

Agenda Item 4: Evaluation Framework (Business Case Analysis)

Background

As per Paragraph 11 of the Payments Strategy Forum's Terms of Reference,

- *The PSR will develop a draft evaluation framework for the Forum's consideration. The framework will be designed to assist the Forum and its working groups in considering how to examine proposals in an objective manner and take steps to abide by competition law. It should ensure that the Forum only pursues initiatives that require collaborative work by industry and have a substantial net benefit to users of payment systems.*

It is important to note the framework is not being established to evaluate the quality of the Forum's work and final strategy but to help the Forum determine which of the potential solutions identified by its working groups are (a) within our scope and (b) should be progressed.

High level structure and objectives of the Evaluation Framework

The framework consists of two phases: triage and prioritisation; and detailed assessment.

Stage One – Triage and prioritisation

The objectives of the triage and prioritisation stage are: (1) to consider whether the detriments identified and any potential solutions may reasonably involve cooperation and should not be left to the competitive market; and (2) to prioritise what should be taken forward for detailed assessment.

Triage addresses the first objective of Stage One. To undertake this process, the **end user needs** and **financial crime** working groups should consider the following questions for each detriment under consideration:

- Whether a solution is already available that, or under development will, appropriately serve the needs of those using payment systems or whether there are needs that are not currently being served?
- Whether a solution can be effectively delivered by individual PSPs or whether collaboration between PSPs could provide a better outcome? In particular, have PSPs acting independently already failed to take the opportunity to deliver an outcome which sufficiently meets the needs of those using payment systems?
- Whether a solution relates to an existing product of one PSP or Operator or whether it relates to the need for a new system or product for which collaboration could provide a better outcome?

In doing so, the *end user needs* and *financial crime* working groups would need to develop conceptual solutions to the detriments. It is expected that some of these solutions developed by the working groups would address more than one detriment.

The ***simplifying access to markets*** working group would need to follow a different process when assessing its detriments, which should focus on the following key questions:

- What aspects of payment systems/payment schemes can be addressed in order to make access to markets simpler?
- Are any of these already addressed, or likely to be addressed by the PSR work programme?
- How can work in these areas promote UK and international interoperability?

Prioritisation addresses the second objective of Stage One. This is the process of prioritising the detriments which remain following the triage phase. In order to do so, the working group responsible for the triage process should conduct a high-level qualitative analysis of the potential costs and benefits of the conceptual collaborative solution(s) for addressing each detriment.

The selection of any detriment to be taken forward to Stage Two does not necessarily imply that the Forum has concluded that the solution(s) to the detriment would in fact bring net benefits or is in the collaborative space – such a conclusion would only be arrived at after the detailed assessment in Stage Two.

This prioritisation process, through the high-level cost benefit analysis of conceptual solutions, should be completed at an early stage by the relevant working groups (*end user needs*, *financial crime* or *simplifying access to markets*) prior to the advancement to Stage Two of the framework.

Stage Two – Detailed assessment

The solutions to the detriments prioritised in Stage One should be assessed in detail to establish whether the delivery of each solution would be expected to bring net benefits and whether these benefits are likely to be greatest when delivered collaboratively or competitively.

The precise depth and extent of quantification of the analysis should be proportionate to the significance of the detriment that the solution seeks to address, with greater detail required for more substantive detriments. Where quantitative analysis of the proposed solution is not practical, a comprehensive qualitative analysis should be conducted instead.

For the *end user needs* and *financial crime* working groups, a non-exhaustive list of relevant considerations are:

- Clear articulation of the problem that collaboration is seeking to solve.
- Systematic consideration of the impacts of the proposed solution including, but not limited to:
 - Costs of the solution, including implementation costs and any potential unintended consequences.
 - Expected extent of demand for the solution.
 - Impacts on price and quality indicators (including issues such as resilience).
 - Impacts (both positive and negative) on competition in different parts of the payment system, e.g. between PSPs, infrastructure providers or Operators.
 - Impacts on the incentives for future innovation.
 - Assessment of direct benefits and the wider costs and benefits.

For the *simplifying access to markets* working groups, a non-exhaustive list of relevant considerations are:

- The benefits of moving to common technical and operational requirements and the associated one-off transition costs.
- Comparisons with using aggregator/translation services to achieve some benefits of common technical requirements.
- Possible benefits from combining settlement cycles.
- Governance, including voting and investment procedures for combined entities.
- The significance of being able to plan investment across the needs of the interbank payment systems.

The analysis undertaken and any recommendations developed by the *simplifying access to markets* working group should be consistent with the following principles:

- competition upstream and downstream from the schemes should be enhanced, not reduced;
- potential for entry and expansion by companies providing new solutions (e.g. those using a blockchain approach) and new operators should not be foreclosed;
- there should be a focus on interoperability both in the UK and across the EU;
- service users should have an active role in advancing future innovations, including through the Forum; and
- direct access should be facilitated.

How to progress Stage Two of the Evaluation (Business Case Analysis)

To progress Stage Two of the Evaluation outlined above we believe there are three possible approaches:

1. ***Require each working group to conduct their own evaluation of the solutions they have identified.*** The benefit of doing so will be that the working groups will have the necessary technical expertise and evidence required to carry out the evaluation of their proposed solutions. On the downside, they may lack the economic expertise to conduct the evaluation. It is also possible that different approaches developed may lead to inconsistent analysis between the various working groups. Further, the evaluation by the working groups of their own solutions can possibly lead to a bias in favour of solutions which may not be in the best interests of the users of the payment systems.
2. ***Form a dedicated working group, constituted by appropriate industry representatives and reporting into the Forum.*** This group would be responsible for developing a detailed framework and evaluating the solutions identified by the other working groups. It will collect the relevant technical input and evidence from the other working groups to assess the solutions using consistent evaluation criteria. The benefits will be the consistent approach to the evaluation of solutions and the limitation of inherent biases. The downside of this approach is that the establishment of an additional working group would still need input from the existing working groups and thus will have to spend extra resources in analysing the proposed solutions.
3. ***PSR contract with an economic consultant to develop the detailed framework and undertake the evaluations on behalf of the Forum.*** The benefits of this approach are that an independent analysis will be conducted on all the relevant solutions without any inherent preferences or biases and ensuring consistency in approach. On the downside, their work will not be fully integrated in the Forum and they will have to consult separately with individual working groups to receive the technical assistance required. This might require additional effort to understand the solutions and additional effort to obtain buy-in to the analysis.

The PSR are not committed to a specific approach but are of the view that whichever is progressed, it is imperative that the Forum is ultimately responsible for owning the process and that industry, through the working groups, is responsible for providing the evidence required to undertake the evaluation.

Account Number Portability

In its March policy statement the PSR indicated that the Forum should consider Account Number Portability (ANP) as part of its strategy setting process. Recognising some work has already been undertaken by the FCA¹ in considering possible technical options, we are proposing that an evaluation of ANP is undertaken in early 2016.

Once the Forum has agreed on a preferred approach to conducting Stage Two of the evaluation, the PSR will provide to the relevant party a more detailed evaluation framework for conducting a business case analysis of ANP. If the Forum's preferred approach is *Approach 1*, then one of the working groups will need to be responsible for conducting the business case analysis of ANP (potentially the *end user needs* working group).

ACTION: The Forum is asked to **consider** the proposed Evaluation Framework; **agree** its preferred approach to progress this work and **note** that the ANP solutions are to be the first set of solutions evaluated using this preferred approach in early 2016.

¹ Account Number Portability: Report commissioned by the Financial Conduct Authority, March 2015:
<https://www.fca.org.uk/static/documents/research/anp-research.pdf>