

HM Treasury Consultation on Setting the Strategy for UK Payments

Response 9th October 2012

I write as the former CEO of LINK Interchange Network Ltd having (with others) founded the company in the 1980s. I remained as Chief Executive until my retirement in 2007 and have maintained contact with the payments industry in an advisory role since then. I thus have considerable experience of the industry and of dealing with banks collectively.

The Payments Council (and APACS before it) are and were not good at innovation for structural reasons. This is not to suggest that the banks individually or collectively are acting unreasonably or anti-competitively. On the contrary, they are acting rationally in the circumstances in which they find themselves, looking to maximise their advantage within the framework of the payments systems which they, the banks, largely own and control. In effect the banks are both owners and customers of the payment systems and commonly, for example, set prices. The banks view the payment systems as subsets of their activities and seek to control them to meet the interests of individual banks. An alternative is that the payments systems are viewed as a superset providing the framework within which the banks compete and where the banks collectively have less overall control.

Question 1

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

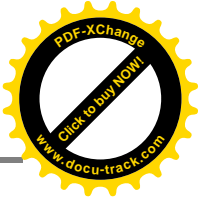
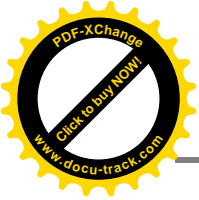
- should be the lead option for reform;
- provides the appropriate balance between Government intervention, impact and cost; and
- effectively tackles the issues the Government has set out?

Yes. This is the best option available but will need to be carefully implemented taking into account the points made below.

- *The PSB should develop and lay out a strategy and then pass action to the Payments Council to implement within a reasonable time or to provide comprehensive explanations for not doing so: a system of sanctions may need to be operated to prevent the PC blocking developments whilst allowing individual banks to opt out*
- *The current veto which may be operated by the independent members of the Payments Council is essentially negative – it prevents the banks doing something the independent members disapprove of but it doesn't encourage the banks to innovate: a super vote by all or a majority of independent or non bank directors requiring industry level action could provide a more useful structure. Funding of partially approved developments would be by those institutions approving and ideally payment systems companies should be able to develop services speculatively.*
- *A mechanism needs to be developed to pay for the operation of the PSB so that funding is wider than the banks*

The major structural issues of the current Payments Council are:

- *The payments systems would almost certainly innovate at a greater speed if free to do so. Logically the payment systems provide the framework in which the banks operate but the banks regard the payment systems as a subset of their operations and some banks will inevitably see some innovations as a potential threat. A more rational framework would be for the payment systems to be a superset of bank operations providing a framework environment in which the banks can compete. This would provide the foundation for*



competition and much less operating by consensus which currently means innovation at the rate of the slowest.

- *Such a structure would be possible if the payments systems companies had separate innovation arms externally funded but benefitting the core payments companies by using their central systems. This would go some way to reducing core systems costs by increasing scale (which is probably the most important single factor in determining costs) and also provide a mechanism for innovation funding which does not necessarily include banks.*

Please provide evidence where appropriate to support your answer.

Question 2

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

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

The current remit of the Payments Council should be split between the PC and a Payments Strategy Board with the PSB acting as the legislature in defining developments which are in the overall interests of the country and setting these out for the PC, and possibly other bodies, to implement. However, it is important that the PC also ceases to operate only on the basis of consensus and this could be achieved to a degree by extending membership of the PC to include payment systems and operating on the basis of a majority vote rather than the current default mode of consensus.

Ideally votes at the PC should be binding but not compelling, i.e. banks opposing a majority decision should not be able to inhibit progress but equally not be compelled to join in or pay towards such a development.

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

The boards of the PSB and the PC should be separate and distinct with the PSB having a majority of non bank directors. The support functions should also be separate for each organisation. However, knowledge of payments systems is highly specialist and possession of the appropriate knowledge and skills is essential

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

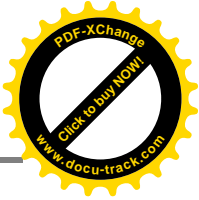
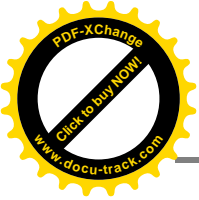
Yes

- 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.

