

Policy Statement
Code of Practice and supervisory statement relating to
governance of recognised payment system operators
June 2017



BANK OF ENGLAND





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Purpose

On 29 September 2016 the Bank of England ('the Bank') published a consultation paper (CP) seeking views on a proposal to introduce a code of practice ('the code') and supervisory statement (SS) on the governance of recognised operators of payment systems (RPSO), being those payment systems specified by order as recognised systems under section 184 of the Banking Act 2009 ('the Act'). The Bank proposed, however, that the code will not apply to a recognised payment system that is operated by a recognised clearing house (RCH) or central securities depository (CSD), given they are or will be subject to other requirements (eg EMIR and CSDR).

This Policy Statement (PS) summarises the responses to the consultation and sets out the final code (Annex 1) and SS (Annex 2) on governance.

References in this PS to 'Articles' relate to Articles of the code.

Introduction

The Bank has decided to develop a code for payment system operators that have been recognised by HM Treasury under the Act. The code will provide transparency on the minimum requirements that all RPSOs to which the code applies must meet. The code is being issued under section 189 of the Act; this means that it will be binding on RPSOs to which it applies. If a RPSO fails to comply with its requirements, the Bank may take enforcement action against the RPSO. The Bank's enforcement powers are set out in the sections 196-202A of the Act.

The Bank has also decided to introduce a SS to complement the code. The SS will set out in more detail how the Bank expects RPSOs to which the code applies to comply with the provisions in the code. Unlike the code, the provisions in the SS will not in themselves be binding although they will provide RPSOs with guidance as to how the Bank will assess compliance with the code. Consequently, a RPSO may demonstrate that they meet the requirements of the code in some other way, if appropriate to its business.

This PS sets out responses to the Bank's CP on Part 1 of the code which concerns governance and related issues only. This part provides transparency on the minimum requirements that all RPSOs to which the code applies must meet when designing and operating their governance frameworks. It will also provide clarity for RPSOs undertaking or planning governance changes as to what the Bank's expectations are. We confirm that the code will be implemented on 21 June 2018.

The Bank may develop further parts of the code and additional SS in the future to set out requirements and expectations in other areas. These will be subject to consultation.

Approach

Good governance is critical to successfully managing risk and controls in payment systems and RPSOs need effective governance structures in place to provide leadership and drive change in pursuit of their objectives.

The Committee on Payment and Settlement Systems⁽¹⁾ and the International Organization of Securities Commissions *Principles for financial market infrastructures* (PFMI)⁽²⁾ form the basis for this code. The Bank has also taken into account the UK Corporate Governance Code,⁽³⁾ Prudential Regulation Authority (PRA) governance requirements, EU requirements on other FMIs and lessons learned from the Bank's own supervisory assessment of governance in some RPSOs. As a result, in some areas, and in line with many other jurisdictions, the Bank sets more specific requirements or provides more detailed guidance to RPSOs than is contained within the PFMI. This extra detail is predominantly contained within the SS.

In 2012, the Bank adopted the PFMI as a published set of principles to which recognised payment systems operators are to have regard, pursuant to section 188 of the Act, and these will continue to apply.

Once the code is implemented, the Bank will no longer expect independent non-executive directors (INEDs) to have an explicit veto for public interest reasons, given that the composition of the board should ensure independence, and the board in its entirety would be expected to perform the function of systemic risk manager.

Response to consultation and final code and supervisory statement

We received thirteen responses to the consultation (from the six RPSOs, the INEDs of another PSO; five banks and one trade association). Respondents supported the introduction of the code and were broadly supportive of the proposals in the CP. The majority of comments related to points of detail or clarification. These comments and our responses are set out below.

(1) Renamed the Committee for Payments and Market Infrastructure (CPMI) in September 2014.

(2) www.bis.org/publ/cpss101.htm.

(3) www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2016.pdf.

Systemic risk manager

Background

The code sets out that a RPSO to which the code applies must be a systemic risk manager. The PFMI state that an RPSO's governance arrangements should promote the safety and efficiency of the payment system and support the stability of the broader financial system.⁽¹⁾ The SS sets out in more detail what the Bank expects a systemic risk manager to deliver. This includes considering how RPSOs' actions may impact financial stability and the management of the end-to-end risks, including operational risk and financial risk. The code also sets out that a RPSO to which the code applies must have objectives that support financial stability and the board must establish and approve the risk management framework.

