



HM Treasury

Opening up UK payments: response to consultation

October 2013



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Introduction

1.1 In March 2013 the Government published a consultation, *Opening up UK payments*, setting out its proposal to bring payment systems under formal economic regulation, and establish a new competition-focused, utility-style Regulator for retail payment systems. This followed a report published in July 2011 by the Treasury Select Committee (TSC), expressing serious concerns about the governance of payment systems, and recommending that the Payments Council be brought into regulation. *Opening up UK payments* built on a previous Government consultation, *Setting the strategy for UK payments*, published in July 2012, following which the Government decided that only a formal system of utility-style regulation could adequately address the problems in UK payments.

1.2 The Government received over 80 responses to *Opening up UK payments*, with submissions from a variety of interested parties, ranging from large banks and payment scheme companies to challenger banks, small, innovative technology firms, retail and consumer groups, charities and private individuals.

1.3 Chapter 2 summarises the responses received, and highlights where changes have been made to take respondents' contributions into account.

1.4 The Government welcomes the constructive and valuable contributions made by stakeholders throughout the consultation process.

1.5 A list of respondents can be found at Annex A.

Next steps

1.6 The Government has tabled amendments in the Lords Committee stage of the Banking Reform Bill to create a new regulatory regime for payment systems.

1.7 The Government envisages that, following Royal Assent, the Regulator's powers will come into force in late 2014 and the Payment Systems Regulator will be fully operational by spring 2015.

Key themes

1.8 The Government welcomes the widespread acknowledgement amongst respondents of the need to bring payment systems under formal regulation. The Government also welcomes the conclusions of the Parliamentary Commission on Banking Standards, which endorsed the proposal to bring payment systems into regulation.

1.9 On balance, the Government's proposals for the form of regulation and the breadth and depth of powers were seen as appropriate and sufficient to deliver the Government's aims.

1.10 The Government has decided that the Financial Conduct Authority (FCA) should be given the role of Payment Systems Regulator. The Payment Systems Regulator will be established as a separate body under the FCA, with its own Managing Director and Board.

1.11 The Government recognises that the FCA faces a significant challenge to build up its capacity and expertise in the given timetable. The Government has considered this challenge

carefully, and will consider ways to use the skills and experience of the existing economic regulators to enhance the Payment Systems Regulator's capabilities for competition-focused, utility-style regulation.

1.12 Having listened to respondent concerns about the importance of maintaining a level playing field, and the need for an adaptable, future-proofed regulatory regime, the Government recognises that the proposal set out in the consultation document to license payment systems and their participants was likely to be unduly constraining. Therefore, the Government has decided to take a 'designation' approach to bringing industry participants within the scope of regulation.

2

Summary of responses

2.1 The consultation document presented nine consultation questions, identifying the key issues on which the Government sought comment and evidence. This chapter summarises the views put forward in response to these questions.

Identity of the Regulator

2.2 *Opening up UK payments* set out the Government's proposed options for the body to take on the role of Regulator for the UK payments industry: either the FCA or one of the existing economic regulators. Views were sought on the relative merits of each option.

2.3 On balance, a majority of respondents agreed that the FCA would be best placed to take on the role. Respondents saw it as an appropriate choice for reasons largely centred on its existing regulatory and financial services knowledge and relationships.

2.4 Challenger banks, small payments and technology firms and end-user groups were particularly consistent in favouring the FCA. Many mentioned the advantage of the FCA's knowledge of existing regulations, its existing financial services knowledge and understanding of the market as a whole, given the integral part of payment systems in UK banking and financial services. The FCA's relationships with relevant regulatory bodies within the UK and EU were also seen as important benefits.

2.5 Of the respondents who did not favour the FCA, most were incumbent banks, payment scheme companies and card schemes, who tended to prefer either Ofcom or a new standalone body. Some respondents specifically suggested that the Bank of England take on the role. These respondents pointed to the risks of diverting the FCA from its existing focus and workload, and of having two different regulatory regimes operating side-by-side.

2.6 Some submissions maintained that payment systems should continue to be self-regulated, with no new regulatory framework required.

2.7 Not all smaller industry players and end-user submissions favoured the FCA. Several preferred giving the role to an existing economic regulator, and two of them favoured building a new standalone body.

2.8 Many respondents highlighted the importance of an independent reporting line and appropriate Chinese walls within the FCA, to ensure that the Payment Systems Regulator is a discrete and independent unit that meets the same standards and criteria as a standalone body.

Government response

2.9 The Government agrees with many of the points put forward by respondents and has concluded that, on balance, the FCA is best suited to take on the role of Payment Systems Regulator. The Government welcomes that the majority of responses endorsed this choice.

