

LYDDON CONSULTING SERVICES LIMITED

**INPUT TO THE STAKEHOLDER
CONSULTATION ON THE PSR MARKET
REVIEW INTO INDIRECT ACCESS TO
PAYMENT SYSTEMS**

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PSR MARKET REVIEW INDIRECT ACCESS TO PAYMENT SYSTEMS

INPUT TO STAKEHOLDER CONSULTATION

Introduction

Lyddon Consulting Services is specialist consultancy in international banking, focusing on matters related to the core domain of Payments and Cash Management. That leads to market change aspects such as the Euro and SEPA, as well as Payment Services Directive, Anti-Money Laundering Directives, and regulations around cards, mobile, eMoney and mandatory information in funds transfers.

We are currently engaged by two organisations operating in this space and attach our feedback into this process, which accords with the views we have given to those two organisations. We say this because it is possible that they may respond direct as well and in a similar vein, assuming they have accepted our views and also decided it is in their interests to make a response.

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**PSR MARKET REVIEW ON INDIRECT ACCESS TO PAYMENT SYSTEMS – RESPONSE TO
CONSULTATION QUESTIONS ON INTERIM REPORT**

Introduction

Lyddon Consulting is a specialist consultancy company and advises clients in this space.

This response, for the purposes of the consultation on the PSR's Interim Report on indirect access to payment systems, concentrates on the lack of efficacy of the measures taken by the PSR so far, and suggests a minimum service scope that should be available from the complex IAPs/Vocalink/PSOs for there to be considered to exist a market for indirect access at all.

1. Do you agree with our interim findings? Please provide evidence to support your response, in particular if you disagree with our findings.

No – the measures ordained by the PSR have had very little effect so far. They are nice-to-haves but do little to enable progress on the main problems:

- IAPs not accepting IPSPs either as agency or non-agency banks;
- Service gaps/the service configuration as a whole, that either:
 - Mismatch the business requirements of IPSPs
 - Represent no effective choice between IAPs
 - Require significant investment by the IPSP
 - Create lock-in due to IT considerations and need for reinvestment

The measures ordained by the PSR are:

- IAP Code of Practice:
 - All process, reporting, websites...
 - No substance about what products and services an IAP must offer as a minimum
- A website on access to payment systems <http://www.accesstopaymentsystems.co.uk/>:
 - Circular and superficial
 - Concentrates on what the applicant ought to think about
 - Click-through to Lloyds Bank information just goes to their Business Banking home page for customers of £25mil annual sales or more
 - Only three IAPs exist really, not seven, as the appearance of RBS, Ulster and NatWest infers, and discounting Lloyds which does not show an offering
- Information on individual IAPs' websites about the IA service offering:
 - The main problem is the service configuration – the IPSPs have to transact through an IAP
 - This imposes limitations and leaves too much to the IAP's discretion
 - Direct Technical Access to FPS and BACS should be the default but not done through IT companies in the way that FPS Direct Technical Access has been configured, unless IPSPs wish to opt for that for their own reasons
 - There needs to be a much lower-cost, lower-effort default option to gain initial access
 - See analysis below

Problem 1 – IPSPs not being accepted by IAPs for either agency or non-agency

This issue is not solved; the PSR is well aware of this so there seems no point in repeating the issues here. Suffice it to say that the underlying issue is witnessed by the section in NatWest's IAP pages on its website about availability of banking services:

QUOTE

Operational procedures and policies

You must have a strong Anti Money Laundering (AML) Policy in place that would also include Terrorist Financing and Anti-Bribery and Corruption. Documented proof of such policy existing may be required in order to verify the existence of at least the following:

- Robust processes in place to identify and verify your customers and the transactions they will be undertaking;
- Policy and procedures in place to comply with UK and EU Payment law regulations;
- Policy and procedures in place for Financial Sanctions and Terrorist Financing (FS&TF) list checking including United Nations, European Union and UK HM Treasury
- Controls in place if cash of more than €10,000 is moved into or out of the EU;
- Policy and procedures in place to report suspicious activity to the National Crime Agency;
- Security procedures in place to maintain the security of your customers' personal information;
- Records management procedures in place to retain customer information for the appropriate period;
- Appropriate screening and monitoring of new and existing staff on a periodic basis;
- Staff training in place on Financial Sanctions and Terrorist Financing, AML, suspicious activity reporting, identifying customers, record keeping requirements;
- Policy and procedures in place for identifying Politically Exposed Persons;
- Audit trail of how money is transmitted/received (i.e. the route the money takes in order to get to its destination);
- Physical security in place to ensure the safety of employees and customers;
- Procedures to ensure that NatWest is provided with the outcome of any Money Laundering Audits;

Your procedures for and demonstration of your compliance with all other relevant regulatory requirements e.g. Consumer Credit (CCA) licence, Tax, FCA.

UNQUOTE

Note the phrase "at least the following". Within this area the IAPs have adequate latitude to turn down any or all IPSPs, and, according to our information, they are doing so. This applies not just to NatWest but to all IAPs, whose policies are similar and which are cut from the same cloth as NatWest's. NatWest has simply provided a very helpful specification.

Problem 2 – Service gaps

The basic problem is that the IAP offerings of the three banks that have put up information are inadequate to the business requirements of IPSPs. Since these three banks are the market, it means there is no market.

The three IAPs are the “market” because direct access to payment systems is precluded by barriers around:

- Sort codes
- BoE settlement account
- Mechanism for intraday liquidity on a settlement account

Sort codes are not available to IPSPs as of right: they have to be sponsored by an IAP. They are controlled by BACS and there is apparently a shortage:

- For IT reasons
- Because the IAPs have a right of refusal on them

Authorised PSPs cannot have a **settlement account** at the Bank of England, and an account balance at the Bank of England in any form of central bank money in GBP (cash, gilts, note&coin) is not explicitly allowed as fulfilling the requirements of safeguarding customer monies.

Even if an authorised PSP were able to have a settlement account, the manner of **accessing intraday liquidity** is operationally complex and therefore militates against smaller players. The current method is not user-friendly: no overdraft is allowed on a settlement account. Instead, “liquidity” (i.e. the creation of a cash balance) has to be generated by repurchase agreements with the BoE on gilts that have to be settled in CREST and then with cash movements both in CREST and in CHAPS. The US system at the New York Fed is far superior: the Fed is the custodian for the securities that are eligible as collateral for an overdraft on a settlement account. The account-holder can overdraw their account up to the full value of the securities in their custody account. It is operationally far simpler, and efficient: the UK system results in banks over-collateralising their intraday needs by entering into repos for far larger amounts than they actually need.

Direct access being precluded to the vast mass of PSPs, their only option is indirect access:

- If IAPs allow it;
- If the IAP services themselves do not result in there being (at best) only one game in town for each PSP i.e. the IAP offering of only one IAP even distantly meets the IPSP’s own criteria.

2. Have we identified the key concerns with the supply of indirect access to interbank payment systems? If not, please identify any other key concerns you have and to the extent possible provide evidence to support your comments.

There has been no attempt to define a service scope and level that should be the basic one available to all IPSPs and which meets the business requirements of IPSPs. Since a payment system process consists of the data format, a communications channel, a communication protocol and a security methodology – as well as a business process – the essence is to ensure that these components are neither:

- IAP-specific
- Payment system-specific
- Interdependent – meaning that the choice of one demands the choice of others, in the worst case building up to a series of business models running in parallel, each one devoted to a particular payment system

A key advantage of ISO20022 XML in this respect is not its ability to act as the format used **within** a payment system, but its suitability as a **universal interface format**. In other words all of BACS, CHAPS and FPS payments can be instructed in ISO20022 XML, whilst within those systems Standard18, SWIFT MT and ISO8583 are used.

The IAPs do say they accept instructions for BACS, CHAPS and FPS payments in different formats but this is in itself bank-specific and not part of a standard, default offering.

