

Payment Systems Regulator Limited Annual plan and budget 2017/2018



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This publication is available at:
www.psr.org.uk/psr-publications/annual-plans-and-reports/annual-plan-2017-18

ISBN 978-0-9957935-0-7



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Foreword

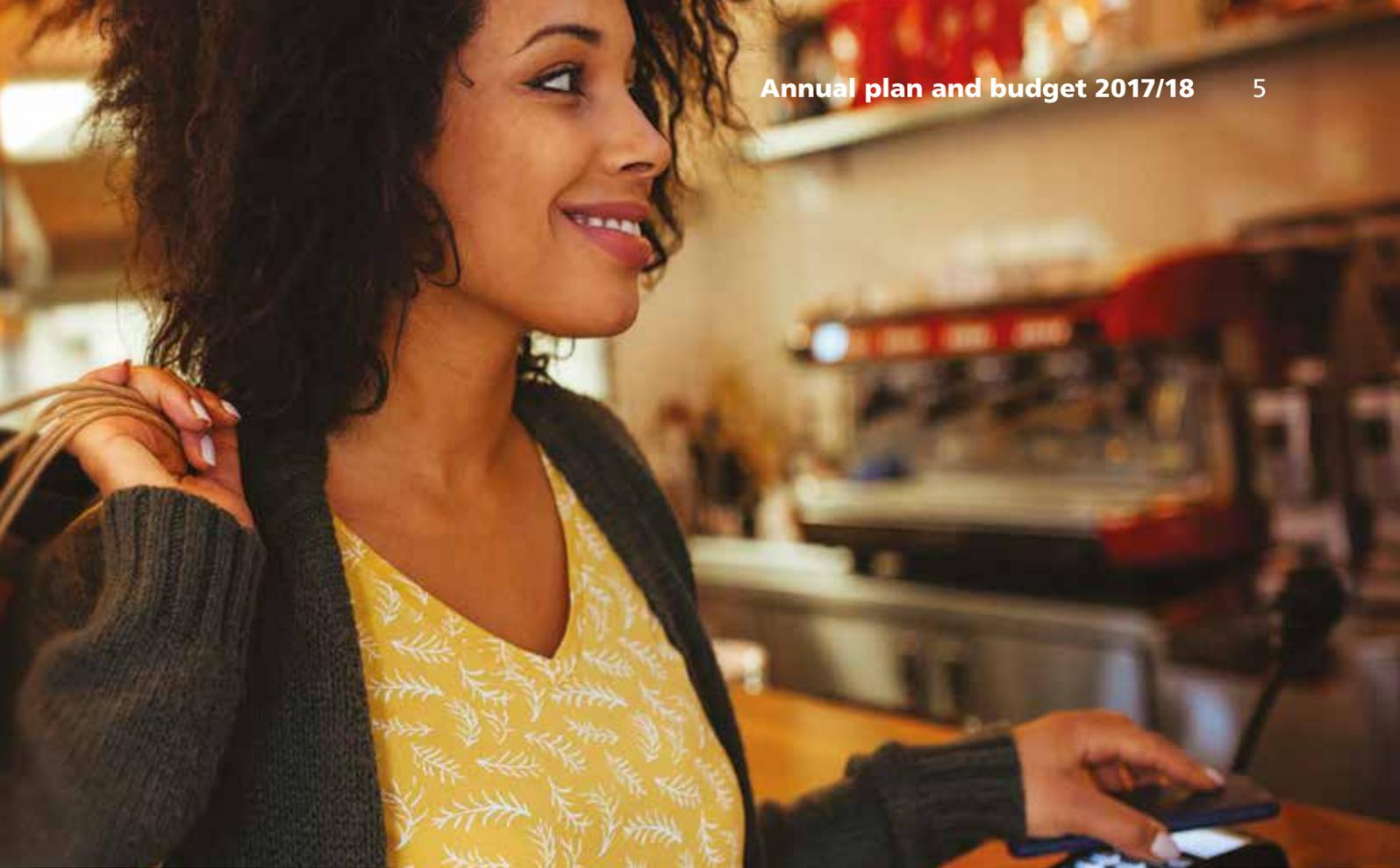
We rely on payment systems in every area of society; they let us easily make the transactions we need to, from buying a house to tapping in and out on public transport. But it's not enough for them simply to work. Payment systems must be versatile enough to adapt to an ever-changing and rapidly advancing technical environment, where technologies evolve and converge. The systems, and the organisations that provide payment services through them, must push boundaries, be creative and innovate. This will be essential if they are to deliver new products and services that work well for their users. Our role is to make sure we have the right conditions to foster this innovation: competition where appropriate and collaboration when needed – and always focused on the needs of users.

