



HM TREASURY

# Setting the strategy for UK payments

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July 2012





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# 1

## The consultation process

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### The subject of this consultation

The regulation and governance of payments networks in the UK.

### Structure of the consultation

Chapter 2: Introduction

Chapter 3: The existing payments regime

Chapter 4: Current and future challenges

Chapter 5: Proposed changes to the regulatory regime

Annex A: List of consultation questions

Annex B: Glossary

### Who should read this

This consultation invites views on options for reforming the regulation and governance of payments networks in the UK. It should be read by those with an interest in the future development and strategy of payments networks and the users of those networks: this includes banks, building societies and other payments service providers, the owners and operators of payment systems, businesses, trade bodies, consumer groups and other interested parties.

### How to respond

HM Treasury invites responses on the specific questions raised. The questions can be found throughout the document and are listed in full at annex A.

This consultation will run from Thursday 19 July – Wednesday 10 October.

Please send responses to:

Payments Consultation

Banking & Credit Team

Floor 1, Yellow

HM Treasury

1 Horse Guards Road

London, SW1A 2HQ

Email: [PaymentsConsultation@hmtreasury.gsi.gov.uk](mailto:PaymentsConsultation@hmtreasury.gsi.gov.uk)

## Confidentiality

**1.1** Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the Freedom of Information Act 2000 (FOIA).

**1.2** If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidentiality. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.



# 2

## Introduction

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**2.1** Under the present regulatory system, the Payments Council, a membership body funded by the payments industry, is responsible for driving strategy for the payments industry in the UK. In late 2009, the Payments Council took a decision that cheques would be phased out by banks and building societies from 2018. This decision caused considerable anxiety for many people in the UK, particularly those who were elderly, housebound or relied on cheques to conduct their day to day business (such as charities, clubs and small businesses). Although the Payments Council was clear that suitable alternatives would need to be available before cheques were abolished, at the point when the Treasury Select Committee (TSC) launched an investigation into this issue in April 2011 ('The Future of Cheques'), no progress had been made to develop suitable alternatives to the cheque.

**2.2** The Treasury Select Committee took evidence from a wide range of consumer groups, small business associations and charitable associations as part of their investigation. They concluded that the decision to abolish cheques had caused deep, unnecessary and unacceptable concern amongst bank customers and that the Payments Council had communicated poorly with the public. They also found that, given the Payments Council is dominated by the banks and other payments industry members, consumers were entitled to be suspicious of the motives of the Payments Council when proposing measures that were in the financial interest of its members.

**2.3** In June 2011 the Financial Secretary to the Treasury wrote to the TSC to express the Government's dissatisfaction with the way the proposed abolition of cheques was handled by the Payments Council. The Financial Secretary noted that, in the absence of an alternative system to replace the flexibility and ease of use of cheques which was widely available, widely acceptable and widely adopted by users, the Government did not believe that there was a credible and coherent case for abolishing cheques. Following pressure from the TSC and the Government, the Government was pleased to see the Payments Council reverse its decision to abolish cheques, in July 2011. In its response to the TSC report into The Future of Cheques, the Government also accepted the case for bringing the Payments Council within the scope of financial regulation and said that it was developing a number of options for potential reforms on which it would consult.

**2.4** The existing regime for payments in the UK is complex, with roles for the Payments Council and a number of regulatory bodies including the Financial Services Authority, the Bank of England, the Office of Fair Trading and HM Treasury. Chapter 5 of this consultation document sets out options that the Government wishes to consider to improve the way that payments strategy is made in the UK. Given the Government's assessment of the status quo and the need for change, there is no "do nothing" option.

**2.5** The Government aims to ensure that UK payment systems and services meet the current and future needs of consumers, businesses, other users and the wider economy without imposing disproportionate regulatory costs on businesses. This means having:

- UK payments networks that operate for the benefit of all users including consumers;
- a UK payments industry that promotes and develops new and existing payment networks;

- UK payments networks that facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms ; and
- UK payments systems that are stable, reliable and efficient.

**2.6** The first option for consultation builds on the present approach to UK payments strategy. It proposes a series of changes that could be carried out within the existing Payments Council to improve the way the Council delivers the Government's aims. The changes are intended to complement the reforms the Payments Council are currently undertaking. These changes would make the Payments Council more responsive to the needs and views of end users, including consumers. The Payments Council must consider fully consumer views before taking decisions and has not been able to inspire confidence in this area to date. This option would address the immediate and essential first step recommended by the TSC to change the composition of the Board of the Payments Council in order to strengthen significantly the voice of consumers among the independent members and ensure any two of the four independent members could veto a decision made by the Board. This option would not increase the overall burden of regulation and would be the cheapest for the industry to deliver. This option would not however bring any increased regulatory oversight to payments strategy in the UK.

**2.7** The second option proposes introducing a new public body to set strategy across the UK payments industry (the Payments Strategy Board). The Payments Strategy Board (PSB) would:

- monitor, report on and make public recommendations to the payments industry;
- be composed of senior industry representatives, senior non-industry representatives (such as consumer bodies) and independent directors;
- be overseen by the new Financial Conduct Authority (FCA) which would, at a minimum, set up the Board, make appointments, approve the business plan and budgets and could appoint an independent person to report on its effectiveness; and
- be funded through a levy, set and collected by the FCA.

**2.8** This approach aims to deliver a credible and strong strategy setting public body which would both hold the industry to account and deliver recommendations for the future direction for payments in the UK. The recommendations of the PSB would be addressed to the payments industry. The Government expects that the recommendations will be accepted and delivered by the Payments Council, on behalf of the payments industry, as improved by some or all of the changes proposed in option one of this consultation.

**2.9** Option 2 brings payments strategy, but not the Payments Council itself, into regulation. Because of the FCA's role in competition and consumer protection, the Government believes that it is best placed to set up and oversee the PSB and the work it does to develop a payments strategy which meets the needs of consumers and promotes competition. The Government believes that this option strikes a good balance between ensuring that the Payments Strategy Board represents the payments industry, balanced by appropriate consumer groups and independent directors, and that its recommendations are public, bringing increased transparency. The Payments Strategy Board would ensure competition concerns and consumer views are fully considered when payments strategy is being formulated, and meets the Government's aims at relatively low cost to the industry. At this stage of the consultation process, this is the Government's preferred option.

**2.10** Finally, another approach would be to create a new regulator for the payments industry. The regulator would be similar to the body ("Paycom") recommended by the Cruikshank Report in 2000. It would be built on a similar model to other regulated sectors such as gas, electricity

and water with providers being licensed and the regulator enforcing license conditions to ensure that:

- open access to payments systems was maintained;
- pricing was transparent and efficient;
- industry governance was adequate and
- fair trading principles were respected.

**2.11** A new statutory regulator for the payments industry would be a major increase in the overall regulatory burden with considerable costs for businesses attached. A new regulator for payments would also take time to design and implement and be less well equipped to identify and drive innovation within the sector. Given these downsides, the Government has not considered this approach in detail in this consultation. If, however, the balance of consultation responses favour this approach and can demonstrate that the marginal benefits would outweigh the costs relative to Option 2, the Government will give it further consideration.