It is also not adequate that individual Payment System Operators (“PSOs”) devise Direct Technical Access solutions which may be:

- Specific to their own payment system;
- Made available through organisations that will want to make a business out of it, raising the all-in cost.

Lyddon Consulting has compiled below a definition of what it believes should be the minimum service scope and service level for an IAP market to work. Please note that the actors that need to collaborate on this are all of the IAPs, Vocalink and the PSOs. At present they are working with too great a degree of autonomy from one another to solve these issues. This disintegration is the result of the PSR’s moves to reduce the influence of the Payments Council, and it is frustrating to observe that there was felt to be a need for the creation of a Payment System Operator Consultative Group so soon after the Payments Council – which fulfilled that role – was disbanded.

The basic IAP offering should consist firstly of a Direct Technical Access offering for FPS and BACS, supported by all IAPs:

- The main contract for this service to be between the IPSP and Vocalink, and not with the PSO;
- This contract to have a box to tick to indicate the IPSP’s IAP, i.e. their settlement agent, but the T&Cs between the IPSP and their IAP for Direct Technical Access to BACS and FPS would be in the Account Opening contract between the IAP and the IPSP, since Direct Technical Access for FPS and BACS would be the default option.

Vocalink, on behalf of both BACS and FPS, would then support the following connectivity and formats for both payment systems, with an IPSP’s choice of which option to go for in each box being independent of the other choices i.e. each choice is interoperable with any of the choices in the other boxes:

Communications	Payment Instruction Format	Report Format
<ul style="list-style-type: none"> • BACSTel-IP • Host-to-host • SWIFTNet FileAct 	<ul style="list-style-type: none"> • Standard18 • ISO20022 XML • ISO8583 (FPS only) 	<ul style="list-style-type: none"> • System proprietary • ISO20022 XML camt

These options would be:

- interoperable;
- available at the same price;
- have the same opening hours;
- not be subject to the discretion of any market actor.

CHAPS cannot be available to an IPSP via Direct Technical Access so the options for the instruction of CHAPS payments to be available from the IAP to the IPSP would be:

Communications	Payment Instruction Format
• SWIFTNet FIN	• SWIFT MT
• SWIFTNet InterAct	• ISO20022 XML
• SWIFTNet FileAct	• SWIFT MT • ISO20022 XML
• IAP eBanking	• IAP-proprietary

These options are not interoperable: only a SWIFT MT message can be sent over SWIFTNetFin and only an ISO20022 XML messages over SWIFTNet InterAct.

The current Reporting offering out of CHAPs for IPSPs is completely inadequate. It needs to be built out with at least the following SWIFT MT messages, to be available from the IAP to the IPSP:

Operation	Message/Communications
• BACS/FPS/LINK settlement payment	• MT900 or MT204/ SWIFT MT • ISO20022 XML camt or pacs/SWIFTNet InterAct • SWIFTNet FileAct for all the messages, MT or ISO
• BACS/FPS/LINK settlement credit	• MT910 or MT202/ SWIFT MT • ISO20022 XML camt or pacs/SWIFTNet InterAct • SWIFTNet FileAct for all the messages, MT or ISO
• Individual CHAPS receipt	• MT910, as well as instruction by 103/202/ SWIFT MT • ISO20022 XML camt/pain/pacs/SWIFTNet InterAct • SWIFTNet FileAct for all the messages, MT or ISO
• Individual CHAPS payment	• MT900, as well as instruction by 103/202/ SWIFT MT • ISO20022 XML camt/pain/pacs/SWIFTNet InterAct • SWIFTNet FileAct for all the messages, MT or ISO

These facilities should then be replicated in the proprietary eBanking systems of the IAPs if they wish to offer that as an alternative channel.

With the above as the offering from the side of the combination of the IAPs/PSOs/Vocalink, an IPSP would be able to have a choice of IAPs without needing to install technology from any third-party and then experience a lock-in i.e. major barriers to switching.

