

Payments Consultation
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BBCCL

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Please do not hesitate to contact me if you would like any clarification on any of our responses or would like more information on our Scheme.

Yours faithfully

Ivan Laird
Chairman

Responses to Individual Questions

1. While we are relatively relaxed as to this question, on balance, we do not think that there is a need for a Payments Strategy Board as this will inevitably duplicate the existing Payments Council management and governance structure with the associated cost there-of. In addition there is the potential for "turf wars" between a Strategy Board and the Council which would only dilute the capacity of both to achieve their objectives.

Instead we consider that a Strategy Advisory Council should be established by the Payments Council, which should have a majority of non-service providers, and which would be tasked with the responsibility of producing strategic initiatives that would advance the services provided by service providers to users/consumers.

2a. No - See I above.

2b. By establishing a Strategy Advisory Council as set out in 1 above. This Council should have a majority of non-services providers and should contain user representatives.

2c. Yes

2d. No, as this would put too much power in the hands of two people. While we believe the Payments Council should have a substantial number of independent directors, which should include user/consumer representatives, the majority should be service providers as it is they who have to meet the cost of all service enhancements. The chairman should be selected from the independent directors and, as a safeguard where it was established as being in the public interest, a majority of the independent directors should have a right to refer board decisions to an independent arbitrator for review. However there should be no process which would permit coercion of the payments industry except any that is legislative.

2e. Yes, subject to them only having advisory powers.

2f. Funders should commit to a minimum contribution of say 75% of their 2012 funding for five years with the balance of funding required being negotiated annually.

2g. We do not agree that the Payments Council should have coercive powers. There will no need for these, provided it brings forward initiatives that have real and lasting benefits for both providers and users.

2h. It should have user/consumer representation.

3. We do not consider that it is necessary or desirable to establish a Payments Strategy Board but have responded to the questions posed on the basis that a decision was taken to establish such a Board.

3a. No

3b. Yes

3c. Yes

3d. No

3e. No

3f. No

Q1: 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?**

We do not believe that the creation of the Payments Strategy Board should be the lead option for reform. We believe that an enhanced option 1 under which the Payments Council tackles all the issues identified by the Government, and in addition, sets up a senior body within the existing structures to set the strategic vision for the Council and monitor progress against its delivery, should be the lead option for reform. The Council has already embarked upon a process of reform under the leadership of a new CEO and this should be allowed to continue, supplemented with the measures set out below.

Strengthening the Council's strategic capability

We believe that the Payments Council needs to enhance its capability in providing and delivering a strategic vision for the payments industry. Work has begun on this and the Payments Council is developing a new strategic document – the Payments Roadmap – alongside its work on National Payments Plan. The Roadmap provides a view of the changes needed to UK payments infrastructure over a two, five and ten year period ensuring that the Council has appropriate strategic focus, work is properly prioritised and the required investment is planned.

Rather than creating a new Payments Strategy Board to be overseen by the Financial Conduct Authority, we support the Payment Council's view that enhancing its strategic capability could be achieved though creating a new senior body within the existing structures, made up of representatives of HMT, Bank of England and FCA, independent directors who would consider the views of key stakeholder groups, and senior industry representatives.

The body, which would function as a strategy board, could meet bi-annually and consider a small number of high-impact strategic issues and decisions about the payments industry. It would set the strategic vision for the Council, monitor progress against its delivery, ensure decisions are being made in the public interest, holding the Payments Council Board to account. In order to enhance the regulatory oversight of the Payments Council, and its perceived lack of transparency and accountability, we believe that the new body could report bi-annually to the FCA on the performance of the Payments Council.

The real strengths of an enhanced option 1 is that it could be undertaken now without delay, would be more cost-effective, meet the Government's policy aims, and be much less disruptive at a time when the new regulatory structures are in transition and industry is grappling with substantial regulatory change. We believe that whatever option the Government decides to pursue, the changes below should be implemented by the Payments Council as a priority.

As a back-stop position, provision could be made for option 2 in the Financial Services Bill. The Government could commence the provision after an agreed review period should enhanced option 1 prove unsuccessful.

Q2: 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

We believe that the changes set out below should be implemented by the Payments Council as a priority.

- **Do you agree that the current remit and objectives of the Payments Council are broadly appropriate? If not, how should they be enhanced?**

We believe that the current remit and objectives of the Payments Council are broadly appropriate. We support the view of the Payments Council that its remit should be broadened to define ‘payments’ as including cards, fraud, and new payment schemes. As we noted above, the Council also needs to provide a long-term and credible view of the industry in developing an approach to strategy and the capacity to implement real change in the short to medium term. We believe that this can be achieved through the senior representative body under an enhanced option 1, as set out above.

- **How can a clearer separation of the Payment Council’s strategy setting and trade body representative functions be best achieved?**

We believe that there needs to be clear functional separation of the Councils strategy setting and representative roles. The Council’s constitution makes clear that its role is not as a trade body. It does, however, undertake work in Europe on the Single European Area and Payments Services Regulations, but this activity is focused on technical engagement. We believe that the improved governance arrangements, including improvements to the transparency and accountability of the Council’s work and the strengthened role of independent directors, will help deliver greater separation in the Council’s strategy and representative functions.

- **Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent reviews?**

We agree that the Payments Council should commit to publishing annual progress reports against its objectives, substantiated by regular, independent reviews. The Council already publishes annual reviews that set out the work it has undertaken over the previous year against its agreed objectives. In future, this will include a progress report against its Payments Roadmap objectives. The Council has also committed to further regular independent reviews following that undertaken by Martin Cave in April 2012 and we agree with this approach.

- **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?**

We agree that the voice of consumers among the independent members of the Council should be strengthened and any two of the four independent members should have the right of veto over a decision of the Board (*see further below*). To strengthen the voice of other stakeholders, including consumers, the Payments Council has committed to introducing a vote for the independent chair which would mean that the independent votes on the Board would increase to five against 11 industry votes. It has also committed to supporting further the

independent directors in their work to ensure they are fully briefed on all issues being debated and agreed at Board level.

- **Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent user councils?**

We agree that the role and functioning of the user forums should be enhanced and developed into more independent user councils able to set their own agendas, work programmes, and to develop their own strategic views on payments to feed into Payments Council board decisions. We believe that enhancing the User forums' role in this way so that they are able to set their own agendas would help increase their autonomy.

- **How can the Payments Council funding be put on a long term, secure footing?**

We believe that the funding of the Payments Council is already secure. Even with a rebalancing of the Board, the funding would remain secure and sustainable. Once the outcome of the consultation is determined, the funding model for the Council could be considered in more detail.

- **How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?**

We support the Payments Council view that having a senior group of representatives, including HMT, the FCA and Bank of England, sitting above the Council, holding it to account and monitoring its decisions, would help provide the impetus to carry through and enforce its decisions more effectively. Increasing the accountability and transparency of the Council and the role of independent directors so that they are better able to provide challenge would also strengthen the Council's means to implement decisions more effectively.

- **How can the membership of the Payments Council be broadened most effectively.**

We agree that the Payments Council should widen its membership and explore the creation of different categories of membership. The Payments Council has been exploring forming closer ties – or creating its own membership category – with representative bodies of different types of payment service providers and is particularly keen to enter into a formal relationship with the UK Cards Association and Financial Fraud Action UK.

We believe there would be benefit in requiring all UK payment schemes operating, and which are above a certain size, to have a form of contractual relationship with the Payments Council, including the card schemes – Visa and MasterCard.

Q3: Do you agree with the proposed remit of the new Payments Strategy Board?

As set out above, we believe that an enhanced option 1 should be the lead option for reform. We believe that the proposed remit for the Payments Strategy Board to, among other things, promote the development of new and existing payments networks, could be more effectively carried out by the Payments Council overseen by the senior representative body. This body would set the strategic vision for the Council, monitor progress against its delivery, and ensure Payments Council decisions are being made in the public interest.

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.

Under enhanced option 1, we believe that the senior body would make recommendations to the Payments Council, rather than requiring action and that this would be a more effective operating model. The senior representative body would hold the Payments Council to account for delivery and should not therefore need to require action.

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?

As we set out above, we believe that the senior representative body would need to have senior industry and non-industry representation, including independent members. The independent members would need to have a range of experience and be able to speak on behalf of the key stakeholders groups – consumers, small businesses, and the charitable and voluntary sectors. In order to be effective and to achieve the aim of increasing regulatory oversight, the body would also need to have representatives from Bank of England and FCA. Given its role in setting the regulatory policy framework for the payments system, HMT should also be represented.

Should the Payments Strategy Board have a formal information gathering power, and what should an appropriate enforcement mechanism be?

As we note above, we believe that the senior representative body should be set up within the existing arrangements. We believe that that body should have formal information gathering powers in relation to setting the Council's strategic vision. As we argue above, we believe that having a senior group of representatives, including HMT, the FCA and Bank of England, sitting above the Council, holding it to account, would help provide the impetus to carry through and enforce its decisions more effectively. We do not believe that there is a need for an enforcement mechanism.

Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?

We believe that a senior representative body could be funded within the Council's existing funding arrangements.

Should the FCA have any further controls over the Payment Strategy Board?

As we noted above in question 1, we believe that in order to enhance the regulatory oversight of the Payments Council, and its perceived lack of transparency and accountability, we believe that the new body could report bi-annually to the FCA on the performance of the Payments Council.



Institute of Credit Management

13 September 2012

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Dear Sir/Madam

**RESPONSE OF THE INSTITUTE OF CREDIT MANAGEMENT TO:
HM TREASURY – SETTING THE STRATEGY FOR UK PAYMENTS**

The Institute of Credit Management is the largest professional credit management organisation in Europe. Its members hold important, credit-related appointments throughout industry and commerce, and we feel it appropriate to comment on this consultation.

Our members' views were divided across options one and two and there was no support for option three.

Despite the divergent responses, there was consensus that, whatever the form of the body taking forward payments strategy, its makeup should be balanced and not overwhelmingly comprise bank representatives. Further, there was agreement that too much bureaucracy and government intervention should be avoided thereby reducing any impact on the public purse.

In response to the specific questions:

Q1. 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.

Please see paragraphs above.

Q2. 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?

The remit and objectives are broadly appropriate but the structure and membership needs review.

- b. How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?

A balanced representation of relevant stakeholders and parties should make up the council.

- c. Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?

Yes, although the independent reviews should not be delivered at great cost.

- 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.

If the structure and governance of the board is appropriately setup, the right of veto should not be required.

- e. Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?

Yes, and/or they should have strong representation on the council.

- f. How can Payments Council funding be put on a long term, secure footing?

It should be funded by the banks.

- g. How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?

All parties to the council should recognise and implement decisions that it makes.

- h. How can the membership of the Payments Council be broadened most effectively?

By identifying and engaging appropriate stakeholders from across a broad range of interests.

Q3.

- a. Do you agree with the proposed remit for a new Payments Strategy Board?

If this becomes the chosen option, then we agree with the proposed remit.

- 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.

As per earlier answers, the council should carry the consensus view and the industry should recognise and implement decisions from it.

- 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?

The composition should equally represent the three categories identified on the basis of one third each.

- 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?

It should be a condition of membership that necessary information is provided to support the decision making process.

- e. Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?

If this option is selected, there should be some government funding to support the additional costs involved.

- f. Should the FCA have any further controls over the Payments Strategy Board?

Only in an overseeing capacity.

Should you have any queries, please do not hesitate to contact me.

Yours faithfully

Glen Bullivant

Chair of Technical Committee

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10 October 2012

Dear Sirs

Consultation Document: Setting the Strategy for UK payment

The Institute of Chartered Secretaries and Administrators Registrars Group (“the Group”) is the representative body for all the main service registrars in the United Kingdom and Ireland. The Group’s members are registrars for more than 99% of all quoted companies in the UK and Ireland. The Group is responsible for formulating policy and best practice guidelines in all areas relating to share registration.

The Group welcomes the opportunity to respond to this consultation and our responses are contained in the below table. However, before providing our viewpoint on the questions raised it is important to note that our response only contains comments on the questions where we felt we had particular feedback.

No.	Consultation Question	ICSA Registrar Group Response
Question 1:		
	<p>Do you agree that the creation of a Payments Strategy Board:</p> <ul style="list-style-type: none"> • 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? <p>Please provide evidence where appropriate to support your answer.</p>	<p>The ICSA Registrars Group questions how well a Payments Strategy Board would be able to enforce any of the strategic decisions that it made. This alongside there being no obligation for the industry to publicly explain why they may not be following a recommendation leads to our conclusion that option 1 may be the better option to investigate further at this point.</p> <p>Perhaps option 1 can be progressed and subsequently reviewed to determine if sufficient improvements have been made before resorting to establishing a Payments Strategy Board.</p>

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?	The main objectives as set out in section 3.18 of the consultation paper seem largely sensible statements. However, what is less clear is the boundaries between the Payments Council and the other payment related organisations and associations (e.g. BACS Ltd, CHAPS, Cheque & Credit Clearing Company) that we assume influence and contribute to the progress or otherwise of any strategy. Obtaining better clarity in this area, such as roles and responsibilities, would help ensure that the Payments Council is correctly focused.
b.	How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?	It is not explicitly clear to us who the Payments Council currently represents and the tasks that this entails when acting in its capacity as a trade body. Understanding this may help with determining how best to ensure there is better separation between the two functions.
c.	Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?	We agree that this is something that the Payments Council should commit to; in particular the introduction of independent performance reviews.
e.	Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?	In principle we do agree that the current user forums need to be enhanced so that they are more than the current perception of being only a forum to which progress on projects is reported. However, more needs to be known about the intended composition, structure, role and responsibilities and terms of reference of the Independent User Councils before understanding whether or not they will become more effective.
h.	How can the membership of the Payments Council be broadened most effectively?	We believe that membership should cover the breadth of the payment network/community. In particular, and as suggested in the paper, the wider more customer focused community should be considered as key stakeholders. This enables any issues and initiatives that arise (the introduction of the Bacs £20m payment limit being one recent example) to be publicised and debated and the community as a whole able to influence any strategic direction.

Question 3:		
a.	Do you agree with the proposed remit for a new Payments Strategy Board?	<p>Whilst our response questions the likely effectiveness of option 2, we accept that the establishment of a Payments Strategy Board could well be the overall agreed outcome of this consultation. If this is the case then we do agree with the remit of the board as outlined in the bullets stated in section 5.24.</p> <p>By virtue of the fact that our members make a combined total of over 21 million payments a year we have assumed we would categorise ourselves as a large user and therefore would welcome the opportunity to contribute to this board.</p>
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.	We can anticipate enforcement action being somewhat problematic and therefore at a minimum any recommendations made by the Payments Strategy Board should be made public.
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?	<p>Alongside our answer to question 2(h) we would like to see a Payments Strategy Board having a fair representation across the community as a whole.</p> <p>We also believe that the statements concerning composition of the board made in section 5.31 seem reasonable.</p>
e.	Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?	<p>We agree that there does need to be a levy on the payments Industry</p> <p>As the 'funding body' for the Payment Strategy Board, it is all the more essential that the payments industry participants have a clear voice in the strategic direction of the Payment Strategy Board.</p>
f.	Should the FCA have any further controls over the Payments Strategy Board?	At this stage we cannot envisage any further requirements for controls beyond those already stated. The FCA's role can usefully be that of 'critical friend'.

Once again we would like to thank you for being given the opportunity to respond to this consultation and look forward to seeing the outcome of this discussion in the near future.

Yours faithfully

Michael Kempe
Chairman

SETTING THE STRATEGY FOR UK PAYMENTS: SUBMISSION FROM LLOYDS BANKING GROUP

EXECUTIVE SUMMARY

Introduction

Lloyds Banking Group (LBG) is pleased to have the opportunity to respond to HM Treasury's consultation on setting the strategy for UK payments.

LBG has been a full member of Payments Council since it was established in 2007.¹ LBG is one of five banks which have the automatic right to appoint a Director to the Payments Council Board. LBG, through Lloyds TSB and Bank of Scotland, is a settlement member of all the UK payment Schemes – CHAPS, Bacs, Faster Payments, Cheque & Credit Clearing and LINK. LBG processes payment transactions for circa 33% of the UK economy, processing 10 million transactions per day worth a total of £125 billion. As a result we have a significant role in the payment industry and we work very closely with relevant stakeholders.

The Payments Council and the UK payment Schemes bring together stakeholders in payments to ensure UK consumers and businesses benefit from efficient, reliable and secure payment systems 24 hours a day, 365 days each year. LBG believes that the Payments Council, the Schemes and their members have to date, in the overwhelming majority of cases, delivered payment systems and services in the UK in a manner consistent with the aims expressed by HM Treasury in the consultation document.

The UK payment industry provides access to market leading payment services, such as:

- the UK Direct Debit Scheme, associated services and customer guarantee is one of the best schemes of its type in the world;
- Faster Payments provides a near real time service for internet and telephone initiated payments;
- in Bacs, ToDDaSO and related services provide support for the transfer of accounts between banks - and this will be brought up to a world class proposition when the new Account Switching service is introduced in September 2013.

The Schemes provide easy access for new entrants to UK payment systems with CHAPS, Bacs, Faster Payments and Cheque and Credit supporting over 4,000, in total, indirect participants and agencies of settlement members.

LBG agrees with the Government that UK payment systems and services must meet the current and future needs of consumers, businesses, other users and the wider economy through:

- 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;

¹ Initially this membership was via Lloyds TSB and HBOS separately; this was subsequently combined under LBG in 2009.

- 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.

While LBG believes that the current system already meets these aims well, we recognise that further improvements can be made.

Options for Reform

The consultation paper published by HM Treasury outlined three options for reform. If the Government were minded to pursue Option 1 (reforms within the existing Payments Council framework), we would support the approach outlined in the Payments Council's submission. This proposes that the most suitable way to improve accountability and public interest scrutiny in the payments framework is to enhance Option 1 with some of the features of Option 2, creating a new senior group within the Payments Council's governance structures to hold the Payments Council to account in respect of the application of public interest tests.

However, we note that HM Treasury's consultation document states that Option 2 (the creation of a Payments Strategy Board) is the Government's preferred option and consequently our approach in this response has been to concentrate on Option 2. We agree that Option 2 would appear to strike an appropriate balance between reform that is sufficiently far-reaching to ensure the Government's aims are achieved, while avoiding the excessive regulatory burden and potential hampering of innovation that might arise from a "PayCom" style regulator.

LBG's strong belief is that any new governance and decision-making structures must give sufficient weight to maintaining the integrity and resilience of the UK payments system. LBG is confident that, within Option 2, this could be achieved by ensuring that the Payment Strategy Board membership contains sufficient representation of senior payments and banking practitioners, combined with a governance and decision-making structure that contains appropriate checks and balances. We believe that scope for development and innovation in payment services can be achieved while the necessary focus on integrity and resilience is maintained.

Specifically, this response sets out to do the following:

- To support the creation of a new body of senior representatives (the Payments Strategy Board) that meets quarterly or biannually, to set the strategy for UK payments;
- To set out how the relationship between this body and the Payments Council might work;
- To consider how the Payments Strategy Board might be constituted and how it might operate in practice and work effectively with the Payments Council and other industry bodies to achieve shared objectives;
- To identify key risks and concerns that need to be considered when implementing the Payment Strategy Board and how these may be mitigated;
- To propose that the Payments Strategy Board should be set up in a manner that is quick, flexible and not burdensome, without the need for legislation.

The Payments Strategy Board

We agree that establishing a new senior body to set the strategy for UK payments could be beneficial. To tackle the issues that the Government has set out, we believe that this body must take careful decisions with due regard for all stakeholders; the industry must be held to account for delivery against those decisions; and the public interest must inform the body's debates and decision-making.

LBG has developed a draft set of guiding principles, membership, operating model, structure and governance framework for the Payments Strategy Board (PSB) that we believe would deliver the Government's objectives. These are set out below.

Payment Strategy Board Guiding Principles

The PSB, to be successful, must operate and make decisions against a set of transparent and published guiding principles. These could be based on the Government's aims as stated in the consultation document combined, we would propose, with others as follows:

- To ensure UK payments networks operate for the benefit of all users including consumers;
- To promote and develop new and existing payment networks in the UK;
- To ensure UK payments networks facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms;
- To ensure UK payments networks remain profitable and sustainable for banks and other providers of payments services;
- To promote the pre-eminent position of the UK and London as a financial centre, including promoting and supporting London as an offshore centre for non-indigenous payment activities;
- To maintain UK payment systems which are secure, reliable and efficient.

LBG believes that these principles could be used as tests against which the PSB would assess the strategy for UK payments and develop an agenda for change.

Payment Strategy Board Membership

The scope of the PSB should cover all bodies in the UK that have a governance role in financial transactions and moving money (e.g. card Schemes, PayPal, new entrants, etc). This is important to ensure the future governance model remains relevant and does not benefit or impact one or more transaction types or group of stakeholders disproportionately.

LBG believes that the PSB membership needs to combine appropriate representation with recognised capability in the field of banking and payments. To meet these requirements, LBG proposes the following membership for the PSB:

- Six banks ("big four" permanent, two others on a rotational basis) – voting members
- Four members from bodies representing users of payments systems (consumer, small and medium-sized enterprises, charities and corporate) – voting members

- Four representatives from non-bank cards and payments organisations (UK Cards Association, Google, etc) – voting members
- Four independents – voting members
- Bank of England - observer at Deputy Governor level
- Financial Conduct Authority - observer
- Payments Council Chief Executive - non-voting, in the role of implementer for the PSB
- Chairman – non-voting

We would propose that PSB members would serve a term of between 2 and 4 years.

Further we would propose a voting structure which ensures that no one group alone (e.g. the banks) could force or block a motion.

LBG is of the view that it is essential that the “big four” banks have permanent representation on the PSB. These banks carry out over 80% of transactions that will fall under the scope of the PSB and will therefore play a critical role in industry change.

A key aspect of this structure is that users of payment networks would be represented directly on the Payments Strategy Board.

In order to achieve our proposed representation model, the Government may need to encourage the creation of representative bodies (e.g. for new entrant networks) where these do not already exist.

Some or all the Payments Council Independent Directors may be elevated to sit on the PSB. Dual membership of some of the Payments Council Independent Directors may also be advantageous.

We believe that, under a PSB set up without legislation, it would be appropriate for the FCA and Bank of England to attend as observers. This will strengthen the PSB’s mandate and ensure that decisions by the PSB are consistent with the FCA’s and Bank of England’s objectives.

We believe that in creating a Payment Strategy Board it will also be important to redefine the role of the Payments Council as: implementing and advising on (not setting) the strategy of the PSB; and the effective running of the UK payment Schemes.

Payment Strategy Board Operating Model

LBG believes it is essential that the PSB has transparent and fair processes, with appropriate checks and balances built into its constitution and operating model. LBG would therefore propose the following outline operating model for the PSB:

- The PSB should operate against a strategic plan/roadmap for UK payments networks to facilitate medium term investment decisions (e.g. a five year manifesto with rolling annual workplan covering a small number of strategic deliverables). The roadmap would be prepared by Payments Council but endorsed by the PSB;
- The PSB should take inputs via a regular, perhaps biannual, consultation exercise with key stakeholders, specifically users of payments, banks, and trade associations, etc.;
- The PSB should make public recommendations on a small number of major strategic issues - it should not involve itself in the day to day running of payments and the detail of how to implement specific strategies;
- The PSB should conduct cost/benefit analysis, and risk and impact assessments, and put proposals to a vote before making a public recommendation;
- The PSB should procure resources and information to undertake the cost/benefit analysis, and risk and impact assessments from the Payments Council and other industry bodies;
- The PSB should be able to raise priority action areas between consultations by exception;
- The PSB should make public recommendations to the Payments Council to initiate change;
- The Payments Council should accept and implement PSB recommendations unless they publicly give reasons for not doing so; any such reasons should be based on a cost/benefit assessment and carefully weighed against PSB's guiding principles promoting the public interest;
- In the event of any dispute within the industry regarding whether or not to accept a PSB recommendation, there should be a route of appeal to an independent arbiter - such a route of appeal would not require a legislative basis;
- The PSB should hold Payments Council and other industry bodies accountable for delivery of public recommendations accepted for implementation;
- The outcome of PSB votes should be made public after the event (similar to the Bank of England's Monetary Policy Committee).

LBG believes that the PSB constitution, membership, guiding principles and operating model as outlined above will help the body to make good decisions that are demonstrably in the public interest, underpinned by the authority to implement change. This framework should now be developed by the payments industry for endorsement by the FCA, Bank of England and HM Treasury. LBG believes that implementation can best be achieved without legislation. Furthermore, by avoiding the need to legislate, the Payment Strategy Board could probably meet for the first time in the first half of 2013. If, however, the Government determines that legislation is necessary, this would probably mean that the Payments Strategy Board could not be formally constituted until 2014 (though there may be some scope for it to operate in a "shadow" form before this).

Proportionality

LBG notes the Government's concern that Option 1 (implementing changes to the existing Payments Council governance and operating model) would not bring any increased regulatory oversight of payments strategy in the UK. However, LBG would point out the considerable levels of regulatory oversight already achieved through the Bank of England's formal role in respect of the principal UK payment Schemes. LBG asks that the Government

takes this oversight – and the regulatory burden borne by providers of payments services - into account when considering the future regulatory framework for payments networks. It will be critical to the success of any new arrangements that they interact effectively with Bank of England oversight of the payment Schemes and other European and Global regulation impacting the UK payments industry, without unnecessary overlap or additional burden.

Conclusion

In summary, LBG supports the creation of a Payment Strategy Board but would urge the Government to ensure that:

- the governance and constitution of the Payment Strategy Board are designed to ensure that the track record of stability and resilience of UK payment systems built up over many years is not undermined;
- the Payment Strategy Board membership contains appropriate representation of senior payments and banking practitioners, combined with a governance and decision-making structure that contains sufficient checks and balances to ensure integrity and resilience of the UK payment systems is maintained, while also giving scope for the development and innovation in payment services; and
- the new regulatory framework works effectively with Bank of England oversight of the payment Schemes and other European and Global regulation impacting the UK payments industry, without unnecessary overlap or additional burden.

SETTING THE STRATEGY FOR UK PAYMENTS: SUBMISSION FROM LLOYDS BANKING GROUP

ANSWERS TO SPECIFIC CONSULTATION QUESTIONS

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.

We believe that the creation of a Payment Strategy Board by the industry, endorsed by the FCA and the Bank of England, would deliver the objectives laid out by the Government in the consultation document. We believe that this would be a proportionate response that strikes an appropriate balance between Government intervention, impact and cost. It would also establish a body that would become the focal point for reform and innovation in UK payment networks.

We feel that it is critical that the Payment Strategy Board should:

- be properly constituted from the outset with balanced representation;
- have credibility and capability derived from senior representatives with appropriate experience;
- have a mandate to take action;
- abide by and fair and transparent processes, including the need to consult widely.

It is our view the Payment Strategy Board needs to bring together a group of senior representatives, meeting quarterly or biannually, that considers key issues that are in the public interest. We feel that it is integral to the PSB achieving its purpose that the FCA and the Bank of England should be included as observers. Their presence would be important to provide authority and a mandate without any need to introduce formal powers.

We believe that the creation of the Payment Strategy Board should be progressed by the payments industry with the endorsement of the FCA and Bank of England under the direction of the Government, thereby avoiding the need for legislation.

The Payment Strategy Board would be supported by a small secretariat with enough capacity to ensure the operation of the board, without being cumbersome in size. The Payment Strategy Board would procure resources and information to undertake cost/benefit analyses and risk and impact assessments from the Payments Council and other industry bodies.

Question 2

The following questions relate to the changes the Government would expect the Payments Council to implement under Option 1. Some 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**

The Payments Council and the UK payment Schemes bring together stakeholders in UK payments to ensure UK consumers and businesses benefit from efficient, reliable and secure payment systems 24 hours a day, 365 days each year. LBG believes that the Payments Council, the Schemes and their members have to date, in the overwhelming majority of cases, delivered payment systems and services in the UK in a manner consistent with the aims expressed by HM Treasury in the consultation document.

We believe that in creating a Payment Strategy Board it will also be important to redefine the role of the Payments Council as: implementing and advising on (not setting) the strategy of the PSB; and the effective running of the UK payment Schemes. The Payments Council should provide resources to the PSB to undertake cost/benefit analyses, and risk and impact assessments. The Payments Council CEO should sit on the PSB as an implementer but should not have a vote.

- b. **How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?**

We agree with the position taken by the Payments Council in its response to this question.

- c. **Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?**

We agree that the Payments Council, in its redefined role, should continue to publish 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.**

We agree that the governance and voting structure of the Payments Council Board should be reviewed to take account of the role of the Payment Strategy Board. We would expect the Payments Council and other industry bodies to implement the public recommendations of the Payment Strategy Board and accordingly, the influence of the independent directors will be on the Payment Strategy Board in the future. It may therefore be appropriate to

elevate all or some of the current Payments Council Independent Directors to the Payment Strategy Board. It may also be advantageous for some of the Independent Directors to sit on both the Payments Strategy and Payments Council boards.

e. Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?

We believe that the voice of users should be by the PSB including members from bodies representing users of payments systems (consumer, small and medium-sized enterprises, charities and corporate) and also by ensuring that the PSB is required to consult widely before making public recommendations for change.