**2.12** The rest of this consultation sets out the existing regime for payments in the UK, including the role of the Payments Council and existing regulatory bodies; the current and future challenges facing them and then the Government's proposed options in more detail. Finally a list of consultation questions and a glossary are included as annexes.

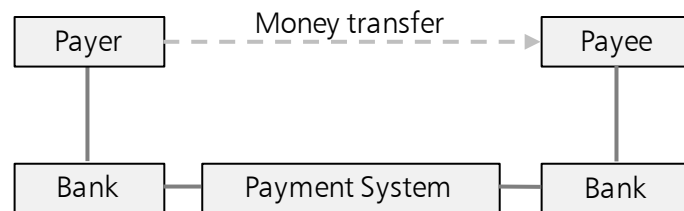


# 3

## The existing payments regime

### Payments networks

3.1 Money transmission is central to the functioning of the economy. Money circulates continuously between individuals, businesses and government, for example when buying goods and services, receiving income or paying taxes. The mechanisms through which such transfers are made are known as payment systems, which are operated by payment scheme companies. This consultation refers to the entire chain from payer to payee as a payments network, and the centralised clearing and settlement mechanisms as a payment system<sup>1</sup>. This is illustrated in the following diagram:



3.2 The principle payment networks are shown in the table below:

The principal payment networks (2010)		
	Transaction volume (million)	Transaction value (£ billion)
Cash	20,397	262
Cheque	1,065	1,077
Plastic card	8,467	430
Direct debit	3,229	948
Automated credit	3,115	3,408
Total	36,273	6125

Source: Payments Council. UK Payment Statistics 2011. Tables 27.1 and 27.2

### The existing regulatory regime

3.3 The existing regulatory regime for payments is complex, with a number of bodies having some responsibility for the regulation and governance of payments. The Bank of England, the Financial Services Authority, HM Treasury and the Office of Fair Trading have roles to play in the

<sup>1</sup> A glossary of relevant terms is included at annex A

regulation of payments systems. The Payments Council, an industry body, is responsible for setting the strategy for UK payments.

**3.4** This chapter sets out the current governance and regulatory arrangements for payments in the UK.

### **Role of the Treasury**

**3.5** The Banking Act 2009 established a new regulatory framework for the oversight of recognised inter-bank payment systems, where any deficiencies in their design or disruption of their operations would threaten financial stability or have systemic consequences. Under the Act, HM Treasury may designate a system, which brings it within formal Bank of England oversight. Currently the Bacs, CHAPS, CLS Bank International, the Faster Payments Service and the payment systems embedded in the Crest, Ice Clear Europe and LCH Clearnet systems are recognised in this way.

**3.6** The criteria for recognition are set out in Part 5 of the Act to identify payment systems (including payment systems embedded in clearing houses recognised by the Financial Services Authority), that should be brought under the Bank's oversight. The Act confers powers on the Treasury to designate, by order, a payment system as a "recognised system", where the Treasury is satisfied that any deficiencies in the design of the system or disruption of its operation would be likely to:

- threaten the stability of, or confidence in, the UK financial system, or
- have serious consequences for business or other interests throughout the UK.

**3.7** The recognition criteria are set out in full in Section 185 of the Act.

**3.8** The Act also confers powers on the Bank of England in respect of recognised systems. The Treasury, together with the Bank and the Financial Services Authority, keep payment systems that operate in the UK under review in order to decide whether they should become recognised. A guide to the recognition process is accessible on the Treasury's website at:

[www.hm-treasury.gov.uk/fin\\_consumer\\_payments.htm](http://www.hm-treasury.gov.uk/fin_consumer_payments.htm)

**3.9** The Financial Services Act 2010 amended Part 5 of the Banking Act 2009 to confer a power on HM Treasury to apply the provisions of Part 5 to service providers (such as telecommunication or information technology providers). This power has not been used to date.

### **Role of the Bank of England**

**3.10** Following the introduction of the statutory oversight regime, the Bank of England published a set of 14 principles to which the operators of recognised payment systems are to have regard. These comprise ten Core Principles for Systemically Important Payment Systems published by the Bank for International Settlements, and a further four principles covering business risk, interdependencies, indirect participation in payment systems and outsourcing. The Banking Act 2009 also gives the Bank of England a graded series of powers and tools to allow it to discharge its oversight function. The Bank published its approach to statutory regulation of payment systems in September 2009. It reports on how it has carried out its role in an annual Oversight Report, accessible on the Bank of England website at:

[www.bankofengland.co.uk/](http://www.bankofengland.co.uk/)

**3.11** The Bank conducts regular risk reviews for each payment system that it formally oversees. The outcome of these reviews is usually formalised in an expectations letter, in which the Bank sets out its expectations for issues to be addressed and actions to be taken by the payment systems. While these expectations do not themselves carry statutory force, the Bank monitors

the responses of the payment systems to ensure that they are adequate and, where necessary, considers using its statutory powers.

**3.12** The Bank also has a role in considering applications for the designation of payment systems under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999, which implement the EU Settlement Finality Directive in the UK. The Bank of England is also a non-voting observer on the Payments Council board.

**3.13** Finally, the Bank has a role in clearing sterling payments across its balance sheet. It operates the Real-Time Gross Settlement system for sterling central bank money which provides final and irrevocable settlement for CHAPS, the UK's large value payments system. It also provides final multilateral net settlement facilities to Bacs, Faster Payments Service, LINK and the Cheque and Credit Clearings. And it is an operational user of some of the payment systems in its own role as a bank, providing banking services to its customers.

### **Role of the Financial Services Authority (FSA)**

**3.14** The FSA has responsibility for regulating firms with permission under Part 4 of the Financial Services and Markets Act 2000 (FSMA), as well as the recognition and supervision of recognised investment exchanges and recognised clearing houses under Part 18 of that Act. Some of these regulated bodies have payment systems embedded within them. Where these payment systems are recognised under the Banking Act, both the Bank and the FSA have regulatory functions. The exercise of these functions is set out in a Memorandum of Understanding between the two bodies.

**3.15** In addition, the FSA is the competent authority for authorised and small Payment Institutions (firms providing payment services) under the Payment Services Regulations 2009. The Regulations implement Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market. The Directive established an authorisation regime for non-bank payment service providers, such as money remitters and non-bank credit card issuers, and sets out conduct of business rules for all firms providing payment services, including banks and payment institutions.

**3.16** The FSA's responsibilities for regulating recognised clearing houses under FSMA will pass to the Bank of England as part of the Government's current regulatory reforms. The FSA's responsibilities for regulating payment service providers under the Payment Services Regulations will pass to the Financial Conduct Authority (FCA), which will replace the FSA in 2013. The FCA will also have an objective to promote effective competition in the interests of consumers in markets for regulated financial services (which includes payment services provided by payment service providers) and new powers to ask the OFT to consider whether features of a financial services market prevent, restrict or distort competition.

### **Role of the Office of Fair Trading (OFT)**

**3.17** The OFT is responsible for enforcing competition rules and Part 8 of the Payment Services Regulations, which aim to ensure fair access to UK payment systems. Part 8 does not apply to payment systems that are designated as systemically important under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 – which includes CHAPS and Bacs. Some UK payment systems do fall within the scope of Part 8, including Link and the Visa and MasterCard credit and debit card systems.

