

# PSR Annual Plan and Budget

2015/2016





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# Foreword

## Hannah Nixon

Payment systems underpin our day-to-day lives – from withdrawing cash from an ATM to enabling large transfers between firms – so it is essential that they work well. The payments landscape continues to evolve, driven by advances in technology, innovative business models and changes in the needs of the individuals and businesses that use payment systems and services. As payment systems become subject to direct economic regulation for the first time, we must work together to ensure the landscape is competitive, innovative and functions in the best interests of the people and organisations that use them and the services they support.

Last year our focus was on building the PSR and developing our regulatory framework. This will be complete by April 2015. By then we will have a near full complement of staff, including our senior leadership team, and have released our Policy Statement that sets out our regulatory framework and approach. The Treasury has also designated the interbank and card payment systems we will regulate. This includes the payment system operators and the other participants in these systems. We also have concurrent competition powers over all payment systems in the UK.

With our framework in place, focus will shift to working with industry to deliver on our statutory objectives. We need to see: open, transparent and accessible payment systems; payment systems that are responsive to new developments and innovations; and improvements in the representation of the people and organisations that rely on services provided by payment systems. We will also work to continue to build our organisation to ensure we are an efficient and effective regulator.

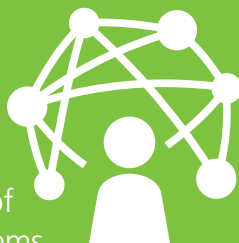
The work outlined in this Annual Plan and Budget is critical in helping us advance our objectives. We want payment systems that work well for the people and businesses that use them and the services they support; that are fast, easy to use, accessible, secure and reliable, and provide value for money; that promote innovation and competition and are responsive to current and future needs. Further detail on our approach and planned pieces of work are outlined in this Annual Plan, reflecting our focus for 2015/16.

For regulation to be truly effective, it is important for the industry to understand and to be invested in what the regulator is trying to do. I believe this approach will secure the best outcomes for all the people and organisations that use payment systems and services. As such, I look forward to working with many of you over the coming year.

# Introduction

## Aims and key activities

### Promote competition



- Market review into the supply of indirect access to payment systems
- Market review into the ownership and competitiveness of infrastructure provision
- Sponsor bank Code of Conduct
- Card payment systems programme of work
- Regulatory directions on access



### Promote innovation

- Payments Strategy Forum

This is our second Annual Plan and Budget, setting out our key aims and activities for the year 2015/16. This is an important milestone for the Payment Systems Regulator (PSR), as from 1 April 2015 we will be fully operational as the UK's independent economic regulator of payment systems.

We will regulate the payment systems designated by the Treasury. These are the main interbank payment systems – Bacs, CHAPS, Cheque & Credit, Faster Payments Scheme (FPS), LINK and Northern Ireland Cheque Clearing – and the two largest card payment systems in the UK – MasterCard and Visa Europe. All participants in designated payment systems will fall within our remit – this includes the payment system operators as well as the infrastructure providers and the payment service providers. In addition, we have concurrent competition powers over all payment systems in the UK, not just those designated by the Treasury.

Our 2014/15 Annual Plan outlined our work to develop our regulatory framework that will provide the basis on which we will advance our objectives in 2015/16 and beyond. Following extensive stakeholder consultation we have now issued our final Policy Statement outlining our regulatory framework.

In this Annual Plan, we outline our activities for 2015/16 to advance our objectives to promote competition, innovation and the interests of service-users (i.e. the people and organisations that use payment systems and services) as well as our work to continue to build and refine our organisation. This includes developing a framework for measuring our performance in achieving our aims, advancing our objectives and realising our vision for payment systems that are accessible, reliable, secure and value for money.

### Promote the interests of service-users

- Investigations
- PSR Panel
- Regulatory directions on governance



### Continue building our organisation

- Measuring our performance
- Working with other authorities
- Our staff

# Our key aims and activities for 2015/16

We are focused on advancing our statutory objectives, functions and duties. Our statutory objectives underpin what we do, driving the activities we undertake and how we prioritise our work and our resources. And, as a new regulator, it is important that we continue to build and refine our organisation to ensure we operate efficiently and effectively.