Responses

Respondents generally supported the proposals with some suggesting various changes which we considered. The most material changes to the code are outlined below:

- One respondent questioned whether, in draft Article 2.2, it was appropriate to give equal weight to safety and efficiency. In response, we have amended the code and the SS, reflecting the concept of 'safety and efficiency' (which is derived from the PFMI (Principle 2)) in the SS and expanding Article 2.1 of the code to retain the reference to financial stability within the code, reflecting the Bank's mission.
- One respondent suggested that the code should state that the board must ensure that it has a clear understanding of the end-to-end risks within the payment systems. We agree with this and have included it in Article 2.3(1).

In relation to the SS, we received two substantive comments:

- One respondent asked for clarification of our expectations in relation to indirect participants. The SS says that references to 'participants' refers to direct participants and indirect participants 'where relevant'. The Bank considers that a RPSO, in determining the scope of its responsibilities as a systemic risk manager, should consider the impact of indirect participants on the resilience of the system, and where indirect participants can affect the resilience and smooth running of the system the RPSO should seek to manage and mitigate those risks in a proportionate way. We therefore propose to make no change.
- One respondent proposed that the expectation that RPSOs undertake 'end-to-end testing of the payment system' should be modified to say 'appropriate end-to-end testing'. We expect RPSOs to apply all of the code and SS in an appropriate, reasonable and proportionate way and we therefore do not consider it necessary to specify it in this particular section.

One respondent recommended keeping the SS under review and expanding on it over time if required. We agree with this recommendation and will review the SS in light of experience.

Governance arrangements

Background

The code sets out expectations for what a RPSO's governance arrangements should include. The SS provides further clarity on some of these expectations, particularly with regard to board responsibilities and committees. This includes that the board is the ultimate decision-making body and, while it can delegate decisions, it remains accountable for them.

Responses

Respondents generally supported the provisions and sought minor clarifications and additions as set out below. One respondent stressed the importance of the funding model of a RPSO to the effectiveness of the governance arrangements. We acknowledge the point being made, but concluded that this was not best addressed in this part of the code. However we have amended Article 3.2 to state that RPSO governance arrangements must include a description of the means by which the RPSO is financed.

One respondent stressed the importance of a company vision, mission statement and/or set of values in a RPSO's governance arrangements. We agree that these are ways in which RPSO governance arrangements might fulfil certain requirements of our code. However, we do not consider that this has to be prescribed within the code and do not feel that further elaboration is required in the SS.

Paragraph 6 (bullet 3) of the SS as drafted stated that 'Major decisions should be clearly disclosed to relevant stakeholders and, where relevant, the public'. One respondent proposed adding that major decisions should also be disclosed to corporate service users. Another respondent proposed that in addition to disclosing major decisions, a RPSO should be required to consult before making significant changes (eg changes to rules, business plan). The provision as drafted reflected the language of the PFMI Principle 2, Key Consideration 7 and it was not our intention to set additional expectations in this area. Consequently we have removed this provision from the SS and clarified upfront in the SS that the PFMI continue to apply.

Composition of the board

The code sets out the Bank's requirements on the composition of the board, including that the board must be independent and appropriately balanced. The SS clarifies what the Bank considers to be a sufficiently balanced and independent board, including that a minimum of a third of the RPSO's board comprise independent non-executive directors (INEDs) and

(1) Principle 2 of the PFMI.

that the board contains at least one executive director and two INEDs.

However, the Bank recognises that some other governance standards, including the PRA's, expect that half of a board should be independent. The CP therefore specifically asked for views on whether the SS should set expectations that a minimum of half of the RPSO's board be independent, rather than a third.

Responses

The majority of respondents supported the approach set out in the SS, although one respondent favoured a minimum of half the board being INEDs and several opposed the SS specifying any minimum ratio. One respondent expressed concern that given its business model, having a third of the board as INEDs could dilute and weaken the governance arrangements. Several of the respondents emphasised the importance of a balanced and appropriately skilled board and, in particular, a few noted the importance of the contribution of the Participant Directors.