### **Role of the Payments Council**

**3.18** The Payments Council is a self regulatory body responsible for setting the strategy for UK payment systems. It was established in March 2007 to ensure that UK payment systems and services meet the needs of users, payment service providers and the wider economy. It has three main objectives:

- 1 Strategic vision: to lead the future development of co-operative payment services in the United Kingdom in order to ensure that payments networks as a whole meet the needs of payment service providers, users and the wider economy, including through:
  - facilitating competition, development and innovation within the sector;
  - the identification and sponsorship of innovative solutions, including where appropriate new payment services, to meet the current and future needs of consumers, businesses and other users promptly and efficiently.
- 2 Openness and accountability: to ensure that payment systems are open and accountable and that:
  - any restrictions on access to payment schemes are fair, reasonable, and non-discriminatory;
  - the governance of payment systems is transparent and open to public scrutiny;
  - any proposals for innovation and major changes in the conduct of payment schemes are subject to rigorous and transparent evaluation, weighing up the costs and benefits to the banking industry and to society as a whole.
- 3 Integrity: to ensure the operational efficiency, effectiveness and integrity of payment services in the United Kingdom.

## Structure of the Payments Council

**3.19** The Payments Council is a voluntary membership body. Full membership is available to payment service providers reaching threshold volumes of payments. The Payments Council also offers associate membership (at lower cost, but with correspondingly fewer rights) for organisations with a more general interest in the payments industry.

**3.20** The Payments Council is governed by a board of directors. The Board has 15 voting directors, an independent non-voting Chairman, and a non-voting observer from the Bank of England. Of the voting directors, 11 are industry-appointed members, representing a cross-section of the Payments Council membership. Five of these are appointed by the five largest Payments Council members, each with over 5% of UK payment volumes in qualifying payment schemes, and who thereby have a seat on the Board by right. Three of these are elected from among the medium-sized members with 1-5% of UK payment volumes, and the remaining three are elected by members with less than 1% of payment volumes.

**3.21** The remaining four voting members of the Board are independent directors, who are appointed by a committee of two existing industry directors and two existing independent directors. Their role is to bring in an outside perspective and expertise, and to represent non-industry views. When voting together, the four independent members have the power to block a decision from the Board. In practice the board works by consensus and the independent directors have not exercised this power.

**3.22** The Payments Council has entered into a contractual relationship with a number of payment scheme companies, such as Bacs and CHAPS. Each of these schemes is owned by a subset of Payments Council members. Each scheme is required to report to the Payments Council, and is bound by Payments Council decisions. This is, however, qualified by a right for both schemes and their members to apply for a formal waiver from a board decision in some instances.

**3.23** The infrastructure contracts for the various payment systems are made available by the payment scheme companies, via competitive tender. Currently, the infrastructure for Bacs, FPS



and Link is provided by VocaLink, a company owned by a number of the major payment service providers in the UK.

**3.24** As a voluntary membership body, the Payments Council is funded through membership fees. Full members pay a fee based on their respective percentage shares of payment volumes in the UK. In addition funding for specific projects is assessed on a case by case basis as the need arises. This approach can cause delays and in some cases can cause projects to be blocked if funding cannot be secured. It may also prevent the Payments Council from making forward plans.

**3.25** The Payments Council is resourced by UK Payments Administration Ltd. This is a service company providing staff, facilities and back-office functions to a wide range of payments companies. The directors of UK Payments Administration Ltd are also directors or senior officers of the Payments Council, and of industry bodies such as the UK Cards Association and certain payment systems.



# 4

## The Government's aims

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### The Government's aims

**4.1** The Government has a number of aims for payments networks in the UK to ensure that payments end-users including consumers, as well as the wider economy, benefit to the fullest extent from payments networks. This means having:

- UK payments networks that operate for the benefit of end users including consumers;
- a UK payments industry that promotes and develops new and existing payment networks;
- UK payments networks that facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms; and
- UK payment systems that are stable, reliable and efficient.

**4.2** The fast pace of technological change and shifting end-user needs presents the payments industry, and the Payments Council in particular, with a number of challenges. The following paragraphs consider the challenges faced by the industry and the Payments Council in meeting each of these aims and the background to those challenges. Chapter 5 considers options for reform.

### How well does the present system deliver the Government's aims?

#### UK payments networks that operate for the benefit of end users including consumers

**4.3** The Payments Council can and should do more to respond to the needs of payments end users, and ensure that wider views are fully taken into account when making decisions on payments strategy. For example, the decision to close the cheque clearing system was taken by the Payments Council in 2009 without an analysis of the costs and benefits, a plan for managing the process, or any indication of what alternative payment instruments might need to be created. The Payments Council did not provide individuals, charities or businesses in the UK who relied on cheques, such as the elderly, the housebound or small businesses, with information on suitable alternative payment methods.

**4.4** This was highlighted by the Treasury Select Committee (TSC) in its report on the Future of Cheques<sup>1</sup>. The TSC found that the Payments Council and banks provided confusing or conflicting information to consumers in some instances and that consumer voices were not given adequate weight by the Payments Council when making their decision. The strength of feeling among the public was highlighted by the 1,200 letters and emails the TSC received from members of the public – far more than they usually receive when conducting a report. The TSC concluded that unnecessary concern was caused among bank customers, that the Payments

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<sup>1</sup> The future of cheques. Eighteenth Report of Session 2010–12. 24 August 2011. HC1147; and The future of cheques: Government and Payments Council Responses to the Eighteenth Report from the Committee Twenty-third Report of Session 2010–12. 16 November 2011. HC 1645

Council's decision was poorly communicated and that the Treasury should bring the Payments Council formally within financial regulation.

**4.5** The Financial Secretary to the Treasury wrote to the TSC as part of their investigation and noted the Government's dissatisfaction with the way that the original announcement to abolish cheques was handled by the Payments Council. He said:

"Regrettably, the announcement was made without an assessment of the costs and benefits, or a plan or timetable for managing the process, or an indication of what alternative payment instruments might need to be created... The result has been to create a great deal of uncertainty and alarm across the country"

**4.6** In the Government response to the TSC report, the Government accepted the case made by the TSC and committed to considering options for reform, which form the basis for this consultation.

**4.7** The Payments Council reversed its decision in July 2011 and committed to maintain the cheque clearing system in the future. However this decision was only taken following significant public pressure.

### **A UK payments industry that promotes and develops new and existing payment networks**

**4.8** The promotion and development of new and existing payments networks is essential for the industry to keep pace with technological change, and to ensure payments end-users such as consumers and businesses benefit from improved services. The development of payment services across the industry has at times been slow. In such cases there may be losses to the wider economy where consumers and businesses cannot benefit from the latest innovations. A recent example is the introduction of the Faster Payments Service, the first new payment system for 20 years. Faster Payments enables users to make payments within hours, with same day clearing and settlement. It is significantly faster than the three day clearing cycle offered by Bacs transfers.

**4.9** The development of the Faster Payments Service was driven in 2005 by pressure from the Office of Fair Trading and HM Treasury through the Payments Systems Task Force. The payments industry expected to deliver the new service within two years.