## Our key aims for 2015/16 are to promote:



- competition in payment systems in the interests of service-users



- innovation in payment systems in the interests of service-users



- the interests of service-users, and



- continuing to build our organisation.

We will pursue our aims with equal priority, and the activities we will focus on this year will enable us to do this. While we pursue all our objectives, promoting the interests of service-users – the people and organisations that use payment systems and services – is a theme that underpins all of our objectives and work, and so all our activities will in some way further the interests of service-users. For the purpose of this Annual Plan, we have identified for each objective the key activities that we are pursuing, although we expect that most of our work programme will advance more than one of our objectives.

In pursuing our aims and objectives we are also conscious of the longer term outcomes we want to achieve. We want payment systems that work well for the people and organisations that use them and the services they support; that are fast, easy to use, accessible, secure and reliable, and provide value for money; that promote innovation and competition and are responsive to current and future needs of the individuals and businesses that use payment systems and services.

To achieve this vision we expect to work closely with the payments industry, leveraging the experience, expertise



and resource that the industry has to help us deliver the best outcomes for the people and organisations that use payment systems and services.

### **Competition**

Our aim is to promote effective competition in the market for payment systems, and the markets for services provided by payment systems, in the interests of the individuals and businesses that use them and the services they support. We want to have payment systems that are open, transparent and accessible to encourage new entrants. We expect that more competition will increase the quality of existing services and the provision of new services which will benefit those individuals and businesses that use payment systems and services. We will undertake a number of activities in 2015/16 that will further our competition objective as follows.

#### **Market reviews**

We will carry out two significant market reviews over the coming year.

One review will look at the supply of indirect access to payment systems. This review is aimed at gathering detailed evidence to determine whether current indirect access arrangements deliver good outcomes for the people and organisations that use payment systems and services.

Our second review is into the ownership and competitiveness of infrastructure provision to support payment systems. This review is aimed at determining whether the current market structure and ownership arrangements in payment systems work in the interests of the individuals and businesses that use them and the services they support, or whether changes may be warranted.

We have now formally launched both of the market reviews, following the scoping work we did over the winter. The work on these reviews will involve gathering detailed information as well as extensive engagement with relevant stakeholders. These reviews will take into account our work in other related areas, such as the implementation of our policy proposals around access

to payment systems, and our card payment systems programme of work.

#### **Sponsor bank Code of Conduct**

We will engage with sponsor banks to facilitate the development of a PSR-approved Code of Conduct that sets out sponsor banks' responsibilities when providing indirect access to payment service providers. We expect sponsor banks to lead on this and to engage effectively with payment service providers to develop a Code.

The Code will set out a range of responsibilities that sponsor banks commit to when providing indirect access and provides a minimum contractual framework the sponsor banks will be expected to meet. The Code will give payment service providers more confidence and certainty in choosing indirect access they receive from sponsor banks, and to invest and develop the services they offer to individuals and businesses. This will allow them to compete more effectively with other payment service providers.

We will approve the Code before it is implemented. We expect it to be approved and in place by 30 June 2015 and to come into effect by 30 September 2015.

#### **Card payment systems programme of work**

We expect to be the competent authority to monitor and enforce the EU Interchange Fee Regulation, which is expected to enter into force in or after May 2015. This regulation includes a range of requirements on participants in certain card payment systems (such as MasterCard and Visa Europe) including caps on domestic interchange fees paid by acquirers to card issuers, and functional separation of certain activities. Interchange fees, which are ultimately passed on to individuals and businesses that use cards to make payments, have been the subject of European and global debate and investigation for many years.

As the competent authority under the regulation, we may have a role in determining whether and how to exercise the national discretions included in the regulation. We would take this work forward as part of the card payment systems programme of work.

