

The Payments Strategy Forum – Being responsive to user needs Draft strategy for consultation

Respondents basic details

Consultation title:	UK Payments Strategy – being responsive to user needs
Name of respondent:	Lyddon Consulting Services Ltd
Contact details/job title:	
Representing (self or organisation/s):	
Email:	
Address:	

Publication of Responses

In responding to this consultation, you are sharing your response with the members of the Payments Strategy Forum (Forum), evaluators appointed by the Forum and the Payment Systems Regulator Limited, ('the PSR' - which provides secretariat services to the Forum). The PSR accepts no liability or responsibility for the actions of the Forum members or evaluators in respect of the information supplied.

Unless you tell us otherwise the Forum will assume that you are happy for your response to be published and/or referred to in our Final Strategy Document. If you do not want parts of it to be published or referred to in this way you need to separate out those parts and mark them clearly 'Not for publication'.

Please check/tick this box if you do not want all or parts of your response to be published:

Declaration

"I confirm that our response supplied with this cover sheet is a formal consultation response that the Forum can publish, unless it is clearly marked 'Not for publication'.

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Response template

This response template is intended to help stakeholders in responding to the questions set out in our Draft strategy for consultation and in its Supporting Papers.

If you do not want parts of or all of your response to be published you need to state clearly ('Not for Publication') over specific information included in your response, please be sure to clearly mark this by yellow highlighting it. We will assume that all other information is suitable for publication.

Responses should be emailed to us at Forum@psr.org.uk in Word and PDF formats by no later than **14 September 2016**. Any questions about our consultation can also be sent to Forum@psr.org.uk.

Thank you in advance for your feedback.

QUESTIONS IN RELATION TO SECTION | RESPONDING TO CONSUMER AND BUSINESS NEEDS

Question 1: Do you agree we have properly captured and articulated the needs of End Users? If not, what needs are missing?

We believe the correlation between the actual end-user needs/desires and the proposals needs to be re-validated, including in the light of other relevant developments in the meantime. The main driver behind Request-to-Pay, for example, was explained by Nick Davies of DWP in the community roundtables as being the differential pricing paid by utility customers who pay by direct debit compared to those who cannot use direct debit – and have to pre-pay. The recent CMA report on utilities requires that the price for pre-pay be equalised with the price paid by other customers, and that ruling would seem to eliminate the rationale for Request-to-Pay.

Question 2a: Do stakeholders agree with the financial capability principles?

We have not responded to this question.

Question 2b: How should these principles be implemented?

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We have not responded to this question.

Question 2c: How their implementation should be overseen and how should the industry be held to account?

We have not responded to this question.

Question 3a: What benefits would you expect to accrue from these solutions (not necessarily just financial)?

We have not responded to this question.

Question 3b: Do you agree with the risks we outline? How should we address these risks? Are there further risks we should consider?

We have not responded to this question.

Question 3c: Is there a business case for investing in solutions to address these needs and if not, how such an investment can be justified?

We have not responded to this question.

Question 3d: Are there any alternative solutions to meet the identified needs?

We have not responded to this question.

Question 3e: Is there anything else that the Forum should address that has not been considered?

We have not responded to this question.

Question 4a: Is there a business case for investing in transitional solutions while the new payments architecture is being delivered and if not, can such an investment be justified?

We have not responded to this question.

Question 4b: Are there any viable technical solutions to deliver some of the consumer benefits early without compromising the longer term solutions recommended by the Forum?

QUESTIONS IN RELATION TO SECTION 6 | IMPROVING TRUST IN PAYMENTS

Question 5a: Do you agree with our proposal regarding customer awareness and education? If not, please provide evidence to support your response.

We have not responded to this question.

Question 5b: Do you agree the delivery of these activities should be through an industry trade body? If so, which one would be most appropriate to take the lead role?

We have not responded to this question.

Question 6: Do you agree with the establishment of guidelines for identity verification, authentication and risk assessment? If not, please provide evidence to support your response.

We have not responded to this question.

Question 7a: Do you agree with our solution to develop a central data repository for shared data and a data analytics capability? If not, please provide evidence to support your response?

