Payment Systems Regulator Consultation
Response Team
25 The North Colonnade Canary Wharf
London E14 5HS

12 January 2015

Dear Sir, Madam,

A new regulatory framework for payment systems in the UK: PSR CP 14/1

SWIFT has reviewed the Payment Systems Regulator's consultation on "New regulatory framework for payment systems in the UK: PSR CP 14/1" of November 2014, and welcomes the opportunity to provide feedback. SWIFT fully supports the Regulator's objectives in promoting competition and innovation, and in ensuring that payment systems are developed and operated in the interests of service-users.

As a member-owned, member-governed cooperative, SWIFT provides the communications platform, products and services to connect more than 10,500 banking organisations, securities institutions and corporate customers in over 200 countries and territories. SWIFT enables its users to exchange automated, standardised financial information securely and reliably, thereby lowering costs, reducing operational risk and eliminating operational inefficiencies. SWIFT also brings the financial community together to work collaboratively to shape market practice, define standards and debate issues of mutual interest.

Beyond the comments set out in the attached annex, we believe additional items could be and will be raised in upcoming discussions. As well as connectivity and access solutions, we believe it will also be important to carefully calibrate the investment and ongoing running costs involved in any eventual solution, particularly given the demands of real-time 24x7 payment operations. The Regulator may also want to give further consideration to issues such as access to the payment system from other jurisdictions and currency zones.

During its forty-year history of serving the global financial community, SWIFT has been involved in many key financial market infrastructure projects both in the United Kingdom and world-wide. This has allowed us to establish best practices, perspectives and acquire unique expertise. Our message templates, protocols and platform have become the industry standard and, as a result, more than a hundred payment market infrastructures and seventy securities market infrastructures currently use them across the world. Amongst others, the Japanese Securities Depository Centre (JASDEC), the Singapore Exchange (SGX), the Australian Stock Exchange (ASX), TARGET2 (T2) and TARGET2-Securities (T2S) in Europe, the Single Euro Payments Area (SEPA) and the first ISO 20022 RTGS in Asia in Brunei, have all embarked on major projects with SWIFT.

Most recently SWIFT was appointed to host and manage the UK's SEPA IBAN Only migration infrastructure platform and to provide the infrastructure for Australia's New Payments Platform (NPP) project, a new fast payments infrastructure.

The UK's new SEPA IBAN Only platform is a cost-effective open access platform which is designed to both enable full compliance with the SEPA directive and to accommodate the growth of other services and functions in line with the pace of change in the UK payments landscape. NPP, an innovative new platform, will provide Australian businesses and consumers with a fast, versatile, data-rich payments system for everyday payments. The NPP is being developed collaboratively with local financial institutions. It is the

local industry's response to the Reserve Bank of Australia's strategic objectives on payments innovation, and implements the former Real Time Payments Committee's proposal on innovation in the domestic payments system.

SWIFT has a long history in the United Kingdom and collaborates closely with the UK financial community to ensure our products, services and standards best support its needs. We would very much welcome the opportunity to contribute to these developments and remain engaged in these discussions as they continue.

Please do not hesitate to contact either myself or Arun Aggarwal, the Head of our UK office (arun.aggarwal@swift.com), should you wish to discuss any of the matters raised in this response

Yours Faithfully,

Natasha de Terán
Head of Corporate Affairs

Society For Worldwide Interbank Financial Telecommunication SCRL
a limited liability company incorporated in Belgium

With place of business at
The Corn Exchange
55 Mark Lane Tel : + 44 20 7762 2000
London EC3R 7NE Fax : + 44 20 7762 2222
United Kingdom swift.com

A branch of a company registered in Belgium – Registration number FC012939

SP4-Q8: Do you agree with our proposed approach in relation to the development (by industry) of Technical Access solutions? Or do you consider that we should take a more prescriptive approach at this time? If you disagree with our proposed approach, please give your reasons.

SWIFT believes that a collaborative industry-led approach to the development of technical access solutions is preferable and therefore supports the adoption of this approach by the Payments Systems Regulator (PSR). This said, for a collaborative approach to be implemented successfully, a basic model should first be identified. There are useful prior examples of collaborative approaches in payment systems development and innovation, and SWIFT would welcome the opportunity to discuss these further with the PSR.

