

New UK Payment Systems Regulator sets out its agenda: transparency, more competition and better access to the marketplace are key focusses going forward

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Financial Services and Regulation

The new Payment Systems Regulator (“PSR”) published a lengthy consultation paper¹ on 13 November 2014 explaining how it proposes to regulate the £75 trillion payments industry in the United Kingdom (“UK”) and which types of undertaking will fall under its regime. The PSR’s powers will come into force fully on 1 April 2015. Amongst its core proposals are: measures to give all service-users, not simply the major banks, a say in the ownership, governance and control of payment systems; direct access for so called “challenger banks” and innovative payment service providers to payment systems on fair terms; and greater transparency for persons seeking indirect access to interbank systems. The consultation recently closed to responses on 12 January 2015.

This note sets out an overview of which payment systems are covered by the new regime, the PSR's core proposals and some useful background.

Background

In the summer of 2011 the Treasury Select Committee published a report² in which it laid bare its misgivings about the state of governance in the UK payments industry, and recommended that the Payments Council be formally regulated. In July 2013, the Government stated³ that it would use the Financial Services (Banking Reform) Act 2013 (the “Banking Reform Act”) to set out the statutory basis for a new regulator of retail payment

¹ Consultation Paper PSR CP14/1 - A new regulatory framework for payment systems in the UK, 13 November 2014 <http://www.fca.org.uk/static/documents/psr/psr-cp14-1-cp-a-new-regulatory-framework-for-payment-systems-in-the-uk.pdf>

² House of Commons Treasury Committee Report - The Future of Cheques, 24 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1147/1147.pdf>

³ It did so in its response to the report published by the Parliamentary Commission on Banking Standards on changing banking for good, which had been published in June 2013. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211047/gov_response_to_the_parliamentary_commission_on_banking_standards.pdf

systems in the UK, the PSR. The Banking Reform Act received Royal Assent in December 2013 and the PSR came into being on 1 April 2014. The PSR has been incorporated as a subsidiary of the UK Financial Conduct Authority (“FCA”), but it is fully independent and has its own distinct objectives and governance. It will be fully operational from 1 April 2015.

What is a payment system?

Under the Banking Reform Act a payment system is defined as a system which enables a person to make transfers of funds, and includes a system which is designed to facilitate this using another payment system. Broadly, this means technology or systems through which individuals or businesses, or both, are able to transfer money. The definition is designed to capture third-party and online systems which use elements of core payments systems, so that they may be designated as payment systems in their own right. However, arrangements dealing with the physical movement of cash are specifically excluded, as are certain securities settlement systems and those systems operated by recognised clearing houses.

Who designates which entities will be regulated and how?

HM Treasury is able to designate which undertakings will be regulated as payment systems through powers given to it under the Banking Reform Act. It is only allowed to do so where it is satisfied the system is so important that any flaw in its design, or any disruption of its operation would lead to serious consequences for persons using, or likely to use its services. It must be too important not to be regulated.

In its October 2014 consultation paper on its designation powers, HM Treasury set out four factors it must weigh up in reaching a decision as to whether to include a particular payment system within regulation. The criteria provide a “multi-dimensional assessment of importance”⁴ and HM Treasury stresses that no one criterion of itself will bring a payment system within scope. The criteria are:

- the number and value of the transactions that the payment system presently processes or likely to process in future;
- the nature of the transactions that the payment system presently processes or likely to process in the future;
- whether those transactions or their equivalent could be handled by other payment systems; and
- the relationship between the payment system and other payment systems.

⁴ HM Treasury Consultation Paper - Designation of payment systems for regulation by the Payment Systems Regulator, 14 October 2014

<https://www.gov.uk/government/consultations/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator>

In line with the fact that there is no one criterion which is crucial for bringing a payment system within regulation, HM Treasury explains that there is no absolute volume or value threshold for transactions. In addition, the existence of close substitutes is a helpful indicator of competition in the market, but it is not enough by itself to determine whether designation is necessary. The paper gives two examples which show that determination may rest on a number of factors: first, a firm might have only two rivals, but still face healthy competition; and second, a situation where there is a new payment system which is a close substitute for another well-established one, which might point to the fact that the new system is ready for designation or that substitutability is not an important criterion in this case.

