BANK OF ENGLAND

Speech

The journey to best in class payments

Speech given by

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Good morning. I would first like to thank the Westminster Business Forum for inviting me to speak at today's seminar on the future for payments regulation in the UK.

When I first spoke at the Forum, three years ago, I highlighted the potential for considerable change in the payments industry in the UK. There was a sense that payments, a sometimes overlooked but vital sector of financial market infrastructure, was no longer going to be so quiet, and an unprecedented amount of innovation and change was on the horizon.

Consumer expectations around payments were evolving in response to the proliferation of mobile devices, smart phone technology and the ever-expanding range of services available through 'apps'. Contactless payment, using a card or mobile device, was becoming a daily reality for many. The term 'FinTech' was entering the mainstream.

Regulatory change was also underway. The Payment Systems Regulator was gearing up for launch with a mandate to promote innovation, competition and the interests of service-users. And at the Bank of England, we had recently created a directorate dedicated to ensuring financial market infrastructure, including payment systems, meet the necessary standards of robustness and resilience. Overall the pace of technical, structural and regulatory change in payments was poised to pick up.

And I have not been disappointed with the level of ambition and innovation we have seen in the past three years. Collectively, we have been on a journey; inching and in some cases taking great strides towards a payments landscape that is competitive, resilient and ready for the future. But, while considerable progress has been made, the journey to best in class payments is far from complete.

Whilst important milestones have been reached, many more lie ahead.

For example, one catalyst for change in UK retail payments was the creation of the Payments Strategy Forum (PSF) in March of 2015. And, with the formal consolidation of the Bacs and Faster Payments systems into the New Payment System Operator (NPSO) just last month, we can say that a key recommendation of the PSF has been delivered. But the NPSO now needs to turn its attention to developing and implementing the remaining critical recommendations which I will come on to discuss. We now need, collectively, to refocus our energies for the next leg of this journey towards best in class payments.

In line with this, today I would like to share how we at the Bank of England are looking to the future to ensure our systemically important payment systems are robust and resilient, their underlying infrastructure is best in class, and our regulatory toolkit remains fit for purpose and future-proof.

NPSO: A mandate to be greater than the sum of its parts

Payment systems, by their very nature, bring together participants that would otherwise transact bilaterally. Crucially, by doing so, they promote increased efficiency and resiliency that is enjoyed by all. They manage risks, eliminate intermediate arrangements and related costs at the back-end of the payments value chain, and provide functionality that enables innovation to proliferate at the front-end. As described in our Annual Report this year[1], financial market infrastructure, including payment systems, exist to reduce the risks and costs involved when participants make payments.

And this leads me to the NPSO and its creation. The PSF, established by the Payment Systems Regulator (PSR) in March 2015, proposed the consolidation of the UK retail interbank payment system operators: Bacs and Faster Payments, as well as the Cheque and Credit Clearing Company[2]. The Bank was engaged closely with the work of the Forum and was supportive of this change as we could see the potential for the consolidated scheme to be greater than the sum of its constituent parts. The consolidated entity is expected to deliver a range of benefits, including:

- Strategic leadership that is forward looking and proactive, with an enhanced ability to identify the challenges and risks of tomorrow and prepare for them today;
- Higher standards of governance and risk management, with an improved ability to leverage best practices across the schemes. As an example, a variety of access models have evolved in schemes over the years, and the NPSO is now in a great position to look across the schemes and consider which models deliver the best outcomes and risk management; and
- The development and delivery of a best in class New Payments Architecture.

The NPSO is also set up to be a leader in the field of retail payments. And the Bank is now their counterpart in the UK wholesale payments space, following the move to direct delivery of CHAPS, the UK's high value payment system (HVPS)[3] in November of last year. Collectively, these developments should lead to a considerable step change in risk management expertise, standards, and capabilities across the entirety of UK payments.

As an example of the two organisations working together to bring such change to the payments industry across wholesale and retail, the NPSO and the Bank recently launched a joint consultation on ISO 20022.[4] This move towards harmonised messaging standards will enable the transportation of richer payments data, improved compatibility and therefore redirection across payment schemes, and new opportunities for collaboration and product development. And parallel migration by both the Bank and the NPSO will encourage widespread adoption of ISO 20022, a precondition for unlocking these benefits. We encourage stakeholders to take this opportunity to feed into the process and help shape the future of payments in the UK.

So, what has been achieved?