In order to achieve this representation model, the Government may need to encourage the creation of representative bodies (e.g. for new entrant networks) where these don't already exist.

f. How can Payments Council funding be put on a long term, secure footing?

We feel that we can only address the question of Payments Council funding once the review is concluded and the role and remit of the Payments Council is confirmed. Whatever funding model is ultimately agreed, it should be transparent, stable and affordable for new and existing members.

We have reviewed the pros and cons of various funding models for the PSB and believe that the cost of implementing and running the PSB should be distributed between firms and other stakeholders so that it is not disproportionately levied on banks. One option would be to allocate costs on usage and benefit rather than market share.

g. How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?

In a self-regulatory environment, transparency will be key to enforcement of decisions. We propose that, as part of the new arrangements, the industry should agree to accept the recommendations of the Payments Strategy Board unless they publicly give reasons for not doing so. Any such reasons should be based on a cost/benefit assessment and carefully weighed against PSB's guiding principles promoting the public interest.

We believe that this kind of "enforcement through transparency" is effective – it can be seen at work in the current programme to implement the new Account Switching service for launch in September 2013: all CEOs of participating banks have publicly given assurances that their banks will deliver the programme on time.

Ensuring senior buy-in to Board decisions across the industry will also help with enforcement. The most senior individuals are likely to be able to take a broader view of both the industry and public interest.

Additionally, a stronger role for the independent directors, where they are better enabled to challenge, will add weight to their authority and ability to ensure effective enforcement in this kind of self-regulatory environment.

The presence of the FCA and Bank on the Payments Strategy Board will be key to enforcement. In the absence of the PSB having regulatory powers, public statements on the state of implementation of PSB recommendations by individual participants will act as an incentive to get the job done in a timely manner. We would argue that the threat of public censure can be a more effective and timely enforcement mechanism than regulatory powers in any case.

Of course, the Government will always have the option to introduce legislation at a later date if it deems it necessary – though the fact that such a need had arisen would probably be an admission that the system had broken down and that wider reform was necessary.

h. How can the membership of the Payments Council be broadened most effectively?

We understand that the Payments Council has addressed this question in its response.

Question 3

a. Do you agree with the proposed remit for a new Payments Strategy Board?

The remit of the Payment Strategy Board should be to:

- set the strategy for UK payments, based on a set of guiding principles;
- to make public recommendations for change, focusing on one, two or three major strategic issues; and
- to hold Payments Council and the wider payments industry accountable for delivery of public recommendations for change.

We would propose that the PSB's remit should *not* include the following:

- technical issues or issues relating to security and system integrity
- infrastructure and contract renewals
- issues relating to the day-to-day running of the UK and Global payments networks

LBG has developed a draft set of guiding principles, membership, operating model, structure and governance framework for the Payments Strategy Board (PSB) that we believe would deliver the Government's objectives. These are set out below.

Payment Strategy Board Guiding Principles

The PSB, to be successful, must operate and make decisions against a set of transparent and published guiding principles. These could be based on the Government's aims as stated in the consultation document combined, we would propose, with others as follows:

- To ensure UK payments networks operate for the benefit of all users including consumers;
- To promote and develop new and existing payment networks in the UK;
- To ensure UK payments networks facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms;

- To ensure UK payments networks remain profitable and sustainable for banks and other providers of payments services;
- To promote the pre-eminent position of the UK and London as a financial centre, including promoting and supporting London as an offshore centre for non-indigenous payment activities;
- To maintain UK payment systems which are secure, reliable and efficient.

LBG believes that these principles could be used as tests against which the PSB would assess the strategy for UK payments and develop an agenda for change.

Payment Strategy Board Membership

The scope of the PSB should cover all bodies in the UK that have a governance role in financial transactions and moving money (e.g. card Schemes, PayPal, new entrants, etc). This is important to ensure the future governance model remains relevant and does not benefit or impact one or more transaction types or group of stakeholders disproportionately.

LBG believes that the PSB membership needs to combine appropriate representation with recognised capability in the field of banking and payments. To meet these requirements, LBG proposes the following membership for the PSB:

- Six banks (“big four” permanent, two others on a rotational basis) – voting members
- Four members from bodies representing users of payments systems (consumer, small and medium-sized enterprises, charities and corporate) – voting members
- Four representatives from non-bank cards and payments organisations (UK Cards Association, Google, etc) – voting members
- Four independents – voting members
- Bank of England - observer at Deputy Governor level
- Financial Conduct Authority - observer
- Payments Council Chief Executive - non-voting, in the role of implementer for the PSB
- Chairman – non-voting

We would propose that PSB members would serve a term of between 2 and 4 years.

Further we would propose a voting structure which ensures that no one group alone (e.g. the banks) could force or block a motion.

LBG is of the view that it is essential that the “big four” banks have permanent representation on the PSB. These banks carry out over 80% of transactions that will fall under the scope of the PSB and will therefore play a critical role in industry change.

A key aspect of this structure is that users of payment networks would be represented directly on the Payments Strategy Board.

In order to achieve our proposed representation model, the Government may need to encourage the creation of representative bodies (e.g. for new entrant networks) where these do not already exist.

Some or all the Payments Council Independent Directors may be elevated to sit on the PSB. Dual membership of some of the Payments Council Independent Directors may also be advantageous.

We believe that, under a PSB set up without legislation, it would be appropriate for the FCA and Bank of England to attend as observers. This will strengthen the PSB's mandate and ensure that decisions by the PSB are consistent with the FCA's and Bank of England's objectives.

We believe that in creating a Payment Strategy Board it will also be important to redefine the role of the Payments Council as: implementing and advising on (not setting) the strategy of the PSB; and the effective running of the UK payment Schemes.

Payment Strategy Board Operating Model

LBG believes it is essential that the PSB has transparent and fair processes, with appropriate checks and balances built into its constitution and operating model. LBG would therefore propose the following outline operating model for the PSB:

- The PSB should operate against a strategic plan/roadmap for UK payments networks to facilitate medium term investment decisions (e.g. a five year manifesto with rolling annual workplan covering a small number of strategic deliverables). The roadmap would be prepared by Payments Council but endorsed by the PSB;
- The PSB should take inputs via a regular, perhaps biannual, consultation exercise with key stakeholders, specifically users of payments, banks, and trade associations, etc.;
- The PSB should make public recommendations on a small number of major strategic issues - it should not involve itself in the day to day running of payments and the detail of how to implement specific strategies;
- The PSB should conduct cost/benefit analysis, and risk and impact assessments, and put proposals to a vote before making a public recommendation;
- The PSB should procure resources and information to undertake the cost/benefit analysis, and risk and impact assessments from the Payments Council and other industry bodies;
- The PSB should be able to raise priority action areas between consultations by exception;
- The PSB should make public recommendations to the Payments Council to initiate change;
- The Payments Council should accept and implement PSB recommendations unless they publicly give reasons for not doing so; any such reasons should be based on a cost/benefit assessment and carefully weighed against PSB's guiding principles promoting the public interest;

- In the event of any dispute within the industry regarding whether or not to accept a PSB recommendation, there should be a route of appeal to an independent arbiter - such a route of appeal would not require a legislative basis;
- The PSB should hold Payments Council and other industry bodies accountable for delivery of public recommendations accepted for implementation;
- The outcome of PSB votes should be made public after the event (similar to the Bank of England's Monetary Policy Committee).

Manifesto/Agenda for Change

We have suggested below examples of major strategic issues facing the Payments Industry which we believe that the PSB could usefully consider.

2013-2014

- Delivery of Account Switching
- Delivery of P2P and P2b Mobile Payments
- Access to UK payments networks for banks and non-banks, to ensure open access and a level playing field
- Reuse of payments and banking infrastructure by Government (HMRC RTI, DWP Universal Credit and GAIA)
- Endorsement of a UK payments networks roadmap 2013 to 2017

2015-2017

- The future of cheques
- Delivery of priority items from the UK payments networks roadmap.

Payment Strategy Board Critical Success Factors

LBG considers that there are a number of factors which will be key to the success of the PSB:

- The PSB must have **strong senior representation from banks and other stakeholders** (we would propose a direct report of CEO or similar level) and be made up of appointees with a track record of knowledge and experience;
- The PSB must operate and make decisions against a set of **transparent and published guiding principles**;
- The PSB will make **public recommendations on big strategic issues** it will not involve itself in the day to day running of payments and the detail of how to implement specific strategies;
- The scope of **PSB must cover all UK payments networks including cards and new entrant models**;
- PSB must have a process to gather views and inputs from users of payments and stakeholders;
- Given the level of change facing banking and payments, the **PSB must publish a strategic plan/roadmap for payments networks** to facilitate medium term investment decisions (e.g. a five year manifesto with rolling annual workplan covering a small number of strategic deliverables);

- Prior to PSB making public recommendations, changes should be subject to a **cost benefit analysis, and risk and impact assessments**;
- If the Payments Council and the industry did not agree with PSB recommendations and chose not to implement them, they should make their reasons public, these reasons should be based on a cost/benefit analysis and weighed carefully against the PSB general principles to promote the public interest;
- The governance model must ensure **stability, integrity and systemic risk are paramount** in any PSB public recommendations;
- The governance model must as far as possible avoid duplication and minimise additional regulatory burden on the payments industry;
- The governance structure must retain a body that PSB can hold accountable for implementing its strategy, roadmap and recommendations; we recommend that this should be **the Payments Council**;
- **The PSB should procure information from the payments industry on a voluntarily basis** or use the powers of the FCA and/or Bank of England to mandate provision of information;
- The PSB should also have the power to seek views and comment on European or Global regulation impacting on UK payments networks;
- The **PSB should have a small Secretariat** and will procure additional resources on a case by case basis from Payments Council, BBA or other industry bodies;
- The **Payments Council should be separate to the PSB but be supportive of its objectives and guiding principles**;
- **The cost of PSB** should be distributed between firms and other stakeholders so that it is not overly disproportionately levied on banks.

LBG believes that the PSB constitution, membership, guiding principles and operating model as outlined above will help the body to make good decisions that are demonstrably in the public interest, underpinned by the authority to implement change. This framework should now be developed by the payments industry for endorsement by the FCA, Bank of England and HM Treasury. LBG believes that implementation can best be achieved without legislation. Furthermore, by avoiding the need to legislate, the Payment Strategy Board could probably meet for the first time in the first half of 2013. If, however, the Government determines that legislation is necessary, this would probably mean that the Payments Strategy Board could not be formally constituted until 2014 (though there may be some scope for it to operate in a “shadow” form before this).

- 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.**

We believe that the Payments Strategy Board should make public recommendations to Payments Council and the wider payments industry. We would expect these public recommendations to have been through a consultation process, subject to a cost/benefit, impact and risk assessment, and voted on before the Payment Strategy Board makes its recommendation.

We would envisage the process working as follows:

- Payment Strategy Board endorses the Payments Roadmap and agrees priority areas to investigate;

- The Payments Council and the wider industry review and presents back a cost benefit, impact and risk assessment to the PSB;
 - Payments Strategy Board takes soundings from key stakeholders and puts proposals to a vote before making a public recommendation to the industry;
 - The Payments Council lead the industry to implement the Payment Services Board recommendation (unless the industry publicly gives reasons for not accepting the recommendation).
- 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?**

We strongly agree that the Payments Strategy Board should have a broad and balanced representation, include senior banking and industry representatives, representatives of user groups and independents. The independents should be recruited based on providing a range of experience and expertise and be charged with getting a comprehensive understanding of the needs and views of all stakeholder groups and, in this respect, we would support the elevation of some or all of the existing Payments Council independents.

We believe that the PSB membership needs to combine appropriate representation with recognised capability in the field of banking and payments. We believe that the seniority of representation on the Payment Strategy Board will be paramount to its success. We would propose that members should be direct reports of the CEO or a similar level.

We have given more specific suggestions for membership of the PSB in our answer to Question 3a.

- 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?**

We strongly believe that it is not necessary for the PSB to have information gathering powers. Currently, the Payments Council has no formal information gathering powers, however the banks have always provided any requested information voluntarily.

In the highly unlikely case that a bank refused to provide requested information, we believe that the FCA and Bank of England might well be able to use existing powers to mandate provision of information where this is not forthcoming.

- e. Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?**

We have reviewed the pros and cons of various funding models for the PSB and believe that the cost of implementing and running the PSB should be distributed between firms and other stakeholders so that it is not disproportionately levied on banks. One option would be to allocate costs on usage and benefit rather than market share.

f. Should the FCA have any further controls over the Payments Strategy Board?

We do not think that the FCA should have any further controls over the Payments Strategy Board. To promote the public interest most effectively, it is important that the PSB should be a multi-party and consensus driven body, rather than being FCA-centric. We support the FCA being represented on the Payment Strategy Board as an observer.



LINK Scheme

Payments Consultation
Banking & Credit Team
Floor 1, Yellow
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Date: 9th October 2012

Dear Sir,

LINK Scheme Response to the Payments Consultation

This letter sets out the response from the LINK Scheme to the Payments Consultation. It has been approved in a formal vote of the LINK Scheme governing body, the Network Members Council, on 27th September 2012. The Network Members Council represents the thirty-seven financial institutions and independent ATM operators that make up the LINK Scheme. Their support for the contents of the letter was 96% with one independent operator voting against it. One financial institution also abstained as it wishes to make its response directly to the Consultation across all payments matters.

The LINK Scheme is a very important route for the UK consumer to access cash. The Scheme operates the UK's cash machine network and allows virtually all Automated Teller Machines (ATMs) to work together to provide one universal access to cash channel for UK consumers. Cash is the dominant payment method for UK consumers (55% of business and consumer payments are in cash¹) and the ATM network is the main source of access to cash (71% of cash is obtained via ATMs²). The Scheme brings together the various competitors that operate the UK's 65,000 ATMs to provide a safe, consumer focused and innovative service that is now in its 25th year of operation.

The conclusions of the Payments Consultation have the potential to enhance or to risk the effectiveness of the LINK Scheme. Our response sets out the issues that need careful consideration in order to maintain the healthy universal access to cash channel that is vital for UK's economic health. In particular, it highlights the need for any reforms to ensure a level playing field across all of the competing schemes that operate in the UK ATM market. These are primarily LINK, VISA and MasterCard. Reforms that have a common approach to the ATM schemes can enhance the already strong consumer position. Reforms that do not have a common approach to LINK and the other the schemes risk undermining LINK's ability to compete and its effectiveness in delivering universal access to cash.

¹ Payments Council; *UK Cash and Cash Machines*, 2012.

² Ibid

Please do not hesitate to contact me directly if I can provide further clarity to our views or background evidence to support them.

Yours faithfully,

John Howells
LINK Scheme CEO

LINK Scheme Response to Treasury Consultation on Payments October 2012

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.

The LINK Scheme supports Option 2 - the creation of the Payments Strategy Board. However, the scope of PSB engagement with the schemes involved in the Automated Teller Machine (ATM) marketplace needs careful consideration or it may risk universal access to cash.

The current arrangements with the Payments Council do not easily enable the government or regulators to influence consumer universal access to cash via the national ATM network. They also introduce risk to the ability of the LINK Scheme to compete. This is due to two challenges:

- **Limited Ability to Influence:** In the absence of regulatory powers, competition legislation severely limits the influence that an organisation such as the Payments Council can have on the individual members of a voluntary payment scheme such as LINK. This legal position is set out in the Appendix to this document in a letter from Hogan Lovells International LLP to the LINK Scheme dated 12th September 2012. The LINK Scheme is made up of a voluntary membership of competitors ranging from the largest banks to small independent deployers of ATMs. There is no easy mechanism for the Payments Council to require these members to act in a certain way. Attempting to do so risks the Payments Council breaching competition law. Recent issues regarding the desirability or otherwise of providing national ATM access to groups such as basic bank account holders is an example of how this situation limits influence. This is so even though political bodies such as the Treasury Select Committee have expressed concern on the potential widespread closure of ATMs and the conversion of free-to-use machines to pay-to-use as a result of basic bank account ATM restriction³. There is no available legal or regulatory mechanism that can address universal access to cash issues of this kind and competition legislation severely limits the influence that an organisation such as the Payments Council can apply to the LINK Scheme now or in the future.
- **Inconsistent Treatment of ATM Schemes:** The Payment Council, as far as ATMs schemes are concerned, only has a relationship with the LINK Scheme and not the other schemes, including VISA and MasterCard that provide competing ATM networks in the UK: This risks LINK's ability to compete. There is no compulsion for any ATM card or machine provider

³ House of Commons Treasury Committee report; *Access to Cash Machines for Basic Bank Account Holders*, 31st August 2012.

to stay part of LINK or to offer universal ATM access through LINK to a particular group of consumers and nor can there be under competition law. Should a LINK Member judge that the Payments Council might apply pressure to require the LINK Scheme to adopt a particular course of action, for example in relation to the provision of ATM services to consumers, then there is nothing to prevent it leaving and joining another ATM scheme such as VISA. This would mean that the remaining LINK Scheme Members had an increased share of the cost base and would reduce the competitive attractiveness of the LINK Scheme to those that choose to remain.

The unintended consequence of this chain of events is a reduction in universal access to cash. This is because:

- Other schemes' cards do not offer the full interconnectivity that LINK currently provides which allows any card to work at any ATM. Some cards will be unable to access all machines.
- LINK would see reductions in its own universal ATM interconnectivity as a number of LINK Scheme ATM Members outside of the largest financial institutions are not linked to eg VISA or MasterCard.
- These factors will also reduce the transaction volumes at LINK Scheme ATMs, leading to a likely withdrawal of free-to-use machines typically in lower volume rural and deprived areas which operate at the most marginal profit levels.

LINK is a competitive scheme in the same way as VISA and MasterCard. Its environment is highly competitive because of the diverse nature of its Membership and the alternative choices of cash access provision available to Members. LINK is not operating in the same competitive environment as the non-Competitive Schemes (such as BACS, FPS and CHAPS).

The diagram below contrasts Competitive and non-Competitive Schemes and shows how LINK is in the same category as VISA and MasterCard. In setting up a new Payments Strategy Board structure it is important that this competitive situation is recognised otherwise risk to LINK Scheme and the universal access to cash provision that it supports may be unintentionally introduced.

The Payments Council has identified this risk and has commented "*Bringing some schemes, but not others, within the scope of a strategy setting regime may result in a non-level playing field.*" LINK endorses this view.

UK Payment Schemes and whether non-Competitive or Competitive

	Is the Scheme Managing a Single Systemic Infrastructure	Is there Only One Choice of Scheme for this Service	Is the Customer Proposition Uniform	Do Members Avoid Competitors Accessing their Customers	Is the Membership Uniform	Type of Scheme
FPS	YES: Single national infrastructure for immediate payments	YES: Single national scheme	YES: Single national offer	YES: Payment experience for customer is with their institution	YES: Large national banks	Non-Competitive
BACS	YES: Single national infrastructure for periodic payments	YES: Single national scheme	YES: Single national offer	YES: Payment experience for customer is with their institution	YES: Large national banks	Non-Competitive
CHAPS	YES: Single national infrastructure for high value payments	YES: Single national scheme	YES: Single national offer	YES: Payment experience for customer is with their institution	YES: Large international and national banks	Non-Competitive
LINK	NO: Consumers can access cash via other channels such as branches	NO: For example, can use VISA	NO: Key customer channel; proposition at ATM variable	NO: Members can access any competitor's LINK cardholder via ATMs	NO: Highly diverse from big banks to small independent deployers	Competitive
VISA	NO: Multiple card payment options	NO: Other Card Schemes	NO: Customer proposition varied eg other card features	NO: Range of issuers/acquirers that consumers will interact with	NO: Range of issuers/acquirers	Competitive
MasterCard	NO: Multiple card payment options	NO: Other Card Schemes	NO: Customer proposition varied eg other card features	NO: Range of issuers/acquirers that consumers will interact with	NO: Range of issuers/acquirers	Competitive

The creation of the Payments Strategy Board can be achieved in a manner that protects universal access to cash for consumers without the need for regulation. The critical components that will enable this are:

- Addressing Limited Ability to Influence:** Given that the Payments Strategy Board will not have regulatory powers and will rely strongly on influence, it will be critical that the standing of the Payments Strategy Board is sufficient to influence the senior management of the various competitors that make up the schemes and maintenance of the ATM network as far as possible. High standing will depend on both the independence of the Board from other organisations and the credibility of the participants. To maximise the influence on the LINK Scheme, the LINK Membership should be directly engaged with the Payments Strategy Board through the Scheme's senior management. This direct engagement will also address the risk of creating inefficiency and cost through adding additional layers into the governance structure.
- Addressing Inconsistent Treatment of ATM Schemes:** The other competitive schemes involved in universal access to cash (VISA and MasterCard) should also be directly engaged by the Payments Strategy Board. Failure to include the other competitive schemes in the same manner as LINK would introduce risk to the Scheme. This is because some of its Members could judge it to their competitive advantage to leave LINK and join a scheme that the Payments Strategy Board had no influence over.

The LINK Scheme is keen to support arrangements as described above. LINK is particularly concerned about the risk to universal access to cash

through inconsistent treatment of schemes. Therefore, should VISA and MasterCard not be engaged in the same way as the LINK Scheme, the LINK Scheme Executive will recommend a review of the proposed arrangements with its governing body the Network Members Council. This will cover matters such as the appropriateness of existing or proposed contractual arrangements with the Payments Council or its successor and with the Payments Strategy Board. It may, for example, be more appropriate to move to a form of contractual relationship with the Payments Council that provided a basis for engagement and information exchange in relation to the development of strategy rather than one of formal oversight. Establishing different contractual relationships with different payment schemes is an approach that we understand that the Payments Council also endorses. The LINK Scheme has recently been requested by the Payments Council Board to explore its relationship with the Payments Council. Establishing what contractual relationship will mitigate the risk of an unlevel playing field with the other ATM schemes will be a key input by the LINK Scheme to this work.

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?

The LINK Scheme has supported effectively the existing light touch relationship with the Payments Council and we would expect to do the same with a successor organisation.

The work of implementation across payments is carried out by the various financial institutions and organisation that operate in the marketplace. They sometimes come together through arrangements such as the LINK Scheme where collaboration is required to deliver a particular feature such as the national ATM network. Organisations such as the Payments Council provide aspects of oversight and coordination. Given the limitations of direct control allowed by the competitive situation, the LINK Scheme has always focused on collaborative engagement with the Payments Council. This has included successful work in areas such as the support for mobile payments, cross-scheme engagement with BACS and FPS on common infrastructure and supplier issues, and support for media handling and research programmes. We would expect to do the same with a successor organisation whatever its form. As discussed in our answer to Question 1, the influence that a Payments Council-type structure can have on a competitive scheme such as LINK is severely restricted. Therefore, we see a strong Payments Strategy Board that is engaged in the same way with all schemes that compete in the UK ATM market as vital if universal access to cash and the maintenance of the nations ATM network is to be protected. The Payments Strategy Board will need to have a very high degree of credibility to fulfill its role without any regulatory powers. This means that it should be independent of influence from other organisations including the Payments Council, and composed of highly credible individuals from the organisations that are chosen to make it up. It should also directly engage with the key schemes including LINK in order to avoid the risk of creating inefficiency and cost through adding additional layers into the governance structure.

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?

A Payments Strategy Board of high standing can enhance industry support for consumers and stimulate innovation in the provision for universal access to cash.

As discussed in our answer to Question 1, a Payments Strategy Board that will not have regulatory powers will rely strongly on influence. So it will be critical that the standing of the Payments Strategy Board is sufficient to influence the senior management of the various competitors that make up the UK ATM schemes. High standing will depend on both the independence of the Board from other organisations and the credibility of the participants. To maximise the influence on the LINK Scheme, the LINK Membership should be directly engaged with the Payments Strategy Board through the Scheme's senior management. This should also be the case for the other UK ATM schemes, VISA and MasterCard. Direct engagement is important as it avoids adding bureaucracy to an already complex governance structure and provides clear line of sight between the schemes that deliver changes in payments and the strategy formulation body.

With regards to the scope of influence of the Payments Strategy Board in the ATM marketplace: The LINK Scheme's track record of operational integrity and oversight is excellent and we do not believe that there is additional value from extra controls beyond the successful mechanisms in place. Operational integrity is a strongly unifying objective across all LINK Scheme Members and it receives a high level of investment and attention.

Instead we believe that the Payments Strategy Board should focus on how to enhance consumer focus and innovation. These have driven many of the matters that have attracted adverse public attention in payments such as cheque provision. In the case of ATMs it includes topics such as is there sufficient investment in new ATM technology, and how to manage risks to the provision of a broad and free universal access to cash network for all consumers. The LINK Scheme has a strong track record of innovation that is recognised by regulators and politicians:

- LINK worked with the Treasury Select Committee to introduce its innovative and globally unique financial inclusion programme. In 2009 when the targets set for it were exceeded, Lord McFall said, *“Hundreds of low-income communities now have instant access to their money, without having to pay for it. I am delighted that the cash machines target has been surpassed. I would like to congratulate LINK as well as all the participating banks and cash machine operators.”*
- The Bank of England has noted the effectiveness of the £5 note programme at ATMs that it has sponsored. In April 2012, Governor of the Bank of England, Mervyn King commented: *“I am delighted that this initiative has been so successful. A key objective for the Bank is to maintain public confidence in the currency, by meeting demand with good-quality genuine banknotes that the public can use with confidence. In my speech at the Mansion House in 2007, I highlighted my concerns about the availability and condition of £5 notes. This initiative has made significant progress in dealing with these concerns, which were also shared by the public. I would therefore like to take this opportunity to thank the ATM operators and those at the Bank of England for their hard work in making this happen.”*
- Charity Giving at ATMs has gone live this year. The Minister for Civil Society, Nick Hurd MP, has worked with LINK and the industry to help achieve this innovation and commented *“Creating accessible opportunities for giving has the potential to benefit small local charities as well as larger organisations and we are pleased to be working in partnership with LINK and its Members to make this a reality.”*

Therefore, in the universal access to cash area, we recommend that the Payments Strategy Board should focus especially on setting high level direction in consumer focus and innovation. The LINK Scheme can then manage delivery in the same effective manner as it does now.

**Appendix: Potential Application of Competition Law to Arrangements
between the Payments Council and the LINK Scheme**

Letter from Hogan Lovells International LLP to the LINK Scheme dated 20th
September 2012

MasterCard response to the HM Treasury Consultation, “Setting the strategy for UK payments”

Introduction

MasterCard welcomes the opportunity to respond to the consultation launched by HM Treasury (‘HMT’) regarding “setting the strategy for UK payments” (‘consultation’). MasterCard is a global payments technology company, which performs its activities in 210 countries around the world, including the United Kingdom. We provide the technology, expertise and flexibility for cardholders, merchants and their banks to conduct business anytime, anywhere. As franchisor, processor and advisor, MasterCard delivers solutions for consumers, businesses and governments who seek faster, more secure and smarter payment methods for the widest possible range of goods and services.

Preliminary comments

Before commenting on the specific proposals put forward by the Government in the consultation, we would like to briefly examine the purpose of the consultation and the Government’s aims for payments in the UK in the context of UK electronic card payments. We believe this will help to inform the discussion on the specific proposals set out in Chapter 5 of the document, ‘Proposed options for changes to the regulatory regime’ in relation to card payment schemes.

1. Background and focus of the consultation

As outlined in the introduction and chapter 4, this consultation has flowed from Treasury Select Committee concerns following its investigation in April 2011 into ‘the Future of Cheques’. In particular, the Committee was critical of how the Payments Council had reached the decision to withdraw cheques from circulation and how this decision had been communicated to stakeholders. The investigation also brought into focus the governance model of the Payments Council, how decisions were made and the dominance by large banks.

Although the Payments Council subsequently reversed its decision to abolish cheques, the Government response to the Committee’s report accepted that reform of the payments Council was necessary, that it needed to be brought within the scope of financial regulation, and that it was developing a number of options for potential reforms, on which it would consult.

The Payments Council has responsibility for setting the strategy for UK payments and set out its strategic vision in its National Payments Plan (NPP), published in May 2008 and updated in October 2011. The Payments Council works closely with a number of contracted bank-owned, interbank UK payment schemes, including BACS Payment Schemes Ltd, CHAPS Clearing Company Ltd and Faster Payments Scheme Ltd as well as consulting with Customer User Forums, in order to deliver the NPP.

MasterCard is not a member of the Payments Council, primarily because we are a card payments scheme and as outlined above the Payments Council's remit is focused around UK interbank payments. There is of course some overlap between card and interbank payments, most notably around mobile payments, but in general card payments and card schemes operate separately to interbank payment systems and adopt quite separate commercial strategies. This is not only because we operate in different payment markets and provide payment options for different scenarios (e.g. card payment at point of sale vs. bank transfer) but, in MasterCard's case, because we also have a very different set of commercial imperatives. MasterCard is a public company, listing on the NYSE in 2006 and as such must adopt a strategy that ensures we compete effectively in the open market.

The consultation makes no mention of card payment schemes (except to say that we fall within scope of Part 8 of the Payment Services Regulations regarding open access) and certainly does not imply that the Government has any problems with the way that card schemes such as MasterCard set their strategies nor how these strategies are overseen.