Another important factor which needs to be addressed is the issue of harmonisation of message formats and standards for technical access to the UK payment systems. We would strongly recommend that the adoption of open industry standards be mandated in the new payment system. This is because, whenever there is a need to communicate – as indeed there is in any payments solution – there is a need for a shared frame of reference by which different industry actors and systems can understand each other.

By way of background, standards are either open meaning that they are “free of levy” and can be used by all, or they are proprietary, meaning that they are subject to usage restrictions and/or that they can be subject to some sort of usage charge or fee. Open standards support the free interchange of information, whilst proprietary standards can be (and often are) used to restrict information interchange and/or access to infrastructures. Open standards are defined by the industry for the industry in a collaborative way. They are free of charge, facilitate investor choice and provide cost-effective tools to achieve the policy objectives of market resiliency and transparency, as well as sustainable compliance with such objectives. As an important tool for longstanding, robust recovery and for growth, we believe that regulators and policy-makers should expressly require at least the option to use them in the context of the regulatory reforms now underway.

Open standards can enable:

- The transport of financial data using standardised processes and languages that cannot be misinterpreted or manipulated by users;
- The standardisation of reporting, enabling supervisors to more efficiently monitor markets and facilitate the exchange of information;
- Easier data capture and better transparency of data delivery;
- Greater cost efficiency for most data exchange, collection and dissemination requirements, including for processing as a whole.

The use of proprietary formats would, in comparison:

- Reduce efficiency in data collection;
- Prevent a comprehensive analysis of financial data by authorities;
- Create unnecessary extra costs for end-users;
- Create barriers to access.

Open standards play a key role in enabling desired regulatory outcomes, whilst delivering cost efficiency and fair competition in the industry. Indeed, in the Recommendations for Financial Market Infrastructures, CPMI-IOSCO recognises the general importance of open standards in the context of the access to, and operations of, financial market infrastructures (defined as; payments systems, CCPs, CSDs and Trade Repositories). Recommendation 22, states that: *“An FMI should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement, and recording.”*

In the payments area, standardised protocols using standardised data elements have been developed to provide a common frame of reference (e.g. BIC, IBAN). Similarly, in the broader wholesale financial services sector, standards allow market participants (intermediaries, market infrastructures, investors) to communicate with one another and with their regulators in the same technical language and using common identifiers throughout the transaction life-cycle (trading, clearing, settlement, reporting).

Currently CHAPS, BACS and FPS all use different messaging standards. As a result, UK market participants have to deal with a variety of messaging standards and gateways, communications networks, communications protocols and security methodologies. This adds cost and friction, increases operational risk, and can prove prohibitive for new entrants. Whilst the difficulties can be alleviated in the short term by the use of a technical access hub provider, such divergences of approach should ideally be reduced or eliminated in the future development of the UK payment systems. Of course the deployment of market-wide standards development and migration should be achieved as a result of careful planning and coordination within the industry.[1]

For the new payment system, we would strongly recommend the use of the ISO 20022 messaging standard. ISO 20022 is an open international standard which is rapidly emerging as the default choice in the payments industry around the world for high- and low-value, international and domestic schemes. The Australian New Payments Platform (NPP) initiative is based on ISO 20022 formats and the Single Euro Payments Area (SEPA) uses ISO 20022 formats. Many other markets are now implementing, or planning to implement, ISO 20022 to replace multiple local or regional formats for low value and high value payments - for example, the next major step in Euro is for TARGET2 and EBA Euro1 to adopt ISO 20022 for order-by-order payments in 2017.

A further observation on this point: we would also recommend that providers of solutions for the UK seek to harmonise their implementations with those of their peers in other jurisdictions, with the goal of reducing overall costs and promoting interoperability. This would benefit global organisations that connect to multiple payments infrastructures internationally.

.