2.10 The Government shares some of the concerns raised by stakeholders who pressed for a standalone regulator – that payments issues must receive sufficient attention under the new regulatory structure. The legislation creating the new regulatory framework for payment systems has therefore been designed in a way which will achieve this.

2.11 The legislation provides for the FCA to establish the Payment Systems Regulator as a separate body. The problems identified in the market for UK payments require a regulatory regime with specialised objectives, powers and skills. While the Government wants the Regulator to benefit from synergies with existing FCA resource, it is also important that it has the freedom to develop its own strategy for meeting its payments objectives. A distinctive subsidiary, closely co-ordinating with and overseen by the FCA is the best way of achieving this.

2.12 The Payment Systems Regulator will have its own Managing Director, appointed by the FCA with the approval of the Treasury. It will also have its own Board, composed of the Managing Director, a Chair and at least one other member. The Payment Systems Regulator will also have its own annual budget, which will be approved by the FCA; before adopting or varying the budget, the Regulator will have to consult with the Treasury. The FCA will be given powers to levy participants in designated payment systems to fund the costs incurred in connection with the discharge of the Regulator's functions.

2.13 The Government has taken on board the concerns raised in some areas about the FCA's resource and skills for the job. Respondents anticipated up-skilling challenges in three main areas: the gaining of requisite expertise in utility-style regulation; industry and technical knowledge specific to payments; and having the requisite skills to exercise concurrent competition powers effectively. To address the need for the Payment Systems Regulator to quickly gain requisite expertise in utility-style regulation, the Government intends to lever skills and experience from existing economic regulators. To address a similar need regarding payments expertise, the new Regulator will be expected to be staffed appropriately so as to acquire the necessary technical knowledge and understanding of the market. The Government expects the FCA to work closely with the new Competition and Markets Authority (CMA), and has also tabled amendments to the Banking Reform Bill to provide the FCA with Competition Act 1998 enforcement powers and Market Investigation Reference powers under the Enterprise Act 2002 from April 2015. These new powers will strengthen the FCA's ability to promote competition in banking markets and payments. The FCA is already equipping itself with the right skills and expertise to be able to exercise these competition powers effectively, and this should assist the Payment Systems Regulator in developing the necessary competition expertise.

2.14 While the new regulatory regime for payments will be established under the FCA, the Payment Systems Regulator will adopt a utility-style approach, distinctive from the FCA's existing remit (which spans consumer protection, the integrity of the UK financial system, and the promotion of effective competition in the interests of consumers in the markets). The Payment Systems Regulator will have a distinctive role to that of the FCA and will require a different set of skills in order to fulfil that role.

Positioning in relation to other regulatory bodies

2.15 The consultation document outlined the existing regulatory landscape and proposed that the existing functions that relate to payments regulation, belonging to HM Treasury, the Bank of England, the FCA in its existing role, and EU-level bodies would remain unchanged. It also proposed that the functions under Part 8 of the Payment Services Regulations 2009 that are currently enforced by the OFT would transfer to the new Regulator.

2.16 Significant problems were identified with the current system of governance for payment systems, including the Payments Council, relating to issues of representation, decision-making and funding. The consultation did not envisage any formal role for the Payments Council in the new regulatory structure; instead it proposed that the Payments Council's current strategy-setting role would operate via each payment scheme company developing their strategy subject to the approval of the new Regulator.

2.17 In consultation responses there was little fundamental disagreement about the proposed positioning of the new Regulator. Most comments underlined the need for clearly defined remits and effective joining-up of the various bodies in this regulatory space, at both a UK and EU level.

2.18 Many respondents recommended that the Bank of England should hold rights of veto over the new Regulator's decisions and actions, on the basis of the primacy of stability and integrity objectives; particularly given the possible introduction of greater systemic risk by opening up access and competition.

2.19 Beyond this, however, some respondents questioned the absence of any express provision in the consultation for an overarching body to replace the Payments Council, and argued that some proactive co-ordination of strategy needed to be driven by such a body or by the Regulator. There were differences of opinion as to the depth of involvement the Regulator should itself have in formulating and directing strategy, and, on a related point, on whether the duties and powers for this needed to be established in statute or not.

2.20 A range of submissions agreed with the Government's analysis of the issues with the governance and accountability of the Payments Council, and several suggested that it should become a pure trade body or be replaced by one.

Government response

2.21 The Government agrees that the various roles and responsibilities of the regulatory bodies must be clearly defined, differentiated and co-ordinated. The Government is committed to avoiding unnecessary duplication of regulation, and to ensuring that industry participants that should be regulated do not slip through any gaps.

2.22 As a number of respondents noted, integrity and stability objectives must remain paramount, and the Government is clear that the Bank of England will retain effective rights of veto over anything the Regulator might do impacting upon these. The Payment Systems Regulator will have a Memorandum of Understanding with the Bank of England and Prudential Regulation Authority (PRA), setting out how this relationship will work.

