

Consultation paper

CP17/1

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# Direct Debit Facilities Management: Switching providers

Consultation on provisional conclusions and proposals to change the Direct Debit rules relating to the switching of Facilities Management providers



In this consultation paper we discuss some concerns that have been raised with us in connection with the effectiveness of the operation of the process to switch between Direct Debit 'Facilities Management' providers. A Facilities Management provider is an organisation that collects and/or administers Direct Debits on behalf of other organisations (who are its clients). A Facilities Management provider, GoCardless Ltd, has asked us to consider using our powers to change the Bacs scheme rules to remove a potential impediment to switching. We propose a potential solution to address these concerns and discuss some alternative implementation approaches.

We are asking for comments on these proposals by 5pm on 15 September 2017. You can send your comments and responses to our consultation questions by email to [DDconsult@psr.org.uk](mailto:DDconsult@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).

Payment Systems Regulator Limited  
Direct Debit consultation team  
25 The North Colonnade  
Canary Wharf  
London E14 5HS  
Email: [DDconsult@psr.org.uk](mailto:DDconsult@psr.org.uk)

We may 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 nondisclosure. Stakeholders who wish to claim commercial confidentiality over specific items in their response should mark their response accordingly, and 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. Any decision we make not to disclose a response is reviewable by the Information Commissioner.

You can download this consultation paper from our website:

<https://www.psr.org.uk/psr-publications/consultations/CP-17-1-Direct-Debit-Facilities-Management-Switching>

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# 1 Overview

## Introduction

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- 1.1** In this consultation paper we discuss concerns that have been raised with us about Direct Debit 'Facilities Management' (FM) services and the options for customers that want to change their Facilities Management provider. A Facilities Management provider is an organisation that collects and/or administers Direct Debits on behalf of other organisations (who are its clients). A Facilities Management provider, GoCardless Ltd, has asked us to consider using our powers to change the Bacs scheme rules to remove a potential impediment to switching. As a result, we surveyed providers to determine the extent and impact of the issues raised on competition and service-users. We set out proposals for changing the Direct Debit scheme rules to address the concerns. We also discuss some potential implementation approaches.
- 1.2** We are consulting on:
- proposed solutions to concerns about the ability of customers of Facilities Management providers to switch to an alternative provider
  - implementation options for our proposed solution
- 1.3** The Direct Debit scheme is part of the Bacs payment system, which is operated by Bacs Payment Schemes Limited (BPSL). We are proposing to use our powers under Section 55 (System rules) of the Financial Services (Banking Reform) Act 2013 (FSBRA) to require BPSL to update its rules in order to address the concerns raised with us and to notify us of its proposed rule changes in this regard.
- 1.4** The period for this consultation closes on 15 September 2017.

## Background

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- 1.5** This document is structured as follows:
- **Chapter 2** explains the role of FM providers and the switching process. It then sets out the concerns that have been brought to our attention and our assessment of the issues and our concerns.
  - **Chapter 3** discusses the proposed solution that we are consulting on.
  - **Chapter 4** discusses some potential implementation options to give effect to our proposals.
  - **Annex 1** provides high-level overviews and examples of how Direct Debits and Facilities Management work in general.
  - **Annex 2** lists our consultation questions.
  - **Annex 3** is a copy of a letter we received from GoCardless Ltd on 30 March 2017 regarding the concerns and asking us to take action.

## Who does this consultation affect?

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- 1.6** We expect this consultation to be of most relevance and interest to:
- providers (and prospective providers) of Direct Debit Facilities Management services (FM providers)
  - the Bacs member banks that sponsor FM providers
  - users (and prospective users) of Direct Debit Facilities Management services (FM clients)
  - BPSL, as the operator of the Bacs system (which includes the Direct Debit scheme)
- 1.7** This consultation paper is primarily aimed at the parties listed above, but consumers may also have interests in this subject as they may be customers of FM clients. Consumers may be making some regular Direct Debit payments to FM providers who are collecting money on behalf of their FM clients.
- 1.8** Under the current Direct Debit rules, consumers may be faced with an additional burden or have concerns if they are asked to authorise a new provider with a new Direct Debit instruction (DDI) to replace an existing Direct Debit. This can happen if an FM client is switching to a new FM provider but is not being adequately supported by its existing provider (see Chapter 2, paragraphs 2.10 to 2.13).

## Next steps

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- 1.9** If you wish to respond to this consultation please send us your comments on the questions in this consultation paper by 5pm on 15 September 2017. You can email us at [DDconsult@psr.org.uk](mailto:DDconsult@psr.org.uk) or write to us at the following address:
- Payment Systems Regulator Limited  
Direct Debit consultation team  
25 The North Colonnade  
Canary Wharf  
London E14 5HS
- 1.10** Once we have received and considered the responses to this consultation, we aim to publish our response towards the end of 2017. If we decide to exercise our powers to require a change to the Bacs rules, we will set out in our response document how we will satisfy ourselves that any rule change has achieved the specified purpose.

## 2 Role of Facilities Management providers and assessment of concerns raised

This consultation relates to the provision and usage of Direct Debit 'Facilities Management' services. In particular we focus on the different options for a user of Facilities Management services (an 'FM client') that wants to switch to a new FM provider.

We have received information that suggests the current Direct Debit rules may be deficient, in that they provide opportunity for an existing FM provider to raise significant cost barriers to an FM client who wants to switch to an alternative FM provider. This is likely to harm competition, innovation and the interests of those who use, or are likely to use, services provided by payment systems.

### Introduction to Direct Debit Facilities Management

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- 2.1** Direct Debit (DD) is one of the most widely used and recognised payment methods in the UK. In 2016 organisations collected over 4 billion individual payments using DD, an increase of 4.9% on the previous year. DD is widely used by organisations such as companies, charities, local councils and government departments, to collect money from their paying customers or donors. Almost 90% of UK adults have at least one DD arrangement in place. A high-level overview of how DD works is contained in Annex 1, and further information is available on BPSL's website: [www.directdebit.co.uk](http://www.directdebit.co.uk).
- 2.2** Any organisation that wants to use DD to collect money from payers must be approved, or 'sponsored', as a Bacs service user. In the rules relating to DD, these organisations are specifically defined as 'service users' (see box below). The sponsor must be a payment service provider (PSP) who is a Bacs member, which currently only includes banks and building societies.<sup>1</sup>

#### The terms 'service user' and 'service-user'

In the rules relating to the DD scheme, the term 'service user' has a narrower definition than the more general 'service-user' term in FSBRA. In the Bacs rules relating to the DD scheme, the term service user is 'A company, group of companies, charity etc. that is sponsored to use one or more Bacs services. A service user may also be referred to as a payee. (See also Originator)'.

In FSBRA, service-users are those who use, or are likely to use, services provided by payment systems. The FSBRA definition of service-users therefore includes both Bacs 'service users' and FM clients, for example.

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<sup>1</sup> Only PSPs that are members of BPSL are able to sponsor service users. PSPs who are non-members may enter into an arrangement with a member, allowing them to introduce customers to that member for sponsorship purposes.