Yes, if it is to identify and store the Know-Your-Customer and Know-Your-Customer's Business credentials of Payment Service Providers including:

1. information on the beneficial ownership structure and to show who any natural legal persons are that need to have an identification check done on them as Ultimate Beneficial Owners
2. all types of PSP contemplated by PSD 2 including Payment Initiation Service Providers and Account Information Service Providers

But the idea of having a repository for information on all UK business customers that make payments is an impossibility, and we conclude this from our long-standing work with an international Banking Club. Business customer KYC information involves proof-of-address for the natural legal persons upon whom an identification check has to be performed. These form a part of the package of 'background documents' about the applicant, its directors, its signatories and its Ultimate Beneficial Owners. Proof-of-address documents must be recent (no more than 6 months old).

The 'background documents' are as distinct from the 'account opening documents' themselves and, in the Banking Club, the 'background documents' are produced first, together with the list of accounts and services required, in order for banks to go through KYC on the applicant and prepare the 'account opening documents' and the service documents (e.g. for eBanking, for SWIFT MT940 and 942) in one process, ready for signature by the applicant.

It has proved impossible to have any other way of getting an account open for an applicant than to have original 'background documents' produced as a pack each time that a particular applicant wants an account at a bank where it does not have an account already i.e. each time a new customer-to-bank relationship is being established.

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The approach proposed in the UK Payments Strategy has no mileage: the concept of having a database on which each applicant has its 'background documents' stored when it first uses the service – or even in advance of that on the expectation that they may need to use the service in future or because of applicable regulation. Then the applicant is supposed to keep the documents refreshed for the next time, so that the documents are always fresh and can be re-used for whatever purpose to do with bank accounts and payments.

There will be intense end-user resistance to this; they will see it as a severe new 'customer detriment'. The applicant does not want extra work now in order just to keep doing their payments business, nor to make preparation for when they may want a new account some time in the future (as they do not know when the next time will be). The experience in the Banking Club has been that the end-user just wants to produce a pack of documents at the time they are needed, and to send them to the bank: not to put them in a database, to do which they would need Board approval and no doubt an investigation by several internal departments. Thus there is no customer support for doing what the Payment Strategy proposes and it will be impossible to impose compliance.

The next, fall-back, approach might be to keep some static documents (Memorandum of Incorporation, Articles of Association) in a database and then produce the others ones freshly for each application. This one was vetoed very strongly by the member banks of the International Banking Club: even Articles of Association do change, so that there was no way of getting a hard-and-fast list of the static documents. In addition to this, the idea of trying to marry up some static documents from a database with some fresh ones received from the customer was taken to be more onerous and error-prone than to ask the customer to produce the whole pack, fresh, each time an application is made.

So the state-of-the-art is not to use any kind of database for this purpose but to create a fresh pack each time.

One should remember that business customers are not high-frequency users of these services. The opening of a new account is a matter that involves Legal, Tax, and Accounting as well as the Banking department. For an SME the accounts held and the signature mandate on them may not change for some years, but that does not mean that there is anything stale about the arrangements.

Financial institutions, on the other hand, are high-frequency users and are smaller in number; a database for this segment would make eminent sense and our recommendation would be to focus on that segment.

Question 7b: Do you agree with the potential risks we outline? How should we address these risks? Are there further risks we should consider?

We have not responded to this question.

Question 7c: If any legislative change is required to deliver this solution, would such change be proportionate to the expected benefits?

We have not responded to this question.

Question Do you agree with our solution for financial crime intelligence sharing? If not,

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8a: please provide evidence to support your response?

The solution needs much greater vetting than appears to have taken place against the latest Data Protection and Privacy legislation.

Question 8b: In what way does this solution improve financial inclusion? More generally, how should the intelligence sharing be used for the “public good”?

We have not responded to this question.

Question 8c: Do you agree with the potential risks we outline? How should we address these risks? Are there further risks we should consider?

We have not responded to this question.

Question 8d: Do the benefits of financial crime intelligence sharing outweigh the new potential risks created?

We have not responded to this question.

Question 8e: Can this operate without changes to legislation? If not, what changes to legislation would be required to make this happen? If any legislative change is required, would such change be proportionate to the expected benefits?

We have not responded to this question.