As well as the work on interchange fees we will, as part of this programme of work, consider the concerns put to us about governance arrangements for card system operators including: the level of transparency surrounding the structure of fees and other terms and conditions, the effectiveness of service-user representation, and the level of transparency of decision-making in card payment systems. This will enable us to consider whether or not to intervene at some future date, given our decision not to impose at this time on card operators the directions we had proposed relating to representation of service-users' interests and transparency through publication of board minutes. We will also seek to understand whether there are any concerns about access to card payment systems.

Taking a holistic approach to monitoring developments in card payment systems, particularly interchange fees, will ensure that any decisions that we take are designed to promote competition, innovation and the interests of the people and organisations that use those systems and services. If we do take action it will be on the basis of an evidence-based assessment of the impact on payment systems and the people and organisations that use payment systems and services. We will engage with all relevant stakeholders as necessary to ensure we have the right information and evidence we need.

We will also examine the concerns raised by some stakeholders about ATM interchange fees to see whether there is a need for us to undertake any further investigation or work.

#### **Regulatory directions for access<sup>1</sup>**

Two directions relating to access will come into force on 30 June 2015 that will open up payment systems by ensuring requirements for direct access to payment systems do not unnecessarily or disproportionately act as a barrier to entry for payment service providers, and improving payment services providers' ability to evaluate their options for access to payment systems.<sup>2</sup> We expect that this will encourage competition in the provision of payment services.

Under our first direction, the operators of the Bacs, CHAPS, Cheque & Credit and FPS payment systems must ensure that their requirements for direct access are open, objective and risk-based. A second direction requires the operators of the LINK, MasterCard and Visa Europe payment systems (which are already subject to an access rule under Part 8 of the Payment Services Regulations 2009) to publish their access requirements on their website. Both of these directions also require operators to submit annual compliance reports on how they are meeting relevant access rules. These directions help ensure that access requirements do not unnecessarily or disproportionately restrict direct access for payment service providers, and to enable them to evaluate if direct access is a suitable option.

A third direction will come into force from 30 April 2015. It requires the four main sponsor banks (Barclays,

1 Our regulatory directions on access do not apply to Northern Ireland Cheque Clearing.  
2 We are able to give directions to, or set requirements on, a participant in a designated payment system. These may, for example, require or prohibit specific actions in relation to the system, or may set standards to be met in relation to the system.







HSBC, Lloyds and RBS) to publish information about the indirect access services they offer to payment service providers. This will make it easier for payment service providers to assess their indirect access options, strengthen their bargaining power and enable them to compete more effectively in the provision of payment services.

We will keep our policies under review and update them as necessary to ensure they have the intended effect and further our competition and other objectives.

### **Innovation**

We aim to promote innovation in payment systems in the interests of the people and organisations that use them and the services they support. We want payment systems and the infrastructure they operate on to be responsive to the new developments and innovations that the individuals and businesses that use them want. These innovations may be new services, improvements to existing systems, or new systems entirely. Individuals and businesses should be able to have confidence that innovations come to fruition in a timely manner and deliver benefits.

Our innovation work will include monitoring and tracking innovation developments in the sector, working with stakeholders – including the Financial Conduct Authority's (FCA) 'Project Innovate' – to identify barriers to existing or potential innovations, and, where appropriate, taking action to remove such barriers. We will be undertaking other work, as follows, throughout 2015/16 that will advance our innovation objective.

### **Payments Strategy Forum**

We are working with industry and the people and organisations that use payment systems and services to establish a Payments Strategy Forum (the Forum). This will bring the payments industry and the different users of payment systems together to develop and agree strategic priorities for the long-term development of payment systems. Once established, the Forum will be focused on driving new innovation where there is a need for parties to work together to achieve this. This new process will be an opportunity for industry and users to jointly develop their own strong vision for the future of payments to drive innovation and enable new and improved services for users. Delivery will be the responsibility of industry.