Chapter 4 of the consultation assesses how well the present systems meets the Government's aims for payments and sets out concerns regarding the operation of and access to interbank payment schemes. As we set out in the next section, we believe that card payment schemes such as MasterCard already meet all of the Government's aims, independent of the Payments Council. Therefore, while we will continue to work closely with the Payments Council and its members, we would encourage the Government to consider carefully how MasterCard might become more involved with the Payments Council rather than including card schemes as part of any reforms merely because they are a significant part of the payments industry.

2. The Government's aims for payments networks

The consultation states that “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 payment 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 payment networks that facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms
- UK payment systems that are stable, reliable and efficient”

While the context of these aims is a reformed Payments Council and the interbank payments systems that it contracts with, MasterCard fully agrees with them and we contend that these aims are already being met by card payments on a daily basis as a result of our open system. Our desire is for an environment that recognises and accounts for the importance and success of electronic payments as an efficient, convenient, safe and cost-effective means of transacting as well as one that facilitates vigorous competition and continuing innovation, for all stakeholders in the system. E-commerce, mobile payments and much of the cross border commerce we now take for granted would not exist without the type of electronic payments MasterCard's open system and network technology provides. We have set out below in more detail some of the ways that MasterCard is already helping to achieve the Government's aims for payments:

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

UK consumers already benefit in a myriad of ways as a result of payment cards. By offering a wide range of products and solutions, card schemes provide equal opportunity to almost everyone – from the wealthiest to the unbanked – to participate in the modern economy. This democratisation of electronic payments has transformed a product once available only to the well-off into one that is now available to consumers in all income brackets. Cards provide consumers with protections against loss, fraud, theft and liability and enable consumers to make transactions anywhere in the world where they are accepted.

In addition, merchants benefit in extraordinary ways when they accept payment cards. Those merchants that choose to accept cards move customers more quickly through checkout and reduce costs, such as counting, transporting and depositing cash, not to mention the cost incurred when cash collected at the cash register fails to make it to the bank because of loss or theft. Accepting cards helps merchants reduce losses from fraud and bounced cheques and other costs that arise from handling paper based payments. Moreover, merchants who accept cards frequently enjoy a significant commercial benefit in additional and larger sales. Consumers who pay by card typically spend more than consumers who use cash, and merchants enjoy a boost from sales made on credit.

The impact payment cards have on the success of small businesses is especially important. Not long ago, access to electronic payments was largely the domain of larger and more sophisticated merchants. Over the years, payment schemes like MasterCard have invested in technology and innovation to make it easier and more cost effective for merchants of all sizes to join payment networks. Today, even the smallest merchant can join and compete for the same customers as the largest retailer.

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

Card schemes like MasterCard are constantly innovating, developing new technologies and enabling solutions that allow consumers, merchants, financial institutions and governments to utilise mobile phone technology, e-commerce applications, and even public transit technologies in ways that are safer, easier-to-use, affordable and more efficient than ever before. E-commerce itself, and particularly in the UK, would not exist on the scale that it does without MasterCard's electronic payment network and entire business models have been built on the back of the type of technology MasterCard provides. These businesses account for a large and growing percentage of total commerce, enable consumers to shop from home and easily compare prices and enable merchants to reach literally millions of customers with little or no investment in retail buildings or similar infrastructure. All the benefits associated with e-commerce are almost 100% enabled by the types of electronic payments companies like MasterCard make possible.

As a direct result of open, competitive systems such as MasterCard's that are able to respond rapidly to demands from consumers and merchants for better products, a new era of payments innovation is underway, the likes of which has not been seen for several

decades. The outcome will be manifested in increased sales to merchants, added convenience, better security, growing e-commerce activity, new products like mobile payments and the rising usage and acceptance of electronic payments throughout the single market for both domestic and cross-border transactions by consumers of all economic backgrounds.

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

The success of open four-party schemes such as MasterCard's in terms of the number of cards in circulation, the number of merchants accepting cards, and the transactions conducted using these cards is to a large extent the result of the fact these schemes are 'open': issuing and acquiring are carried out by a multiplicity of different entities. Issuers and acquirers can play to their strength, build on existing customer relationships and differentiate their offerings.

Subject to compliance with the scheme rules that govern their interaction and certain mandates linked to products, issuers and acquirers are entirely free in setting their charges or defining specific product features. MasterCard does not decide, for example, on the level or structure of merchant service charges for accepting its cards, nor on many of the features that issuers may offer to their cardholders. This drives down prices and improves service levels without losing the network effects that are so crucial for the success of a payment product. Working under the rules of the scheme, every single issuer can offer its customers the combined acceptance level of all the scheme's acquirers, and every acquirer can offer its customers access to the combined customer base of all the scheme's issuers.

Because of their scale, open schemes have an incentive to (and can) be more innovative as the return on innovation is large and, they are driving the improvements in payment technology that makes paying more convenient and secure. For example, the EMV standard on which Chip & PIN cards are based was introduced by Europay, MasterCard and Visa and is now the global standard for the interoperation chip-based payment cards.

Open schemes also support wide co-operation between different parties – a factor that is crucial for much of the innovation expected to take place in the payments sector and that will involve many different parties to pull together. The obvious case is the development of efficient mobile payments, where a workable solution has required competing handset

developers, mobile operators, banks, payment networks, merchants and technology companies to work together to develop a reliable and efficient system. While there is still some way to go, such co-operation is in the DNA of open schemes, and such schemes are best placed to turn the opportunities that exist into real products that succeed in the market.

- **UK payment systems that are stable, reliable and efficient**

MasterCard's network provides unrivalled integration, connecting financial institutions and other entities and 33 million acceptance locations in over 210 countries through the payment industry's only globally integrated processing network to ensure their payment experience is:

- Consistent, knowing payments will be accepted and guaranteed virtually anywhere in the world.
- Reliable, knowing payments will be managed quickly, seamlessly and accurately.
- Secure, knowing payment data is protected under the strictest compliance guidelines.
- Valuable, knowing unique value-added payment programs are available and tailored to spending needs.

Our systems balance the speed and reliability of distributed processing with the availability and agility of centralisation to dynamically adapt processing for each transaction and by extending bandwidth on demand we can customise processing for any payment transaction, channel or market. Using tri-ductant routing and multi-site processing, MasterCard is able to achieve a 99.9% global availability and provide a network response time that's more than twice as fast as other networks, averaging 130 milliseconds per transaction, to process over 27 billion MasterCard-branded transactions per year around the globe.

MasterCard also plays a leading role in payment card security, pioneering innovative technologies and solutions, defining industry standards and practices, and fostering collaboration among global businesses and industry professionals. Addressing the current global fraud challenge requires a holistic strategy that relies on the participation of everyone – financial institutions, service providers, merchants, governments, law enforcement and cardholders. MasterCard works with these stakeholders on everything

from championing industry initiatives designed to create and maintain uniform data protection around the globe to offering advanced fraud management solutions to helping financial institutions and merchants achieve fraud and risk management objectives

Response to the questions contained within the consultation

Question 1

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

- **Should be the lead option for reform**
- **Provides the most 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

Option 1: an enhanced Payments Council

In Chapter 5 of the consultation, the Government is very clear in explaining the areas that the Government would expect the Payments Council to tackle, ranging from becoming purely a strategy setting body and enhancing the delivery of said strategy to a reformed Board composition, enhanced 'User Councils' and wider membership. While we understand and agree with the reasons behind the Government undertaking this consultation, given that option 2 will require all of the suggested reforms outlined in option 1, in addition to the length of time it is likely to take to establish a Payments Strategy Board (PSB), MasterCard believes that option 1 would achieve the desired outcome for both the Government and all payment stakeholders. It would also enable organisations such as MasterCard, who are not currently members of the Payments Council, to make their own decisions on membership based upon a number of different factors.

In order to meet the desire of Government for the Payments Council to be subject to greater scrutiny, the Payments Council has also suggested the creation of a body of senior representatives under option 1, membership of which would include representatives from the Financial Conduct Authority (FCA), HMT, the Bank of England as well as a mixture of industry and independents. This body would provide public interest scrutiny, hold the

payments industry to account, provide a challenge function and focus on key issues. MasterCard would be supportive of such a body being created as long as its remit and scope were very clearly defined and executed and would want to be involved in determining this.

Option 2: Payments Strategy Board

If the Government does decide to establish a PSB, MasterCard believes that it would be more appropriate for it to provide oversight of the Payments Council's activities as they impact the public interest, rather than having responsibility for setting the strategy of the payments industry. As option 2 would include all of the reforms set out under option 1, the PSB could hold the Payments Council to account by suggesting 2-3 themes per year for the Payment Council to focus on, reviewing its Payments Roadmap at regular intervals (perhaps biennially) to assess progress, publish any concerns it may have and assess whether any previous concerns are being addressed.

As outlined in the consultation, membership could include FCA representatives, senior industry and non-industry representatives and independent experts and perhaps be enhanced by members from HMT and the Bank of England. By adopting this high level and strategic approach, the PSB would have a clearly defined remit to provide a pivotal coordination role whilst simultaneously ensuring that market forces are not unnecessarily restricted and allowing competitors to introduce new products and services.

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?**

We agree that the remit of the Payments Council as currently defined is appropriate, in that it is the body responsible for ensuring that UK payments services (interbank payments) function effectively and meet current and future needs. As mentioned above, we believe that Option 1 would more effectively achieve the Government's aims for UK payments and that the proposed remit of the PSB in paragraph 5.24 of the consultation should actually sit with

the Payments Council, which, under Option 1, would be held to account by a body of senior representatives:

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

We also agree that the objectives of the Payments Council are appropriate when taken in conjunction with its remit, as agreed by the OFT Payment Systems Taskforce in 2007:

- To have a strategic vision for payments and lead the future development of cooperative payment services in the UK
- To ensure that payment systems are open, accountable and transparent; and
- To ensure operational efficiency, effectiveness and integrity of payment services in the UK

As currently stands, the Payments Council's remit does not include card payment schemes or new payment services such as mobile payments via a phone bill. The Payments Council wants to broaden its remit to include these and other payment types. As explained above, we believe that MasterCard already meets both the Government's aims and Payments Council's objectives and we will continue to operate a close and cooperative working relationship with the Payments Council.

We are therefore currently unsure what beneficial impact would be achieved by extending the Payments Council's remit to cover card schemes, particularly as the constitution of the Payments Council is clear that it must take account of the interest of all payments stakeholders, not just members. However, if the remit were to be extended, MasterCard would welcome working with the Government and the Payments Council to ensure a very clear definition and agreement of what this might entail, particularly in terms of membership, strategy-setting and MasterCard's role in both.

b. How can a clearer separation of the Payments Council's strategy setting and

trade body representative functions be best achieved?

The situation that arose around the announcement to withdraw cheques has been viewed as a direct consequence of the Payments Council only representing the views of member banks. We do not have any particular suggestions on how a clearer separation could be made, apart from to say that the reforms the Government sets out under Option 1 will make it far more likely that a similar situation does not arise again.

c. Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?

MasterCard supports the Payments Council publishing annual progress reports against its objectives. In addition, the Payments Council commissioned Professor Martin Cave to conduct a governance review and assessment of its performance. This process could be repeated in the future, or the suggested body of senior representatives could instead conduct a review, in addition to assessing the Payments Council's annual progress reports.

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.

MasterCard agrees that any two independent directors with a right of veto over board decisions may produce greater checks and controls and potentially better outcomes. However, it is of course important that independent directors are as knowledgeable as possible about all aspects of the payments industry, in order to be able to challenge effectively and impartially proposals at the board.

e. Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?

MasterCard does not have experience of these user forums and so is unable to provide any objective comment on how these might be improved.

f. How can Payments Council funding be put on a long term, secure footing?

As the Government states, if the board is to be rebalanced and membership widened then funding will have to be altered. However, we do not feel that we are in a position to comment on how this would operate until we have confirmation of the option that the Government wishes to pursue and far more detail on what this would entail.

g. How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?

There is an inherent responsibility amongst Payments Council board members to make decisions that they are also able to take forward in tier own organisations, which in turn necessitates a certain level of seniority amongst Payments Council members. As discussed above, there also needs to be an appropriate level of accountability in place, which the body of senior representatives would be able to provide. This would allow those representatives from HMT, the FCA and the Bank of England to provide an effective level of enforcement, without the need for formal regulation.

h. How can membership of the Payments Council be broadened most effectively?

We agree that the Payments Council should be taking a wide view of payments and wider membership could help achieve that. However, as mentioned earlier, the Payments Council's constitution requires it to look beyond its membership to encompass the needs of all stakeholders in the payments landscape. Therefore, rather than merely widening

membership to merely cover all payment types and issues, it is more important to understand what this would mean for members and how this would work in practice.

The Payments Council currently has two levels of membership, full and associate. Members would need to understand what, if any, changes there might be to these categories, whether there might be additional categories and how an effective share of voice might be achieved in any decision-making process. This would have to be achieved while also ensuring that the decision-making process was not held up unnecessarily, which increase win likelihood as membership is widened.

As mentioned above, MasterCard believes that we already meet the various objectives set out by both the Government and the Payments Council and already works very closely with the Payments Council on cross-industry issues and issues of strategic importance to payments. If the Payments Council remit were to be extended to cover card schemes, it may be more effective for MasterCard and other similar schemes to create some form of contractual relationship with the Payments Council. This would formalise the relationship that we already have and that we believe is working well and would enable both parties to continue to cooperate closely on issues of strategic priority.

Question 3

a. Do you agree with the proposed remit for a new Payments Strategy Board?

As outlined above, we believe that Option 1 is the best and most effective course of action for the Government to achieve its stated aims for payments in the UK. However, if a PSB is to be created, then we would urge the Government to work very closely with the industry to ensure the most effective model is created. As summarised above, MasterCard strongly believes that the PSB needs to be able to take a strategic, high-level approach to the oversight of the UK payments system. Otherwise, there is a very real risk of stifling the industry by adopting well-intentioned but ultimately overly-burdensome regulatory oversight.

We have already commented that the remit of the PSB as set out in paragraph 5.24 is probably too detailed and it would be far more appropriate for the Payments Council to adopt as its objectives. The PSB should instead look to hold the Payments Council to account in

line with these objectives, providing oversight and challenge and suggesting two or three themes a year for the payments Council to focus on.

Additionally, this consultation is necessarily high-level and in order to ensure consistency and clarity of responsibility, there is a great amount of detail that needs to be determined should the Government decide to pursue the creation of the PSB. One crucial example is the scope of the PSB, particularly which payments systems and schemes it would cover. MasterCard would urge the Government to consider very carefully the impact of including card schemes merely because they are significant players in the payments landscape. MasterCard will continue to work closely with the Payments Council regardless and as discussed above, card schemes are very different to interbank payment systems. Including them without a clear determination of market failure and an understanding of what the Government would be trying to achieve risks creating unintended consequences.

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.

If the Government decides to establish a PSB, notwithstanding the need for a very clear and appropriate definition of its remit and scope, it should make recommendations based upon holding the Payments Council to account in line with its strategy and annual plan, applying a public interest test and making recommendations that are strategic enough to enable the Payments Council to adapt its strategy in line with its objectives.

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?

As outlined above, the PSB should include the above representatives at a suitably senior level, in addition to HMT, the FCA and the Bank of England.

d. Should the payments Strategy Board have a formal information gathering power? If yes, what should be covered by such a power, and what should an appropriate enforcement mechanism be?

MasterCard believes this would be appropriate, in the context of gathering information to inform PSB understanding regarding the Payments Council strategy

e. Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?

We have no particular comment on this other than it may more appropriate for any levy to include industry participants.

f. Should the FCA have any further controls over the Payments Strategy Board

MasterCard does not believe that the FCA should have any further control over the PSB.



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10th October 2012

Payments Consultation
Banking and Credit Team
Floor 1, Yellow
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Via E-Mail

paymentsconsultation@hmtreasury.gsi.gov.uk

Dear Sir/Madam

RE: Nationwide Building Society response to the HMT consultation on setting the strategy for UK Payments

Nationwide Building Society welcomes the opportunity to respond to the above consultation.

We are the UK's third largest mortgage lender, second largest High Street savings provider and sixth largest High Street Financial Services organisation, with around £190 billion in assets. We are the only building society that provides a viable alternative to the plc banks through our size and scale, product proposition, pricing structure, branch network and brand strength. As a modern mass-market mutual, we are owned by and run for the benefit of our 15 million members. We are naturally consumer focused and, though we must take a commercial approach to remain competitive, we do not compromise our mutual principles.

Nationwide broadly supports any attempts to strengthen the governance and strategic oversight for the UK Payments industry.

Nationwide is a member of a number of industry bodies, trade associations and card schemes who have provided a detailed response to the consultation. Therefore, the remainder of this letter seeks to highlight areas that have a particular impact on Nationwide Building Society and our unique mass-market mutual business model.

1. Nationwide supports reform of the UK Payments Strategy Board

1.1 Whilst Nationwide is aware that the Payments Council already has a strategic level Board, we would fully support the strengthening of this Board to ensure there are robust mechanisms in place which ensure;

1.1.1 The public interest is sufficiently represented (business and consumer groups)

1.1.2 Innovation is permitted to flourish both within a UK Payments Board and by individual organisations

1.1.3 Security and stability of the various payments infrastructure and systems are maintained and are not sacrificed at the expense of innovation

1.1.4 Decision making processes support UK plc with the industry being held to account against agreed objectives

1.2 However, the method by which UK Payment Strategy is strengthened must take account of the complexity of payments and the existing innovation and competition issues which exist within the payments arena. Any option which is determined to provide the maximum stability of Payments in terms of security and capability whilst nurturing innovation and diversification from both Payments Council members and those trade associations and schemes who also offer payments solutions, would be supported by Nationwide.

2. Remit for a reformed Payments Strategy Board

2.1 With the level of complexity which already exists within the Payment Services arena there is a requirement to ensure full engagement with all stakeholders from within the UK who either offer, or wish to offer, payment solutions.

These stakeholders may be already contracted within the Payments Council (e.g. BACS, Chaps, Faster Payments) or currently sit outside (Visa, MasterCard, Everything Everywhere).

As such any oversight body, be that the strengthened Payments Council approach, the proposed Payments Strategy Board or full regulatory body, would need to ensure full representation across the breadth of stakeholders.

2.1.1 This is important because providing such oversight enables the review of objectives and future plans of the Strategic Group/Payments Council/other, against relative prioritisation of activities, to meet the public interest (including but not limited to, transparency, fairness, access to cash etc.).

2.1.2 Ability to consider the full breadth of payment services, not just restricted to those currently contracted to the Payments Council.

3. Funding impact on Nationwide

3.1 As a mutual organisation, we are run for the benefit of our 15 million members. Any increase in the cost of oversight and governance could impact on the continued ability of Nationwide to continue to provide a competitive alternative to the plc banks for customers.

3.1.1 If costs were prohibitive, Nationwide and by association consumers, would be negatively impacted.

I would be happy to arrange a meeting to discuss any of the issues raised in this response in more detail. If in the meantime, I can provide any further information regarding this matter; please do not hesitate to contact me.

Yours faithfully



Paul Horlock
Head of Group Service Management

**The response of the Office of
Fair Trading to the HM
Treasury consultation *Setting
the strategy for UK payments***

October 2012

INTRODUCTION

1. The Office of Fair Trading (OFT) is the UK's competition and consumer authority. Our mission is to make markets work well for consumers.
2. The OFT has had a particular interest in payment systems for many years, and has played a part in improving and safeguarding the way that payment systems in the UK operate. It is mentioned in two contexts in the consultation document itself; as part of the existing payments regime (enforcing Part 8 of the Payment Services Regulations), and as one of the bodies that drove the payments industry into developing the Faster Payments Scheme.
3. The OFT also has a wider interest in payment systems through our continued work on interchange fees¹ and retail banking.² We are currently reviewing the implications of the recent European General Court judgment regarding cross-border interchange fees³ for our investigations into MasterCard and Visa's UK interchange fee arrangements and will issue a project update in due course. We have also indicated that we will consider the operation of payments systems as part of our programme of work on Retail Banking in the UK, in which improving customer focus is a key theme.
4. The rest of this document is structured as follows. It begins with an overview of the OFT's position on the proposals in the consultation document. This is followed by answers to the specific questions raised.

¹ More information about the OFT's work into interchange fees can be found here:

www.offt.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/interchange-fees/

² More information about the OFT's concerns about the Retail Banking sector can be found here:

www.offt.gov.uk/OFTwork/financial-and-professional/retail-banking/

³ Case T-111/08, MasterCard Inc & Others V European Commission

AN OVERVIEW OF THE OFT'S POSITION

5. Efficient and effective payment systems are vital to the economy since all businesses use payment systems either directly or indirectly. The OFT strongly agrees with HM Treasury's view that the Payments Council can and should do more to respond to the needs of end users and promote and develop new and existing payment systems. As such, we agree that there is a compelling case for reforming the governance of payment systems.
6. The OFT has provided below some responses on the detail of the options of enhanced self regulation and creation of a Payments Strategy Board, but we think there are two key points that are worth highlighting in relation to these options. First, we consider it important that any governing body for the payments industry is given the ability to compel member organisations, individually and collectively, to take actions where there is a clear case that doing so would be in the interests of wider stakeholders in the UK's payment systems. Without an element of compulsion, there is a risk that innovation moves at the pace of the slowest member. Second, we consider it important that there is adequate representation of payment systems users on the governing body in order to ensure that payment systems meet the needs of their customers.
7. Both these points are illustrated by a comparison of the achievements of the Payment Systems Task Force with the subsequent lack of progress by the Payments Council. Among the Task Force's achievements were:
 - Agreement over the introduction of the Faster Payments Scheme; the UK's first new payment system for 20 years⁴
 - Agreement over improvements to the way the cheque clearing scheme works, in particular the speeding up of the slowest cheque clearers and the introduction of certainty of fate (the money from a

⁴ This announcement is explained in more detail here: www.offt.gov.uk/news-and-updates/press/2005/94-05

cheque cannot be reclaimed by the bank from the customer after seven days have elapsed unless that customer is party to fraud)⁵

- Agreement over improvements to the governance arrangements of both BACS and LINK.⁶

8. When the Payment Systems Task Force was established it was made clear to the industry that a failure to make progress would lead to regulation.⁷ While stopping short of compulsion, this gave the industry an incentive to make significant improvements to the way it worked. The Payment Systems Task Force also benefitted from a balanced board able to recommend innovative solutions for different classes of stakeholders. The Payment Systems Task Force consisted of 18 members, but only just over half of these members represented the industry.⁸ Government was represented by the OFT and HM Treasury, which - along with the Bank of England - attended as an observer. Business customers of payment systems were represented by the Federation of Small Businesses, the British Retail Consortium and the British Chambers of Commerce. Consumers were represented by Which? and by the National Consumer Council.⁹
9. Finally, although there have been a number of significant developments in payment systems and their regulation over the last decade or so, we believe that some of the fundamental features that led to the recommendation for regulation in the Cruickshank report *Competition in UK Banking* remain. In particular, payment systems exhibit strong network

⁵ This announcement is explained in more detail here: www.of.gov.uk/news-and-updates/press/2006/159-06

⁶ More detail on these two announcements can be found here: www.of.gov.uk/news-and-updates/press/2006/42-06 and www.of.gov.uk/news-and-updates/press/2006/69-06

⁷ www.of.gov.uk/news-and-updates/press/2004/43-04

⁸ The payments and banking industries were represented by APACS (the forerunner of the Payments Council); the British Bankers' Association; the Building Societies Association; and the major payment systems at the time (BACS; CHAPS; the Cheque and Credit Clearing Company; LINK; MasterCard; S2 Cards and Visa)

⁹ The membership of the Payment Systems Task Force is explained in more detail here: www.of.gov.uk/news-and-updates/press/2004/43-04

economies and tend to be governed by their banking members. To the extent that underlying problems identified in the Cruickshank report remain, we do not think that the case for regulation is closed. Equally we would not recommend regulation lightly – costs and benefits must be properly considered, and in particular any regulation of existing systems must not deter entry by new players or technologies. We propose to consider whether the case for regulation, as set out in the Cruickshank report, still stands as part of our forthcoming work on payment systems.

OFT'S ANSWERS TO THE SPECIFIC QUESTIONS

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.

10. The OFT feels strongly that action is required to make the payments industry more competitive and open to consumers' needs. As noted above, the OFT is seeking to promote competition and a greater focus on meeting consumer needs in the wider retail banking area, as described in paragraph 3 above.
11. Regarding the specific options identified in the consultation, our views can be summarised as follows:
 - **Option 1** appears to offer only an incremental increase in self-regulation and we do not believe that this would be sufficient to address the underlying concerns in the market. While it could go

some way to delivering a board representative of all stakeholders, it is unclear how it would address our concern regarding the lack of compulsion. This is explained in more detail in the answers to the individual points in question 2 below.

- **Option 2** could also address the concern about representation. However it is unclear whether having both a Payments Strategy Board and a Payments Council would be advantageous or would simply add another layer of bureaucracy. Furthermore it is not clear that this option would answer the OFT's first concern regarding the ability to force the industry to take action. Without this element of compulsion, even if both the Payments Strategy Board and the Payments Council were in favour of a certain course of action, they would be reliant on the individual financial institutions to implement that action.

12. As noted above, it may be worth considering further the regulatory option. There are a number of issues relating to the current regulatory framework and how this might develop in the future that would need to be considered. The Payment Services Directive (PSD)¹⁰ contains provisions which affect two of the five main Cruickshank concerns,¹¹ namely price transparency and non-discriminatory access to payment systems.¹² Any further attempt to regulate these issues would need to

¹⁰ The PSD has been transposed in the UK by the Payment Services Regulations (PSRs). Although the PSRs are the relevant UK law, we refer to the provisions of the PSD in the rest of this document.

¹¹ The Cruickshank report highlighted how network effects and the mutual governance model in payment schemes interact to generate concerns about lack of innovation, poor adaptation to consumer needs, anticompetitive restrictions on access and anticompetitive and inefficient wholesale pricing.

¹² The provisions of the PSD relating to information to be provided to the customer before and after execution of a payment transaction are transposed into Parts 5 and 6 of the PSRs. The non-discriminatory access provisions of the PSD are transposed into Part 8 of the PSRs. To summarise, these provisions seek to ensure that authorised Payment Institutions (bodies licensed by the PSRs) are allowed access to payment systems in the UK on an even playing field. The Financial Services Authority's Approach Document, which explains the role of

take account of the provisions of the Payment Services Directive (PSD). The Communication on the Single Market Act II published by the Commission on 3 October 2012¹³ indicated that the Commission will propose a revision of the PSD and make a legislative proposal on multi-lateral interchange fees for card payments.

Question 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?

13. We agree with the Government that the current remit and objectives of the Payments Council are broadly appropriate. However, we would recommend sharpening the focus of the Payments Council (or any successor body) by adding an objective which makes clear that the Payments Council should balance, and then act in, the interests of all its stakeholders. This could look something like:
- To ensure that all stakeholders in the UK's payments systems are given consideration in decisions taken, and receive a fair share of the benefits
14. Innovation has been an area of poor performance by the UK's payments industry for a number of years. To address this, it may be beneficial to include a duty on either the Payments Council or on individual payment service providers to carry out regular research into payment means which would be valued by consumers, as well as cost-benefit analyses to establish whether the benefits of such a payment means would outweigh the costs of introducing it. Such a methodology was used by the Payment Systems Task Force to establish whether there was justification for a Faster Payments System.

the FSA and OFT under the PSRs, can be found here:

www.fsa.gov.uk/pubs/other/psd_approach.pdf

¹³ http://ec.europa.eu/internal_market/smact/docs/single-market-act2_en.pdf

B How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?

15. As a first principle, we believe that regulatory and representative functions should be separate - we have successfully advocated for this separation in oversight of the legal profession for example.
16. We think that there should be two separate bodies undertaking these functions; one body charged with strategy setting, and an entirely separate body carrying out the role of a trade body, such as carrying out advocacy on behalf of its members. This could be achieved by introducing clearer objectives demonstrating that the Payments Council operates in the interests of all parties, not just the industry (see answer to question 2A), and by changing the make-up of the Board to demonstrate that the Board balances the interests of all stakeholders (see paragraph 8). There would therefore be a vacancy for the role of trade association, as the Payments Council would no longer speak with the voice of the industry.

C Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?

17. Yes. We think that this would be an important way of checking that the Payments Council is meeting its objectives. The Independent Review of Governance and Performance of the Payments Council 2009-11 carried out by Professor Martin Cave ('the Cave report') has already demonstrated some of the benefits associated with this approach.¹⁴

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.

¹⁴ www.paymentscouncil.org.uk/current_projects/governance_review/

18. We are supportive of the idea of empowering independent directors. If however – as stated in the consultation paper – in practice the board takes decisions by consensus rather than majority vote, decreasing the number of independent directors needed to be able to veto a board decision may not have a significant impact.
19. A key problem identified with the operation of the Payments Council in the Cave report was the relative lack of knowledge of payment systems of independent directors compared to that of industry directors.¹⁵ This is to some extent inevitable. There may be some measures to help close that knowledge gap – for example independent or non-industry directors might be given the right and resources to commission research or advice directly. Fundamentally however, it may make sense to look for non-industry directors to make a different sort of contribution – they may be able to bring their own expertise to the Payments Council. For example, a director with knowledge of the SME sector may provide valuable insight into how these customers use payment systems.
20. HM Treasury may therefore wish to consider whether the board of the Payments Council should include directors with either recent experience of, or recruited directly from, organisations that represent non-payments industry stakeholder groups, such as consumer or small business organisations. This would be in addition to other independent directors. Should this happen, it may be worth revisiting the veto arrangements for the Payments Council board, as the change in composition and dynamic of the board may mean it is less likely that the board will always make decisions by consensus in future.