- 2.3** Some organisations do not want to be a Bacs service user, or are unable to be. This could be for a variety of reasons – for example, they may be small or newly formed entities, without a sufficient trading track record or financial standing to get a sponsor.
- 2.4** These organisations may instead be able to use a DD Facilities Management (FM) service provider (an FM provider). This can enable the organisation (an FM client)<sup>2</sup> to offer DD as a payment option to its customers. The FM provider will be responsible for some or all of the following:
- corresponding with the payer
  - receiving completed DDIs and forwarding details to the payer’s bank or building society (the paying bank)
  - complying with the Direct Debit rules including handling any refund requests
  - management of returned, amended and cancelled DDIs
  - management of files and collection of Direct Debits on the due dates, including reconciliation of processed, rejected and returned items
- 2.5** The FM provider collects funds from the bank accounts of its FM client’s customers (payers) using DD. After the FM provider has received the funds, it forwards the proceeds (less any agreed deductions) to its FM client.<sup>3</sup> A high-level overview of how FM works is contained in Annex 1, and further information is available on the Bacs website.<sup>4</sup>
- 2.6** Depending on the nature of an FM provider’s business and its FM clients, it may need to be authorised as a type of PSP (typically as a payment institution<sup>5</sup>). From our analysis so far it appears that there are several thousand FM clients and that this number is growing year on year. There appear to be approximately 50 FM providers, although only a subset of these act as PSPs and provide FM services on a commercial basis to third party clients.
- 2.7** An FM provider might also offer its FM clients additional services, such as customer-facing websites or information and data processing services. The FM client will enter into a contract directly with its chosen FM provider, covering the DD collection services and any additional services that the FM provider will deliver.
- 2.8** The Direct Debit Guarantee applies to all DDs under the Bacs Direct Debit scheme. Under the Direct Debit Guarantee, if an error is made in the payment of a DD, the relevant paying bank will provide its customer, the payer, with a full and immediate refund of the amount paid from their bank or building society account.
- 2.9** The FM provider, in its capacity as a sponsored Bacs service user, is liable to all of the banks and building societies that participate in the DD scheme for settling any refunds falling due to their payers if the refund claim resulted from an omission or error on its part when collecting the DD. This liability is established by way of a ‘standard indemnity’ that all Bacs service users must provide. In the Direct Debit rules, a refund claim is called an ‘indemnity claim’ or ‘Direct Debit Indemnity Claim’. The standard indemnity is an essential requirement of the Direct Debit scheme and contains a legally binding undertaking by the service user to make payment to a paying bank in response to an indemnity claim.

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2 Note that in the letter we received from GoCardless (see Annex 3), the term ‘service-users’ is used to refer specifically to FM clients.

3 This is in contrast to a Bacs bureau service provider, who may process DDs on behalf of its customer (who must be a service user), but does not take receipt of any proceeds, which flow directly to the bank account of the bureau service provider’s customer.

4 See <https://www.bacs.co.uk/Resources/FMclients/Pages/FMclients.aspx>

5 When payment services (as defined in the Payment Services Regulations 2009) are carried out as a regular occupation or business activity.

## Switching to an alternative Facilities Management service provider

- 2.10** An FM client (typically a small or medium enterprise) will have a customer base, many of whom may already have provided a Direct Debit Instruction (DDI)<sup>6</sup> and are paying by DD. The DDI is actually made in favour of the FM provider. According to the Direct Debit rules, each DDI should be named in the form '*FM provider re: FM client*' to help the payer identify the payments and understand the relationship. The FM provider owns and controls the DDI data, and is required to comply with the Direct Debit rules.
- 2.11** If an FM client wishes to switch to an alternative FM provider, it effectively has two options<sup>7</sup>:
- a. It can contact all of its customers (payers) and ask each one to provide a new DDI for '*New FM provider re: FM client*'.
  - b. It can ask the existing (outgoing) FM provider and the new FM provider to cooperate to transfer existing DDIs to the new FM provider. This transfer would be carried out using the Bacs **bulk change process**, which includes a step that notifies paying banks that the DDIs and responsibilities for DDs have switched to the new FM provider.
- 2.12** FM clients tend to prefer using option 'b'. This is the approach recommended by both BPSL and sponsor banks, as the alternative (option 'a') of contacting each payer and asking them to provide a brand new DDI is slow, costly and 'likely to be the most disruptive to stakeholders'.<sup>8</sup>
- 2.13** One FM client we spoke to in June 2017, faced with having to contact all its customers in order to switch FM provider (using option 'a'), told us that its customers perceived that they had already signed a DDI and so to request a new one would confuse them and 'have a negative [impact] on our business'.
- 2.14** The bulk change process requires the outgoing and new FM providers, and the new FM provider's sponsor bank, to do some administrative work. This includes executing a 'bulk change deed'. The FM providers may also need to prepare and process data files, and to generate and submit files of DDI-related electronic 'AUDDIS'<sup>9</sup> messages into the Bacs system.
- 2.15** The bulk change deed is a supplement to the standard indemnity, given in favour of all credit institutions that participate in the Direct Debit scheme, such as high street banks and building societies, and the outgoing FM provider (the indemnitees). Under the bulk change deed the new FM provider indemnifies the indemnitees against indemnity claims relating to DDs collected against a transferred DDI, both before and after the transfer date. In other words, the new FM provider becomes liable for all indemnity claims, including those relating to DDs collected by the outgoing FM provider (prior to the transfer date).<sup>10</sup>
- 2.16** Therefore, from a liability perspective, it appears advantageous to the outgoing FM provider to use option 'b' (the bulk change process) as it enjoys an indemnity from the incoming FM provider. In contrast, under option 'a' it does not, and the outgoing FM provider would need to settle any indemnity claims (with recourse to its former FM client).

<sup>6</sup> Direct Debit Instructions are sometimes also commonly referred to as Direct Debit 'mandates'.

<sup>7</sup> *The Little Bacs Guide to Switching Facilities Management Provider*, pages 4 to 5: [https://www.bacs.co.uk/documentlibrary/little\\_bacs\\_guide\\_to\\_switching\\_fm\\_providers.pdf](https://www.bacs.co.uk/documentlibrary/little_bacs_guide_to_switching_fm_providers.pdf)

<sup>8</sup> Ibid.

<sup>9</sup> AUDDIS is the 'Automated Direct Debit Instruction Service' which enables information about DDIs (e.g. whether they are new, amended or cancelled) to be transferred electronically from service users to paying banks via the Bacs system.

<sup>10</sup> It should be noted that, in relation to pre-transfer claims under option 'b', the bulk change deed does not extinguish the indemnity provided by the outgoing FM provider under the standard indemnity, so it may have some residual contingent liability. However, even then, the liability of the outgoing FM provider in respect of pre-transfer claims is no greater than it would have been under option 'a'.