All of our work is guided by this aim, and we've been encouraged to see the wider payments industry working with us to achieve our objectives.

Over our first two years of operation we've made significant headway in addressing the key concerns we identified with stakeholders. In particular:

- We've worked hard to open up access to payment systems. It's now easier, quicker and cheaper to get direct access, and new technical solutions mean more ways to connect both directly and indirectly. For example, last year five companies gained accreditation to provide direct technical access to Faster Payments Scheme (FPS) via the new aggregator model. During 2016 we saw the first new joiners of FPS since it was launched in 2008, and there is a strong pipeline of potential new direct members across the interbank schemes over the rest of 2017. In addition, we have seen new indirect access providers enter the market and we expect to see more by the end of 2017. This should help facilitate greater competition in retail banking, and in payment services more widely.





- We've reviewed competition in central infrastructure for key payment systems and concluded that it is ineffective. As part of this, we have answered longstanding questions about the ownership of infrastructure. In particular we concluded that the ownership of VocaLink by the large payment service providers gets in the way of competition and innovation. We've consulted on clear remedies to address the problems we had identified.
- Through the creation of the Payments Strategy Forum we've built momentum in collaborative innovation in payments. In the autumn the Forum published its strategy for collaboration in the interests of consumers. Its proposals for a new payments architecture and additional functionality are potentially game-changing, leading to more competition and innovation in payments in the interests of service-users.

In the coming year we will continue to work with the industry on all these issues – further opening up access, implementing the remedies for infrastructure, and making sure the Forum moves towards delivery of its strategy. We will look ahead to explore the changing competitive dynamics, use of data and consumer protection issues in payments, to see what role – if any – we might play.

And we will continue to examine the area of consumer protection and education – work we began last year when we responded to the super-complaint we received from consumer group Which? In less than 90 days we built a clearer picture of a growing issue and kickstarted an industry-wide effort to tackle payment scams.

I look forward to working with you over the next 12 months to build a payments landscape we can all be proud of.



Hannah Nixon
Managing Director

Introduction

This is our fourth annual plan and budget, setting out our key aims and activities for the year 2017/18 alongside our expected costs.

We publish this document to give a clear overview of our work programme for the year ahead to our stakeholders – those we regulate and those with a professional or personal interest in our work. In the summer, we will publish our annual report on how we performed against our plans for 2016/17.

Our vision, role and powers

Our vision is of payment systems that are accessible, reliable and secure, and represent value for money.

Our role as an economic regulator 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

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, FPS, LINK, Cheque and Credit Clearing, 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

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

In addition, we have responsibilities relating to EU legislation such as the Interchange Fee Regulation (IFR),¹ the Payment Services Directive² and, replacing it, the forthcoming second Payment Services Directive (PSD2).³



Competition, innovation and beyond

In our 2015/16 annual plan we highlighted the importance of improving access to payment systems, making it easier and simpler for challenger banks to enter the market. We also said that greater competition in the provision of payments infrastructure should help to stimulate innovation – but the industry would also need to collaborate to make things happen.

Last year we were starting to see progress: the emergence of greater competition and innovation in payment systems that would benefit all who use and rely on them. In this annual plan we reflect briefly on that success and set out our plans for building on it.

In 2017/18 we will still focus on promoting competition and innovation in the UK payments sector. But we will also look at whether we should pay specific attention to areas which flow from these, including the data associated with payments, the changing competitive structure of the market, and consumer protection and education.