Which systems will the PSR regulate?

HM Treasury currently proposes to designate the following payment systems for regulation:

- BACS;
- CHAPS;
- Faster Payments Service;
- LINK;
- Cheque and Credit Clearing;
- Northern Ireland Cheque Clearing;
- MasterCard; and
- VISA.

It is still considering whether systems such as PayPal and American Express should fall within scope, but currently, does not envisage that they will. Where a payment system is designated, the PSR will also have oversight of all participants in that system. This will, therefore, include not only the operator of the system, but also any payment service providers on the system, such as high street banks, and any infrastructure providers in the system such as VocaLink.

What are the PSR's objectives?

The Banking Reform Act provides the PSR with three overriding statutory objectives, which are designed to ensure that payment systems and the regulatory framework "operate in the best interests of service-users and the wider UK economy"⁵. The objectives are:

- to promote effective competition in markets for payment systems and for the services provided by those systems in the UK;

⁵ Consultation Paper PSR CP14/1 - A new regulatory framework for payment systems in the UK, 13 November 2014

- to foster the development of and innovation in payment systems, especially in the infrastructure used to operate such systems; and
- to ensure that the interests of service-users are considered and promoted when payment systems are in operation or under development.

What are the PSR's core proposals?

The PSR intends:

- to **take control of strategy development** and to drive collaboration and innovation in the industry through the creation of a Payments Strategy Forum (the Forum). This is expected to have a broad representation of both industry and service-users. On 19 December 2014, the PSR launched its plan to convene a Working Group for developing the Forum. It will be formed shortly after the PSR is fully operational and will, amongst other matters, look to develop terms of reference for the Forum and work towards identifying a selection process for its independent chair.
- to **open up governance and control of payment systems** by giving a wider range of persons a say in decisions, thereby making the entire industry more transparent. All operators⁶ will be required to ensure that service-users are appropriately represented in any decision making, and will have to publish board minutes and votes. Any conflicts of interest must be anticipated and addressed, meaning that, in future, an individual will not be allowed to be a director of an operator and infrastructure provider⁷ to the same payment system. In addition, operators will need to report to the PSR on an annual basis on how they are complying with requirements.
- to **provide more open and direct access to payment systems**. Operators will be required to have objective, risk-based and publicly disclosed access requirements which will permit fair and open access to payment systems. This will allow banks and new payment service providers to obtain direct access to payment systems in future. MasterCard, VISA and LINK are already subject to similar access requirements under EU rules, but under the PSR's proposals, they will all have to publish their requirements. All operators will have to report how they are complying with access requirements on an annual basis from 30 June 2015.
- to **effect greater transparency** for those businesses which are looking to gain indirect access to interbank systems. Under this, sponsor banks will have to publish information on any sponsor services they offer, including access criteria and processes. Further, the industry is required to develop a Code of Conduct which the PSR will approve.
- to **introduce three high-level principles** which will set behavioural standards within the industry for participants. These include:

⁶ "Operators" means those persons which have the responsibility for the operation of payment systems such as BACS, CHAPS and Faster Payments, as defined in the Banking Reform Act.

⁷ "Infrastructure providers" are defined by the PSR as any person who controls or provides any part of the infrastructure used for the purposes of operating a payment system, as defined in the Banking Reform Act.

- ensuring that participants deal with their regulator in an open and cooperative way, and disclose anything relating to the participant of which the PSR would reasonably expect notice;
 - observing proper standards of conduct; and
 - in the case of an operator or infrastructure provider, maintaining or having access to adequate financial resources to carry on its functions and activities.
- to **introduce detailed measures on monitoring, enforcement and dispute resolution** for firms within scope, including requiring participants to report on their compliance with access and governance requirements on an annual basis as mentioned above. The PSR will also have similar enforcement and investigatory powers to those of the FCA, including the rights to compel persons to provide information or documents as necessary, to appoint a skilled person and to impose punitive sanctions for non-compliance with rules.

Next Steps

The PSR's consultation has now closed to responses. It expects to publish its final policy statement prior to 1 April 2015, when it becomes fully operational.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services and Regulation practice group:

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