## Issues regarding current switching arrangements and the extent of those issues

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- 2.17** An FM provider (GoCardless Ltd) has asked us to consider whether the Direct Debit rules on Facilities Management (FM) services should be changed, specifically concerning the options and processes for FM clients who wish to switch to a new FM provider. A copy of this request is in Annex 3.
- 2.18** The concern raised is that, under the current DD rules, the bulk change process can only proceed with the consent of the outgoing FM provider. This effectively allows outgoing FM providers to increase the costs and disruption associated with switching, should they seek to do so, by refusing to use the bulk change process to assist a switch.
- 2.19** One FM provider provided us with information about 13 instances since April 2015 where it claimed that an outgoing FM provider refused to use the bulk change process. In six of these instances this led to the switch being abandoned. In the other seven instances, the switch proceeded but with increased cost and disruption for the FM client and its customers, as the FM client had to obtain new DDIs from its customers (in some cases there were more than 10,000 of these).
- 2.20** In early July 2017 we conducted an online survey to get feedback from FM providers on aspects of their FM services, and their experiences in helping FM clients switch their business to them or away from them. Our survey was sent to 30 Bacs service users that we believe act as FM providers. We received complete responses from 11 firms, of varying sizes, that said they provide FM services on a commercial basis to third party clients.<sup>11</sup> The key findings from this survey were:
- Ten out of the 11 commercial FM providers who responded said they had attempted to use the bulk change process to assist an FM client who wanted to switch to them from another FM provider. Of these ten, five providers said they had experienced examples where the outgoing FM provider had refused to sign the bulk change deed or to cooperate with a request to use the bulk change process. A sixth FM provider said that although they had not encountered a case of an outgoing FM provider refusing to sign the bulk change deed 'sometimes the ceding [outgoing] provider delays data transfer to complicate the process or tries to impose fines or conditions on the client to put them off making the switch'.
  - All 11 commercial FM providers who responded said they had been asked by an FM client to use the bulk change process to help switch some or all of their business away to another FM provider. Ten out of the 11 said they had never refused these requests. One FM provider said they had sometimes refused, saying they have a contingent liability to their sponsor bank even if the client switches away using the bulk change process. They also said they may, on occasion, refuse a request to use the bulk change process to switch away if they 'are either uncomfortable with the request due to the nature of our client's financial status or otherwise'.

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<sup>11</sup> We also received two partial and anonymous responses, which we have discounted, and two responses from firms that said they only provide FM services for group entities or not at all.

- Most respondents confirmed that they see significant benefits in using the bulk change process to assist FM clients who wish to transfer either in or out, in terms of:
  - reduced administration
  - a clear transfer of liability (see paragraphs 2.15 and 2.16)
  - a smoother transition process
  - clearer communications to payers

However, they also noted that the bulk change process involves numerous actors and manual steps, and that different sponsor banks often require different notice periods to fulfil their parts of the process. This can create complexity and confusion.

**2.21** BPSL's approach so far, following the work it has done in this area (see paragraph 3.5) has been to seek to address concerns by way of providing new voluntary best practice guidance to FM providers, and to seek further feedback from stakeholders of instances where it is felt 'another stakeholder involved in the process is unreasonably hindering or preventing a switch from taking place'.<sup>12</sup>

**2.22** We are keen to understand in detail any legitimate reasons why an existing (outgoing) FM provider might wish to refuse to support a bulk change process request and how FM providers evaluate each request.

**Question 1: What objective justifications would an existing FM provider have to refuse to use the Bacs bulk change process to switch some or all its business to an alternative FM provider?**

### **Why is the PSR concerned regarding FM clients' ability to switch?**

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**2.23** The discussions we have had, and the information we have seen so far, suggest that a refusal by an incumbent (outgoing) FM provider to use the bulk change process to assist its FM client to switch away increases switching costs and business disruption not only for the FM client but also for the FM clients' customers (the DD payers). Such switching costs may include financial costs of switching, monetary losses if the switch is not successful and procedural costs such as the time and effort involved. High switching costs may deter FM clients from pursuing a switch of FM provider and may increase barriers to entry if prospective new FM providers consider that it would be challenging to acquire customers. These effects would be expected to reduce the degree of competition within the market.

**2.24** Furthermore, refusal by FM providers to use the bulk change process could also have implications for innovation. If customers choose not to switch their FM provider because the process is too onerous or cumbersome then existing FM providers may have a reduced incentive to offer or develop better and more innovative customer solutions.

**2.25** If an existing FM provider does not cooperate with a request to use the bulk change process, its FM client's ability to switch to (what it considers to be) a more attractive service proposition and/or tariff is likely to be impeded, possibly to such an extent that the switch fails altogether.

**2.26** FM clients should be confident that when they switch their FM provider the process does not introduce additional risks for their customers (the DD payers), for example missing any DDs or of paying twice for the same amount due.

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<sup>12</sup> *The Little Bacs Guide to Switching Facilities Management Provider*, page 5:  
[https://www.bacs.co.uk/documentlibrary/little\\_bacs\\_guide\\_to\\_switching\\_fm\\_providers.pdf](https://www.bacs.co.uk/documentlibrary/little_bacs_guide_to_switching_fm_providers.pdf)

**2.27** We do not think it appropriate that FM clients should be unduly restricted in their ability to switch between FM providers, so any ability for the existing FM providers to influence the switching costs of FM clients and incoming FM providers should only occur where there is a strong objective justification. We note that under the Current Account Switch Service there are obligations on certain banks to facilitate customer current account switching, which mean that the existing bank cannot prevent a customer choosing to move another bank for current account services. However, as noted in paragraph 2.20, around half of the respondents to our July 2017 survey indicated that they had experienced difficulties when they attempted to use the bulk change process as a result of the actions or inactions of the incumbent FM provider, which indicates that this is potentially a significant issue.

**2.28** We have reached a provisional conclusion that the current ability of existing FM providers to affect the switching costs of other providers and clients is not appropriate (we refer to this as our first provisional conclusion). In Chapter 3 we discuss potential solutions to the concerns that have been raised.

**Question 2:** Do you agree with our first provisional conclusion? What are the reasons for your answer?

# 3

## Potential solutions

In this chapter we consider options to address the concerns identified and present our provisional conclusions that BPSL should change its rules to achieve the specified purpose of requiring outgoing FM providers acting in the course of business to use the bulk change process unless certain exceptions apply.

We welcome stakeholders' comments on the proposals.

### Introduction

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- 3.1** We share the concerns discussed in Chapter 2 regarding the ability of an incumbent FM provider to make it difficult for its customers to switch to an alternative FM provider. As set out in paragraphs 2.11 and 2.12, the difficulty arises if the incumbent FM provider refuses to cooperate with a request by its FM client (or its FM client's prospective new FM provider) to use the bulk change process.
- 3.2** In this chapter we consider potential solutions to address the concerns, including whether the operator of the Direct Debit scheme (BPSL) should change its rules in a way that would address them.
- 3.3** We do not propose a specific wording for any new rule. Instead, the outcome of this consultation should:
- enable us to determine whether to use our statutory powers<sup>13</sup> to require BPSL to implement a new rule to address the concerns and achieve the specified purpose
  - inform us whether there are any exceptions where such a rule should not apply

### Potential solutions and our regulatory framework

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- 3.4** This section explains the possible solutions we have given consideration to so far. These are:
- a. doing nothing
  - b. implementing a voluntary code of conduct
  - c. requiring a rule change

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<sup>13</sup> We have rule change powers under Section 55 of FSBRA (System rules).