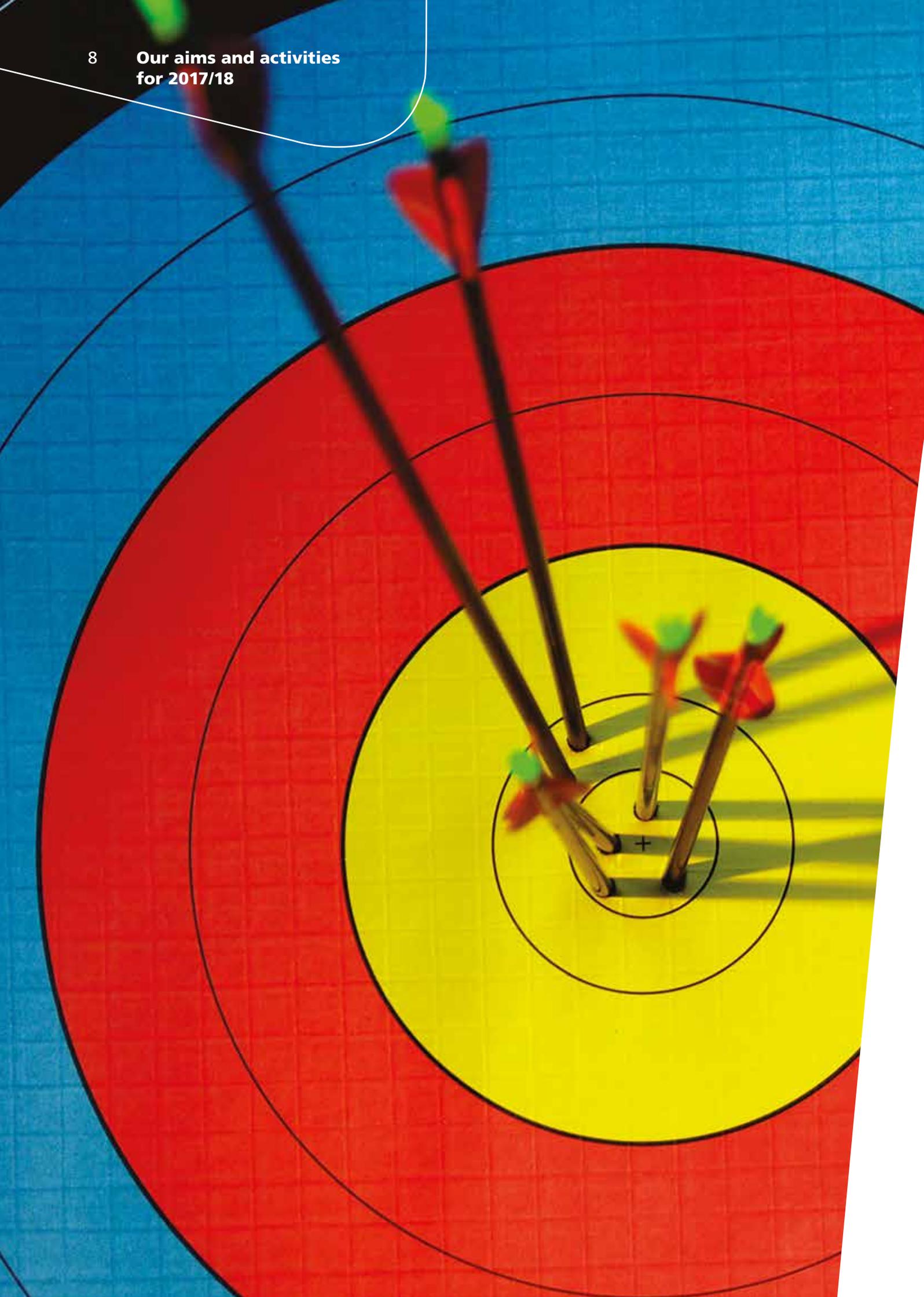
We will work with other relevant bodies where we have common interests to ensure that our respective roles and responsibilities are clear and that, ultimately, the right organisation takes action when needed.

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 act in the way that helps us best achieve our objectives. We will keep our stakeholders informed where lawful and practicable.

1 Regulation (EU) 2015/751: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_2015.123.01.0001.01.ENG

2 Directive 2007/64/EC: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32007L0064>

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



Our aims and activities for 2017/18

During 2017/18 we will do further work on four substantial existing projects: the Payments Strategy Forum (the Forum); our market reviews on infrastructure and indirect access; and the Which? super-complaint on authorised push payment scams. We will also continue our important work to implement and monitor compliance with the EU Interchange Fee Regulation (IFR), the first and second EU Directives on Payment Services (PSD1 and 2), and the Payment Accounts Regulations (PARs). We will also continue to develop our roles as an effective enforcement regulator and as a competition authority.

We recognise that we have important work to do to deliver the outcomes from our work to date. Alongside this work we've been considering how we can pursue our vision and objectives as the payments sector evolves. We are also aware of how this evolution may affect our competition powers. The rapid growth of innovation in payments, the increasing penetration of fintechs and the convergence of technologies will have a significant combined impact on the market. It's important that we are abreast of both the changes and their consequences.

