



Payment Systems
Regulator Limited
Annual plan and
budget 2018/2019

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Forewords





We use payment systems every day – to receive our pay, settle our bills or manage our savings. We depend on them to make these things happen safely, quickly and cheaply. In the background, however, the payment systems landscape is changing, opening up to competition and to innovative ways of doing business. The PSR's job is to ensure that this competition and innovation takes place in a way that benefits us all.

I am therefore delighted to have been appointed chair of the PSR with effect from 1 April 2018, and to introduce this plan. It was approved by the PSR board under the chairmanship of John Griffith-Jones. He has chaired the PSR during its first three years and I would like to thank him for leading and guiding the organisation to this point. The PSR is already making big changes to this vital sector of the financial system, overseeing the design and implementation of a new architecture for payment systems and taking action to promote competition and protect consumers.

Looking ahead, there are big changes still to come, as more and more payments are made without cash and open banking brings new players to the market, offering new choices to consumers. The PSR will be at the centre of these changes, and I look forward to taking up my new role at this exciting time.

A handwritten signature in black ink that reads "Charles Randell". The signature is written in a cursive, flowing style.

Charles Randell

Chairman



We're in an era where massive technological advancements are being made, where the use of technology by consumers is increasing, and where consumers are benefiting from more competition within the payments sector – as a direct result of action that the PSR has taken. This is leading to greater choice, better value and improved customer service. As the regulator, we've worked hard to create market and regulatory arrangements that should help consumers get the most from these changes.

We were created to shake up a sector that was hard for new entrants to break into, one dominated by the established players and resistant to collaboration. One of the key concerns of stakeholders was getting access to UK interbank payment systems; our open access programme is now delivering meaningful results for the people and businesses that use payment systems.

Our work has changed the structure of the industry. For example, the big banks no longer control either the infrastructure or the operators of the main interbank payment systems. We have also led work to better protect consumers from authorised push payment (APP) scams which has seen the industry make good progress on a broad range of initiatives, demonstrating the difference that can be made when the industry works together and with other interested parties.

Collaborative working was also the guiding principle when we established the Payments Strategy Forum (the Forum), which developed strategic initiatives where the industry and other interested parties worked together to deliver innovation. The Forum was not necessarily the obvious approach a regulator would take, but it has produced a compelling strategy for the future of interbank systems which will let the UK payments sector maximise the potential of new technology and innovation.

In an industry that changes so much and so fast, we have a responsibility to be proactive and forward-looking. Our horizon-scanning work allows us to take action when appropriate. We will continue to build our organisation while ensuring we allocate our resources in the right way to deal with a shifting landscape and keep up with the pace of change. We will also follow through on what we have started so far while engaging constantly with a range of stakeholders and other regulators. This will make sure we have the best insight and information to inform our work and make high quality decisions at the right time.

This year, we are committed to ensuring that LINK's work on the ATM network doesn't have a negative impact for consumers. We know that people value the ability to access cash through a widely spread network of largely free-to-use ATMs, and we will intervene if the needs of those that use ATMs is threatened.

We are also monitoring the work of the New Payment System Operator (NPSO) to ensure that the implementation of the new payments architecture (NPA) stays on track and does everything it

should. We will continue to engage with the NPSO to encourage a smooth transition to the new organisation. We will also focus on the development and introduction of the contingent reimbursement model that we proposed as part of our work to help protect victims of APP scams.

We will also continue our work as a competition authority, and are now carrying out our first investigation under our competition powers.

These examples illustrate how we keep the interests of the people and businesses that use payment systems at the centre of the industry's approach to its services. We'll continue to build on those strong foundations to keep the sector moving towards our vision of payment systems that are reliable, safe and fit for purpose for everybody that uses and relies on them every day – payment systems for now and the future.



Hannah Nixon
Managing Director

Introduction

Our annual plan and budget sets out our key aims and activities for the year 2018/19, alongside our expected costs. We publish this document so anybody with an interest in payments and payment systems can have a clear overview of what their regulator is doing, why and how.

In the summer, we will publish our annual report on how we performed against our plans for 2017/18.

Our vision, role and powers

Our vision

Payment systems that are accessible, reliable and secure, and represent value for money.

Our role

As an economic regulator we're here to make payment systems work well for those that use them. We have three statutory objectives to help us achieve this:

- promote the interests of those that use or are likely to use payment systems
- promote competition in payment systems
- promote innovation in payment systems

These objectives are set by the Financial Services (Banking Reform) Act 2013 (FSBRA). We consider them in everything we do under our FSBRA functions, and we expect the same from those we regulate.

We regulate:

- the eight payment systems that have been designated by the Treasury (Bacs, CHAPS, FPS, LINK, Cheque and Credit¹, Northern Ireland Cheque Clearing, Mastercard and Visa)
- the participants in those payment systems (such as banks, building societies, merchant acquirers and other payment service providers (PSPs))
- the companies that provide the infrastructure for payment systems – the connections that make the systems work
- designated alternative switching schemes under the Payment Accounts Regulations 2015 (PARs)² – this currently includes the Current Account Switch Service (CASS)

We are also the lead competent authority for the Interchange Fee Regulation (IFR)³ in the UK. The IFR mainly imposes requirements on payment card schemes, and issuing and acquiring PSPs.

1 And any development of it.

2 The PARs transpose the Payment Accounts Directive (EU) 2014/92 into UK law: EU <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0092>

8 3 Regulation (EU) 2015/751: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2015.123.01.0001.01.ENG



Our powers

We have a range of powers under FSBRA, in particular in relation to:

- providing directions, both generally and in relation to particular participants
- changing or establishing rules regarding the operation of regulated payment systems
- granting access to regulated payment systems (subject to the changes made by the second Payment Services Directive (PSD2))⁴
- varying agreements between the operators of regulated payment systems and PSPs
- requiring the disposal of interests in an operator of a regulated payment system

In addition, we have enforcement powers relating to EU legislation such as the IFR and certain provisions under PSD2, which we explain further in this document. We also have powers to monitor and enforce compliance under the PARs.

We have powers under the Competition Act 1998 in relation to participation in any payment system, including systems not designated under FSBRA. We can conduct market studies and make market investigation references under Part 4 of the Enterprise Act 2002.