We will control the setup of the new Forum, including providing the secretariat and participating in the Forum and its working groups. We will hold the industry to account for the Forum's success. If the strategy setting process is ineffective or industry delivery of agreed priorities is too slow, then we may decide to intervene. If necessary and proportionate, this could include making directions on industry participants.

We expect the Forum to consider existing developments in the sector, like the Current Account Switch Service and Account Number Portability. We will also monitor such developments to ensure they are aligned with our objectives and progress in a timely manner.

### **Interests of service-users**

Our aim is to ensure that payment systems are operated and developed in a way that considers and promotes the interests of both the people and organisations that rely on the services provided by payment systems, as well as those that provide these services (i.e. service-users). The interests of these users are at the heart of what we do, underlying all of our objectives. We want to see improvements in the representation of the interests of the individuals and businesses that rely on the services provided by payment systems, as well as those that provide these services. There are several activities we will undertake in 2015/16 that will promote our service-user objective as detailed below.

### **Investigations**

We may initiate investigations over the coming year where we receive complaints or where we have concerns and taking action would be consistent with our



objective to promote service-user interests or our other objectives for competition and innovation. To gather the evidence we need we will use our information and investigation powers. We can require information to be provided or relevant people to attend interviews, and we can appoint skilled persons to provide reports.

We recognise that investigations may require significant resources, both for the regulator and the parties involved. Decisions regarding which investigations we open and continue, and how we respond to applications and complaints we receive, will be made in accordance with our Administrative Priority Framework (which will also be used more generally in deciding whether we should start significant policy projects or reviews). In making these decisions, we will consider the degree to which taking action provides us with an opportunity to advance one or more of our statutory objectives, functions and duties, as we are unlikely to pursue an action which does not clearly do this. Where practical we will endeavour to give advance notice of information requests so that the parties involved can manage their resources effectively.

Our investigations may result in us taking regulatory action or action under our concurrent competition powers. We might also impose sanctions for non-compliance with existing regulatory requirements where it is appropriate and proportionate to do so, or order that remedial action be taken.

### **The PSR Panel**

We recently established the PSR’s Statutory Panel – an independent panel of representatives of the individuals and businesses that use payment systems and services, and industry experts. We will regularly consult with the Panel on our regulatory policies. The Panel is one of the avenues that we will use to ensure that service-user interests as well as our competition and innovation objectives are considered in, and promoted by, our regulatory policies and approach.

### **Regulatory directions on governance<sup>3</sup>**

We are issuing several directions to open up the governance and control of payment systems. Our first direction, which takes effect from 30 September 2015, will ensure that the interests of the individuals and businesses that use payment systems and services are represented in the decision-making processes of operators of interbank systems. Directions on interbank operators relating to requirements to address specific conflicts of interest of certain decision makers and to publish the minutes of board meetings, which will bring more transparency to the operators’ decision-making, will both come into effect from 30 April 2015. We are continuing our analysis with respect to the governance of card operators in our wider programme of work on card payment systems.

We will ensure compliance with our directions by monitoring governance changes in payment systems and, in some cases, annual compliance reporting.

We will keep our policies under review and update them as necessary to ensure they have the intended effect and further our service-user and other objectives.

### **Continuing to build our organisation**

As a new regulator, we aim to continue to build our organisation, including refining our capabilities and the way we operate. It is important that we are an efficient and effective economic regulator and that our approach,

<sup>3</sup> Our regulatory directions on governance do not apply to Northern Ireland Cheque Clearing.



policies and processes are proportionate and evidence-based. We will update our processes and policies as necessary to ensure we operate in the interests of the people and organisations that use payment systems and services. We will also be forward looking and proactive to ensure we are prepared for any new and evolving issues in the payment systems sector, such as changes in consumer concerns and outcomes. There are several key areas of work that we will undertake in 2015/16 to achieve this.

### ***Measuring our performance***

To be an open and transparent regulator we must be held to account, not only as set out in the statutes that govern us but also more broadly. We have a board to which we are answerable, a requirement to report to the Treasury in the event of a regulatory failure, and we are setting up a complaints scheme. Ultimately, we are accountable to Parliament.

