used where it has not been possible to reach a consensus and in certain situations which are set out in the Articles of Association. Details for all Operators can be found at Appendix B of the Accenture Governance Report pp. 40-61, included as an Annex to this Supporting Paper.

<sup>10</sup> Under s. 172 of the Companies Act 2006 "a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard to [factors set out in s172 (a) – (f)]". In addition, under s. 172(2) where the purposes of the company include other purposes, s. 172(1) "has the effect as if the reference to promoting the success of the company for the benefit of its members were to achieve those [other] purposes". See s.172 of the Companies Act 2006, available at <http://www.legislation.gov.uk/ukpga/2006/46/section/172>.

- 3.36 In the case of BPSL, C&CCCL, CHAPS Co and FPSL, independent directors have the ability to declare that a matter is in the 'public interest' which then enables them to exercise a veto, thereby blocking a proposal, in order to protect the public interest. Each of the relevant Operators defines a 'public interest' matter as a matter concerning the Operator, the respective interbank payment system and the *"payments industry for the long term benefit of the UK, its citizens and businesses as a whole, with particular emphasis on customer needs, competition, innovation, reducing barriers to entry in the payments industry and limiting system risk"*.

### Appointment of directors to the boards of Operators

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- 3.37 Although directors are required to act in the interests of the Operator as described above, there remains potential under this governance arrangement for the appointing PSP to influence their director in his or her decision-making capacity relating to the operation or development of the payment system. In some cases, governance arrangements exist which reinforce the link between the director and his or her employer, for example, if a director's allocated voting rights are based on the payments volume of their employer.
- 3.38 By contrast, other service-users, including Indirect PSPs, are not entitled to appoint directors to the boards of Interbank Operators, and therefore do not have the same level of influence over the Operators. This could result in systems being developed or operated in a way which favours Direct PSPs, to the detriment of service-users including Indirect PSPs. An example may be the potential for Direct PSPs (through Operators' boards) to influence Access Requirements to their advantage.
- 3.39 For this reason, in addition to examining the concerns raised to us by stakeholders, this Supporting Paper will cover:
- how to ensure that the interests of service-users, who do not appoint board directors, are appropriately represented in decision-making at the board level of Operators
  - incentives that Direct PSPs may have to influence the operation or development of the payment system to their advantage or to the detriment of other service-users

### What are the issues?

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- 3.40 Our analysis of feedback and engagement with stakeholders has identified a number of concerns relating to the current governance arrangements of the Operators. These concerns centre on:
- the representation of the interests of service-users in board level discussions and decisions impacting the operation and development of regulated payment systems (see **Part C**)
  - actual or potential conflicts of interest within Interbank Operators (see **Part D**)
  - transparency and clarity of decision-making for Operators (see **Part E**)

## C.

# Concerns about the representation of the interests of service-users

- 3.41 There are a number of routes through which service-users engage and provide their views to Operators:
- directly with the Operator
  - through the Direct PSP with which they have a relationship
- 3.42 We summarise concerns regarding these routes for service-user engagement below.
- 3.43 We also make an additional number of observations below regarding card payment systems.

### Direct engagement with Operators

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- 3.44 It has been noted by a number of service-users, (ranging from Indirect PSPs, to consumer and charity representatives) that under current governance arrangements (for both interbank and card payment systems), the views and interests of some stakeholders are not adequately considered or addressed by the Operators and their boards when decisions or discussions relating to the operation or development of the payment system take place.
- 3.45 Some stakeholders believe decisions are made in the interests of Direct PSPs, rather than other service-users. Some stakeholders expressed their views that the governance arrangements for Interbank Operators operate as a closed shop or are bank-centric. These views echo those from the Child Report and the Cruickshank Report as well as the OFT's Payment Systems Task Force.
- 3.46 Stakeholders have indicated that wider participation or greater representation in decision-making and governance of payment systems would be welcome. This would enable Operators to hear a broader range of views and perspectives. For example, one PSP noted that they have never been given an opportunity to engage in discussions about payment systems in their capacity as a major issuer of pre-paid cards.
- 3.47 Operators use a number of mechanisms to engage with service-users, including affiliate/user forums for some payment systems.<sup>11</sup> An Electronic Payments Affiliates Group covers BPSL and FPSL.<sup>12</sup> CHAPS Co has recently set up the Chaps Affiliates Group,<sup>13</sup> and C&CCCL runs an annual user forum. In some cases, views may also be obtained through the Payments Council's

11 Payments Council user forums, information available at: [http://www.paymentscouncil.org.uk/who\\_do\\_we\\_work\\_with/user\\_forums](http://www.paymentscouncil.org.uk/who_do_we_work_with/user_forums), Electronic Payments Affiliates, information available at <http://www.bacs.co.uk/Bacs/Affiliates/Pages/WhatsAnAffiliate.aspx>, and CHAPS Affiliate Group, information available at [http://www.chapsco.co.uk/chaps\\_services/chaps\\_affiliate\\_group](http://www.chapsco.co.uk/chaps_services/chaps_affiliate_group).

12 <http://www.bacs.co.uk/Bacs/Affiliates/Pages/WhatsAnAffiliate.aspx>

13 [http://www.chapsco.co.uk/chaps\\_services/chaps\\_affiliate\\_group](http://www.chapsco.co.uk/chaps_services/chaps_affiliate_group)

user forums.<sup>14</sup> The LINK Scheme has a Consumer Council which includes representatives from consumer organisations and PSPs.<sup>15</sup>

3.48 Views on the Operators' affiliate/user groups were mixed, for example:

- LINK Scheme – Some service-users thought that these mechanisms were effective. For example, LINK Scheme's Consumer Council received positive feedback from a number of consumer representatives we met with.
- BPSL and FPSL – The Electronic Payments Affiliates Group was described as consultative and informative but it was also noted that it did not take any action or add value. A corporate service-user noted there was limited scope to 'influence upwards' through the group and that the same issues were repeated over a number of years. A Direct PSP noted that it can often be difficult to corral the views of diverse affiliates into coherent messages for the board.
- CHAPS Co – The Operator for CHAPS only recently set up its own dedicated affiliate group in July 2014. One stakeholder has told us it is "*a promising start*".

### Engagement through Direct PSPs by service-users, including Indirect PSPs

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3.49 In addition to engaging directly with Operators through forums (and bilaterally), service-users may share their views with Direct PSPs in respect of particular payment systems.

3.50 Indirect PSPs rely on Sponsor Banks for information about changes to the payment systems. A small PSP noted that it did not feel that it was appropriately represented at the Operator's board through the Sponsor Bank from which it obtained payment services.

3.51 Some corporate service-users noted that the large banks tend to engage only when there is a commercial opportunity. They suggested that earlier engagement on issues would be helpful – so that they could make suggestions on implementation.

### Additional issues that apply for card payment systems

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3.52 We are not aware of affiliate groups that enable direct engagement with the Card Operators to formally represent the views of different service-users.

3.53 Some merchants have said they have no direct relationship with Card Operators, despite being subject to the rules, technical requirements and interchange fees<sup>16</sup> set by the Card Operators (including the costs associated with compliance and fines if they do not comply), and they called for greater representation.

3.54 The views of these merchants were echoed by large acquirers. One acquirer expressed concern that the Card Operators did not have clear accountability to those affected by their rules.

3.55 We received feedback from stakeholders that they considered that the Card Operators were "*issuer-centric*" which meant stakeholders such as acquirers struggled to have a voice in discussions.

<sup>14</sup> [http://www.paymentscouncil.org.uk/who\\_do\\_we\\_work\\_with/user\\_forums](http://www.paymentscouncil.org.uk/who_do_we_work_with/user_forums)

<sup>15</sup> <http://www.link.co.uk/Cardholders/Pages/ConsumerCommittee.aspx>

<sup>16</sup> See *Supporting Paper 5: Interchange fees*.



## Our assessment of these concerns

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- 3.56 The issue of representation of the interests of service-users other than Direct PSPs is longstanding and was highlighted by the Cruickshank Report in 2000. Cruickshank noted that “*those with full membership*” (i.e. Direct PSPs) had a range of benefits (not enjoyed by other service-users), including better information and influence over the governance of the payment systems.<sup>17</sup>
- 3.57 The concerns raised above (about Interbank and Card Operators) indicate that measures taken since the Cruickshank Report to give service-users, including Indirect PSPs, greater representation and influence on governance have not gone far enough.
- 3.58 As set out above, for the Interbank Operators, these measures have included the creation of the affiliate groups covering BPSL, CHAPS Co and FPSL, LINK Scheme’s Consumer Council and C&CCCL’s annual user forum, which are all designed to enable service-users to provide their views to the Operators on a range of matters.
- 3.59 The mixed views we have received about the effectiveness of the affiliate/user groups highlight the challenge of maintaining appropriate representation of the interests of service-users.
- 3.60 However, without appropriate mechanisms across all the Operators (both Interbank and Card Operators), the interests of some service-users may be neglected in the operation and/or development of payment systems.