During summer and autumn 2016, we worked with the PSR Panel and other interested parties to identify some key areas for us to explore. Our aim is to see what issues there are and whether it would be appropriate for us to respond to them. We decided on three areas:

- the increasing use and value of payments data
- changing competitive dynamics
- consumer protection and education

For instance, greater availability and use of payments data (including cards data) could potentially drive innovation in the sector, resulting in more payment products and services being made available to end users. However, the increased commercial use of payments data could have implications for end users with respect to privacy, security and data protection.

At this early scoping stage, we are exploring our role in these areas, taking into account the distinct responsibilities of other public bodies (for example, the Information Commissioner's Office, the Competition and Markets Authority and the Trading Standards Institute). Once we've established what the relevant issues are, we can determine what our role should be, if any, and whether the existing regulatory framework is fit for purpose. The outputs from our exploration will continue to shape our overall strategy.

Projects in 2017/18

Promoting the interests of service-users

Promoting the interests of service-users – the people and businesses that use payment systems – is a thread which runs through everything we do. We engage with service-users in various ways, including meetings and wider engagement.

For example, in 2015 we established the Payments Community to influence the Forum's work programme.⁴ Participation in the Payments Community is open to everyone. Its purpose is to provide a flexible way for all interested individuals and organisations to engage with the Forum and shape its thinking.

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 (PSOs), payment service providers (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 continue to monitor LINK to understand how any changes it might make could affect the interests of the people and organisations that use and rely on ATMs.

This year we will also survey consumers and other relevant stakeholders directly about what they want from payment systems. This will give us a better understanding of consumers' views on issues within our remit. We will reflect what they care about in our vision, work programme and communications.

The increasing use of payments data

The data associated with payments will become increasingly important as its availability and commercial use increases. These changes will be further stimulated by forthcoming regulatory and industry initiatives, and by an increase in the number and diversity of participants in the payments industry. This may have implications for consumer protection, including data privacy and security, as well as for the development of the competitive market.

Our recent scoping project for our exploratory work has enabled us to plan further work on payments data. Through this work we will:

- discover and understand the emerging issues as the market develops
- see what we need to focus on under our existing role
- understand the role of other relevant public bodies
- consider whether the existing regulatory framework is fit for purpose

⁴ <http://implementation.paymentsforum.uk/payments-community>



Working in consumers' interests

The changing nature of the payments sector raises questions for consumers. Issues were also raised by Which? in its super-complaint about authorised push payment (APP) scams, which we responded to in December 2016. In exploring the theme of consumer protection and education, the questions we need to consider include:

- What consumer protection issues exist now, and what issues will there be in the future?
- What is our role in these areas, and are there regulatory gaps?
- How can we help consumers when they use payment systems? And how can we help them understand the relevant benefits and risks?

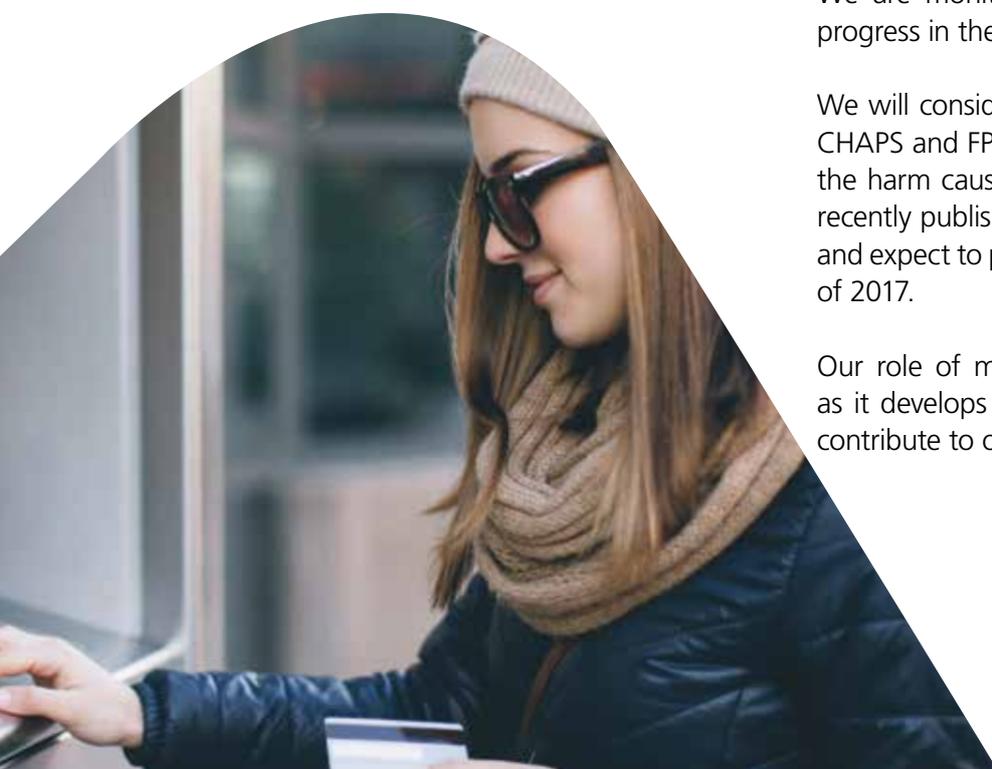
Following our response to the Which? super-complaint we agreed a programme of work with Financial Fraud Action UK (FFA), which the banking industry is leading on. The programme will help us and the industry understand more about the scale of APP scams, and improve how PSPs work together in responding to them. This programme of work includes the following:

- industry, liaising with the Information Commissioner's Office as appropriate, to develop a common understanding of what information can be lawfully shared
- industry to develop a common approach, or best practice standards, that PSPs should follow when responding to instances of reported APP scams
- industry to develop, collect and publish robust APP statistics

We are monitoring this work and will review its progress in the second half of 2017.

We will consider the potential for the operators of CHAPS and FPS to play a greater role in minimising the harm caused to consumers by APP scams. We recently published terms of reference for this work, and expect to publish our findings in the second half of 2017.

Our role of monitoring and observing the Forum as it develops its financial crime solutions will also contribute to our service-user objective.





Projects in 2017/18

Promoting competition

Access and governance

We will continue to monitor the impact of our work to open up access, and will report on this through our annual access and governance report. To support this, PSOs will submit compliance reports to us in October, detailing their own assessment of their compliance with our directions for the past year.

We will consider applications made to us under section 56 of FSBRA, which allows us to grant PSPs access to certain regulated payment systems. We will also consider applications under section 57, which allows us to vary the terms of agreements for access to certain regulated payment systems. In January this year we opened our first detailed assessment of a section 57 application, which we expect to conclude by the end of June.⁵

We believe we will need to revise our directions in 2017 for a variety of reasons. In our consultation on our approach to handling applications under sections 56 and 57 of FSBRA, we set out our proposal to amend the test used in General Direction 2 to make it consistent with:

- the test we will use in assessing these applications
- the test used in the second EU Payment Services Directive (PSD2)

The introduction of PSD2 will, from January 2018, supersede the application of sections 56 and 57, in respect of indirect access, to several of the regulated payment systems. We may also need to amend our Sponsor Bank Information Direction 1

to ensure it is enabling indirect payment service providers to assess their options and to reach the correct contacts within indirect access providers.

In addition, through our ongoing monitoring of the effectiveness of General Direction 4, we have identified that we may need to consider whether this direction is working as well as it could.

We are also considering the future regulation that would need to apply to the new consolidated PSO, including our directions.

We plan to conduct a review and will consult on any proposed changes later in the year.

Our infrastructure market review

In July 2016 we published the final report of our market review of payment systems infrastructure. We found that there was no effective competition in the provision of central infrastructure services for Bacs, FPS and LINK. We proposed three potential remedies. In December 2016 we consulted on detailed proposals for two of these – mandating competitive procurement exercises, and enhanced interoperability. Given Mastercard's proposed acquisition of VocaLink, the current infrastructure provider to all three systems, we did not consult on our third proposed remedy – the divestment of banks' ownership interest in VocaLink. The proposed acquisition is subject to a merger control decision by the Competition and Markets Authority (CMA).

⁵ www.psr.org.uk/psr-publications/news-announcements/psr-receives-first-application-section-57-fsbra



It is currently consulting on whether the remedies offered by Mastercard and Vocalink will address the competition issues it has identified. It is due to decide whether to accept these or move to a more detailed investigation by 15 May.

We intend to make a final decision in spring 2017 on the two remedies that we have consulted on to date. If Mastercard does not acquire VocaLink, we intend to consult on a divestment remedy in due course.

Monitoring competition in the market

We will continue to monitor the payments sector and to consider complaints of anti-competitive behaviour raised with us (alongside the CMA and the European Commission's Directorate-General for Competition, as appropriate), to ensure that competition is effective and that breaches of relevant competition law are addressed appropriately.