It is also important that we measure our progress in advancing our objectives and towards realising our vision for payment systems that are accessible, reliable, secure and value for money. We can do this, in part, by using output measures – that is, by monitoring our progress in the key activities set out in this Annual Plan. For instance, we can monitor the completion of our market reviews and industry compliance with our directions. We could also assess our progress by referencing the establishment and implementation of the Payments Strategy Forum and the sponsor bank Code of Conduct.

Ultimately we want to measure the outcomes of our work to ensure we have been successful in advancing our objectives. We have begun to articulate these outcomes through our vision. Over the coming year we will be working to determine the appropriate outcome measures that should be used to assess our performance in the years to come. We expect this will involve establishing a model for collecting structured feedback from industry participants, as well as some quantitative measures where these can be devised in a practical way.

We will publish Annual Reports in which we set out what we have done to meet our aims and advance our objectives, the outcomes, and the measures of our success in advancing our objectives. Our Annual Report will also highlight our key achievements for the year. Our first Annual Report for 2014/15 will be published in the coming months.

### ***Working with other authorities***

We expect to work closely with other regulators and competition authorities. Where possible we will cooperate to advance our objectives and coordinate to reduce costs on our regulated communities.

There are a number of authorities regulating various participants in payment systems, notably the Bank of England, the Prudential Regulation Authority and the FCA. We have entered into a Memorandum of Understanding with them that sets out how we will work together effectively.

We also expect to enter into a Memorandum of Understanding with the Competition and Markets Authority (CMA), with which we have concurrent competition powers. We have published our concurrent competition guidance, which sets out the procedures for applying our competition powers, and we are currently consulting on this. The final guidance will be published as soon as possible after our operational launch.

Over the next year, we will collaborate on work with the FCA and the CMA. We will work closely with the FCA on its credit card market study. We will also coordinate with the CMA on its retail banking market investigation.

Our participation in the UK Competition Network, the UK Regulators Network, the European Competition Network and the International Competition Network will enable us to share experience and best practice on regulatory and competition matters, which we will incorporate into our regulatory approach.

### ***Our staff***

Our staff numbers have grown over the past year with the recruitment of staff with the skills and experience needed for us to undertake our responsibilities when we become fully operational in April 2015. We have a target of around 50 staff, and we are close to achieving this. Our team includes economic, legal, regulatory, and communications professionals alongside our industry experts; each bringing different skills, experience and expertise. We will also draw on the experience and operational support of the FCA, where appropriate.

## Breakdown of the PSR's operating costs for 2015/16\*

### Our budget for 2015/16

Our annual budget for 2015/16 reflects our operating costs from 1 April 2015 to 31 March 2016. We estimate these costs to be in the region of £15.9 million.

#### Staff costs and professional fees

Our largest operating expense is staff costs, and reflects the internal staffing resources we need to carry out our activities and responsibilities. Over the past year, our staff numbers have grown as we focused on recruiting permanent staff in preparation for our operational launch in April 2015. As a result, the ratio of temporary staff to permanent staff has fallen, and we are close to achieving our target of 50 employees.

Professional fees relate to specialist services needed to support our work over the coming year. This includes external expertise focused on helping us with our market reviews and our work on interchange fee regulation. We will also utilise external expertise to help with our investigations as appropriate.

#### Other operational costs

As we are a subsidiary of the FCA, we have sought to use its resources wherever possible to gain economies of scale. For example, we utilise the FCA's accommodation, information systems and office services capabilities. We will reimburse the FCA for costs incurred on our behalf on an annual basis.