In many cases, clear communication with the industry about what we want to achieve leads to the industry doing what's needed without us using our powers (for example, requirements or directions) – but we do use these when we think it is appropriate, and monitor compliance. Our enforcement approach also plays an important role in the pursuit of our statutory objectives, whether involving enforcement of directions (specific or general) made under FSBRA; our role as monitor and enforcer of the IFR, PSD2 or PARs; or our concurrent competition powers.

We will decide whether to pursue enforcement action on a case-by-case basis, having regard to our statutory objectives, functions and duties. In determining whether enforcement action is appropriate we will consider all matters that appear to us to be relevant in each specific case.

⁴ Directive (EU) 2015/2366:
<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015L2366>

The story so far

Our work is all about creating conditions where competition and innovation in payments can thrive – so that everyone can benefit from new technology, products, services and ways of thinking. All of us – from big business and government to charities and individual consumers – rely on payment systems every day, so it's vital they work well and make our lives easier.

We were set up to address some critical issues in the payments industry, and in the last year we've seen some landmark changes:

- **Collaborative innovation:** We set up the Payments Strategy Forum in 2015 to get the industry to collaborate on innovation. The Forum has now delivered a compelling strategy and plan for change that will ensure UK retail payment systems remain at the cutting edge, enabling greater functionality for consumers and promoting competition and innovation. Bacs, Faster Payments and Cheque and Credit have already been consolidated into a New Payment System Operator (NPSO) as part of this strategy.



- **Access to payment systems:**

This is now simpler, quicker and cheaper, meaning new banks and payment companies can enter the market. Our work has led to a record year for new applications in 2017/18; there are now twice as many participants using Faster Payments and more ways to connect, opening payment systems up to non-banks. All this is helping new banks come to market quicker and giving more choice to consumers about how they manage their money, and who they manage it with.

- **Ownership of infrastructure:**

The infrastructure provider, Vocalink, was owned and controlled by the banks that ran the payment systems it served, so there was little incentive to look at other providers that could provide improved services. That has now changed. We've also designed a new, more competitive, tender process for supplying payments infrastructure – ensuring competition can influence this particular market. This work is driving innovation to help meet the needs of all users of payment systems.

- **A more open market:** With the sale of Vocalink and the creation of the NPSO, the market for payment services is no longer controlled by a handful of big banks. New PSPs can provide different services, and a wider range of perspectives inform the industry's decisions and direction.

- **Payment scams:** Our November 2017 update showed how we have been tackling authorised push payment scams and protecting consumers. There is now much better data available about this crime, so people and banks can better protect themselves; there is agreement between the banks about how best to respond to reports of fraud, which will improve victims' experience; and the banks now have a clearer idea of what data they can legally share with each other to help prevent scams. We also set out an innovative industry-led solution that would see victims reimbursed where their bank hasn't done as much as it could to prevent a scam.

- **A cap on card interchange fees:** We are the lead regulator in the UK for the Interchange Fee Regulation (IFR), which capped interchange fees in 2015 and also introduced a number of business rules. The IFR aims to reduce the costs of card payments for merchants and consumers, and strengthen competition.

This work doesn't stop here. There is much more to do, but the direction of travel is clear and we see good progress being made on all fronts to deliver better outcomes for consumers.

Our work is all about creating conditions where competition and innovation in payments can thrive.

What next?

We will continue promoting the interests of the people and organisations that use payment systems in the UK, focusing on greater competition and innovation to promote security, reliability, convenience and value for money. We have made a conscious effort to build a regulatory approach fit for the future, to create the conditions that will help the industry deliver better outcomes for all of us. We have also considered what new issues we could act on to make a difference, and begun exploratory work on the use of payments data, and on the changing competitive dynamics in the markets we regulate.

Our focus this year can broadly be arranged into two areas.

First, we must maintain our momentum – by building on what we've already achieved, and ensuring that key projects we've already talked about are delivered successfully; this continues to require substantial work. We encourage positive change and are paying close attention to the following developments: the new competitive tender process for infrastructure; faster, cheaper access to payment systems; and the smooth introduction of the NPSO and the new payments architecture (NPA) it will introduce.

We will continue to work with other regulators, the industry, and consumers to tackle payment scams, and push ahead with our plans for a contingent reimbursement model – which will return money to victims when the banks haven't done enough to protect them.

Our second area of focus will be to continue to build on our original remit, and ensure that we stay on the front foot as a regulator in an ever-changing payments sector. We will continue the exploratory projects we began last year, looking at payments data, changing competitive dynamics in payments, and consumer protection. These are significant pieces of work that will give us detailed insight and help us understand how best to deliver our objectives.

As well as increasing our focus on our exploratory work, there will be new projects for 2018. For example, we will take a deeper look at card payment systems, building on what we have learned from monitoring the IFR, to give us a more detailed understanding of how the market works and determine whether there are issues that we need to address. We will also consult on adapting our general and specific directions to the industry so they remain fit for purpose in a changing payments world.

We will monitor industry issues that could affect our objectives, as we are already for concerns around the provision of ATMs and access to cash.

As always, we will intervene if we think decisions are being taken that are not in the interests of consumers and the organisations which use payment systems, and will continue to carry out enforcement activity or competition investigations wherever necessary. We expect we will need to intervene more to ensure our objectives are adhered to as the character of some of our work moves from implementation to oversight. Intervention is also made more likely by the increasing number of applications for access to payment systems, and awareness among people and organisations of what we do.

The consequences of EU withdrawal will also have some impact on our work; we are working closely with the government, industry and other regulators to ensure we are as prepared as we can be to make any necessary changes as smoothly as possible.

As part of the UK's regulatory framework, we will continue to engage and share relevant information and best practice with fellow regulators and authorities to do as much as possible to ensure regulation works well for UK businesses and consumers.

In 2017/18 we opened our first Competition Act 1998 case, working closely with the Competition and Markets Authority (CMA). The ongoing investigation will be an important part of our work in 2018/2019.

There will be change for the PSR as well: our new Chair, Charles Randell, begins his tenure on 1 April, and 2018/2019 will also see the PSR move office to the Olympic Park in Stratford, East London. This will bring us an innovative place of work in an exciting part of town, with new technology to help us do our work.

Our focus this year is on maintaining our momentum – by building on what we've already achieved, and ensuring that key projects are delivered successfully.