The exercise of a veto by two independent directors is essentially a negative option: it stops the PC doing things which are not in the interests of the community but it doesn't promote innovation. Perhaps an alternative would be to give three or four of the independent directors the power to require the PC to take action in a form of super vote? It would also be useful if the membership of the PC was significantly broader although it may then become a danger that organisations which are not paying for developments still require them to be implemented. The structure, membership and terms of reference are therefore very important.

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

Yes: converting the forums to Independent User Councils would be a good idea. The support staff would ideally be from the PSB and thus independent of the PC.



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

Ideally the Payments Council and the Payments Strategy Board should have access to some degree of non bank funding, perhaps partially from payment systems companies or perhaps by a small payment transaction tax. Funding by the industry inevitably leads to perception of control by the industry.

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

I believe it should be the role of the PSB to require the PC to take action and that the PC should be compelled to allow developments desired by a majority and possibly a minority of members rather than operate on the basis of consensus as at present. Proposals for the funding of such developments will be needed.

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

Membership of the PC could be extended to payments systems companies but this may be ineffective so long as the banks control such companies

Question 3

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

Yes

- 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.

The default methodology of the PSB should be to recommend actions to the Payments Council but with the option of reverting to mandating action in the event of inaction by the Payments Council in the absence of a reasoned explanation.

- 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 PSB should be much broader in composition than the Payments Council. Clearly the banks will need to be represented but they should be in a minority. The Board should include currently serving payment executives and, in order to avoid bank control, perhaps retired and thus independent knowledgeable executives, users and consumer association people

- 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?

Yes: the PSB needs a strong support function operating at a high level. Ideally the support function should be able to observe and analyse developments in payments systems and the digital economy generally with a broad geographical reach to other parts of the world as well as the UK and to recommend the most appropriate developments. Cooperation with European institutions is also highly desirable

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

It is difficult to see another funding solution unless the Treasury agrees to fund the PSB. But industry funding via a levy may imply some degree of control. Some modest form of payment transaction levy may provide an answer.

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

Probably not other than a formal review to ensure the defined objectives are met.

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22nd September 2012

HM Treasury, Setting the Strategy for UK Payments.

Dear Sir,

I am pleased to include below my response to the above consultation.

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?

Yes to the three bullet points in this question. I am happy to go along with Option 2 in principle. Setting up a new organisation seems appropriate, so that a fresh start can be made.

The Payments Council in its existing form has shown itself (as regards the issue of scrapping cheques) to be (i) out of touch with consumers and (ii) unresponsive to the concerns of consumers. As paragraph 4.27 states "... the current model of self-regulation has not adequately delivered the leadership and strategic direction needed to meet the current and future challenges that the payments industry faces."

Option 1 refers to making the Payments Council more responsive to consumers, which is desirable. However, it is still open to question if the new approach (contained in Option 1) would be able to inspire confidence.

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?

Yes.

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

Of the two alternatives outlined in paragraph 5.4 I prefer the approach that removes any trade body or lobbying functions from the work of the Payments Council. This approach is likely to be more effective than the alternative of clearer functional separation of roles / reporting lines / accountability within the Payments 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.

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.

This is a step in the right direction, but the Board would still seem to be too heavily weighted in favour of the industry-appointed members. I would reduce the number of 11 industry-appointed voting Board members from 11 to 7.

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

Yes.

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

The Payments Council could be funded by a Financial Conduct Authority levy on the payments industry.

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

It could be argued that enforcing decisions in a self-regulatory environment is likely to be difficult. This strengthens the case for a regulatory approach.

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

Two new voting board members could be appointed to represent consumer groups. Also, see my response above to Question 2d.

Question 3

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

Yes.

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.