2.23 The Government also recognises the importance of overarching, co-ordinated strategy development across the payments industry. The Government has worked to develop an approach to strategy-setting that takes into account comments on the need for some kind of collaborative structure, while also recognising the feedback on difficulties encountered with the existing Payments Council model.

2.24 While the Government does not propose to legislate for an industry strategy-setting body, it anticipates that the Payment Systems Regulator will be able to expressly instruct the industry to organise themselves to produce an integrated, holistic plan for development and innovation in UK payments. The Government expects that the industry will replace the existing Payments Council with a pure trade body to co-ordinate the owners and operators of payment systems and related infrastructure, to guard against the development of payments strategy in silos.

2.25 This will be backed up by giving the Payment Systems Regulator statutory powers to issue directions to operators of designated payment systems (paragraphs 2.36 to 2.39 explain the designation approach), infrastructure providers in respect of such systems, indirect access providers and other participants. The Government expects the Payment Systems Regulator to use these powers when it judges that the proposed strategy is inadequate to support its objectives.

Scope of regulation

2.26 *Opening up UK payments* proposed that the Payment Systems Regulator should have powers over UK retail payment systems and their direct members. The Government intended that the scope of regulation would cover, in the first instance, the cheque clearing systems; automated payment systems (Bacs, CHAPS, Faster Payments), the LINK ATM network; and the main three- and four-party card schemes.

2.27 The Government did not propose to include payment systems that are embedded in securities trading systems, clearing houses or central counterparties such as CREST, LCH Clearnet and ICE CLEAR Europe, or messaging services like SWIFT. The consultation also proposed to exclude 'no-party' schemes from the scope of regulation.

2.28 The Government proposed to require relevant payment systems, and their direct members and participants, to be licensed by the Payment Systems Regulator. The Payment Systems Regulator would then apply conditions to these licences, with which licensed parties would be required to comply.

2.29 In responses to the consultation, the proposed inclusion of the inter-bank systems within the scope of regulation was largely supported across the range of submissions. Of the incumbent banks who answered this question, none directly opposed the inclusion of the inter-bank systems.

2.30 There was some resistance to the idea of direct members (i.e. banks) being licensed in addition to the core systems themselves, and a few questioned the inclusion of agency services (whereby direct members provide access for third parties to the payment systems) in scope. The necessity of licensing direct members was also queried by several of the payment scheme companies in their responses. As is explained below (paragraphs 2.36 to 2.39) the Government has now decided to proceed with an alternative to licensing, so these concerns are largely addressed.

2.31 Opinion was most mixed on the questions of including CHAPS, infrastructure providers and the card schemes within the scope of the Payment Systems Regulator. There were strong opinions on both sides regarding the regulation of infrastructure providers and how exactly the Regulator should interact with them. Some submissions assumed that powers over schemes and direct members would in turn provide the necessary influence over infrastructure providers; other responses disagreed with this and thought that, without direct powers over the infrastructure, the Regulator would have problems with enforcing measures.

2.32 Responses from both three- and four-party card schemes argued against their respective inclusion in the proposed scope. They argued that the Government's analysis did not adequately differentiate the global card networks from the domestic inter-bank systems, or supply sufficient evidence of specific market problems relevant to the card networks to justify their inclusion in scope.

2.33 On the other hand, respondents of other types were clear that there should be a level playing field, observing that card schemes touch too much of the market to be excluded, and

arguing that cards should not be allowed to gain an advantageous position over alternative payment methods, simply because of their international nature.

2.34 Many respondents to the consultation mentioned the importance of setting a framework that genuinely takes into account the full payments landscape, arguing variously for the inclusion of not just card scheme companies but also emerging 'no-party' schemes. Some viewed that cash should also be in scope.

2.35 Several challenger banks warned of the risk of anti-competitive effects if regulation placed disproportionate requirements on small industry participants. However, there was a broad consensus that the regime must be future-proofed to capture new businesses and payment types as they emerge and potentially become significant players in the market.

Government response

2.36 In response to the points raised in consultation responses, the Government has amended its original proposition of requiring payment systems and their direct participants to be licensed. Instead, the Government has decided to introduce a designation system, similar to the regime for bringing inter-bank payment systems under Bank of England oversight for stability purposes, as set out in Part 5 of the Banking Act 2009.

2.37 The Government wishes to make clear, however, that while the Banking Act 2009 framework provides a useful model, the designation of payment systems for regulation by the Payment Systems Regulator will be entirely separate and unconnected to the recognition of inter-bank systems for oversight by the Bank of England on stability grounds.

