FINANCIAL CONDUCT AUTHORITY
PAYMENT SYSTEMS REGULATOR

Payment Systems Regulator Limited Annual report and accounts 2016/2017

HC 95

Payment Systems Regulator Limited
Annual Report and Accounts 2016-2017
(for the year ended 31 March 2017)

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Forewords

The world of payments is constantly evolving – moving forward with a faster pace every day.

Our interventions and the industry's own actions over the last two years have created new opportunities for access, competition and innovation. New developments in fields such as biometric technology and automated banking are creating further groundbreaking opportunities in payments, making it more vital than ever for us as a regulator to stay with the pace.

I am proud of the work we have completed. Our market reviews shone a light on the key areas of access and infrastructure. We now have an environment where access to payment systems is fairer and more open; and our final remedies for infrastructure provision should see competition in this field increase and improve outcomes for the people and organisations that use the systems.

But other fundamental changes are imminent, such as the Payments Strategy Forum's final strategy. This includes consolidating three payment system operators and creating a new, streamlined payments architecture – big changes designed to make payments more competitive and flexible in a modern world. We will support and closely monitor the Forum's initiatives – and also look to the future across the payments sector, to make sure we are involved in the right areas in the right ways.

To this end, in addition to our work already underway, we will focus on exploratory work in three key areas in the coming year: consumer protection, payments data and the changing dynamics of competition in payments. This will allow us to be ready for the next developments as the industry continues its rapid evolution.

I look forward to the year ahead, the challenges we face and the successes we will share in helping to reshape the payments landscape.

John Griffith-Jones
Chairman

In 2014 we set out on a mission to change the agenda for payment systems in the UK. We wanted to see streamlined, state-of-the-art systems that offer better functionality, efficiency, control and choice for all their users. We're still at an early point in our journey, but things are already changing – pointing to a more open and competitive future.

Last year saw some of our early actions bear fruit. Following our work to open up the market, the first influx of new participants gained access to payment systems, with more to come. We continued our investigation into the underlying infrastructure of the interbank payment systems, and proposed remedies to stimulate competition. The banks who owned the current infrastructure provider have relinquished their control. And the Payments Strategy Forum made some bold proposals that are going to fundamentally change the industry, including consolidating operators and rebooting the technical architecture that the systems rely on.

Our work is coming together with efforts within the industry to streamline the whole payments process, which will make it easier for new players to offer proposed new services like request-to-pay and confirmation-of-payee. These are examples of services allowing consumers to have greater control and protection in their finances. This is what the future looks like for payments – and we're building it right now. As a regulator we will continue to try to strike the right balance between intervening and letting the industry find its own solutions. We'll take action if needed to stimulate competition and innovation, but we won't get in the way if the industry is achieving this by itself.

With changes coming thick and fast, it's vital we stay on top of industry developments and keep up the conversation with the people and organisations that use payment systems. This is particularly important if we are to fulfil our vision for payments systems that work well for everybody, and that inspire confidence in their use. We get feedback from our stakeholders through consultations and regular engagement, and welcomed some of you in person at our annual plan launch event – where we had a great opportunity to talk to people from across the payments industry, to share our views, and most importantly – to listen.

To be an effective and trusted regulator, we must be willing to take on board feedback. It's good to hear what we are doing well on, but it's important to know where we need to improve and what action we need to take if we are to continue to advance our objectives. We will continue to be open and transparent by considering your views on the direction we should take, and sharing our vision and plans for the future.

There are exciting developments happening in UK payments, and much work for us all to do. I look forward to working towards another year in which we have made a positive difference to the people and organisations that use payment systems.

Hannah Nixon
Managing Director

Strategic report

This is our third annual report. It covers our activity in 2016/17, our second operational year, and reports on how we have met the aims and priorities we set out in our 2016/17 annual plan and policy work programme.

In our 2016/17 annual plan, and in line with our statutory objectives, we said our key aims for the period were to:

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

This year we've seen progress in a number of areas, with access to payment systems becoming more open and our first market reviews coming to their conclusion. We've also begun work that will guide our future direction, and have seen bold proposals for change from the Payments Strategy Forum (the Forum).

Infrastructure and access

We published the final reports for our two market reviews on indirect access and infrastructure. For indirect access, we found that competition was largely working well and we are keeping a watching brief on developments that should address outstanding concerns. On infrastructure we consulted on two remedies that we believe will boost competition. We also suggested a third remedy – the divestment of the four largest stakeholders' interests in Vocalink, the infrastructure provider for Bacs, Faster Payments Scheme (FPS) and LINK. Since then, Vocalink has been bought by Mastercard, and we consider that this will address our concerns in this area.

We've also seen some groundbreaking access milestones in recent months. It's now quicker, cheaper and easier to connect directly to the interbank payment systems, and there are more ways to connect – leading to an unprecedented number of new participants. This means the market will be more open and competitive than ever before, with new and innovative services giving customers payment choices that suit them.

The Payments Strategy Forum

We set up the Forum and the Payments Community to promote collaborative innovation in the interests of those who use payment systems. In November the Forum set out its Final Strategy. Its proposals included consolidating the governance of the operators of three payment systems: Bacs, FPS, and Cheque and Credit Clearing. We set up a delivery group to draw up a detailed and practicable delivery plan, which it published in May.

The Forum also proposed a new payments architecture (NPA), an industry-led initiative to simplify the way payment systems operate so they can interact with different participants more easily. Cost and complexity will be reduced, so that more providers can plug into the systems to offer competitive and innovative services. We will continue to monitor and support the NPA's progress throughout the year.

"The PSR has been proactive and gone to great lengths to seek information from all perspectives in consultations and early thinking strategy."

Indirect PSP

Protecting consumers

We worked with a wide range of stakeholders to investigate the problem of authorised push payment scams. This was prompted by a super-complaint from Which?, which we responded to in December. We put together a package of work aimed at reducing fraudsters' ability to perpetrate scams, and increasing the chance that victims will be able to recover lost funds. We have also started to consider our wider role in protecting and educating consumers; this will be a key focus for us over the year ahead.

EU legislation

We published our approaches to various pieces of legislation and regulatory procedures, including the EU Interchange Fee Regulation (IFR) for card payments, and the Payment Accounts Regulations (PARs). For the IFR, we were one of the first regulators in Europe to publish finalised guidance setting out how we will monitor compliance in the UK. Under the PARs we designated the Current Account Switch Service as an 'alternative switching scheme', which is one of the ways payment service providers can provide an account switching service to customers. We also developed our proposed approach to monitoring and enforcing relevant parts of the second Payment Services Directive (PSD2), which we are consulting on.