## What are the impacts of these concerns?

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- 3.61 We are concerned that the current governance arrangements may adversely impact on our ability to advance our objectives of competition, innovation and the interests of service-users. We think the issues raised can have impacts in terms of competition, innovation and the quality and scope of services provided to service-users. We consider each of these impacts in turn below.

### Impact on competition

- 3.62 We consider that a failure to provide for the appropriate representation of the interests of service-users within Operators’ governance arrangements has the potential to impact on competition. For example:
- If decisions about the development of payment systems to enable services in downstream payments markets are influenced by a narrow group of stakeholders (such as the large PSPs noted in paragraph 3.20), without sufficiently considering the views or interests of service-users, including for example Indirect PSPs, this could result in the narrow group of stakeholders deriving a competitive advantage vis-à-vis the wider group.
  - A lack of a ‘wider voice’ in board discussions could prevent Operators from being made aware of the demand for changes to be made to rules, or new and improved services to be developed for service-users. For example, as set out in *Supporting Paper 4: Access to payment systems*, several Payment Institutions (PIs) and Electronic Money Institutions (EMIs) are interested in becoming Direct PSPs, but do not have the representation at board level to discuss and influence Access Requirements. This impacts on their ability to compete in the provision of payment services.
  - More generally, a lack of regular service-user representation at board level could adversely impact on the pace of innovation in downstream markets as external input and views will

<sup>17</sup> See the Cruickshank Report, formally titled ‘*Competition in UK Banking: A Report to the Chancellor of the Exchequer*’ (March 2000) – paragraph 3.146, p87, available at <http://webarchive.nationalarchives.gov.uk/20050301195359/http://hm-treasury.gov.uk/media/805/C0/BankReviewChaptthree.pdf>



need to be sought each time development is considered, instead of being provided as part of the normal decision-making process.

### Impact on innovation

3.63 We consider that governance arrangements which fail to enable a wide range of interested stakeholders to feed into discussions and decision-making about the operation and development of payment systems have the potential to adversely impact on the development of, and innovation in, payment systems. This is the case, for example, where:

- The scope of discussions and decision-making is limited to issues which concern a narrow group of stakeholders. In this case, there is a risk that the focus will be on 'maintaining the status quo' as opposed to developing payment systems that benefit service-users.
- As set out in *Supporting Paper 2: Payments industry strategy and areas for collaboration*, we believe that the views from a wide range of stakeholders will be important to drive forward change, in particular in relation to the development of, and innovation in, payment systems infrastructure.
- Specifically, if discussions and decision-making are limited to a particular type of institution – such as large credit institutions – there is a risk that payment systems are developed in a way which does not take into account the interests of other PSPs and service-users. We understand that much of the innovation in payment systems, and the services provided by payment systems, comes from smaller PSPs, Pls and EMLs and non-financial institutions such as retailers.<sup>18</sup>

3.64 Ultimately, we consider wide service-user representation to be important in delivering world class payment systems (also see *Supporting Paper 2: Payments industry strategy and areas for collaboration*).

### Impact on service-users

3.65 Inadequate arrangements and mechanisms to collect and consider views from a wide range of service-users may result in the payment systems being operated and developed in ways that do not benefit service-users. This could impact on:

- The scope of services (e.g. more limited) and the quality of services (e.g. inferior) than would otherwise be the case if the interests of service-users were better represented and service-users were better able to make their interests known to the boards of the Operators.
- The development and operation of payment systems may be more limited than would otherwise be the case, if the views and suggestions of service-users are not effectively or efficiently brought to the attention of the boards of the Operators.
- The inability of service-users to provide effective input into decision-making may result in situations where the impacts of operational decisions on service-users are not sufficiently considered by the boards of the Operators before being introduced.

## Our proposal on the representation of the interests of service-users

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3.66 We propose to make a **general direction** to address concerns about the **representation of the interests of service-users** under the current governance and control arrangements of the Operators. This will be supported by **compliance reporting** requirements.

<sup>18</sup> See the Accenture Innovation Report, included as an Annex to *Supporting Paper 2: Payments industry strategy and areas for collaboration*.

### Proposed general direction on service-user representation

- 3.67 **We will direct all Operators to ensure appropriate representation of the interests of service-users in their decision-making processes at board level by 30 September 2015.**
- 3.68 We note the mechanisms already in place to encourage service-user representation within current governance arrangements of some of the Operators. Currently, the CPSS-IOSCO Principles include a principle (Principle 2) on governance that encompasses engagement with stakeholders. BPSL, CHAPS Co and FPSL must 'have regard' to these principles under the Bank's oversight regime. However, given our assessment of the concerns, we are not confident that, in the absence of our proposed direction, representation of the interests of service-users will be provided for and maintained consistently and comprehensively across all of the Operators. For the Operators that have regard to the CPSS-IOSCO Principles, we consider that there is benefit in establishing a substantive regulatory requirement that must be complied with.
- 3.69 This requirement is expected to increase the level of attention that Operators give to the representation of the interests of service-users at board level decision-making. We have not adopted prescriptive rules on how service-users should be represented, but we will monitor the approach taken by the Operators.
- 3.70 We consider our direction is an appropriate and proportionate way to advance our service-user objective. This is because it gives Operators the opportunity to build on existing mechanisms where appropriate, and allows each Operator to identify changes designed to work well for their service-users and boards.
- 3.71 In order to comply with our proposed **general direction**, all Operators must have appropriate measures in place for the representation of the interests of service-users. Such measures could include for example:
- Formal arrangements through which service-users are provided with a meaningful opportunity to be consulted at an early stage (i.e. before major decisions are made), to influence the board and the Operator's strategy and to give feedback on the quality of the services and scope for improvement.
  - Provision of sufficient and relevant information to service-users so that they can understand and input into decisions which may have consequences for them.
  - Measures to ensure that the composition of the board does not negatively impact on or outweigh the relevant interests of service-user groups.
- 3.72 We would also welcome feedback on how appropriate service-user representation can be made easier for both service-users and the Operator's board seeking to engage with those service-users.
- 3.73 We expect that measures adopted by Interbank Operators will be consistent with CPSS-IOSCO Principles covering governance and transparency including *"identifying and appropriately managing the diversity of stakeholder views."*<sup>19</sup> For the Card Operators, measures need to be consistent with the ECB's 'Oversight Framework for card payments schemes' which explains that *"adequate and transparent governance arrangements are vital to ensure that the [Card Operator] is able to take decisions appropriately, balancing the needs of all stakeholders"*.<sup>20</sup>
- 3.74 We do not consider it appropriate or proportionate at this time to impose a requirement relating to representation of the interests of service-users (or the related compliance reporting

19 See CPSS-IOSCO's 'Principles for Financial Market Infrastructures' (April 2012) – paragraph 3.2.18, p31, available at <http://www.bis.org/cpmi/publ/d101a.pdf>

20 The ECB also notes *"issuers, acquirers, cardholders and card acceptors should have access to relevant information in order to evaluate financial risks affecting them"*. See the ECB's 'Oversight Framework for Card Payment Schemes' (January 2008) – pp 10 and 15, available at <http://www.ecb.europa.eu/pub/pdf/other/oversightfwcardpaymentss200801en.pdf>. In addition, the ECB advocates transparency of information in the ECB's 'Card Payments in Europe – A Renewed Focus on SEPA for Cards' (April 2014) – available at [http://www.ecb.europa.eu/pub/pdf/other/cardpaymineu\\_renfconsepaforcards201404en.pdf](http://www.ecb.europa.eu/pub/pdf/other/cardpaymineu_renfconsepaforcards201404en.pdf)

requirement) on NICC, although we will keep this under review.<sup>21</sup> Our requirement relating to the representation of the interests of service-users and the related reporting requirement will accordingly only apply to pan-GB Operators (i.e. the Operators of the following payment systems: Bacs, C&CC, CHAPS, FPS, LINK, MasterCard and Visa).

## Reporting Requirements

### 3.75 **Interbank and Card Operators will be also subject to reporting obligations.**

3.76 We propose to require all Operators to provide us with an annual report (the first being due by **30 September 2015**) on compliance with our proposed direction on the representation of the interests of service-users in their decision-making processes at board level.

3.77 The annual report must include at least the following:

- a self-assessment of how the representation of the interests of service-users reflects the service-user direction
- details of all occasions in which the Operator has engaged with, and has considered, the views of service-users in decision-making at board level
- details of any anticipated review, or engagement with interested parties and PSPs, that the Operator plans to take over the coming year in relation to the representation of service-users in its decision-making at board level

3.78 Operators may wish to undertake a **review** of their current arrangements for service-user representation in order to identify specific areas for change in their governance arrangements in order to comply with our proposed direction.