In light of these responses, we propose to retain the expectation in the SS that a minimum of a third of the board will be INEDs. We consider that this will enable RPSOs to balance the need for independence and expertise and, in particular, reflects the fact that many RPSO boards contain three constituencies (Executive, Participant and INED). This provision sits within the SS and not the code. Consequently, if an RPSO considers that this is not appropriate to its business model, it has the option of demonstrating that it can meet the requirements of the code through an alternate structure.

One respondent asked for clarification of the term 'INED'. Our decision not to define an INED is consistent with the approach taken in the PRA rulebook. However, we have noted in the SS that an RPSO may wish to take account of the UK Corporate Code, which includes guidance on factors to consider in assessing independence, but an RPSO should ultimately make its own assessment of whether a potential INED is suitably independent.

One respondent suggested that the SS should state that the Risk Director and Finance Director should sit on the board. We agree that in some cases it would be appropriate for one or both of these role holders to act as board directors and we consider that this is compatible with our current expectation which states that 'at least one member of the executive' sits on the board.

We received several comments in relation to our expectations of board sub-committees.

- One respondent asked for clarification of whether the provisions in the SS relating to the combination of executive

directors, non-executive directors and INEDs on board committees apply to board committees. This was not our intent and we have clarified the SS accordingly.

- One respondent commented that a minimum of one INED should attend and chair any board sub-committee. We considered this and concluded that, in order to ensure appropriate independence from the executive, all board committees should be chaired by a non-executive director, but not necessarily an INED in all cases.
- One respondent questioned the proposal that only board members should have voting rights on board sub-committees, arguing that this could result in the loss of specialist input to a board sub-committee. We have considered this and concluded that we will not retain this proposal. However, a RPSO and all committee members should understand that anyone sitting on a board committee is acting in the interest of the RPSO only and not, for example as a representative of a participant.

In light of these comments we have made the following changes:

- We have clarified in the code and SS whether the provisions apply to the board only or to the board and its committees.
- We have removed the requirement that only board directors have voting rights on board sub-committees.
- We have added provisions to the SS which specifically address board committees. These include the following:
 - Members of a board sub-committee should understand that they are acting solely in the interests of the RPSO (paragraph 8, bullet 3).
 - A board committee should be chaired by a non-executive director and committees which address governance or the assessment of risks should be chaired by an INED (paragraph 14).
 - A risk committee should have mechanisms to reflect the systemic risks to the ecosystem through participant membership or some other mechanism (paragraph 15).

One respondent expressed concern that specifying that a senior INED is responsible for holding the chair to account is too prescriptive and could dilute collective board responsibility. We have amended to SS so that it now states, in the section on performance management, that there should be appropriate mechanisms to review the performance of the chair including an accountable person, who should be a senior INED.

The Executive

The code sets out that the board must ensure that the executive have appropriate skills and experience and act appropriately.

Responses

Respondents generally agreed with these provisions except that a few questioned whether it was appropriate to require that the board 'ensure that the members of the executive... are provided with the appropriate information'. We agree that this was incorrect and have amended this so that it states that the board must ensure that the executive provides the board with appropriate information.

Conflict of interest

The code sets out that the board must have a procedure to identify and manage conflicts of interest. The SS sets out examples on the types of conflict that can arise.

Responses

Respondents supported these proposals and made no comments. We are making no changes.

Performance management

The code sets out that the board must review its performance at least annually, in addition to seeking regular independent performance assessments, and there must be procedures for managing the performance of the executive.

Responses

Two respondents asked for clarification of the requirement for a 'regular' review of board effectiveness. We consider that an RPSO should determine how frequently this is required and we do not propose to set a more prescriptive requirement. We have therefore made no change.

Records

The code requires that governance arrangements, policies and procedures should be documented and kept up to date.

Responses

Respondents supported these proposals and made no comments. We are making no changes.

Firms subject to supervision by multiple regulators

We consulted on the basis that the code and SS will apply to all RPSOs (excluding those operated by a RCH or a CSD).

Where RPSOs are supervised by authorities in other jurisdictions, for financial stability purposes, the CP indicated that the Bank expects the RPSO to abide by the code and discuss the applicability of the SS to their situation with us.

Some RPSOs are regulated by multiple entities including the Payment Services Regulator (PSR). The CP therefore indicated that the Bank would expect RPSOs to consider, and be able to demonstrate if required, how their governance arrangements also take into account the objectives and requirements of other regulators such as the PSR, in the case of RPSOs that are also designated under the Financial Services (Banking Reform) Act 2013.