**3.5** We note that in late 2016 and early 2017, following discussions with ourselves, BPSL undertook some relevant work with its members and a number of FM providers to investigate the concerns around FM switching and use of the bulk change process. BPSL found that while awareness of the bulk change process is high, it was not always well understood as a process and that there are factors that may deter wider use of bulk change. BPSL has told us that its work has so far resulted in:

- increased levels of engagement between BPSL and FM providers
- a review of the FM switching process being undertaken, including input from BPSL members and seven FM providers, leading to the creation of new collateral on FM switching and use of the bulk change process
- new areas being established on the Bacs website to hold information and new collateral of interest to FM providers<sup>14</sup> and FM clients<sup>15</sup>
- the publication of new BPSL guidance in March 2017, that encourages FM providers to use the bulk change process to assist their FM clients who want to switch<sup>16</sup>
- plans to add a new 'marker' in the Bacs system to clearly identify FM providers and their transactions

### **'Doing nothing' option**

**3.6** One option therefore would be to do nothing in the short term and give time to see whether the new BPSL guidance improves the situation. However, our July 2017 survey responses and our dialogue with an FM client (see 2.13) suggest that the best practice guidance is unlikely to be sufficient to address the concerns.

### **Code of Conduct**

**3.7** Another option might be to raise awareness of the best practice guidance, and encourage FM providers to adhere to it by way of a Code of Conduct. However, it is not clear how much more effective a Code of Conduct would be, over and above the existing situation.

**3.8** Since a Code of Conduct would be a voluntary instrument, the onus would be on an FM client to check that its prospective FM provider had signed up to the Code of Conduct, and then to satisfy itself (for example via its contract with its FM provider) that switching support would indeed be provided if and when required in the future. For existing FM clients a Code of Conduct would, at best, only be of assistance if their FM provider decided to sign up to it.

**3.9** We are concerned that any voluntary action, including a voluntary code, would still leave existing FM providers with an ability to frustrate switching by FM clients. We note that in many other markets, where co-operation is required to facilitate switching, rules exist which require participants to provide such co-operation.

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<sup>14</sup> <https://www.bacs.co.uk/Access/FMProviders/Pages/FMProviders.aspx>

<sup>15</sup> <https://www.bacs.co.uk/Resources/FMClients/Pages/FMClients.aspx>

<sup>16</sup> [https://www.bacs.co.uk/documentlibrary/little\\_bacs\\_guide\\_to\\_switching\\_fm\\_providers.pdf](https://www.bacs.co.uk/documentlibrary/little_bacs_guide_to_switching_fm_providers.pdf)

## Rule change

- 3.10** Our power to alter<sup>17</sup> system rules applies to the rules of regulated payment systems and allows the PSR to require the operator of such systems to:
- a. establish rules for the operation of the system
  - b. change the rules in a specified way or so as to achieve a specified purpose
  - c. notify the PSR of any proposed changes to the rules
  - d. not change the rules without the approval of the PSR
- 3.11** The requirements under 'c' or 'd' may be general or specific.
- 3.12** In making any decisions regarding the exercise of our FSBRA power to alter system rules, we will consider our statutory objectives and any relevant regulatory principles. In summary, our three statutory objectives are:
- a. to ensure that payment systems are operated and developed in a way that considers and promotes the interests of all service-users
  - b. to promote effective competition in the markets for payment systems and services in the interests of service-users
  - c. to promote the development of and innovation in payment systems, in the interests of service-users with a view to improving the quality, efficiency and economy of payment systems

In these objectives, 'service-users' has the meaning defined in FSBRA (see page 5).

- 3.13** If we decide to require BPSL to change its rules, we will also consider the effectiveness and proportionality of any proposed rule change in light of the concerns that have been raised:
- a. **Effectiveness:** The rule change must address the problem(s) we have identified and be practicable to implement, monitor and enforce. We take account of current laws and regulations, as well as those expected in the near future.
  - b. **Proportionality:** The rule change needs to solve the problem(s) we have identified in a way that is no more onerous than necessary. For example, if there is a choice between two equally effective solutions, we would choose the option that is least intrusive. The rule change should also not produce disadvantages which are disproportionate to its aim.
- 3.14** We will also consider the following:
- a. **Principles of Better Regulation** in the Legislative and Regulatory Reform Act 2006, including proportionality and transparency, and the additional requirements of the Regulators' Code.
  - b. **Equality and Diversity Implications:** In line with our public sector equality duty under the Equality Act 2010, we assess the likely equality and diversity impacts and rationale of our proposals to assess whether they give rise to any concerns as a result of any protected characteristic, as part of our decision-making processes.

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<sup>17</sup> Section 55 FSBRA.

**3.15** In light of the potential for effects on competition, innovation and service-users, we have provisionally concluded that:

- a voluntary approach is unlikely to address the concerns
- a rule change to make use of the bulk change process compulsory for FM providers (when an FM client wants to switch), provided that certain conditions are met, appears to be a proportionate and effective approach to address the concerns, given the information we've received so far (we refer to this as our second provisional conclusion)

**Question 3:** Do you agree with our second provisional conclusion? What are the reasons for your answer?

**Question 4:** In particular, do you think that imposition of a rule to achieve such a purpose would unfairly reallocate liability in any way (given the bulk change deed)?

**3.16** At this stage we consider it a sensible approach for the PSR to specifically require BPSL to change the DD rules to achieve a specified purpose. This would be to require existing FM providers, acting in the course of business, to use the bulk change process unless certain exceptions apply (we refer to this as our third provisional conclusion).

**Question 5:** Do you agree with our third provisional conclusion, and that the specified purpose of the proposed rule is appropriate? Please give your reasons.

**Question 6:** What considerations should BPSL and the PSR take into account in the formulation of the rule change?

### Conditions in which a new rule might apply

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**3.17** In the context of our statutory objectives, we are concerned with the operation of competition between FM providers who provide FM services on a commercial basis to third party clients. Some FM providers only provide FM services to other entities within the same corporate group and we would expect any disagreements between these parties to be resolved within the corporate group's governance arrangements. Therefore we see no need for the change in rules to apply to all FM providers, and instead suggest that any new rule should only apply to FM providers who provide commercial FM services and who are acting in the capacity of PSP.

**Question 7:** Do you agree that any new rule should be applicable only to FM providers who are PSPs providing commercial FM services?

**3.18** From the discussions and information we have received so far, our provisional view is that an FM client's existing FM provider should support it to switch to another FM provider, using the bulk change process, if the following conditions are all met:

- a. The relevant FM client and its proposed new FM provider agree that use of the bulk change process is the preferred method to execute a transfer of some or all relevant DDIs .
- b. The new FM provider's sponsor bank agrees it will support the request. Using the bulk change process results in a transfer of indemnity claim liability from the outgoing FM provider to the new FM provider (and its sponsor bank) so it is important to obtain agreement from both the new FM provider and its sponsor bank.
- c. Both the outgoing and new FM providers are capable of effecting the bulk change process request using the AUDDIS service (i.e. they are both registered in the Bacs system as AUDDIS users).
- d. No exceptions apply (see paragraph 3.19).

**Question 8:** Do you agree with the proposed conditions a) to d) in paragraph 3.18 regarding when a new rule should apply?