3.79 Given the varying nature of the concerns raised in relation to Interbank and Card Operators, as well as different governance arrangements, the following areas for review are only examples and may not be relevant for all Operators:

- Arrangements which give rise to concerns that directors act in the interest of a narrow group of Direct PSPs or that these PSPs have inappropriate levels of control and influence over the Operators. For example:
  - the association between the allocated votes a director has and the transaction volumes of the PSP which appointed the director to the board
  - the practice of a banking group appointing more than one director to the board of an Operator (where there are multiple PSPs from the same banking group, e.g. through subsidiaries)
- The attendance of service-user representatives at board meetings, either on a standing basis, or where relevant discussions or decisions are taking place, for example, through the appointment of new non-executive directors, with specific additional responsibilities for representing the interests of service-user groups.
- The provision of sufficient and relevant information to service-users so that they can understand and meaningfully contribute to decisions which may impact them.
- Measures to identify and appropriately consult service-users who are not already represented when major decisions are made which have the potential to impact those service-users.

<sup>21</sup> We are not proposing to apply our direction on service-user representation to NICC given the limited nature of stakeholder concerns raised with us, the more limited scope of its activities, and because the development of cheque imaging (see *Supporting Paper 2: Payments industry strategy and areas for collaboration*) means that the future of NICC is unclear.

- 3.80 We have set out a checklist (at the end of this Supporting Paper) containing further guidance on how Operators could approach their reviews.

**Our proposed general direction on the representation of the interests of service-users is consistent with our objectives and duties**

- 3.81 We anticipate that our proposed general direction for the appropriate representation of the interests of service-users in decision-making processes at board level will address the concerns detailed above by:

- Limiting the extent to which decisions taken by directors appointed by large PSPs gives those PSPs a potential competitive advantage in downstream payments markets. Improving the representation of service-users should ensure that the views and interests of service-users are given sufficient prominence, and are appropriately considered, in Operator decision making. In particular, our general direction should address concerns that, under the current arrangements, the decision making is skewed towards only progressing developments that provide an advantage to larger PSPs, and that insufficient consideration is given to changes that might benefit smaller or challenger PSPs, including by improving their ability to compete in downstream payments markets.
- Addressing the perception of some service-users that payment systems are operated to the advantage of the Direct PSPs rather than of the system as a whole. To the extent to which this perception is widely held, or is materially impacting on the decisions of some service-users, our proposed general direction should mitigate this perception. By ensuring that service-users come to perceive payment systems as being operated for the benefit of service-users, and not just for the benefit of Direct PSPs, our proposed general direction is fully consistent with our objective of promoting the interests of service-users.
- Making the boards of Operators more aware of new and innovative approaches which service-users would value, and which may improve the efficiency and operation of payment systems. Such innovations can bring benefits in terms of reduced costs, or improved quality of service, for service-users which in turn, could increase the intensity of competition in downstream payments markets.
- Improving the communication between service-users and boards which should lead to improved certainty around the operation and development of the payment system for all service-users. The improvements in communication should allow service users to make better informed decisions, including in relation to the scope of their operations and investments, and is therefore fully consistent with our objective of promoting the interests of service-users.

- 3.82 As we develop our proposed direction, we have had and will continue to have regard to how our proposals could impact on the Bank's functions<sup>22</sup> and objectives and the stability of, or confidence in, the UK financial system.

- 3.83 We will continue to work closely with the Bank to assess these impacts and ensure there are no adverse impacts.

- 3.84 Indeed, we note that our proposed direction is consistent with CPSS-IOSCO Principle<sup>23</sup> on governance regarding stakeholders which BPSL, CHAPS Co and FPSL are required to have regard to by the Bank, and which we understand C&CCCL also has regard to. Our proposed direction is also consistent with the ECB's 'Oversight Framework for card payments schemes'.

- 3.85 We have had regard to our regulatory principles when considering our proposed direction. In particular:

<sup>22</sup> in its capacity as a monetary authority, including the Bank's other relevant functions such as settlement service provider, provider of infrastructure, security trustee, Direct PSP in some payment systems, and resolution authority.

<sup>23</sup> See Principle 2 - Governance of the CPSS-IOSCO 'Principles for Financial Market Infrastructures' (April 2012) – Key Consideration 7 and paragraph 3.2.18, pp 26 and 31 respectively, available at <http://www.bis.org/cpmi/publ/d101a.pdf>.

- We consider that our proposed direction is consistent with the principle of proportionality. We consider that our proposed direction will be effective in addressing the concerns identified, and that we have adopted the least onerous approach to effectively address these concerns. We acknowledge that some representation models may already be appropriate and others may need improvement. We consider that the costs of compliance with our proposed direction is not disproportionate to the benefits we see the measure having (we present a discussion of the expected benefits and costs of our proposed direction below).
- Our proposed direction also gives each Operator the opportunity to design their own arrangements for the representation of the interests of service-users, and thereby recognises differences in the nature of, and objectives of, each Operator.
- Our proposed direction would result in new responsibilities being put on the senior management of the Operators, and would require them to ensure that there is appropriate representation of the interests of service-users in the decision-making processes at board level.
- Appropriate representation of the interests of service-users would provide channels for service-users to engage with Operators which may further facilitate the ability of service-users to take responsibility for their decisions.

3.86 Our draft direction requiring appropriate representation of the interest of service-users in decision-making processes at board level is set out in *Annex 2* to the Consultation Paper.

#### **Other proposed options to address service-user representation**

3.87 We considered a more prescriptive approach to ensure appropriate representation of the interests of service-users, namely specifying exactly how Operators should ensure appropriate representation of the interests of service-users. For example, we could direct Operators to adopt service-user forums and affiliate groups, and direct how such forums/groups must be constituted and operated, along with how they must interact with the board of the Operator.

3.88 Such a direction could also set out how each board should be established, which category of service-user can make appointments to the board and the voting rights of each category of director.

3.89 We do not regard this approach as proportionate or appropriate at this stage. All Operators are different in their board compositions and the nature of their service-users, who can be represented in different but similarly effective ways. We believe that Operators are best placed to identify appropriate solutions for their service-users.

3.90 However, if our preferred option of a less prescriptive approach does not advance our objectives within a reasonable timescale, we may consider whether further regulatory intervention is required.

**SP3-Q1: Do you agree with our proposed direction requiring all Interbank and Card Operators to ensure that there is appropriate representation of the interests of service-users in discussions and decision-making at board level? If you disagree with our proposed approach, please give your reasons.**

## What are the intended benefits of our proposals and related anticipated costs for industry?

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3.91 We expect that our proposed direction on the representation of the interests of service-users in decision-making processes at board level would have notable benefits for those who use, or are likely to use, the services provided by payment systems. In our opinion, it is not reasonably practicable to produce a quantitative estimate of the benefits given the nature of the benefits described below.

3.92 We summarise below our opinion of the expected benefits and costs of our proposed direction.

### Intended benefits

3.93 The principal benefit of our proposed service-user direction would be to create clearer and more effective channels of communication between service-users and the boards of Operators. We expect that enhanced representation would ensure that a wider set of views and perspectives are reflected in the decision-making of Operators. This should result in better decision-making which considers the interests of service-users. For reasons set out above, we believe that there is benefit in elevating the relevant CPSS-IOSCO Principle on governance and the ECB's 'Oversight Framework for card payments schemes' to a substantive regulatory requirement which must be complied with.

3.94 Historically some service-user interests have only been addressed after external pressure, suggesting that there was demand for new, or improved, services to be developed, and that these services were not being developed in a sufficiently timely manner. Improved service-user representation should foster innovation as Operators' boards are made aware of new, or improved, services which service-users would value.

3.95 For many Operators, a small number of large PSPs have considerable influence over decision-making. This has the potential to have a detrimental impact on competition in payment markets. This could arise to the extent that a small number of large PSPs are able to operate and develop the payment systems in ways which suit their own operations and other interests, and do not sufficiently take into account the interests of PSPs against whom they compete. Greater representation from other PSPs should therefore have a positive impact on competition in payment markets.

3.96 Greater engagement with Indirect PSPs and service-users generally should also give greater visibility to the Operators' boards regarding the services that Indirect PSPs and service-users would value. This should improve the quality of services that they receive with the benefits of these improvements in quality being passed on to end-users. It could also increase Indirect PSPs' willingness to make investments in their own new, or improved, services as their interests are appropriately taken into account.

### Anticipated costs

3.97 We expect that meeting our requirement to ensure appropriate representation of the interests of service-users in decision-making processes at board level would impose costs of minimal significance. Most Operators already engage with at least some service-users and gather some of their views, hence ensuring that this is done more thoroughly and effectively communicated into the decision-making processes at board level should add little additional cost.