Responses

Respondents were generally content with the proposed approach but there were a few specific comments.

Of the RPSOs supervised by the Bank, one (CLS) operates on a cross-border basis and is overseen by other authorities with financial stability objectives similar to those of the Bank, using an oversight regime which is based on the PFMI, and which involves close co-operation with overseas authorities including the Bank. Three respondents questioned the applicability of the code to such a RPSO. We have reflected on this feedback and carefully considered this from a general policy perspective and assessed the specific case in respect of CLS.

Taking account of Responsibility E of the PFMI,⁽¹⁾ we have concluded that the existing model for the supervision and oversight of CLS is an example of effective international co-operation. Authorities in the United States, led by the Federal Reserve Bank of New York, have responsibility for direct oversight of CLS along with the central banks of the 18 participating currencies, in the CLS supervisory college.⁽²⁾ We engage directly with the US authorities and also participate in college activity.

Having discussed this matter with the Federal Reserve Bank of New York, we believe that the requirements of the code are consistent with, and would not conflict with, their supervisory approach. However, we recognise the point raised by respondents that national authorities placing a RPSO under more than one set of requirements which are designed to achieve the same outcome may be inefficient and, in some cases, could lead to materially different and potentially conflicting requirements.

The Bank has statutory requirements and supervisory functions which apply to a recognised payment system whether or not it operates wholly or partly in relation to persons or places outside the United Kingdom (section 182 of the Act). In respect of a RPSO based overseas, we do not consider that these requirements and functions require us to bring such a RPSO within the scope of the code in

(1) Responsibility E (co-operation with other authorities) of the PFMI covers how central banks, market regulators and other relevant authorities are to co-operate with each other, both domestically and internationally, as appropriate, in promoting the safety and efficiency of FMIs.

(2) See www.cls-group.com/MarketInsight/RegAffairs/Pages/IP.aspx.

circumstances where we consider that: the RPSO is subject to a domestic regime for supervision or oversight with the objective of promoting financial stability and which implements the PFMI; and arrangements for international co-operation are in place that enable us to discharge our statutory requirements and supervisory functions in respect of the RPSO.⁽¹⁾ We will assess this for any overseas RPSO on an ongoing basis. Our current assessment is that these criteria are currently met with respect to CLS and therefore we do not propose to apply the requirements of the code to CLS at this point.

Separately, one respondent suggested that a passage of the draft SS which referred to the disclosure of major decisions should be aligned with PSR requirements (PSR GD6) which relates to the confidentiality of legally privileged or competitive information. We have decided to remove this provision from the SS because its inclusion in the draft SS reflected PFMI Principle 2: Key Consideration 7 and did not therefore set any new expectations on RPSOs. We have added some explanatory text early in the SS confirming that the PFMI continue to apply and that the SS is not intended to be a substitute for reading and having regard to the PFMI.

UK payments landscape

Transitional period for compliance

The Bank notes that the Payment Strategy Forum (PSF) issued its final strategy document on 29 November 2016 which, among other things, recommends consolidation of three retail payment system operators (Bacs Payment Schemes Ltd, Faster Payments Scheme Ltd and Cheque and Credit Clearing Company Ltd) into a single legal entity (referred to as the 'new PSO' below). On 4 May 2017, the new PSO Delivery Group published its report on this consolidation. It is expected that this consolidation will occur by no later than 31 December 2017. The Bank expects that any new PSO will be a RPSO and will therefore fall within the scope of these requirements and expectations. The timeframe for implementation of this code takes this into account.

Responses

Several respondents made the point that the consolidation of retail interbank payment systems into the new PSO required careful consideration and that the Bank's expectations should be aligned with this change. Some of these respondents raised questions over whether the transition period was sufficient. We believe that the twelve-month transition period is reasonable and appropriate. The Bank will continue to liaise directly with affected RPSOs on how to manage their transition and our expectations during the transition period. We also note that there are RPSOs not directly affected by the scheme consolidation to whom the code will also apply.

One respondent argued that if we were to require a minimum number of INEDs then there should be a transitional period of five years. As indicated above, the detailed provisions on the composition of the board sit within the SS rather than the code and we therefore do not consider that a five-year transitional period is required.

The code will come into force on 21 June 2018.