**Question 9:** Are there any other conditions you think should also apply? Please explain your justification for these.

## Exceptions to the rule

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**3.19** During the course of our discussions with stakeholders, we have sought feedback regarding what may constitute a reasonable justification for an outgoing FM provider to withhold its consent in relation to a request to use the bulk change process (Question 1 in this consultation seeks further feedback in this regard). These reasons have been suggested to us so far:

- a. The outgoing FM provider's contingent liability to its sponsor bank.
- b. Where the DDIs subject to the bulk change process transfer request have been obtained for multiple purposes. For instance, where the FM provider is collecting money from a payer under a single DDI in relation to more than one product or service, and only one of the products or services is the subject of the intended switch.
- c. Where there is an ongoing commercial dispute, payment arrears or other service-related issues between the FM client and its current FM provider.

**3.20** Taking each of the suggested reasons in turn:

- a. As discussed in paragraphs 2.15 to 2.16, our understanding is that the indemnity claim risk for the outgoing FM provider reduces when the bulk change process is used to support an FM client who is switching to another FM provider, in that:
  1. The exposure amount in respect of any indemnity claims (against pre-transfer DDs) is no greater than the exposure amount would have been had the FM client moved to another FM provider and the existing DDIs been cancelled instead of transferred by the outgoing FM provider.
  2. Using the bulk change process means that indemnity claims in respect of pre-transfer DDs will in future be directed to the new FM provider and be subject to the indemnity in the bulk change deed, making it far less likely that the outgoing FM provider would incur liability.
- b. BPSL's guidance is that 'It is strongly advised that service users use the preferred standard practice of a one contract – one DDI approach'. Use of DDIs for multiple payment purposes therefore goes against BPSL's guidance but it does sometimes occur.
- c. We would welcome further feedback from stakeholders as to why a commercial dispute, payment arrears or service-related issues between the FM client and its current FM provider should be treated as a reason for an outgoing FM provider to be able to withhold its consent to using the bulk change process. Our initial view is that these are matters to be resolved contractually between the FM client and its current FM provider, and should not hold up a switching process for future service provision.

**Question 10:** Do you consider each or any of the suggested exceptions discussed in paragraphs 3.19 and 3.20 to be valid grounds for an outgoing FM provider to withhold its consent to a bulk change process request to support one of its FM clients switching its business to another FM provider? Please provide justification for your views.

**Question 11:** Are there any other exceptions that should be applied to the rule? Please provide justification for your views.

# 4

## Implementation and effectiveness

In this chapter we discuss the implementation and potential effectiveness of the provisional conclusion in light of the current contractual arrangements that exist between the parties involved in the FM switching process.

We welcome stakeholders' comments on the issues raised.

### Introduction

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- 4.1** As discussed in Chapter 3, we are currently of the view that the most appropriate and practicable way of addressing the concerns would be for us to require BPSL to implement a new rule. We note that BPSL normally issues an annual update to its Service User's Guide and Rules to the Direct Debit Scheme during the final quarter of each year, with any changes becoming effective at the start of the next calendar year.
- 4.2** We will not propose specific wording for that rule. The responsibility for drafting the rule in a way that meets the specified purpose would sit with BPSL. Similarly, we also do not propose to intervene in the commercial relationships between FM providers and their FM clients.
- 4.3** In order to be effective any rule needs to be clear, unambiguous and enforceable. If there are difficulties in the enforcement of a new rule regarding the use of the bulk change process then the rule may fail to be effective and so not succeed in addressing the concerns.
- 4.4** FM providers are a type of Bacs service user. All service users undertake to comply with the Direct Debit Service User Guide & Rules by way of their providing a form of the Direct Debit standard indemnity. They may separately also undertake to comply with these rules through commercial agreements with their Bacs sponsor banks.
- 4.5** Service users do not have a direct contractual relationship with BPSL. Therefore under the current contractual arrangements, if an FM provider failed to comply with a new rule requiring it to support a FM client wishing to switch to another FM provider, BPSL would need to rely on the relevant sponsor bank being able and willing to enforce the rule, and to do so effectively.
- 4.6** Depending on the detail of the commercial bilateral agreement between an FM provider and its sponsor bank, the sponsor bank may only be able enforce the DD rules against the FM provider under the terms of the standard indemnity, and this may be limited by the extent of loss the sponsor bank suffers. We are also not aware of any ability for BPSL to directly hold the FM provider to account for failing to abide by the scheme rules.

- 4.7** We wish to consider potential approaches to implementing the proposed rule, so that it will be effective in addressing the concern. So far we have considered the following options, which are discussed further below:
- a. No change to the status of FM providers. Sponsor banks would remain responsible for ensuring that their sponsored service users comply with the DD rules including the proposed rule change.
  - b. Create a new Bacs participant category for FM providers. FM providers would be directly bound, via contract with BPSL, to any new rule(s) relating to FM providers using the bulk change process to assist switching FM clients.
- 4.8** Whichever implementation approach is adopted, we expect BPSL to monitor the effectiveness of any new rule and to report back to us, after an agreed period, on whether any revision or other action is necessary to address the concern, and whether any related new concerns have arisen.

### **Option (a): No change to the status of FM providers**

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- 4.9** Under this option FM providers would retain their existing status as a type of Bacs service user. BPSL would have no direct relationship with the FM providers, so any non-compliance with the DD rules would be a matter for the non-compliant FM provider's sponsor bank to address.
- 4.10** The benefits of this approach include that it avoids the need for FM providers or BPSL to enter into any new contractual relationships. An FM provider's sponsor bank may be in a good position to determine whether non-compliance is occurring and to consider any necessary action needed.
- 4.11** The disadvantages of this approach include the fact that the liability of FM providers in relation to the DD rules (and including any new rule) is limited to the contractual arrangements with their sponsor bank and the standard indemnity. Therefore, depending on the nature of the separate commercial agreement between FM provider and sponsor bank, the sponsor bank may have limited ability to take action against its sponsored FM provider. In addition, the sponsor bank is likely to share similar incentives of its FM provider in relation to its FM clients. The disadvantages of this option may therefore lead to inconsistent and ineffective enforcement of the rule by sponsor banks.

### **Option (b): Create a new Bacs participant category for FM providers**

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- 4.12** This approach would directly and contractually require FM providers to comply with the new rule (where applicable, for example this might just be FM providers who are acting as PSPs) and would allow BPSL to take action directly in response to non-compliance.
- 4.13** BPSL advised us in July 2017 that it is considering developing an accreditation scheme for FM providers and that it will consult on its potential development. This may provide a suitable means of FM providers entering into a direct contractual relationship with BPSL.
- 4.14** The benefits of this approach include that it would support a uniform approach to enforcement of the relevant rules, under a common form of contractual arrangement between BPSL and the relevant FM providers. BPSL has a clear and unambiguous interest in ensuring that the rules are adhered to, and would not have commercial incentives in its relationships with FM providers, which could potentially create conflicts of interest in enforcement matters. It would also be potentially more transparent than option (a).
- 4.15** The disadvantages of this approach include that it entails the creation of additional contractual relationships between BPSL and the FM providers.

**Question 12:** Do you have any comments or suggestions regarding the relative benefits and disadvantages of the two options: 'a' (no change) and 'b' (new Bacs participant category)? Which do you think is likely to be most effective, and why?