What's next?

We have achieved some positive results and our work in several areas is starting to pay off. We will continue all the important work we've laid the foundations for. With so many fundamental changes and opportunities in the near future, we're also beginning three major new pieces of work to make sure we stay abreast of industry developments. We will conduct extensive research into:

- the implications for consumers of a changing payments sector
- the increasing use of payments data
- changing competitive dynamics in payments

These new pieces of work will help us continue to regulate effectively and fairly, making sure payment systems remain accessible, reliable and secure for all that use them.

This annual report explains in greater detail how we have met our statutory obligations and the commitments we made last year.

Competition

Competition in the various parts of the payments chain has benefits for participants at each stage, from payment service providers (PSPs) to consumers. Effective competition helps create the conditions for new and innovative services, taking advantage of new technology and lowering prices.

Our early work to promote competition has been focused on access and infrastructure, which we report on here. This year we have widened our focus to consider competition in other areas, and are studying the competitive dynamics of the changing payments landscape as preparation for future projects.

Access and governance

Opening up access to payment systems to more PSPs is essential to help create greater competition and innovation in payments.

Since we were established in 2015, we've taken a number of steps to improve both direct and indirect access by removing barriers to PSPs accessing regulated payment systems, or encouraging their removal. Our directions on direct access require operators of certain regulated payment systems to have objective, risk-based and publicly disclosed access requirements. We're now seeing more participants joining payment systems than ever before – four in 2016 and as many as ten by the end of this year.

In December 2015 we began publishing an annual report on access to payment systems and the governance of regulated payment system operators in the UK. In March 2017 we published our second report, which outlines the progress that has been made in realising five key outcomes:

- **Choice:** PSPs now have a better choice of access options. Direct participation in the interbank payment systems increased in 2016 and this looks set to continue, with up to ten new joiners by the end of 2017. There has been progress on indirect access too, with three banks now planning to become new indirect access providers (IAPs).
- **Time:** The operators have reduced the time and complexity for new PSPs to become direct participants. The Payments Strategy Forum (the Forum) has made recommendations on simplifying access that we think will bring further improvements (see page 20).
- **Value:** The cost of direct access to payment systems seems to be coming down. Recent joiners have told us that it has cost them around £1.2 to £2.5 million – compared to £2.5 to £4 million in 2015. We also expect the new IAPs to increase competition in the provision of indirect access, which could lower prices further.
- **Quality:** There have been improvements in the quality and availability of technical access to Faster Payments Scheme (FPS). More IAPs are offering 'direct agency' access to FPS, giving their customers the same quality and availability of access as direct participants.
- **Engagement:** The operators and IAPs have made their information more transparent and have engaged more effectively with their service-users.

Although progress has been encouraging, we said that we want the operators and IAPs to build on this success during 2017. We set out a number of areas where we thought further improvements were necessary. For operators, these areas include:

- improving their access offerings
- enabling aggregators for enhanced technical connection
- readiness to progress applications for access from non-bank PSPs

For IAPs these areas include:

- doing more to promote indirect PSPs' awareness of the IAP Code of Conduct
- implementing further enhancements to the Code, and adhering to commitments they have made in it

Indirect access market review

We published the final report of our market review into the supply of indirect access to payment systems in July 2016.

"The PSR are beginning to push for the kinds of things that need to happen to create a dynamic atmosphere for payment in the UK."

Authorised payment/e-money institution

We concluded that competition in the supply of indirect access appears to be producing some good outcomes, but we had specific concerns about:

- the quality of access
- limited choice for some PSPs
- barriers to switching

We said in the final report that we were seeing developments that, combined with our work on access, are likely to address these concerns for many stakeholders – and we've focused on encouraging those developments, rather than intervening directly. We have seen good progress in many areas, although there are still aspects that the industry needs to do more on (see *Access and governance* on page 11 for more details).

Access disputes

Sometimes, a PSP may find itself in dispute with a payment system operator over access to that system. This might be about the conditions of access, or the PSP being allowed access in the first place. Under section 56 of the Financial Services (Banking Reform) Act 2013 (FSBRA), we can grant PSPs access to certain regulated payment systems. Under section 57 we can change the terms of certain agreements relating to certain regulated payment systems between operators and PSPs, and between IAPs and other PSPs.

These powers also enable us to vary the fees and charges in connection with participation in certain regulated payment systems or the use of services they provide.

We can only use these powers if a person asks us to through a formal application. In July 2016, alongside our final report on our indirect access market review, we published draft guidance on how we will assess applications under these powers.

In February 2017 we received our first formal application under section 57. We expect to make a decision on the application in the summer of 2017.

Infrastructure market review

We looked at the state of competition in the provision of infrastructure for the three main interbank payment systems (Bacs, FPS and LINK). In our final report, published in July 2016, we concluded that competition in the provision of central infrastructure is not effective. We proposed three remedies:

- The operators of Bacs, FPS and LINK should run competitive procurement exercises when they buy central infrastructure services. This remedy applies to any future operator of these systems and contains some flexibility around the timing of procurement; this is to take account of the Forum's proposals for consolidating operators and developing a new payments architecture (see page 22).
- The next procurement exercises for Bacs and FPS must enable the use of ISO 20022 messaging standards.
- The four largest shareholders in Vocalink (the current infrastructure provider for all three systems) should divest their interest. These shareholders are also the largest banks using the systems.

In July 2016, Mastercard announced its intention to buy Vocalink. We consulted on our provisional conclusion that the transaction would address the infrastructure ownership issues we raised in our market review. Therefore, we didn't consult on a divestment remedy at that time. We consulted on our other two remedies between December 2016 and February 2017.

The acquisition of Vocalink was approved by the Competition and Markets Authority (CMA) in April 2017 and has now completed.

In June 2017 we published our final decision to adopt the other two remedies. We believe they will allow the people and businesses that use these payment systems to receive the benefits of competition for the market. The remedies will let new infrastructure providers enter the market and drive new and innovative products and services. This could benefit all users of payment systems, from large PSPs to consumers.