**4.10** The design and implementation of the system was led by the industry and was subject to many delays, limiting the consumer and business benefits available. Initially faster payments were only available to retail customers for certain types of payment, such as online and telephone banking credit transfers. Value limits on the amount of money consumers could send via Faster Payments then remained low once the service was adopted, and there remain substantial differences in the limits applied by each member bank.

**4.11** The full benefits of Faster Payments have only been available since January this year, following a provision in the Payment Services Regulations 2009. These regulations require that from January 2012 many payments must reach the recipient's account by close of business the next working day after a customer has initiated a payment.

**4.12** The Payments Council has also found it difficult to make progress in the development of other payment services, such as mobile payments, where individual Payments Council members failed to reach a consensus on the way forward. A recent Governance review of the Payments Council, published by one of the Payments Council's independent directors<sup>2</sup>, makes clear that though a mobile payments service has been under consideration "virtually from the Council's

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<sup>2</sup> Independent review of governance and performance of the Payments Council 2009-11, Martin Cave, January 2012 Available at: [http://www.paymentscouncil.org.uk/files/payments\\_council/governancereview/governance\\_review-martin\\_cave\\_report-february2012.pdf](http://www.paymentscouncil.org.uk/files/payments_council/governancereview/governance_review-martin_cave_report-february2012.pdf)

inception” a clear decision to proceed with the creation of a mobile service was only taken by the Payments Council in December 2011. The Payments Council also failed to develop an alternative to cheques once it had announced the decision to phase out cheques.

### **UK payments networks that facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms**

**4.13** Open and fair access to payment systems and services is essential for effective competition in banking and can be a particular issue for smaller banks. Smaller banks and building societies need to be able to process payments on behalf of their customers at reasonable cost, on reasonable terms, to compete.

**4.14** Not all banks access payment systems directly. The banks that have lower payments volumes may instead choose to access payments systems via larger banks through “agency” arrangements. These arrangements may be mutually beneficial for both the agency bank and the sponsoring bank given the fixed and ongoing costs of direct membership (particularly if the agency bank processes only very low payments volumes). However, in some circumstances the agency model has the potential to cause distortions in competition. For example, through the terms of an agency agreement a large bank that acts as a direct member of the payment system could restrict access to the agency bank, or provide a level of service that makes it difficult for the agency bank to offer a competitive service. This concern was raised by the Independent Commission on Banking (ICB), in their Final Report<sup>3</sup>. The ICB said:

“There is some evidence to suggest that the ability of banks to access the payment systems through incumbents, and the ability of the Payments Council to maintain a level playing field in payments, are not conducive to a competitive market”.

**4.15** Overall the ICB considered that the evidence was not clear-cut. The ICB did not make any substantive recommendations regarding access to payment systems. It recommended that the Bank of England, in collaboration with the Financial Conduct Authority (FCA) and OFT, should monitor access to payment systems and the effectiveness of the Payments Council in providing adequate governance to ensure innovation and competition.

**4.16** The Government is aware that there are still a number of issues for challenger banks in this area. Concerns have been raised by some smaller banks, for example, that complexity and a lack of transparency make it hard to assess how competitive their sponsorship arrangements are. A lack of transparency may also make it difficult for a bank to smoothly navigate the process for gaining direct access to the systems. How much direct membership would cost and how long direct membership would take to achieve may not be made available.

### **UK payments systems that are stable, reliable and efficient.**

**4.17** The Bank of England’s regular risk reviews for each payment system that it formally oversees, and collaboration with the Payments Council, have helped to ensure that systemically important UK payment systems have not been subject to instability. The regime has maintained a stable, reliable and efficient set of payment systems that performed well throughout the financial crisis.

### **Problems with the current system**

**4.18** Based on the evidence set out below the Government considers the Payments Council has not been as successful as originally intended in terms of either developing new and existing services, ensuring that payments networks operate for the benefit of all users and effectively

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<sup>3</sup> The Independent Commission on Banking, Final Report, September 2011. Available at [http://www.hm-treasury.gov.uk/fin\\_stability\\_regreform\\_icb.htm](http://www.hm-treasury.gov.uk/fin_stability_regreform_icb.htm)

communicating their decisions. The Payments Council's own recent Governance review has highlighted these points. The Payments Council could also do more to demonstrate that it can provide a channel for challenger banks to access better agency agreements to access payment systems on fair and open terms.

**4.19** The Government has no concerns over the Bank of England's stability remit. Under all the options discussed in this consultation, the oversight regime for systemically important payment systems, operated by the Bank of England, which seeks to ensure that payment systems manage their rules and operations in a way that minimises risks to the financial stability of the financial system as a whole, would remain unchanged. Preserving financial stability will continue to be given priority in decision-making in relation to payments networks.

### Advisory issues

**4.20** There are a number of reasons why the Payments Council's current structure undermines its ability to fulfil a strong advisory and strategy setting role. This helps to explain why the Payments Council has not adequately taken into account consumer and wider views when making decisions, as highlighted by the TSC in their report on the future of cheques.

**4.21** The main reason is the Payments Council is dominated by the UK's largest banks. This allows the largest banks to set the strategic direction for the Payments Council overriding alternate views or stakeholder interests. This has been recognised by the Payments Council's own recent Governance review (conducted by an independent director) which noted that "the Payments Council is dominated by the financial services industry and ways need to be found to communicate more effectively with consumer groups and SMEs".

**4.22** In their report into the future of cheques, the TSC had similar concerns. The TSC said that: "The Payments Council is dominated by the banks and other payment industry members . . . Consumers are entitled to be suspicious of the motives of a body with such a composition proposing measures that are in the financial interests of its members."

**4.23** The position of the major UK banks as both the owners of the payment systems, and the dominant decision-making force on the Payments Council can cause the perception of conflicts of interest when the Payments Council makes decisions. It is important that the UK payments regime is able to inspire confidence in this area and the Payments Council has not been able to do this successfully to date.

**4.24** As well as reflecting the dominance of voices from within the industry over those of end-users, the Payments Council's decision making has been slowed by the need to work by consensus. It seems to give undue weight to individual large members in determining whether a particular proposal by the Payments Council should be taken forward. For example, where a proposal may be in the interests of the industry or the UK as a whole, but not in the commercial interests of a particular participant, that proposal may be blocked or delayed. As a result, there has been a tendency for decision-making to be at the pace dictated by the slowest and by the biggest banks. The largest banks in the UK have large shares in the current account market and process the highest volume of payments, and it is therefore understandable that the largest banks will have a significant voice within the Payments Council. However it is important that all views are heard from a wide variety of sources, and the current situation does not appear to work as well as was originally intended.

### Delivery issues

**4.25** The Payments Council could also improve its performance in delivering specific projects. The Payments Council currently works by consensus and can struggle to enforce decisions effectively, once they are taken. This has meant that a single member can block or slow progress on any given issue. This creates a tendency to restrict development or implementation to the

pace of the slowest, and can partially explain the slow implementation of the new Faster Payments Service, for example.

**4.26** The provision of stable funding for development and implementation projects has also proved difficult for the Payments Council. The Payments Council is not able to raise funding on its own initiative and it is not able to borrow to fund projects. Funding is instead assessed on a case by case basis as the need arises. This approach makes it difficult to prepare forward looking plans. It can cause delays and in some cases can cause projects to be blocked if funding cannot be secured.