Our aims and activities for 2018/19

As in previous years, we will pursue and prioritise our aims for 2018/19 as a collective package, each one supporting the others. This includes not just our project work but also managing the organisation and the development of our stakeholder engagement, both of which are inherent to achieving our overall objectives.

In developing the actions to take to advance our aims, we have had regard to making sure that we focus on those actions that have the best prospect of advancing our objectives, as well as fulfilling our other statutory responsibilities (for example, monitoring and enforcing legislation).

Promoting the interests of service-users

Our service-user objective is the key to our work as a regulator, supported by competition and innovation as the primary means of promoting and protecting the interests of all those that use payment systems, from business to consumers. Whatever situation we're looking at, and in every decision we make, these interests are what drive our approach.

In the coming year our top priorities in this area will be overseeing developments in the ATM network, and responding to the threat of authorised push payment (APP) scams, which will continue our work focused directly on consumer protection. We will also develop further our investigation into the increasing use of payments data, and ensure that changes to the Direct Debit scheme serve users as intended.

We may also run further research into user needs and other specific policy issues if the need arises.

Authorised push payment scams

In December 2016 we published our response to the super-complaint from Which? concerning the growing problem of APP scams. Since then we've led a range of initiatives to better prevent APP scams and support victims when scams do happen, working with the Financial Conduct Authority (FCA) and the financial services industry. The industry, as represented by UK Finance, published the first set of robust statistics on APP scams late last year and has started collecting more detailed statistics to publish later this year. UK Finance has also committed to implementing new best practice standards that banks will follow when a victim reports an APP scam. These should improve victims' experience and banks' response times. Additional initiatives are also being developed to provide a more comprehensive suite of new protections. We have set milestones for these initiatives and will monitor their progress during 2018.

We have also consulted on the introduction of a contingent reimbursement model, which sets out when and how APP scam victims could be reimbursed for their losses – provided they acted appropriately when they made the payment. Under this model, PSPs that do not meet the expected steps to guard against APP scams will be responsible for reimbursing victims where they acted appropriately. It incentivises the use of measures to better prevent and respond to APP scams. In February 2017 we published the outcome of the consultation, outlining how we

will drive forward plans to introduce a model, and the next steps. We consider that an effective reimbursement model should make it harder for criminals to perpetrate these scams in the first place, and help improve the victim's experience if they do occur. To do this, we are setting up a steering group to develop an industry code, which will set out the rules of the model. This group will consist of consumer and industry representatives, and have an independent chair appointed by us. We will be an observer in the steering group, providing oversight and support. Other relevant regulatory and government bodies will also be involved as observers.

We have set a timetable for the steering group that balances the need to protect consumers with the logistics of making sure the industry code is robust and effective at reducing the harm caused by APP scams. The group should issue an interim code in September, which the Financial Ombudsman Service can take into account in its relevant considerations for future victims of APP scams. The steering group will publicly consult on the code, and publish the final code in early 2019. We expect the code to continually evolve to ensure the preventative measures are up to date.

ATMs

The ATM sector is in the middle of a period of significant change. As consumers choose to make payments in different ways, some are using cash less while others continue to rely on it. We appreciate that consumers value the ability to access cash through a widely spread geographic network of primarily free-to-use ATMs, and we are committed to ensuring that the network continues to meet consumers' evolving needs.

During 2017/2018 we conducted extensive work to provide us with insights into the ATM sector and understand how changes may affect consumers. As part of that work, we commissioned two independent studies. Both studies are exploratory and forward-looking in nature, and therefore give us useful insights rather than precise answers.

The first study, carried out by Europe Economics, considers the potential impact on the provision of free-to-use ATMs of:

- any reduction in demand for ATM withdrawals
- changes to the ATM interchange fees paid by banks

The second study explores the prospects for, and potential impact of, competition between ATM schemes. At present, there is competition both in the provision of ATMs and in the retail banking market.

We have published summaries of these studies on our website.⁵

In November 2017, LINK consulted on a proposal to change its interchange fees. We conducted extensive work to understand the potential impact of LINK's proposal. We made it clear to LINK that we wanted to ensure that consumers continued to have widespread free access to cash. In particular, we told LINK that:

- it needs to do whatever it takes to protect the current broad geographical spread of free-to-use ATMs
- any cuts in the interchange fee must be incremental and accompanied by close monitoring by LINK to understand the impact on the overall ATM estate – with action taken by LINK where the impact is not as expected
- it should focus more on its Financial Inclusion programme – to continue to fill gaps in the free-to-use ATM network

We were pleased that LINK's announcement on its decision following its consultation addressed these points.

We have set out additional requirements of LINK, who will report to us each month on the impact of its decision, and on the action it has taken to address any unexpected negative impact on the free-to-use ATM network. We will not hesitate to intervene and use our powers if we believe the current broad geographical spread of free-to-use ATMs is threatened.

The work we have done to date has provided us with useful insights to the ATM sector. We have gained a good understanding of what is happening now and what needs to happen in the future to ensure that people will be able to access their cash. We will continue our work on access to cash.

⁵ Europe Economics study: www.psr.org.uk/psr-focus/the-uk-atm-network/atm-impact-study
ATM scheme competition study: www.psr.org.uk/psr-focus/the-uk-atm-network/atm-scheme-competition-exec-summary

Payments data

The data associated with payments is becoming more and more important as its availability and commercial use increases. This will be amplified by new initiatives and new players entering the market. Because of this increasing influence on the payments landscape, payments data was one of the areas we committed to exploring in depth last year.

We have done a range of work to understand the impact that this dynamic and evolving issue will have on the payments industry, on consumers, and on our statutory objectives. This includes:

- **Desk-based research:** To understand the emerging debate about payments data and how it's collected and processed. This includes research into data completed by various academics, regulators (both UK and international) and sectoral organisations (including consumer organisations).
- **Informal discussions with payments industry stakeholders:** To discuss their current practices and planned changes in relation to data collection and use (as a result of legislation, technology, etc).

- **Discussions with other UK regulators:** To better understand data collection and processing activities in other regulated sectors, the policy issues they generated, and how these compare with practices in the payments sector.

We will publish the outcome of this work in a discussion paper in April 2018. This will include:

- our findings on how payment service providers (PSPs) such as banks, building societies or electronic money issuers collect, process and use payments data
- our findings on specific payments data issues that we believe could affect the extent to which competition, innovation and end-user benefits are delivered within the industry
- a discussion of our proposed approach to these issues as an economic regulator

We will consult to discover stakeholders' views and opinions. Once we have considered the responses, we will publish an update on our planned next steps.