2.38 Under the Government's approach, HM Treasury will designate a payment system when it is satisfied that any deficiencies in the design of the system, or any disruption in its operation, would be likely to have serious consequences for those who use, or are likely to use, the services provided by the system. In considering whether to designate a system, the Treasury may take advice from the Payment Systems Regulator, the FCA, the PRA and the Bank of England.

2.39 Once a system is designated, this will bring the payment scheme company and the system participants (e.g. members, card issuers and merchant acquirers, and the system infrastructure providers) within the scope of the Regulator's powers. Coming into scope will not necessarily entail regulatory action or new obligations on those brought within scope. Designation will mean that the Payment Systems Regulator is then in a position to potentially exercise certain powers in respect of those persons, if there is a case for regulatory action.

2.40 The reach of powers over all system participants reflects the point made by various respondents that the Regulator should have powers to cover the total "payment journey" from end-to-end. Furthermore, given concerns around competitive neutrality and the future-proofing of regulation, the Government has decided to include all retail systems active in the UK within the potential scope of regulation, meaning 'no-party' schemes may also be brought into the scope of regulation, if they meet the threshold for designation.

2.41 The Government has also decided to re-visit its initial proposal to exclude infrastructure providers from the scope of regulation. Originally, the Government was concerned that directly regulating infrastructure providers could discourage new entrants and the emergence of competition, freezing the current structure of the market. However, the Government accepts that leaving infrastructure providers out of scope could cause difficulties for the Payment Systems Regulator in ensuring the successful implementation of required changes.

2.42 As set out in the consultation document, the Government does not intend to include cash in the scope of the Payment Systems Regulator. Cash is not a payment system exhibiting network effects, and therefore does not fit within the proposed scope of the new Regulator. However where there are problems relating to cash falling within its remit, the FCA can take actions using its existing powers and, from April 2015, its new concurrent competition powers.

2.43 The Government recognises the concerns expressed by a wide range of stakeholders about future-proofing the regulatory regime, while at the same time minimising the burden of regulation and keeping it proportionate and under review. The designation approach has significant advantages in this respect, as it will allow HM Treasury to focus the Regulator's attention where it is required, without the need to designate less relevant schemes at the outset. It then provides the flexibility to bring emerging payment schemes and participants into scope, as and when they meet the threshold for designation.

2.44 This solution also avoids the need to issue separate licences to scheme participants and infrastructure providers, as designating a system will automatically extend the Regulator's powers to all participants. This reduces red tape and helps avoid gaming. It removes the incentive to be an indirect, rather than direct, member, to avoid a requirement to be licensed, which would be counter to the Bank of England's de-tiering objectives.

2.45 Some respondents were worried that the Regulator would issue blanket demands across the industry; however, the Payment Systems Regulator will be under a duty of proportionality in its actions, to curb the risk of demands that are irrelevant or inappropriate for particular areas of the payments market.

2.46 Payment systems that are embedded in securities trading systems, clearing houses or central counterparties will be excluded from the scope of regulation, as will the Bank of England in its role as payments provider and operator of the Real Time Gross Settlement infrastructure.

Duties of the Regulator

2.47 The consultation set out that the Payment Systems Regulator would have duties, defined in statute, to guide the use of its powers. The Government proposed that it would have a general objective, focused on promoting the interests of current and future end-users, where appropriate by promoting competition and innovation; and to ensure payment systems are adequately funded to achieve it. This would be subject to a requirement to avoid actions with a material negative impact on financial stability.

2.48 The consultation also described the range of secondary duties to which the Regulator would need to have regard, in line with the Better Regulation Principles set out by the Department of Business, Innovation and Skills (BIS), which covered transparency, accountability, proportionality, consistency and keeping the regulatory burden under review. It also proposed that the Regulator operate in accordance with the Government's Principles for Economic Regulation.

2.49 Responses submitted across all types of stakeholder accepted the duties outlined in the consultation, generally viewing the proposals as reasonable, as to be expected, and capable of achieving the Government's aims. The focus on competition and innovation was warmly welcomed. There was also strong support for the Regulator operating in accordance with the Government's Principles for Economic Regulation and the use of BIS Better Regulation Principles.

2.50 One incumbent bank proposed additional duties – to have regard to the financial sustainability of payment networks for providers and operators, and to London and the UK's

position as a global financial centre. Other respondents also suggested expressly stating the priorities of the stability, integrity and resilience of the financial system, a duty to have regard to the operational efficiency and effectiveness of payment services, and to ensure that systems are open, accountable and transparent.

2.51 Certain respondents did not view the proposed duties as going far enough to tackle competition and market dominance issues.