¹⁵ 'There is a substantial asymmetry between the resources and information about payment systems available to the banks and to the Payments Council, and asymmetry between the knowledge of payment systems of the industry of the independent directors on the Payments Council Board.' Click here to see the report:

www.paymentscouncil.org.uk/files/payments_council/governancereview/governance_review-martin_cave_report-february2012.pdf

E Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?

21. Yes, and these should be linked to Directors that represent the interests of those particular stakeholder groups (see answer to question D). For instance, the User Council responsible for consumers should have a direct role on the Payments Council board through its director, who represents consumer stakeholders.

F How can Payments Council funding be put on a long term, secure footing?

22. We have not provided an answer to this question.

G How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?

23. While self-regulation can in principle enforce rules by taking action against non-compliant members, the sanction for non-compliance is typically expulsion. It is not immediately clear that this sanction is either practicable or desirable in payment systems.

H How can the membership of the Payments Council be broadened most effectively?

24. In 2009 the OFT carried out a review of the Operations of the Payments Council and noted that:

'Membership of the Payments Council for a wider group of institutions with an interest in payment issues would bring a number of benefits. These include:

- A wider background of expertise, including specialist knowledge from other industries.

- A less bank-dominated membership profile (currently the membership of the Payments Council is dominated by banks and other financial institutions).

The Payments Council would therefore benefit from membership which includes different types of organisation, especially including those, like mobile 'phone providers that may soon be processing payments (even if they are not providing payment services). This would require amendment of the Payments Council Rules and a consequent change to the constitution.¹⁶

25. The OFT still believes that although financial and payment institutions will always be the most important providers of payment services, other types of institutions will increasingly have a role to play. For example, developments in Near Field Communication technology may result in significant changes to the payment systems landscape. For that reason the OFT still believes that membership of the Payments Council should be open to bodies such as mobile 'phone providers who can demonstrate an interest in delivering payment solutions, or that potential entrants to the market are represented by a director on the board of the Payments Council.

Question 3

<p>A Do you agree with the proposed remit for a new Payments Strategy Board?</p>
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26. We agree with the proposed remit for the Payments Strategy Board. Our concerns relate to its ability to deliver on that remit without the power to compel the industry to make improvements.

<p>B Do you agree that the Payments Strategy Board should make recommendations to the payments industry, rather than requiring action? If you</p>

¹⁶ *Review of the Operations of the Payments Council:*

www.of.gov.uk/shared_of/reports/financial_products/oft1071.pdf para 6.9 to 6.10

consider mandated action to be appropriate, please set out how such a method could work most effectively.

27. As discussed above, the OFT considers that the ability to make recommendations to the payments industry may not be sufficient to ensure that the needs of all stakeholders are met. Without the power to compel payment bodies to take certain actions the same problems of slow delivery identified in the consultation paper at paragraphs 4.10 and 4.12 may continue to occur.
28. The Cruickshank report identified the tendency for innovation to take place at the 'pace of the slowest' when left to decisions of associations of payment bodies. This may be because payment bodies are reluctant to make changes that will lead to costs to them which are difficult to pass on directly to customers, or they may be willing to introduce new innovations but lack the leadership to do so. A regulator with the power to mandate the introduction of new payment methods would address both these problems. One way of achieving this could be to give the regulator the ability to impose fines on members of the Payments Council who fail to take the required action within the appropriate time.
29. We consider that payment bodies have had a number of years to demonstrate that they can act voluntarily in the interests of all stakeholders but have not shown they are able or willing to do so.

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?

30. As stated above, we consider that a greater balance of non-industry representatives is needed in the governance of the payments industry. A near 50/50 split between industry and non-industry directors, similar to that of the Payment Systems Task Force, would be a model worth considering. In addition to the industry representatives (perhaps split by the type and size of organisation as is currently the case for the Payments Council) non-industry directors representing consumer, small business and

corporate stakeholders could be appointed, as well as independent directors recruited on the basis of their personal skills or experience.

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?

31. Yes. We consider that any body – whether it be a regulator or self-regulatory body – should have formal information gathering powers. Having such powers would help to inform any decisions or recommendations made by that body.

E Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?

32. We have not provided an answer to this question.

F Should the FCA have any further controls over the Payments Strategy Board?

33. As discussed above, we consider that there is a need for an organisation independent of the payments industry to have powers of compulsion to ensure that the payments industry works in the interests of all its stakeholders.

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By email: PaymentsConsultation@hmtreasury.gov.uk

10 October 2012

Dear Sirs

Setting the strategy for UK payments

We are writing in response to the consultation initiated by HM Treasury in its document: "*Setting the strategy for UK payments*" (July 2012) (the "**Consultation**").

Osborne Clarke

Osborne Clarke is an international law firm with offices (amongst other places) in the City of London and some 150 partners and 550 lawyers. Our priority sectors include Financial Services and Digital Business, such as the creation of the Payments Council, the merger creating VocaLink and the UK's first NFC enable stored value mobile payment solution (QuickTap). We have a market-leading Payments practice which has acted on transformational projects in this field. This gives us a unique insight into the governance matters raised in the Consultation.

Consultation

We warmly welcome the Consultation: it is timely to review how the strategy for UK payments is developed, implemented and reviewed:

- **formal review** – the Payments Council has now been operating for over 5 years;
- **complex regulatory regime** – the regulatory regime affecting payments has become much more complex, pervasive and structured, and in the UK is shared amongst several bodies; and
- **evolving market** – the payments market has been developing rapidly with the evolution of technology and the digital economy, convergence across financial services, retailers and mobile network operators (MNOs) and new non-bank market entrants.

We also warmly welcome HM Treasury's approach in this field – led by Brian Garcia – which we have found at all times to comprise open, constructive dialogue, with plenty of listening.

We would encourage HM Treasury to reflect upon all the views expressed in response to the Consultation and, in arriving at its conclusion as to the optimal governance structure, to be open to

changing its mind: it should not feel constrained by political concerns, but should be motivated solely by the desire to facilitate a first-rate payments strategy for the UK which is enabling, progressive and, above all, holistic.

We set out below our views on the three Options presented in the Consultation (in reverse order).

Option 3

We agree with HM Treasury that Option 3 – the creation of a new regulator for the payments industry (similar to the 'PayCom' recommended by the Cruikshank Report back in 2000) should be dismissed. The UK regulatory regime affecting payments is already shared amongst too many bodies (HM Treasury, the Bank of England, the FSA (soon to be split into the PRA and FCA), as well as the OFT), and another would add further complexity, cost and unnecessary duplication. Also, the perceived failings of the Payments Council are not regulatory in nature and the response to these does not justify a whole new regulator just for payments.

Option 2

In the Consultation, HM Treasury indicates its strong preference for implementation of Option 2 – the proposed creation of a new public body (known as the Payments Strategy Board, or "**PSB**" for short) to set strategy across the payments industry.

We are not persuaded, however, that Option 2 is the best way forward. We much like the idea and concept of a PSB but, in our view, it should not be established by and operated under the FCA. This would be wrong for a number of reasons:

- **philosophy** – the FCA will operate under clear regulatory objectives, which will not align (wholly or, even, mostly) in nature or scope with the strategic objectives we would expect to be set for the PSB: the emphasis which would unavoidably seep down from the FCA would differ markedly from the PSB's strategic work. Regulation tends to be inherently negative or restrictive in nature, if not in form, then in the way it is practised. Regulations and regulators, rarely, of themselves, create innovation or stimulate growth, yet they can facilitate both;
- **day-to-day conduct** – our experience is that regulators tend to focus on the perimeters of regulation and achieving the right balance between the regulated provider and the protected user (most often the consumer). The focus on day-to-day conduct of financial services regulators does not lend itself to formulating industry-wide strategic plans (as distinct from dealing with structural conduct issues); and
- **dilutive effect** – the breadth of coverage of the FCA's regulatory remit would detract from the focus and credibility of the PSB: to be publicly accountable, the PSB needs to have its own, separate profile, and not to be seen as subservient to the FCA and its broader remit. It needs its own political arena.

Regulators absolutely can play a key role in helping deliver better outcomes for users of the UK payments system. Indeed, the continuing threat of further (i.e. stronger) regulation in this field is critical. However, the use of regulation is typically at its most effective when dealing with specific mischiefs. We give a few examples below as to how the existing regulators might be involved:

- **FCA** – the FCA could reinforce strategic objectives (like account switching) through pinpoint regulation, delivered after proper consultation and interpreted and applied consistently, as it has done with particular issues arising from the Payment Services Directive;
- **PRA** – the PRA's application of Basel III's liquidity requirements could be informed by a strategic objective to facilitate and encourage the inter-bank market and the provision of agency bank services by clearing members to other banks and non-bank financial institutions (so-called NBFIs);

- **OFT** – there may be areas within payments which are appropriate for referral to or investigation by the relevant competition authorities (access to payment systems, interchange fees, governance of standards are examples which are already being examined).

Option 1

In our view, Option 1 – reformation of the Payments Council's governance framework – is critical, but would not, of itself, be enough. The Payments Council has done plenty of good work and achieved much, a lot of it behind the scenes. The Consultation focuses, however, on its perceived failings: essentially, the Payments Council is judged to have been too biased in favour of the industry, too tolerant of moderately paced (or slow) progress and lacking in political focus. Additionally, the Payments Council has not promoted innovation and positive change as much, as loudly or as effectively as it should.

Many of these failings have been accepted, and are being addressed, by the Payments Council. We feel sure that it will have other suggestions of its own also, but these reforms alone will not suffice.

Option 1¾

We would strongly advocate a combination of Options 1 and 2, with an additional element – Government support. We see the most effective governance structure as follows:

- a Payments Strategy Board created as a separately identifiable body, whether within the legal structure of the Payments Council or a directly designed body working very closely with the Payments Council;
- the Payments Council reformed as suggested (with other changes as well – see below); plus
- a Government truly supportive of development in UK payment systems, represented on the PSB and armed with some budgetary allocation.

Three rhetorical questions support this view:

- In what other field, does the regulator also set the strategy for the industry as a whole?
- Would the payments equivalent of HS2 be built without Government support or intervention?
- Does not a strategic plan for UK payments require all relevant stakeholders to come together?

Key features for a successful PSB

In our view, however constituted, the PSB must have the following characteristics:

- **broader stakeholder base** – the PSB must have representatives from all stakeholders interested in UK payments – regulators, providers, users and policy makers. It must reflect a holistic view of payments, meaning card networks, acquirers, retailers, institutional users (i.e. Government departments, utility companies, insurance companies, pension funds, employers, all of whom make huge numbers of payments), infrastructure providers, MNOs, digital service providers etc. must all (somehow) be represented. Every person, firm, company, institution in the UK (the Government included) makes and receives payments.
- **independence** – the PSB must be (and be seen to be) independent from the industry. This does not mean it needs to be wholly divorced from the industry nor form part of the regulatory architecture: such independence can be created in other ways, (e.g. through inclusiveness, objectivity, transparency and public accountability. In this context, funding is a particular issue to be addressed.

- **strong leadership** – to be effective, the PSB – its chairman and membership – must comprise senior individuals from a diverse background.

Ideas for further changes within the Payments Council

Our interaction with the industry prompts a few further thoughts for change within the Payments Council where a little thought and effort could go a long way:

- **education** – the evolution of technology demands education. The benefits and risks of mobile technology, 'cloud' computing, SaaS, (open) source, security measures and new services (prepaid, overlay, etc) are not well understood. Similarly, the inter-connection between different regulatory regimes (data privacy, anti-money laundering, e-signatures, etc) requires oversight. The Payments Council is well placed to assist here.
- **innovation** – the Payments Council also could do more to facilitate innovation, not just through its own research and development, but also in providing or simply providing the means (or 'air time') for others to promote new ideas. We have suggested providing a notice board on its website, brokering innovations with interested parties (a 'speed dating' event, perhaps with private equity or VC houses for whom investment in technology is attractive). This would begin to address complaints that the industry is closed to new ideas.
- **simplicity** – there are often overlooked simple means of delivering positive change (as various new market entrants have found by 'piggy-backing' off existing infrastructure), perhaps through focusing on the 'last mile';
- **standards** – similarly, here, the Payments Council (or the PSB) could play a greater, more proactive role in standards setting, both at a UK and European level; and
- **transparency** – the Payments Council could look at ways in which its (often excellent) work is made more accessible (both in content and visibility).

Government as a key stakeholder

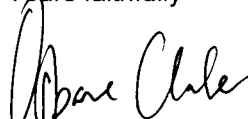
We would also advocate greater support from the Government for the development of UK payments: it is one of the largest (if not the largest) sender and receiver of payments in the UK. There must be significant cost and efficiency savings to be achieved simply through changes in its own policy towards making and receiving payments. As such, it must be represented on the PSB (if not, ultimately, through HM Treasury, be responsible for it) and should be willing to contribute some funds.

Concluding remarks

UK competitiveness demands a first-rate payments strategy which is enabling, progressive and holistic. The key features of the industry – the inter-connectedness, the network effect, the regulatory regime, the universality of touch points, the international (and global) reach, the velocity of change and its fundamental role in society – must all be reflected in its governance.

If you would like to discuss this response with us, we would be pleased to do so. Please contact either Paul Anning, partner and head of the Financial Institutions Group or Kate Johnson, associate, at Osborne Clarke.

Yours faithfully



Osborne Clarke

Payments Council Independent Directors'
Response to the HMT Consultation:

Setting the Strategy for UK Payments

10 October 2012



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1. Introduction



This document has been prepared by the independent directors of the Payments Council. Its conclusions are also supported by the independent chair.

The purpose of this document is to specify our view of how to accommodate the concerns raised by HM Treasury in the consultation document. Our response should be read in conjunction with the full Payments Council response. Later in this document we describe our preferred model for protecting public interest when setting a strategy for the payments industry. This model is predicated on an assumption that all relevant aspects of the Payments Council Option1 response are implemented.

In this document we refer to:

- The **Payments Strategy Board** - meaning the organisation as described in the HMT consultation document.
- The **Payments Council** - meaning the organisation comprising the executive team and 50 to 60 staff.
- The **Payments Council Board** - meaning the current Board comprised of 4 independent directors, 11 industry directors, the independent chair and the Bank of England attending as observer.
- A **Strategy Board** - meaning a Board as specified in this document and recommended by the independent directors of the Payments Council.

2. Context



It should be said, at the outset, that we broadly agree with the analysis of HM Treasury and the objectives set in the consultation document. While the Payments Council has generally been effective in respect of matters that relate to integrity and inclusion, it has not been effective enough in terms of innovation. We agree with the arguments for setting up a Strategy Board. What we aim to do in this document is to focus on those aspects of establishing a Strategy Board, that - in our view - are critical if the Strategy Board, the Payments Council and the payments industry are to be successful in terms of meeting the needs of customers and the UK economy.

3. Observations



Before turning to our recommended governance arrangements, it is important that we lay out our views of the Payments Council and strategy-setting as they exist today. The bulk of the HM Treasury consultation document comments on the Payments Council and its issues as they existed over a year ago. It must be recognised that substantial progress has been made over the last 12 months in respect of the way the Payments Council operates. Acting on the basis of an out-of-date understanding of the Payments Council would run the real risk of undermining this progress and implementing solutions that address the wrong problem. Key developments over this period include:

- The appointment of a new CEO, who has overhauled the organisation and put it on a footing where it is more capable, has rebuilt much of the confidence of stakeholders and is delivering tangible results.
- A strengthened team of independent directors and chair who are making a material impact on key decisions.
- The Board, with active support and strong challenge from the independent directors, has approved important and progressive decisions with significant resource implications – for example the implementation of mobile payments; and the funding of a multi-million pound central communications campaign for account switching.
- The development a Payments Roadmap of the industry that will - for the first time - provide a proper view of how the industry should develop over the medium to long term (2 to 10 years).
- Additionally, the planned introduction of a veto model whereby only two independent directors are needed to block any proposition that is against the public interest, combined with active support for independent directors from the Payments Council executive and access to dedicated resources, are important further steps forward.

As independent directors of the Payments Council, we plan further changes in our *modus operandi*, which are material to the role of the Strategy Board and are consistent with the main Payments Council response. We intend to:

- Use the earmarked resources, committed by the Payments Council, to develop new

proposals for changes in the industry. We will require these to be addressed in the Payments Roadmap. This may include matters that might otherwise have been voted down by those with vested interests. To be clear, this means that we would develop our own views of what the next major initiative should be (for example addressing infrastructure and scheme issues that frustrate challenger banks). We will require these to be addressed in the Payments Roadmap, whatever discomfort this might bring to incumbents.

- Ensure that CEOs of key banks are directly engaged in debates and critical decisions that affect the industry. This will include an annual series of meetings between the Payments Council and the CEOs of large and challenger banks at which we will be in attendance and when we will question the CEOs as needed. Recent dialogue between independent directors and retail bank CEOs has demonstrated that such CEOs are keen to engage. We also firmly believe that the more that the Payments Council is able to push for major changes in the industry, the greater will be the attention of CEOs.

Having said this, it is our view that it is still too difficult to get high impact, high-value (in public interest terms) decisions taken. An unaltered Payments Council Board or a separately constituted Payments Strategy Board (PSB) as described in the consultation document are unlikely to improve matters in this key area. Indeed, it is quite possible that a PSB as currently described could lead to delayed decision-making and instability. This is because of confusion between the roles of the PSB and Payments Council, and the potential risk of a PSB recommending changes that do not balance the interests of customers, regulators, public policy and industry.

We also believe that a 'Paycom', as described in option 3 in the consultation, is unlikely to be workable in terms of the fostering and implementation of new innovations.

4. Recommended Governance Model



We want to see not only that the substantial improvements in the way the Payments Council operates made over the last 12 months are not lost, but also that we do not miss a one-off opportunity to get better, quicker decisions about the future form of the payments industry. Our recommendation is summarised below:

1. Confirm that the Payments Council Board and Executive must serve and balance the interests of customers, regulators, government and industry. Require that the Payments Council Board makes decisions about the industry with a mandate to address the needs of the UK economy and customers and which are set within the framework provided by the Payments Roadmap.
2. Specify that a Strategy Board should be established as quickly as possible, to include:
 - 2.1. Senior representatives attending from the Bank of England (as overseer and operator) and the FCA (addressing competition matters). We also believe the Strategy Board would be more effective if government were represented (in terms of policy and as a corporate customer). Government could be represented by an official¹ acting as an observer or by an independent director with a government background and who would be charged with understanding and representing the varied interests of government, including government as a major customer of payments systems.
 - 2.2. The four independent directors and independent chair of the Payments Council. The independent directors would be charged with representing the interests of the full range of customer segments as well as reviewing any impact on the UK economy. The independents would also be charged with ensuring that the knowledge, concerns and dynamics of the PC Board were reflected in Strategy Board deliberations. Consultation and engagement with stakeholders would still take place primarily through the Payments Council - thereby simplifying matters for customer and other groups - but with the independent directors ensuring engagement was sufficient for Strategy Board purposes.

¹Partnerships UK plc might usefully be compared with the Payments Council. PUK is not entirely analogous, but there are parallels. This organisation was private sector classified. It had two HMT appointed directors on its executive board, but also had an advisory board made up of DG and Permanent Secretary level membership drawn from across government.

2.3. Two additional independent directors who have previously held Main Board roles in the industry, but are now free of any commercial ties, and are seen to be both 'public-spirited' and strategic across the industry as a whole. The idea is that these two independents would bring with them a deep understanding of the issues that need to be addressed when making major investment decisions: both about the industry and of the larger banks, who are the primary source of funding. At the same time, these independents would need to have the confidence of public interest stakeholders, based on a track record that inspires such confidence. We recognise the critical aspect of getting the right engagement with industry. We would expect all members of the Strategy Board to have regular engagement with the industry at senior level, but the two additional independents we have proposed would need to develop strong links with industry CEOs (and this addressed more elsewhere in this document). There might be merit in giving industry a say in the appointment of these two independent directors.

2.4. Also in attendance would be the Payments Council CEO who would be charged with ensuring the Payments Roadmap reflected the concerns of the Strategy Board.

3. Re-launch and rebrand the Payments Council. Take full advantage of the fact that the changes described above, combined with developments in the Payments Council over the last year, mean that it will be a very different organisation than that which existed a year ago. It would be perfectly logical and probably advantageous for the government to announce that the Strategy Board concept and reworked Payments Council had been combined into one entity. This would be achieved by:

3.1. Overhauling current Payments Council rules and legal documents.

3.2. Renaming and rebranding all Payments Council activities and staff.

3.3. Positioning the current Payments Council board as its executive board.

3.4. Introducing the Strategy Board - as described above, and with governance and legal arrangements such that it does not run any risk of being deemed an NDPB.

4. Recognise the essential role of the Payments Roadmap in any governance structure and strategic decision-making process. Recent discussions between the independent directors and challenger banks, incumbent banks and other stakeholders have confirmed the value of using the Payments Roadmap. It can help identify, gain support

for and anchor key decisions about the future form of the industry and the shape of collaboratively provided services. It is essential that the Payments Roadmap is the primary product of the Payments Council and that accountability for its quality and the incorporation of public interest tests are both key responsibilities of the Payments Council. We also believe it is vital that the Strategy Board should own the Roadmap by satisfying itself that it meets the full range of public interest tests. We believe the best way to achieve this is for the Roadmap to be put to the Strategy Board with an opportunity for detailed scrutiny and a request for the express endorsement of the Roadmap and the funding needed to implement it. We believe that effective and balanced major decisions about the industry cannot be made without the full range of inputs described above or without a consensus across the Strategy Board.

The Strategy Board would be transparent in terms of its considerations and decision-making process. It would publish its findings on a regular basis and would comment specifically on the key decisions taken by the Payments Council board and the application of public interest tests in the Payments Roadmap. We recognise that some of the attendees listed above might prefer to be positioned as observers, rather than members of the Strategy Board.

The Strategy Board would focus on two or three major issues at any one time and would use the Payments Roadmap as the anchor for its deliberations - holding the Payments Council to account for its content and the application of public interest tests. The Strategy Board would focus on identifying areas where progress in reaching key decisions was being impeded. The Strategy Board should have a small, dedicated secretariat, which would work collegiately with Payments Council staff and executives. We believe the Strategy Board should be able to rely on the resources and executives in the current Payments Council organisation to provide data and analysis to support deliberations at the Strategy Board. However, the Strategy Board should be able - as an exception - to employ an external consultancy to examine and test material and propositions developed by the Payments Council e.g. if there were concerns about its accuracy, completeness or bias.

The Strategy Board would look to the Payments Council Board for effective implementation of major decisions, decision-making in respect of second-order strategic issues and oversight of operational issues. Finally, but critically, the Strategy Board would test the

budget and resourcing set for the Payments Council and any major project (such as Account Switching). The Strategy Board would make clear any concerns about under-funding or other resources and pursue the issue until it was seen to have been satisfactorily addressed.

5. Legislation, Regulation and Constitution



We believe that legislation should be used to recognise the role of this Strategy Board within the structure described above. We also believe that legislation should specify that the Strategy Board produce a report – separate to the Payments Council Board - on progress and issues. We also believe that this structure could be implemented without the Strategy Board being deemed to be a quango or non-departmental public body, but great care would need to be taken to avoid this risk when the legislation is drafted.

There would need to be a designated route for the Strategy Board to pursue in the event that the priorities, performance, analysis or decisions of the Payments Council were flawed e.g. in respect of their ability to meet public interest concerns. The options here need further consideration but we would expect all three relevant organisations – the Treasury, Bank of England and FCA – to have an interest. These three bodies would also have an interest in ensuring that the process to appoint independent directors was sound, but they need not run the process itself or be accountable for the performance on individual directors. Indeed, if any or all of them were to join the Board in their own right as proposed above, it would be better if their role were constrained.

We do not believe that constituting the Strategy Board as a separate legal entity and run as a freestanding organisation adds any value to the model described above. There is a material risk that a separate entity would lead to a completely unacceptable split between strategy and implementation, resulting in slower and more unstable decisions and a lot of time wasted on turf warfare.

We believe it is vital that the government's approach to strategy-setting for the industry focuses on addressing remaining governance issues, but also builds on the progress of the last year. Stable arrangements that encourage aligned interests and decision-making processes between the Strategy Board and the Payments Council (both executive and board) are much more likely to lead to substantive positive change in the industry based on a successful strategic vision and a clear public interest dimension.

We also continue to hold the view that the Strategy Board would be more effective if it was able to 'borrow' some regulatory authority. We do not mean that we seek the power to levy fines, but rather an express obligation on the Strategy Board to pursue the public interest, using similar tests to those set out in legislation, in major payments industry decisions. We have considered how this might work in practice and we believe the following scenario is plausible:

1. Legislation specifies that the Strategy Board should be required to ensure that the payments industry develops in a way that fosters competition and protects consumers.
2. The Strategy Board will require that the Payments Roadmap addresses current issues related to the general obligations (access of challenger banks to payment systems might be an example).
3. The Payments Roadmap is used as the platform to collect data, assess impacts (applying public interest tests) and recommend specific solutions.
4. The Strategy Board considers the analysis and recommendations, and either expressly endorses the recommended approach or reports on the public interest failings using the route described above.
5. The Bank of England or FCA then uses any regulatory powers at their disposal to require or cause the underlying issue to be addressed.
6. The 'lending' of authority to the Strategy Board comes about because of the 'credible threat' that comes from reporting failings to HMT/BoE/FCA combined with the option available to the FCA of outsourcing specific activities to the Strategy Board. HMT/BoE/FCA attendance at the Strategy Board would provide the comfort that the implied authority of the Strategy Board was being properly used.

6. Funding



The matter of funding is going to be one of the challenging issues to get right. While the consultation document proposes a levy, it is only a partial solution. Given the growing importance of bodies other than banks to the development of the payments sector, this is likely to become an even less complete solution over time.

In normal circumstances the marginal cost of the Strategy Board as proposed in this document, is very small. The real issue is how to secure funding for major initiatives that are likely to cost, in aggregate, hundreds of millions of pounds, much of which would be a direct cost to the banks themselves. It would be unwise to assume that any governance structure makes funding easy. It will always be the biggest challenge when trying to implement change aimed at innovation, as opposed to regulatory requirements aimed e.g. at managing business conduct or minimising a range of risks. The political environment at the time of such decisions will always be critical. The Payments Council has learned how to anticipate, react to and garner positive political support for important initiatives. The general threat of further regulation or legislation may remain an important element when pushing for change.

7. Conclusion



The philosophy that underpins our recommended model is driven by similar concerns to those raised in the consultation document. We accept much of the thinking that lies behind the HMT Option 2 but we propose a variant on this option. Rather than introducing another layer of detached governance, that has no accountability for the consequences of its recommendations, it is better to focus on seamless decision-making and accountability.

It is the composition, rather than legal structure, of the Strategy Board - as we have specified in this paper - which gives it both its authority and credibility. If the government were able to use legislation to 'lend' it further authority by obliging it to fully account for the public interest and report failings it would be more effective still.

The most important consequence of our recommended model is that we believe the very big decisions about the future of the industry could be taken faster and stick better, while ensuring government, regulators and customer groups are confident in the decisions taken. This model would also allow the Payments Council in an evolved form to do more, rather than less.

**HM TREASURY:
SETTING THE STRATEGY FOR UK PAYMENTS
RESPONSE FROM THE PAYMENTS COUNCIL
10 OCTOBER 2012**

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10 October 2012

HM TREASURY CONSULTATION: *SETTING THE STRATEGY FOR UK PAYMENTS* RESPONSE FROM THE PAYMENTS COUNCIL

1. EXECUTIVE SUMMARY

Introduction

This document forms the response from the Payments Council to the consultation launched by HM Treasury in respect of setting the strategy of the payments industry. The Payments Council has consulted extensively with stakeholders who represent: customer interests; public policy views; regulatory concerns; and the payments industry. This response takes account of the feedback from stakeholders and is intended to provide analysis and propose solutions that address HM Treasury's concerns, but which also ensure that the setting of strategy for the payments industry takes place within a stable environment that is set for success.

Specifically, this response sets out to do the following:

- To argue that changes that are being made to the Payments Council will go a long way to addressing the concerns of HM Treasury.
- To argue that the most stable and effective way of improving accountability and public interest scrutiny in the payments framework is to take an enhanced version of option 1 and the features and objectives of option 2, and to create a new senior group that provides the required outcome for governance changes to the framework.
- To argue that this new layer should be a group of senior public interest representatives that meets bi-annually and holds the Payments Council to account in respect of the application of public interest tests and, typically, focuses on a two or three key strategic issues. We describe why we believe this group should be established as soon as possible, and that we will be going ahead with establishing a senior body as an important strengthening of the Payments Council governance.
- To describe how if option 2 – setting up a Payments Strategy Board is pursued, how it could be best constituted so that it offers as stable a solution as possible to setting strategy and could work effectively with the Payments Council to achieve shared objectives.
- To describe the residual risks and concerns that would remain in the event of different governance models being implemented and how such risks might be mitigated.
- To describe the full gamut of Payments Council activities that go beyond high-level strategy setting and which must be maintained in order to ensure the future success of the payment industry and that the needs of customers and economy are met.