The data associated with payments is becoming more and more important as its availability and commercial use increases.





Direct Debit

Direct Debit guarantee

We have been liaising with Bacs, the operator of the UK Direct Debit scheme, which has implemented changes to help ensure that:

- Refund requests claimed under the Direct Debit Guarantee are handled fairly (for example, by taking into consideration the specific facts of a claim), including whether or not the organisations involved in the process complied with relevant rules and procedures.
- Any inappropriate claims are identified. In 2018 we will monitor the effectiveness and operation of these changes to make sure they are delivering the intended improvements for Direct Debit users. Progress so far is encouraging and we are seeing evidence that potentially fraudulent claims are being dealt with more rigorously, and that this may be deterring the making of such claims in the first place.

Direct Debit facilities management – switching service provider

Last year we investigated concerns about Direct Debit Facilities Management (FM) services. FM service providers collect Direct Debit payments on behalf of other organisations. The key concern was that FM providers could effectively prevent these other organisations from switching to an alternative FM service provider. We ran a public consultation on the concerns and potential solutions, and subsequently required Bacs to put in place a solution to make switching easier. In the coming year we will monitor Bacs' implementation of the necessary changes, so organisations can more easily choose the FM provider that suits them best.

Promoting competition

Competition in the markets for payments supports our vision of payment systems that work well for everyone, by encouraging new and better services and more choice for consumers. We will continue our work to ensure access to payment systems is as fair and open as possible, allowing new providers to compete and innovate. As part of this work, we will monitor compliance with the directions we introduced following our infrastructure market review, and review some of our existing directions to make sure they continue to have the right effect in a changing payments environment.

Access and governance

When we were set up, access – direct and indirect – was a big area of concern for many people we spoke with. It took too long, it was too complicated, it cost too much, and there was not enough choice. We have seen great progress over the last few years, with more entrants bringing competition to the market. 2017 was a record year for PSPs getting direct access to Faster Payments, Bacs and CHAPS; the number of direct participants in Faster Payments has almost doubled since 2016. In terms of indirect access, we have seen new entrants into the market either providing a full suite of services or specialising in Faster Payments access.

Over 2018 we will see non-bank PSPs gain direct access to Faster Payments and Bacs for the first time. This follows our access work, and the Bank of England's announcement in July 2017 that it has opened up

access to settlement accounts for non-bank PSPs. Early projections suggest that 2018 will be another record year for direct access. This will further increase the level of competition between direct participants within the payment systems.

We are monitoring the impact of our work on access, focusing on identifying and resolving any barriers to direct or indirect access. Payment system operators will submit compliance reports to us in October, detailing their own assessment of their compliance with our directions for the past year, and we will report on this through our annual access and governance report.

We will also continue to work with the Bank of England, and with the New Payment System Operator (see page 27), to deliver non-bank access to the Bank's Real-Time Gross Settlement (RTGS) system.

We will consider applications made to us under sections 56 and 57 of FSBRA, which allow us to require indirect access providers (IAPs) to grant PSPs access to certain regulated payment systems, and to vary the terms of agreements for access to certain regulated payment systems, respectively. We received two applications under section 56 and one under section 57 in 2017. We will issue our final guidance on our approach to these kinds of applications in the coming months, which will take into account PSD2 and its effect on the scope of these powers.

Competition in the markets for payments supports our vision of payment systems that work well for everyone, by encouraging new and better services and more choice for consumers.

The second EU Payment Services Directive (PSD2)

The second EU Payment Services Directive (PSD2) was implemented in the UK through the Payment Services Regulations 2017 and came into force in January 2018. PSD2 aims to promote competition, enhance consumer protection and encourage innovation in payments. These aims are consistent with our statutory objectives so, in addition to our specific role as competent authority for some of its provisions, we will work with the FCA, industry and others to help realise the benefits of PSD2 in the UK.

We are the competent authority for provisions concerning access to payment systems, access to payment account services (we are jointly responsible with the FCA for this regulation), and information that independent ATM deployers must provide to customers when they withdraw cash.

As we have noted elsewhere, we have made great progress with improving access choice and quality in the UK. The relevant PSD2 provisions help to reinforce the approach we have taken to date, and place clear requirements on payment system operators and credit institutions to take a proportionate, objective and non-discriminatory approach to access decisions going forward. We will monitor the approaches that payment system operators and credit institutions take to requests for access, and will take action if we find they breach the PSD2 requirements.

Access to payment systems is essential to create effective competition and innovation in payment services, and retail banking services. The changes that PSD2 brings in build on the work that PSR has done to create an environment in which small and new financial institutions (such as new banks, payment service providers or fintechs) have greater opportunities to obtain access. This could help, for example, a new challenger bank that wants to become a member of a card scheme, or a small money remittance business that needs an account with one of the large banks in order to make payments for its customers.

In the majority of cases we will now consider disputes related to indirect access to regulated payment systems under the PSRs 2017 rather than sections 56 and 57 of FSBRA (with the exception of applications for access to Cheque and Credit and applications from credit unions). We anticipate that the regime introduced by these Regulations will result in us actively considering a greater number of access disputes than in previous years under solely sections 56 and 57 of FSBRA.



Our infrastructure market review

In 2015 we started a market review into the ownership and competitiveness of payment clearing infrastructure services in the UK. In 2016 we found that there was no effective competition in the market for central infrastructure services for the Bacs, Faster Payments and LINK interbank payment systems, and consulted on a package of remedies. In 2017, we decided to impose:

- Two specific directions under section 54 of FSBRA, requiring the operators of Bacs and FPS to undertake a competitive procurement for future central infrastructure contracts. The first procurement must enable the use of ISO 20022 messaging standards.
- A specific direction under section 54 of FSBRA, requiring the operator of LINK to undertake a competitive procurement for future central infrastructure contracts.

Our directions make provision for the operators of Bacs and FPS to apply to us to amend the date on which they have to comply with the directions as a result of any future new payments architecture (NPA) developments.

Our directions also allow the operators to apply for an exemption to the directions if there are unforeseen exceptional circumstances and they believe, and we agree, that a full competitive procurement exercise isn't the best approach. This may be either an exemption from certain elements of the competitive procurement remedy or all of the elements (for a defined period).