Consolidating payment system operators

The Forum published its Final Strategy for innovation through collaboration in November 2016. One of its key components is the proposed consolidation of the governing bodies of three payment system operators (PSOs): Bacs Payment Schemes Ltd, Cheque and Credit Clearing Company Limited and Faster Payments Scheme Ltd. The proposal received a high level of support through the Forum's consultation process. It presents a major opportunity to enhance the structure and operation of UK interbank retail payments, in a way that addresses historical problems in the payments industry.

The consolidation aims to further develop the capability and capacity of the operators by bringing them within a single organisation, and reduces the complexity and costs of having three separate retail PSOs. This single entity would also become responsible for taking forward the next stage of development for the Forum's proposed new payments architecture (NPA) (see page 22).

We worked closely with the Bank of England (the Bank) to establish the PSO Delivery Group (PSODG) to take forward the initial planning for the potential consolidation. We did this as quickly as possible, to minimise uncertainty for stakeholders and any potential risks to the resilience and stability of the payment systems. In October 2016 we announced the members of the PSODG, who include senior personnel from the respective PSOs and key stakeholders. The PSODG is led by an independent chair.

At the end of March 2017, the PSODG gave us and the Bank of England its recommendations for the key characteristics of the new PSO and an implementation plan for the effective consolidation of the three operators. The report was the result of considerable effort and collaboration between a range of stakeholders, and builds on a substantial volume of work assessing the governance model of PSOs. We and the Bank reviewed the report from the perspective of our respective objectives and duties, and in May 2017 published our expectations on the next steps for this work.

The EU Payment Services Directive (PSD) and Revised Payment Services Directive (PSD2)

The Payment Services Directive (PSD) was implemented into UK law by the Payment Services Regulations 2009 (PSRs 2009) and provides the legal foundation for a single market in payment services within the European Economic Area (EEA).

We currently have functions regarding access to certain payment systems under the PSRs 2009. The provisions contained in the updated version of the PSD, known as PSD2, are required to be transposed into UK law by 13 January 2018. The UK will do this by revoking the PSRs 2009 and replacing them with the Payment Services Regulations 2017.

PSD2 updates the rules put in place by the PSD. It is intended to stimulate competition in the electronic payments market by providing the necessary legal certainty for companies to offer payment services. This should then allow consumers to benefit from more and better choices between different types of payment services and service providers.

The Treasury published the draft Payment Services Regulations 2017 in February for consultation. They propose that we will be a competent authority for four Regulations:

- **Regulation 61:** Information on ATM withdrawal charges.
- **Regulation 103:** Prohibition on restrictive rules on access to payment systems.
- **Regulation 104:** Indirect access to designated payment systems.
- **Regulation 105:** Access to bank accounts (the PSR and the Financial Conduct Authority (FCA) are both competent authorities for this Regulation).

During 2016/17 we developed our proposed approach to monitoring and enforcing these Regulations, working closely with the FCA on Regulation 105. We published our draft approach for consultation in April 2017.

The Payment Accounts Directive (PAD)

In May 2016 we published our final guidance for designating alternative switching schemes under the Payment Accounts Regulations (PARs) and monitoring the schemes' compliance with the PARs. In September we used our PARs powers to designate the Current Account Switch Service (CASS) as an alternative switching scheme, following an application from Bacs, the operator of CASS.

In addition, this year the CMA introduced regulatory oversight over CASS, to ensure that the service continues to be developed with effective participation from a wide range of relevant stakeholders and operated in the interests of customers. We will monitor CASS's compliance with the requirements and notify the Treasury of our findings.

Contactless mobile payments

The rapid growth in mobile payments in the UK could affect all three of our statutory objectives and so, in line with our function of keeping payments markets under review, we want to make sure our understanding of this sector is up to date. We therefore issued information requests to a wide number of selected participants in the contactless mobile payments sector in September 2016 and are reviewing the responses. This work is ongoing; we will expect to re-engage with stakeholders in the coming months as we deepen and clarify our understanding of the issues involved and whether any action might be needed. We expect to publish a progress update in autumn 2017.

Our perceptions survey

In this report we've included statistics from our annual survey of our stakeholders, showing their perceptions of various aspects of the payments industry and our work. We've also shown how these results compare to last year.

We have maintained our broadly positive overall reputation score, with stakeholders saying we are professional, set out the right objectives for the industry, and are making the industry more transparent and inclusive. However, we have seen some scores rising and some dipping slightly in relation to specific objectives and industry changes. This is a natural progression; last year's inaugural survey captured views of us in our start-up phase, and many respondents felt it was too early to form a positive or negative opinion on some matters so they wanted to 'wait and see'.

The last 12 months have seen changes that benefit many participants in the payments industry, but will inevitably create some upheaval. This is reflected in the views of stakeholders in different areas – particularly where we've imposed new requirements on some parties, or where they see positive movement in the industry but are less aware of our role in leading this change.

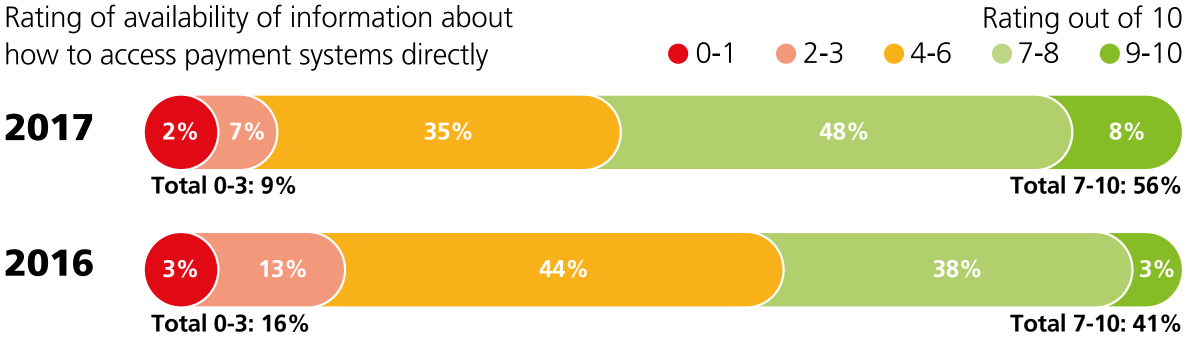
We value the results of these surveys to help inform our future work and strategy, and improve the way we engage with our stakeholders as part of this process.