- To describe those changes we are implementing to enhance our ability to consult and to empower stakeholders to contribute to the decision making process. We also highlight those areas where our remit could be usefully widened to cover cards, fraud, and new payment schemes.

Overview of the current Payments Council

The HM Treasury consultation document tends to focus on the Payments Council in the form of its Board of Directors and this is for fairly obvious reasons as it is where the key decisions are made. However, the Payments Council is much more than just its Board. It is important that the key functions of the Payments Council as an organisation are maintained. The consultation document is also rooted in a concern about the way decisions were made in respect of setting a target date for closing cheque clearing, the roll-out of Faster Payments and – by implication - the structure and governance of the Payments Council Board as it operated over a year ago. A lot has happened in that time, including the appointment of a new chief executive. There has also been a restructure and enhancement of the organisation, some of which came out of an independent review of our governance arrangements and led to the strengthening of the capacity and authority of independent directors, as well as reconfigured Customer Forums. The regular Forums bring together customer stakeholder representatives and provides them with the mechanism to ensure their views and needs are input into the Payments Council's decision making process.

Following these recent changes, the Payments Council is now very clear and specific in its positioning. It is structured to achieve positive change in the payments industry by striking an optimal balance between the needs of the economy, the payments industry and its customers, whilst meeting regulatory requirements aimed at managing systemic risk and competition concerns. It is also uniquely placed to pay regard to public policy and, critically, the capacity of the industry to implement absolutely reliable, functional change.

In 2012 Board decisions have included: the approval to move to the full implementation of a pan-industry mobile payments hub, that will enable customers to make account to account transfers using their mobile phone regardless of who they bank with; and approval for a substantial, central national advertising campaign to ensure customers are aware of the new faster and easier account switching service being introduced in September 2013. These both represent very important and significant steps forward in services for customers. In both cases, the functionality delivered and the central engagement with customers will put the UK at the forefront of change in payments. Where we lead, others in the world follow. Looking ahead, our ambitions go far beyond these changes and these will be addressed via a new strategic document called the Payments Roadmap and the ongoing work of our National Payments Plan, which are complimentary documents. The purpose of the Roadmap is to provide a plan for assessing what changes are needed to the UK payments infrastructure over a two, five

and ten year time period, in order to appropriately prioritise the work and to plan the required investment.

The Payments Council has some 50 people working on a wide range of issues including the development of strategy, industry and global standards, stakeholder engagement and research. We also undertake the project management activities needed to implement agreed strategies so that new services come to life – such as the account switching service or mobile payments - so that they are accessible to all customers who need them and their impact can be assessed. Before any change the Payments Council expends significant effort in engaging with all types of customer and business groups to ensure that their needs are met in terms of new policies and projects. The Council also has a continuing role in respect of payment schemes to ensure that both in the short-term and over the long-term, they develop to meet the needs of customers and the economy, as well as responding effectively to the concerns of regulators and those who formulate public policy.

It is our strongly-held view, and we have received similar responses from many stakeholders, that any new arrangement for setting strategy for the payments industry must be very mindful of the wide range of activities undertaken by the Payments Council – particularly in respect of the integrity of payment systems – so that none of these are undermined in an effort to ensure that the right long-term strategic decisions are made.

We recognise that in addition to the substantial changes made over the last 12 months to the way the Payments Council operates, more is needed. We want to ensure that major decisions about the form and future of the payments industry are made and implemented so that the interests of the UK economy and customers are always put first. This submission aims to confirm how this can be achieved.

The new Payments Roadmap to increase transparency

A critical aspect of the way the Payments Council has been reconfigured over recent months to be more effective is the agreement to develop a new strategic document called the Payments Roadmap. This Roadmap will be updated at least once per year and will provide a rolling two, five and 10-year view of how the payments industry, and its underpinning infrastructure and policies, should develop over those time-frames. It will be transparent in its production and there will be a process to ensure that stakeholders are comfortable that the correct priority is being given to questions and analysis about the shape and direction of the industry.

It is vital that the Payments Council is accountable for the development, production and implementation of the Payments Roadmap. It provides a platform that allows stakeholders, industry and new and emerging payment providers to consider the benefits, risks and trade-offs between various policy options, while continuously testing the practical form and implementation path for preferred options. The positioning of the

Payments Council between customers, industry, public policy and the regulators means that we are ideally placed to do this.

The National Payments Plan

Our National Payments Plan is an important framework to help us reach out and respond to all those who have an interest in payments. First published in 2008, the Plan was refreshed in 2011 following public consultation. The Plan provides an action plan to deliver innovation, inclusion and change, focused on the needs of the 'customer' - be it an individual, business, charity or other organisation, payer or payee.

A number of actions in the Plan are about new payment services; what is needed and how to develop these ideas. But other actions focus on how consumers and businesses think that existing payment methods can be made to work better for them, and issues around the inclusivity of payments. Examples of projects in the Plan include a highly successful communications campaign on chip and signature cards and a comprehensive review of the obstacles older people (aged 80 and over) and disabled people experience when making and receiving payments.

It is important that the Payments Council continues to be accountable for the development, production and implementation of the National Payments Plan. It provides a framework for us to consult and document stakeholders' concerns, and address these issues and following detailed consultation, research and analysis.

New Body of senior representatives to increase accountability

Regardless of any decision taken by the Government, there is a consensus amongst our members and Board, that there is real merit in establishing a bi-annual meeting of senior representatives to consider a small number of high-impact issues and decisions about the payments industry. This is required to strengthen the external scrutiny given to any key decisions. By bringing together representatives of HM Treasury, Bank of England, Financial Conduct Authority, independent directors and senior industry representatives, there would be increased confidence that decisions made on the back of Payments Roadmap analysis and evidence would be balanced and effective.

We believe that it would benefit stakeholders if this group were to be established without delay. There is no need to wait for legislation as this could be achieved within the legal framework of the Payments Council under the direction of the government and then moved across to sit under the FCA if required, presuming appropriate legislation was in place.

The function and purpose of this group would be:

- to provide a challenge function and hold to account the Payments Council Board, the wider membership and the Payments Council Executive for delivery against the agreed strategic goals;
- to ensure public interest tests were being properly applied by the Payments Council;
- to focus at any moment in time on one or two big strategic issues, particularly those where a consensus across this group would make a material difference in the pace and form of change in the industry; and
- to have dedicated support staff within the Payments Council headcount with enough capacity to ensure an effective, focused challenge function and briefing of directors, without being cumbersome.

As stated above, we believe this model would be valuable and workable and should be pursued whether the government ultimately prefers an enhanced version of option 1 or a variation on option 2. The remainder of this executive summary should be read with this in mind.

Core principles

In all governance models being considered, we believe:

- It is vital that the Payments Council be accountable for the production of the Payments Roadmap. We should be held to account for the quality, balance and relevance of the Roadmap.
- That a broad definition of payments is agreed when specifying the role of the Payments Council and content of the Payments Roadmap that includes cards as well as new and emerging forms of payment. Currently the Payments Council does not have the same contractual relationship with the cards industry as it does with other payment schemes.
- That the membership of the Payments Council be substantially broadened, but with different types of membership to cater for the management of systemic risks and the limited capacity of smaller organisations to get involved in Payments Council initiatives.

Option 1: An enhanced Payments Council

As is recognised elsewhere in this response, virtually all elements of option 1 are required to make any version of option 2 work effectively. In addition to this it may be some time, perhaps years, before any Payments Strategy Board, if pursued, is established via legislation and fully functioning. It also remains the case that the Government may conclude that an enhanced version of the Payments Council could be effective and address the concerns that gave rise to the consultation in the first place. Finally, we have found a diverse range of stakeholders keen to build on the changes made to the Payments Council over the last year, and which they have found to be valuable. With all

of this in mind we have explained later in this document how an enhanced version of option 1 in the Treasury's consultation document could be implemented on a voluntary basis to greatest effect.

Key elements of our option 1 response to draw out here are:

- During 2012, the Payments Council has increased the challenge function of its independent directors with new appointments and enhanced support provided to them.
- Further enhancements are planned to better equip independent directors, including dedicated resources to assist with preparing Board papers and briefings so that they can be confident in challenging their industry counterparts.
- In future, it would only take two independent directors to block any motion deemed not to be in the public interest.
- Since the reversal of the decision on setting a target date for closing central cheque clearing in July 2011, the Payments Council has been working to a new operating model specifically intended to balance the interests of customers, regulators, policymakers, the industry and the UK economy (consistent, it should be noted, with the original intent if not always the practice of the organisation).
- Over the last few months and as result of the Martin Cave governance review, the Payments Council has worked even harder to ensure that the Customer Forums have an effective and significant say in Payments Council decision-making.

Other new enhancements will include introducing more direct communication for stakeholders to raise any concerns directly with the independent directors where they feel that a 'challenge' is required; establishing formal relationships with all substantial schemes operating in the UK; and establishing different categories of membership to widen the industry representation without threatening our ability to reach consensus on core stability issues. It is important that Payments Council is able to play an informed role in new and emerging payment issues. We will state with absolute clarity that the role of the Payments Council does not involve advocacy activities for the benefit of the industry.

We will be starting to implement the changes outlined in this response as soon as possible and will publish an update on progress at the end of March 2013.

Option 2: A Payments Strategy Board

After significant engagement with stakeholders, it has become clear that if the Government decides to establish a Payments Strategy Board as a separate entity then it is likely to be most effective and most stable if it is constituted specifically as a board designed to provide oversight of Payments Council activities, insofar as they impact on public interest issues. The Payments Strategy Board would have a specific mandate to look at the Payments Roadmap as it is going into an annual cycle, focusing on the two or three big strategic public interest issues, and then to test the results at the end of that

cycle to ensure their concerns have been properly addressed and to make public their views if this is not the case.

The Payments Strategy Board could be comprised of appointees from the FCA and joined by appointees or attendees from the Bank of England, HM Treasury and other independent and industry stakeholders in order to ensure that public interest concerns are tested in all dimensions. Executives of the Payments Council would work regularly with the Payments Strategy Board and its support staff to ensure that continuing work on the Payments Roadmap was likely to be fit for purpose. A small secretariat and support staff in the PSB (in the region of 5 people) would ensure that the PSB had the material from the Payments Roadmap in advance of that twice-yearly board meeting and was adequately briefed.

The model described above is predicated on the critical assumption that the Payments Council is constituted to incorporate virtually all aspects of option 1 as described in the HM Treasury consultation document and outlined above. We believe it is essential that whatever form the Payments Strategy Board might take that HM Treasury is specific about the relationship of the Payments Strategy Board with the Payments Council to minimise any lack of clarity and overlap in the responsibilities of the two bodies.

This response later describes specifically how decisions would be taken between the Payments Strategy Board, the Payments Council, the industry and stakeholders. This document also goes on to describe residual risks that would have to be recognised in establishing the Payments Strategy Board.

Our aim has been to test to the limit how a Payments Strategy Board could be made to work most effectively and to achieve the Government's objectives. It is important to recognise feedback from stakeholders that there would be residual and potentially significant risks even with an optimised PSB. These risks typically pertain to the speed, efficiency and stability of decision-making. In other words, decisions could take longer and it might prove more difficult to balance the needs of customers, regulators, policy-makers and the industry. We have tried to design out many of those risks, but some would remain.

2. ANSWERS TO SPECIFIC CONSULTATION QUESTIONS

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.

We understand the Treasury's objectives in undertaking this review and we agree with its aims for payment networks in the UK. It is clear that there needs to be a modification to the existing framework to provide a check for the payments industry in its decision-making and delivery against objective.

We do, however, have concerns about the creation of the Payments Strategy Board as set out in the consultation paper. In an industry that is already complex, we feel that the addition of a free-standing body with a lack of clarity over its remit and authority could add further complexity. Changes need to bring stability, with a clear line of oversight and accountability so that all parties – the industry, customers and interested stakeholders alike – know the role and purpose of each organisation involved.

It is our considered view that this additional layer will work most effectively if it brings together a new group of senior representatives, meeting on a bi-annual basis that considers key issues that are in the public interest. Integral to the group achieving its purpose is the inclusion of HM Treasury, the Financial Conduct Authority and the Bank of England, as observers or with voting seats. Their presence is important in providing authority, legitimacy and mandate powers without the introduction of formal regulatory powers.

In creating the Payments Strategy Board, an additional concern is that there will be a significant delay in its implementation whilst the necessary legislation is put in place. In the absence of the appropriate regulatory framework for the FCA to set the Payments Strategy Board up, the creation of a new body could be achieved within the legal framework of the Payments Council under the direction of the Government. We still see benefit in using legislation to give the necessary authority to the FCA to set up a version of the Payments Strategy Board which could easily be enforced if and when required; but we are proposing to implement something on a voluntary basis and in a much quicker timescale.

Body of senior representatives

We are putting forward this proposal on the basis that we are implementing the changes described in option 1, plus further enhancements to build on the Payments Council's current governance arrangements as outlined in our response to question 2.

The role of this senior group would be:

- **To provide public interest scrutiny** – providing a check that the decisions taken, and the way they are delivered, have had public interest tests properly applied.
- **To hold the payments industry to account** – to ensure that the Payments Council and the industry are addressing the ‘right’ issues, appropriately prioritising and that delivery against the agreed strategic items is undertaken in an efficient and timely manner.
- **To provide a challenge function against those agreed strategic items** – having the ability, expertise and authority to challenge when required, and provide other stakeholders with a route through which to raise the need for a particular challenge.
- **To focus on key issues** – focusing at any moment in time on one, two, or three big strategic issues, particularly those where a consensus across this group would make a material difference in the pace and form of change in the industry.

The senior group would be supported by a dedicated staff with enough capacity to ensure an effective, focused challenge function and briefing of directors, without being cumbersome in size.

The senior group would agree and own a ‘Strategic Vision and Principles’ document – a short document of two to three pages – which would be developed in conjunction with the Payments Council Board, and is reflected in the longer and more detailed Payments Roadmap. This Vision and Principles would include the two or three key strategic issues that the senior group will consider, and it would be reviewed on an annual basis. The Payments Council Board, executive and wider membership will be held accountable by the senior group for the delivery of the Roadmap against the agreed Vision. An overview of the Payments Roadmap can be found in annex 4.

Alongside the seats held by the FCA, the Bank of England and HM Treasury, there should be a mixture of industry representatives and independents, the latter group being charged with considering the views of other stakeholder groups.

The problems that this review seeks to resolve are that the right decisions are taken and with due regard for all stakeholders; that the industry is held to account for delivery against those decisions; and that the public interest voice is strong in the debate.

We believe that the proposed senior body addresses these concerns in its make-up and remit. Authority is provided through the individuals and what they represent rather than where the body sits in the structure, particularly in the absence of any plans to provide statutory powers. It is therefore better to put the emphasis on who sits on the body, and ensure that its role and remit are stable, and to get it set up and functioning as soon as possible. The industry is keen that this is done quickly and is therefore offering to do it on a voluntary basis.

There are three prime examples in Payments Council’s history to consider when looking at how things might have been different had the proposed senior group been in place:

1. Faster Payments implementation

The existence of a senior body holding Payments Council Board, Executive and wider membership to account for delivery may have created more pressure on individual banks to prioritise their implementation for roll-out of the service internally. The presence of HM Treasury, the Bank of England and the FCA sitting on the oversight body would have been key to this. In the absence of regulatory powers, public statements on the state of implementation by individual participants would have acted as incentive to get the job done in a timelier manner.

2. Decision to set a target date for closing central cheque clearing

In light of ever decreasing cheque usage amongst all customers, work to consider the future of cheque clearing was inevitable, both to ensure choice for customers but also the continued stability of the system. At the time of making a decision to set a target date for closing the central cheque clearing system, it is likely that a senior body would have challenged the rationale and research undertaken, and that there would have been more pressure to create alternatives prior to a target date being set. It would have helped if regulators were party to this process. Beyond the decision to set a target date, in terms of progressing with developing and delivering alternatives, the ongoing scrutiny of a senior body might have helped ensure a more concerted effort was made by the industry to address customers' needs to develop clear alternatives to cheques – particularly making a decision on alternatives such as mobile payments.

3. Mobile payments

The Payments Council Board has recently agreed to a substantial investment into the next stage of developing a central mobile payments mechanism, which means that customers will be able to start using the system by the end of 2013. If a decision to proceed with the mobile payments programme had been taken at a senior level, and with regulators involved in the decision-making body, then there is likely to have been a broader view taken of both the industry and public interest in delivering this new payment method sooner.

Question 2

The following questions relate to the changes the Government would expect the Payments Council to implement under Option 1. Some 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?**

The role of the Payments Council is the body with responsibility for ensuring that payment services work in the UK. This is a unique role that means we listen to a wide range of

stakeholders to drive innovation in payments and implement change so that access to payments meet current and future needs.

Our objectives, as agreed with the OFT Payment Systems Task Force when we were set up in 2007, are:

- to have a strategic vision for payments and lead the future development of co-operative payment services in the UK;
- to ensure payment systems are open, accountable and transparent; and
- to ensure the operational efficiency, effectiveness and integrity of payment services in the UK.

The shape of the payments industry has changed substantially since the Payments Council was set up. It is therefore right that our objectives should be reviewed at this time to consider whether they are still appropriate, both to our role and to meet the needs of the industry and its customers.

We agree with the Government that the objectives of the Payments Council remain broadly appropriate, although the exact wording may need to be reviewed to be fully reflective of our role and responsibilities, subject to the conclusions of this consultation.

Whilst our remit remains accurate we believe that it should be broadened to categorically define 'payments' as including cards, fraud, and new payment schemes. It also needs to provide for a long term and credible view of the industry in developing an approach to strategy, and the capacity to implement real change in the short to medium term.

We believe that the remit proposed for the Payments Strategy Board in paragraph 5.24 of the consultation paper should actually live with the Payments Council, and that the Council is held accountable for delivery against those objectives by the senior body:

- to promote the development of new and existing payment networks (to encourage innovation and collaboration in the payments industry);
- to encourage the payments networks to operate for the benefit of all users; and
- to promote access to payment 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).

In the role of a Payments Council enhanced by the changes we are committed to making, we will be clear that the organisation does not exist to serve its members. Our constitution is clear that we look after the interests of all of those that provide and use payment services – taking into account the needs and views of all types of customers and payment service providers.

The Payments Council is, and should be seen to be, the authoritative voice on all payments issues. This ranges from being a commentator with the ability to challenge

whether industry practices or policies serve the best interests of customers, to actively seeking evidence and bringing about change where necessary. It should continue to be the source of payment statistical information. We are also the experts in payments industry issues – in the UK, the EU and internationally – and providers of educational resource for all those who require impartial information or advice.

When acting as commentator on payments industry issues, we do not seek to defend the industry, but only to explain processes and different views and educate customers on the different payment options available. We are not afraid to criticise individual institutions, payment options or the industry more generally, where it is justified and in the public interest.

A prominent role played by the Payments Council is the project delivery aspect of our work. Payments Council manages the implementation of major projects, such as account switching and mobile payments and is a substantial part of our day-to-day work and in-house expertise. Our National Payments Plan provides a rolling programme of activity to research and consult on how payment services can be enhanced to better meet the needs of consumers, businesses and other organisations, and to drive change to address the issues identified. We see this as continuing to play a major part in what we do. A summary of some of the key National Payments Plan activities is outlined in annex 5.

A summary of some of the day-to-day work carried out by the Payments Council, that touches peoples' daily lives, can be found in annex 1.

b. How can a clearer separation of the Payments Council's strategy setting and trade body representative functions be best achieved?

We have considered the range of activities that we undertake and what could be seen to be trade body representative functions. We are defining such functions as those that are carried out on behalf of the members, only taking into account their views and representing their interests, without consideration of wider stakeholders.

The Payments Council has never been a trade body in this sense, and our constitution makes it clear that this is not our role. The industry activities that we undertake are approached with the views of all stakeholders at front of mind, including using the Customer Forums to gather views when appropriate. Often industry issues are of little interest to stakeholders, but in pursuing these issues we are careful to ensure that we are not working to the detriment of customers. One example is our work on standards, where we work closely with the British Standards Institute (BSI) and the International Organisation for Standardisation (ISO). Standards are of critical importance to the industry, play a key role in ensuring that payment systems work efficiently, but are of negligible interest to most customers with the exception of some corporates. Our drive in looking at the areas is not to protect the interests of the industry, at the possible detriment of customers; it is quite the opposite.

Similarly, while the National Payments Plan includes many issues that are of direct benefit to customers, it also includes several areas that are of limited interest to consumers and most other customer groups, but are integral to the efficient running of our payment system in the UK.

One area of Payments Council work that could be seen as akin to a trade body is the activity we undertake in Europe, chiefly on Single Euro Payments Area (SEPA) and the Payment Services Regulations. However:

- much of the work is around technical detail and is not ‘against’ stakeholders’ views, just of little relevance;
- it is in stakeholders’ best interests that the work is carried out by Payments Council, which places itself at the centre of several constituencies, rather than as a pure trade body that only looks after interests of the industry
- other stakeholders (including regulators and consumers) benefit from our work as the Payments Council has established work with these groups and a broader strategy-setting approach than trade bodies
- complete separation of this work would affect the ability of the Payments Council to retain knowledge, expertise, access to information and ‘a voice’ for UK customers in relation to Europe payments issues; and
- this also means that we are able to flag up European developments that are likely to have an impact on the industry including alerting the schemes and wider stakeholders.

We therefore believe that such activities should continue to reside with the Payments Council. This will be supported by changed governance arrangements to:

- widen the membership and industry base with which we engage;
- ensure greater transparency for interested stakeholders on all the work undertaken by the Payments Council; and
- continue to ensure that no “advocacy” work is undertaken exclusively for the benefit of members.

As outlined in our answer to the question above, we are absolutely clear on our role as commentator and the authoritative voice on payments issues and not as a defender of the industry’s interests.

c. Do you agree that the Payments Council should commit to publishing annual progress reports against its objectives, supported by regular, independent performance reviews?

The Payments Council supports and is fully committed to publishing annual progress reports against its objectives, supported by regular, independent performance reviews.

The Payments Council recently commissioned an independent governance review and assessment of performance, published in April 2012. This was undertaken by Professor

Martin Cave, one of our independent directors until December 2011 and an expert in regulation and competition issues.

The review was carried out at the request of the Office of Fair Trading, following their review of the Payments Council in 2009 after its first two years of operation. One of the conclusions of that review was that the Payments Council should conduct a self-assessment after a further two years. Rather than undertaking the review ourselves, we wanted the exercise to be done with independence, which is why we commissioned Professor Cave.

The review process comprised a public consultation, including a short online questionnaire to make it more accessible for any individuals wishing to submit their views on our activities, followed by a series of bi-lateral meetings and a roundtable discussion. The bilateral meetings were undertaken by a third party so that participants did not feel uncomfortable by having to share their views directly with the Payments Council. This culminated in Professor Cave making seven recommendations, all of which were accepted by the Payments Council Board. Our progress against these objectives is detailed in annex 2 to this response. Both Professor Cave's report, and our response to it, are publicly available on the Payments Council website.

We found the review to be a helpful exercise, both to gather the views of stakeholders and to also enable Payments Council as a comparatively young organisation, with no comparable bodies, to take a step back and assess how well we think we have performed against the views of others; seeing what functions or areas of work are particularly valued and where more needs to be done. The Board will be undertaking a similar exercise on a regular basis going forward, with the next taking place after a suitable period following the conclusions of this review by HM Treasury. After publishing the response to that review, we will remain ready to address any residual concerns. We will also publish an update at the end of March 2013 on our progress with implementing the changes outlined in this response.

In terms of annual progress reports, the Payments Council publishes an annual review that details the work undertaken by the Council over the previous year against our agreed objectives. It also includes a report from the independent directors providing their views on the functioning and activities of the Payments Council. A major part of future annual progress reports will include progress against Payments Roadmap objectives.

We publish annual progress and update reports to the National Payments Plan (NPP). These reports provide the progress against specific NPP actions, and also explain if and why we have had to deviate from the agreed schedules on any particular activities. Transparency in our work is very important to us, hence we are keen to set out how we are delivering against expectations. In addition to these annual progress reports, the Customer Forums also get updates on NPP actions at their meetings, as do the Board (the minutes of which are published on our website).

We remain committed to continuing annual progress reports and to commissioning regular independent governance and performance reviews. We will tailor both accordingly to the conclusions of this consultation exercise.

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.

We agree that any two independent directors should have a right of veto over Board decisions.

Currently the four independent directors can vote together and prevent a decision from being taken if they do not feel that it is in the best interests of all users of payment systems. The fact that the independent directors have this collective power means that the Board is aware of the need to work through all the concerns and questions that may arise before pressing ahead.

However, we recognise the concerns that have been raised about the functioning of the Board and the need to ensure that the voices of the banks do not dominate the Board's decisions. Whilst increasing the voting power of the independents will be a positive change, we also think that more can be done to strengthen the non-industry voice on the Board.

To these ends we will be making an additional change to the voting rights to introduce a vote for the independent chair, which is currently a non-voting position. This would mean that the independent votes on the Board would now stand at five against the 11 available industry votes, and adds further strength to the increased power of veto.

However, we would argue that a more impactful change to the composition of the Board would be to enable the independent directors to better effect their challenge function. We are therefore going to commit more dedicated resource to supporting the independent directors in their work, to ensure that they feel fully briefed and knowledgeable on all the issues being debated and agreed at Board level. This is one of the commitments made in our response to the Professor Cave governance review, in which we agreed to provide better support for independent directors by arranging days for them throughout the year to spend time with Payments Council staff on areas where they wish to increase their knowledge, and offering additional briefings on all major proposals well in advance of them being put to Board.

It is important that the independent directors feel fully versed in the topics being discussed at Board to have the confidence to challenge an industry director, who will often be an expert in the area being discussed, when they feel a challenge is necessary or warranted. This is not just in technical know-how, but also in understanding the market dynamics within which a particular proposition or issue sits. This is one of the reasons why other projects underway on, for example, the economics of the industry, are so important to provide all of the stakeholders involved with the supplementary information required to make good strategic decisions on payments issues.

This is also important in enabling the independent directors to bring about positive change, rather than only preventing decisions from being taken. By having the support to

bring fully researched and thought-through proposals to the table, it ensures issues seen to be in the public interest can be given thorough consideration.

Good recruitment of independent directors is, of course, key. Appointments should be made with the experience and expertise that individuals will bring at front of mind. The independent directors should collectively bring a diverse range of views, taking into account all different stakeholders, to the discussion. We believe that we have achieved a good balance of experience across the four independents following the two new appointments in January 2012.

We have considered whether the number of independent directors on the Board needs to be increased. This consideration was one of the recommendations made by Professor Cave in his review of the Payments Council, which he suggested should be addressed as part of this consultation by the Treasury. The conclusion we have come to is that to make a real difference to the balance and composition of the Board, it is not the number of independent directors that needs to be increased but their ability to effectively challenge and to bring their own thought-out proposals to the Board. We feel we are addressing these issues by implementing the changes outlined above.

e. Do you agree that the existing user forums should be given enhanced functions and autonomy by being upgraded to independent User Councils?

We do support giving an enhanced role to the Users Forums, and we have already made significant progress in this regard. We do have concerns that giving them full independence could undermine the authority that these groups have and which they value. In drawing up our response to this question, we have directly asked the chairs and members of the User Forums for their views.

We believe that the Forums should constitutionally stay the same as they are now. When discussing the option of making them fully independent with the Forum members, it was concluded that they appreciate having that direct relationship with the Payments Council. We also debated whether truly independent chairs should be elected, but on balance it was agreed that having independent directors as chairs worked well and the Forums valued having that direct line into Board.

We also value that direct relationship and the benefit of knowing that the Forums will discuss key Board agenda items before Board itself meets, and that the independent director chairs can relay the views of their respective Forums to the rest of the directors.

The Forums have recently undergone some changes, both in response to the Professor Cave governance review and also as part of a restructuring of our committees and groups. These are:

- the User Forums have been renamed 'Customer Forums' to better reflect the status of the participants;
- the SME Forum was proving to be an ineffective way of engaging with the sector and we were struggling to have suitable representatives attend the meetings; the SME and Large Corporate Forums have therefore been merged into a single

Business Forum and we are investigating better ways of engaging with the SME sector;

- the needs of the self-employed have been drawn into the Consumer Forum, as their requirements are more akin to consumers than businesses;
- the Charity and Voluntary Sector Liaison Group has been reconstituted and is now a formal Charity and Voluntary Sector Forum on the same footing as other Customer Forums; and
- we have implemented a better line of communication between the Forums and the Board so that the Forum members receive a written report from their chairs summarising the Board discussions on specific agenda items within two weeks of the Board meeting taking place.