2.52 Stakeholders stated regularly across submissions their expectation of robust analysis and evidence of market failure as a sensible requirement before any regulatory intervention. Challenger banks and smaller industry players particularly welcomed the requirements of proportionality and keeping the regulatory burden under review.

2.53 Some respondents requested greater detail on the proposal. Some also noted that 'end-users' will not exist as a homogenous group, and anticipated possible tensions between the interests of different types of end-users of payment systems. Similarly, given the potential for conflict between separate objectives, some respondents called for a clear statutory framework with a hierarchy of priorities.

Government response

2.54 The Government notes that the principles set out were met with broad support in responses to the consultation. The objectives of the Payment Systems Regulator will be set out in legislation separate from the FCA's existing functions, as a discrete set of objectives, duties and powers, reflecting the fact that utility regulation is a significantly different function from that which the FCA currently performs. Many stakeholder submissions had made this point (see paragraph 2.8), stressing the importance of a distinct identity and framework for the Payment Systems Regulator, and it not becoming diluted or subsumed into the rest of the FCA.

2.55 The Government has given consideration to the structure that would give best effect to the policy intent, and has slightly adjusted the framework of duties from 'general'/'specific' model to take account of this. The Payment Systems Regulator must, as far as is reasonably possible, act in a way that advances one or more of its three objectives – the promotion of competition, innovation and the interests of end-users.

2.56 In discharging its payment systems functions, the Payment Systems Regulator will be required to have regard to the importance of confidence in, and the stability of, the UK financial system, with the Bank of England and the PRA having effective powers of veto in relation to this.

2.57 The Payment Systems Regulator will be under a duty in line with the Legislative and Regulatory Reform Act 2006 to have regard to principles of better regulation, which includes the concept of proportionality. It will also be under a duty to have regard to specific regulatory principles modelled on those contained in section 3B of the Financial Services and Markets Act 2000.

Concurrent competition powers

2.58 The consultation proposed that the Payment Systems Regulator would exercise enforcement powers under the Competition Act 1998 and Market Investigation Reference powers under the Enterprise Act 2002 concurrently with the Competition and Markets Authority (formed by the merging of the OFT and the Competition Commission in April 2014).

2.59 The majority of respondents to the consultation, including all the smaller industry participants and end user groups, agreed that the new Payment Systems Regulator would need

concurrent competition powers, viewing it as critical for achieving a level playing field and tackling anti-competitive conditions in this market. Amongst the incumbent financial institutions, many acknowledged that the position should be the same as with other economic regulators, who, in general, have concurrent competition powers.

2.60 Some respondents (mainly from larger banks, payment scheme companies and card networks) argued that it would be better for the Regulator to refer issues to the Competition and Markets Authority. They pointed to the fact the wider FCA does not currently have concurrent competition powers.

Government response

2.61 The Government has tabled amendments to the Banking Reform Bill to provide the FCA with Competition Act 1998 enforcement powers and Enterprise Act 2002 Market Study and Market Investigation Reference powers under the Enterprise Act 2002 from April 2015. As no significant concerns about giving concurrent competition powers to the Payment Systems Regulator were raised in response to *Opening up UK payments*, the same powers will be given to the Payment Systems Regulator, strengthening its ability to promote competition in payments. The FCA and the Payment Systems Regulator will join the new UK Competition Network, a forum enabling economic regulators with concurrent powers and the CMA to share expertise, ideas and experience for the purpose of ensuring a consistent and high-quality approach to competition policy and enforcement in the regulated sectors, and to co-ordinate matters relating to concurrency.

Licence conditions

2.62 The Government proposed that operators of payment systems and their direct members would be statutorily required to be licensed by the Payment Systems Regulator, and licence-holders would be required by statute to adhere to a set of principles covering pricing, access, governance, development of the system and co-operation.

2.63 For licence conditions, as on the question on duties, most respondents to the consultation agreed with the high-level principles outlined by the Government.

2.64 The larger banks, on balance, accepted the broad intentions of the proposed licence conditions, with caveats generally relating to two particular conditions: those covering pricing and investment plans (for maintaining and developing the system). Many of the incumbent banks and payment scheme companies emphasised that pricing formulae should acknowledge the need for owners to earn an acceptable return, and should take into account owners' total costs. Some worried that a regulator amending development plans and pricing would dampen competition and stifle innovation, or they saw the proposals on pricing as simply burdensome and unnecessary for this market. Before implementing any pricing controls, it was generally expected that the Regulator would undertake a comprehensive competition review and provide robust evidence justifying the case for intervention.

2.65 Several inter-bank and card scheme companies felt that they were already fulfilling the licence conditions listed in the consultation, mentioning the requirements of their own scheme companies and rules, or the conditions stipulated by Article 28 of the Payment Services Directive that applies across the EU.