Question 8f: What governance structure should be created to ensure secure and proper intelligence sharing?

We have not responded to this question.

Question 9: Do you agree with the proposal to develop a Central KYC Utility? If not, please provide evidence to support your response?

Please see response to 7a. Our evidence for that opinion is 14 years assisting an international banking club with 30+ banks in 28 countries: the concept is impractical for business customers. On the other hand it would make eminent sense if restricted to Payment Service Providers.

Question 10: Do you agree with our solution for enhancing the quality of sanctions data? If not, please provide evidence to support your response?

We have not responded to this question.

QUESTIONS IN RELATION TO SECTION 7 | SIMPLIFYING ACCESS TO PROMOTE COMPETITION

Question 11: Do you agree with our proposal regarding access to sort codes? If not, please provide evidence to support your response.

Yes but this should already have happened now. It was supposed to be a Vocalink release in May or June 2016 so we cannot understand why this is still being discussed as a proposal rather than being advertised as a “here is exactly how a PSP gets one”.

Question 12: Do you agree with our proposal regarding access to settlement accounts? If not, please provide evidence to support your response.

This fine as a proposal but the Bank of England do not seem to be on board on delivering more than 20 or 30 new Settlement Account numbers in advance of their (possibly) having a new RTGS system. Is the BoE ledger system so limited that only 20 or 30 new numbers can be set up on it? The BoE’s recent press release makes clear that a more general availability would be contingent upon there being a new RTGS system – for which a blueprint has been promised in early 2017. This means that greater availability than 20 or 30 accounts will not happen under the current CHAPS system but only when and if there is a new one. From a 2017 blueprint to a new CHAPS system in stable production with all existing members migrated and in stable state has to be a four-year timescale, and only then would the BoE anticipate widening access and then only to players with very high resiliency. This is not a general solution to the issue at all.

Question 13a: Do you agree with the proposal regarding aggregator access models? If not, please provide evidence to support your response?

Yes it is all very nice but the reality is that aggregators right now can deliver a £1mil/1year Direct Technical Access to Faster Payments for Indirect Members (or a £5mil solution for new Direct Members) which (i) is no solution towards BACS, CHAPS... (ii) is beyond the pocket of most new-entrant PSPs. Two further models need to emerge (i) hosted version of FPS Direct Technical Access where the PSP does not have to go through the 1 year accreditation and (ii) hosted ‘single pipe’ relationship with an aggregator to FPS, BACS, SEPA, SWIFT MT....

Whether these two increments can be made available to new-entrant PSPs at a price that matches their pocket is another matter. The PSPs would be looking for a business model that is some form of API with their aggregator – let’s say using the ISO20022 messages – and they would expect the aggregator to do message transformation and also business-model transformation in the case of systems which operate 24*7 and a PSP that does not, all for a pricing model in the same ballpark as basic SWIFT membership using Alliance Lite2. In fact the PSP might well wish to connect with their aggregator using ISO20022 messages inside FileAct envelopes using Lite2: for the PSP that would equate to being the ‘single window’.

Question 13b: How can the development of more commercial and competitive access solutions like aggregators be encouraged to drive down costs and complexity for PSPs?

If aggregator models emerge that are more commercial and competitive, and which drive down costs and complexity for PSPs as per answer to 13a above.

Question 14: Do you agree with our proposal regarding Common Payment System Operator participation models and rules? If not, please provide evidence to support your response.

We have not responded to this question.

Question 15a: Do you agree this proposal regarding establishing a single entity? If not, please provide evidence to support your response.

We have not responded to this question.

Question 15b: If you do not agree, how else could the benefits be achieved without consolidating PSO governance in the way described?

We have not responded to this question.

Question 16: Do you agree with the proposal to move the UK to a modern payments message standard? If not, please provide evidence to support your response.

We have not responded to this question.

Question 17a: Do you agree with the proposal to develop indirect access liability guidance? If not, please provide evidence to support your response?

We have been advising an industry association representing small payment companies on this issue. In our view the guidance needs to be geared to banks that want to come into the market and service small PSPs for their UK payments: it should not be geared to the four current Independent Access providers who (i) have a US banking licence in their group and (ii) are subject to ringfencing. We have made these views known extensively through the sub-stream of Simplifying Access to Markets entitled “LIAM” – Liability in Indirect Access Models – and so we will only summarise the view here.