The Bank expects that RPSOs begin to self-assess their compliance and put in place transition plans to ensure that they meet the requirements of the code, including having made any necessary changes, by the coming into force date. The supervisors at the Bank will discuss these transition plans with their respective RPSOs. A RPSO that is newly recognised would have twelve months from the date of recognition to comply with the requirements of the governance part of the code.

Other matters

Having had regard to the public sector equality duty under the Equality Act 2010, the Bank does not consider this package to have any implications for equality matters.

The code and SS are based on best practice drawn from international principles and commonly used UK standards. It is compatible with the Bank's financial stability objective in that it facilitates robust governance which prioritises systemic risk management.

Responses

One respondent queried whether the Bank had undertaken adequate cost-benefit analysis of the extent to which there was overlap with existing legal or regulatory requirements and the costs and benefits of the new requirements.

The provisions of the code and SS are based on the PFMI. In addition, we reviewed relevant provisions of the UK Corporate Governance Code, European Regulations (EMIR and CSDR) and the PRA rulebook to ensure that we were consistent to the extent appropriate. We also consulted with other relevant regulators such as the PSR and overseas regulators. We are consequently satisfied that the requirements of the code reflect commonly applicable standards and are consistent with other relevant regulatory regimes. In relation to the SS, these provisions represent guidance and set out how we expect RPSOs will comply with the requirements of the code. However, a RPSO may demonstrate that it complies with the code in an alternative way if the particular circumstances of that RPSO make the expectations set out in the SS inappropriate or unduly burdensome. The expectation that RPSOs have at least a third of their board comprising INEDs is

⁽¹⁾ In addition, we note that in 2012 the Bank adopted the PFMI as a published set of principles to which RPSOs are to have regard (pursuant to section 188 of the Act), and the PFMI continue to apply.

the only expectation with potentially a material cost, depending on a RPSO's current board composition. That said, independence of the board is essential to good governance and, therefore, the Bank believes that this is a reasonable and proportionate expectation. Some RPSOs already meet these expectations, with others requiring only minimal changes.

List of non-confidential respondents to the consultation

Bacs Payment Schemes Ltd
Barclays Bank plc
CHAPS Co
CLS Bank International
Faster Payments Scheme Ltd
HSBC Bank Ltd
The Independent Directors of the Cheque and Credit Clearing Company Ltd
Link Scheme Ltd
Lloyds Banking Group
Payments UK
The Royal Bank of Scotland plc
Santander UK plc
Visa Europe Ltd

Annex 1

CODE OF PRACTICE ABOUT THE OPERATION OF RECOGNISED PAYMENT SYSTEMS

Powers exercised

- A. This code of practice is published under section 189 of the Banking Act 2009.
- B. A failure to comply with this code will constitute a “compliance failure” under section 196 of the Banking Act 2009, which can result in the imposition of a sanction under section 198 to 200 of the Banking Act 2009 (financial penalty, management disqualification, and in certain specified circumstances, a closure order). It can also involve publication of the details of the compliance failure and any sanction imposed (section 197 of the Banking Act 2009).

Commencement

- C. This code of practice comes into force on 21 June 2018

Citation

- D. This code of practice may be cited as the Bank of England Recognised Payment Systems Code of Practice.

21 June 2017

PART 1: GOVERNANCE

1 APPLICATION AND DEFINITIONS

- 1.1 This code of practice applies to a *RPSO* that is not operated by a recognised clearing house or a central securities depository unless 1.2 applies.
- 1.2 The Bank of England may notify a *RPSO* that this code shall not apply to it where:
 - (1) The *RPSO* is not incorporated in the UK; and
 - (2) The Bank of England considers that:
 - (a) the *RPSO* is subject to a domestic supervisory or oversight regime that has the objective of protecting and enhancing financial stability and which implements the Committee for Payment and Market Infrastructure and the International Organization of Securities Commissions ‘Principles for financial market infrastructures’; and
 - (b) arrangements in place for international cooperation enable it to discharge its statutory requirements and supervisory functions in respect of the *RPSO*.
- 1.3 The following definitions shall apply:

board

means a *RPSO*'s body or bodies which are appointed in accordance with national law, which are empowered to set a *RPSO*'s strategy, objectives and overall direction,

and which oversee and monitor executive decision-making, and include the persons who effectively direct the business of a *RPSO*.

executive

means the senior management of a *RPSO* who are responsible for and accountable to the *board* for the day-to-day management of the *RPSO*.

