

# Payment Systems Regulator Limited Annual Plan and Budget 2016/2017





# Foreword

## Hannah Nixon

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Managing Director  
Payment Systems Regulator

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We are seeing the green shoots of progress. There are signs that the industry is becoming more competitive. So 2016/17 promises to be another busy year. We will build on our successes so far. But we will also reflect on our engagement with the industry and our processes, so that we can achieve our aims while focusing on creating the right incentives in the market.

Payment systems are the pipes and wires that enable us to move money from A to B: be it paying for a coffee with contactless, receiving your salary at the end of the month, or high-value payments between city traders. If they were switched off tomorrow, the economy would eventually grind to a halt. These systems are central to our everyday lives.

They must be resilient, of course, but they should be more than functional and reliable. To realise all their potential benefits they must be competitive and innovative, and be operated in the interests of those that use and rely on them. That's why the PSR exists – to promote these aims so that payment systems work well for everybody that uses them.

And there's much at stake. More competition in payment systems opens the door to a more competitive banking industry, where there should be more choice for us all as consumers. This can contribute to improving productivity and economic growth.

Competition on its own is not a panacea. We are one of a number of regulators dedicated to improving financial services – but without more competitive payment systems, a more competitive retail banking sector will be much harder to achieve.

As we move into our second year of operation, the good news is that we are seeing the green shoots of progress. There are signs that the industry is becoming more competitive – our December 2015 Access and Governance report is a good place to start if you want to see how.

This plan for 2016/17 maps out the important next steps of our journey. The year ahead will continue to be one of progress in market developments and we will continue to strive to ensure that our organisation is a first class regulator and place of work. Major pieces of work will come to fruition, such as our two market reviews – one looking at indirect access to interbank payment systems, the other at the underlying infrastructure. We will also develop our approach as the UK regulator of the Interchange Fee Regulation for credit and debit cards. And I'm excited about seeing the Payments Strategy Forum help the industry to innovate through collaboration.

There are new projects, some responding to concerns that our stakeholders have raised with us. We will also keep a vigilant watch for poor practice, using our enforcement powers if we need to address anti-competitive behaviour or non-compliance with our directions.

Last year was one of laying foundations, of helping the industry to adapt to a new regulatory framework and become accustomed to having a regulator for payment systems. This year we will build on those foundations, and hope to see more opportunities developing for competition and innovation.

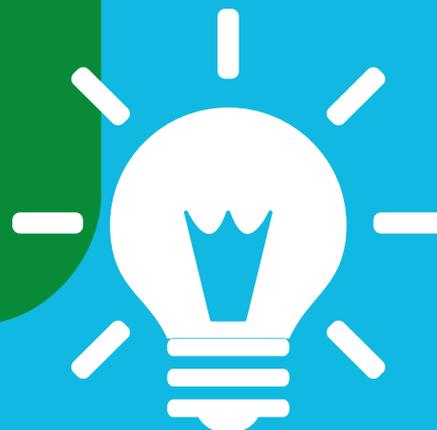
Recalling the past year, I'm reminded that much of what we are doing has never been tried before. There are no other payment systems regulators and financial institutions across the globe are watching what we do. It's an exciting challenge and one that my colleagues and I are proud to be part of.

So 2016/17 promises to be another busy year with some new and significant challenges for the PSR and the payments industry. We will build on our successes so far. But we will also reflect on our engagement with the industry and our processes, so that we can achieve our aims while focusing on creating the right incentives in the market.

I look forward to working with many of you over the next 12 months to help the payments industry serve everybody as well as it can.



Promote competition  
in payment systems



Promoting innovation

# Introduction

This is our third annual plan and budget. It sets out our key aims and a summary of our anticipated key activities for the year 2016/17, alongside our expected costs for performing them.

We publish this document so that our stakeholders – those we regulate and those with a professional or personal interest in our work – have access to a clear overview of our work programme for the year ahead.

Similarly, this summer, we will publish our annual report on how we performed against our plans for the previous year.