The consolidation and transition of Bacs and the Faster Payments Service (FPS) to the NPSO has been delivered. On the 1st of May of this year, the NPSO formally took over responsibility for the operation of these

[1] See: The Bank of England's supervision of financial market infrastructures – Annual Report 2018.
[2] Which manages the paper processing system for cheques and the recently launched Image Clearing System.
[3] See: public statement on the commencement of the Bank's direct delivery of CHAPS.
[4] See: ISO 20022 consultation paper: a global standard to modernise UK payments.

two systemically important payment systems and was brought within the supervisory remit of the Bank. It has been operational for almost two months now, and, with the Cheque and Credit Clearing Company to be integrated shortly, another key milestone on this journey will soon be achieved. Between these retail payment systems, the NPSO will be responsible for the processing of £6.4 trillion payments each year, almost two and half times the UK's GDP.

I think we would all agree that its continued resilience and smooth functioning is a matter of primary concern. Our priority throughout this transition has been to ensure that it has been and continues to be managed in a way that promotes the robustness and resilience of the payment systems, and of wider financial stability. And a considerable amount of work was undertaken to achieve this - by the retail scheme operators, their participants and the NPSO.

What we now expect to see:

Tangible progress has been made, and this should rightly be recognised. But, as with any journey, we cannot lose sight of the work that lies ahead to deliver these benefits from consolidation.

The NPSO's primary focus should be on completing integration of the payment systems and embedding robustness and resilience within all of its activities, including the New Payments Architecture (NPA) programme. There is still much to do to complete the integration of these systems, from an organisational perspective, but also at the system level; completion of which will allow the NPSO to begin realising the ultimate goal of strategic leadership and higher standards of management and control.

For this to succeed, the NPSO's strategy will need to be realistic and consistent with its objectives and capabilities. It will also need to include an appropriate focus on reviewing and enhancing the activities the NPSO has inherited, to manage its own risk profile, its outsourced infrastructure partner, and risks to the wider system emanating from participants.

For our part, the Bank's long-term focus will be on ensuring that the Bacs and FPS systems are robust and resilient and able to play their part in mitigating systemic risk, and that the NPA is developed to maintain and enhance this. In the short term this means that we will focus our supervisory efforts on ensuring the NPSO effectively manages its integration to deliver the benefits of consolidation. In particular, we expect the NPSO to:

- Establish itself as a credible payment system operator, setting out a clear strategy for both what it will, and will not, do over the next three years;
- Provide strategic leadership within the retail payments ecosystem that is forward-looking;
- Demonstrate high quality governance across the systems it operates; and
- Put robustness and resilience at the heart of design decisions of the NPA.

Now, the NPSO does not exist in a vacuum. For this programme to succeed, support is necessary from the financial industry itself as well as the payments community and the authorities. The NPSO has a lot to deliver and a great many expectations upon it – but it cannot deliver everything at once. It is vital that stakeholders allow the NPSO the space and time to set out, and then ultimately deliver, a realistic but ambitious set of goals. And, equally, the NPSO will need to manage stakeholder expectations carefully. As the NPSO's supervisor we will watch closely to ensure the underlying resilience of the payment systems is maintained.

NPA: Resilience at its core

As I have said on many previous occasions, resilience is key. This is true both for the current systems being run by the NPSO, but also as it thinks about its journey to a new payments architecture. One of the NPSO's key priorities will be designing, developing and facilitating the safe and secure transition to this new architecture that will underpin retail payments in the UK. The NPA is intended to replace the three separate systems with an integrated framework which facilitates competition, innovation and interoperability.

When I last spoke to this Forum I discussed the PSF's vision for an NPA based on a Simplified Payments Platform and highlighted several key themes from a financial stability perspective. The NPSO inherited this blueprint for the NPA and it is now at the behest of the NPSO to decide how it will take these plans forward.

And this responsibility becomes even more demanding in the face of rapid change. Especially since the design and build of the new architecture will pose its own challenges. The NPA design must be driven by a strong business case; and resilience and security need to be built into every step of the NPSO's process from inception to any ultimate transition from one system to another. The smooth operation of payment systems must remain a priority. Any change or upgrade of capability must be managed in a way which minimises disruption or detriment to the important services provided and the wider financial system.

The Bank's role

Within this journey I've talked a lot about the important work that industry is driving, and I'm sure Hannah and Melanie will also touch on this today. However, I also want to reflect on what the Bank is doing to prepare for the changes we expect to see in the payments space. Not in the least to ensure that we, as a regulator, are not left behind.

As I have just discussed, we have a role through our supervision of Bacs and FPS, and now the NPSO, to maintain financial stability. We will continue to ensure that financial stability is at the heart of what the payment system operators do and that risks are being appropriately managed, particularly during this time of unprecedented change and innovation, and therefore heightened risk. However, we have also made wider changes to ensure we are well equipped for what is to come. Three developments are of particular importance.