### The Government's options for reform

**4.27** As a whole, this assessment of the current regime's performance against the Government's aims provides a compelling case for reforming the governance of payment networks and the Payments Council in particular. It is the Government's view that the current model of self-regulation has not adequately delivered the leadership and strategic direction needed to meet the current and future challenges that the payments industry faces. For this reason this consultation includes no "do nothing" option.

**4.28** There are two constraints on any potential programme of reform:

- First, the stability, integrity and smooth functioning of payment systems is of vital importance to the economy. Any changes to the governance or operation of payment networks must not lead to increased systemic risks or barriers to competition.
- Secondly, any potential reform must be consistent with the Government's better regulation agenda. Any increase in regulation must be proportionate, and should not impose excessive burdens on business.

**4.29** The Government considers that the advisory problems relating to the Payments Council must be tackled. This is likely to require structural changes to the set up of the Payments Council and wider payments regime. The Payments Council is dominated by a narrow set of interests and has not always taken the wider views of end-users into account when making long term and strategic decisions. The Payments Council should also improve on delivering and implementing projects, once they have been agreed upon.

**4.30** The next chapter outlines the Government's options for reform. The first option builds on the present approach to UK payments strategy. It proposes a series of changes that could be carried out within the existing Payments Council to improve the way the Council delivers the Government's aims. These changes would make the Payments Council more independent and responsive to end users. This option would not increase the overall burden of regulation and would be the cheapest for the industry to deliver but would not bring any increased regulatory oversight to payments strategy in the UK.

**4.31** The second option proposes introducing a new public body to set strategy across the UK payments industry (the Payments Strategy Board). The Payments Strategy Board would:

- monitor, report on and make public recommendations to the payments industry;
- be composed of senior industry representatives, senior non-industry representatives (such as consumer bodies) and independent directors;
- be overseen by the new Financial Conduct Authority (FCA) which would, at a minimum, set up the Payments Strategy Board, make appointments, approve the business plan and budgets, and could appoint an independent person to report on its effectiveness; and
- be funded through an FCA levy.

**4.32** This approach would deliver a respected strategy setting public body which would deliver recommendations for the future direction of travel for payments in the UK. The public nature of the recommendations would hold the industry to account. The second option is designed to complement the reforms proposed under Option 1 of this consultation. The Government expects that the recommendations of the PSB would be delivered by the Payments Council, as improved by some or all of the changes proposed in Option 1.

**4.33** Option 2 would bring payments strategy, but not the Payments Council itself into regulation. The Government believes that this option strikes a good balance between ensuring that the Payments Strategy Board is represented by the industry, balanced by appropriate interest groups and independent directors, and that its recommendations are public, bringing increased transparency, with the industry responsible for implementing the recommendations as they are accepted. This option meets the Government's aims at relatively low cost to the industry. At this stage of the consultation process, it is the Government's preferred option.

**4.34** An alternative approach would be to introduce a new utility-style regulator for the payments industry. The regulator would be similar to the body ("Paycom") recommended by the Cruikshank Report in 2000. It would be built on a similar model to other regulated sectors such as gas, electricity and water with providers being licensed and the regulator enforcing license conditions to ensure that:

- open access to payments systems was maintained;
- pricing was transparent and efficient;
- industry governance was adequate; and
- fair trading principles are respected.

**4.35** A new statutory regulator for the payments industry would be a significant increase in the regulatory burden with considerable costs attached and an open question over whether this would be the best way to meet the shortfalls identified with the current system. The Government has not therefore considered this in detail in this consultation. If the balance of consultation responses favour this approach and can demonstrate that the benefits would outweigh the costs, the Government will give this option further consideration.

#### **Question 1**

Do you agree that the creation of a Payments Strategy Board:

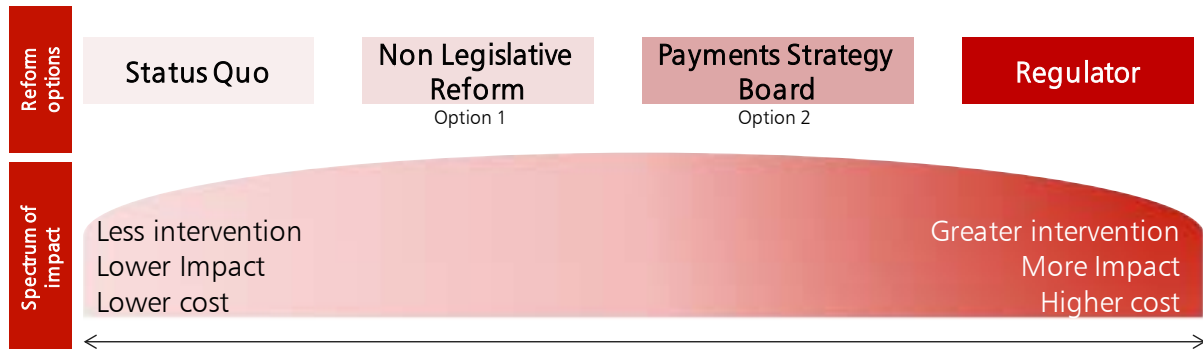
- should be the lead option for reform,
- provides the appropriate balance between Government intervention, impact and cost, and
- effectively tackles the issues the Government has set out?

Please provide evidence where appropriate to support your answer.



# 5

## Proposed options for changes to the regulatory regime



### Option 1: Enhanced self regulation

#### Key features

- Continued self-regulation through the Payments Council
- A range of changes to the Payments Council to enhance the responsiveness to end-users, and to empower strong independent voices

#### Description of Option 1

**5.1** The first option proposes a range of reforms which could be carried out within the existing Payments Council governance framework. These reforms could be carried out by the existing members of the Payments Council. They would improve the way the Council supports the Government's aims, and substantially improve the effectiveness of the Payments Council, while avoiding new regulatory burdens on business. These changes would make the Payments Council more responsive to the needs and views of end users, and strengthen the role of the independent directors whilst ensuring the continuing stability of payments networks. This option would not increase the overall burden of regulation and would be quick and inexpensive to deliver. This option would not however bring payments strategy within regulatory oversight.

**5.2** The Government would negotiate these changes with the payments industry and agree them on a voluntary basis. No legislation would be required. The Government would expect the Payments Council to tackle a number of issues, explained below.

#### The remit and objectives of the Payments Council

**5.3** The Government considers that the current remit and objectives of the Payments Council are broadly appropriate. However the Payments Council's capacity to translate these objectives into an appropriate strategic vision for the payments industry, and deliver on that strategy, should be enhanced.

#### The functions of the Payments Council

**5.4** At present, the Payments Council and its officers both exercise strategy setting functions and represent the payments industry as a trade body. This may create, or give the appearance of, a

potential conflict of interest and is detrimental to the ability of the Payments Council to deliver its objectives. The Government would expect that any trade body or lobbying functions would be removed from the work of the Payments Council (leaving the strategy functions intact). Alternatively, this separation could be achieved by a clearer functional separation of roles, reporting lines and accountability within the Payments Council, removing the present conflicts of interest.