US AML/CFT in our view makes a bank liable for its customers’ customers’ customers etc, and no guidance from any UK authority will be enough to convince the current IAPs that they are not liable. A positive, categorical legal opinion would be needed from a leading US law firm assuring them of the opposite – and a US law firm of the magnitude required would not give such an opinion because (i) it would not be true in our view (ii) the financial penalties for the law firm if it proved not to be true would be disastrous.

In addition no recourse to a US law firm would address the risk to an IAP of losing their US banking licence if the advice turned out to be wrong.

As regards ringfencing, the four current IAPs and Santander are subject to it, and the result can be expected to be that FI relationships will go into the Non-ringfenced bank (NRFB) whilst small PSPs require the services of the ringfenced bank (RFB). So firstly there is a mismatch between the services the PSPs want (retail ones, those of the RFB), and where their relationship would be managed.

Furthermore the Customer Acceptance Criteria of the NRFB for Non-Bank Financial Institutions can be expected to be take only the very largest Money Services Businesses. NBFIs includes the likes of investment banks and fund managers, and these customers are more germane to the activities of the NRFB itself.

Money Services Businesses would not be prime target customers of the NRFBs, and only ones of the size of PayPal or Western Union would generate the types and volumes of business attractive to the NRFB. This could leave the vast majority of MSBs frozen out – as well as many credit institutions including foreign banks in the UK.

This aspect of the Regulatory Horizon was largely overlooked by the PSF's Horizon Scanning WG but could make a major difference to the provision of Indirect Access to credit institutions as well as to the other classes of PSP.

Question 17b: What, in your view, would prevent this guidance being produced or having the desired impact?

See above: it needs to be directed to credit institutions who have no US banking licence and who are not subject to ringfencing, and it needs to be guidance about specific solutions, not generalities. Lyddon Consulting has designed small range of solutions arrayed along a timeline (1 year, 2 years and long-term) and believes it is these that should be examined, not the general principles. The long-term solution, in our view, can be based on the AML/CFT liability of intermediary banks enshrined in the recent EU Regulation on information accompanying funds transfers. This regulation would support the contention that IAPs – i.e. intermediary banks in the sense of the regulation – are responsible for ensuring the presence of beneficiary and remitter information but not its correctness or of what is behind it.

In other words, the EU view makes intermediary banks not responsible for the customers' customers' customers in certain limited circumstances. A limitation of liability is enabled by this regulation for payments with both endpoints in the SEPA Area and denominated in a SEPA Area Member State currency. The PSPs' main problem is getting access to GBP domestic payment systems and so the risk view embedded in this Regulation is highly instructive – but can only be enjoyed by UK banks who have no US banking licence.

This is a further aspect of the Regulatory Horizon that was largely overlooked by the PSF's Horizon Scanning WG; supposedly the EU Regulation was one of the regulations looked at but the HSWG did not fulfil its ToR with respect to this Regulation (and others) as laid out in PSF15122015 - 6j Horizon Scanning Working Group ToR_0.pdf and specifically para 6.

Question 17c: In your view, which entity or entities should lead on this?

The PSR.

QUESTIONS IN RELATION TO SECTION 8 | A NEW ARCHITECTURE FOR PAYMENTS

Question 18a: Do you agree with the proposal for a co-ordinated approach to developing the various types of APIs? If not, please provide evidence to support your response?

We have not responded to this question.

Question 18b: What are the benefits of taking a co-ordinated approach to developing the various types of APIs? What might be the disadvantages of taking this approach?

We have not responded to this question.

Question 18c: How should the implementation approach be structured to optimise the outcomes?

There are some major gaps in the research work that has gone into the SPP so far, in our view. These can be laid at the door of the Horizon Scanning Working Group and its failure, even if it had the respective regulations on its list, to adequately assess them and play them into the work of the rest of the Forum and into its own initiative to propose the SPP (which itself goes beyond the HWGS ToR).