2.66 On access, several different respondents stressed the importance of the continuing priority of systemic integrity and stability, and urged that opening up access to payment systems must not result in compromise on this. The conditions or minimum standards determining how

access is granted and denied should reflect this priority. On the other hand, one major charity felt that the proposals on access did not go far enough.

2.67 On maintaining and developing the system, several incumbent banks argued that the incentives of competition and the play of market forces remain the best way of encouraging innovation. It was also stated that the Regulator should avoid incurring disproportionate expenditure. Some incumbent banks and payment schemes questioned the need to individually license participants in schemes, as this could be a potential barrier for new entrants.

2.68 Incumbent banks expressed their support for the requirement to co-operate where interdependencies exist, often reiterating the need for an overarching, collaborative strategy-setting function.

2.69 Card network participants were concerned that the licensing regime was 'one size fits all' in approach, and they pressed for a solution that better recognised the differences between inter-bank systems and card schemes.

2.70 Smaller industry players on the whole welcomed the proposals, although some noted the risk of conditions for investment plans over-burdening small or new entrants, to the detriment of access and competition. One challenger bank argued that the proposed licence conditions were unlikely to be sufficient to achieve the Government's objectives, on the basis that as long as existing ownership structures continue, the Payment Systems Regulator will be unable to deliver a truly competitive market.

2.71 Several challenger banks, a consultancy firm and a consumer group were especially pleased by the requirement for efficient and transparent pricing and non-discriminatory access, some expressly welcoming the Regulator's power to directly set prices. The requirement for co-operation was also generally warmly welcomed by these stakeholders. As with the submissions by incumbent banks and payment scheme companies, smaller financial institutions, firms and end-users also raised some concerns about the means by which the Regulator could drive innovation; some respondents were concerned that the Government's proposal could lead to disjointed strategy-setting.

Government response

2.72 The Government welcomes the expressions of support for the principles outlined in the consultation document.

2.73 As explained in paragraphs 2.36 to 2.39 above, the Government has decided to adopt a designation approach instead of the licensing system initially proposed. Therefore, instead of the Payment Systems Regulator having statutory powers to enforce the licence conditions listed in the consultation, regulation will work in a slightly different way, as set out in paragraphs 2.80 to 2.84 below.

2.74 Among the issues of pricing that fall within the Regulator's purview, in particular the Government expects that the Regulator will look at issues surrounding the European Commission's proposed regulation on multilateral interchange fees (MIFs), where appropriate within the framework that emerges from the European process.

Regulatory powers

2.75 *Opening up UK payments* set out a range of proposed statutory powers, for the Regulator to use in order to facilitate effective competition, or to remedy problems in the market where competition cannot function appropriately. These proposed powers were:

- information-gathering powers;
- a power to remedy a breach of licence conditions;
- a power to impose financial penalties for breach;
- a power to share information;
- a power to create advisory bodies;
- a power to levy the regulated population to fund its own activities; and
- a power to amend the licence conditions.

2.76 In responses to the consultation, stakeholders broadly accepted that the high-level powers were appropriate. Most of the larger banks commenting on this question agreed that the powers were correct, providing they were applied proportionately. Almost all respondents agreed with the Government that the powers should mirror those which are standard for other economic regulators.

2.77 On the proposed powers to levy and fine, the incumbent banks warned of a risk of unintended, anti-competitive consequences resulting from these powers, for example, the risk of a levy creating a barrier to entry. Some expressly disagreed with the power to direct investments; one thought fines could make operators more risk averse. There were requests for further detail on proposed charging structures.

2.78 Challenger banks and other types of small industry player tended to strongly support the proposed regulatory powers as appropriate and necessary for achieving the Government's objectives. The key concerns for these stakeholders centred around the comprehensiveness of the powers, their full enforcement and the use of the whole toolkit in practice, and the practical effectiveness of deterrents such as financial penalties.

2.79 There was solid support for the power to create advisory bodies, which was seen as a critical function for the new Regulator. Some submissions suggested additional powers, including an explicit, statutory power for developing strategic objectives and ensuring their implementation; and additional powers for consumer redress or compensation.

Government response

2.80 The Government welcomes the broad support for the proposed regulatory powers outlined in the consultation. As explained above, the Government has decided to pursue a designation, rather than licensing, approach, and powers originally defined based on proposed licence conditions have been re-drawn to reflect this. The Payment Systems Regulator will have the following generally stated powers:

- powers over requirements regarding system rules – to require the establishment of, or changes to, the rules for the operation of the system; and to require an operator not to change the rules without regulatory approval; and

- powers to give directions to operators, infrastructure providers, indirect access providers and other participants. The Regulator can therefore require or prohibit the taking of action in the operation, management, development or provision of infrastructure, provision of access, or any other matter concerning a designated payment system. These directions can be made to individual persons – meaning they can be tailored and kept relevant – or to categories of person i.e. sector-wide, generally applicable directions.