The rapid growth of innovation in the payments sector, the increasing penetration of fintechs and the evolution of technology all help to create the potential for a change in 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 recently concluded a scoping project which gives us the basis to target any new work that may be prompted by changes in competition in different payments areas. This will help us monitor the evolving market, direct our focus, and design our approach and regulatory response to emerging issues.

The Payment Accounts Regulations 2015 (PARs)

We will continue to fulfil our obligations as the competent authority for alternative switching schemes under the PARs. We will consider applications from schemes to be designated as alternative switching services, and monitor and ensure continued compliance with the designation criteria.

The CMA's retail banking remedy: monitoring CASS

Following a recommendation by the CMA in its *Retail Banking Market Investigation: Final Report* (August 2016), we will also monitor the performance of the Current Account Switch Service (CASS) against two key performance indicators set by the Treasury (CASS is an alternative switching scheme under the PARs). We will report on this annually to the Treasury.



Projects in 2017/18

Promoting innovation

The Payments Strategy Forum

The Forum published its final strategy on 29 November 2016. We have decided that, to ensure continuity and momentum, the Forum should continue into 2017 and be responsible for implementing the first phase of the strategy. The strategy identifies the key milestones for 2017:

1. By July 2017, the Forum will design and document its 'blueprint' and run a pilot for a new payments architecture (NPA), and complete the design and cost benefit analysis work on the relevant financial crime solutions.
2. Between July and September the Forum will consult on its work to date.
3. By the end of 2017, the Forum will finalise and document its design work ready for handover to the new payment system operators (NPSOs).

We set up the Forum in 2015 and appointed its Chair. We will continue to provide secretariat support to both. We will also, alongside the Bank of England and the Financial Conduct Authority (FCA), be an active observer and provide guidance to the Chair in relation to our objectives.

We believe that we will see better outcomes if the industry takes ownership and responsibility for its own strategy. The Forum's strategy demonstrates this: it outlines a set of proposals for the industry to collaborate on to meet users' needs without regulatory intervention. However, we will take action if we believe the strategy is not achieving its goals.

Having identified the needs of end users for greater control, greater assurance and the ability to send and receive more information with their payments, the Forum has proposed three specific solutions:

- **Request to Pay:** A service that would enable consumers and other end users to have greater control over the payments they make. Payment requests may be made by organisations such as government, businesses or charities. The recipient would be able to decide if, how and when they want to respond – for example, by choosing the amount or date to pay.
- **Assurance data:** This will give end users more assurance that their intentions in originating or requesting payments have been followed through accurately. This will be delivered by a 'Confirmation of Payee' function that will help avoid misdirected payments and prevent certain types of fraud.
- **Enhanced data:** Users will be able to attach data to a payment to allow a recipient to easily identify what the payment relates to. This will enable an end user – for example, a business or a government department – to reconcile the payment with their internal systems accurately and more efficiently.

PSO consolidation

The PSOs are owned and controlled by a largely common set of banks. This means that there are limited incentives for the PSOs to compete against each other – instead, we believe that their products and services have been designed to be distinct and complementary.

In its final strategy the Forum proposed the consolidation of the operators of Bacs, FPS, and Cheque and Credit Clearing (C&CC) as a first step towards its vision of a new payments architecture (NPA). The NPA will promote competition and innovation across the payments value chain. The functions of the PSOs form only a small part of that value chain. Encouraging competition in other parts such as infrastructure and retail banking could boost innovation significantly. For example, end-to-end interoperability would allow multiple providers of value-adding infrastructure to compete in the market simultaneously.

We don't think the current structure of separate interbank PSOs would be able to support a transition to an NPA effectively. In particular it would not be efficient for three separate bodies to develop a single set of rules and standards to underpin the NPA.

The Forum is developing the detailed design for the NPA in 2017. We expect the design to follow several core principles:

- 1.** A single set of standards and rules with strong central governance. Currently, multiple payment systems are governed in different ways. A single set of rules and standards will help simplify the environment.
- 2.** End-to-end interoperability between systems and functions (including open software platforms and a common ISO 20022 messaging standard).
- 3.** A thin collaborative central infrastructure. The NPA will be based on a 'layered model' that separates the processes involved in making a payment into their constituent parts (such as accessing the platform; sending the core payment information; the transmission of related 'richer data'; and the provision of overlay services such as direct debit management or Request to Pay functionality). This will make it possible to implement change in individual layers without needing to change the whole system, making it easier and cheaper to introduce innovation.