1) A regulatory perimeter that is future-proof and appropriate for the innovations of tomorrow

When I spoke at last year's Forum, I highlighted two notable changes to the scope of our regulatory regime that were in-train. These have now been delivered to help ensure that the Bank is prepared for emerging and future technologies, participants, and relationships across the payments value chain.

Firstly, our regulatory perimeter has recently been expanded to allow us to supervise critical service providers to recognised payment systems and we have started supervision of our first service provider, VocaLink, who provides critical services to the Bacs, Faster Payments and LINK systems.

It is important to be clear here that this change does not, in any way, replace the role of the scheme operators in managing their risks. Indeed we do not expect scheme operators to change how they work as a result. Instead, we see this supervision as a complementary corner stone supporting financial stability. We published our supervisory approach to service providers in February, setting out how we will use international principles that are specifically tailored for this type of firm.[5]

Secondly, we worked with HM Treasury to further widen our regulatory perimeter to include non-interbank payment systems through the Digital Economy Act 2017. We are now in a position where a non-bank payment system, for example a 'FinTech' payment system whose users are not banks, can be brought under the Bank's supervision, should one become systemically important to the UK financial system.[6]

On both of these changes, the Bank has worked extensively with the other UK authorities to make sure our regime is future-proof and well-equipped to keep pace with and respond quickly to a payments landscape that continues to change shape. And we will continue to do so.

2) A renewed RTGS service

As the Bank, we not only need to ensure that the firms we supervise promote our broader financial stability objective, but that we are also facilitating it through the work we do as operator of the wholesale payment system.

The Bank has embarked on a programme of renewing its Real Time Gross Settlement (RTGS) service with a view to safeguard financial stability whilst enabling innovation. This is a multi-year programme, led by my colleagues in our Banking, Payments and Financial Resilience Directorate, to implement a world leading RTGS system in the UK. Collaboration with the payment sector to deliver this RTGS renewal programme is vital. To that end, the Bank has established an extensive industry engagement approach to gain views on the scope and approach of the programme and I encourage you all to engage with it.

The Blueprint for the new RTGS service was published in May of last year and important milestones have been, and continue to be, delivered along the way. At the end of last year, the Bank moved to a direct

[5] The expectations around service providers to recognised payment systems and the Bank's approach to their supervision are set out in Annex 1 of the Bank's Annual Report.
[6] In line with the recognition criteria laid out in the Banking Act 2009.

delivery model of the UK's high value payment system. This was to enable a single entity to manage risks right across the system, increasing resilience and positioning the UK at the leading edge of global best practice in terms of technology, governance and risk management for payment systems.

And from a regulatory perspective, the Bank's FMI Directorate continues to supervise the HVPS to the same standards as other systemically important payment systems. Since the transition, the Bank has introduced new mechanisms to maintain openness, accountability and challenge in the operation of the HVPS.[7]

As part of the wider renewal programme, the Bank has also broadened RTGS settlement account eligibility to non-bank payment service providers, subject to appropriate safeguards.[8] Non-bank payment service providers are now eligible to apply for direct access to payment systems, with TransferWise and Ipagoo becoming the first non-banks to join FPS and Bacs, respectively. Here, more diverse payment arrangements with fewer single points of failure, and increased settlement grounded in central bank money, all contribute to enhanced financial stability. And we cannot ignore the game changer that wider access represents for the promotion of innovation and competition in the payment market.

Taken together, these examples illustrate the Bank's work to stay in touch with the evolving payments sector and to facilitate innovation, wherever possible, in a thoughtful and proactive way.

Conclusion

To conclude, we in payments are working through a period of extensive change, on a journey to reinforce the UK as world leading in delivering best in class payments. It is important after key milestones have been delivered to take the time to reflect on how far we've come, but it is equally, if not more, important that we do not lose sight of the future, the benefits to be leveraged and the work that remains. Good progress has been made so far, but there is much left to do. And of course there will be challenges for firms as we continue along the course, navigating complexities around the implications of financial technology and EU withdrawal.

Seeing this journey through will require ongoing focus, care and attention from all involved. But I am confident that collectively we will get there.

[7] See: A blueprint for a new RTGS service for the United Kingdom.
[8] This includes having the operational capacity to operate a settlement account, and demonstrating compliance with a comprehensive risk management framework development with the Financial Conduct Authority, HM Treasury, HM Revenue & Customs, the PSR and the payment system operators.