Access is more open

More than half our respondents now have a positive impression of the information available on getting access to payment systems. Overall, they're more positive about the ease of gaining access to payment systems, although many still report a 'neutral' response to this question.

Availability of information about getting direct access

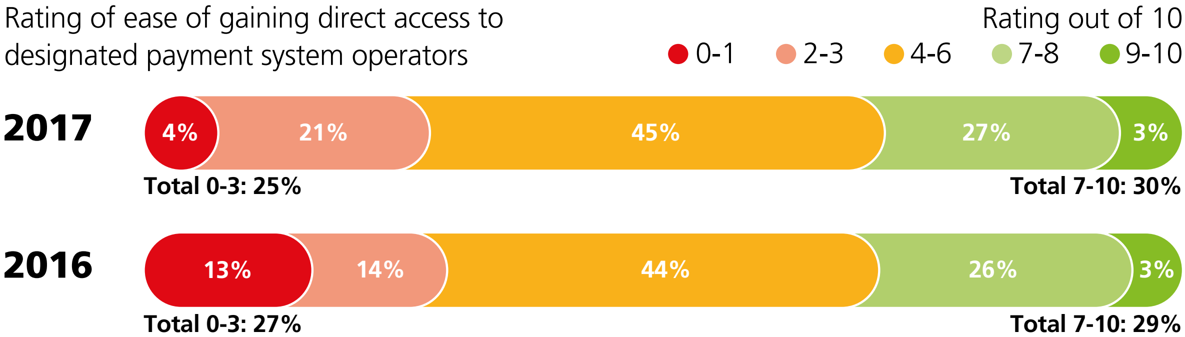
Rating of availability of information about how to access payment systems directly



Sample sizes: 107 in 2017, 105 in 2016. These exclude those who answered 'don't know'.

Ease of gaining direct access

Rating of ease of gaining direct access to designated payment system operators



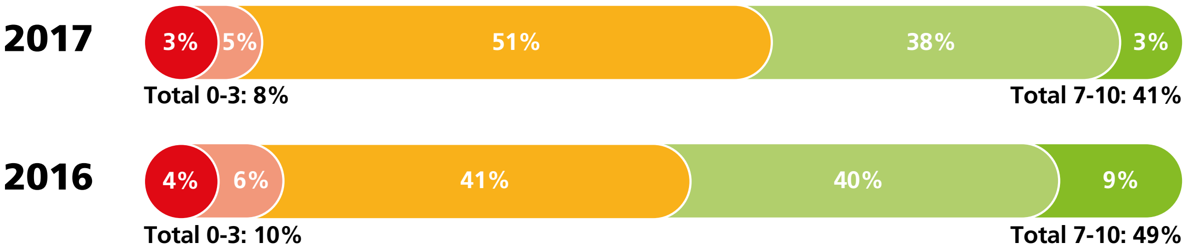
Sample sizes: 107 in 2017, 102 in 2016. These exclude those who answered 'don't know'.

Meeting our competition objective

Overall, a significant proportion of stakeholders agree that we are promoting effective competition. Representatives of businesses, end users, indirect PSPs, authorised payment institutions and e-money institutions are more likely to agree; as a group, operators are least likely to agree.

Meeting our competition objective

Extent to which the PSR promotes effective competition in the markets for payment systems and services



Sample sizes: 94 in 2017, 96 in 2016. These exclude those who answered 'don't know'.

Delivering our commitments

What we said we'd do	What we've done
Market reviews Publish our final reports for both market reviews.	We published the final reports in July 2016. We consulted on two remedies for infrastructure and published our final decision in June 2017, implementing competitive procurement and common message standards.
Regulatory directions on access Monitor and assess the effectiveness of our access and governance directions.	In March 2017 we published our second report on access to payment systems and the governance of operators in the UK, outlining progress and setting focus areas for the operators to work on.
Card payment systems programme of work Consult on Phase 2 of our guidance on the implementation of the Interchange Fee Regulation (IFR).	We published our final guidance on the IFR in October 2016. We also published two infographics in April 2017 aimed at educating merchants and consumers about the IFR.

Our role as a competition authority

As well as our regulatory powers over FSBRA designated payment systems, we have concurrent competition powers with the CMA in relation to participation in payment systems. We can carry out investigations and take enforcement action against anti-competitive agreements and conduct under both the Competition Act 1998 and EU competition law. And under the Enterprise Act 2002 we can conduct market studies and make market investigation references to the CMA.

We continue to have regard to our duty in FSBRA to consider, before exercising certain powers under sections 54 to 58 of that Act, whether it would be more appropriate for us to proceed under our concurrent competition powers. This is commonly known as the 'primacy obligation'.

Innovation

We live in a time of technological revolution. Constant advances in capability and capacity mean new ideas can thrive that wouldn't have been possible just a few years earlier. The payments industry needs to be able to respond to these changes and adapt at the right pace, to make sure it provides the right services for modern users – without compromising on security and stability.

Our aim is to make sure the right conditions exist to support innovation that works in the interests of those who use payment systems.

The Payments Strategy Forum and Payments Community

We set up the Payments Strategy Forum (the Forum) in 2015 as a major initiative to promote innovation in payments where collaboration is needed. The Forum is a collaborative body made up of experts from across the payments industry and representatives of those who use payment systems, such as consumers, retailers and the government. We gave it the task of developing a strategy for collaborative innovation in payments within 12 months of its first meeting.

During 2016/17 we have supported the work of the Forum, ensuring appropriate pace and direction and providing secretariat support to the Forum and the Chair. We have also maintained a wider group of stakeholders, the Payments Community, to help guide the Forum's work.

In November 2016 the Forum delivered its ambitious and innovative Final Strategy, outlining a set of collaborative proposals to meet the user needs it had identified. It aims to:

- create easier access to the current payment systems, fostering more competition and enabling innovation
- deliver a payment system that is simpler, more agile and responsive to the changing needs of users
- introduce measures to reduce the weaknesses in current payment systems that are exploited for financial crime

> **"The PSR has done a lot of detailed work to increase competition and innovation and has been very consultative with all stakeholders."**
>
> *Indirect PSP*

The centrepiece of the Strategy is the proposal to create a new payments architecture (NPA), which will be based on four key design principles:

- A single set of standards and rules, with strong central governance.
- End-to-end interoperability (including application program interfaces (APIs) and a common message standard).