Example gaps and their significance are to be found below:

Basel III Internal Liquidity Adequacy Assessment Programme

Credit institutions will monitor intraday positions more closely and report on them, where they are a settlement system member themselves and when they are representing others in a settlement system. Credit institutions will identify which customers cause them settlement risk (and capital adequacy costs for the credit lines) and intraday liquidity usage (and the cost of posting up cash or collateral). Credit institutions will be less willing to act as a credit risk and liquidity buffer in a sponsor bank relationship and will want to be paid the costs, and will want 100% cash or collateral in advance – the same asset classes that the clearing system will ask the sponsor bank to put up.

Basel III Liquidity Coverage Ratio

LCR defines the types of collateral ('High-Quality Liquid Assets') that credit institutions will want if they are to factor them into their Liquidity Coverage Ratio with the optimal weighting. That requirement will be passed down to sponsored PSPs. If PSPs wish to put up collateral that counts as Level 2A or Level 2B rather than Level 1, they will have to post a larger nominal amount, and they may not have it.

Bank Recovery and Resolution Directive

The issue is the credit risk taken by PSPs in a sponsor bank relationship where they have their cash/collateral at their sponsor. What happens if their sponsor goes down and the sponsored PSP has more than £75,000 in the sponsor? Will there be any banking assets in the resolution pool to meet claims of creditors where the claim exceeds £75,000?

Ringfencing and credit risk between sponsor bank and sponsored PSP

Ringfenced banks are strongly discouraged – if not actually prohibited – from doing business with other FIs, principally in order to deter the RFB from building up a book of interbank deposits and using it to buy wholesale assets (investment banking or international banking assets). How do sponsor bank relationships with PSPs fit with that? Does the PSP have to get sponsored by the non-ringfenced bank? If so, they won't be covered up to even the £75,000 amount of compensation. Should the PSP take collateral on their credit risk on the non-ringfenced, sponsor bank? All its other creditors will probably be taking collateral so that any unsecured creditors of the NRFB have supplied subordinated debt to the NRFB without realising it. The NRFB does not have enough collateral to go round and the NRFB wants to have collateral for the credit risk it is taking as sponsor bank. Both sides need to have collateral >> logjam.

Question 19a: Do you agree with our proposal to create a Simplified Delivery Mechanism? If not, please provide evidence to support your response?

No, it is a Distributed Ledger based solution but seems unwilling to admit to it: DCL is the only technical basis in existence now that can deliver the SPP as designed. However the customer detriments that would result from going down the SPP route are large and it is surprising that SPP has made it this far without those new detriments being tabled: (i) freezing of functionality until SPP becomes available – that is if it ever becomes available (ii) thereby achieving that the UK payments landscape fails to be responsive to end-user needs until SPP delivers (iii) imposing a high-effort – and therefore high-all-in-cost and high-risk – pathway on all the market actors (iv) threatening basic continuity of services for end users.

DCL technology is far too immature for a country-wide solution based on it to be contemplated. It is simply disingenuous of its proposers within the PSF Working Groups to put a solution forward without giving it its name, or articulating it against important aspects such as settlement and credit risk.

One of its proponents, at the 13th July event, stated that SPP could support many settlement models. We believe that answer to be disingenuous because a prime value point of DCL purports is that it operates in near-real-time. SPP by inference proposes to bring all UK retail payments onto an NRT basis – and if they are exchanged in NRT and paid onto customer accounts in NRT, then settlement and systemic risk ensue if they are not also settled with finality in NRT.

It was inferred – though again not admitted to openly – that the SPP settlement model would mirror the current settlement model of FPS: payments settle on an interim basis within the system (“intra-system”) against pre-funding lodged to the system's order, and then periodically the intra-system balances are cleared to zero through CHAPS: three times a day on CHAPS opening days at present.

The bringing of cheques, cards and BACS onto SPP makes a radical change to the amounts involved when intra-system interim settlement is done in near real time and 24*7, but final settlement remains 3 times a day on CHAPS business days. It will require much larger amounts of pre-funding to be put up – or else the new CHAPS has to be open 7-days-a-week so that intra-SPP interim settlement balances can be finally settled in CHAPS more frequently. Much larger amounts of pre-funding could lock smaller PSPs out – increasing a detriment that the strategy is meant to be eliminating.

While the draft strategy identified a dependency of SPP on CHAPS, this is not articulated in any depth and the above issues are not explored.