RPSO

means a recognised payment system operator that is the operator of a payment system specified by order as a recognised payment system under section 184 of the Banking Act 2009.

2 SYSTEMIC RISK MANAGER

- 2.1 A *RPSO* must perform the function of a systemic risk manager, including by having objectives that support financial stability.
- 2.2 A *RPSO* must establish and maintain a clear internal control and risk management framework that:
- (1) includes the *RPSO*'s risk-tolerance policy;
 - (2) assigns responsibilities and accountability for risk decisions; and
 - (3) addresses decision making in crises and emergencies.
- 2.3 In relation to a *RPSO*'s function and obligations in this chapter, the *board* must:
- (1) ensure that it has sufficient understanding of the risks to the end-to-end flow of payments across the payment system;
 - (2) ensure that it receives appropriate information;
 - (3) have sufficient oversight as to how a *RPSO* performs this function; and
 - (4) approve and periodically review the risk management framework to ensure that it is fit for purpose.

3 GOVERNANCE ARRANGEMENTS

- 3.1 A *RPSO* must have governance arrangements that:
- (1) are clear and transparent; and
 - (2) promote the safety and efficiency of the payment system.
- 3.2 In relation to a *RPSO* the governance arrangements must include:
- (1) a description of:

- (a) the roles, responsibilities and lines of accountability of the *board* and *executive*;
 - (b) the functioning of the *board*;
 - (c) the ownership structure;
 - (d) the means by which the *RPSO* is financed; and
 - (e) the strategy of the *RPSO*;
- (2) the mechanisms for regular review of its efficiency and effectiveness;
- (3) the design of risk management, internal control and audit functions, including a description of how these functions have adequate authority, independence, resources and access to the *board*;
- (4) the procedures for:
- (a) the appointment of *board* members and the *executive*; and
 - (b) the recruitment, induction and training arrangements for the *board*; and
- (5) the policy regarding the term of appointment for the *board*.
- 3.3 In this chapter references to the *board* include the *board* and its sub-committees except where 3.2(5) applies.

4 COMPOSITION OF THE BOARD

- 4.1 A *RPSO* shall ensure that the members of the *board*:
- (1) are of sufficiently good repute;
 - (2) possess sufficient knowledge, skills and experience to perform the role for which they are appointed;
 - (3) act with honesty and integrity; and
 - (4) commit sufficient time to perform their functions in the *RPSO*.
- 4.2 The composition of the *board* must be appropriately balanced in order to facilitate the *board* carrying out its duties in an independent manner and must:
- (1) collectively possess:
 - (a) adequate knowledge and skills; and
 - (b) a broad range of experiencesto understand the payment system, including the main risks and controls; and
 - (2) have an appropriate combination of executive and non-executive directors including a substantial and effective number of independent non-executive directors.

- 4.3 In this chapter references to the *board* includes the *board* and its sub-committees except where 4.2(2) applies.

5 THE EXECUTIVE

- 5.1 The *board* must ensure that the members of the *executive* of a *RPSO*:
- (1) possess appropriate skills and experience necessary to discharge their responsibilities for the operation and risk management of the payment system;
 - (2) act with honesty, integrity and due skill, care and diligence; and
 - (3) provide it with appropriate information and support to discharge the *board's* responsibilities effectively.

6 CONFLICT OF INTEREST

- 6.1 The *board* must have in place a policy and procedure to identify, address and manage conflicts of interest.

7 PERFORMANCE MANAGEMENT

- 7.1 The *board* must review its overall performance, and the performance of its individual members at least annually.
- 7.2 A *RPSO* must:
- (1) ensure that the effectiveness of the *board* is assessed independently on a regular basis; and
 - (2) have procedures for ensuring and assessing the performance management of the *executive*.
- 7.3 In this chapter references to the *board* includes the *board* and its sub-committees.

8 RECORDS

- 8.1 A *RPSO* shall ensure that the objectives, risk management framework, governance arrangements, policies and procedures in chapters 2, 3, 6, and 7 are:
- (1) documented in writing;
 - (2) approved by the *board*; and

(3) reconsidered from time to time by the *board* to ensure they remain fit for purpose.