Our role is to make payment systems work well for those that use them. We do this by following the three statutory objectives we were given by the Financial Services (Banking Reform) Act 2013 (FSBRA). These require us to:

- promote the interests of those that use or rely on payment systems
- promote competition in payment systems
- promote innovation in payment systems



### Promote the interests of those that use or rely on payment systems

These objectives inform everything we do when fulfilling our functions under FSBRA, and we expect those we regulate to adhere to them too. We regulate:

- the eight payment systems that have been designated by the Treasury (Bacs, CHAPS, Faster Payments Scheme, LINK, Cheque and Credit, Northern Ireland Cheque Clearing, MasterCard and Visa)
- the participants in those payment systems (such as banks, building societies and other payment service providers)
- the companies who provide the infrastructure for payment systems – the connections that make the systems work

Our competition powers cover every UK payment system, including those not designated by the Treasury. At the end of 2015 we also became the lead UK regulator for monitoring and enforcing the Interchange Fee Regulation (IFR), the new European regulation covering payment cards.

We want our work to result in payment systems that are accessible, reliable and secure, and represent good value for money.

More competitive and innovative payment systems can help create a more competitive financial sector. For example, if we remove unnecessary barriers to entry, it may be easier for challenger banks to enter the market and provide greater choice for consumers. It could also help fintech companies to innovate and create new ways of paying.

We also want to see more, and faster, innovation in the central payment infrastructure. The network nature of this infrastructure means that the industry will sometimes need to collaborate to make things happen; greater competition alone will not be enough.

Our first annual plan, for 2014/15, outlined how we would develop a regulatory framework to provide the basis for us to deliver our statutory objectives. Our second annual plan, for 2015/16, outlined the specific activities we proposed to advance our objectives, and how we would build and refine our organisation.

This plan is our first since we became operational. 2016/17 will be a year of building on the foundations we've laid and seeing the impact of some of our early work.

While we intend to deliver what we have set out in this plan, there is always a chance that we may need to reprioritise in the light of unexpected developments. If this happens, we will keep our stakeholders informed and act in the way that helps us best achieve our objectives.

# Our aims and activities for 2016/17

We have grouped our work programme for the year into three main categories, reflecting our statutory objectives:

- promoting competition
- promoting innovation
- promoting the interests of service-users (those that use or rely on payment systems)

In the table we have grouped our projects according to the objective they are most closely aligned to; a number of projects cut across more than one objective. Some work will be carried out under our wider FSBRA duties, and some under our functions under EU legislation and UK competition legislation.

We also provide a brief summary of how we will work with other regulators.

Each strand of work moves us towards our overall vision of payment systems that are accessible, reliable and secure, and represent good value for money. The strands are also in line with our approach of proportionate, evidence-based and meaningful regulation.

We are very conscious of the burden of regulation and will always look to operate in the most efficient and effective way to keep our costs and time demands as low as possible.

To this end we will focus on effective collaboration with other competition and economic regulators to reduce overlap.

**Promoting innovation**  
Payments Strategy Forum  
Regulating for the future ✨



New work programmes for this year are marked with a '✨'.



**Promoting competition**

- Infrastructure market review
- Indirect access market review
  - Cards programme
- Access and governance – monitoring compliance with directions
- Horizon scanning

- Compliance with PSR directions
- FSBRA enforcement cases
- Success measures

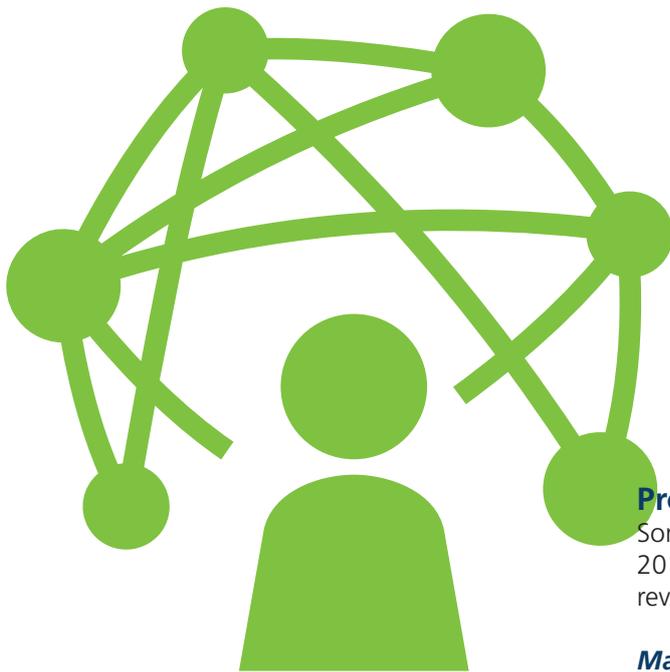
**Other work outside of our FSBRA duties**