3.98 If, for example, each of the Operators appoints a director with special responsibility for representing the views and interests of service-users, an estimate of the costs would be of the order of £0.28-£0.52 million per annum across all of the proposed regulated payment systems.<sup>24</sup> Such costs would only arise if this led to an additional director needing to be appointed. Alternatively, an existing independent director could be tasked with this responsibility which

<sup>24</sup> PwC estimates that non-executive directors receive median pay of £35,000 for a small or medium company in the financial services sector and median pay of £65,000 for a FTSE100 company in the financial services sector. If eight Operators appointed an additional director each, this would cost between £0.28-0.52 million. Source: PwC Non-executive director fees 2013. <http://www.pwc.co.uk/assets/pdf/pwc-non-executive-director-fee-summary-2013.pdf>.

would not be expected to impose additional costs of this magnitude. Further, Operators may choose less costly methods of fulfilling our proposed direction than the appointment of an additional director.

- 3.99 As many Operators already have existing arrangements for engaging with service-users, any costs resulting from our proposed direction would be incremental to existing arrangements. As described above, many of the Operators must either have regard to the CPSS-IOSCO Principles or the ECB's 'Oversight Framework for card payments'. Both of these documents refer to engagement with stakeholders.
- 3.100 Greater engagement with service-users may also lead to higher costs for the service-users concerned. We note that service-users are not obliged to participate in this engagement and therefore should they consider that these costs are not worth incurring, we would expect that they would choose not to engage.
- 3.101 Operators may incur some costs due to providing us with an annual report, although we expect these to be small. We do not expect the reporting to be onerous and we believe that these incremental costs would be of minimal significance.
- 3.102 We consider that a planned annual reporting cycle should also ensure that costs are minimal. This is considered to be a less costly approach to ensuring that we are kept informed compared to irregular requests for information which we could make under our general information gathering powers.
- 3.103 We intend to engage with Operators with regard to the level of detail and information that we may require.
- 3.104 Overall, we consider that these costs would be outweighed by the direct benefits of enhanced service-user representation outlined above.

**SP3-Q2: Do you agree with the costs and benefits identified for our proposed direction on Operators to ensure there is appropriate representation of the interests of service-users? Can you provide any data that might further inform our analysis of the likely impact of our proposed directions?**



## D.

# Concerns relating to conflicts of interest

- 3.105 The concerns examined in this **Part D** relate to possible conflicts of interest faced by individuals who make decisions about the management and development of the interbank payment systems. Similar concerns were not raised to the same degree, or do not apply, in relation to card payment systems, so we have not at this time considered conflicts of interest further for card payment systems.
- 3.106 Under current arrangements, individuals appointed by Direct PSPs as directors to the boards of the Operators of those systems have a number of different roles relating to the interbank payment systems. Identifying the scope for actual or potential conflicts of interest faced by these individuals is important to us because such conflicts may adversely impact on our ability to advance our objectives. Directors with conflicts of interest may be involved in taking decisions which impact on:
- competition in the provision of payment services and/or of infrastructure
  - development of new payment services and the speed at which they can be brought to the market
  - development of, and innovation in, payment systems
  - whether the operation and development of payment system is in the interests of service-users

### **Background to the roles of individuals appointed by PSPs**

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- 3.107 As described in **Part B** of this Supporting Paper, through their participation in the interbank payment systems, Direct PSPs are able to appoint directors to the boards of the Operators of those systems. This potentially gives these PSPs significant control and influence over decisions made by the Operators relating to the development and operation of these payment systems.
- 3.108 In addition to appointments to Operator boards, some of the same PSPs also make appointments to other organisations involved in the management or operation of payment systems:
- A number of PSPs have interests across several payment systems.
  - A number of PSPs have an interest in, and appoint directors to, the board of Vocalink, a major supplier to BPSL, FPSL and the LINK Scheme.
  - A number of PSPs appoint directors to the board of the Payments Council, which, through generic contracts it currently has with BPSL, CHAPS Co and FPSL, reserves a right of approval



over certain decisions made by these Operators, for example relating to the renewal of infrastructure contracts.

- A number of PSPs appoint directors to the board of UK Payments Administration (UKPA), a company providing shared services to some of the Interbank Operators, including employment of Operator's staff. This company has historically shared its chief executive with the Payments Council.

3.109 In some cases, the same individual is appointed simultaneously to:

- the boards of multiple Operators
- the boards of the Payments Council and of VocaLink
- the boards of the Payments Council and Operators

### What are the issues?

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3.110 Conflicts of interest arise where the concerns or aims of two different parties have the potential to be incompatible. Given that in a number of cases, the same individual may be simultaneously appointed to the boards of different parties with different roles relating to the operation and development of interbank payment systems, we believe there is a potential for these individuals to face conflicts of interest.

3.111 In discussion with stakeholders, a number of areas of concern were identified:

- Situations where the same individual is (or could be) appointed simultaneously as a director of an Interbank Operator as well as of a Central Infrastructure Provider to that payment system.
- Situations where directors appointed by PSPs to the boards of Operators make decisions where the interest of their employer and of the Operator are not aligned.
- Situations where reporting lines are not clear for senior staff of Operators. For example, where the managing director of an Operator is accountable to his or her company board, but is employed by a different company, such as UKPA.<sup>25</sup>
- Situations where the same individual is appointed simultaneously to the boards of multiple Operators, who each have different interests.

3.112 We do not consider the last of these situations in this Supporting Paper. At this stage, we have not yet formed a view on whether cross-directorships across multiple Interbank Operators is a cause of concern. This is something that we will keep under review, and we welcome stakeholder views on this point.

### Concerns on conflicts about directors appointed to both an Interbank Operator as well as a Central Infrastructure Provider to that payment system

3.113 We are not aware of any directors who are currently appointed by a PSP simultaneously to the board of an Interbank Operator and to the board of a Central Infrastructure Provider to that payment system, but we cannot rule out that this situation could arise under current arrangements. We are however aware that discussions around appointments of individuals to multiple boards across different companies in the payment systems industry do occur. These highlight the potential for conflicts of interest of this type to exist and that there are

<sup>25</sup> In the case of the LINK Scheme, the executive director and independent chair are employed by VocaLink (rather than UKPA). Directors of Interbank Operators appointed by Direct PSPs are non-executive directors (see <http://www.ukpayments.org.uk/>).

conflicting views both on what constitutes a conflict of interest, and how such conflicts should be managed.

- 3.114 We are aware of directors who are appointed to both the Payments Council's board and the board of one of the infrastructure suppliers, VocaLink, who provides central infrastructure to some payment systems.
- 3.115 These directors potentially face conflicts of interest in relation to the commercial provision of services because, at present, the Payments Council must approve infrastructure contracts for certain Interbank Operators (BPSL, CHAPS Co and FPSL) (see further **Part F** of this Supporting Paper).
- 3.116 Over and above the appointment of specific individuals to the boards of companies on both sides of a commercial relationship, there remains the fact that a number of PSPs have interests on both sides. For example, a director of an Interbank Operator may favour the award of contracts to a major supplier which their employer has an ownership, or other, interest in. This potential conflict exists to a degree irrespective of whether that individual is also a director of that supplier or not.
- 3.117 We note that some of the Interbank Operators do recognise these issues and have taken steps to mitigate the risk that certain individuals will be conflicted in decision-making concerning the supply of services to Interbank Operators. For example:
- The Companies Act 2006 requires that a director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company (that he is a director of).<sup>26</sup>
  - The BPSL Articles of Association state that the 'main' director cannot also be an employee or director of a 'supplier of significant services' to Bacs.<sup>27</sup>
- 3.118 Some stakeholders have also noted that measures have been introduced which may address such potential conflicts of interest. For example, when discussions regarding the renewal of an infrastructure contract were conducted at the Payments Council, conflicts of interest were declared, and conflicted directors left the room and did not participate in deliberations or decision-making about those contracts.