2.81 The content of these requirements and directions will be subject to whatever the Payment Systems Regulator determines is required to meet its objectives.

2.82 In addition to these two generally stated powers, the Payment Systems Regulator will also be given the following specific regulatory powers:

- a power to amend commercial agreements governing service levels, access prices and other fees; this includes a power to amend contracts, including prices; a power to exercise ex-ante price setting; a power to stipulate minimum service or access levels, and to set the price charged by the operator or indirect access provider for membership of the scheme or indirect access to the system;
- a power to order the provision of direct and indirect access to payment systems; and,
- a power to carry out investigations and issue reports.

2.83 As noted above, the Payment Systems Regulator will also have concurrent competition powers.

2.84 Further, the Government has decided to provide for the following powers of enforcement for the Regulator:

- a power to publish details of compliance failure;
- a power to impose financial penalties in respect of a compliance failure;
- a power to require owners of payment systems to dispose of their interests in them – subject to the satisfaction of certain pre-conditions and subject to HM Treasury approval.

2.85 The adjustment to the suite of regulatory powers since the consultation results from the decision to model the legislation on Part 5 of the Banking Act 2009. Therefore, although the precise form of the set of powers has evolved, the Government’s objectives have remained the same.

Ownership of payment systems

2.86 The consultation document argued that many of the problems of access and competition flow from the fundamental ownership arrangements for the inter-bank systems – which are jointly owned by their biggest users, the UK incumbent banks. These ownership structures mean that smaller players and new entrants to banking must seek access, whether directly or indirectly, to systems jointly-owned by their most powerful competitors.

2.87 Moreover, the common ownership of payment systems by an overlapping group of banks means that there are limited incentives to develop new or more efficient services: all the big banks stand to benefit equally from advances, and there is no competitive advantage to be gained.

2.88 The consultation identified that while the Regulator would be given a full range of powers to tackle potential abuses of ownership, these might be found insufficient for addressing all the potential ill-effects of vertical integration and common ownership. The Government proposed two further means of addressing this:

- the Payment Systems Regulator to use its competition powers to refer the market to the Competition and Markets Authority (CMA), which could then investigate the market; if the CMA finds problems in the market, it will have far-reaching powers to address these, including power to order divestments; and
- the Payment Systems Regulator to have powers to impose additional requirements on a system – including actions relating to its governance (to increase independence from the system’s owners; to address any abuses of ownership); and the power to divest the banks of their ownership stakes in the systems – a power to be exercised subject to the approval of HM Treasury.

2.89 In responses to the consultation, many of the larger banks and the payment scheme companies stated that they felt comfortable with the proposals, on the basis that no regulatory intervention would take place before a market review and robust evidence of market failure was provided.

2.90 However, for a small number of respondents, it was seen as sufficient for the Regulator to simply have the power to refer to the CMA, and some submissions recommended a solution via industry dialogue, without any need for regulatory intervention. Several of the larger banks viewed powers to divest of ownership stakes as unnecessary, disagreeing with the principle of having powers to achieve this; or advocating that, at a minimum, it should not be possible without reference to the CMA or must be a last resort.

2.91 Card network participants argued that the proposed powers applied to the inter-bank systems rather than the card schemes. One card company expressed its approval of divestment of inter-bank ownership.

2.92 Some respondents pointed out the potential tension between the principle of regulatory independence and the requirement of HM Treasury approval for the exercise of divestment powers.

2.93 Most of the smaller financial institutions and industry participants answering this question viewed the proposals for tackling abuse of ownership as appropriate and sufficient. Several welcomed the idea of systems becoming more independent of the larger banks and regarded divestment as essential for achieving a truly fair playing field. They were not satisfied with the Regulator acting as ‘middleman’, just referring to the CMA but unable to itself take immediate action.

2.94 Some challenger banks characterised the current reliance of new entrants or small banks upon agency arrangements as anti-competitive. There were various calls for an independent, ‘plug and play’ platform; but at the same time it was generally recognised that simply stripping the banks of ownership stakes, before developing a viable alternative, would be irresponsible and indeed detrimental to end-users.

2.95 A cluster of responses – a mixture including larger banks, challenger institutions, technology players and charities – concurred in identifying some of the benefits that arise from existing ownership structures, and they questioned the feasibility and desirability of divestment, regarding it as an imperfect solution.