In 2018, we will monitor the operators' progress in complying with our directions. The purpose of these directions is to introduce competition into the market for central infrastructure for Bacs, FPS and LINK for the first time. Our monitoring of these directions will make sure this happens and will include:

- monitoring the compliance reports submitted by the operators and assessing their progress towards running an effective competitive procurement
- assessing any application from Bacs and FPS for an extension to their compliance deadline
- assessing any application from LINK, Bacs and FPS for an exemption from one or more obligations

Monitoring competition in the market

We are a concurrent competition regulator alongside the Competition and Markets Authority (CMA) and the European Commission's Directorate-General for Competition. We will continue to have oversight of the payments sector and to consider complaints of anti-competitive behaviour raised with us, to ensure that competition is effective and that we address breaches of relevant competition law appropriately. Before exercising our FSBRA powers, we have a duty to consider whether it would be more appropriate to use our powers under the Competition Act 1998 (CA98).

There are constantly changing aspects of the payments market – the rapid growth of innovation, the increasing penetration of fintechs, and the evolution of technology – which could all affect the competitive dynamics of the market. This raises a number of questions, including:

- How are the economics of the sector changing?
- Where will competitive advantage come from in the future?
- What are the implications for market structure and competition?

We have conducted internal scoping work to identify key changes to the competitive dynamics in the payments industry, which may have an impact on our objectives.

We are continuing our horizon-scanning work to anticipate and understand industry trends. For example, we monitor and research new business models and assess their implications for competition, innovation and service-user interests.

The aim of this body of work is to ensure that we are continuously informed of the changes in the industry. Where we identify particular issues of interest, we will look into them in more detail and take appropriate actions – for example, through consultations, input from specialist experts, or market reviews.

We have also begun our engagement with other regulators to discuss potential policy implications of data use on competition and service-user and consumer interests.

In 2017/18 we opened our first Competition Act 1998 case and carried out several searches under warrant at business premises. The inspections involved close collaboration with the CMA, which provided specialist investigative and forensic support, and search teams included PSR, CMA and also FCA staff appointed as PSR officers. This investigation will be an important part of our work in 2018/2019.

In addition, we will keep a close eye on the market and will use our competition powers if required. We will continue to be an active member of the UK Competition Network, engaging with other concurrent authorities. We use this kind of close liaison, particularly with the CMA, to share best practice, resources and expertise.



Review of our Directions

When we launched in 2015, we put in place a number of general and specific directions for the payments industry. These were designed to help create the conditions where innovation and competition thrive, for the benefit of consumers. These directions focused on:

- improving service-user representation in operators' decision-making structures; improving transparency of decision-making through publication of minutes; and avoiding conflicts of interest where someone could be a director of an operator and its central infrastructure provider (General Directions 4, 5 and 6)
- opening up direct access to payment systems by ensuring that their access requirements are objective and risk-based (or otherwise in line with EU law on payment system access), and that operators publish information on their access options, including indirect access services (General Directions 2 and 3, and Specific Direction 1)

We also adopted General Direction 1, which governs the way we expect regulated participants to engage with and disclose relevant information to us.

We are now reviewing these directions to ensure they are advancing our objectives and delivering good outcomes for service-users, as well as taking account of recent changes in the market and legislative developments such as PSD2. The review encompasses General Directions 1 to 6 and Specific Direction 1.

In March 2018 we published a consultation paper explaining where we think change is needed, and proposing various options. The consultation will close in June. After considering the responses we will issue a policy statement later this year and, where necessary, consult on revised legal instruments for directions that we need to revise significantly.

We are continuing our horizon-scanning work to anticipate and understand industry trends.



The Payment Accounts Regulations 2015 (PARs)

We will continue to fulfil our obligations as the competent authority for alternative switching schemes under the PARs. Switching schemes allow consumers to move their payment accounts from one PSP to another. Alternative switching schemes are services that are not operated by the PSPs themselves. We will consider applications from schemes to be designated as alternative switching services, and monitor and ensure their compliance with the designation criteria.

In 2016 we designated the Current Account Switch Service (CASS) as an alternative switching scheme. We reported that it continues to meet the designation criteria. We will continue

to monitor its performance against two key performance indicators set by the Treasury, and will report on this annually to the Treasury.

Bacs's Current Account Switching Service (CASS) was developed to support the government policy objective of supporting more active and engaged consumers shopping around. The aim of the service is to make the switching process simple and stress free for prospective current account switchers. Since its launch in September 2013, over 3.5 million account switches have been made using the service. The service is currently offered by 47 UK bank and building society brands, accounting for over 99% of the UK current account market.

Card payment systems

We are the main competent authority for the EU Interchange Fee Regulation (IFR), which introduced a cap on interchange fees for certain card payment transactions. It also introduced a number of business rules. The IFR aims to reduce the costs of card payments for consumers and retailers, and promote competition in the cards market.

We were the first national competent authority to publish guidance on our approach to monitoring and enforcing compliance with the IFR. Since then, we've been proactive in monitoring compliance. We've required schemes, and a subset of issuers and acquirers, to provide information on their compliance with the caps and several of the business rules.

We will continue to monitor compliance with the IFR this year by collecting and assessing information from regulated parties. If we find evidence of breaches of the IFR we have powers to take enforcement action, including by imposing fines. We will also consider any complaints received and act on them as appropriate.

In the coming year, we also aim to explore wider issues relating to the way that the cards market works.

Contactless mobile payments

One particular area we have been considering is payments made using mobile devices (using 'contactless' technology). Contactless payments in general – including payments made with cards – are growing rapidly. Mobile payments – where you pay by holding

your smartphone or watch over a reader, for example – are a relatively new and small part of the overall payments landscape, but they are growing fast. We estimate that the number of transactions doubled between autumn 2016 and summer 2017.

We expect them to grow further as:

- more people start using contactless mobile payments
- there are more contactless-enabled point-of-sale terminals
- more innovations offer more functionality

Developments in this area could have an effect on all three of our statutory objectives, so we want to make sure we understand the relevant issues in this sector. We considered that the best way to gain the knowledge we need would be to launch a broad call for information from a range of stakeholders. We issued two information requests (in autumn 2016 and in summer 2017), using our powers under FSBRA.