Lyddon Consulting's view is that SPP cannot be deployed at all before there is a CHAPS systems in operation 24*7 behind it, eliminating any need for pre-funding and interim intra-system settlement. Otherwise the need for pre-funding will be a multiple of what is required now, will be beyond the pocket of many market actors, and the result will either be log-jams, PSPs locked out of the market, or settlements models where banks take commercial bank risk on one another rather than taking central bank money risk.

Were this latter eventuality to materialise, settlement and systemic risk get built back in, as the settlement model ceases to be the same for all participants, and can be subject to different bilateral and multilateral arrangements – a leading driver for which would be to avoid pre-funding completely or to pre-fund in a medium that was not central bank money. That is the meaning of the statement on 13th July by a proponent of SPP that SPP will be able to support various different settlement models, and, in our view, this should be resisted.

Question 19b: Should the new consolidated entity be responsible for leading the development of the new rules/scheme or should a new body be given this responsibility?

We have not responded to this question.

Question 19c: Could an existing scheme adapt to provide the Simplified Delivery Mechanism or should a new one be developed?

We have not responded to this question.

Question 19d: Would it be better for the processing and clearing functions of the simplified framework to be built on distributed architecture or a centralised infrastructure? Could there be a transition from a centralised structure to a distributed structure over time?

We have not responded to this question.

Question 19e: Do you think it is feasible to begin work to design a new payments infrastructure given existing demands on resources and funding?

We have not responded to this question.

Question 20a: Do you agree that the existing arrangement of the payments system in the UK needs to change to support more competition and agility?

We have not responded to this question.

Question 20b: Will the package of proposals we suggest, the Simplified Payments Platform, deliver the benefits we have outlined? What alternatives could there be?

We have not responded to this question.

QUESTIONS IN RELATION TO SECTION 9 | OUR STRATEGY IN SEQUENCE

Question 21a: Do you agree with this proposed sequence of solutions and approach outlined to further clarify this?

No – the short-term proposal contains two items that should already be live, and two that are not solutions in any meaningful sense. The solutions to End User Needs are all in a box at 3+ years out, which could be 7 or 10 years as the box contains no end date.

Meeting End-User needs that supposedly exist now is the objective of the whole strategy and so the lead time to that is not acceptable. However, if delivering on the EUN WG's projects really can wait for several years, it begs the question whether the needs are real.

The box of Mid-term proposals for delivery between 1 and 3 years out contains some very big projects which, however, are mainly about “engine room” initiatives and are not necessarily enablers for the solutions that meet End-User needs. SPP for sure is not vital as an enabler for the End-User needs solutions.

Question 21b: If not, what approach would you take to sequencing to bring forward the anticipated benefits, in particular for end users?

Abolish the box “Short-term proposals” because (i) independent access to Sort Codes should already be live (ii) aggregator models will emerge or not whether there is a Payment Strategy or not (iii) the two other solutions are background streams that could be started and refined over a 3-year period and have no dependency relationship to the solutions for meeting End-User needs.

Set up a delivery box that is 1-2 years and place all the EUN projects in it, and work back to what needs to be done to deliver them, at the same time validating the need for each of them.

Set up a third box: “Proposals for validation” and put each of them through a thorough validation process to see if they are feasible, sensible and do not introduce significant new detriments.

QUESTIONS IN RELATION TO SECTION 10 | IMPLEMENTATION APPROACH

Question 22a: What approach should be taken to deliver the implementation of the Forum's Strategy?

We have not responded to this question.

Question 22b: Who should oversee the implementation of the Forum's Strategy?

We have not responded to this question.

Question 22c: What economic model(s) would ensure delivery of the Strategy recommendations?

We have not responded to this question.

QUESTIONS IN RELATION TO SECTION 11 | COST BENEFIT ANALYSIS APPROACH

Question 23a: Do you agree with the proposed approach for quantifying the potential costs and benefits of the proposed solutions?

We have not responded to this question.

Question 23b: Do you agree with the costs and benefits drivers outlined in this document?

We have not responded to this question.

Question 23c: We would appreciate any information on the potential costs and benefits you may have to assist our analysis.

We have not responded to this question.