Initially the approach should be via recommendation. However, the Payments Strategy Board should have reserve powers that can later be used to require specific action. If there is no prospect of specific action in the wings there is the risk that the Payments Strategy Board could lack cutting edge.

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?

I agree that the Payments Strategy Board should include senior industry representatives, non industry representatives and independents. Regarding the composition of the Board I consider that senior industry representatives need to be in the majority. I suggest that the composition of voting members should be senior industry representatives 7, independents 4 and consumers 2.

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?

I agree that the Payments Strategy Board needs to have a formal information gathering power. For the Payments Strategy Board to be fully effective it needs to have access to comprehensive information. I would leave it to the Payments Strategy Board to decide what information it needs. As regards enforcement see my response to Question 3b above.

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

Yes.

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

No comment.

Yours faithfully

Graham M. Phillips

I write as an interested party in relation to the setting of a strategy for UK payments, which is addressed in a consultation document issued by HM Treasury on 19 July 2012 and which is expected to lead to decisions by the Government.

Specifically, I was an employee of UK Payments Administration Ltd for 23 years, having a variety of roles prior to my retirement last year. Those roles included Head of Cash, and pension scheme trustee: it is on those two matters that I suggest that the Government's response should be more explicit than the consultation document.

In other respects, the analysis of the situation broadly accords with my own observations; the emphasis on the integrity and efficiency of payments schemes is essential; but I would not be comfortable nor credible commenting on the merits or otherwise of the options proposed for the future.

CASH

The consultation document notes that cash is used to make payments in the UK more often than any other payment mechanism, but does not propose how cash matters should be handled in future.

Cash is the original payment mechanism, but is different from other payment mechanisms: it is not part of a 'payment network', as defined; it is a store of value, unlike other payment mechanisms; and it circulates, unlike any other payment mechanism. But it is a direct competitor to some payment mechanisms, such as cheques and cards.

Decisions on the future for payments impact the future for cash, and there should be competitive equality between each payment mechanism, including cash. This is easier said than delivered, as the cash stakeholders have different perspectives:

- # some banks regard cash as a costly service for customers, and less profitable than issuing cards or acquiring card transactions;
- # the Bank of England, as the main issuer of cash, sets certain benchmarks for good practice and benefits from seigniorage; and
- # all consumers expect cash to be freely available, many consumers prefer to use cash even when they are card holders, and millions of consumers only ever use cash.

Compared to average, people who rely on cash are typically older (age 65+) or teenagers; from lower socio-economic groups; and 'northern' (eg northern England and Scotland, rather than London and southern England). Some further background was set out in the Payments Council's 'Future for Cash in the UK' which is available on its website, and which I drafted for a steering group chaired by the Bank of England.

SUGGESTION: however developing the strategy for payments is organised in future, the senior body or regulator should embrace explicitly the role of cash as a payment mechanism, treating it on a par with other payment mechanisms where appropriate.

ARRANGEMENTS FOR STAFF AND PENSIONERS

The consultation document states that "there is no "do nothing" option", so change is inevitable, and this will impact current and former staff, and pensioners.

Around 280 staff and pensioners (of whom I am one) are relying on the pension scheme to fund their old age, yet the scheme is currently in relatively significant deficit: additional funding from the banks and other payments entities is required. But the ambition of the Payments Council's members to fully fund the pension scheme is likely to be diluted with increasing membership (proposed in one option) or with more formal regulation (the other options).

There are other complexities, but with the Government requiring change which may well resonate throughout the payments industry, it may be beyond the abilities of the pension scheme trustees to protect adequately the interests of current and future pensioners. The covenant underpinning this pension scheme could be materially weakened by the changes under consideration.

It would not be acceptable for a re-arrangement of the role of the Payments Council to lead eventually to a call for support from the Pension Protection Fund.

SUGGESTION: in determining the way ahead for payments in the UK, the Government should require the current members of the Payments Council to ensure that the reasonable and legitimate expectations of staff and pensioners are fully met.

If there are queries arising from these comments, I would be willing to respond as far as possible. I understand that these comments may be made public and have no objection to that.

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