  (These two elements make it easier for participants to join and use the systems.)

- A 'thin' collaborative infrastructure, allowing multiple providers of overlay services to compete in the market simultaneously.
- Secure and resilient, with financial stability a key principle.

Adhering to these principles will produce an accessible basic infrastructure that is based on simple push payment messages, in a common language. These changes are anticipated to lower costs, complexity and rigidity, allowing competition and innovation to flourish. This in turn should give a wider choice of services to best suit the needs of users.

The proposals in the Forum's Strategy are only a starting point. To implement them successfully the industry must remain committed to collaboration and coordination across a number of initiatives. We've asked the Forum to oversee the first phase of design and implementation work in 2017, to push ahead with the detailed design of the user needs solutions and the NPA while also taking action to reduce financial crime. The design and implementation plan for the NPA should be ready to hand over to the new consolidated payment system operator in early 2018.

Perceptions survey

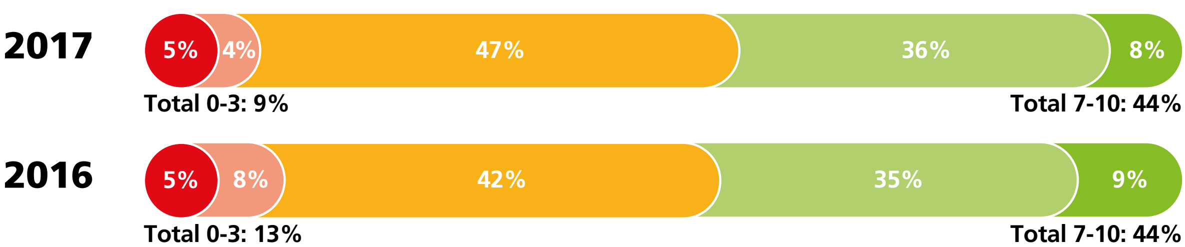
Our work on innovation is progressing steadily

Opinion on our impact on innovation is similar to last year, but with fewer people having a negative impression and nearly half giving a neutral rating for this objective.

Meeting our innovation objective

Extent to which the PSR promotes innovation in payment systems, and particularly the infrastructure that supports them

Rating out of 10
0-1 2-3 4-6 7-8 9-10



Sample sizes: 94 in 2017, 96 in 2016. These exclude those who answered 'don't know'.

Delivering our commitments

What we said we'd do	What we've done
Payments Strategy Forum Continue to provide secretariat support, and provide guidance and challenge where necessary.	We've supported the work of the Forum, providing secretariat support for it and the Chair. We have also maintained the Payments Community. The Forum has now produced its final strategy and will guide the first phase of implementation planning.

Service-users

Our competition and innovation objectives may have been the most visible in our first two years of operation, but our work in these areas always has a fundamental principle – to help the users of payment systems get the benefits of competition and innovation in the industry. This means payment systems that are easy to access and use, and that respond to the changing needs of businesses and consumers alike.

In 2016 we began to look more closely at issues of consumer awareness and protection, and will expand on this work in the coming year.

Authorised push payment scams

Certain representative bodies may make super-complaints to us if they believe that features of the payment systems market are, or appear to be, significantly damaging to the interests of service-users. On 23 September 2016, we received our first such super-complaint, from the consumer organisation Which?.

Which? said there's not enough protection for people who are tricked into transferring money to a fraudster via an authorised push payment (APP) – when someone instructs their bank to send money to another bank account. Which? asked us to investigate:

- the extent to which banks' conduct could change to reduce consumer harm from APP scams
- possible changes to legislation or regulation to alter incentives on banks and payment systems to ensure that more is done to manage the risks from APP scams and to protect consumers from harm

Following a period of intensive investigation and stakeholder engagement, we issued our response to the super-complaint on 16 December 2016 (we are required by law to publicly respond to super-complaints within 90 days of receipt). We concluded that this type of fraud was a growing issue and that more needed to be done to address it. We identified three main areas of concern:

a. The ways in which PSPs, including banks, currently work together in responding to reports of APP scams needs to improve.

b. There is some evidence to suggest that some PSPs could do more to identify potentially fraudulent incoming payments and to prevent accounts falling under the influence of scammers.

c. The data available on the scale and types of APP scams is of poor quality. However, there is evidence suggesting the scale is significant – and the problem is likely to get worse.

As part of our response, we announced a package of work to address these issues. We considered work already under way, or planned for the near future, that could reduce consumer harm caused by APP scams. Particularly significant are the work of the Joint Fraud Taskforce and a number of the initiatives recently announced in the Payments Strategy Forum's Final Strategy (including the confirmation-of-payee work that should help tackle scams where the victim is duped into making a payment to the wrong account).

Our proposals consisted of three elements: industry-led actions, a PSR-led project looking at the role of payment system operators, and FCA-led work.

We worked with Financial Fraud Action (FFA) UK – the UK payments industry body responsible for leading the collective fight against fraud – to agree a programme of work that the industry should deliver. This includes collecting better statistics on the scale of this type of fraud, developing a common approach for PSPs responding to reported APP scams, and improving information sharing. We have been monitoring FFA UK's progress on this work and will publish a review in the second half of 2017.

We have also launched a project considering the potential for the operators of CHAPS and Faster Payments Scheme (FPS) to do more to minimise the consumer harm caused by APP scams. We published the final terms of reference for this work on 30 March 2017, setting out two objectives:

a. We will consider whether it would be effective and proportionate for operators of push payment systems to play a greater role in preventing and responding to APP scams (and possibly wider fraud).

b. If we conclude that new measures are appropriate, we will consider whether it would be best to introduce them through regulatory action or through other approaches (for example, industry-led). If we decide on a regulatory approach, we will develop proposals for consultation.

We are now gathering information and plan to publish our findings in the second half of the year.

The FCA has committed to working with firms to tackle concerns around both sending and receiving banks in relation to APP fraud. It will also examine evidence received in relation to the super-complaint, and address any firm-specific issues directly. If there are unresolved sector-wide issues following the above steps, the FCA will initiate further work.

The Interchange Fee Regulation (IFR)

The IFR has brought about major changes to the way UK card schemes operate, most notably by introducing a cap on interchange fees on consumer cards. These fees are generally paid by the merchant's PSP (the acquirer) to the cardholder's PSP (the issuer) when a card payment is made. The IFR also introduces a number of business rule provisions.