Based on these principles, we expect the design to drive competition and innovation in the interests of service-users, while maintaining security and resilience.

⁶ The Terms of Reference for the PSO Delivery Group can be found here:
www.psr.org.uk/sites/default/files/media/PDF/PSODG-Terms-of-Reference.pdf

In late 2016 we set up the PSO Delivery Group (PSODG) to create a timely and effective process for consolidating Bacs, FPS and C&CC, aiming to maximise the benefits and minimise any risks.⁶ The PSODG is expected to finalise its recommendations soon, and the consolidation process should be complete by the end of 2017. We will continue monitoring developments closely, to ensure the process is smooth and orderly, and aligned with our objectives.

Overseas stakeholder engagement visits

Alongside a programme of engagement with UK-based stakeholders, we continue to meet with stakeholders outside the UK, in places where developments in technology and payment systems and services may provide useful experience and ideas that we can draw on in the UK. These visits also give us an opportunity to share best practice and developments from the UK payments industry, which is seen as world leading, while building broader awareness of our work as the world's first dedicated payment systems regulator.



Projects in 2017/18

Other projects which relate to our role as regulator

Contactless mobile payments

The rapid growth in mobile payments in the UK could affect all three of our statutory objectives, so we want to make sure our understanding of this sector is up to date. We issued information requests to a wide number of selected participants in the contactless mobile payments sector in September 2016. This followed an initial engagement with the relevant stakeholders where we requested their comments on our draft information request. We are in the process of reviewing the responses and analysing the information. We are considering how best to deepen and/or clarify our understanding of any issues, including the filling of any gaps in our knowledge. As part of this work, we expect to re-engage with stakeholders in the coming months. We expect to publish a progress update in autumn 2017.

The Interchange Fee Regulation

We are the main competent authority for the EU Interchange Fee Regulation (IFR) which, among other things, introduced a cap on interchange fees for certain card payment transactions. We are being proactive in monitoring compliance with the IFR. We will collect information from card schemes, issuers and acquirers to understand what participants and schemes are doing to comply with the fee caps and business rules introduced by the IFR. We will also consider any complaints received and act on them as appropriate.

The Payment Services Regulations 2017

The second EU Payment Services Directive (PSD2) will be implemented in the UK through the Payment Services Regulations 2017. The Treasury has proposed that we will be the competent authority for four of these provisions. These concern:

- direct access to payment systems
- indirect access to payment systems
- access to payment account services (the Treasury has proposed that we will be jointly responsible with the FCA for this regulation)
- information that independent ATM deployers must provide to customers when they withdraw cash

The Treasury has proposed that we will be jointly responsible with the FCA for regulation 105, concerning PSP access to bank accounts.

In April we expect to publish our draft approach to monitoring and enforcing the regulations that we will be the competent authority for. We will consult on this draft, and publish our final approach in summer 2017. We will work closely with the FCA on our joint approach to the regulation on access to payment account services.



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. Our aim is to identify and respond promptly and effectively to emerging issues. Some of the risks we face are outside our control, including international events – and Brexit in particular. We are carefully considering how withdrawal from the EU may affect our objectives. We are working to identify and address any risks to our objectives, including any operational challenges. We are also ensuring that we are prepared to deal with different contingencies that may arise. It is too early to ascertain all the potential risks, as they will partly depend on the eventual relationship negotiated between the UK government and the EU.

Existing financial regulation, much of which derives from EU legislation, remains in place unless and until the government and Parliament make any changes to the applicable legislation. We are also continuing with implementation of EU legislation that will come into force before the UK leaves the EU.

We will monitor this and the possible impact to our work and the longer-term regulatory framework 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's 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 continually addresses our policy work programme and operational risks.



Building the organisation

We continue to refine the way we operate and take whatever measures are needed to ensure we are an efficient and effective regulator. We continue to recruit staff with the relevant skills and experience when the need arises, to help ensure we have an effective team of economic, policy, legal, regulatory, communications and operations experts.

We are committed to developing a collaborative, engaging and progressive environment that delivers value for money. We aim to manage our people's performance effectively and recognise excellent contributions and demonstrations of our values of Integrity, Unity, Knowledge, Purpose and Engagement.

We are moving from our current location in Canary Wharf to Stratford in April 2018. This year we will plan for the transition to ensure we have modern and fit-for-purpose offices and systems.