**Question 13:** Do you have any comments or suggestions regarding the best time to implement any changes?

# Annex 1

## Part 1: A basic overview of Direct Debit

**1.1** In Part 1 of this annex we provide a basic overview of the Direct Debit (DD) scheme, which is operated through the Bacs payment system, and the relationship between the parties involved. In the most basic DD arrangements, these are:

- **The payer:** The person or organisation making the payment.
- **The Bacs service user:** The organisation the payer is paying, and which uses DD to collect the money. Sometimes also referred to as a 'collecting organisation' or 'originator'.
- **The paying bank:** The payer's bank or building society.
- **The service user's bank:** The bank that sponsors the service user to use the Direct Debit system, underwriting certain risks (also known as the **sponsor bank**).

### Setting up a Direct Debit

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#### Step 1

**1.2** To set up a DD, the payer must give the service user permission to collect money from their account in the form of a Direct Debit Instruction (DDI). The DDI can be provided on paper with a signature, or by non-paper means such as over the phone, face-to-face or through a web form.

Every service user is identified in the Bacs system by a unique number called a Service User Number (SUN). The service user is likely to include its SUN in any correspondence about the DD with the payer.

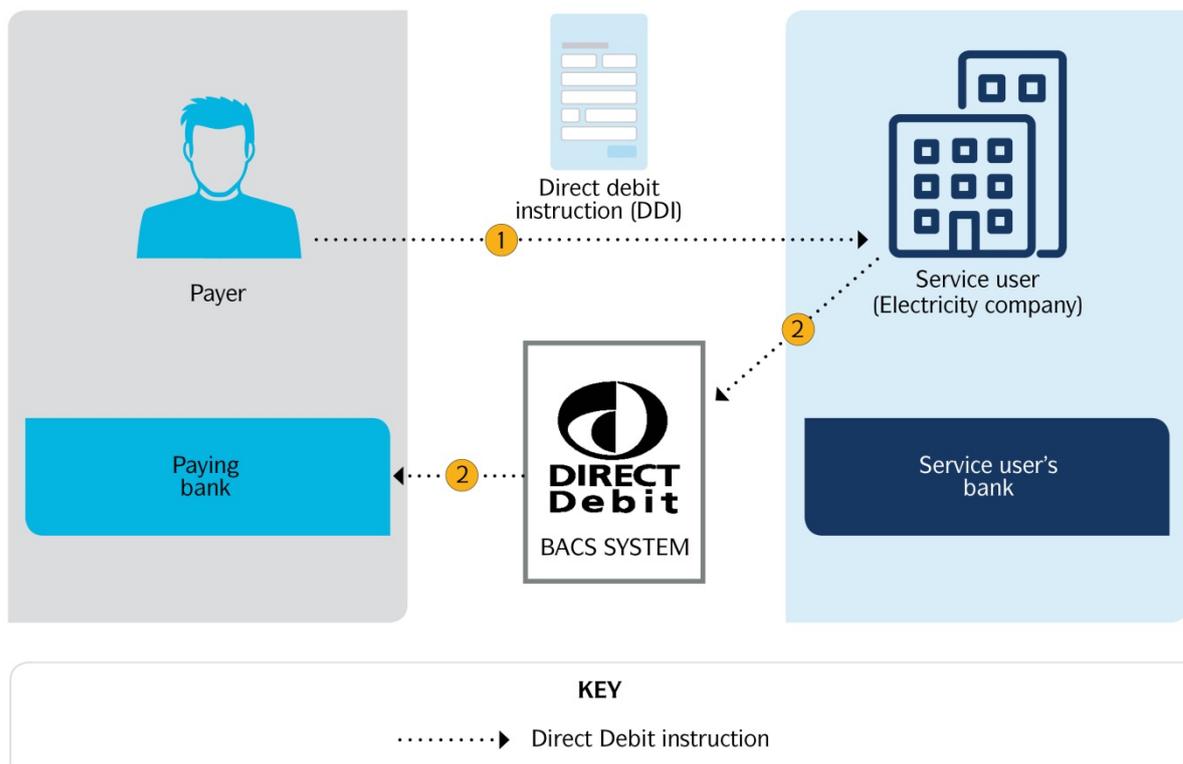
#### Step 2

**1.3** The service user then sends the relevant information from the DDI to the payer's bank or building society (the paying bank), so that it can allow the relevant DD payments to be collected. The information can be sent in two ways:

- **Electronically:** The service user can send information to the paying bank via the central Bacs system. The vast majority of DDIs are now sent electronically. Service users that submit directly to Bacs can send the information via Bacs themselves (as shown in Figure 1). Service users with indirect access submit files via their bank or a bureau service provider<sup>18</sup>, which will handle the technical processing on their behalf.
- **By post:** The service user can post the signed paper DDI to the paying bank. This was how DDs were set up before electronic methods were introduced in 1996.

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<sup>18</sup> Over half the organisations using Bacs make their payments or DD submissions through an approved bureau service provider. Bureau providers do not handle settlement or take ownership of payment proceeds at any stage – they only provide technical and processing services.

**Figure 1: The Direct Debit Instruction**

## Collecting payments by Direct Debit

### Step 3

**1.4** Once the DDI has been sent to the paying bank (which will record it in its systems), the service user can begin to collect payments from the payer's account. To do this, it sends a file either directly or indirectly via the Bacs system, containing (among other details):

- the service user's SUN
- details of the payer's account
- the DD amount it wants to collect
- reference information that links the individual collection with the DDI

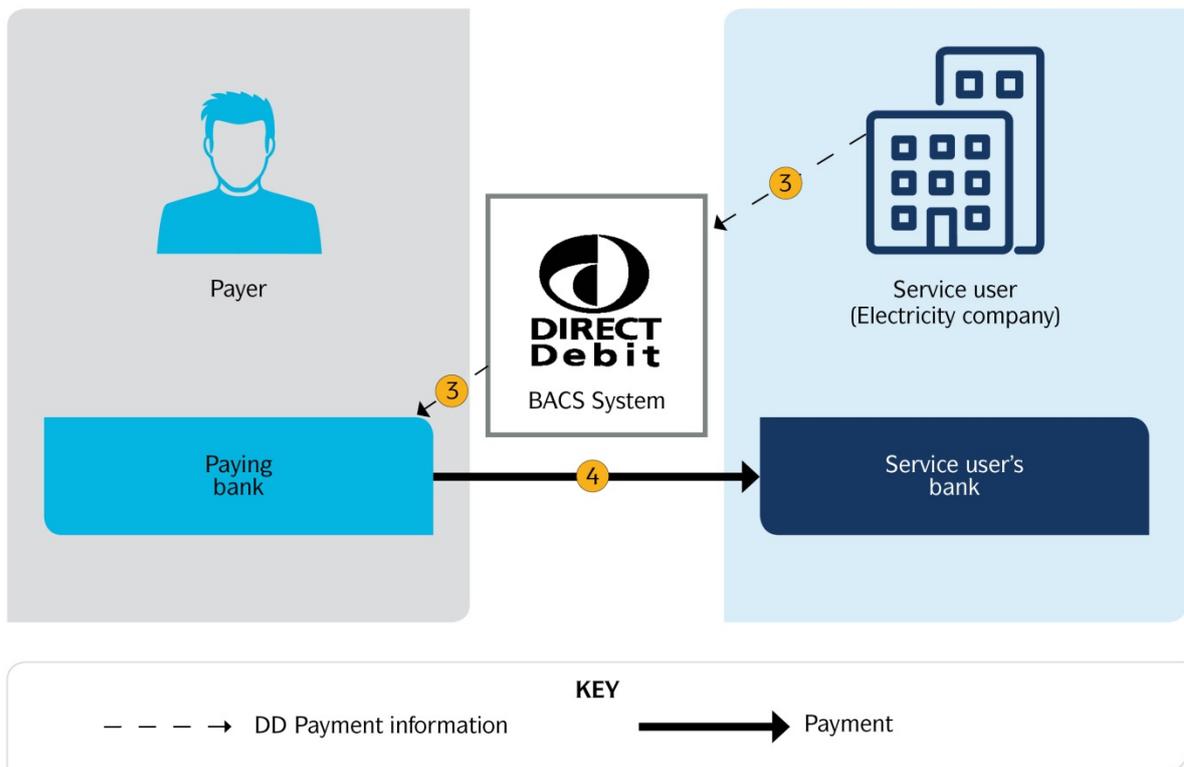
Figure 2 shows how this works if the service user is a direct submitter and sends its files directly via the Bacs system. It could also send them through its bank or a bureau.