We are the competent authority for the IFR in the UK. Following separate consultations, we published guidance on our approach to monitoring and enforcing compliance with the IFR in two stages, in March and October 2016.

"The PSR operates in an incredibly open way. It is interested in speaking to a wide range of stakeholders. It is interested in challenging the established paradigms of the industry."
ATM operator

We are now proactively monitoring compliance with the IFR. In January 2017, we required card schemes, and some acquirers and issuers, to tell us how they ensure compliance with the interchange fee caps. We received responses in March and are assessing the information. We will also ask regulated parties for information on how they have complied with the business rules in 2017/18. We share responsibility with other competent authorities for monitoring and enforcing compliance with some of the IFR business rules. As part of our work to develop our guidance, we identified how we will cooperate effectively with the FCA and the Part 8 Enterprise Act 2002 general enforcers.

We also took steps to raise awareness of the regulation and its impact. This included developing two infographics aimed at merchants and consumers, explaining at a high level what changes they can expect as a result of the IFR. We published these in April 2017, and have had a positive response from stakeholders.

Direct Debit

Since early 2016, we've been looking at potential concerns around the Direct Debit scheme, engaging with Bacs and other stakeholders – including through Direct Debit roundtable events hosted by the Council of Mortgage Lenders and the Finance & Leasing Association. One area we're examining is the provision of 'facilities management' services that enable (typically) smaller organisations to appoint a service provider to collect payments on their behalf. We're considering whether the Direct Debit rules need improving, to remove any unnecessary barriers to facilities management clients switching their service providers.

Faster, image-based cheque clearing

In 2015, the Treasury and the payments industry agreed a need for a new, image-based cheque clearing system. The Image Clearing System will reduce the cheque clearing time from 'six weekdays' to a maximum of 'next weekday', and should be gradually rolled out from late 2017. We've kept engaged with the programme and are keen to ensure it delivers against its intended benefits for cheque users, including more options for paying by cheque, and that it meets our expectations regarding easy and open access for PSPs.

Delivering our commitments

What we said we'd do	What we've done
Cheque imaging Monitor industry progress on the migration to cheque imaging.	We've kept engaged with the industry programme to develop a new, image-based cheque clearing system for the UK. We expect it to be introduced later this year.
The PSR Panel Consult regularly with the PSR Panel on our policies and approach.	The PSR Panel met four times between April 2016 and 31 March 2017: 19 April 2016 29 June 2016 12 October 2016 23 January 2017

Perceptions survey

Payment systems are working well for users, but we need to do more

An increasing majority think payment systems are serving their users well; however, some of those surveyed thought we should be doing more in this area.

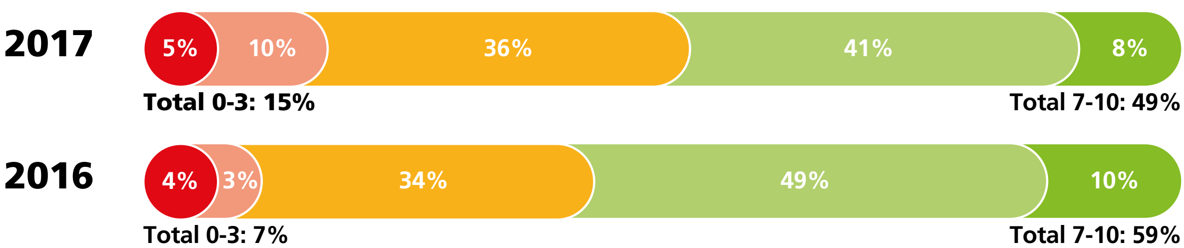
Payment systems effectively meeting consumer needs

Extent to which payment systems effectively meet the needs of their end users such as consumers, businesses and other organisations

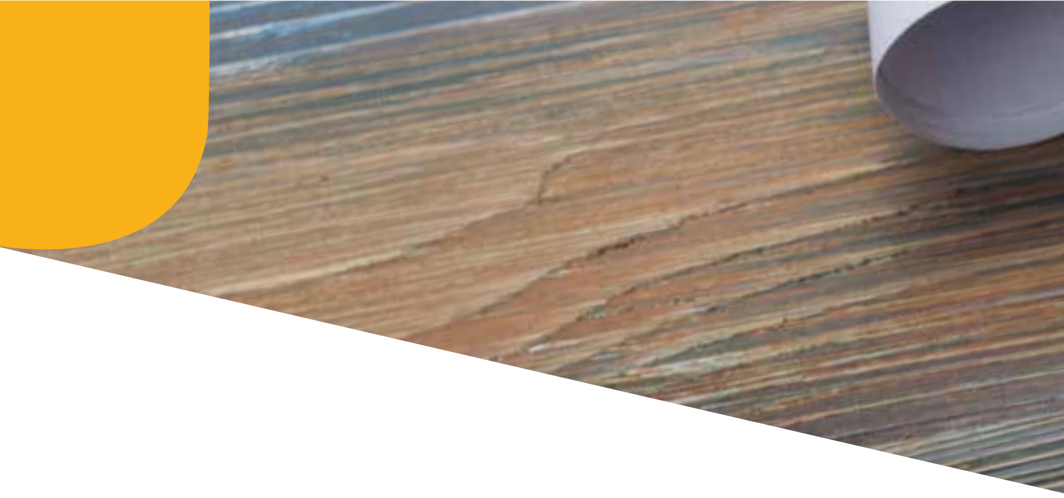
Sample sizes: 130 in 2017, 147 in 2016. These exclude those who answered 'don't know'.

Meeting our service-user objective

Extent to which the PSR ensures that payment systems are operated and developed in the best interests of the businesses and consumers that use them



Sample sizes: 95 in 2017, 94 in 2016. These exclude those who answered 'don't know'.



Building our organisation

In our 2016/17 annual plan we said we would continue to recruit permanent staff as required to ensure we had the right people and skills for our aims and activities. On 31 March 2017, we had 60 permanent and 11 temporary staff.

We have met all of the commitments made in our annual plan and policy work programme regarding building our organisation.

We continue to work closely with colleagues in other authorities, in particular the FCA, the Bank of England (the Bank) and the CMA, to make use of their experience and ensure efficient and effective coordination across the sectors we regulate.