### Transparency and accountability

**5.5** The Payments Council should be open, transparent and accountable. As previously mentioned the Payments Council has recently published an internal governance review and should make further steps to greater transparency. In future the Payments Council should commit to publishing annual progress reports against its objectives and commission regular, independent performance reviews.

### The Board of the Payments Council

**5.6** The Treasury Select Committee, in its report on The Future of Cheques, recommended that “the composition of the Board of the Payments Council be altered in order significantly to strengthen the voice of consumers among the independent members. In addition, any two of the four independent members, rather than all of them as at present, should have the right of veto over a decision of the Board”. The Government supports these recommendations and would expect the Payments Council to make the necessary changes to its board structure.

**5.7** The Government would be interested in views on whether the Payments Council’s board could be strengthened further. For example with respect to the Board’s composition and voting structure.

### User Councils

**5.8** The Payments Council currently has a number of “user forums”, chaired by independent directors. The present user forums are the main conduit for payments end-users, such as businesses, individuals and the charitable and voluntary sectors, to interact with the Payments Council. The Payments Council is currently reviewing the existing user forums as part of a wider review of the Payments Council’s structure.

**5.9** The role and functioning of the user forums could be significantly enhanced to better represent end-user interests and views. The existing user forums should be strengthened and developed into more independent User Councils. For example, enhanced User Councils would no longer be passive sounding boards. They should be able to set their own agendas and work programmes as well as developing their own strategic views on payments to feed into Payments Council board decisions.

**5.10** The Government expects that the Payments Council will enhance their existing user forums in this way and consider how best stronger, more autonomous User Councils should operate.

### Funding the Payments Council

**5.11** At present the five largest banks contribute over 80% of the Payments Council’s budget. A rebalanced board would require a rebalancing of funding. There is also a case for replacing the current ad hoc annual funding model with sustainable, long term funding arrangements. This would be more consistent with the Payments Council’s role as a long term strategy body undertaking long term projects. Stable funding and control of budgets would be critical for the independence of a reformed Payments Council.

**5.12** The Government invites views on how best funding of administration and development budgets can be put on a long term, secure footing.

## Powers of the Payments Council

**5.13** Full members agree to be bound by Payments Council rules and decisions. Some payment schemes also contract with the Payments Council and are also bound to accept its decisions. However, there are no sanctions for failing to comply, short of expelling a member. This forces the Payments Council to operate by consensus, with related delays and blockages of proposals.

**5.14** The Government invites views on how a reconstituted Payments Council could be given the means to enforce decisions more effectively in a self-regulatory, non legislative environment.

## Membership of the Payments Council

**5.15** The membership base of the Payments Council should be broadened to ensure that it is representative of all its stakeholders. It should also be opened to payment service users and organisations with an interest in payments through the creation of different categories of membership. The Government has considered whether membership by payment service providers should be made compulsory. However the Government currently considers that this would be a disproportionate means of achieving the aim of greater participation in the Payments Council. Compulsory membership would be burdensome and would not guarantee active participation by the members.

**5.16** The Government invites views on how membership of the Payments Council can best be broadened.

## Interaction with the existing regulatory regime

### Role of the regulatory bodies

**5.17** Under this option, the existing statutory roles of the Treasury, the Bank of England, the Financial Services Authority and the Office of Fair Trading would remain unchanged. The Bank of England would continue to sit on the Payments Council board as a non-voting observer with a strong stability mandate, and should have the opportunity to raise concerns before a board decision, if necessary.

**5.18** Given the new consumer and competition remit of the new FCA, and its role as competent authority for aspects of the Payment Services Directive, the FCA could also be invited to have non-voting observer status on the Payments Council board.

### Comment

**5.19** The Payments Council has already begun a process of reform which the Government welcomes. The reforms proposed under Option 1 are designed to support this process and ensure the Payments Council takes greater account of a wider range of views when reaching decisions. It leaves the strategy setting function of the Payments Council intact, but enhances and strengthens the current model.

**5.20** Option 1 still leaves challenges for the Payments Council. The Payments Council would become more independent of the big banks and more accountable to end users. Its board would be more robust, and its independent directors stronger. The potential for conflicts of interest would be reduced, through clearer separation of the strategy setting and industry representation functions.

**5.21** The Payments Council would still need to consider how best to hold its membership to account, to strengthen the role of the Payments Council in implementing projects.

## Question 2

The following questions relate to the changes the Government would expect the Payments Council to implement under Option 1. Some of the changes will also be considered if the Government proceeds with Option 2.

- a Do you agree that the current remit and objectives of the Payments Council are broadly appropriate? If not, how should they be enhanced?
- b How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?
- c Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?
- d Do you agree that any two independent directors should have a right of veto over board decisions? The Government invites views on how the Payments Council's board can be strengthened further.
- e Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?
- f How can Payments Council funding be put on a long term, secure footing?
- g How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?
- h How can the membership of the Payments Council be broadened most effectively?

## Option 2: Creation of a Payments Strategy Board

### Key features

- the creation of a new public body to set strategy across the UK payments industry (the Payments Strategy Board (PSB))
- the PSB would monitor, report on and make public recommendations to the payments industry
- the PSB would be composed of senior industry representatives, senior non-industry representatives (such as consumer bodies) and independent directors
- the PSB would be overseen by the new Financial Conduct Authority (FCA) which would, at a minimum, set up the Board, make appointments, approve the business plan and budgets and could appoint an independent person to report on its effectiveness
- the PSB would be funded through an FCA levy

### Creation of the Payments Strategy Board

**5.22** Option 2 delivers a new approach for the strategy setting functions of the payments industry by moving them from the Payments Council to a new public sector body. The Government proposes the creation of the Payments Strategy Board (PSB) – a body which would monitor, report on and make recommendations to the payments industry. These recommendations would be made public and the payments industry would be expected to accept them and implement them or make public why they could not or should not be implemented. This would bring transparency to decision-making and offer an opportunity for the payments industry to be held publicly to account for its decisions and performance.

### The role of the Financial Conduct Authority

**5.23** The remit of the Payments Strategy Board, which is set out below, is focussed on meeting consumer needs and promoting competition. It is for this reason that the Government believes that the Financial Conduct Authority should be responsible for overseeing the Payments Strategy Board, given their overlapping objectives. The Payments Strategy Board would be created by the FCA, and the FCA would make appointments to the PSB's decision making board, including its independent directors and its Chair, the latter with approval from HM Treasury. The FCA would also approve the PSB's budget and business plan, monitor the PSB throughout the year and have a power to appoint an independent person to produce reports into the PSB's effectiveness.

### The remit of the Payments Strategy Board

**5.24** The remit of the PSB would be to:

- promote the development of new and existing payments networks (to encourage innovation and collaboration in the payments industry);
- encourage the payments networks to operate for the benefit of all users; and
- promote access to payments networks by the industry on reasonable terms (to ensure, for example, that agency arrangements do not stop smaller banks from accessing the payments systems on fair terms).

**5.25** This remit would be set out in legislation, with a power for the Treasury to amend it as appropriate.

## Functions of the Payments Strategy Board

**5.26** The PSB would fulfil its remit by, for example:

- making recommendations to the payments industry;
- monitoring developments in the payments industry and reporting on industry performance against previous PSB recommendations (where appropriate); and
- carrying out research into the operation of payment systems.