We asked questions on: the different mobile payments technologies and offerings; the incentives in the sector; likely future developments; and, in particular, whether there are any restrictions or barriers to developing competition in mobile contactless payments arising from regulatory, technical or contractual factors. We also met a range of industry stakeholders.

In particular, we are interested in understanding if this sector is developing in ways which might inhibit innovation or competition and, ultimately, are not in the interests of consumers. We will publish a summary of our work in the coming months.

Promoting innovation

The next couple of years will see some of the biggest changes in UK payments in a generation, as our early initiatives make a big impact. Competition stemming from our access changes should see more choice and better products for consumers. The Payments Strategy Forum, which we set up in 2015, has completed its mission to create a strategy for innovation through collaboration in the industry. Now we will be closely involved as the major changes are implemented – a new consolidated payment system operator, the new payments architecture (NPA), and new approaches to tackling financial crime.

The Payments Strategy Forum and financial crime solutions

We set up the Payments Strategy Forum in 2015 to help the industry create its own strategy for collaborative innovation. The Forum successfully completed its work on 11 December 2017 with the publication of its NPA Blueprint, and collaborative industry solutions to address financial crime.

The NPA will provide the modern, efficient processes and infrastructure that payment systems will need to function properly in our ever-changing technological landscape. The Forum handed over the NPA to the NPSO to implement, and the financial crime solutions to UK Finance. We are working with both the NPSO and UK Finance to ensure these initiatives are implemented in a way that advances our objectives.



Payment system operator consolidation

One of the fundamental industry changes that our work has led to is the consolidation of the governance of Bacs, Faster Payments and the new cheque Image Clearing System into a single NPSO. We want to see the NPSO develop into an organisation that drives innovation and competition in retail payment systems, while maintaining their resilience – and we want it to design its approach to this around service-users' needs.

In January 2018 we wrote to the NPSO setting out our expectations for its work across a range of its functions. This included the key issues it should consider as it establishes its strategy development process, designs the NPA rules and governance arrangements, procures the NPA, and manages its risks. We explained that we will closely monitor the next stage of the NPA's development, and will continue to engage with the NPSO on a regular basis to ensure it delivers the NPA in line with the Forum's plans.

Effective and ongoing engagement with its stakeholders, including fintechs, will enable the NSPO to remain transparent and accountable. It also means it can remain fully informed of stakeholders' views, and ensure they are content with its approach to work which affects them. Considering how its decisions could affect users across the value chain will be crucial to the success of those decisions and help build broad support and legitimacy. This will be particularly important as the NPSO embarks on its ambitious programme of work to establish the NPA.

The consolidation should support one of our key requirements to support increased choice of access and develop common participation models and rules, as one party will be responsible for managing the different rule books. This should make it easier for banks, fintechs, and other payment service providers to enter the market and compete effectively. This is because access to payment systems is a key input for their business models, and simplifying the process of getting access (i.e. by having common rules) can reduce a barrier to entry.

The consolidation is also an important first step towards a generational change in UK payments. It can help facilitate the safe and secure transition to, and management of, the NPA, which we believe could deliver more dynamic competition and innovation in payments. Consumers will also benefit from new entrants coming into the market and offering new, innovative products.

The next couple of years will see some of the biggest changes in UK payments in a generation, as our early initiatives make a big impact. Competition stemming from our access changes should see more choice and better products for consumers.

External stakeholder engagement

We continue with our programme of engagement both in the UK and globally. We will focus on opportunities to explain our work in the UK's world-leading payments sector, and areas where developments in payments, financial services and fintechs may be of particular interest to us. And also to learn from others and continue to challenge and expand our own thinking, informing the work we do and how we do it, alongside developing opportunities to lead a global discussion on payments.

We held successful regional events in 2017/18 around the UK; we will continue these to ensure that we engage directly with all relevant UK stakeholders through a range of channels and develop the fullest possible picture of any regional differences or issues. We will once again run our annual perception survey to understand how our stakeholders think we're doing, and to make sure we're taking their views into account in our work and focusing our communications appropriately.



Working with other authorities

We have a legal duty to coordinate with the Bank of England, the Prudential Regulation Authority (PRA) and the FCA. This coordination improves our knowledge and approach to financial regulatory issues. We have established good working relationships with the new FCA payments team. For example, we have engaged with them on the monitoring and enforcement of PSD2, and a number of ad hoc payments issues. We continue to work closely with the FCA in preparation for EU withdrawal, including its potential effects on our powers and responsibilities. We will continue to work with them to help ensure payment systems work well for those who use them.

We continue to have a joint Memorandum of Understanding with the Bank, the FCA and the PRA. This sets out the high-level framework we use to cooperate with one another in relation to payment systems in the UK, which each body has a different mandate for. During 2017 we were formally adopted into the Authorities Response Framework (ARF) alongside the existing members (FCA, PRA and the Bank of England). The decision to extend the membership to the PSR reflects our interest in stable and well-functioning payment systems. We will continue to work closely with these stakeholders and other regulators and competition authorities in 2018/19 – in particular in relation to our shared competency with the FCA in monitoring and enforcing compliance with Regulation 105 of the Payment Services Regulations 2017.

To support this coordination and develop skills and knowledge, we currently have three secondments in place with more in the pipeline – one inwards and one outwards between us and the Bank of England, and one outward secondment to the FCA.

Our concurrent competition powers, and our role as lead regulator under the IFR, lead to regular engagement with the Directorate-General for Competition and other EU national competent authorities. Our participation in networks such as the UK Competition Network, the UK Regulators Network and the European Competition Network enables us to share experience and best practice on regulatory and competition matters, which we will incorporate into our regulatory approach.

Where possible we will cooperate to advance our objectives, and coordinate to reduce costs to our regulated communities.

The PSR Panel

The PSR Panel is an independent group of industry experts that contributes towards the effective development of our strategy and policy. Establishing and maintaining the Panel is one of our statutory requirements. The members are drawn from payment system operators, PSPs and service-users, and offer advice and early input on our general policies and practices.

The Panel remains a key channel for us to be able to understand how our wide range of service-users may respond to our policies and approach, and we will continue to consult it regularly. We are grateful to the Panel for contributing again this year to the development of this annual plan.