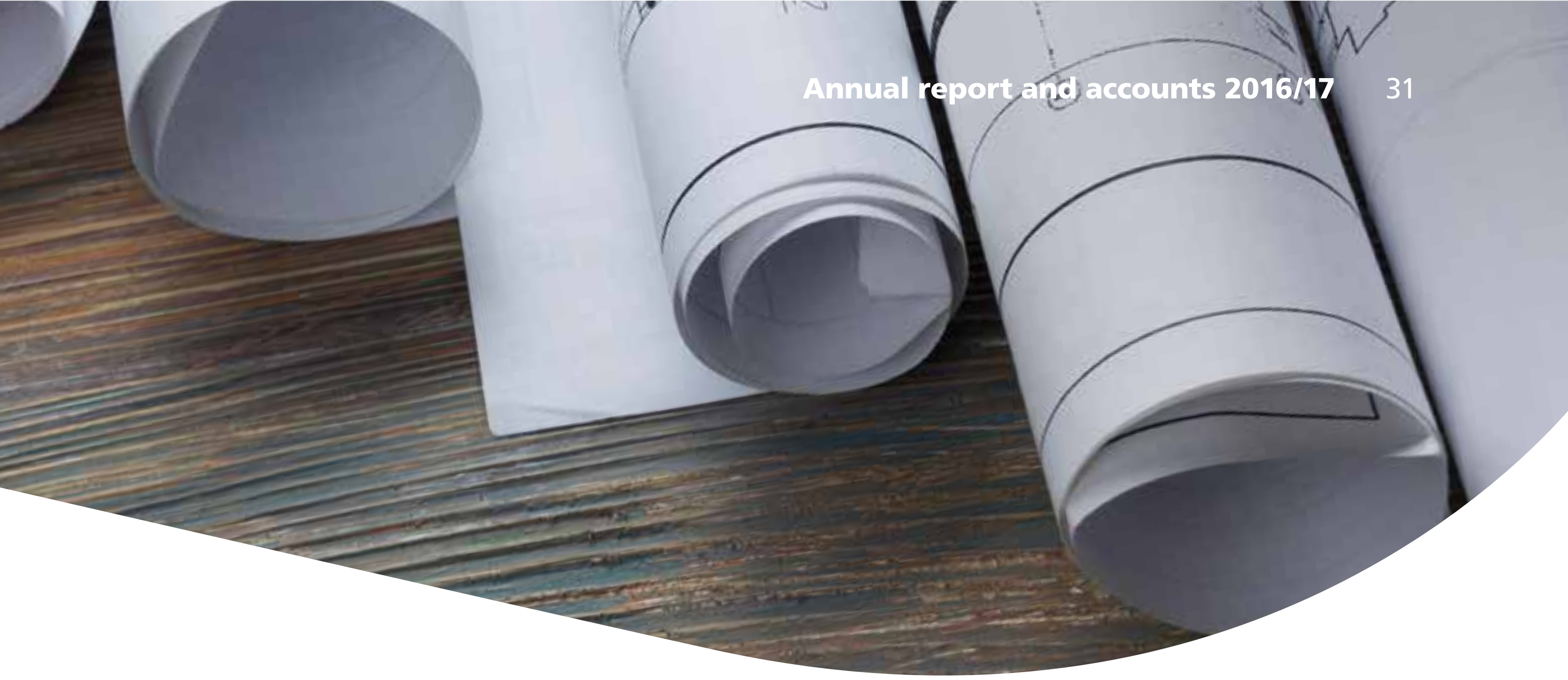
We have established and appointed the members of the Enforcement Decisions Committee (EDC) and the Competition Decisions Committee (CDC), and the procedural adjudicator. The purpose of the EDC is to take certain regulatory enforcement decisions on behalf of the PSR. The purpose of the CDC is to take certain competition law enforcement decisions on behalf of the PSR, linked to our competition functions under the Competition Act 1998 and under Articles 101/102 of the Treaty on the Functioning of the European Union.

The EDC and CDC have not yet received any cases. In the absence of any case work, the Committees have been undertaking training on relevant matters to ensure that they are properly prepared to deal with cases when they are submitted.

Measuring performance

We run an annual survey of our stakeholders to gauge their views of both the industry and our own performance. This lets us see where we're having a positive impact and where we could do more. We can also see where views differ in different parts of the industry and consider the implications. This year we've conducted this survey for the second time, so can now begin to see how perceptions are changing alongside changes in the wider payments sector. The survey shows that the positive overall perception of our role and actions remains, but as our work and impact broaden there are fluctuations in some areas. We expect to see this at this stage in our development as a relatively new regulator, with different areas of the industry reacting differently to changes we've introduced. We've included some of the key statistics in this report.

Last year we said we'd refine these measures to produce a small set of key metrics to use consistently over time. We adapted some of the questions in this year's survey and will continue to do so over the next few years.



Working with other authorities

We continue to coordinate certain regulatory functions with the other UK financial regulators – the Bank, the Prudential Regulation Authority (PRA) and the FCA. This is a statutory duty that helps us share and enhance our knowledge and work more efficiently.

As well as our regular ongoing engagement with our stakeholders, our work includes collaboration in several key areas in the UK and abroad.

We continue to work and engage regularly with the Bank, the PRA and the FCA about payment systems, their evolution and regulation. For example, the PSR and the FCA are expected to become competent authorities in relation to Regulation 105 of the Payment Services Regulations 2017, covering access to bank accounts. In our role as competent authority for some of the business rule provisions in the Interchange Fee Regulation, we worked with the FCA to identify how we will cooperate effectively to monitor compliance. Further, we have worked closely with the FCA to develop our proposed approach to applying this Regulation and continue to work with them in preparation for the coming into effect of those Regulations in January 2018.

A memorandum of understanding between the UK financial regulators is in place which describes the role of each regulator in relation to matters of common regulatory interest and how the regulators intend to cooperate. The memorandum is reviewed annually.

During the last year, we've continued to engage regularly with other concurrent regulators in the UK Competition Network to share expertise and insights into the identification and effective delivery of competition cases. We also participate actively in the European Competition Network and the UK Regulators Network, which allow relevant bodies to pool their experience and identify best practices.

As part of our development programme, members of our staff have been seconded to the FCA and the Bank to develop their skills and knowledge.

We engage with the European Banking Authority, the European Commission and other international supervisory authorities as needed. We are also members of the Organisation for Economic Cooperation and Development's (OECD's) Network of Economic Regulators, which advises the OECD Regulatory Policy Committee.