It is vital that any IPSP have available to it a messaging option that is low-cost, with a light client-side implementation, and which can be used for:

- All UK payment systems
- International payment systems

The IPSP must also have available to it the option of issuing IBANs, and of upgrading, without excessive cost, to diversifying out of one initial, ubiquitous data format into ones that are payment-system specific or simply closer to the ones used within a particular payment system, but then at a time of their own choosing and at acceptable cost.

This is the configuration at an IPSP that would fulfil all of those criteria, based on the access to the UK's payment systems being re-gearred as proposed above:

Operation	Message/Communications
<ul style="list-style-type: none"> Obtaining own Sort Code 	<ul style="list-style-type: none"> This is not a luxury but an absolute basic of being able to operate Without a Sort Code the IPSP cannot issue IBANs A sort code should come with the PSP licence and not be at the discretion of an IAP
<ul style="list-style-type: none"> Basic SWIFT membership using Alliance Lite 2 	<ul style="list-style-type: none"> SWIFTNet FIN, FileAct and InterAct Own BIC
<ul style="list-style-type: none"> Issuing own IBANs 	<ul style="list-style-type: none"> With a Sort Code and a BIC, the IPSP can now issue IBANs and do SEPA payments
<ul style="list-style-type: none"> Gearing up own IT systems for ISO20022... 	<ul style="list-style-type: none"> All instructions issued in ISO20022 All advices and reports received in ISO20022 ISO does not have to be used within IPSP's applications, nor within the payment system ISO20022 is open-source and the IPSP only needs an adaptor, not the kind of Service Bureau that is offering FPS direct technical access
<ul style="list-style-type: none"> SWIFTNet FileAct Store-and-Forward on Alliance Lite 2, the base option through which to access... 	<ul style="list-style-type: none"> IAP's CHAPS service BACS and FPS SEPA International banks that are FileAct-enabled
<ul style="list-style-type: none"> Adopting FIN at its own election for... 	<ul style="list-style-type: none"> IAP's CHAPS service International banks that do not have FileAct
<ul style="list-style-type: none"> Adopting Standard18 and/or ISO8583 	<ul style="list-style-type: none"> As and when the IPSP's own volumes justify it, without it being forced on them

In all of this, the IAP's role is to:

- Make and receive CHAPS payments;
- Settle balances in FPS and BACS owed by the IPSP;
- Receive balances in FPS and BACS owed to the IPSP;
- Receive proceeds of any cheques owed to the IPSP: they do not issue chequebooks to their customers.

3. Do you think that the current and anticipated developments we have listed are likely to address the concerns we have identified?

No, for reasons explained above.

4. What other steps could we take to promote or support the developments, in particular the entry of new IAPs and/or expansion of existing IAPs/direct PSPs, or any further steps we could take to make the process of switching easier/more transparent? In particular, are there any technical or regulatory matters that are acting as barriers to switching, which we could seek to address?

Revert to the beginning, solve the sort code, settlement account and intraday liquidity issues, and then issue a minimum service scope and level.

5. Are there any important developments that are likely to affect the supply of indirect access that we have not identified in this interim report? If so, please also set out the timelines for these developments, and any factors that might impact on the likelihood of them occurring. Please also indicate how you think these developments might address the concerns we have identified.

Yes:

- “Panamanian papers” – liable to make AML/CFT issues worse and to result in even fewer IPSPs being taken on by the IAPs;
- Basel III, PSD2 and ring-fencing – higher cost of credit lines for IPSPs.

6. If the developments do not sufficiently address the concerns we have identified in the next 12 months, what action, if any, do you consider we should take at that point? What would be the advantages and disadvantages of such action?

We do not accept the premise of the question. The actions taken by the PSR, which it considers justification for not acting now, have been ineffective, so action is needed now, not in 12 months.

7. Is there any regulatory or other action that you consider we should take now? What would be the advantages and disadvantages of such action?

No further comment.

BL/2.5.16