The service user must follow the DD rules, including providing the payer with advance notice of the amounts to be collected.

### Step 4

- 1.5 When the paying bank receives the DD collection, it checks whether it should honour the debit request (for example, it will check if the payer has enough money in their account and that the payer has not cancelled the DDI or asked for the debit to be stopped). Once it is satisfied that the payment can be made, it debits the payer’s account. The service user’s bank receives funds via the Bacs settlement process and credits the service user’s account. The accounts are debited and credited on the same business day, two business days after the service user submitted the DD file to the Bacs system.<sup>19</sup>

Figure 2: Collecting payments



<sup>19</sup> Service users may also submit files earlier and specify the date they want them to be processed.

# Annex 1

## Part 2: How Facilities Management works

**2.1** In Part 2 of this annex we provide a basic overview of how Facilities Management (FM) works. To do this we introduce the concepts of:

- **The FM provider:** The service user using DD to collect money from payers on behalf of another business or organisation (an FM client).
- **The FM client:** A business or organisation using the services of an FM provider.

### Setting up a Direct Debit under a Facilities Management arrangement

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#### Step 1

**2.2** If a business or organisation doesn't have the capability to offer Direct Debits to its customers, it can arrange for a Bacs service user to manage the process and collect money from its customers on its behalf. This service is called facilities management (FM). The service user in this relationship is acting as an 'FM provider', and the business or organisation using the service is an 'FM client'.

**2.3** The payer still needs to provide an authority (the DDI) for money to be collected from their account at the paying bank. The FM provider will then send the Direct Debit file and collect the money on behalf of the FM client.

**2.4** In the example in Figure 3, the payer is setting up a DD with their local gym. The gym uses an FM provider, Payments Company Ltd, to process its DDs. The gym is the FM client.

**2.5** The Direct Debit rules say that Payments Company Ltd must register a SUN in the Bacs system specifically for the DD activity it conducts on behalf of the gym. DDIs allowing Payments Company Ltd to collect money for the gym from the paying bank must show this dedicated SUN.

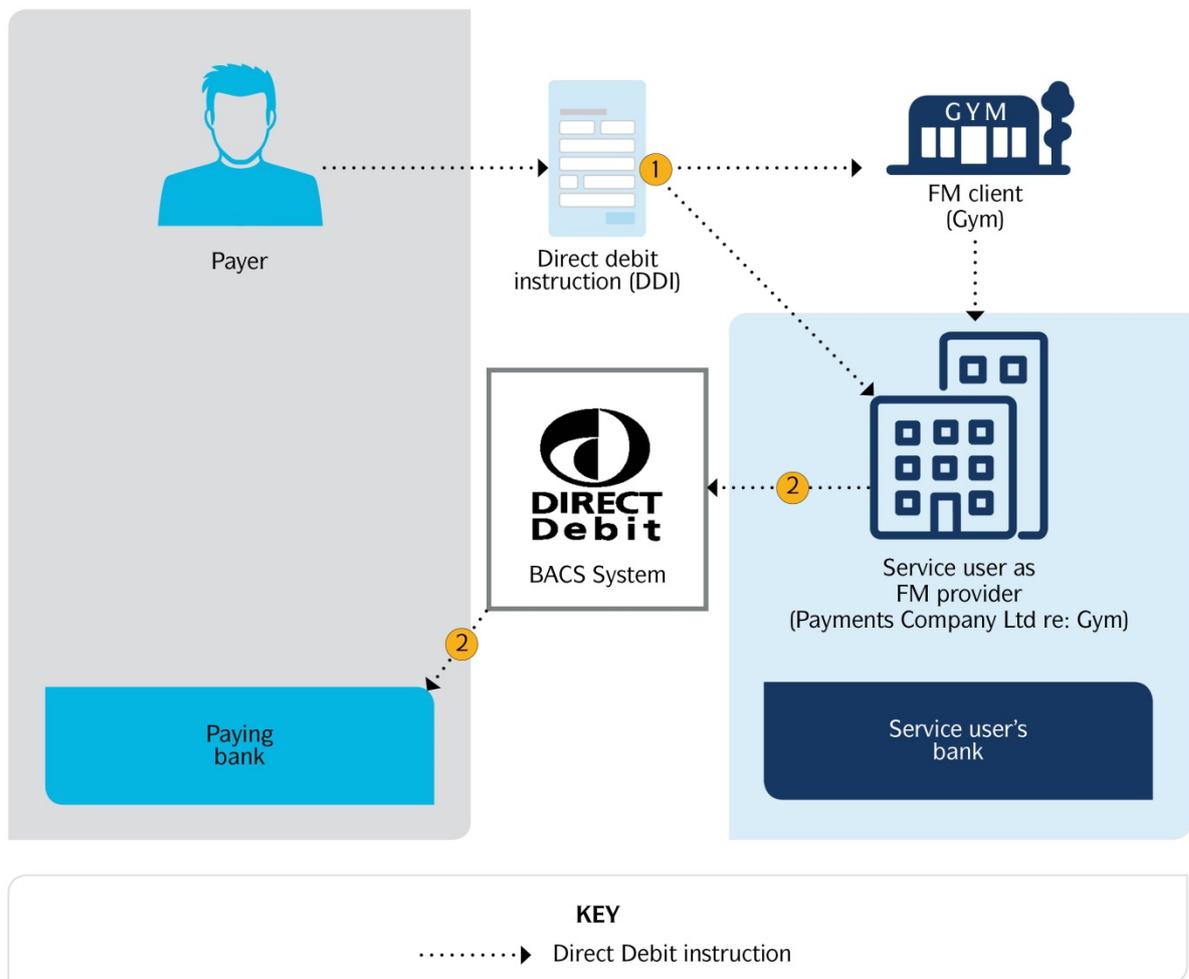
**2.6** The DDI can be arranged in different ways:

- As the FM provider, Payments Company Ltd can provide a service on the gym's behalf for the payer to provide a DDI (for example, a website, mobile application or other sign-up services using the gym's branding).
- The gym can deal directly with its customer (the payer) and then forward details of the new DDI to Payments Company Ltd.
- There can also be a combination of these approaches.