We are also in the process of another significant change to our Customer Forums, which relates to the Vendor Forum that is run in partnership with Intellect. We are considering whether to reconstitute this as a Technology Forum and transfer the current vendor and payment processing members of the Business Forum to it. This Technology Forum would be better aligned to their interests and mean that the Business Forum can better focus on that sector's needs and requirements.

We will continue to encourage Forum members to put forward their own agenda items for discussion at meetings, which some members already do. It is important that Payments Council has input into the agendas to ensure that certain items are included, particularly those that are being discussed at Board and on which the views of the Forum members are required.

The Consumer Forum and the Charity and the Voluntary Sector Forum have always been very well attended and we feel strongly that we have the right people sitting round the table. Now that the Business Forum has been reconstituted, and we are looking at other ways of engaging with the SME sector, we are comfortable with the representation at this group. In terms of those people and organisations that are directly engaged, we are confident that we are doing as much as we can, bearing in mind that we can only ask so much of the stakeholder groups that we deal with. We appreciate that they are all busy people and so can only devote so much resource to engaging on payments issues.

In addition to the Customer Forum meetings, we do of course also run consultations on setting and reviewing the NPP and will undertake investigative pieces of work on particular issues. We greatly value the input that the stakeholder groups also put into these.

We also hold special meetings and workshops for stakeholders on topics of particular interest and where in-depth feedback is needed. We recently set up an Advisory Group of representatives from the Consumer Forum and other relevant consumer bodies to support an NPP action to conduct research with older people and disabled people. The Group, chaired by an independent director, has helped shape our approach to the work and will support subsequent policy analysis. This approach of co-working with stakeholders has worked well and we hope to replicate the model for other relevant projects.

Separately, we have regular in-depth research looking at how consumers use payments and we have also commissioned specialist research on how charities and voluntary groups, and businesses of all sizes make and receive payments. This was the first time that research of this nature had been carried out with the charity and voluntary sector, and the first time in 10 years that such an exercise had been undertaken with businesses. Findings will be public in line with our commitment to full transparency.

Consultation and research findings are always shared with our Customer Forums for their comment and views. We use their input in examining the results and deciding what actions are required as a result of the findings.

An additional enhancement that we will implement is a more direct line of communication for stakeholders into the independent directors, so that they have a route by which to raise any areas of concern and to help facilitate the independent directors' ability to challenge.

f. How can Payments Council funding be put on a long term, secure footing?

We have discussed the pros and cons of our current funding model and whether it can be apportioned in a different way. We feel that we can only really address this question once the review is concluded and the role and remit of the Payments Council is confirmed. Whatever funding model is ultimately agreed – whether it continues to be the current arrangements or a new model - it should be transparent, sustainable, stable and affordable for new and existing members.

g. How should a reconstituted Payments Council be given the means to enforce decisions more effectively in a self-regulatory environment?

There are several ways that this can be achieved with our proposal. We believe that having a senior group above the Payments Council Board, on which sits HM Treasury, the Bank of England and the FCA, will be effective in this way. The impetus to deliver against the decisions is heightened with the appropriate level of accountability in place. Currently accountability for decisions taken at Board, rests with the Board. This is why it is so important that these three public bodies are involved, as their presence provides the next effective enforcement method to having regulatory powers themselves.

Ensuring senior endorsement of Board decisions within the banks also helps with enforcement. More senior involvement from industry means that more individuals are able to take a broader view of both the industry and public interest in delivering this new payment method. We are already actively taking steps to pursue this engagement.

Additionally, the stronger role being played by the independent directors, where they are better enabled to challenge, adds weight to their authority and ability to ensure enforcement occurs in a self-regulatory environment.

One of the examples we provide in an earlier answer is how the implementation of the Faster Payments Scheme may have been different under the framework we have

described. The existence of a more senior body holding the Payments Council Board, Executive and wider membership to account for delivery may have created more pressure on individual banks to prioritise their own implementation for the roll-out of the service internally. The presence of HM Treasury, the Bank of England and the FCA on the oversight body would have been key to this. In the absence of regulatory powers, public statements on the state of implementation by individual participants would have acted as an incentive to get the job done in a timelier manner. We would also argue that in many ways, the threat of public censure is a more effective and timely enforcement mechanism than regulatory powers in any case.

h. How can the membership of the Payments Council be broadened most effectively?

We agree that the Payments Council should be widening its membership, particularly as broad input is required if the payments strategy is to be inclusive of all payment types and issues.

Having a wider industry base is generally supported by all stakeholders we have spoken to in the course of developing this response, and by our current members. Some see it as a vital development to the Payments Council.

At the same time there is a concern that an increasingly heterogeneous membership could create difficulties in reaching consensus, particularly on important issues such as those impacting the stability and integrity of the payment schemes currently contracted to the Payments Council. In order to strike the right balance between enabling a more inclusive membership and wider involvement in innovation, and protecting the stability of our clearings, we are going to explore different membership categories. We are aware that small institutions have limited resource, so we need to enable their participation in those important discussions to them without dissuading their involvement completely with unreasonable demands on their time. Making membership of the Payments Council as affordable as possible is very important, so that the cost of joining is not prohibitive in any way.

Another option we have been exploring is forming closer ties – or perhaps creating its own membership category – with representative bodies of different types of payment service providers. This is particularly for those types of institutions that can be very small, and which could be considered micro or small businesses themselves. We would be particularly keen to enter into a formal relationship with The UK Cards Association and Financial Fraud Action UK.

We also need to consider those bodies outside of the traditional payment service provider model, but which are becoming more and more ingrained in the payments industry and offering services directly to customers. The Treasury estimates in its consultation paper that there are 642 financial institutions (including the current members) that are eligible for Payments Council membership. This breaks down into 441 credit institutions, 183 payment institutions, and 18 electronic money institutions. We believe that these non-traditional players fall outside of these estimated numbers.

We believe there would be benefit in requiring all payment schemes operating in the UK, and which are above a certain size, to have a form of contractual relationship with the Payments Council providing, as a minimum, a basis for engagement and information exchange in relation to the development of the strategy. This should include the card schemes – Visa and MasterCard - as we believe that the payments industry can only truly be represented if cards are also included in the strategy. For some of the schemes, this contract could potentially be focused on how the industry pursues new issues and innovations.

Question 3

a. Do you agree with the proposed remit for a new Payments Strategy Board?

We believe that the best course of action to address the Treasury's concerns and to create a stable framework is to establish a senior body within the existing structure of the Payments Council, but if a Payments Strategy Board is created as a separate entity we have views on how it could be made to operate most effectively.

Proposed objectives for the PSB

The consultation paper sets out in paragraph 5.24 a proposed remit for the Payments Strategy Board (PSB) as being to:

- promote the development of new and existing payment 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 payment 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).

As argued earlier in this response, we believe that these objectives are better addressed by the Payments Council. The role of the PSB should be to:

- focus on two or three big strategic issues where there is a public interest angle, making recommendations to the industry on them;
- provide oversight and hold the Payments Council accountable for delivering against these agreed objectives (where the recommendations are accepted);
- provide the public interest scrutiny to a payments strategy and ensure that appropriate public interest tests are applied; and provide a challenge function, and provide other stakeholders with a route by which a need for challenge can be raised.

What the PSB does lack is any formal powers, without which it is in danger of adding very little to what can be achieved on a voluntary basis and in a much quicker timescale.

There does need to be recognition of the increasingly international space that the payments industry is operating in. Whilst the PSB should be focusing on the UK market, it does need to have regard to the international nature of many of the transactions originating and ending in the UK and the impact of international and EU regulation.

We would also recommend that if this remit is to be set in legislation, then the detail needs to be removed to keep it as high-level as possible and to maximise the PSB's flexibility. The more explanatory information should be written into the PSB's operating material.

Scope of the PSB and the payments strategy

We would also want clarity over the scope of the PSB's remit and the types of institutions and transactions that would be covered. For example, there is an inconsistency in the consultation paper over the status of the card schemes, Visa and MasterCard. On page 16 of the impact assessment it states: "It is assumed that the payment systems, and their participants, that will fall within the scope of the Payments Strategy Board will be LINK, Bacs, Cheque and Credit Clearing, CHAPS, Faster Payments and the card schemes like Visa and MasterCard." However, on page 19 in table 2.6 (setting out the population of potentially affected firms), the list of payment systems does not include the global card schemes.

We strongly believe that the payments strategy, the delivery of which Payments Council would be responsible for, needs to encompass all methods of payment. This in turn means that the scope of the PSB would need to be equally as broad. The lines of demarcation between different payment types are becoming increasingly blurred – customers are making card payments using only their mobile phones; transactions through online banking are being done through apps. This trend is only going to continue and so policy on different payment methods can no longer be considered in silos and this includes card payments. We therefore believe that the global card schemes Visa and MasterCard and their participating institutions need to be treated as equivalent to the electronic payment schemes and their participants.

Fraud and security issues run across all transaction types and methods by which customers access their accounts. It is imperative that a payments strategy fully encompasses these policy areas as we know, for example, that security is the primary concern cited by customers when they are asked about methods of payment. For a body tasked with looking after the public interest, it is clear that these issues should be firmly in scope.

The one area of cards policy that does need to continue to be addressed separately is the use of credit cards as a borrowing tool, and all the associated credit issues. These are very clearly outside the remit of the Payments Strategy Board, as they are not part of the payment function.

We provide an analysis of the payments industry and current and emerging trends in annex 3.

Development of the payments strategy

In the case of the specific issues against which the PSB should hold the Payments Council to account for delivery, we believe that they are best placed to focus on a small number, but strategically very important, issues at a time. These can be set out in a short document (two to three pages) detailing the PSB's Strategic Vision and Principles, which would be reviewed every few years. This is a statement owned by the PSB but which is worked up with the Payments Council to ensure that the vision is addressed in the Payments Roadmap.

The PSB should have the ability to identify issues where change is, or may be, required. This implies a high level of insight and understanding of a large, diverse and complex industry. There are a number of ways in which it can achieve this:

- relying on the knowledge of its Board members, chosen for their expertise and range of view-points;
- responding to issues raised by others (customer groups, industry groups, parliamentarians, etc); or
- through research (including exploiting that which has already been conducted and paid for by others, such as the Payments Council or by consumer groups).

We would envisage that there will be a two-way communication between the PSB and the Payments Council of the issues and what the outcomes should be for consumers and businesses. The PSB will develop its own views separately from the Payments Council, but the Payments Council can still play a major role in helping the PSB to identify what those outcomes should be. It is where our expertise lies and is a more efficient use of resource to avoid duplication of knowledge and skills in the two organisations. We would continue with our comprehensive range of regular and one-off research projects, particularly as these will also feed into those strategic areas of work that sit at the level below the Payments Strategy Board.

This Strategic Vision and Principles document would inform the recommendations that the Payments Strategy Board puts to the industry.

Beneath the PSB's Strategic Vision and Principles sits the comprehensive strategy for the payments industry – the Payments Roadmap – the delivery for which the PSB would hold the Payments Council accountable. The recommendations accepted by the industry would go into the Payments Roadmap and be developed into proper delivery programmes, complete with the required capabilities and milestones.

It is important that there is a single strategy for the whole payments industry, which comprises an increasingly diverse range of organisations in delivering payment services, from the traditional institutions like banks to the newer players such as mobile telecoms operators.

Role of the Payments Council in delivering the strategy

We believe that accountability for the payments industry strategy needs to sit with a single organisation, and that the Payments Council remains the best place for this given our unique positioning. The Payments Council has the capability to deliver the strategy and should therefore also be accountable for it. The addition of the Payments Strategy Board

sitting above the Payments Council ensures that we are held to account for the strategy and that scrutiny from a public interest angle exists. We believe the benefits for this arrangement are:

- it ensures single organisation accountability for the definition and delivery of the strategy;
- it ensures that the strategy is subjected to thorough public interest scrutiny; and
- it provides a transparent and effective arrangement for exposing and managing tensions that may arise between public interest and the interests of the payments industry.

In terms of the successful delivery of a strategy, it is important that it is developed hand-in-hand with knowledge of what is required for it to be implemented. We believe that in order to fully define the outcomes that are to be achieved, there needs to be an understanding of their costs as well as their benefits. This requires a detailed understanding of the underlying capability, and any changes required to it. This capability doesn't just exist in the central body, it is also needed in the organisations responsible for the actual implementation, which in our case would be the Payments Council members and the wider industry.

Outcomes often have to be traded off against each other to find an optimum balance and to achieve appropriate prioritisation, and this trade-off is governed by the constraints inherent in the underlying capability (such as availability of resource, assessment of risk, etc). Changes in capability designed to deliver certain outcomes may also be exploited to deliver other desirable outcomes, for example an increase in the capacity of a particular infrastructure. It therefore makes for a more successful strategy when it is developed by the same organisation which holds the capability to make it a reality.

The detachment of the strategy-setting objective from the ownership of capability in the proposed model – i.e. strategy-setting sitting with the PSB and capability sitting with the Payments Council and the wider industry – creates an inherent instability. In an attempt to provide clarity in the different roles – both for the Payments Council and the PSB, as well as the wider stakeholder community – it is absolutely vital that a Memorandum of Understanding is set out and agreed. This should be published and available in the public domain.

- 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.**

If the Payments Strategy Board is put in place, it needs to make recommendations to the industry, but they will be stronger and more likely to be fully implemented if they take into account public interest and consensus from across the different stakeholder groups, including the industry. This is why we are putting forward our proposal for a senior body to

be created within the Payments Council framework to ensure that credible and achievable recommendations are publicly tabled and accepted.

Strategy is only effective if it is developed looking at both the outcomes required and the means of achieving it at the same time. Otherwise the risk is that the agreed actions are not realistic and are limited in their ability to be looked at with an holistic view – in other views, only addressed looking at payment silos.

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?

We do agree that the Payments Strategy Board should include senior industry representatives and independents. The independents should be recruited based on providing a range of experience and expertise and be charged with getting a comprehensive understanding of the needs and views of all stakeholder groups. The Board will not be effective unless suitable seniority is achieved.

We also feel strongly that HM Treasury, the Bank of England and the FCA should have seats on the Strategy Board. This is why we are seeking this combination in the proposal we have put forward and set out in our answer to question 1 of this consultation paper.

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?

The PSB should have formal information gathering powers, but these should be exercised through the Payments Council and the Payments Roadmap. If the PSB were to routinely gather its own information and process it, it would lead to the detachment that we are trying to avoid. Good quality information collected on a regular basis will provide for quality analysis and decisions being made.

e. Do you agree that the Payments Strategy Board should be funded by an FCA levy on the payments industry?

We have no particular view on this as the advantage of having a very focused Payments Strategy Board would mean that it would be relatively cheap to run.

f. Should the FCA have any further controls over the Payments Strategy Board?

We do not think that the FCA should have any further controls over the Payments Strategy Board as it is important that this is a multi-party body and is a more collective force of public interest rather than being FCA-centric.

ANNEX 1

THE VITAL DAILY WORK OF THE PAYMENTS COUNCIL *An article by Adrian Kamellard, Chief Executive*

A casual observer of the payments industry might be forgiven for thinking that the Payments Council is comprised only of its Board: a few senior individuals making big, important strategic decisions that affect the rest of us. Yet this perception overlooks the meat and the bones of what we do and achieve on a daily basis, and our staff's vital work with the payment schemes to keep the payments infrastructure running smoothly and safely day in, day out.

It quickly becomes apparent why that work is vital when you stop to consider how integral payments are to our everyday lives. A single day for anyone of us is likely to involve a range of different types of payments, all of which we depend upon to work efficiently and securely. You probably don't give a second thought to the central systems that enable you to take cash out of an ATM; pay a gas bill by Direct Debit; book tickets over the phone using a credit or debit card; transfer money via Faster Payments to a savings account using online banking, use contactless technology on plastic card to buy a coffee; or buy something on eBay using PayPal.

If the day in question happens to be a payday you are likely to receive your salary into your bank account by Bacs Direct Credit and if you are feeling generous you may even make a charity donation by writing a cheque. And of course, it isn't impossible that the day in question might just be a particularly momentous one where you instruct your solicitor to make a high value CHAPS payment to buy a house. No matter how you choose to pay, you expect to be able to rely on the central systems that enable all these payments to happen, and the integrity, reliability and security of these systems is at the heart of the critical and often invisible day-to-work work that happens across the Payments Council.

We work with banks, building societies and other payments providers, schemes and associations wherever collaboration is required or investment is needed while also consulting widely with consumer, charity and business representatives to understand payment users' needs and make sure payment systems are inclusive both now and in the future. And not only do we research and deliver enhancements to existing payments, but we manage massive projects to deliver major new payment innovations for customers such as mobile payments and a faster account switching service.

Keeping payments safe

Security is one of the most critical aspects of any payment and so maintaining the integrity of our systems lies at the heart of pretty much everything we do.

Most recently we played a key role to support RBS Group when IT issues caused a backlog of payments. Although our central systems were not affected, we worked closely with RBS Group and payment schemes acting as a facilitator to help ensure customers of other banks and financial institutions were not left out of pocket. This involved getting a voluntary agreement for handling claims in place across the industry as well as issuing clear advice for customers. To achieve this we engaged with stakeholders such as the British Banker's Association, the Building Societies Association, The Council of Mortgage Lenders, The Association of Foreign Banks, the UK's three credit reference agencies and of course the Financial Ombudsman Service and the FSA. There was also a great deal of work done behind the scenes to make sure that the technical issues didn't impact the central payment schemes. Looking forward, in the wake of the FSA's review we will ensure we share any lessons that can be learnt from this exceptional incident across the industry.

In much the same way that the country's road network would grind to a halt without the Highway Code, agreed standards are vital to keep payments moving both nationally and internationally. We help drive payments standards creation and adoption both in the UK and across the globe. Standards enable processes to be streamlined, reducing the risk of manual errors. They also set the foundation for tomorrow's payment systems which are often European or global in their reach.

Much of what we do is aimed at improving customers' experience of using payment and enhancing the options open to them. So, for example, we have been working to reduce error rates and enhance efficiency during the internet and telephone banking payment process due to the customer providing incorrect payment reference information and best practice guidelines for billers and payers have been developed to increase consumer confidence and cut down on the problems that can arise if reference information is entered inaccurately or incompletely.

Security and fraud

The failure of any component of the end-to-end payment process risks damaging people's confidence in that service. The Payments Council's Information Security Advisory Group (ISAG) works to cover issues such as confidentiality, integrity, availability, authorisation and privacy. The scope of the work embraces all payment types – card payments (including contactless), automated credit transfers, direct debits, cheques and emerging payment methods – as well as the IT infrastructure that underpins their operation. Technological change guarantees that this is a fast moving area - our recent security priorities include cryptographic recommendations, mobile telephone payments and cloud computing.

A Payments Council group on fraud and security brings together existing payments industry fraud and security groups and public sector organisations. The group helps define priorities and explores how the payments industry and public sector fraud

prevention activities can complement each other. The group provides regular assessment of key trends, emerging threats and counter measures in payments fraud and security, including new technology, and reviews what additional action may be needed to mitigate any risks.

Payments that work for everyone

Everyone needs to be able to make and receive payments. So we have put enhancing the inclusion of payment systems at the heart of the work we do, whether we are looking at current ways to pay or developing new ones. A recent example has been our work to improve awareness of chip and signature cards – the alternative option for people who are unable to use a PIN. We spoke to banks, retailers and people who might need an alternative to PIN and have developed updated resources to help ensure this vital alternative works in practice, directly reaching more than a quarter of a million people in the target audience.

Research is essential to understanding the needs of individuals, businesses and consumers and so we regularly carry out qualitative and quantitative research, including with groups that may have been overlooked elsewhere, such as disabled people, the over 80s, charities and small businesses. And we are all too aware that payment systems are not always easily understood, so we are constantly working to improve understanding of the available options through our consumer education campaign, Pay Your Way. Earlier this year we undertook a major public awareness campaign to publicise a fraud scam which involves innocent customers, particularly the elderly being called by a fraudster pretending to be their bank and trying to dupe them into handing over their card and PIN. This resulted in several national TV appearances, on ITV and BBC TV and working with regional police forces across the country.

Working together

More than seven billion payments worth almost £70 trillion were made in 2011 via Bacs, CHAPS, Faster Payments and the Cheque and Credit Clearing Company. We also used cash machines connected to the LINK network almost 3 billion times, taking out in excess of £191 billion. With so many different ways to make a payment, it's essential that all the options work seamlessly together and to achieve this collaboration is required. For that reason, each of these payment schemes is contracted to the Payments Council setting out their respective rights and duties towards each other. Under the contract, schemes are required to report to the Payments Council, lending the organisation a unique position to ensure that payments of every type meet the needs of customers.

Payments of course spread even further – encompassing the notes we carry in our wallets and purses. The Payments Council's Strategic Cash Group looks at a wide range of issues regarding banknotes and coins, and the routes through which they circulate. The group, together with the Bank of England and the Royal Mint plays a key strategic

role in note and coin developments in the UK. The Group also helps make sure there is enough cash ready and available in all the places customers need them, particularly at times of high demand like in and around this year's Olympic and Paralympic events.

Our work with our user forums ensures we keep up to date and able to respond to the needs of payment service users. To ensure we take the widest possible range of opinions there is a forum for corporate users, a consumer forum, which includes groups such as Age UK, Citizens Advice and Which?, a forum for organisations representing charities and the voluntary sector and a technology forum to foster collaboration with the telecommunications and electronics industries. These forums played an extremely important part in the consultation process on the National Payments Plan and all are playing a key role in shaping the big account switching and mobile payment projects that the Payments Council will deliver over the coming months.

All of the important work set out above runs in parallel with the day-to-day business of the Payments Council - acting as a trusted source of data on payments, communicating and educating consumers about payments through the Pay Your Way campaign and carrying out the research that is required to inform the National Payments Plan and other plans for the future.

Responding to change

Looking ahead, the scope of the Payments Council's work is going to need to extend in response to how the world of payments is changing. Payments are no longer the preserve of banks as they were just a decade ago. New players are becoming more firmly established in the payments sphere. As well as online providers such as PayPal, we are seeing a stream of new developments from the telecoms sector, and as the growth in the prepaid market being driven by an increasingly diverse range of new providers. We need to make sure the Payments Council is involved. It's also true that as cross border payments become more popular, whether buying online or sending money to and from friends overseas we have an opportunity to play a bigger role.

Maintaining integrity of payments is a key aspect of our remit, and one area I'm particularly keen to develop is the role the Payments Council plays in strategic fraud development. We have an excellent track record in the UK for tackling fraud, intelligence gathering, publishing data and responding to new threats. A great deal of our expertise has been gleaned from our experience tackling card fraud and is undertaken at an operational level. To reflect all the changes we are seeing and the new players involved in the payments arena I believe the Payments Council is uniquely placed to take a much needed look at fraud challenges from a strategic viewpoint. Security is the one thing every customer cares about and our education remit should be used to help ensure customers have the security advice they need for every type of payment.

This is a timely point to shine a light on payments. We want a model that works best for consumers, businesses, the industry and the UK economy, which isn't an easy balance to strike. I believe that thanks to the tireless work of our excellent staff that the Payments Council is already uniquely placed to listen and respond to the needs of customers and businesses who rely on payments in their everyday lives.

ANNEX 2

PROGRESS MADE BY THE PAYMENTS COUNCIL AGAINST GOVERNANCE REVIEW RECOMMENDATIONS

In April 2012 the Payments Council published an independent review of its governance arrangements and performance. The review was authored by Professor Martin Cave, an expert in regulation and competition and an independent director on the Payments Council Board until December 2011.

The review was carried out in line with the 2009 recommendation of the Office of Fair Trading and included consultation with a wide range of stakeholders, including industry, consumer groups, small business representatives, and payment service providers.

Since the publication of the Governance Review in April this year, the Payments Council has placed significant emphasis on delivering against the recommendations of the Review and is pleased to report that substantive progress has already been made. The Payments Council continues to work to deliver on the recommendations and is currently implementing changes to its practices and procedures to ensure timely delivery on these.

Recommendations made by the Governance Review all related to measures aimed at improving the Payments Council's effectiveness and covered:

- Transparency of the Payments Council Board decision-making process;
- Communication with customers of payment services;
- Improvements to the Payments Council user groups and methods of involvement;
- The role and power of independent directors;
- The scope of activity undertaken by the Payments Council;
- Internal resources for the Payments Council; and
- Reviewing the Payments Council relationship with the cards industry, in particular the schemes, Visa and MasterCard.

Transparency of Payments Council Board's decision-making process

Transparency was at the fore of many of the recommendations of the Governance Review and since its publication the Payments Council has worked to improve the transparency of its processes and its communications activities with both customers, through revitalisation of the User Forums, but more widely through all external communications activities.

The Payments Council is ensuring that the decisions made at Board level are clearly and consistently articulated with stakeholders. Work is underway to develop a defined set of criteria to provide an analytical framework upon which decisions are taken, including detail on the origin of work, and what stakeholder consultation is required. A project

prioritisation portfolio has been created. Following consultation with the Forums, the framework will be established and an overview of what other considerations feed into the decision-making process will be published on the Payments Council website.

The Payments Council website is being developed further to ensure greater transparency across all Payments Council work. This will ensure that information is available to all interested parties who want to see information about the Payments Council work and governance structure.

In light of a recommendation made in Professor Cave's Governance Review, changes are also being implemented to provide further clarity on the role of the independent directors and User Forums within the organisation.

Communication

The Governance Review identified communications as a key area of focus for the Payments Council. In response, the Payments Council is reviewing its overarching communications strategy. The framework for this strategy has been agreed by the Payments Council Board and is being implemented through the Payments Council work. Specifically, the Payments Council's current programme to deliver account switching in 2013 has consumers' interests at its core. The Payments Council will be initiating a public communications programme to ensure that customers are aware of the ability to switch accounts and that the service will be easy to use and provides them with a clear guarantee of a consistent and known timescale.

In order to extend awareness of the Payments Council work with all its customers, the Payments Council has extended the remit and circulation of its quarterly newsletter, *Communiqué*. The content of the newsletter has also been reviewed and the content adapted to increase the contributions from external authors and stakeholders. Editions also focus on particular subject areas in order to reflect what interests consumers, for example the latest version includes a focus on financial inclusion matters.

The Payments Council is continuing to improve the amount of information publicly available to consumers. In addition to the *Pay Your Way* website promoting clear information on how payments work, the Payments Council supports the consumer's ability to choose the method of payment most suitable to them and therefore increase competition within the market. In 2013, the promotion of an industry-wide mobile payments service will increase the choice available to customers.

We've also partnered up with a few different organisations to help get information on payment options out to different customer groups. Recent partners have included Citizens Advice Bureaux, RNIB, Alzheimer's Society, Carers' Support Service, Stroke Association, and University of the Third Age on information campaigns such as raising awareness of chip and signature cards. Much of this has been through the *Pay Your Way* campaign.

In July 2012 the Payments Council conducted a roundtable discussion on payments and SMEs with Shadow Business Minister, Toby Perkins MP; John May, Director of Policy at the Genesis Initiative; representatives of the SME community; and academics. Discussion focussed on the importance and speed of payments for this sector, and the development of mobile payments. The roundtable was the first of a series of SME-focussed roundtable events that the Payments Council will be undertaking on a regional basis to connect further and understand the needs of SME users across the UK.

Role of the independent directors and User Forums

The roles of both the independent directors and User Forums, and the relationship between each, are integral to the work of the Payments Council. For clarity, the User Forums have now all been reconstituted as Customer Forums, underling the Payments Council's focus on ensuring that customers – whether consumers, businesses or charities – form a key focus of Payments Council's work.

Independent directors, who chair the Payments Council's Customer Forums, are important in ensuring that there is a fluid exchange of information between the Payments Council Board and each of the Forums. Remarks made through the Governance Review consultation process highlighted an appetite for this information exchange as well as specific recommendations as to how this can be achieved. Since publication of the Governance Review the Payments Council has implemented a system by which members of the Customer Forums are clearly informed of Board discussions on areas of interest within two weeks of the Board meeting having taken place.

Members of the Payments Council Customer Forums are also given regular reminders of the opportunity to contribute to the setting of the agendas for the Forum meetings, in light of specific requests during the consultative process for the Governance Review. In recent meetings topics including mobile payments and disruption with RBS payments services have both been included on Forum agendas reflecting the delivery of this objective.

In line with the Governance Review recommendations, the Payments Council has now formalised the Charity & Voluntary Sector Liaison Group so that it is now constituted in the same way as the Customer Forums. The Charity & Voluntary Sector Forum is chaired by one of the independent directors, Gerard Lemos, in line with the other Customer Forums.

The recommendation to merge the SME User Forum and the Large Corporate User Forum has been realised and a new single Business Forum now exists. Additionally, the needs of the self-employed have been subsumed into the Consumer Forum, which is a better match in terms of addressing their requirements, and other more effective ways of engaging with the SME sector are being investigated.

Conclusion

The work undertaken by the Payments Council firstly in successfully completing the Governance Review with the assistance of Professor Martin Cave; and subsequently making significant progress in delivering changes across the Payments Council in line with his recommendations has resulted in the Payments Council developing into a better connected organisation with its customers' – both individual and business - interests at its core.

The Payments Council is continuing to make changes to its practices and procedures, many of which have been taken forward as part of our response to HM Treasury's consultation.