- Our role as a Concurrent Competition Authority
  - Interchange Fee Regulation (EU)
  - Payment Accounts Directive (EU)
  - Payment Services Directive 2 (EU)
  - Future EU regulation✳



**Promoting the interests of service-users**

- Industry projects oversight
- PSR Panel



### **Promoting competition**

Some of our projects from 2015/16 will continue into 2016/17. Foremost among these are our two market reviews and our work on payment cards.

#### ***Market reviews***

Later in the year we will publish final reports for our market reviews on indirect access and infrastructure, which began in 2015/16.

In our infrastructure review we are considering competition in the provision of infrastructure services in UK interbank payment systems, focusing on the supply of infrastructure to Bacs, Faster Payments and LINK. We have initially found that there is not effective competition and provisionally proposed a package of remedies to make the market work better. These include the divestment of Vocalink by the group of banks that currently own it.

The indirect access market review is part of our wider programme of work to promote better access to payment systems. Our interim report revealed that our work to open up access is generating increasingly positive results. Banks, building societies and other payment service providers now have a genuine choice between direct and indirect access. Indeed, nine banks are expected to secure direct access in the coming year. We are also aware of at least four organisations that are planning to start offering indirect access, and two that are expanding their current services. While we are clear that there are some issues that still need to be addressed, we believe that a number of current and anticipated developments should alleviate these concerns and improve access for banks, building societies and other payment service providers. We therefore proposed to support these developments rather than take immediate regulatory action at this stage. However, if our concerns are not sufficiently addressed over the next 12 months we will take further action.

We are now consulting on both market reviews and would like to receive written responses to our interim

reports. We will also meet stakeholders and hold workshops to get further feedback, and to help us develop our analysis as we prepare our final reports.

We expect to publish our final reports for both market reviews later in the year. Where remedies are required, we will then consult on how we implement any measures we have proposed. We recognise that if the final remedies include those we have proposed in the interim report, we will need to work effectively with stakeholders to deliver them while maintaining reliable payment services for service-users and consumers.

### **Access and governance**

As part of our wider programme of work on access, we continue to monitor and assess the effectiveness of our access and governance directions. In December 2015 we published our first annual report summarising the operators' progress in making direct access more open and flexible, and governance more inclusive and transparent. In particular, it showed that the operators are reducing the time it takes to 'onboard' new direct participants, and that decision-making processes are becoming more transparent and inclusive. These changes have been prompted by the direct access and governance directions that we introduced in March 2015. As well as highlighting their progress, the report sets out further 'focus areas' for the operators to do more work on during 2016.

We will build on this work in 2016/17, and monitor and assess how other current and anticipated developments will help deliver widespread access for banks, building societies and other payment service providers. To do this, we will take into account our final report for the indirect access market review, and collect further information from the operators and their service-users to produce a second annual report on access and governance. If progress has not been made to sufficiently address any concerns we have, we may identify additional work or take further action.

### **Cards**

The cards programme focuses on the implementation of the EU Interchange Fee Regulation<sup>1</sup> (IFR), which came into force in December 2015. We have already consulted on Phase 1 of our guidance and will consult on Phase 2 this summer.

We will continue to listen to our stakeholders' views and concerns more generally about card systems.

### **Horizon scanning**

The speed of innovation in payments means we must always be aware of and understand how the market is evolving. This project will ensure that our other projects are kept up to date, and will inform our future work programme and prioritisation. We think it's important that we understand how our future regulatory decisions could affect the ability to innovate, and we want to avoid inadvertently creating barriers to innovation and technological developments.