#### ***Our assessment of these concerns***

- 3.119 We consider that there is potential for conflicts of interest to arise in this area. Notwithstanding the efforts described above, we are concerned that the opportunity could still arise in future for some individuals to, for example:
- engage in designing a tender as well as responding to that tender
  - access confidential information about an intention to tender or the terms of a tender
  - access commercially sensitive information, including prices and service offerings, of competing suppliers

<sup>26</sup> The Articles of Association for BPSL, C&CCCL, CHAPS Co and FPSL make provision for such conflicts to be authorised by the board allowing the director in question or any other interested director to vote on any matter giving rise to a conflict of interest. See BPSL's 'Memorandum of Association', available at [http://www.bacs.co.uk/Bacs/DocumentLibrary/Memorandum\\_and\\_articles\\_of\\_association.pdf](http://www.bacs.co.uk/Bacs/DocumentLibrary/Memorandum_and_articles_of_association.pdf); C&CCCL's 'Articles of Association', available at [http://www.chequeandcredit.co.uk/files/candc/c&ccc/pdf\\_and\\_docs/articles\\_of\\_association.pdf](http://www.chequeandcredit.co.uk/files/candc/c&ccc/pdf_and_docs/articles_of_association.pdf); CHAPS Co's 'Memorandum of Association', available at [http://www.chapsco.co.uk/files/chaps/governance\\_documents/memorandum\\_and\\_articles\\_of\\_association.pdf](http://www.chapsco.co.uk/files/chaps/governance_documents/memorandum_and_articles_of_association.pdf); FPSL's 'Articles of Association', available at [http://www.fasterpayments.org.uk/sites/default/files/FB%20036\\_14%20Articles%20of%20Association%20and%20Written%20Resolution%20%28Clean%29.pdf](http://www.fasterpayments.org.uk/sites/default/files/FB%20036_14%20Articles%20of%20Association%20and%20Written%20Resolution%20%28Clean%29.pdf)

<sup>27</sup> See BPSL's 'Memorandum of Association of Bacs Payment Schemes Limited' – p.16 section 41 (a), available at [http://www.bacs.co.uk/Bacs/DocumentLibrary/Memorandum\\_and\\_articles\\_of\\_association.pdf](http://www.bacs.co.uk/Bacs/DocumentLibrary/Memorandum_and_articles_of_association.pdf)

- take part in the decision to award a contract to a supplier
- 3.120 Uncompetitive tender processes could result in higher prices or lower quality goods or services, adversely affecting the Interbank Operator and service-users.
- 3.121 Compromising the integrity of the tendering process may also reduce the incentives on suppliers to participate in a tender, if the tender is not perceived as likely to be a fair one.

### **Concerns about directors acting against the interests of Interbank Operators**

- 3.122 In discussion with stakeholders we have identified that under current arrangements, there exists a potential for non-executive directors of the Interbank Operators to influence decisions in the interest of the PSP who employs them, rather than the interests of the Operator itself. In such cases, these individuals may face a conflict of interest between their duties as a director of an Interbank Operator and as an employee of a PSP.
- 3.123 There would be a clear incentive for such influence to be exercised, for example, if proposals put to the board of the Operator could lead to significant costs being incurred (or avoided) by particular PSPs.
- 3.124 In our engagement, directors themselves have acknowledged that individuals can often face decisions which give rise to difficult choices between acting in the interest of the relevant Operator, or of their employer PSP and its customers.
- 3.125 However, we have also been informed by directors employed by PSPs that they act in the interests of the Operators first and foremost. Indeed, we have been given examples of a Direct PSP-appointed director voting against the interests of their employer.

### ***Our assessment of these concerns***

- 3.126 It concerns us that the potential exists for the interests of particular Direct PSPs to be put above the interests of an Operator when decisions are being made by a PSP-appointed director about the development and operation of a payment system. This is a focus for us given our objective to ensure payment systems are operated and developed in ways which take account of, and promote, the interests of service-users.
- 3.127 However, we also acknowledge that there are a number of legitimate reasons why Direct PSPs should have the ability to appoint directors to the Interbank Operators:
- Direct PSPs are typically the largest users of the interbank payment systems and have a genuine business need to be involved in decisions relating to the systems
  - investment decisions made by Interbank Operators are typically funded by Direct PSPs
  - directors appointed by Direct PSPs typically bring specialist knowledge and skills to the Operator's board in relation to banking, payments and payment systems
- 3.128 Furthermore, we have been made aware of a number of safeguards in place to ensure that decisions are made in the wider interests of the Operator and the payment system. For example:
- Under company law, the director of a company (in this case the Interbank Operator) must take decisions in accordance with the purpose of the company, even in circumstances where these may not align with the interests of their employer.
  - Directors are made aware of their duties toward the Interbank Operator through specific training courses, disclosure requirements and policies requiring directors to remove themselves from decisions where conflicts of interest arise.

- Each board of an Interbank Operator has an independent chair and one or more independent directors who have not been a recent employee of a Direct PSP. Some of the Interbank Operators also have an executive director on the board. The executive and independent directors help ensure Direct PSP-appointed directors are focused on their duties towards the relevant Interbank Operator.<sup>28</sup>
  - Three of the Interbank Operators (BPSL, CHAPS Co and FPSL) must have regard to the CPSS-IOSCO Principles and have in place governance arrangements that support “*other relevant public interest considerations, and the objectives of relevant stakeholders*”.<sup>29</sup>
  - The Articles of Association for BPSL, C&CCCL, CHAPS Co, and FPSL make reference to special decision-making processes that must be adopted for declared public interest matters.
- 3.129 At this stage, we do not intend to make any proposals in relation to this issue. However, we encourage the Interbank Operators to further consider this area. We will continue to monitor the situation and will consider taking further steps if required.

### Concerns about reporting lines for executive and independent Operator directors

- 3.130 Some stakeholders have raised concerns about situations where reporting lines are not clear for independent and executive directors, for example, where the Managing Director of an Operator is accountable to his or her company (Operator) board, but is employed by a different company, such as UKPA.
- 3.131 We are aware of the close relationship between UKPA and the Payments Council, which have historically shared a chief executive. This relationship has added to uncertainty about reporting lines for the Interbank Operators. We address the Payments Council in **Part F** of this Supporting Paper.

#### *Our assessment of these concerns*

- 3.132 We do not consider it to be appropriate for directors or senior staff of Operators, particularly executive directors or independent directors, to be employed by UKPA.
- 3.133 Rather, these directors should be accountable to the board of the Interbank Operator on whose board they sit, without any other reporting lines. They should be employed directly by the Interbank Operators for whom they work, and should not line report to UKPA or to any other third party.
- 3.134 We expect any reporting line between the Managing Director of an Interbank Operator and the Chief Executive of the UKPA to be terminated.
- 3.135 We expect Interbank Operators to act swiftly to address our concerns on this issue. We therefore do not propose to make a direction formally requiring the Interbank Operators to make modifications in this respect at this stage; however, we will monitor the situation and will consider taking further actions if Interbank Operators do not take the necessary steps as soon as reasonably practicable.

### What are the impacts of these concerns?

- 3.136 Of the issues identified above, we are particularly concerned about the impact of conflicts that could arise where a single individual is appointed simultaneously as a director of an Interbank

<sup>28</sup> C&CCCL response to Payment System Regulation: Call for Inputs (14 April 2014) – p4.

<sup>29</sup> BPSL, CHAPS Co and FPSL set out how they have regard in [http://www.bacs.co.uk/Bacs/DocumentLibrary/CPSS-IOSCO\\_disclosure\\_for\\_Bacs\\_payment\\_schemes.pdf](http://www.bacs.co.uk/Bacs/DocumentLibrary/CPSS-IOSCO_disclosure_for_Bacs_payment_schemes.pdf) – p9-10 (BPSL); [http://www.chapsco.co.uk/files/chaps/chaps\\_cpss\\_iosco\\_summary\\_report\\_final.pdf](http://www.chapsco.co.uk/files/chaps/chaps_cpss_iosco_summary_report_final.pdf) p10-11 (CHAPS Co); <http://www.fasterpayments.org.uk/sites/default/files/FPSL%20FMI%20PUBLIC%20Disclosure%20Summary%20Report%202014%201.0.pdf> – p9 (FPSL).

Operator and of a Central Infrastructure Provider that provides, or may provide, central infrastructure services in relation to that payment system. We have accordingly focussed only on the impacts associated with this type of conflict of interest in this section.

- 3.137 We consider that the potential for particular individuals to be conflicted in decision-making concerning the supply of infrastructure services to Interbank Operators can impact on our ability to advance our objectives relating to competition, innovation and service-users. We consider each of these impacts in turn below.

### **Impact on competition**

- 3.138 We consider there will be an impact on competition, where for example:

- An individual on the board of an Operator gives undue preference to a major infrastructure supplier because of their (or their respective employer's) relationship with the supplier, which puts other suppliers at a competitive disadvantage.
- Due to the perceived advantage of certain infrastructure suppliers (those who have a director sitting on the board of the Operator carrying out the tendering process), alternative suppliers may not be inclined to participate in tendering processes, resulting in the market for supply of such infrastructure services remaining relatively closed to new entrants.
- Where an individual is party to both sides of a commercial relationship, there is the potential for inappropriate exchange of competitively sensitive information, which may adversely affect competition between the suppliers.

### **Impact on innovation**

- 3.139 We are interested in the development of and innovation in the infrastructure used to operate payment systems (recognising the impact that infrastructure can have on costs, functionality and the quality of services provided to service-users). We consider there will be an impact on innovation, where for example:

- Undue preference for a particular infrastructure supplier (as described above) may prevent tenders being awarded to alternative providers who could potentially provide innovative new, or improved, solutions.
- Undue preference for a particular infrastructure supplier may also prevent tenders being awarded to alternative suppliers whose infrastructure is better suited to Indirect PSPs, thereby restricting the functionality in payments services those Indirect PSPs could provide.
- The perceived advantage of certain infrastructure suppliers may discourage other potential innovative suppliers from participating in tender processes if they feel that any selection process will be unfair or skewed.