[1] By way of example, the EBA selected the MT103+ message for their SEPA-forerunner service: the Credeuro service. The Credeuro service was the solution to the EU Directive 2560/2001, which required that basic credit transfers in euro up to EUR12,500 should cost the customer the same whether the other endpoint was within their own country or in another EU country.
While this Directive was a stepping stone towards SEPA, it only affected cross-border payments. It was important therefore, that the message type for the Credeuro service be the same as the message type used in other cross-border contexts, albeit adapted to address the issues specific to Credeuro.
The use of code words and the absence of detailed remittance information meant that the business information could be contained in the MT103+ message, rather than the full MT103. The processing cycle meant that bulk processing, rather than order-by-order, was feasible. Over time Credeuro's timecycle was reduced thanks to Payment Services Directive, and then the entire traffic was migrated onto ISO 20022 XML, but without the need to either alter the message type for PSD compliance, nor to alter the communications channel for the migration to ISO 20022 XML.
MT103+ and FileAct proved to be a cost-effective and flexible basis for launching the Credeuro service which the European Commission now views as a vital stepping stone towards SEPA. Following this planning methodology it is logical that high-value euro payments now be migrated onto ISO 20022 and off MT103, as is the plan when TARGET2 and EBA Euro1 move onto InterAct in 2017.

General Comments Relating to Access to UK Payment Systems

In our view there are several other important issues that need to be considered in the context of delivering easier access options to UK payment systems. Amongst other considerations which we would happily discuss further with the Regulator, we would note that Technical Access solutions on their own may not open up the market in the way that the PSR envisages, without accompanying solutions addressing Financial Crime and Settlement issues. We set out some observations on these two matters below.

1. Financial Crime

All financial institutions have a responsibility to ensure that the financial system does not fall victim to terrorist financing or money laundering activities. However, AML rules have been widely cited as a blocker to new entrants setting up banking relationships with Sponsor Banks and obtaining access to payment systems.

New legislation such as the EU's AMLD IV requires that institutions processing payments for their customers implement robust customer due diligence (CDD) measures. New Payments Services Providers (PSPs) should also comply with these AML requirements and perform appropriate CDD on their customers. In the case of indirect access to UK payment systems and schemes, this will be of particular concern to the Sponsoring Banks, since - as Sponsors - they will potentially have no relationships with the customers of the PSPs for whom they are acting.

Where a new entrant is a direct member of a payment system, it acts as its own "Account Servicing Institution" (ASI) and so is fully responsible for the integrity of the traffic it sends into the system. Were the new entrant to breach AML rules, the penalties would fall on them directly.

Where a new entrant has indirect access to a payment system, however, the Sponsor Bank would count as the ASI and carry the risk related to the indirect member's traffic. In such a case, the new entrant's traffic is sent, either to the Sponsoring Bank, or direct to the payment system. In the case that the traffic is sent to the Sponsor Bank, the Sponsor can filter the messages within its own IT environment, before debiting the new entrant's account and sending the traffic to the payment system and performing the necessary checks. Where the traffic is sent direct to the payment system (as per BACS), however, it is unclear how the Sponsor Bank can control the risk, and at what point in the payment process this can be done. Clearly, direct technical access by a new entrant to a payment system makes their Sponsor's AML position more difficult.

The three elements commonly bundled under the term AML are: AML procedures, processes and controls; Know Your Customer (KYC) and Know Your Customer's Business (KYB).

The AML procedures, processes and controls are subject to vetting by the authority, during the PSP licencing process. Assuming that the Sponsor Bank can rely on the licence provision to provide assurance on this first element, it would only need to deal with the other two elements.

"Know Your Customer" rules would require the Sponsor Bank ASI to identify the institution, its owners and ultimate beneficial owners, its directors and officers. The SWIFT KYC Registry addresses for Correspondent Banks is an industry utility which offers a secure portal for exchanging Enhanced Due Diligence (EDD) and Simplified Due Diligence (SDD) documents and data. Its initial scope focuses on Correspondent Banking, and provides information about institutions, not individual or private customers.

The KYC Registry offers a unique approach compared to current alternatives by providing access to a standard set of due diligence documents and data. All information in the KYC Registry undergoes quality control and transparent validation by a dedicated operational team at SWIFT. Each registry user retains ownership of its data. Registry users can only access each other's data when permission to do so has been granted by the data owner.

There is no reason why such a registry could not cover PIs, eMIs and whatever other classes of new entrant are permitted in the UK, and as a result to effectively solve the second aspect of AML for sponsor banks.