Our staff obtain market intelligence and information about potential new industry developments and innovations that are relevant to our work. Our horizon scanning project coordinates the gathering of that information and helps to make sure we:

- consider it within the relevant projects
- use it to inform our longer-term thinking about market developments and our regulatory responses

The project covers the broad range of market developments within the scope of our regulatory and competition roles, recognising that innovation is happening rapidly in payment services. In addition to our own work, the horizon scanning team learns of innovative initiatives by maintaining close relationships with the Financial Conduct Authority's (FCA) 'Project Innovate' and with the government's Engagement and Advisory Group.

<sup>1</sup> Regulation (EU) 2015/751

## Promoting Innovation

### **Payments Strategy Forum**

The Payments Strategy Forum (the Forum) is about driving innovation where the industry needs to work together. It is supported by the Payments Community – people and organisations that use payment systems who provide a ‘sounding board’ and are the Forum’s primary means of consultation.

Last year the challenge was to get the Forum up and running; now it’s operating, our role is different. We will continue to provide secretariat support, and provide guidance and challenge where necessary. 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 issuing directions to industry participants.

The Forum has set up four initial working groups in its first year of operation:

- **End user needs:** Aiming to understand and address the user needs identified by the Payments Community.
- **Simplifying access to markets:** Examining whether and how payment systems can be developed to simplify access to the markets.
- **Financial crime:** Examining whether and how payment systems can be used to develop centralised functions aimed at preventing financial crime.
- **Horizon scanning:** Researching and presenting a regular horizon scanning report to the Forum. This will identify key regulatory and technological developments and suggest how they might be relevant to the Forum’s work.



In our interim report on our infrastructure market review, we proposed that FPS, Bacs and LINK adopt a common international message standard. The Forum, in its work on simplifying access to markets, will analyse the business case for moving to a standard such as ISO 20022.

The Forum is also considering the issue of potential simplification of the operators, and we expect this work to inform the future structure of the payments industry.

When the Forum has produced its strategy, it will be important to consider how it can best be implemented, and how it will coordinate with the rest of our work and that of other organisations.

### **Regulating for the future**

Innovation in the financial sector has already produced a range of products that use the existing infrastructure to support new business models. But we also need to reduce the barriers to new entrants where possible.

Other innovations bring more choice by incrementally adding new hardware or infrastructure to an existing payment mechanism, or – in some cases – creating new payment and accounting infrastructures altogether.

Our two market reviews, the work of the Payment Strategy Forum, and other work we are doing are intended to help significantly advance our objectives over the coming year. However, we are aware that alongside these changes the payment systems and services sectors are continuing to evolve, as technological changes open up new options to better serve service-users and consumers.

We want to understand what the market may look like in the future and start thinking about the regulatory tools we might need as it develops. For example, what scope might there be for payment services that directly connect banks and consumers? How might the market for acquirer services develop in the future? In an increasingly fast-moving sector, significantly shaped by technological change, it is important for us to understand these developments and consider how our approach to regulation should evolve. This can help inform the development of our future work programmes.

We will begin this process by engaging with stakeholders in early 2017.

## Promoting the interests of service-users

### *Industry projects oversight*

The industry continues to progress the migration to cheque imaging. It is right that industry is responsible for delivery of this programme; we will monitor this project to ensure it is delivered in a way that meets our objectives.

### *The PSR Panel*

The 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 service operators, payment service providers and service-users, and offer advice and early input on our general policies and practices.

We will continue to consult regularly with the Panel on our policies and approach. The Panel remains a key channel for us to be able to understand how our wide range of service-users may respond to a new or altered regulatory approach.



## Projects that relate to all of our aims for 2016/17

### **EU Regulation: PSD2<sup>2</sup>**

The revised EU Payment Services Directive (PSD2) is designed to open up competition and innovation in banking and payments through enhanced access to accounts and services for non-traditional and non-bank participants.

PSD2 updates the PSD1 directive, under which we are the competent authority for access provisions. Our work on this project, in conjunction with the Treasury and the FCA, will help us determine if PSD2 will affect our current access rules.