### **Impact on service-users**

- 3.140 We consider there will be an impact on service-users, where for example the supply of infrastructure services to the Operator is influenced as a result of a director of the Infrastructure Provider also sitting on the board of the Operator carrying out the tendering process, rather than on the basis of what will benefit service-users.

- 3.141 Undue influence and the negative impacts on competition and innovation described above could result in higher costs and lower quality of service for service-users than would otherwise be the case if supply was decided in a fully open and competitive manner.

## Our proposals to address potential conflicts of interest

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- 3.142 We propose to make a **direction** on Interbank Operators requiring them to take all reasonable steps to ensure that any individual acting as a director of an Operator must not simultaneously act as a director of an actual or potential Central Infrastructure Provider in relation to that payment system. In this context a Central Infrastructure Provider is a provider of a package of systems and services, comprising hardware and software, provided under contract to an Operator for the purposes of operating the relevant regulated payment system, including the processing of payment transactions and funds transfers.
- 3.143 **We will require Interbank Operators to be compliant with this direction by 1 April 2015, and on an ongoing basis.**
- 3.144 We do not consider it appropriate or proportionate at this time to impose such a direction on NICC, although we will keep this under review. Our requirement relating to the conflicts of interest will accordingly only apply to pan-GB Interbank Operators.
- 3.145 We consider that our proposed direction will address the potential for conflict of interests that may have a material adverse impact on competition, innovation and the interests of service-users.
- 3.146 We believe that this approach will address our concerns by removing the risk of a specific conflict of interest arising (i.e. where the same individual is simultaneously acting as a director of an Interbank Operator and of an actual or potential Central Infrastructure Provider to that payment system) which could influence directors in the course of their duties and which is likely to have a material adverse impact on our ability to advance our objectives. We have focused our proposed direction on the specific concern identified.
- 3.147 We consider that our proposed direction requiring the Interbank Operator to take all reasonable steps to ensure that any individual acting as a director of that Operator must not simultaneously act as a director of an actual or potential Central Infrastructure Provider in relation to that payment system will promote competition, innovation and the interests of service-users. Specifically, we consider that our proposed direction will:
- Promote competition by addressing the potential that exists for undue influence on decisions regarding the award of infrastructure supply contracts by the Interbank Operators. In addition, to the extent that potential suppliers may have been reluctant to incur the costs associated with the participation in such supply contract tendering processes, our proposed direction should increase their willingness to participate by giving them confidence that no undue preference will be given to any infrastructure supplier in the award of new contracts. We will also consider this during our review of the ownership of, and competition in the provision of infrastructure as set out in *Supporting Paper 2: Payments industry strategy and areas for collaboration*.
  - Promote innovation by addressing the potential for conflicts of interest to result in suppliers being unduly discriminated against in the process for the award of major infrastructure supply contracts. Our proposed direction might also encourage innovative suppliers to be more proactive in putting forward proposals to Interbank Operators relating to systems development, on the basis that such proposals will be given full and impartial consideration.
  - Benefit service-users by addressing the potential for conflicts of interest to result in undue preference being given to a particular infrastructure supplier in circumstances where other, alternative suppliers offered a package of services which would be of greater benefit to service-users (e.g. either because of lower prices, increased scope and functionality, or improved quality of service).

- 3.148 As we develop our proposed direction, we have had and will continue to have regard to how our proposals could impact on the Bank's functions<sup>30</sup> and objectives, and the stability of, or confidence in, the UK financial system. We will continue to work closely with the Bank to assess these impacts and ensure there are no adverse impacts.
- 3.149 We have had regard to our regulatory principles when considering and developing our proposed direction. In particular we consider that our proposed direction is consistent with the principle of proportionality. Specifically, we are of the view that our proposed direction will be effective in addressing actual or potential conflicts of interest associated with individuals simultaneously acting as both a director of an Interbank Operator and of an actual or potential Central Infrastructure Provider in relation to that payment system. We have adopted a proportionate approach by only applying our proposed direction to conflicts of interest which are likely to have a material adverse impact on our ability to advance our objectives. We believe the potential benefits of our proposed direction will likely exceed the costs (see paragraphs 3.154 to 3.162 below for a discussion of the expected benefits and costs of our proposed direction).
- 3.150 In light of the broader concerns in relation to conflicts of interest we have considered above (see paragraphs 3.110 to 3.135), we also expect Interbank Operators to review their conflicts of interest policies and mechanisms. Interbank Operators should consider whether aspects of their conflict of interest policies and mechanisms are sufficiently robust or could be better implemented. In particular, we encourage Interbank Operators to consider how to address perceptions of conflicts of interest, as well as actual conflicts of interest. Specifically, Interbank Operators may want to consider:
- ensuring that robust processes are in place to ensure that there are no inappropriate flows of commercially or competitively sensitive information beyond what is strictly necessary and justified, including in respect of any outsourcing arrangements
  - publication of a register of commercial interests declared by directors (which may assist in improving perceptions)
  - whether the appointment of additional independent directors could further improve decision-making and impartiality
- 3.151 Some Interbank Operators will need to assess these issues in the context of recent changes (e.g. the appointment of independent chairs and directors). We consider it preferable that industry-led solutions which deliver suitable governance and control arrangements are developed and adopted. However, we do not exclude giving consideration to the further use of more prescriptive rules, if necessary, in the future.
- 3.152 We expect all PSPs who appoint directors to the boards of Operators to be mindful of our concerns when also appointing directors to any payments-related infrastructure or service providers (i.e. other than Central Infrastructure Providers). If stakeholders raise concerns with us about Interbank Operators' directors simultaneously acting as a director to a supplier of that payment system (other than a Central Infrastructure Provider), we will consider the case for taking further action, including considering expanding the scope of our direction to capture additional types of service providers.
- 3.153 A draft of our proposed direction is set out in *Annex 2* to the Consultation Paper.

<sup>30</sup> in its capacity as a monetary authority, including the Bank's other relevant functions such as settlement service provider, provider of infrastructure, security trustee, Direct PSP in some payment systems, and resolution authority.



**SP3-Q3: Do you agree with our proposed direction on Interbank Operators requiring the Interbank Operator to take all reasonable steps to ensure that any individual acting as a director of that Operator must not simultaneously act as a director of an actual or potential Central Infrastructure Provider to that payment system? If you disagree with our proposed approach, please give your reasons.**

**SP3-Q4: Do you agree with our proposed approach not to issue directions at this time in relation to the other types of conflicts of interest identified by stakeholders? If you disagree with our proposed approach, please give your reasons.**

### **What are the intended benefits of our proposals and related anticipated costs for industry?**

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- 3.154 We expect that our proposed direction would result in benefits in excess of its costs.
- 3.155 In our opinion, it is not reasonably practicable to produce a quantitative estimate of the benefits given the nature of the benefits relate to the avoidance of future conflicts of interest and in light of the level of costs. We believe that the costs associated with our proposed direction would be of minimal significance.
- 3.156 We summarise below our opinion of the expected benefits and costs of our proposed direction.

#### **Intended benefits**

- 3.157 Our proposed direction on conflicts of interest would prevent an individual from acting simultaneously as a director of an Interbank Operator and of an actual or potential Central Infrastructure Provider in relation to that payment system. This would help to prevent conflicts of interest of this kind from arising in the future.
- 3.158 Were such conflicts to be permitted, when awarding infrastructure contracts that director could give undue preference to the offer of services provided by a Central Infrastructure Provider even when this is not in the best interests of the Operator. Such actions could distort competition in the supply of infrastructure including by reducing the likelihood that other suppliers participate in any tendering process. This could result in higher prices or lower quality services (including innovative new services) being provided over time, adversely affecting service-users. The relevant direction prevents such conflicts from arising in the future.

#### **Anticipated costs**

- 3.159 The level of costs associated with our proposed direction is expected to be of minimal significance. We are not aware that any Interbank Operator currently has a director who is also a director of a Central Infrastructure Provider. Hence no immediate changes in directorships will be required.
- 3.160 Over time, Interbank Operators would be required to monitor any directorships held by their directors in order to ensure that they remain compliant with the direction on conflicts of interest. Given the relatively small number of directors and the small number of Central Infrastructure Providers, this monitoring cost would be of minimal significance.
- 3.161 For a small number of PSPs who have an ownership interest in Central Infrastructure Providers which entitles them to appoint directors, and who appoint directors to Operators' boards, the direction would restrict the choices that they have regarding the selection of directors for Operators and such Central Infrastructure Provider. Since this affects large organisations, we



consider that this restriction would impose costs of minimal significance. We note that these PSPs have already selected a sufficient number of directors with appropriate skills such that they do not currently have directors in the situation that our proposed direction is intended to avoid.

- 3.162 We expect that our proposed direction would therefore result in costs of minimal significance and benefits in excess of these costs.