9 TRANSITIONAL PROVISIONS

9.1 This code of practice shall not apply for the first twelve months after a payment system becomes a *RPSO*.

Annex 2

Supervisory statement for operators of recognised payment systems: governance

1 This supervisory statement applies to recognised payment systems operators (RPSOs) to which the corresponding Code of Practice (Bank of England Recognised Payment Systems Code of Practice) ('the code') applies. References to Articles are references to the relevant Articles of the code.

2 This supervisory statement should be read alongside the code and does not replace it. It provides additional guidance on how the Bank of England ('the Bank') expects RPSOs to comply with some elements of Part 1: Governance of the code.

3 In 2012, the Committee on Payment and Settlement Systems⁽¹⁾ and the International Organization of Securities Commissions 'Principles for financial market infrastructures' (PFMI)⁽²⁾ were adopted by the Bank as a published set of principles to which RPSOs are to have regard, pursuant to section 188 of the Banking Act 2009. The PFMI continue to apply. At certain points in this supervisory statement we have referred to relevant text from the PFMI but this statement is not intended to be a substitute for reading and having regard to the PFMI.

Systemic Risk Manager

4 The Bank, in Article 2.1, requires a RPSO to function as a systemic risk manager, including by having objectives that support financial stability.

5 As set out in the PFMI, a RPSO should place a high priority on the safety and efficiency of the operation of the payment system.

6 In respect of Article 2.1 the Bank expects that a RPSO shall, as a minimum:

- assess and mitigate the impact of the RPSO's own requirements and actions on UK financial stability. This might include, but would not necessarily be limited to:
 - considering in the design and implementation of its requirements and actions, the potential impact on the financial position of participants⁽³⁾ and/or the ability of participants to maintain access to the relevant payment system; and
 - considering the risks that the RPSO may pose to other payment systems and other financial market infrastructures.

- assess and mitigate financial risks that may build-up in the payment system between participants (eg tiering risk), and between participants and the RPSO; and
- assess and mitigate operational risks to the end-to-end flow of payments across the relevant payment system. This might involve, but would not necessarily be limited to:
 - setting rules, standards, service level agreements or similar for participants of, and critical service providers to, the payment system; assessing appropriate delivery against such rules, standards or service level agreements; and taking appropriate action in the event of any non-compliance;
 - identifying and managing any incidents or issues that could cause, or are causing, widespread disruption to the smooth flow of payments across the payment system and/or reputational risk to the payment system, whether caused by one or more participants or critical service providers, and assessing lessons learned from such incidents and reflecting these in rules, standards, service legal agreements or similar, as appropriate;
 - undertaking end-to-end testing of the payment system, including simulating the operation of the system under extreme scenarios; and
 - putting in place and maintaining business continuity plans that include consideration of risks to the end-to-end system.

7 The RPSO should consider the above aspects in the context of setting its risk appetite and in the design of its risk metrics.

Governance Arrangements

8 The governance arrangements referred to in Article 3.2 should include:

- A clear articulation of the RPSO's board and committee structure which appropriately differentiates between board committees and other committees (eg participant or executive committees).
- Clear terms of reference for the board and its committees which set out the purpose, membership, responsibilities, delegated authorities and reporting lines.
- A clear articulation of the responsibilities of committee members and the capacity in which they sit on a committee.

(1) Renamed the Committee for Payments and Market Infrastructure (CPMI) in September 2014.

(2) www.bis.org/cpmi/publ/d101.htm.

(3) In this document, references to 'participants' should be taken to refer to direct participants and, where relevant, indirect participants.

In order for board committees to be independent, all members of a board committee should understand that they sit on the committee solely in the interest of the RPSO and not, for example, as a representative of a participant. A board director who is a member of a non-board committee should understand that they are not acting as a board director in that context.

9 The Bank requires in Article 3.2(1)(a) that the governance arrangements should describe the roles, responsibilities and lines of accountability of the board. The Bank expects these arrangements to be disclosed to owners, relevant authorities, participants, and, at a more general level, the public. In describing the responsibilities and lines of accountability, a RPSO should take into account the following:

- The board of a RPSO is ultimately responsible for the decisions and actions of the RPSO. It can delegate decisions and responsibilities, but it remains accountable.
- The board of the RPSO should be aware of the environment in which it is operating and of all its regulatory responsibilities. This should include any responsibilities imposed by other regulators where a RPSO is regulated by multiple regulators.