### **EU Regulation: PAD<sup>3</sup>**

The EU Payment Accounts Directive (PAD) sets common regulatory standards that member states are required to meet in order to:

- improve transparency and comparability of current account fees
- facilitate current account switching
- ensure access to bank accounts with basic features

<sup>2</sup> Directive (EU) 2015/2366

<sup>3</sup> Directive 2014/92/EU

In December 2015 the government published the Payment Accounts Regulations 2015 (the PARs), which transpose PAD into UK law. The PARs will come into force on 18 September 2016.

The government has appointed the PSR as the competent authority responsible for designating account switching services as 'alternative arrangements'. The PARs also give us powers to take enforcement action against the operators of these services if they fail to comply with the regulations.

We will publish guidance on our approach to implementation, monitoring and enforcing compliance, following our consultation in March/April 2016.

### **Future EU Regulation**

Successful and proportionate implementation of EU regulations is vital to our effectiveness as a regulator. As well as our work on PSD2 and PAD, we will operate a Future EU Regulation horizon scanning project. Through this we will monitor the evolution of the EU regulatory agenda and coordinate policy advice with the Treasury, the FCA, the Bank of England and the Prudential Regulation Authority (PRA).



**Success measures**

It is important that we understand whether our regulatory approach is achieving our stated aims.

We will include and reflect on our success measures in our annual report for 2015/2016. This year we will assess whether the 2015/16 measures are still appropriate, and suggest any amendments that might improve the way we measure our success.

**Compliance with PSR directions**

We will monitor the industry's compliance with the existing regulatory regime, and – where necessary – investigate cases of non-compliance. Where there has been non-compliance we will take appropriate enforcement action.

**Competition and FSBRA enforcement cases**

We may initiate investigations where we receive complaints, or where we are concerned about compliance and enforcement action is consistent with our objectives.

We can require organisations to provide information and relevant people to attend interviews, and we can require skilled persons to provide reports.

We recognise that investigations may require significant resources, both for the regulator and the parties involved. We will decide which investigations we open and continue, and how we respond to applications and complaints we receive, in accordance with our Administrative Priority Framework, which is available on our website at [psr.org.uk/administrative-priority-framework](http://psr.org.uk/administrative-priority-framework).

Our investigations may result in us taking regulatory action, or action under our concurrent competition powers. Where appropriate, we might impose sanctions for compliance failures or require remedial action to be taken.

**Risk**

Identifying and assessing risk forms a key part of our planning process. It helps us to prioritise our use of resources, while retaining some flexibility to respond to new issues as they appear.

We start this through our external horizon scanning activities. These help us understand how the UK payments market is evolving, so we can consider how to respond to ensure that our statutory objectives can be met. It is through this cycle of research, assessment and sense-testing that we identify our key areas of risk.

Once we have identified the risks, we can assess whether our existing regulations will still achieve their goals as designed, and if not, how we need to change them. Our strategic risks are managed to ensure we meet our statutory objectives. Alongside this, our risk management activity addresses our policy work programme and operational risks on an ongoing basis.

**Working with other authorities**

We will continue to work closely with other regulators and competition authorities in 2016/17.

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.

# Budget for 2016/17

Our annual budget for 2016/17 reflects our operating costs from 1 April 2016 to 31 March 2017. We estimate these costs to be around £15.2 million.

## **Staff costs and professional fees**

Staff costs are our largest operating expense, reflecting the resources we need to operate and carry out our objectives.

Since our launch on 1 April 2015, we've replaced many temporary staff with permanent staff and we will continue to do so this year. We will recruit as required to ensure we have the right people and skills for our aims and activities.

We expect to have close to 65 permanent members of staff in post this year, supported by around ten contractors who will provide specialist advice as appropriate.

Our professional fees (for specialist services to support our work) this year have almost halved, from £6m in 2015/16 to just over £3m in 2016/17.