**SP3-Q5: Do you agree with the costs and benefits identified for our proposed direction requiring the Interbank Operator to take all reasonable steps to ensure that any individual acting as a director of that Operator must not simultaneously act as a director of an actual or potential Central Infrastructure Provider to that payment system? Can you provide any data that might further inform our analysis of the likely impact of our proposed directions?**

## E.

# Concerns regarding transparency and clarity of decision-making

### What are the issues?

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- 3.163 Stakeholders have concerns with how opaque the development and operation of payment systems is. This points to a lack of transparency in decision-making at the Operators' boards notwithstanding recent efforts to increase openness by some Interbank and Card Operators.
- 3.164 The inability of Indirect PSPs and other service-users in particular to see how decisions are made along with the reasons for those decisions reinforces the perception of some stakeholders that payment systems are operated in the interests of Direct PSPs, and do not sufficiently take into account the interests of other service-users (see **Part C** above).

### Our assessment of these concerns

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- 3.165 A lack of transparency around board level decision-making of Operators can lead to a perception, which has been expressed by stakeholders, that decisions are taken which principally benefit Direct PSPs (or a small number of large banks – see **Part C** above), to the detriment of service-users, including Indirect PSPs.
- 3.166 A lack of transparency of decision-making at board level can also mean that the interests of service-users are not taken into account, and the implications for service-users are neither fully understood nor factored into decision-making, which may result in unintended adverse consequences for service-users.
- 3.167 We consider that a lack of transparency in and of itself reinforces the negative stakeholder perceptions around how Operators take decisions, and also makes it more difficult for stakeholders other than Direct PSPs (who directly participate in decision-making) to understand the rationale for decisions.

### What are the impacts of these concerns?

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- 3.168 A lack of transparency and clarity around the board level decision-making of Operators can have an impact on competition, the development of and innovation in payment systems, and the interests of service-users.

### Impact on competition

- 3.169 A lack of transparency in board decision-making can make it difficult for service-users to be aware of decisions that have been taken by Operators which might impact on their activities. This lack of visibility around board decisions may make those service-users, including Indirect PSPs, who compete with Direct PSPs in payment markets, more cautious in their decisions because of the uncertainty about how decisions taken at the Operator level might impact on their activities.
- 3.170 There could also be impacts arising from poor visibility about the way in which decisions are taken by Operators. In particular, where there is a lack of transparency about the basis on which decisions are taken, such as concerns that conflicts of interest result in decisions being taken which only benefit particular types of service-user, this may act as a barrier to entry and reduce incentives for expansion for other service-users, which could have the effect of lessening competition in services provided by payment systems.

### Impact on innovation

- 3.171 A lack of transparency may make it difficult for those who want to propose new initiatives or innovations for the development of payment systems to assess the extent to which these proposals are actively being considered by the boards of Operators. For example, a service-user who makes an innovative proposal to improve the development and operation of a payment system may not be made aware of how the proposal was considered and the basis on which the proposal was either rejected or accepted.
- 3.172 In addition, the lack of visibility around Operator board decision-making may make PSPs more cautious in their own decisions relating to innovation, including decisions to adopt new technologies.

### Impact on service-users

- 3.173 The key impact of the lack of transparency on service-users is that they lack full visibility of how Operator board decisions are taken, and which considerations featured in discussions or deliberations of the board. This may foster an environment where the views of service-users are not given sufficient prominence in the decision-making at Operator board level. That is, in the absence of transparency requirements, boards may not feel the need to seek out, or give appropriate consideration to, issues that may impact on service-users in their deliberations and decisions.
- 3.174 Even with improved arrangements for the representation of the interests of service-users that should follow from our proposed direction (see **Part C** above), some service-users, particularly those for whom payments is not their primary business, may still lack the ability or resources to engage directly with forums and affiliate/user groups.

## Our proposals on transparency and clarity

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- 3.175 We consider that there is a need for greater transparency and clarity around decision-making at Operators' boards. We propose to make a **direction requiring all Operators<sup>31</sup> to publish board minutes**, including votes, in a timely manner, from **1 April 2015**. Operators will be required to place a copy of such minutes in a prominent, easily accessible position on their website, and provide us with a copy (and link to the website).
- 3.176 We do not consider it appropriate or proportionate at this time to impose a requirement relating to transparency on NICC, although we will keep this under review. Our requirement relating to transparency and the publication of board minutes will accordingly only apply to pan-GB Operators.

<sup>31</sup> The governing body for the LINK Scheme is the NMC rather than a board of directors. Our proposed direction in the case of the LINK Scheme refers to the minutes of the NMC.

- 3.177 Specifically, we will require all Operators to publish, as soon as reasonably practicable after each meeting, board minutes which must include at least the following, in a clear, comprehensive and easily accessible form:
- an accurate summary of the discussions of the board, including any dissenting views
  - all decisions and all votes by directors (including, where a decision is made by consensus, all directors present and entitled to vote must be recorded as supporting that decision, with any dissenting views being recorded and attributed to the relevant director)
  - reasons behind each and every decision, including the reasons given by directors for their vote
  - a statement from independent directors saying how, for each board decision, they have exercised their discretion related to public interest matters (public interest is described in the footnote to paragraph 3.15a), where applicable
- 3.178 Minutes may be published in a redacted form where this is absolutely necessary to protect commercial confidentiality, candid board debate and the financial stability or integrity of the payment system, or in respect of information relating to an Operator's activities outside of the UK, to the extent that those activities do not impact on the relevant payment system in the UK but any and all redactions should be limited to the extent necessary, reasonable and justifiable.<sup>32</sup> Any and all redactions must also be made in accordance with a stated and reasoned policy regarding the redaction of board minutes which we will require each of the Operators to have (and provide us with a copy of) which ensures a consistent and appropriate approach to redactions.
- 3.179 We also expect Operators to:
- clearly signpost documents relevant to decisions made by their board so that, if appropriate, they can easily be accessed by stakeholders
  - review the effectiveness of their board secretariats to ensure that they can meet the above requirements
- 3.180 We consider that our proposed direction will enhance overall transparency in decision-making by the boards of all Operators. The recording of reasoning behind decisions in board minutes will assist service-users in understanding how and why decisions are taken. It will facilitate service-user engagement and make directors more clearly accountable for their decisions.
- 3.181 We consider that:
- Greater visibility of decision-making at board level will allow service-users to have sight of decisions which may impact on competition in payments markets. In addition, service-users will also have sight of the extent to which the board actively considers proposals that may impact on competition. Our proposed direction requiring the publication of board minutes will make board debates and voting behaviour more transparent and should therefore discourage directors, individually and collectively, from voting for proposals that could be considered as introducing or maintaining barriers to competition.
  - Greater levels of transparency of decision-making will provide insight into how Operators' boards consider proposals relating to innovation in their payment system. Increased visibility of decision-making may also provide some service-users with increased confidence when it comes to making decisions relating to innovation, for example, in decisions whether or not to adopt new technologies. By increasing the visibility of decision-making at Operator board level, our proposed direction requiring the publication of board minutes should

<sup>32</sup> We note that there is an increased move towards the publication of minutes. The minutes of the Payments Council board have been published since its set up in 2007. BPSL already provides board briefings to the Electronic Payments Affiliates Group.

discourage directors, individually and collectively, from not giving appropriate consideration to innovative proposals, or from voting for proposals that could be considered as obstructing innovation.

- By making Operators' board decision-making more transparent, our proposed direction requiring the publication of board minutes will reinforce and/or foster a culture in which Operators' boards are required to give appropriate consideration to the interests of service-users in their decision-making and deliberations. In addition, by increasing the visibility of board decision-making, our proposed direction should discourage directors, individually and collectively, from voting for proposals that could be considered as not taking account of, or promoting, the interests of service-users.
- 3.182 We believe that our proposed direction requiring Operators to publish board minutes will further strengthen our proposed directions to address conflicts of interest (see **Part D** above) and improve the representation of the interests of service-users (see **Part C** above).
- 3.183 As we develop our proposed direction, we have had and will continue to have regard to how our proposals could impact on the Bank's functions<sup>33</sup> and objectives, and the stability of, or confidence in, the UK financial system.
- 3.184 We will continue to work working closely with the Bank to assess these impacts and ensure there are no adverse impacts.
- 3.185 Our proposed direction is consistent with CPSS-IOSCO Principles relating to governance. In particular, we accept that certain redactions may be necessary (among others) to protect the stability and integrity of payment systems.
- 3.186 We have had regard to our regulatory principles when considering our proposed direction to require all Operators to publish board minutes, in particular:
- We consider that our proposed direction is consistent with the principle of proportionality. Specifically, we consider that our proposed direction will be effective in addressing the concerns identified, and that we have adopted the least onerous approach to effectively address these concerns. We consider that the costs of compliance with our proposed direction are not disproportionate to the benefits in general terms which can be expected to result from our proposed direction (we present a discussion of the expected benefits and costs of our proposed direction below).
  - We also consider our proposed direction to be consistent with the principle that those who use services provided by payment systems should take responsibility for their decisions. The publication of board minutes will enhance the information available to service-users.
  - Our regulatory principles explicitly recognise that it may sometimes be desirable for us to require others to publish information as a means of contributing to the advancement of our objectives.
- 3.187 A draft of our proposed direction is set out in *Annex 2* to the Consultation Paper.