## Recommendations from the Payments Strategy Board

**5.27** The Payments Strategy Board would make recommendations to the payments industry rather than requiring specific action. This approach recognises that the industry is the primary source of expertise on payments costing and development, and ensures the final decision on development projects remains with the (industry) bodies which will pay for them.

**5.28** The Government has considered whether the Payments Strategy Board should make binding rulings, rather than recommendations, but considers that this would represent a significant increase in regulation without corresponding benefits. If you consider binding rulings to be appropriate, please set out how such a method could work fairly and effectively.

**5.29** The Payments Strategy Board's recommendations to the industry would be publicly available, and the published recommendations would increase transparency and ensure that issues were addressed by the industry. The recommendations would be credible, supported by thorough cost benefit analysis and would carry significant weight. Though the Government expects that all recommendations from the Payments Strategy Board would be accepted by the industry, recommendations might not be accepted in some instances. If and when recommendations were not accepted by the industry the Government would expect the industry (though not require it) to publicly set out the reasons why. The Government would then consider what further action might need to be taken.

**5.30** The Payments Strategy Board would bring the analysis and decision making process for payments strategy out into the open for the first time, provide clarity for end users and provide strong, focused recommendations for the payments industry to deliver.

## Leadership and composition of the Payments Strategy Board

**5.31** The Government envisages that the Payments Strategy Board would be led by a part-time decision making board composed of a balance of senior industry representatives, non-industry representatives such as consumer representatives, and independent directors. Strong Board members, including senior industry representatives, would ensure that the Payments Strategy Board was a credible and strong body. The Bank of England and the Financial Conduct Authority could also sit on the Board as non-voting observers. The Board would be supported by a small permanent staff and greater numbers of temporary staff could be brought in if required for specific projects.

## Information gathering power for the Payments Strategy Board

**5.32** The Payments Strategy Board would need information to make expert recommendations (for example performance data, cost estimates from banks on infrastructure changes, information on bank IT systems, etc). A formal information gathering power might be necessary to enable the Payments Strategy Board to have access to all the information it needed. This would ensure that the Board was not reliant on voluntary disclosure. This would require enforcement mechanisms and it would be likely to change the nature of the Payment Strategy Board recommendations.

**5.33** Without powers, the Payments Strategy Board would be reliant on voluntary disclosure to make recommendations, and so its recommendations would be less detailed. In such a case the Payments Strategy Board could be considered to be facilitating industry development by providing an initial steer. An information gathering power would allow the Payments Strategy Board to make more detailed recommendations to drive development in payments.

**5.34** The Government invites views on whether or not a formal information gathering power for the Payments Strategy Board is necessary, what information should be subject to such a power and what enforcement mechanisms are necessary to support it.

### **The funding of the Payments Strategy Board**

**5.35** The Payments Strategy Board's operational costs would be funded through an annual levy, collected and administered by the Financial Conduct Authority. The levy would be raised from specified classes of firms (such as credit institutions and other payment service providers). The FCA would have the power to approve the Payments Strategy Board's budget and the fees levied on relevant firms. The FCA would provide for the distribution of levies between relevant firms in its rules.

**5.36** A levy based funding structure would put the funding of the Payments Strategy Board on a secure and stable footing.

### **Interaction with the existing regime**

#### **The Payments Council**

**5.37** The Government expects the recommendations of the Payments Strategy Board would be addressed by the payments industry within a reasonable time period. It would be for industry to consider how, and through whom, the response might be made but the Government envisages a role for the Payments Council, as improved by some or all of the changes proposed in Option 1 of this consultation. The Payments Council may be considered the most appropriate body to respond to the recommendations of the PSB, and coordinate and implement the recommendations of the PSB on behalf of the payments industry. However, this role would be for the payments industry to decide.

**5.38** Should the Payments Council exercise this role, then depending on the outcome of this consultation, the Government would also consider seeking the self regulatory reforms to the governance of the Payments Council as set out in Option 1.

#### **Role of the Bank of England and HM Treasury**

**5.39** The Payments Strategy Board would be expected to consult the Bank of England in formulating its recommendations. The Bank of England could choose to attend the Payments Strategy Board's decision making board as a non-voting observer. The Bank would continue to fulfil its current statutory functions with respect to the continuing stability of payment systems.

**5.40** The FCA's appointment of the Chair of the Payments Strategy Board would be subject to approval by HM Treasury.

### **Comment**

**5.41** The creation of a Payments Strategy Board would deliver a fresh start, enhance the responsiveness of payment networks to the needs of their users and ensure that the views and needs of all payments users are taken into account when strategic recommendations are made to the industry. Recommendations made by the Payments Strategy Board to the industry would be public, bringing increased transparency to the market and ensuring that issues are addressed by the industry. This approach recognises the significant role the industry must play in the future

development and strategy of payments networks, and ensures that decisions on development projects and investment decisions would remain with the institutions that will pay for them.

**5.42** The Payments Strategy Board will tackle specifically the advisory problems with the current regime highlighted in the previous chapter at a relatively low cost to industry. The industry would still be responsible for delivering projects once they had been recommended by the Payments Strategy Board and would need to consider how best to deliver projects most effectively.

### Question 3

- a Do you agree with the proposed remit for a new Payments Strategy Board?
- b Do you agree that the Payments Strategy Board should make recommendations to the payments industry, rather than requiring action? If you consider mandated action to be appropriate, please set out how such a method could work most effectively.
- c Do you agree that the Payments Strategy Board should include senior industry representatives, non industry representatives and independents? What do you consider to be the right composition of the Board?
- d Should the Payments Strategy Board have a formal information gathering power? If yes, what information should be covered by such a power, and what should an appropriate enforcement mechanism be?
- e Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?
- f Should the FCA have any further controls over the Payments Strategy Board?

## Creation of a new regulator to oversee payments structures

### Key features

- the creation of a new and independent regulator
- the regulator would create a licensing regime for potential market participants and set license conditions to ensure that:
  - open access to payments systems was maintained;
  - pricing was transparent and efficient;
  - industry governance was adequate; and
  - fair trading principles were respected.

### Description of alternative approach

**5.43** An alternative approach would be to create a new regulator for the payments industry. This would give government much stronger levers to tackle the advisory and delivery problems that have been identified in this consultation document. This approach would, however, also create a significant new regulatory burden which would carry considerable costs for business. The Government does not currently consider that the marginal benefits of this approach 3, in relation to Option 2, are high enough to justify the increases in costs but invites views from respondents on the desirability and effectiveness of this option.



## Description of new regulator to oversee payments structures

**5.44** The Cruickshank report on competition in the UK banking industry, published in March 2000<sup>1</sup>, recommended the creation of a new regulator, “Paycom”, for the payment services industry, on a similar model to other regulated sectors (e.g. Ofgem for gas and electricity, Ofwat for water.). Firms operating in the payments marketplace would be required to be licensed by Paycom, which would then be able to enforce license conditions to ensure that:

- open access to payment systems was maintained;
- pricing was transparent and efficient;
- industry governance was adequate; and
- fair trading principles were respected.