Last year, a number of the existing PSR Panel members' first terms came to an end as the Panel reached the end of its third year. We wanted to ensure a balance between continuity (by renewing some members), new perspectives (by bringing in some new people), and a commitment to open competition for recruiting a number of positions. Consequently, during 2017 we successfully recruited six new members across a variety of sectors including: direct and indirect PSPs; infrastructure providers; payment technology experts; electronic money institutions; and merchant acquirers. We also renewed eight members' terms for a further three years – they will continue on the Panel with those members whose terms did not end last year. Stephen Locke was also reappointed by the Treasury as Chair of the PSR Panel for a second three-year term.

EU withdrawal

We are assessing the potential impact EU withdrawal could have on our role under the parts of EU legislation we are responsible for. We are also supporting the Treasury in its work to transpose all EU-derived financial services legislation into UK law. This entails reviewing the relevant EU legislation in force in the UK that falls within our remit (either in whole or in part), to check for any potential 'deficiencies' that would prevent retained EU law from operating effectively after the UK withdraws from the EU. We are conducting this work under guidance from the Treasury.

The longer-term impact of EU withdrawal on the overall regulatory framework for payment systems in the UK will depend, in part, on the UK's future relationship with the EU. The final outcome of the withdrawal will depend on any agreement negotiated between the UK and the rest of the EU. Given the range of potential outcomes and the uncertainty at this stage, we are continuing to prepare for a range of scenarios to ensure a robust regulatory system is in place on day one. We are also seeking to mitigate any risks that may arise as a result of withdrawal.



Managing the organisation

Our people

We continue to refine the way we operate and take whatever measures are needed to ensure we are an efficient and effective regulator. In order to deliver our work programme it is essential that we recruit, develop and retain a talented, engaged and diverse team of economic, policy, legal, regulatory, communications and operations experts with the relevant skills and experience.

As a maturing organisation, our aim is to continue to develop a collaborative, engaging and progressive environment that delivers value for money. We have:

- streamlined our resourcing strategy to increase efficiency and reduce the time to hire, while ensuring that we're able to flex based on the demands of particular work streams
- improved the way we allocate work to encourage greater collaboration and knowledge-sharing
- introduced a new reward and recognition programme, which enables us to recognise those who go above and beyond either as individuals or as part of a team – creating a link to the PSR Values of Integrity, Unity, Knowledge, Purpose and Engagement

Looking forwards, our People Strategy focuses on:

- continuing our programme of leadership and management development
- helping our staff develop by increasing awareness of and access to our learning and career development resources, using the PSR Capability Framework
- carrying out our work in line with the PSR Values

We anticipate that our headcount for 2018/19 will increase to around 100. The increase is spread evenly across all areas of the organisation and reflects the anticipated growth and direction of our work programme. Of particular note is the projected increase in competition and enforcement work, which we have reflected in our budgeted increases for both Legal and Policy. In addition, and in response to stakeholder feedback, we will increase our focus on external engagement – and we have increased the skill set and breadth of our Communications team to do this.



The majority of the new roles are planned as permanent hires, with some flexibility to hire on a fixed-term or temporary basis where appropriate. However, it should be noted that the quality and volume of the candidate pool, particularly of temporary lawyers, is limited due to the increased external demand for high calibre candidates to work on EU withdrawal related matters. Our ability to recruit flexibly using contractors has also reduced dramatically due to changes in the IR35 off-payroll working rules (in addition, the accompanying cost increase has greatly reduced the value for money of using contractors).

Diversity and inclusion is a subject which is close to our hearts at the PSR. One of our key objectives is to work on behalf of consumers, ensuring that payment systems are operated and developed in a way that considers and promotes the interests of all people and organisations that use them. We are committed to building and sustaining a diverse and inclusive workplace, where our people can bring their whole selves to work. We are a signatory to the Women in Finance Charter, and our commitment to diversity and inclusion includes disability, ethnicity, lesbian, gay, bisexual and transgender (LGBT) and gender identity as well as mental health and social mobility issues.

Our people have access to a range of employee-led networks which help to raise awareness of diversity and build an open and inclusive workplace.

Currently 62% of our senior leadership team are women. Our target is to maintain the gender balance within a range of 40% to 60%, and to continue to develop a balanced pipeline of talent through to 2025 and beyond. We are also committed to achieving a range of 8 to 15% for black, Asian and minority ethnic (BAME) representation across our senior leadership team by 2025. Currently our BAME representation is 8%.

We, along with the FCA, are moving from Canary Wharf to Stratford this year. We anticipate the move being completed by July 2018. The new site, in Endeavour Square, provides a modern and fit-for-purpose office, excellent facilities and brand new infrastructure and technology to meet our future needs. We are looking forward to embracing new ways of working in the new workspace, with a particular focus on increased efficiency, collaboration and agile working. Enabling our people to work in a more collaborative, flexible way also provides a further link to our resourcing strategy, as well as helping us to create a working environment which encourages increased employee engagement.

Our aim is to continue to develop a collaborative, engaging and progressive environment that delivers value for money.

Our budget for 2018/19

Reflecting our relatively small size, our resources must remain flexible and agile to work across the spectrum of activities we carry out in support of our aims. Our annual budget for 2018/19 reflects our operating costs from 1 April 2018 to 31 March 2019. We estimate these costs to be around £14.9 million.

Staff costs and professional fees

Staff costs continue to be our largest operating expense, reflecting the resources we need to operate and carry out our objectives. This year we anticipate staff costs increasing to £10.4 million, as a result of increased demand for resources to support growth in activity across the organisation. We anticipate our overall 2018/19 headcount will be around 100, with phased recruitment throughout the year. This will be comprised of predominantly permanent and fixed-term employees, with a small number of temporary staff where required to provide specialist services or short-term resourcing. We expect this will continue to be the appropriate scale of resources in future years, based on our current scope of work. We will continue to recruit as required to ensure we have the right people and skills to meet our aims and activities.

Our professional fees (for specialist services to support our work) will be around £2.0 million in 2018/19, down from £2.5 million in 2017/18.

Other operational costs

As an independently accountable subsidiary of the FCA, we continue to use its operational support for services

such as human resources, finance and information services where it is viable, effective and efficient to do so. We will continue to reimburse the FCA on an annual basis for costs incurred on our behalf. The increased headcount for 2018/19 drives consequential increases in operational costs of approximately 45% – primarily due to the increase in headcount, but also as a result of the move to Stratford and investment in cyber security.