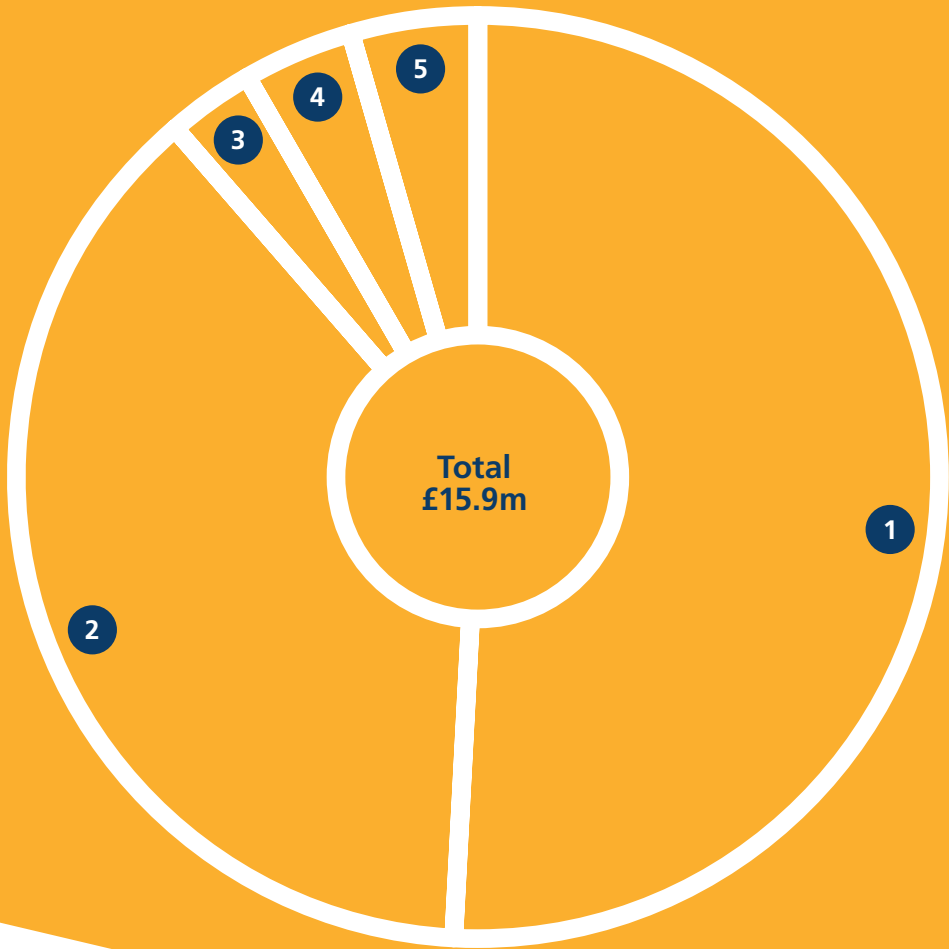
#### Annual funding requirement and impact on fee payers

We will recover all our costs through annual fees paid by the organisations that we regulate, specifically the operators of the eight designated payment systems. The annual funding requirement for the PSR in 2015/16 will include the operating costs (as outlined above) as well as the set-up costs of the PSR, which are expected to be around £12.2 million. We worked with the FCA on its November consultation paper on fees policy<sup>4</sup> that set out proposals for how the PSR's annual funding requirement would be recovered, including the period over which the PSR set-up costs should be recovered.

<sup>4</sup> See the FCA's consultation paper 'Regulatory fees and levies: policy proposals for 2015/16' CP14/26 (November 2014).

- 1 Staff costs  
£8.1m
- 2 Professional fees  
£6.0m
- 3 Information systems costs  
£0.5m
- 4 Accommodation  
and office services  
£0.6m
- 5 Training, recruitment  
and travel  
£0.7m

\* Figures have been rounded



We have been working with the FCA to publish feedback on the responses received to the November consultation as well as the final decision on the proposals in the FCA’s annual March fees rates consultation paper, which is expected to be published contemporaneously to this Annual Plan. The March consultation paper will also consult on the proposed fee amounts for each of the PSR-regulated organisations. The final PSR fee amounts and feedback on the March consultation paper will be published in June. Invoices will be issued to organisations from July 2015.

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