## Interaction with existing regulatory regime

**5.45** This approach would extend regulation to a narrow area of financial services that is not currently regulated. As discussed in Chapter 2, however, there is already an oversight regime for systemically important payment systems, operated by the Bank of England under Part 5 of the Banking Act 2009. This oversight regime is confined to weaknesses in risk management and operations that could have a major potential impact on stability of the financial system as a whole. The regime therefore applies to ‘recognised’ interbank payment systems which are designated as such by the Treasury. The Chaps, Bacs and FPS payment systems are currently among those overseen by the Bank under this regime, as well as a number of commercial trading payment systems. The Banking Act 2009 includes requirements for the operators of recognised systems to have regard to principles published by the Bank of England, and confers a power of direction on the Bank, powers to collect information and enforcement powers.

**5.46** Additionally, the FSA supervises the conduct of credit institutions and payment service providers under the Payment Services Regulations 1999. The Office of Fair Trading is responsible for enforcing the competition rules in this area.

**5.47** The new regulator would take on the current functions of the OFT with respect to payment systems. It would focus on the collaborative space where firms come together to agree on the rules for the provision of payment services – with the emphasis on achieving the best outcomes for end users. It is not therefore envisaged that adopting this approach would disturb the present oversight regimes operated by the Bank of England and the FSA. To ensure that this was achieved, the regulators would be under a statutory duty to coordinate, and to consult each other before making rules. Priority in decision making would be accorded to considerations of financial stability.

## Comment

**5.48** This approach proposes the creation of a new utility-style regulator for the payments industry. It would be built on a similar model to other regulated sectors such as gas, electricity and water with providers being licensed and the new regulator enforcing license conditions. A new statutory regulator for the payments industry would be a major increase in the regulatory burden with considerable costs attached and an open question over whether this would tackle some of the problems identified with the current system. It would also take time to implement and would require further detailed consultation to design. If the balance of consultation responses favour this approach and can provide evidence that the marginal benefits would outweigh the costs relative to Option 2, the Government will give this approach further consideration.

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<sup>1</sup> *Competition in UK Banking. A report to the Chancellor of the Exchequer. Don Cruickshank. March 2000 HMSO.*



# A

## List of questions

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### Question 1

Do you agree that the creation of a Payments Strategy Board:

- should be the lead option for reform;
- provides the appropriate balance between Government intervention, impact and cost; and
- effectively tackles the issues the Government has set out?

Please provide evidence where appropriate to support your answer.

### Question 2

The following questions relate to the changes the Government would expect the Payments Council to implement under Option 1. Some of the changes will also be considered if the Government proceeds with Option 2.

- a Do you agree that the current remit and objectives of the Payments Council are broadly appropriate? If not, how should they be enhanced?
- b How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?
- c Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?
- d Do you agree that any two independent directors should have a right of veto over board decisions? The Government invites views on how the Payments Council's board can be strengthened further.
- e Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?
- f How can Payments Council funding be put on a long term, secure footing?
- g How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?
- h How can the membership of the Payments Council be broadened most effectively?

### Question 3

- a Do you agree with the proposed remit for a new Payments Strategy Board?
- b Do you agree that the Payments Strategy Board should make recommendations to the payments industry, rather than requiring action? If you consider mandated action to be appropriate, please set out how such a method could work most effectively.
- c Do you agree that the Payments Strategy Board should include senior industry representatives, non industry representatives and independents? What do you consider to be the right composition of the Board?

- d Should the Payments Strategy Board have a formal information gathering power? If yes, what information should be covered by such a power, and what should an appropriate enforcement mechanism be?
- e Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?
- f Should the FCA have any further controls over the Payments Strategy Board?

# B

## Glossary

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### Payments networks

A payments network describes the entirety of participants, processes and systems, and the links between them, that constitute the process for transmitting money from a payer to the payee using any particular payment instrument. It describes the entire chain from payer to payee. For example, payments made by cheque form a single payments network for that method of payment.

### Payment systems

A Payment system forms the shared part of the chain linking the bank of the payer (and therefore the payer's account) with the bank of the payee (and the payee's account). For example, direct debits, direct credits and standing orders are processed using the Bacs payment system.

A payment system is therefore the mechanism at the centre of a payment network which is used for processing payment instructions, and clearing and settling accounts between the participating payment service providers (typically banks). The procedures may include a mechanism for calculating the bilateral or multilateral net obligations to the participating banks to one another, with a view to facilitating the settlement of their obligations on a gross or net basis.

### Clearing

The process of reconciling and, in some cases, confirming payment instructions prior to settlement, possibly including the netting-off of instructions and the establishment of final positions for settlement. Sometimes the term is used imprecisely to include settlement.

### Settlement

"Settlement" discharges obligations in respect of funds owing between two or more participants in a payment system.

### Payment scheme

A payment scheme is the set of membership rules, common standards and procedures needed for the smooth running of a payment system. The rules and procedures are made by payment scheme companies, which are also the owners and operators of their payment systems. The main payment scheme companies are described below:

- Bacs Payments Schemes Ltd (Bacs)

Bacs is a not-for-profit, membership based industry body. It is responsible for the processing of payments through two principal electronic payment schemes; Direct Debit and Bacs Direct Credit. It is owned by 15 banks and building societies and is responsible for the schemes behind the clearing and settlement of a large proportion of automated payments in the UK and maintaining the integrity of payment related services. VocaLink provides to Bacs and its members the central

processing infrastructure for the Bacs payment system. This is provided through a non exclusive commercial agreement

- CHAPS Clearing Company Ltd

The CHAPS Clearing Company (CHAPS CO) manages the CHAPS payment scheme. CHAPS operates in real time. It is primarily used for large value payments. The relationship between the CHAPS scheme and the Bank of England, which processes CHAPS payments, is governed by a Memorandum of Understanding. The memorandum sets out the understanding of the respective responsibilities of the Bank and CHAPS with regard to the performance of the CHAPS System.

- Faster Payments Ltd

The Faster Payments Service provides real time telephone, internet and standing order payments. The scheme handles single immediate payments, forward dated payments, payments originating overseas, direct corporate access payments, and standing orders. VocaLink is formally contracted to provide the processing infrastructure. This is provided through a non exclusive commercial agreement.

- Cheque and Credit Clearing Company Ltd

The Cheque and Credit Clearing Company is a membership-based industry body which manages the cheque clearing system. The system is also used to process banker's drafts, building society cheques, postal orders, warrants and government payable orders. The company also manages the systems for clearing paper bank giro credits and euro cheques.

- LINK ATM (Automated Teller Machine) Scheme

LINK is the operator of the UK cash machine network. The LINK ATM scheme sets the rules for new and existing participants in the cash machine network and sets standards for signage, encryption, messaging, security and other features of the network. LINK does not itself install or operate cash machines. VocaLink has a contract directly with members of the LINK scheme. This sets out services provided to members and service levels required. The same contract covers members' relations with each other, and sets out how the LINK scheme operates, with governance arrangements, a scheme executive and scheme funding controlled by the scheme members and independent of VocaLink.

- The Currency Clearings Committee

The Currency Clearings Committee is a scheme managed by the Cheque and Credit Clearing Company. It facilitates processing of cheques in any currency (other than sterling or Euros); although at present it processes only cheques drawn in US Dollars drawn on UK branches of its members.



## **HM Treasury contacts**

This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

Fax: 020 7270 4861

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

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