However, the third element – "Know Your Customer's Business" – will likely prove the most intractable for Sponsor Banks. The prevailing view is that it is not possible for a Sponsor Bank to know and then to continuously monitor who the customers of these new entrants are; why they are making the payments; and who the participants in the extended business or payment chain are – all this adds unacceptable risk.

In SWIFT's view there is no way around this issue if the message traffic runs through the Sponsor Bank's IT environment and/or the Sponsor Bank is in any way responsible for the KYB of the new entrant.

One option that could be explored is for the responsibility of the Sponsor Bank to be limited to settlement (and therefore credit risk) only. This option would require that new entrants have direct technical access to payment systems, so that the traffic does not run through the Sponsor Bank environment, and entail a Sponsor Bank arrangement that was limited to the Sponsor Bank underwriting the settlement risk on the new entrant's payments towards the respective payment system (although the Sponsor Bank would still be responsible for performing upfront KYC on the new entrant for whom it acts as sponsor).

In summary, without addressing this issue, we believe that efforts to widen access could be inhibited. Even if new entrants are licenced and can deal with KYC requirements, Sponsor Banks will be very wary of taking the KYB risk; KYB risk is very hard to quantify, but the fines can be extremely high and of such a magnitude that might mean that few PSPs would be able to reimburse their Sponsors.

2. Settlement

The other major obstacle to new entrants wishing to join payment systems, directly or indirectly, is settlement. This is especially true when considering participating in payment systems designed to settle in central bank money.

Whereas many countries allow the equivalent of the Settlement Account to go into overdraft as long as the account holder has placed or pledged eligible bonds to the Central Bank, under the prevailing arrangements in the UK, payments must be covered by cash on a Settlement Account. The Bank of England, of course, permits banks to undertake repurchase agreement operations through which they can sell their eligible bonds to the Bank and buy them back later, thus creating cash on their Settlement Accounts in the interim. The Bank also allows Reserves System banks to use all or part of their Reserves balances as cash balances on their Settlement Accounts during the day, thus reducing their need to obtain liquidity elsewhere to meet their payment settlement obligations.

Many new PSPs, however, neither have Settlement Accounts nor are they part of the Reserves system. As a result, they will need to clear quite a high hurdle if they are to be direct payment system members, or even indirect members. Furthermore, since eMoney institutions may not use customer funds in their own operations, they would have to have separate cash or security of their own with which to back their settlement obligations. Without such resources eMoney institutions will not be afforded direct membership.

However, even those new PSPs seeking indirect access will face significant cost burdens – since they will be passed on the related capital and credit costs incurred by their Sponsors.

It has to be a working assumption that new PSPs will not, in the main, qualify for a Settlement Account at the Bank. Therefore the majority will need a Sponsor Bank. The minority who become direct members and have a Settlement Account are likely to find that:

- They will have to hold relatively large amounts of cash to cover their obligations;
- The amount will not just be their net sender cap during one day, but, in the case of FPS, overnight and – with weekends and Bank Holidays – over several nights;
- Depending upon the exact timing of flows during a settlement cycle, the net sender cap may need to be set nearer to the gross debit turnover, because a new entrant may not be able to predict timing as exactly as an experienced member might be able to, and they would not want to have payments blocked if they were dependent upon incoming funds and unsure exactly when those funds might materialise;
- For this same reason the new entrant would be well advised to own eligible collateral and to be able to regularly use the repurchase facilities with the Bank to create intraday liquidity; to do this the new entrant will have to have the infrastructure for managing this collateral, and the cash accounts and payments that go with it.

All this adds up to a degree of liquidity and net worth, and management effort which may make new entrants' business plans unviable. Over the longer term, a move towards real-time or at least continuous settlement across UK high and low value payments, could be considered as a means of extending all forms of access, but it is clear that settlement questions will require significant immediate focus if the overall objectives of increased competition and prudential safety are to be achieved.

London, 12 January 2015

Arun Aggarwal
Managing Director UK, Ireland & Nordics
SWIFT
55 Mark Lane, EC3R 7NE
arun.aggarwal@swift.com
Tel: +44 207 762 2009