#### Step 2

**2.7** After the payer has given their authority, the FM provider (Payments Company Ltd) sends the DDI information to the paying bank (as is usual for setting up any DD).

Payments Company Ltd must also manage the processing of any returned, amended or cancelled DDIs on the gym's behalf.

**Figure 3: The Direct Debit Instruction (FM set-up)**

## Collecting Direct Debit payments under a Facilities Management arrangement

### Step 3

- 2.8** Once the DDI information has been sent to the paying bank, the FM provider (Payments Company Ltd) can collect payments on behalf of its FM client (the gym).
- 2.9** The FM provider must:
- use the SUN that it registered for the FM client
  - include the service user name (which should match the name used with the payer when the DDI was set up) – for example, *'Payments Company Ltd re: Gym'*
  - comply with the Direct Debit rules

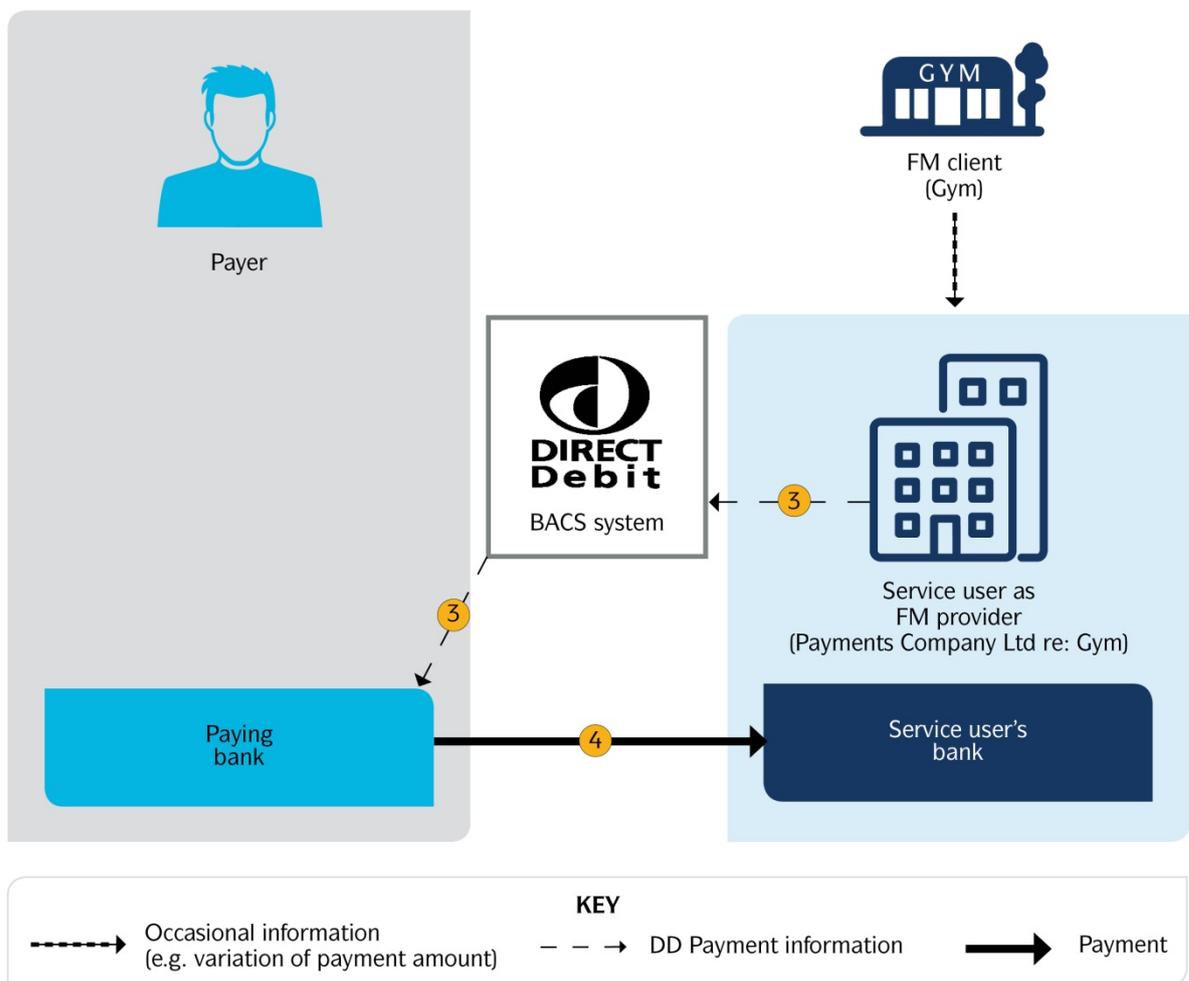
### Step 4

2.10 The settlement of DDs happens in the same way as usual. The money must not be collected directly to the FM client’s own account but instead must be credited to an account that is:

- in the FM provider’s name
- designated as a ‘client monies’ or ‘trust’ account
- held at the FM provider’s bank

The FM provider will subsequently forward on the proceeds (less any agreed deductions) to the FM client.

**Figure 4: Collecting payments (FM set-up)**



## Annex 2

# Consultation questions

We are asking for responses to the following consultation questions:

- Question 1:** What objective justifications would an existing FM provider have to refuse to use the Bacs bulk change process to switch some or all its business to an alternative FM provider?
- Question 2:** Do you agree with our first provisional conclusion? What are the reasons for your answer?
- Question 3:** Do you agree with our second provisional conclusion? What are the reasons for your answer?
- Question 4:** In particular, do you think that imposition of a rule to achieve such a purpose would unfairly reallocate liability in any way (given the bulk change deed)?
- Question 5:** Do you agree with our third provisional conclusion, and that the specified purpose of the proposed rule is appropriate? Please give your reasons.
- Question 6:** What considerations should BPSL and the PSR take into account in the formulation of the rule change?
- Question 7:** Do you agree that any new rule should be applicable only to FM providers who are PSPs providing commercial FM services?
- Question 8:** Do you agree with the proposed conditions a) to d) in paragraph 3.18 regarding when a new rule should apply?
- Question 9:** Are there any other conditions you think should also apply? Please explain your justification for these.
- Question 10:** Do you consider each or any of the suggested exceptions discussed in paragraphs 3.19 and 3.20 to be valid grounds for an outgoing FM provider to withhold its consent to a bulk change process request to support one of its FM clients switching its business to another FM provider? Please provide justification for your views.
- Question 11:** Are there any other exceptions that should be applied to the rule? Please provide justification for your views.
- Question 12:** Do you have any comments or suggestions regarding the relative benefits and disadvantages regarding the two options: 'a' (no change) and 'b' (new Bacs participant category)? Which do you think is likely to be most effective, and why?
- Question 13:** Do you have any comments or suggestions regarding the best time to implement any changes?

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