A number of PSR Panel members' terms of engagement will finish this year, so we anticipate recruiting to replace them, including the Chair.

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. To support this coordination and develop skills and knowledge, we currently have one member of staff seconded to the Bank of England.



Working with other authorities

We 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. We will continue to work closely with these stakeholders and other regulators and competition authorities in 2017/18.

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.



Our budget for 2017/18

Our annual budget for 2017/18 reflects our operating costs from 1 April 2017 to 31 March 2018. We estimate these costs to be around £12 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. As a result of our continued drive to replace temporary staff with permanent staff, costs are expected to reduce by £1.7 million. We anticipate our overall 2017/18 headcount of 73.6 to be comprised of 65 to 70 permanent members of staff and 3 to 8 temporary staff, providing specialist services or short-term resourcing in this financial year. We will continue to recruit as required to ensure we have the right people and skills to meet our aims and activities.

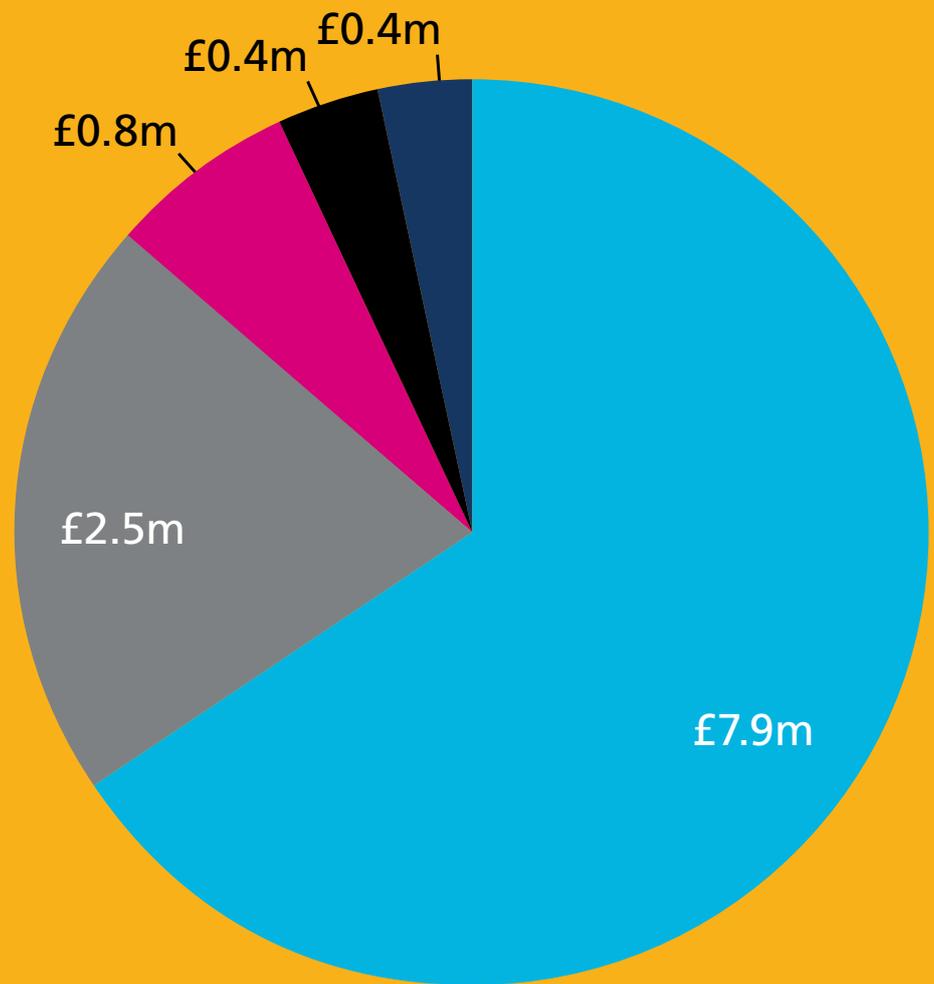
Our professional fees (for specialist services to support our work) will be £2.5 million in 2017/18, down from £3.27 million in 2016/17.

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.

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, these are 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.



Budget costs

- Staff costs: £7.9m
- Professional fees: £2.5m
- Accommodation and office services: £0.8m
- Training, recruitment and travel: £0.4m
- Information systems: £0.4m

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Website: www.psr.org.uk
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ISBN 9780995793507