Composition of the board and board committees

10 The Bank requires in Article 4.2 that the board and its committees each be appropriately balanced to facilitate the carrying out of their duties in an independent manner and that they each collectively possess adequate knowledge and skills.

- In order to ensure an appropriate balance of skills and knowledge, the Bank would expect the board to identify the skills and experience that it requires. This should include, but not necessarily be limited to:
 - understanding of fiduciary duties;
 - relevant experience (eg of payment systems, board membership, wider financial system);
 - interpersonal skills;
 - strategic awareness;
 - understanding of risks and internal controls and management; and
 - relevant technical knowledge.

11 The chair should assess the skills of the board against its requirements periodically and identify any gaps. Likewise, the chairs of board committees should periodically assess the skills of the committees they chair. There should be an appropriate programme to ensure that the board and individual directors, and members of board committees, have the necessary skills and knowledge to fulfil their responsibilities, including understanding their fiduciary duties. This should include, but not necessarily be limited to:

- a comprehensive induction programme;
- individual development plans;
- board training/development programmes; and
- periodic updates on external and internal developments.

12 The Bank requires in Article 4.2(2) that a RPSO board comprise an appropriate combination of executive and non-executive directors including a substantial and effective number of independent non-executive directors ('INEDs').⁽¹⁾

13 To be independent and appropriately balanced, no single group should be able to dominate the board. In addition, in order to meet these requirements, the Bank expects that:

- The board will contain at least one member of the executive.
- The board will have a minimum of two INEDs.
- A minimum of a third of the board will comprise INEDs. The INEDs individually and collectively should have the competence and capability to ensure a balanced board and that the risks arising from the conflicts of interest (as set out below) can be managed.
- The chair of the board will be an INED.

14 In order to ensure an appropriate degree of independence from the executive, the Bank expects that all board committees should be chaired by a non-executive director. In addition, those board committees which address governance issues or the assessment of risk should be chaired by an INED, eg the nomination, risk, audit and finance committees. The RPSO should consider whether it is necessary for an INED to chair other board committees.

15 In order to fulfil the responsibilities of a systemic risk manager, the board risk committee should take account of the wider risks in the payments ecosystem. RPSOs may include risk committee members nominated by participant firms to support this. Where this is not the case, the RPSO should be able to demonstrate that it has alternative mechanisms to ensure that the risk committee appropriately considers the wider risks in the payments ecosystem in its deliberations.

Conflict of interest

16 The Bank requires (Article 6.1) that a RPSO board must have a process for identifying, addressing and managing conflicts of interest. Examples of potential conflicts that would need to be managed include, but are not limited to the following:

(1) See the treatment of independence in the UK Corporate Governance Code (www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2016.pdf) which may assist a RPSO in identifying factors for consideration when determining the independence of non-executive directors, but which should not be exclusively relied upon to meet the requirements of Article 4.2(2) of the code.

- where a director is an employee of a participant, a conflict arises as the board is responsible for setting, assessing and enforcing rules that apply to that participant;
- where a director is an employee of a participant, a conflict arises as the board is likely to decide upon issues that could impose costs on that participant;
- where a director is an employee of a parent company that owns the RPSO, a conflict can arise where a director sits as representative of the parent on the subsidiary; and
- where a director represents an organisation which has ownership of a critical service provider conflicts can arise, eg when discussing contract terms, or possible contract termination.

17 These conflicts do not mean such people cannot serve on a RPSO's board. Indeed, conflicts could be managed through a variety of methods, including recusal, ring-fencing of information and separation of roles. In addition, the INEDs would have a key role in ensuring that the board collectively

mitigates the risk arising from conflicts of interest faced by individual directors (as indicated above).

Performance management

18 The Bank expects a RPSO, as part of its performance management arrangements, to have in place the means necessary to ensure that the chair of the board is held to account, eg through consideration of the chair's performance, appointment/reappointment, remuneration and training. The Bank further expects that a senior INED should have ultimate oversight of the means by which the chair of the board is held to account.

Transitional arrangements

19 The code contains a transitional provision stating that it does not apply for the first twelve months after a payment system is recognised as a RPSO. The Bank expects, however, that a newly recognised payment system will make all reasonable effort to work towards full compliance as soon as practicable in its first year, and in any event will be fully compliant by the end of the twelve month period.