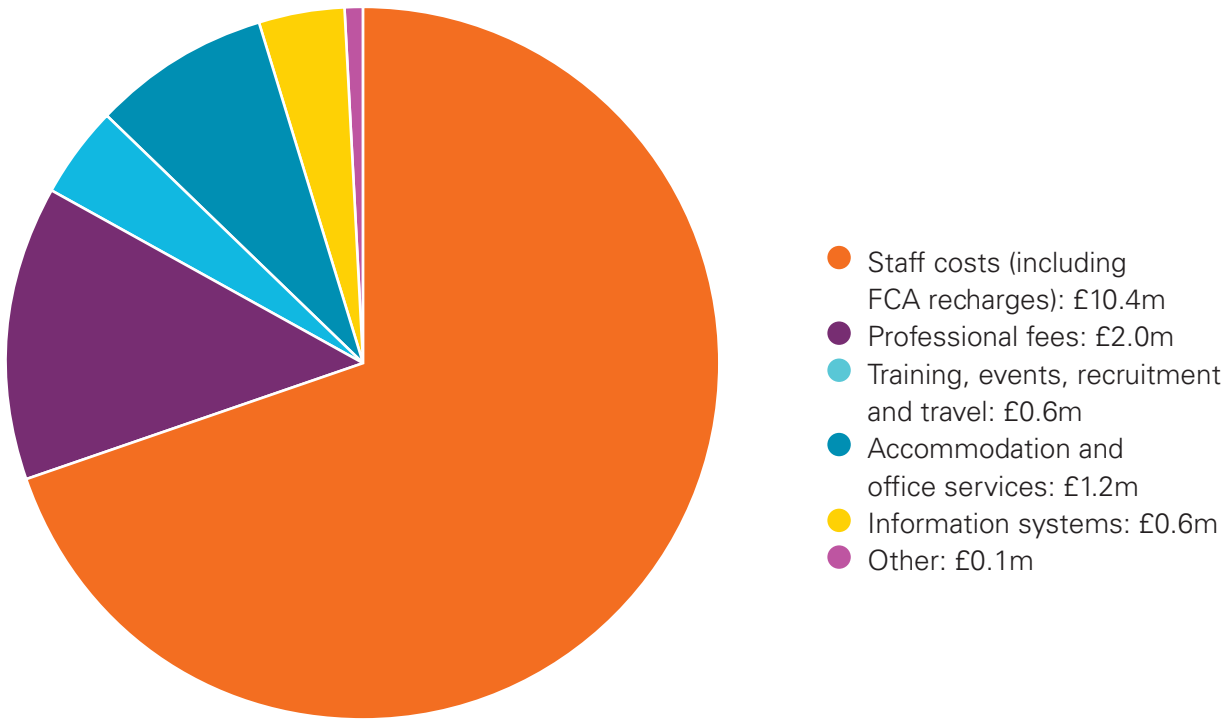
Annual funding requirement and impact on fee payers

We will continue to recover all our costs through the annual fees paid by the organisations that we regulate, specifically the PSPs that directly participate in any of the eight regulated payment systems or in the card schemes subject to the IFR, and also (in some cases) operators of IFR card schemes and operators of alternative arrangements designated under the Payment Accounts Directive.

Value for money

Our overarching Value for Money (VFM) strategy is to maximise the impact of delivering our statutory objectives, while minimising costs. Our drive to deliver improvements in effectiveness, efficiency and economy is ongoing and VFM criteria are being embedded in our decision-making processes at all levels. This, together with reviews of our internal processes, benchmarking, and ensuring flexibility in our workforce, will drive further efficiencies. We also work closely with other regulators to share expertise, best practice and resources where possible.

Budget costs



Risk

Identifying and assessing risks to delivering our statutory objectives forms a key part of our planning process. Our aim is to identify and respond promptly and effectively to emerging issues so we can best promote the achievement of our statutory objectives.

We look beyond our immediate remit by horizon scanning across the industry to anticipate user needs and market requirements, while working closely with other regulators to get the right outcomes. This helps us assess whether our existing regulations will continue to achieve their goals as designed and, if not, how we need to change them.

To properly focus our efforts we identify and assess the potential impact associated with each programme of work. We also look at the harm to consumers that is or may be caused by inadequate action or resources.

In turn, this helps us to assess and manage our operational risks including prioritisation of our resources, ensuring that we have the expertise we need and that our business processes and systems support our vision while delivering value for money.

The following are the most material external risks and trends that could pose a risk to the PSR's objectives in the coming years.



Demographic trends and longevity

The payment needs of future generations of consumers are likely to evolve from the needs of previous generations, and we need to continue to consider how we ensure consumer choice across cross-generational, regional and SME type.

Technology and innovation

Technology has the potential to increase competitiveness, support innovation and efficiency, transform business activities and shape access to payment systems and services. However, this can also lead to incumbent businesses trying to protect their markets with barriers which could block innovation and competition.

UK withdrawal from the European Union

Understanding how EU withdrawal affects the operation of payment systems within the UK is a key focus for us. Where our regime will intersect with European requirements, i.e. on interchange fees we will work closely with the FCA, the Bank of England and the Treasury, who negotiate with the EU on behalf of the UK to ensure our interests are represented.

The longer-term impacts of EU withdrawal on the overall framework for the regulation of payment systems in the UK will depend, in part, on the relationship that the UK seeks with the EU in the future.

Smart data, digitisation and data analytics

The expected increase in the availability and commercial use of payments data within the industry in the future could impact the rate of innovation in the industry, influencing the ability of the sector to deliver new and improved services to end-users. It could also influence how competitive advantage is derived, ultimately impacting market structure and the nature of competition in the sector. Finally, it could also create risks for end-users with respect to data privacy and security.

Cyber security and resilience

Consumers are looking for greater trust and assurance that payments are protected and secure, including protections from cyber crime and other systemic incidents. Consumers also expect that incidents will be dealt with appropriately and recourse provided where required. We, along with the Bank of England, the Prudential Regulation Authority and the FCA, all have an interest in, and certain responsibilities with regard to, payment systems resilience issues.

In view of the functions of the Bank and the FCA, together with their specific objectives regarding stability and resilience, we would not usually expect to lead on issues of cyber security and resilience. However, we continue to work closely and coordinate with both the Bank and the FCA on these issues, and we continue to have regard to our objective to ensure that payment systems are operated and developed in a way that promotes the interests of service-users.