ANNEX 3

AN ANALYSIS OF THE PAYMENTS INDUSTRY AND CURRENT AND EMERGING ISSUES

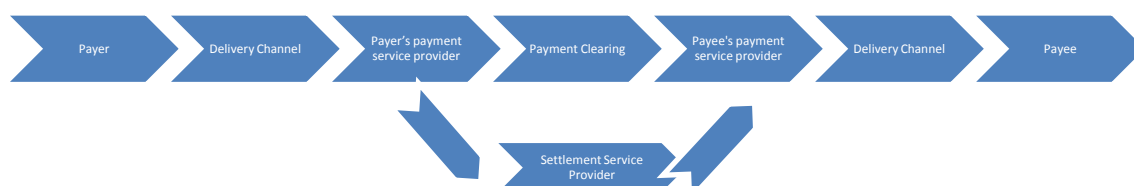
1 INTRODUCTION

This annex provides an overview of the payment industry and the key trends in the UK payment markets over the last few years. It also describes the current and emerging issues that shape the industry and the ways in which individuals, businesses and other organisations in the UK make and receive payments.

2 THE PAYMENT INDUSTRY

Payment systems are networks that enable consumers, businesses and other organisations (the ‘payers’) to purchase goods and services from the sellers of those items (the ‘payees’). To do this they transfer funds from the payer customer’s account with their payment service provider to the payee customer’s account with their provider. In its broadest terms, the payment industry constitutes those businesses and other bodies that maintain and enhance the current payment systems and innovate in delivering new payment services to their customers.

Figure 1. The Payment Value Chain



In generic terms the main elements of the value chain linking the payer to the payee are set out in Figure 1. In practice there is considerable variation with different payment systems; this complexity is manifested in the different financial, technical and operational roles that the businesses along the value chain perform, and in the commercial relationships between them. Table 1 gives a summary of the main types of organisations involved in the payment value chain.

The value chains are not static as consumers’, businesses’ and other organisations’ demands are changing rapidly as are the services on offer and the providers of those services. Compared with ten years ago, consumers and businesses now have a much wider choice of payment methods available to them and more channels through which payments using these methods can be initiated. The numbers and types of organisations

providing payment services also continues to grow with many new entrants to the market such as internet and mobile payment service providers alongside the traditional players including banks, building societies and credit card issuers.

The international dimension has also grown in importance, through more payments being made through the international schemes, adoption of international standards and regulation at the EU level. As a result, the payments industry looks very different now than it did ten years ago. Some of the main changes in the payments industry over that period are discussed in more detail in section 3. The remainder of this section provides a walk-through of the value chain.

Payers can initiate payments in a number of ways using a range of different **channels**, with each channel often supporting a range of different payment methods. They may make the payment face-to-face at the payee's or payer's premises, such as a card payment in a retailer or restaurant, or a cheque given to a window cleaner or carer. They can make payments remotely, such as a card payment made over the internet or through a mobile phone, a cheque sent through the post, or a bill payment initiated through internet banking or a mobile banking app. Payments can also be initiated in the branches of banks, building societies and post offices. Payment initiation may also be outsourced by the payer, for instance many businesses outsource the processing of wages and salaries to payroll bureaux.

SMEs and large corporate customers may have their own infrastructure with which payments are initiated such as software provided by their bank. This may be integrated with other business processes such as enterprise resource software in larger organisations. They may also receive other services such as those of a cheque printer. Private individuals are more likely to have no or little dedicated infrastructure of their own.

In some cases the payers or payees may also be overseas. In these circumstances the payment system will process the sterling leg of a **cross-border** transaction. The substantial majority, 90% plus, of payments through most systems are domestic; however in some payment systems, especially CHAPS, they are more important. Around 40% of CHAPS payments are cross-border.

The **payer's payment service provider** may play a role in authorising the payment, for instance checking that the payer has sufficient funds or credit on their account or that a Direct Debit mandate is in place. They may process and input customers' payments into the payment clearing system, including bill payments made in a branch by cheque and payments initiated through internet banking. Banks and other payment service providers may process the payments themselves or some functions may be outsourced to suppliers, as is the case with cheque processing. They will also debit their paying customers' accounts and communicate transaction details to those customers.

Table 1: Players in the Payment Value Chain

The table is not intended to be exhaustive but to illustrate the complexity of the industry and the wide range of different bodies in the payment value chain.

Payers and Payees	Suppliers of related services to payers and payees	Payment Service Providers	Suppliers of services to payment service providers
<ul style="list-style-type: none"> • Consumers • Micro-businesses and sole traders • SMEs • Large corporates • Charities and voluntary organisations • Local government • Central government • Government departments and agencies 	<ul style="list-style-type: none"> • Cheque printers • Cash in transit companies • Bacs bureaux • Providers of accounting, corporate treasury and ERP software solutions • Providers of accounting and ERP outsourced solutions • Card terminal manufacturers • Providers of point of sale software solutions • Providers of shopping cart software and other internet payment solutions • Providers of mobile billing solutions • Telecommunications companies • Mobile network operators • Mobile handset manufacturers 	<ul style="list-style-type: none"> • Banks • Building Societies • Credit Unions • Credit card issuers • Pre-paid card issuers • Card acquirers • Internet payment service providers • Mobile network operators • Mobile payment service providers • Independent ATM Deployers • Electronic money issuers • The Post Office • Remittance service providers • Bill payment service providers 	<ul style="list-style-type: none"> • Cheque printers • Cheque processing outsourcers • Cash processing outsourcers • ATM manufacturers • ATM network management services • Cash in transit companies • Card production and initialisation service providers • Card terminal manufacturers • Providers of payment processing software • Payment system gateway suppliers • Automated and card payment transaction processors • Providers of security, fraud and risk management solutions • Network providers, including SWIFT • International card schemes • UK scheme companies • Providers of scheme processing services • Providers of scheme settlement services

In addition to the bodies listed above, the Bank of England has a role as issuer of sterling banknotes in England and Wales. In Scotland and Northern Ireland banknotes are issued by commercial banks. The Royal Mint makes and distributes United Kingdom coin.

The payment service provider may be a **direct participant** of the payment system, responsible for settling the obligations of its customers, or it may be an **indirect participant** in receipt of an agency service from a direct participant. Direct participants are usually the larger financial institutions whereas indirect participants tend to be smaller organisations who find it more cost-effective to operate that way. In numerical terms there are far more indirect participants than direct participants in the main payment systems. However, payment volumes are heavily concentrated with the direct participants.

As discussed in more detail below, one of the major developments within the payment industry in recent years has been the **disaggregation** of this element of the value chain. This includes the market entry of ‘over the top (OTT)’ or ‘overlay’ services, where the organisation acts as an intermediary between buyers and sellers and may have the commercial arrangement with these parties rather than their bank or card company. A related trend has been an increase in the types of organisations providing payment services, which can include Independent ATM Deployers, electronic money issuers, mobile phone network operators and pre-paid card issuers alongside banks, building societies, and credit card issuers.

Payment clearing is the system between the payer’s and the payee’s payment service provider by which the payment is sent. The clearing system may include a messaging network connecting payment service providers, as is the case with the IBDE network for cheque clearing and in the CHAPS system, where SWIFT is used. It may also process payment transactions, as is the case with the VocaLINK infrastructure in the Bacs system.

The business rules behind the clearing and settlement of transactions in the main payment systems are set and managed by the **scheme companies**. The rules cover issues such as how transactions are made, maintenance of the integrity of the system and criteria for membership.

The payer’s and the payee’s payment service provider settle their obligations through the **settlement service provider**. In most payment systems this role is fulfilled by the central bank, although commercial banks may also play this role. In most systems the obligations are settled net on a periodic basis, but with the CHAPS system each individual payment is settled gross in real time across accounts held with the Bank of England.

The **payee’s payment service provider** may play a role in processing and inputting their customers’ payments into the payment clearing system. Examples include card acquirers processing transactions from their merchants and the processing of customers’ cheque deposits. They will also receive payment data through the clearing systems, credit their payee customers’ accounts and communicate transaction details to those customers.

As with the payment services provided to payers, there has been **disaggregation** of this element of the value chain. Some examples include organisations providing card acceptance services to small businesses and bill payment services to large corporates.

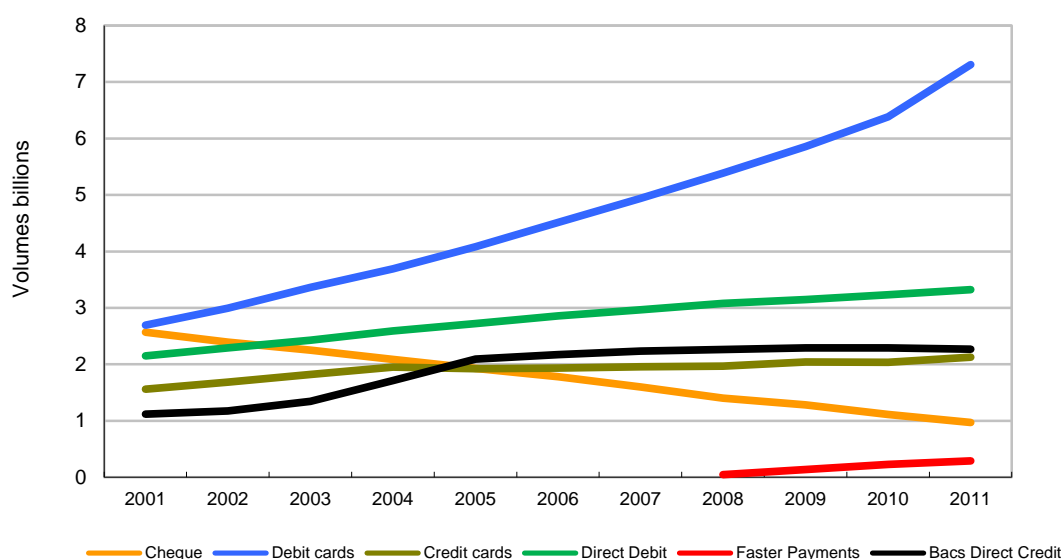
In many cases the **payee** will only receive details of payments received and associated transaction data from their payment service provider, but in some the payee may also have a role in the initiation too. This can occur with cheque payments received by the payee from the payer, collections of Direct Debits and processing of plastic card transactions. SMEs and large corporates may have their own infrastructure with which payments are received and reconciled. For instance, large retailers will have their own point-of-sale systems, and major corporates will run integrated payments and accounts receivable systems. They may also purchase other services such as renting a payment terminal or lock box services from their bank.

3 KEY TRENDS

3.1 Use of different payment methods

As can be seen from Figure 2, there has been major change in the payment landscape over the last ten years. During that period there has been exponential growth in **debit card** use, driven by increased holding by consumers, wider acceptance by retailers and other merchants, and migration away from cash and cheques. Over 85% of consumers now have a debit card and more than 1 million outlets in the UK now accept payment by plastic card. Use by small businesses is also growing rapidly, both for making and accepting payment by debit card.

Figure 2: Number of payments made by each of the main payment methods



Cheque volumes have been falling at double digit rates in recent years as a result of adoption of electronic payment methods by consumers and businesses, and fewer businesses accepting payment that way. However, they remain an important payment method for some people and organisations and are a major source of income for some payees including the self-employed, charities, schools and other providers of child-related, clubs and societies. They also remain widely-used for payments to friends, family or tradespeople.

Direct Debit use has been growing steadily with both consumer and businesses for regular payments such as utility bills, council tax, rates, subscriptions, mobile phones and settlement of credit card bills. Direct Debits were used for 66% of regular household and individual bill payments in 2011, and 25% of business-to-business payments.

The personal **credit card** market has been subdued for the last seven years. The supply of credit card credit has been constrained and, amid concerns about indebtedness and their financial prospects, consumers have been reining in their borrowing. However, value-added benefits such as interest-free periods, cashback and loyalty schemes make them an attractive product for some consumers. Use of credit and charge cards by businesses also remains subdued reflecting the economic slowdown and continued constraints on travel and entertainment budgets.

Bacs Direct Credits are well-established and used extensively by businesses and other large organisations for payments to their trade suppliers and other businesses and to individuals for purposes such as payroll. The total number of Bacs Direct Credit payments nearly doubled over the years 2003 to 2005 as a result of the Government programme to pay state benefits and state pensions that way. Total volumes have changed little for the last four years as modest growth in some areas including state benefits and supplier payments has been offset by declines in the number of payroll payments and in migration of internet and telephone banking payments to the Faster Payments Service.

Since its launch in 2008, use of the **Faster Payments** Service has grown rapidly. Alongside migration from Bacs Direct Credits and, to a much lesser extent, CHAPS, there has been market growth in several areas. Both the number of people initiating payments through internet or phone banking and the number of payments that they make have been growing. The almost instantaneous nature of the service has opened up new markets including weekly wages with businesses such as employment agencies, pay-day loans and other advances.

CHAPS payments are not presented on the chart as the number of payments is much lower than by other methods. However, as it is the system that processes high value financial transfers, it is the dominant method in value terms. CHAPS payments represented around 90% of the value of all payments in the UK last year.

The number of **cash** payments has been falling steadily but cash remains the dominant payment method in numerical terms, accounting for 55% of all of the payments in the UK last year. For over 6 million adults, cash is the method that they use for all of their day-to-day purchases, and with almost everybody it remains heavily used for low value purposes, for payments between individuals, and for payments to tradespeople and other smaller businesses and organisations. Businesses make much less use of cash as a payment method than consumers, accounting for around 1% of all cash payments last year.

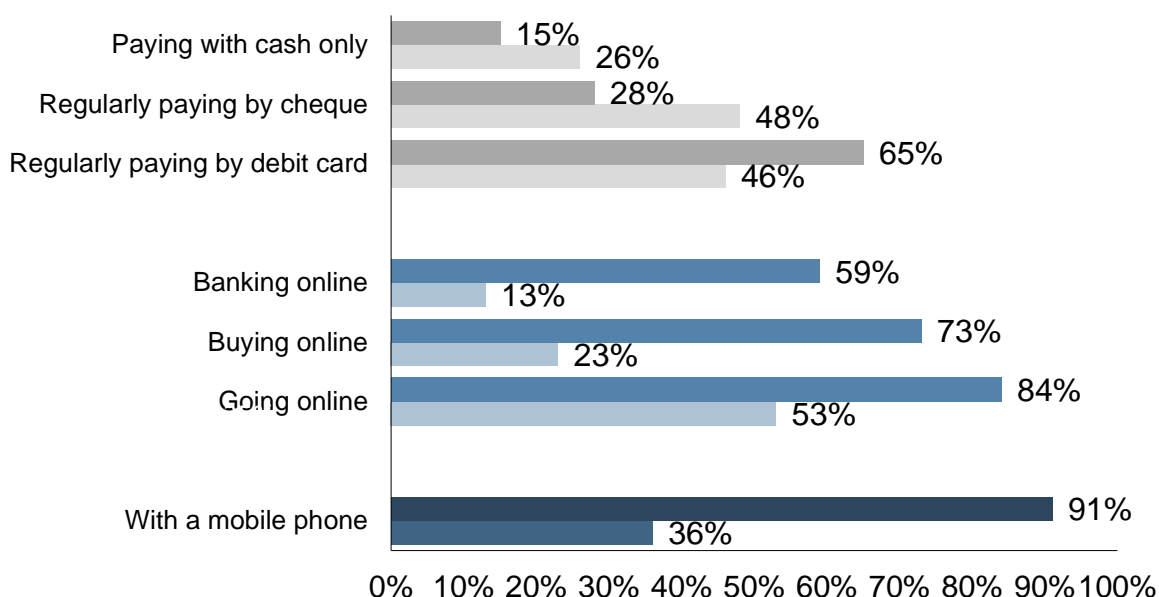
3.2 Use of different channels

Underlying the changes described above in the levels of use of different payment methods has been a major change in how customers access different channels and payment services. Reflecting the trends in the number of payments, nearly two adults in three now regularly make debit card payments (i.e. more than one payment per month on average). The numbers of people who regularly use cheques and make all of their day-to-day payments by cash have fallen over the last ten years but remain significant.

However, the most dramatic changes have been in **consumer access and use of mobile phones and the internet**. 84% of adults accessed the internet in 2011, compared with 26% in 2001 and nearly all internet connections are now broadband. Mobile phone ownership grew from around 36% of adults in 2001 to over 90% in 2011. 70% of all new mobile phones are smart phones, and more than 35% of people now have one. The switch to digital TV will be completed in 2012, multi-channel TV has become the norm and HD is growing in popularity.

We also live in an increasingly convergent world with 3G and Wi-Fi enabling internet access whilst on the move through laptops, smart phones and tablets. Last year 14 million people, or 27% of adults, accessed the internet through their mobile phone. Voice and video calls can be made over the internet and TV programmes can be viewed online. Smart TV is delivering internet services through the television.

Figure 3. How the % of people using different channels and services has changed between 2001 (lower bars) and 2011 (upper bars)



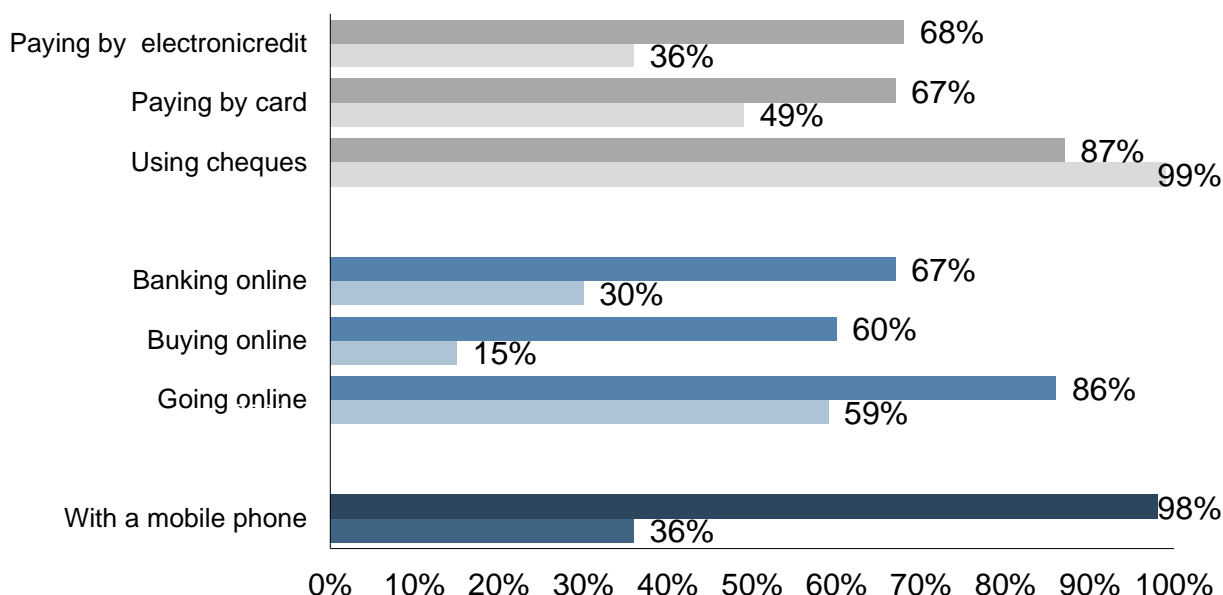
Source: Payments Council and APACS market research

Note: regular payers are those using the method once a month or more often.

The UK is Europe's leading e-commerce market and online is an essential part of the shopping experience for many people. The e-commerce market has continued to defy the overall depressed state of the economy with strong growth in most sectors in 2011. Around three adults in four now buy online, and **consumer e-commerce spending** on goods and services rose by 19% in 2011 to £76 billion. For the first time there were more than 1 billion purchases made online, with 1,075 million last year compared with 903 million in 2010.

The **business payment landscape** has also changed substantially. Nearly all firms have **mobile phones for business purposes** including 43% with a smart phone. **Use of the internet** is near-universal with medium and larger businesses, and over 8 in 10 of businesses of all sizes go online. The numbers of businesses **banking online** and **purchasing over the internet** has increased dramatically. This has also had an influence on business payment behaviour, with many more businesses now using debit or credit cards to make payments and initiating electronic credits through their online banking service. 27% of businesses accept orders and payments via the internet and over a third of business-to-business sales are now being made online.

Figure 4. How the % of businesses using different channels and services has changed between 2001 (upper bars) and 2011 (lower bars)



Source: Payments Council and APACS market research

Most businesses continue to use cheques, but for many larger organisations they will only be used for a small minority of payments such as ad hoc purchases. However, many small businesses and other organisations such as charities, clubs and societies continue to prefer to pay and be paid by cheque.

3.3 The competitive and collaborative environment

The collaborative space has seen two of the largest payment initiatives of the last decade with the changeover to **chip and PIN** and the launch of **the Faster Payment Service**. From the start of the programme in 2003 to the changeover in 2006, over 120 million debit and credit cards were upgraded to chip and PIN as were over 750,000 card terminals. Using chip and PIN is now part of everyday routine for the 42 million people who make card payments. For those customers who cannot use chip and PIN, chip and signature cards are available from their card issuer, and a campaign was launched in July 2012 by the Payments Council to raise awareness of chip and signature cards among both consumers and the industry. The Faster Payments Service was launched in 2008 and now handles virtually all inter-bank standing orders and online or phone banking payments. As discussed elsewhere in this annex, the service has opened up new payment markets and has the potential to make a substantial impact upon the payments landscape.

Competition is the major driver of change in the payments industry. Developments in e-commerce have created new demands for payments and have reduced barriers to entry enabling more players to enter the payment markets. The mobile payments arena is

currently the most dynamic part of the payment markets, both in the UK and overseas. Other new entrants have also come into the payment markets offering cash-related services and card issuance and acceptance solutions.

Some of the main examples of **internet payment service** innovation include:

- PayPal, which launched a Sterling service in 2001. Initially targeting the payment needs of buyers and sellers in online auctions, PayPal is now accepted by a growing number of internet merchants allowing them to accept card payments or transfers from PayPal accounts.
- A number of other overlay providers offer payment acceptance services to merchants and the provision of overlay payment services to specific customer groups is also expanding. The major online book sellers provide listing and payment services to small businesses. A number of commercial providers give parents the opportunity to pay for school-related goods and services through their web sites. Online charity giving is seeing rapid growth and there are emerging solutions in other areas such as subscriptions and other payments to clubs and societies.
- The Payments Council is investigating a scheme to make payments to internet merchants through internet banking. There are some overlay service providers already active in this space.

Some **mobile services** are already well-established, including the use of premium rate SMS messages to pay for goods, and the use of SMS messages or smart phone apps to initiate payment from a linked card or bank account, for instance to pay for public parking in many local authorities.

Mobile phone network operators also offer payment services to consumers and businesses enabling purchases to be made out of mobile phone accounts. These may be competitive services or there may be a co-operative element as with the PayForIt service.

A growing number of banks offer payment functionality as part of their **mobile banking** solutions. These allow transfers between bank accounts with the same bank or different banks to be initiated through the customer's mobile phone using either the browser or a downloaded app. PayPal customers can download a payment application to their mobile phone allowing them to initiate person-to-person and other payments.

In February 2012 Barclays launched its 'Pingit' mobile payment service enabling real-time person-to-person payments for registered customers. Banks and mobile operators have also worked in partnership on mobile payment solutions. In April, O2 released O2 Wallet, which allows users transfer up to £500 to another individual by text message, store their credit and debit card details for online purchases and lets customers with NFC-enabled devices make contactless payments in shops.

In a major development in mobile payments, the Payments Council is developing a central database that links mobile phone numbers to account details. This will open the possibility of making and receiving almost-instantaneous **account-to-account payments using mobile phones** without needing to know account details - regardless of who the payer and payee bank with. The database will be available before the end of 2012 as a platform for banks and building societies to build their own competitive services.

Innovation has also continued in the delivery of cash-related services. **Independent ATM Deployers** (IADs) were first allowed to become members of the LINK network in 2000. Initially providing pay-to-use machines, in recent years IADs have expanded their free-to-use estates, opening up new sites and acquiring locations previously occupied by machines owned by banks or building societies. At the point of sale, many retailers offer **bill payment and other services** such as mobile phone top-ups through PayPoint, PayZone and other providers. **Remittance services** have also expanded to meet the needs of the growing number of migrant workers in the UK.

In the card payment arena, card issuers and acquirers are now rolling out cards and terminals with **contactless functionality**. The card industry is also working with mobile phone handset manufacturers, mobile phone network operators and other stakeholders to deliver contactless payments through mobile phones. A number of card issuers have launched services. New entrants are coming in to the card acquiring market, offering innovative solutions such as **card acceptance through smart phones and other mobile devices**. These solutions aim to provide a cost-effective method of card acceptance for mobile businesses such as self-employed builders, people providing services in the home, or for businesses that handle low transaction volumes including market traders or service providers such as hairdressers.

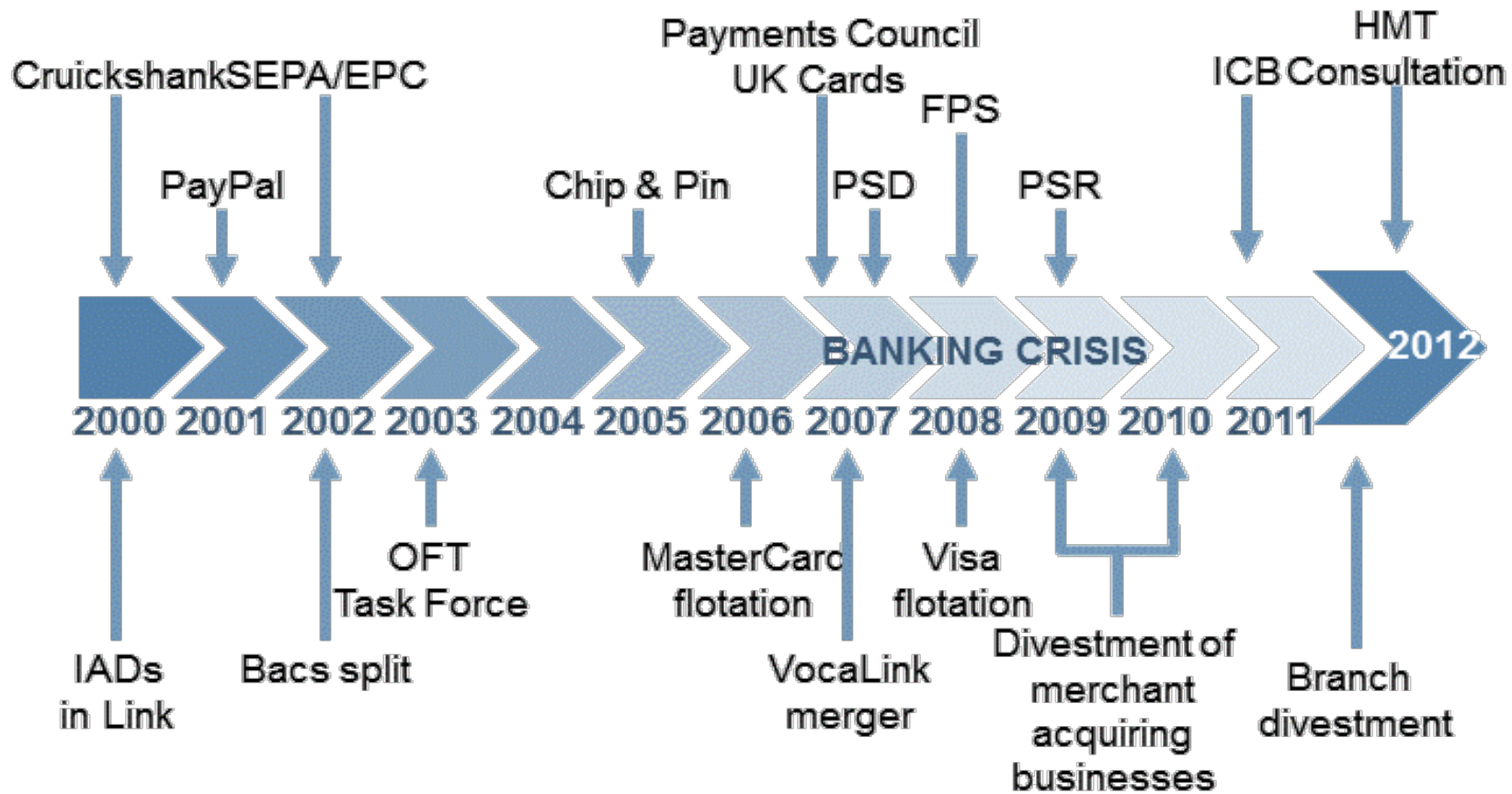
Prepaid cards are now an established niche in the payment markets. Card issuers and other players provide a range of pre-paid solutions meeting needs such as gifting, remittance, travel money and government pay-outs.

In addition to supporting a widening range of channels and infrastructures, the industry has also faced the issues arising from **new banking groups** formed, and **divestments** made. With the formation of new groups, disparate payment systems have to be integrated whilst maintaining continuity of service and a consistent customer proposition. Divestments present similar challenges for the banks selling parts of their business, and the businesses that are spun off may become new entrants to the payment markets or have to be absorbed within existing businesses. There has also been significant change in the nature of the payments schemes and in the companies delivering the main payment systems infrastructures. Some of the key developments of the last ten years include (see figure 5 for a timeline):

- The flotation of MasterCard in 2006 and of Visa Inc in 2008, although Visa Europe remains a membership organisation which partners with Visa Inc to enable global Visa payments.

