The Bank of England's supervision of service providers to recognised payment systems

The Bank's approach to the supervision of service providers to recognised payment systems specified under the Banking Act 2009.

What is a service provider?

The ability of a recognised payment system to deliver its responsibilities may depend on the functioning of other infrastructure or service providers (SPs) to which it has outsourced critical parts of its operations. SPs deliver functions which are essential to the operation of a recognised payment system such as information technology, telecommunications, or messaging services.

Why has the Bank started supervising specified SPs?

HM Treasury (HMT) has extended the Banking Act 2009 ('The Act') under s.206A, allowing the Act to be applied to service providers to recognised payment systems. In order for this to occur, HMT must specify a service provider in the recognition order of the payment system to which it relates. This action brings a service provider into the Bank's direct supervision. Although the Bank has existing expectations of how RPSOs should manage their SPs, additional powers over certain SPs are considered necessary to enable the Bank to effectively deliver its mandate. In these cases, the Bank's ability to supervise SPs will support the Bank's objective of protecting and enhancing financial stability.

RPSOs will continue to have a primary role to play in monitoring, managing and mitigating risks that their service providers pose to their systems, and the Bank's expectations in this regard are unchanged. The role of the Bank and RPSOs in overseeing risk from service providers will be different and complementary.

What powers will the Bank have over specified SPs and what will specified SPs need to do?

Section 188 of the Act gives power to the Bank to publish principles to which service providers are to have regard. The Bank requires service providers specified under the Act to have regard to Annex F (Oversight expectations applicable to critical service providers) of the CPMI-IOSCO 'Principles for Financial Market Infrastructures'(1) (Annex F). The expectations set out in Annex F should ensure that the operations of an SP are held to the same standards as if the RPSO itself provided the service. The expectations are written at a broad level to allow SPs flexibility in demonstrating their compliance.

SPs have responsibility for satisfying the expectations as set out in Annex F. The Bank expects SPs to complete a self-assessment against the Annex F expectations annually, and to provide this to the Bank. This self-assessment is an important test of an SPs' ability and willingness to demonstrate their understanding of, and commitment to, risk objectives. Self-assessment does not, however, mean self-regulation. The SP's self-assessment does not replace the Bank's own judgement, but is one input to the Bank's assessment. It is viewed as indicative of the SP's own risk tolerance and risk management capability.

The expectations outlined in Annex F are specifically targeted at SPs and cover:

- risk identification and management;
- robust information security management;
- reliability and resilience;
- effective technology planning; and
- strong communications with users.

In addition to requiring specified SPs to have regard to Annex F, the Bank has a range of other powers and expectations of specified SPs. These include tools for intervention and enforcement in the event that SPs fail to satisfy supervisory requirements. These powers fall into four main areas (information gathering; imposing requirements and rules; powers of direction; and enforcement). They are set out in Part 5 of the Act. The most widely used powers and expectations include:

- The Bank requires data from SPs it supervises to inform its supervisory and systemic risk analysis. The Bank will discuss its data needs, and the appropriate mechanism to collect those data, with individual SPs.
- The Bank has powers to commission reports from external experts where it judges them necessary or useful — for example to diagnose risks. Reports from external experts may be required in response to specific needs as they arise.
- The Bank will assess some proposed appointments to an SP's board, and some senior executive positions, to determine if the Bank has any objection. The Bank will agree which roles it will assess with each SP.

(1) www.bis.org/cpmi/publ/d101a.pdf.

- The Bank will assess proposed changes to an SP's business that could materially alter its business model or risk profile to determine if the Bank has any objection. Examples of the types of changes which would fall within the scope of such an assessment include (but are not limited to):
  - launch of a significant new product or service that could materially alter the business model or risk profile;
  - material changes in the ownership, structure or governance of the SP;
  - material changes to the risk appetite; or
  - outsourcing/in-housing of critical functions.

How will the Bank supervise SPs?

The Bank's supervision will focus on elements of the SP that relate to the RPSO it serves. However, the Bank will supervise any area of an SP's business that could have a material impact on critical services provided to the RPSO. This will include, for example, elements of an SP's governance and overall risk management frameworks and other business areas if they could materially impact the services provided to the RPSO.

The Bank will conduct an assessment of an SP which will include an analysis of the main risks it presents to the Bank's objective of financial stability. This risk assessment is regularly reviewed including a full review at least annually. Following the Bank's annual assessment, or any other interim examinations and assessments as the Bank judges necessary, the Bank will set expectations for mitigating actions to be taken by the SP. The Bank expects there to be a relatively small number of prioritised issues on which supervisors will seek action from the SP, leaving responsibility for provision by provision alignment with the Annex F expectations to the SP itself.

The Bank's assessment against the Annex F expectations will use the Bank's standard supervisory risk element model (**Table A1** below), as used for FMIs, with the exception of two elements not applicable to SPs. For further detail on the key supervisory pillars as outlined in **Table A1**, please see the *Bank of England's approach to the supervision of financial market infrastructures*.[1]

The Bank carries out a programme of 'core assurance' which entails a broad and structured set of review into SPs' operations. These are intended to gain assurance that SPs are suitably mitigating risks across their operations, rather than focusing on the narrower key risk areas identified during the Bank's continuous assessment. The core assurance programme consists of a number of different modules which specify the areas reviewed by the Bank. These modules relate to the risks and mitigants which are set out in the Bank's supervisory risk model above, and ultimately to the Annex F expectations. The modules which are applicable to SPs are listed below in **Table A2**.

Table A2 Core assurance modules applicable to SPs and the risk model elements they relate to

Supervisory risk assessment model	Core assurance module
Management and governance	Governance
Risk management and controls	Enterprise-wide risk management
	IT infrastructure resilience
	Cyber resilience
	Outsourcing
	Internal audit
Disaster recovery plans	Business continuity/disaster recovery
Liquid resources	Liquidity management
Capital	Capital
Recovery and resolvability	Recovery plans
	Continuity (special administrative regime)[a] plans

(a) This applies where HMT has designated the SP under the Special Administrative Regime.

How will the Bank report on its supervision of SPs specified under the Banking Act 2009?

The Bank's responsibilities and powers in relation to supervision of SPs are conferred by Parliament. The Bank is committed to being transparent and accountable to Parliament and the public for performance of these responsibilities and use of these powers. It publishes an annual report specifically in relation to its supervisory priorities and activities in respect of FMIs, and supervision of SPs will be included within this report.

Table A1 High-level overview of the Bank's supervisory risk assessment model

Risk			Mitigating factors							
Potential systemic impact	Risk context		Operational mitigants				Financial mitigants			Structural mitigation
	External risks	Internal risks	~~Promotion and maintenance of standards~~	Management and governance	Risk management and controls	Disaster recovery plans	~~Collateral/Margin and Default Fund~~	Liquid resources	Capital	Recovery and resolvability

(1) www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/the-boe-approach-to-the-supervision-of-fmi.pdf.

Abbreviations

BIS	Bank for International Settlements
CPMI	Committee on Payments and Market Infrastructures
FMI	Financial market infrastructure
IOSCO	International Organization of Securities Commissions
PFMI	Principles for Financial Market Infrastructures
RPSO	Recognised payment system operators
SP	Service provider