Government response

2.96 Having considered the consultation responses received, the Government remains of the view that the Payment Systems Regulator must have the power to require the owners of designated payment systems to divest of their ownership stakes in those systems. The Parliamentary Commission on Banking Standards recommended, in their final report, that the Government consider further the ownership arrangements of payment systems. The Government has committed to ask the Payment Systems Regulator to investigate this issue once it is set up, and the divestment power will give it the means to require a change in ownership structures, should it decide that that is the appropriate outcome. This power will be subject to significant safeguards, however; it will be exercisable only with the consent of HM Treasury, and will be subject to full merits appeal to the Competition and Markets Authority.

Appeals

2.97 The consultation document set out a proposed appeals mechanism that would mirror that for existing utility regulators:

- decisions made by the Payment Systems Regulator under its concurrent competition powers to be subject to the appeals process set out in the Competition Act 1998 and Enterprise Act 2002;
- licence modification decisions appealable to the CMA; and
- other regulatory decisions not subject to appeal, but subject to judicial review, in line with decisions from other public bodies and utilities regulators.

2.98 Respondents to the consultation, including incumbent banks, payment scheme companies and card scheme companies, widely accepted the proposed appeals process as providing sufficient safeguards, and generally agreed with the Government that the appeals routes should mirror those for other economic regulators.

2.99 A few respondents saw judicial review as an inadequate remedy in all cases, with particular concerns about only having judicial review principles on, for example, pricing methodology decisions. Several of the incumbent banks and payment scheme companies called for appeals on competition matters to be full merits to a specialist court such as the Competition Appeals Tribunal (CAT). One of the charities that answered this question also identified the CAT as best placed to hear major areas of dispute.

2.100 Smaller industry players tended to accept the proposed appeals processes. Like many of the larger banks, they saw the mirroring of existing utility regulatory processes as an appropriate solution. Their reservations tended to focus on the risk of protracted appeals stringing-out and delaying regulatory compliance and unfairly burdening small enterprises. Some respondents argued that consumers and other end-users should have access to effective appeals processes, without the need to resort to judicial review; and for this to cover decisions by the Regulator not to act as well as to act.

Government response

2.101 Given the broad endorsement of the proposed appeals provisions, there have been no significant changes in the Government's final position. The decision to adopt designation rather than licensing of participants naturally removes the need for a specific appeals process for licence modification decisions.

2.102 Decisions to impose requirements concerning system rules and to give directions will be subject to appeal to the CAT, to a judicial review standard rather than full merits-based appeal.

2.103 For actions and decisions taken under the specific regulatory powers, appeals will be made to the CMA, and the level of scrutiny will be a full merits review. This will include the exercise of price-setting, access-ordering and divestment powers by the Regulator.

2.104 On actions and decisions relating to the Regulator's concurrent competition function, appeals will be made to the CAT on the same basis as provided for appeals of the CMA's decisions under the Enterprise Act and Competition Act.

2.105 A finding of an infringement under the Competition Act 1998 and the level of any penalties will be subject to a full merits appeal to the CAT.

A

List of respondents

Accenture
Age UK
Aldermore Bank
American Express
Andrea Leadsom MP
Andy Smith
Association of British Credit Unions Limited
Association of Chartered Certified Accountants
Association of Convenience Stores
Association of Foreign Banks
ATM Industry Association
Australian Payments Clearing Association
Bacs Payment Schemes Limited
Bank Machine Limited
Barclays
Belfast Bankers' Clearing Company Limited
Bottomline Technologies
British Retail Consortium
Building Societies Association
Campaign for Community Banking Services
Cash Services
Cashzone
CHAPS Clearing Company
Cheque & Credit Clearing Company
Citizens Advice
Clydesdale Bank
CMS Payments Intelligence
Department for Work & Pensions
Emerging Payments Exchange
Euroclear UK & Ireland
Experian
Faster Payments Scheme Limited
FCA Financial Services Consumer Panel
FCA Practitioner Panel
FCA Smaller Business Practitioner Panel
Federation of Small Businesses
Friends Provident Foundation
GoCardless
Handelsbanken
Institute of Credit Management
Intellect
LINK Scheme
Lloyds Banking Group
MasterCard
Metro Bank
Monitise
National Rail
Nationwide Building Society
Neopay
NewFinance
NoteMachine
Osborne Clarke
Payments Council
PayPoint

Petroleum Retailers Association	Toynbee Hall
Prepaid International Forum	TransferWise
Professor Jane K. Winn, University of Washington School of Law	Tusmor
Professor Richard A. Werner, University of Southampton Management School	Ukash
Rachel Beckett	UK Cards Association
Raphael's Bank	Vanquis Bank
Royal Bank of Scotland	Vendorcom
Santander UK	Virgin Money
Seamless	Visa Europe
Servebase	VocaLink
Shawbrook Bank	Wonga
Silicon Valley Bank	Which?
Tesco Bank	Yorkshire Building Society
	YourCash Europe Limited

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