- The creation of Lloyds Banking Group in 2008 in response to the banking crisis.
- The merger of the Voca and LINK infrastructure companies in 2007.
- The divestment of their merchant acquiring businesses by HSBC and Royal Bank of Scotland in 2009 and 2010 respectively.
- The sale of branches by Royal Bank of Scotland to Santander and by Lloyds Banking Group to The Co-operative Bank.

Figure 5. Timeline of Selected Major Industry Milestones



3.4 The regulatory environment

Alongside competitive pressures and co-operative initiatives, regulation and regulatory pressures have impacted upon the structure of the industry and on the products which individual payment service providers offer to their customers. The Payments Council operates in a multi-layered regulatory environment, working with parliament, government and regulators in the UK, the EU and worldwide.

Some of the notable regulatory milestones include (see Figure 5 for a timeline):

- The Cruickshank review published in 2000, which led to the establishment of the OFT Payment Systems Task Force in 2003.
- The industry response to the review, which led to the splitting of the Bacs system into a scheme company and an infrastructure company (Voca) in 2002.
- The work of the Task Force leading to the creation of the Payments Council in 2007.
- The launch of the Single Euro Payment Area (SEPA) programme and the creation of the European Payments Council in 2003 to support and promote its realisation through the development of SEPA payment schemes and frameworks.
- The Payment Services Directive (PSD) of 2007 which lead to the Payment Service Regulations (PSR) coming into force in the UK from 2009.
- The creation of The UK Cards Association in 2009, together with the winding down of APACS as the payment industry's trade body
- The Independent Commission on Banking, which reported in 2012 and has led to the Payments Council initiative to introduce a new account switching service to go live in 2013.
- The 2012 HMT consultation on strategy in payments.

There is also continuing regulatory scrutiny of the card industry at both domestic and European levels. From a European perspective, key developments include the continuing scrutiny of interchange rates and those arising from the Payment Services Directive and the Consumer Credit Directive. In the UK, alongside a number of other regulatory initiatives such as the OFT investigations into default fees and PPI on credit cards, the credit card industry reached a settlement with the Department for Business, Innovation, and Skills in March 2010 arising from its consultation into the sector.

3.5 Integrity, Fraud and Security

Customers depend on, and need to be confident in, the smooth functioning of the payment systems and in their resilience, reliability and security. Maintaining and enhancing the integrity of the UK payment systems is a critical responsibility of the

payments industry. The factors which threaten this reliability or security need to be understood and monitored, and checks and controls introduced to eliminate risk and prevent disruptions. The focus of the work of the Payments Council has included:

- **Business continuity.** Payment systems needing to continue to operate in the face of major shocks such as a terrorist attack or a pandemic is crucial. Having robust and properly tested codes of conduct and plans to deal with such shocks which have been tested is crucial. This work involves the Payments Council working together with the authorities and the broader financial community in the UK and internationally. As part of this activity, there is a bi-annual Payments Council contingency exercise.
- **Fraud and security.** The fraud and security landscape is constantly changing as criminals continue to develop and employ new and advanced methods to attack payment service providers and their customers. These threats need to be pro-actively identified and managed, with concerted action and investment in counter-measures both at industry level and by individual institutions. This is a multi-stakeholder environment, and the Payments Council works alongside law enforcement, other industry groups, technology providers, consumer and business groups and other organisations.
- **Settlement risk control.** Robust legal, financial and operational mechanisms need to be in place to manage and to reduce the impact if a direct participant fails to settle what it owes to other participants of a payment system.
- **Payment scheme integrity.** Work has included addressing the issues identified by the Bank of England and other financial authorities on cross scheme integrity. This has included running several ‘scenario exercises’ to test and rehearse actions required for situations that would put stress on the payment, and consideration of the options available to Schemes to route transactions through another scheme in the event of an incident that impacts their ability to operate normally. Other areas of activity have included reviewing the scheme contingency arrangements.
- **Standards and interoperability.** Using international standards for payments enable processes to be streamlined, reducing the risk of manual errors. The benefits of standardisation also include simplified entry criteria for new participants and improved resilience and integrity. They also sets the foundation for tomorrow's payment systems which have to be European or global in their reach. The Payments Council plays an active role in the work of the main national and international standards bodies in developing new global/European standards relevant to the banking and payments industry. In this it works alongside industry trade bodies, the scheme companies and other corporate representative bodies.
- **Audit.** Risk controls are of practical value only if their everyday use is regularly checked and procedures are monitored and improved on a regular basis. The Payments Council provides independent assurance to ensure that payment systems’ controls are in place and operating effectively.

4 EMERGING ISSUES

4.1 The technological environment

Technology is a major driver of change in the payment industry. It can create whole new markets for goods and services and hence for the payment services needed to purchase those items, and influences the demands that consumers and businesses place on existing payment services. Technological change can also reduce barriers to entry and enable new business models to emerge.

It is always unwise to make specific predictions about the change that technology will usually bring about. Eight years ago Facebook had only just been launched with an initial target market of students and MySpace was the leading social networking site. Twitter wasn't launched until 2006. However, some general trends can be identified that are likely to shape the technological environment over the next few years:

- **Networks** will become faster and more accessible. Broadband speeds will continue to grow with superfast broadband supplanting current service levels. The licences for the radio spectrums to support 4G mobile services will be auctioned in early 2013 and 5G could make its appearance later in the decade. Public access and other commercial wi-fi services are spreading rapidly.
- **Devices** will become more powerful and have greater functionality. Economies of scale will also be achieved through developments such as cloud computing.
- There will be greater **convergence** of devices and networks. Most networks will be accessible through most types of device. This will increasingly reach into the physical environment, including within the home, the office and retail locations. For instance, as discussed below, payments at the point of sale in retailers will increasingly be made through mobile phones, potentially bypassing the existing systems.
- More **interactivity**. For individuals and businesses the boundaries between what they do for themselves and what they are prepared to share or outsource will continue to change. Businesses, including payment service providers, will look to capitalise on the culture change that has been introduced by social media.
- No '**down-time**'. Networks and devices are always on and consumers and businesses will increasingly want to access all services, including payment services, as and when they may need them and to be in receipt of up-to-date information on their transactions and consumption of these services.
- The services delivered will become **smarter and more personalised**. In the payment space this includes e-wallets, as discussed below.
- Greater **usability** and **security**. For instance, we may see the emergence of robust security solutions based around the use of **biometrics**.

Against this backdrop, the Payments Council needs to ensure that payment systems continue to meet the needs of all users and that the integrity of the payment systems is

maintained, and that its policies for innovation and inclusion are followed. This means that, inter alia:

- The industry environment is one which is **supportive of innovation**, both in the delivery of new payment services and the enhancement of existing services. For instance, in ensuring that barriers to entry are kept at a minimum, consistent with maintaining integrity.
- **Integrity and fraud** risks are understood and that appropriate measures to address these risks are introduced at as early a stage as possible in the design stage for innovations.
- An **inclusive** approach is taken to the design of any innovation. As with any measure to guard against fraud, inclusivity needs to be a principle adopted throughout the design and implementation of innovations.
- The continued **efficiency** of processing by existing payment systems is addressed, often in the light of slow growth or falling volumes. This ensures that potential diseconomies of scale do not disadvantage the users of those systems.
- Customers are **informed** about the payment choices available to them and the pros and cons of each.

4.2 Payment innovations

This section describes some of the main payment innovations under development or investigation at the industry level by the Payments Council and other industry bodies, as well as in the competitive space.

Contactless Card Payments

There is already a strong trend for low value cash transactions to migrate from cash to debit cards, and this will be enhanced by the use of cards with contactless NFC (Near Field Communications) technology. The pace of change with the issuance and acceptance of contactless cards is picking up. By the end of 2012, travellers will be able to pay by contactless credit or debit card for fixed fare journeys on the bus network in London and Transport for London will follow this up in 2013 by opening up the underground and rail network for contactless payments. This may encourage regular use and grow confidence in the technology, and may fuel demand for wider acceptance. Transport solutions are likely to be increasingly adopted in other parts of the country, such as the current service to pay tolls using contactless cards on the M6 toll road. The Olympics in 2012 provided an opportunity to showcase contactless payments to a wide audience. Alongside coffee shops and other fast food outlets, adoption is spreading in other sectors including chemists, supermarkets, transport, parking, and vending machines. The increase in the maximum value limit for a contactless transaction to £20 in June 2012 has increased the attractiveness of the technology to some retailers.

Contactless card rollout is the opening phase of a wider rollout of contactless payment solutions including mobile NFC. Smartphone ownership is growing rapidly and many of

the next generation of phones will be usable for contactless transactions. NFC mobile payments will make use of the expanding contactless acceptance technology at the point-of-sale. The capability also exists to support higher value PIN-based payments through mobile phones. Retailers will therefore be able to accept all chip & PIN card transactions, contactless card transactions (up to the value limit) and mobile transactions (up to the value without PIN, higher values with PIN).

Mobile Payments

Mobile payments come in many forms and involve a wide range of players including banks and other payment service providers, card schemes, mobile network operators and mobile handset manufacturers. Innovation is happening at a rapid pace and for many of the new generation of consumers beginning to enter the market, mobile devices may become their preferred way to make payments. Within the next ten years, we may see significant numbers of people who leave home with just their mobile phone and do not carry cards or cash, in the same way that many people no longer take their cheque book with them.

The Payments Council Board has recently agreed to a substantial investment into the next stage of developing a central mobile payments mechanism, which means that customers will be able to start using the system by the end of 2013. This approval to move to the full implementation of a pan-industry mobile payments hub, will enable customers to make account to account transfers using their mobile phone regardless of with whom they bank.

Looking beyond account-to-account mobile payments, the Payments Council will also develop a clear mobile payments strategy to bring together our current work on mobile payments with the wider landscape and any future work on mobile contactless or other mobile payment initiatives.

Other mobile payment services will continue to evolve rapidly:

- A number of solutions have been launched or are in development for the UK market providing **card acceptance services** as an alternative to a traditional card terminal.
- The experience in other countries is that mobile payments can work best when combined in an **e-wallet** with other applications such as electronic vouchers, tickets, loyalty schemes or direct marketing. Three of the major mobile network operators in the UK have announced a joint venture to develop the technology to enable the rapid adoption of mobile e-wallets and payments, to allow these sorts of services to be integrated within the mobile phone and delivered to UK consumers.
- Applications which bypass the need for consumers to make a payment at the point-of-sale have also been launched by several merchants such as Pizza Express. Product details and prices are sent directly to the customers' mobile

phone with payment made through that channel. These may be combined with other services such as product selection to enhance convenience and choice for the customer.

Online payments

The Payments Council is investigating the introduction of a scheme to make payments to internet retailers. When choosing to pay this way at a participating internet retailer, customers would be redirected to their own bank's internet banking site. They would then authorise payment to the retailer, with all of the payment details pre-populated. The retailer would receive the payment through the Faster Payments Service and may also be sent a separate real-time notification that the payment has been initiated, to enable them to release the goods or services being purchased. Initial assessments of the security implications and of the potential market have been carried out. The next steps will include assessing the feasibility of potential solutions and confirming the business case, to enable a decision on whether or not to implement a service to be taken.

Similar schemes have been launched in several countries and have captured a substantial share of online payments in some markets. These include Germany and the Netherlands, although these two markets are very different to the UK in that credit card holding is much lower and debit cards cannot be used online.

Information alongside payment

The payment transaction is often only part of a wider process. For instance, businesses need to reconcile payments received against invoices or bills sent to their customers. Providing accurate reference information along with the payment can streamline the reconciliation process and make it more efficient. The Payments Council has been working to understand where the main problems lie, how big they are and to assess potential measures which could improve the accuracy of reference information. As a result, best practice guidelines for billers and payers have been developed to help limit the likelihood of payers entering wrong reference information. There are also some measures banks can adopt to help reduce the frequency of errors. The Payments Council is also actively involved in the work of the European commission's Multi-Stakeholder Forum on E-Invoicing.

Government can also benefit from receipt of timely information to improve the services it provides to consumers, and HMRC is introducing Real Time Information (RTI) to collect information about tax and other deductions alongside salary payments to improve the operation of the PAYE system. It will make the PAYE system easier for employers and HM Revenue & Customs (HMRC) to operate, and employees will receive information more quickly. It will also help support the introduction of Universal Credits.

The industry via Bacs is trialling, with HMRC, a solution for RTI. The term 'strategic RTI' is used to refer to the longer term evolution of RTI. In this strategically focused work the Payments Council will work with central Government (DWP and HMRC) to analyse their

needs as one of the largest volume users of the UK payments infrastructure, to identify opportunities to facilitate the delivery of the Universal Credit Programme through reuse of payments industry expertise and infrastructure.

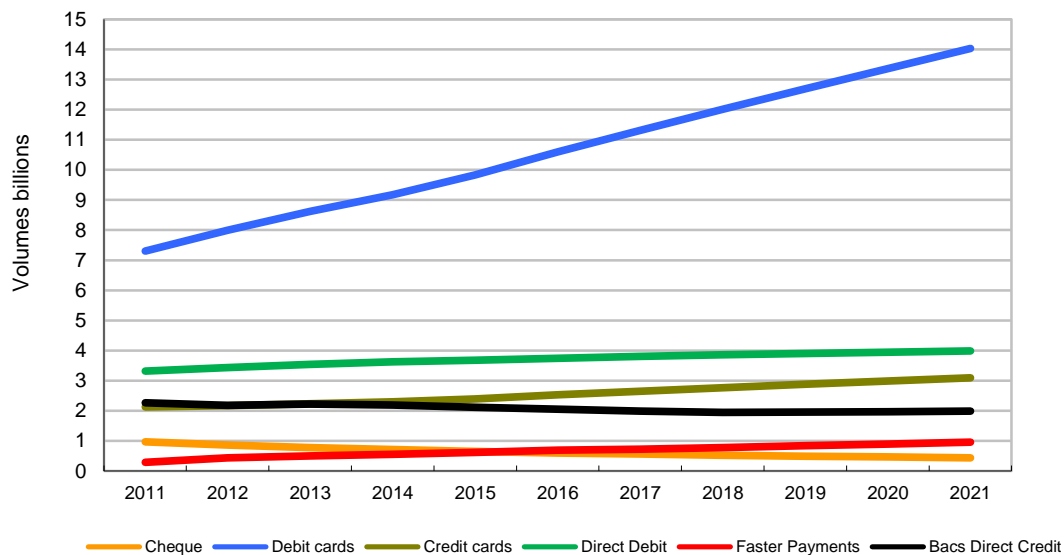
Other National Payments Plan Innovations

Within the Payments Council's National Payments Plan, innovation is one of the main areas of activity and includes several of the initiatives already discussed in this section. Other innovation-related activities include:

- **Electronic multiple authorisation.** From the end of 2013, customers that need to have more than one person authorise a payment will have an option available to them to authorise those payments electronically. This facility will be offered as an alternative for customers who have multiple signatory cheque books on their account, such small businesses, charities, clubs and societies.
- **Reducing the likelihood of sending an electronic payment to the wrong account.** Work has focused on understanding the size and nature of this issue, through talking to large corporates, the electronic payment schemes and organisations like the Financial Ombudsman Service that help customers deal with payments that go wrong. Further work will be conducted to investigate potential solutions to address the issues identified.
- **A new 'pull' payments scheme.** Work is underway to investigate the potential for a new pull payments scheme that would enable payers to authorise pull payments on an individual basis, for business-to-business or consumer-to-business payments.
- **Delegating payments.** Work will begin on investigating options to allow people to delegate limited payment authority to other individuals, for instance a carer who does the shopping for a housebound person. There may also be needs for delegating payments with small businesses, charities and other voluntary organisations.

4.3 Payment Market Forecasts

Figure 6. Payments Council forecasts for the number of payments made by each method



Each year the Payments Council updates its forecasts for the UK payments markets. These forecasts are based upon the existing trends in the use of different methods by individuals and businesses. They also incorporate scenarios for the impact of innovations which are in the process of being, or will be, brought to market such as contactless cards and mobile account-to-account payments, and for structural change such as the introduction of Universal Credits. The main forecasts are set out in Figure 6.

The total number of **debit card** payments is projected to grow to 14.0 billion in 2021. Consumer use will be boosted by generational preferences, by expansion in the self-service sector and in card acceptance by smaller organisations, and by continued growth in e-commerce. The strong trend away from cash to debit cards for low value payments will be strengthened by wider issuance and acceptance of cards with contactless technology and the use of mobile phones as a form factor for card payments. Small- and medium-sized enterprises' use of debit cards has been growing strongly and that trend is expected to continue. In a notable development, in 2012 debit cards are expected to be used for more payments than cash.

Significant growth in **credit card** holding and in the demand for credit card credit may not return to the market until the economic recovery is well-established, consumer confidence picks up to pre-recession levels and issuers' risk appetites increase. Growth in business credit and charge cards is unlikely while the economy remains subdued. In the short to medium-term, 'transactors' who use their cards for the loyalty or other rewards will continue to be an important source of growth in credit card use

Personal **cheque** use is expected to fall as the current demographic trends and migration to alternative payment methods continue. Business cheque use will also decline as

organisations switch the payments that they make from cheques to more efficient methods or encourage their customers to use electronic methods. The rate of decline in cheque volumes is expected to slow as use becomes concentrated into those areas where other methods are not as widely available, such as payments to small businesses or charities, and with those users who prefer to make or receive payments that way. Over the next ten years total cheque volumes are forecast to fall from 970 million in 2011 to 444 million in 2021.

It is forecast that **Direct Debit** volumes will grow steadily to 4.0 billion in 2021, when they will be used for 71% of household and individual bill payments and 33% of business-to-business payments. Alongside increasing penetration in established sectors, more rapid growth is expected in a number of areas including the settlement of credit card bills, monthly mobile phone subscriptions and funding of accounts with internet merchants and payment service providers.

Bacs Direct Credit volumes are expected to decline in 2012 due to further migration of transactions to the Faster Payments Service. Looking further out, the number of payments made for state benefits will be reduced by around 300 million per annum by 2018, primarily as a result of the introduction of Universal Credits. Changes to the state pension age and other policy changes such as the restrictions on eligibility for child benefit will put further downwards pressure on volumes. Payroll volumes are expected to pick up as the economy recovery becomes more solid and full-time employment grows. There will also be steady underlying growth in other areas such as dividend and supplier payments. On this basis, it is forecast that the total volume of Bacs Direct Credits will be 2.0 billion in 2021.

Faster Payments are expected to see the strongest growth of any of the main payment methods over the next ten years, with volumes nearing 1 billion in 2021. Awareness and confidence in the level of service that consumers and businesses can expect with internet and telephone banking payments should grow now that there is near-universal reach for the service and fixed processing timescales. This will promote further growth in payment volumes displacing payments by other methods and growing the overall market. Consumers and businesses are also likely to take greater advantage of the near-real-time functionality of Faster Payments, for instance for urgent payments or where this may give a business competitive advantage. Payments Council members are to introduce alternative multiple authorisation capability for their small business and charity customers by the end of 2013, which should boost use of automated payments by these organisations. Finally, mobile payments are expected to be a major source of volumes and the service is one of the payment options for providers using the Payments Council's mobile payments database to deliver mobile payments to their customers.

The share of all payments made by **cash** has been shrinking slowly year on year as consumers and business adopt electronic payment methods. This trend is expected to continue and it is forecast that the number of cash payments will decline to 13.7 billion in 2021.

CHAPS volumes will be boosted slightly in the short term by planned expansion of direct CHAPS membership. Into the longer term, migration to the Faster Payments Service will erode CHAPS growth, though the pace of this change is not expected to outstrip organic growth in the remaining volumes from economic and financial recovery. CHAPS volumes are expected to be 43 million in 2021, compared with 34 million last year.

The forecasts presented above are based on a conservative set of assumptions and there are a number of **disruptive scenarios** in which the payment market in ten years' time is quite different. These could include:

- Much greater use of **real-time account-to-account transfers**. The Faster Payments Service allows funds to be moved between accounts almost instantaneously. Mobile devices provide a means by which these payments can be initiated in any location and through which payees can provide the information needed to make that payment such as pricing and reference data. In addition to person-to-person and online payments, these services have the potential to provide a cost-effective alternative to cash and debit cards at the point-of-sale.
- Much greater use of **digital currencies**, which may allow payments to be made outside of the main payment systems and potentially at much lower cost. One example is that of Bitcoin, a peer-to-peer digital currency. Bitcoin is in effect a virtual version of gold – it is not dependent upon conventional payment systems, can be 'mined' and the total supply is fixed – but is much more efficient as a medium of exchange. Bitcoin can be arbitrarily sub-divided, and can be exchanged between buyers and sellers over the internet for an economic cost of less than one tenth of a penny per transaction. The levels of use of such currencies will depend critically upon whether buyers and sellers have confidence in their integrity and that they will not lose their value relative to conventional currencies.
- A much greater role for **OTT payment services**. A number of OTT players have developed strong and trusted brand identities. As the volume of payments that they process grows they will benefit from economies of scale and lower unit costs for their customers. As a result, the use of these services may grow very rapidly. In this scenario the traditional providers of payment services may be increasingly relegated to a 'wholesale' role of moving funds into and out of accounts with the OTT players, and with a much diminished relationship with their personal and business customers.

ANNEX 4

OVERVIEW OF THE PAYMENTS ROADMAP

What is The Payments Roadmap?

The Payments Council Board has agreed to the development of a new strategic document called the Payments Roadmap. The Payments Roadmap will be a regularly refreshed document that will describe the future form of the UK payments industry viewed over a rolling two, five and ten year time horizon, providing a view of how the payments industry, and its underpinning infrastructure and policies, should develop over those time-frames. It will offer:

- a compelling vision of the payments industry;
- clarity for customers, suppliers and the wider industry about what will be delivered;
- a strategy with tangible and continuing results; and
- confidence for customers and the payments industry in future investments and decisions.

Why is a Roadmap needed?

Currently there is no vehicle for systematically and comprehensively analysing fundamental UK payment issues, services and infrastructure; assessing priorities and initiating actions. The customer (both corporate and individual) and industry need clarity about what the future provision of a secure, efficient and leading edge payments service should look like.

Each of the current schemes works well in its own right. Each is designed to safely process a payment instruction or group of instructions, and each new scheme or system has to fit the needs of all parties involved and be able to be plugged into the current settlement infrastructure.

However, they have been designed in isolation, at different times in the development of the banking system, rather like four or five separate rail networks, where the start point and the destination (the payer and the payee) are the same, and the mid-point of the journey (a reserve account held at the Bank of England), is the same, and everything else is different. This is not surprising nor to be criticised, as each is the result of a specific need at a time in the past. However, it means that industry-wide initiatives are difficult to consider, co-ordinate and deliver. Furthermore, the older schemes or systems have challenges when considering re-design options that address current industry trends or customer needs.

These issues become amplified when taking a longer term view of future trends and evolution. The schemes and payments systems do not have a strategic framework within which they should fit.

Also, the pressures from customers, increasing demands for improvements in service levels and cost, may be better met by shared cost and re-use of major technology platforms in financial institutions and in the infrastructures.

Thus there is a requirement for a common plan or vision, which reflects those broader needs, to guide development of the payments industry over the next ten years. This plan manifests itself in the Roadmap.

The very nature of the investment cycle, scale and degree of interconnectedness of payments infrastructures means that most change will have to be incremental; the opportunity for substantial “big bang” change will be limited. Change should be a way of life in the payments industry and although the UK industry has introduced much, the process must be faster, cheaper and deliver more customer benefit.

Therefore a Roadmap is the best way of achieving such change because:

- it allows for co-ordination across payment systems, instruments and infrastructures;
- enables incremental change in the systems, instruments and infrastructures;
- major change can be planned to be consistent and co-ordinated; and
- planning certainty rather than planning blight can become order of the day.

The Roadmap objectives and vision

The Roadmap will analyse and present answers to a series of fundamental questions about the shape and form of payments services in the UK; in particular it will address 4 high level questions:

- Viewed as a collective, what will the payments industry, including new and prospective providers and schemes, deliver to customers and provide for the economy now and in the future?
- What services are provided on a collaborative basis and how will these services and supporting infrastructures change over time?
- What services and infrastructure could additionally be provided on a collaborative basis? What are the pros and cons of such and when will decisions be made about the collaborative provision to be put in place?
- What are the views and policies of the Payments Council that touch on services provided in the competitive space which are material to the shape and form of the industry?

The vision of the Roadmap is broad. It will take into account the interests of customers, payment service providers, public policy makers and financial regulators alike. Given that the payment and clearing systems and their infrastructures cannot be changed either easily or quickly, the Roadmap will be long-term and comprehensive. The Roadmap will be used to support investment decisions that affect collaboratively sourced and operated infrastructure, as well as policies that define the collaborative and competitive domains.

What will it achieve?

The deliverables of the Payments Roadmap will be agreed following consultation with the Payments Council Board, HM Treasury, the Bank of England, the Financial Services Authority and other stakeholders. The Roadmap will specify clear checkpoints and deliverables that will enable decisions to be made and investment to be undertaken. These results will be evident for all stakeholders to see and will drive nationwide improvements in payments services. The possible benefits could include:

- the ability to combine additional services and data with core payments services through the provision of a simple re-usable model for clearing, netting and settlement services;
- increased and vibrant competition between current and future providers;
- payment services centred on the customer; and
- services and infrastructure design that better addresses the systemic risk of bank failure.

ANNEX 5

THE NATIONAL PAYMENTS PLAN

The National Payments Plan is an ambitious portfolio of projects and actions, developed following a public consultation, stakeholder engagement, market research and direct engagement with the public. First published in 2008, the Plan was refreshed in 2011. It is set around our three key themes of innovation, inclusion and integrity. Many activities in the Plan are exploratory, designed to help us understand more about an issue and consider how we can address it; whilst others have clear deliverables that we're working towards.

We recently published an update on our progress with the Plan, which is available on our website: http://www.paymentscouncil.org.uk/files/august_npp_newsletter_v4.pdf

Examples of actions in the 2011 Plan that we are currently working on include:

Payments to the wrong account

Work is underway to review the extent to which there are problems around sending electronic payments to the wrong account in error. Our aim is to identify solutions that will reduce the risk of payments being made to the wrong account and to improve the process for customers when a payment does go wrong.

Chip and signature

Chip and signature is an alternative for people unable to use a PIN. Research shows, however, that many people who could benefit from using a chip and signature card are not aware that they exist or have experienced difficulty using them at retailers. To counteract this, the National Payments Plan has implemented a targeted awareness campaign is underway to ensure that bank staff know how to offer them to customers, retailers know how to accept them and that those consumers that may need a chip and signature card, know that they exist.

To inform our campaign, we conducted focus group research with consumers and a mystery shop with bank staff and retailers. We have been working closely with a wide range of organisations such as the RNIB and the Alzheimer's Society to help us disseminate our message to those consumers that may find a chip and signature card a useful and necessary alternative to using PINs. A leaflet for consumers has been developed and over 200,000 copies distributed to organisations working with consumers. We've also had a great response to our media activity on this, with articles in a wide range of regional press and radio, as well as national items.

Electronic multiple authorisation

From the end of 2013, customers that need to have more than one person authorise a payment will have an option available to them to make those payments electronically.

This facility will be offered as an additional way to pay for customers who have dual signatory cheque books on their account, such as charities, clubs and societies. Although some organisations and businesses can already make multiple-authorized payments electronically, Payments Council members are working to change their systems to offer this facility more widely as part of the National Payments Plan.

Access to cash

A broad ranging and comprehensive review of access to cash is now underway. This aims to assess the current situation for consumers and businesses and to identify what actions, if any, are required to improve access and enhance inclusion where cash is not readily available.

As a first step, we have been talking to a range of organisations representing consumers and businesses and reviewing existing market research available. New qualitative and quantitative market research has been commissioned to support the review.

Research with people aged 80 and older and disabled people of all ages

The Payments Council has a wealth of research on consumer and business use of payments. However, we know there are some groups of consumers that are less well covered in our existing research, including people with cognitive, sensory and physical disabilities and people aged 80 and over. As a result, new research has recently been completed that is designed to help us understand more about the use and experience of older and disabled people using payment services, as well as their perceptions and attitudes to payment services more broadly. Our focus is on how barriers can be removed and where different choices could help people overcome the obstacles they are experiencing. We intend to use the findings to identify potential actions to enhance payment services for these consumers.

To help shape our approach to this work, we have set up a special advisory group with representatives from consumer organisations representing older and disabled people. The Advisory Group is chaired by one of the Payments Council Independent Directors, Stephen Locke. We will publish the findings later in the autumn.

Minimum standards on customer authentication

A special group has been set up with representatives from the banking industry to review the requirement for standards on how customers authenticate themselves when making internet and telephone banking payments. The group is discussing what level of change is needed and considering how our work will fit with other regulatory change that may be happening at a European level. Input has also been sought from our consumer, business and charity forums to consider what users need. Our aim is to have reached a conclusion on what is needed by the end of 2012.