## **Other operational costs**

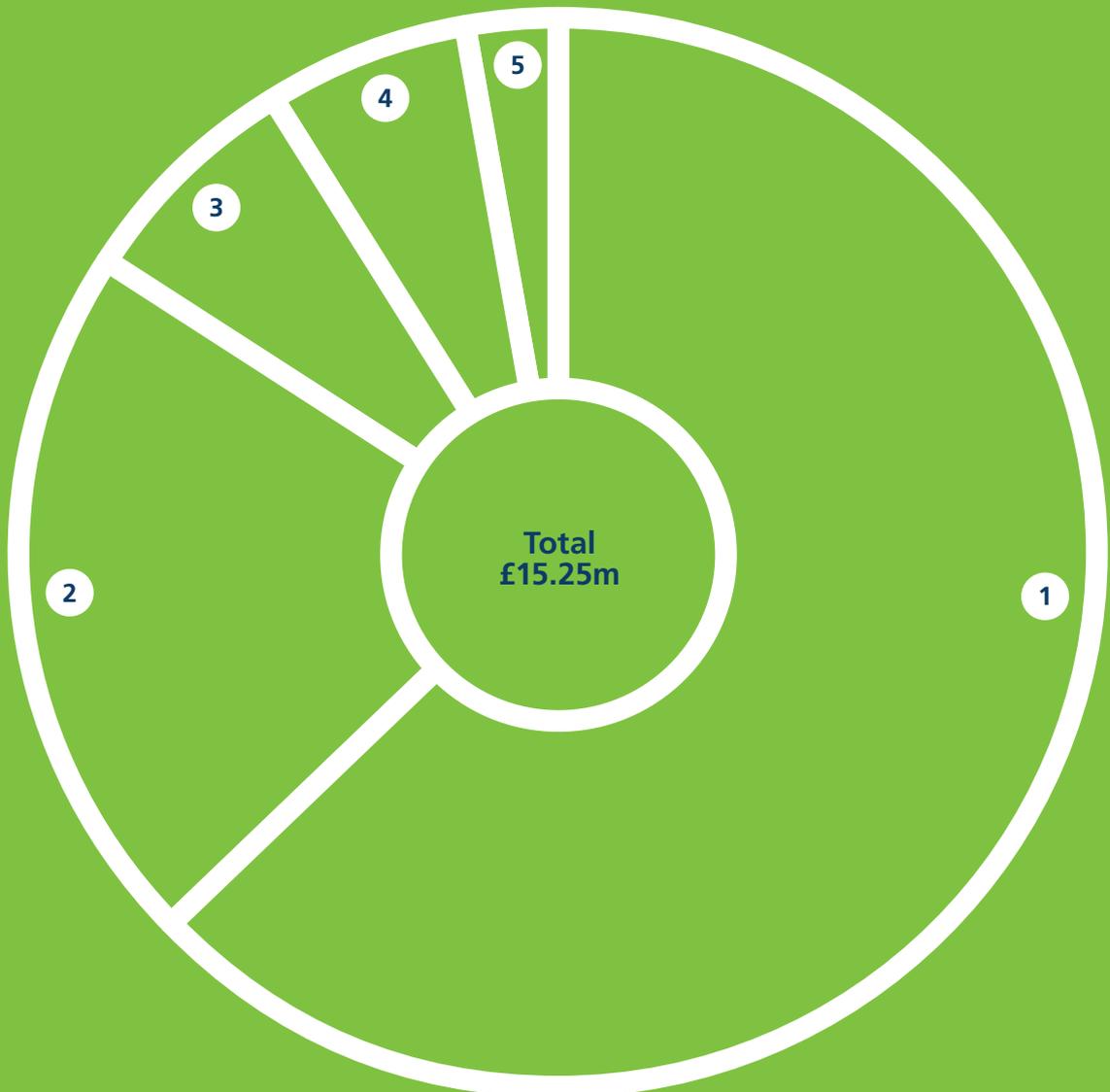
As an independently accountable subsidiary of the FCA, we continue to use their support services where it is viable, effective and efficient to do so. We will continue to reimburse the FCA on an annual basis for costs incurred on our behalf.

## **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 payment service providers 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 PAD.

- 1 Staff costs  
£9.58m
- 2 Professional fees  
£3.27m
- 3 Training, recruitment  
and travel  
£1.06m
- 4 Accommodation  
and office services  
£0.93m
- 5 Information systems costs  
£0.41m

\* Figures have been rounded



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