**SP3-Q6: Do you agree with our proposed direction to require all Operators to publish board minutes in a timely manner? In particular, do you agree with our proposal for the published minutes to include a record of votes and reasons for decisions made? If you disagree with our proposed approach, please give your reasons.**

<sup>33</sup> in its capacity as a monetary authority, including the Bank's other relevant functions such as settlement service provider, provider of infrastructure, security trustee, Direct PSP in some payment systems, and resolution authority.

## What are the intended benefits of our proposals and related anticipated costs for industry?

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- 3.188 We expect that our proposed direction on Operators requiring the publication of board minutes would result in benefits in excess of its costs.
- 3.189 In our opinion, it is not reasonably practicable to produce a quantitative estimate of the benefits given the nature of the benefits related to conveying greater clarity surrounding decision-making processes and in light of the level of costs. We believe that the costs associated with our proposed direction would be of minimal significance.
- 3.190 We summarise below our opinion of the expected benefits and costs of our proposed direction.

### Intended benefits

- 3.191 The principal benefit of our proposed direction is that it would help to address the general concern that the governance arrangements for Operators are opaque, as described in paragraph 3.163 above. Our proposed direction would enable service-users to see what information and considerations featured in the decision-making of Operators' boards, and the reasons why some directors supported or did not support a specific decision.
- 3.192 The fact that this information would be revealed publicly may ensure that the views of service-users are given greater prominence in the decision-making of Operators' boards. To the extent that this occurs, decisions are more likely to be in the interests of service-users, which may in turn help to promote competition between PSPs.
- 3.193 If publication of minutes means that PSPs and other service-users become more aware of the decisions that are taken by Operators' boards and the basis on which these decisions are made, this may lead them to have greater certainty regarding future developments in payment systems. A lack of certainty may make some PSPs and other service-users cautious about investment decisions, whereas greater certainty may mean that they are more willing to make investments including in innovative new services.
- 3.194 Even with improved arrangements for the representation of the interests of service-users that should follow from our proposed direction (see **Part C** of this Supporting Paper), some service-users, particularly those for whom payments is not their primary business, may still lack the ability or resources to engage directly with Operators' forums and affiliate/user groups. For these service-users, the availability of published minutes would help to keep them informed of the key decisions made and how their interests were represented or factored into decision-making. Their reading of the board minutes could also trigger their interest and lead to a period of increased engagement on specific topics.

### Anticipated costs

- 3.195 We expect that the incremental costs related to publishing Operators' board minutes would be of minimal significance. It is already the case that minutes are written and circulated to directors after board meetings, although it may take marginally longer to include summaries of discussions and votes in the minutes (and make any necessary redactions). Overall these costs would be minimal.
- 3.196 Similarly, since existing websites are already available to Operators on which information can be published, any incremental additional costs associated with publishing the information on their websites would be limited. Updates to websites are very frequent events and we expect this to involve minor administrative and system costs.
- 3.197 We recognise that making all directors openly accountable for the decisions they take, and the reasons which underlie their decision, may lead to changes in the way Operators conduct discussions and decisions are taken. It is possible that this could lead some directors to be unwilling to offer dissenting views because of the fact that such views would be attributed to

them. It seems unlikely, however, that this would cause significant risks to the Operators, and consequently the detrimental impact of this is anticipated to be minimal.

- 3.198 Overall, we expect that our proposed direction requiring the publication of Operators' board minutes would result in costs of minimal significance and benefits in excess of these costs.

**SP3-Q7: Do you agree with the costs and benefits identified for our proposed direction requiring all Operators to publish board minutes in a timely manner? Can you provide any data that might further inform our analysis of the likely impact of our proposed directions?**

## F.

# Concerns regarding the Payments Council's contractual arrangements with the Interbank Operators

### What are the issues?

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- 3.199 When the Payments Council was established, generic contracts were agreed between it and a number of the Interbank Operators. These contracts were later amended for BPSL, CHAPS Co and FPSL, and now reserve a number of matters to the Payments Council board (reserved matters). The reserved matters give the Payments Council, rather than the board of the relevant Interbank Operator, final approval over a number of matters, which include:
- strategy of the Interbank Operator
  - appointment of senior staff
  - approval of infrastructure contracts
- 3.200 These contracts were intended to support an enhanced role for the Payments Council in setting and implementing industry strategy, and in its role in relation to the integrity of payment systems.
- 3.201 These contracts are currently still in effect. The relevant Interbank Operators have questioned the continuing relevance of the Payments Council's right of approval over the reserved matters set out in the generic contracts, particularly given the addition of independent directors to the boards of the relevant Interbank Operators and the changing regulatory environment.

### Our assessment of these concerns

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- 3.202 We consider that the approval role ceded to the Payments Council by the Interbank Operators under the generic contracts gives the Payments Council an unnecessary and inappropriate level of control over the relevant Interbank Operators, thereby restricting their autonomy and independence. We consider, in agreement with the views expressed by Interbank Operators, that such arrangements are both unnecessary and incompatible with the new regulatory framework for payment systems.
- 3.203 We understand that the Payments Council and the relevant Interbank Operators are in the process of modifying or terminating their generic contracts, such that the Payments Council will no longer have a right of approval over reserved matters as set out in those generic contracts,



instead of the board of the relevant Interbank Operators. We expect these contractual modifications to take effect by, at the very latest, 1 April 2015.

- 3.204 Given the steps which are already currently being taken by the relevant Interbank Operators and the Payments Council, we do not consider it necessary to exercise our powers on this issue at this time. However, we will keep this under review should any relevant contract between an Interbank Operator and the Payments Council not be modified or terminated on a sufficiently timely or effective basis such that the provisions relating to reserved matters no longer apply to those Interbank Operators by, at the very latest, 1 April 2015. In such a case, we would consider taking further action.

**SP3-Q8: Do you agree with our proposed approach not to issue a direction at this time in relation to Payments Council reserved matters? If you disagree with our proposed approach, please give your reasons.**

## Appendix:

# Guidance Checklist of items Operators may wish to consider when carrying out a governance review

### **Governance review relating to ensuring appropriate representation of the interests of service-users in decision-making at Operator board level**

Applicable to all Interbank Operators (including LINK Scheme's Network Members Council where relevant) and Card Operators (with the exception of NICC):

- Nature of representation of Indirect PSPs and their interests, including how they make proposals to the Operator's board
- Nature of representation of all other types of service-users and their interests, including how they make proposals to the Operator's board
- Ability of independent/constituency directors to make proposals to the Operator's board, including on behalf of service-users
- Extent to which current affiliate/user groups provide a genuine opportunity for service-users to be meaningfully consulted at an early stage, influence the board and the Operator's strategy, and give feedback on the quality of service and the scope for improvement
- Extent to which links between affiliate/user groups and independent/constituency directors should be formalised
- Any arrangements where a director's voting powers are linked to transactions
- Appointment of directors where banking groups can nominate more than one director
- Appointment of alternate directors, if any, and consideration of alternative arrangements

### **Other matters that could be considered in the service-user review**

Operators may also wish to consider how increased transparency of decision-making processes could further support awareness of how stakeholders' views are taken into account in decision-making and address issues of perception.

The scope of the review could also cover areas where we are not making a direction but that would be beneficial, for example, how to reduce complexity and the burden for smaller organisations seeking to engage with an Operator's board.

### **Governance review in relation to managing conflicts of interest (actual or perceived)**

Applicable to all Interbank Operators only (including LINK Scheme's Network Members Council where relevant) (with the exception of NICC)

Declaring and managing conflicts of interest – particularly:

- Clear statement of roles and responsibilities for the board (as a whole) and different classes of directors (if applicable)
- Terms of employment for independent and executive directors with a view to ensuring a clear reporting line to the board and appropriate independence respectively
- Processes for handling commercially or competitively sensitive information, including the flow of sensitive information within the PSPs making appointments to the boards of Operators and other entities
- Appointment of additional independent directors to improve decision-making and impartiality

### **Output from these governance reviews:**

- Matters considered, explanation of conclusions and issues identified
- Changes identified to meet service-user direction (consultation and representation)
- Changes to board policies in relation to the appointment of directors and the management of conflicts of interest
- Publication of Operator board minutes and of policies relating to the redaction of information from those board minutes
- Publication of a register of directors' commercial interests for Interbank Operators

**PUB REF: PSR CP14/1.3**

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