Our Financial Penalty Scheme

In March 2017 we published our Financial Penalty Scheme. The scheme describes what we will do with the money we retain from penalty payments to cover our enforcement costs (the retained amount), before passing on the penalty to the Treasury.

The scheme is a requirement under FSBRA, which requires that the retained amount must be used in a way that benefits participants in regulated payment systems, while ensuring that any person who has become liable to pay a penalty in one year doesn't receive the benefit from the scheme in the following year.

We decided to use this money to reduce the money we collect in regulatory fees from PSPs, while ensuring that fee payers that became liable to pay a penalty do not get the reduction. We consulted on our approach, and our final guidance was broadly welcomed by stakeholders. Our approach also minimises the administrative burden to the industry as operators will not have to adjust invoices.

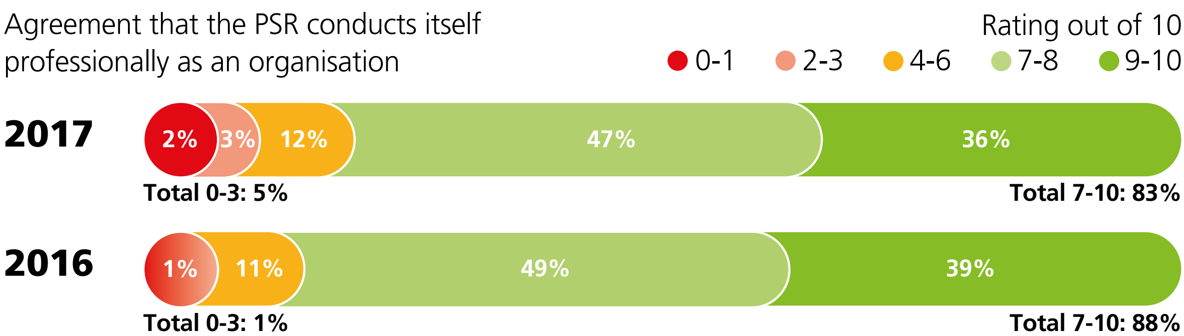
Perceptions survey

We continue to operate to a high level of professionalism

The overwhelming majority of stakeholders agreed that PSR staff are professional, honest and responsible, and that we communicate with them clearly and in a timely manner.

Our professionalism

Agreement that the PSR conducts itself professionally as an organisation



Sample sizes: 97 in 2017, 100 in 2016. These exclude those who answered 'don't know'.

Our staff

Having spent time since our launch recruiting staff with the skills and experience needed to make us an efficient and effective regulator, we have now moved to focusing on developing our staff, our processes and our ways of working. Our team includes economic, policy, legal, regulatory, communications and operations experts, alongside payments industry specialists. Aided by a provision of services agreement, we continue to draw on the operational support of the FCA as appropriate.

This year we have launched the PSR Values and also developed a people strategy for 2017 to 2020, which encompasses three areas: growing leadership and management skills; building a high performance organisation; and enabling a collaborative and engaging working environment. We have also established eight strategic targets to be delivered by March 2018 to help us focus our work and ensure we deliver our objectives and people strategy.

The Business Impact Target

Under The Enterprise Act 2016, we are now within scope for the Business Impact Target (BIT) – a monetary figure for the savings businesses will make because of deregulatory measures that the government has taken. We must report to the government on our performance against the BIT. Our first report covered the period 6 May 2015 – 8 June 2017; in this period we did not have any qualifying regulation adding to the burden of business regulation. We will report annually in the future.

Financial overview

Business model

The PSR is responsible for regulating the main interbank payment systems – Bacs, CHAPS, Cheque & Credit, Faster Payments Scheme, LINK and Northern Ireland Cheque Clearing – as well as Mastercard and Visa Europe, the two largest card payment systems in the UK.

The PSR is co-located in the FCA's building at Canary Wharf and is operationally supported by the FCA through a provision of services agreement. The aim is to fully maximise the FCA's existing resources and infrastructure to enable the PSR to operate efficiently and effectively.

The PSR is moving to the Queen Elizabeth Olympic Park in Stratford from May 2018. The move to Stratford will give the PSR a quality building, excellent facilities and the right infrastructure to meet our future needs, and provides value for money.

The PSR seeks to make neither a profit nor a loss from its regulatory activities, although in practice this obviously can happen due to unforeseen circumstances or timing issues.

Fee income: The PSR does not receive funding from the UK government as it funds the cost of delivering its statutory objectives by raising fees from the firms it regulates. The FCA is given powers to levy fees to recover the PSR's costs under the Financial Services (Banking Reform) Act 2013 and the Interchange Fee Regulation.

Analysis of performance during the year

During 2016/17 the PSR issued a rebate of £5.0 million to fee payers, relating to the underspend of fees in 2015/16. In 2016/17 the PSR underspent against fee income by £4.4 million. Therefore the PSR made a loss of £0.6 million for the year ended 31 March 2017 (2016: surplus of £17.6 million), as summarised in Table 1 on page 36. The 2016/17 underspend reflects an overestimation of the costs it was believed the organisation would incur to fulfil its regulatory duties and to further develop as an organisation. The PSR continues to pay due regard to the costs of regulation and offering value for money, and will provide a rebate to fee payers of £4.3 million in 2017/18.

Overall operating costs have increased by £0.3 million (2.8%) to £10.9 million (2016: £10.6 million). This was driven by increase in staff costs as the PSR recruited permanent employees needed to bring the team up to full strength. The PSR had an average of 58 full-time-equivalent employees during the year, compared to 44 in 2015/16. Administrative costs decreased by £0.2 million, driven mainly by reductions in travel, training, recruitment and IT costs. We provide a further breakdown of the PSR's operating costs in Table 2 (page 37).

The year-end cash position is £13.3 million (2016: £7.5 million). The increase is due to the PSR collecting £6.1 million in 2017/18 fees in advance. The PSR had an accumulated surplus of £5.4 million at 31 March 2017 (2016: accumulated surplus of £6.0 million). It will retain £1.0 million as reserves and, as noted above, provide a rebate to fee payers of £4.3 million in 2017/18.

Principal risks and uncertainties facing the PSR

The PSR's overriding purpose is to make sure payment systems work well for the people and organisations that use them. The PSR's *Annual plan and budget 2017/18* (March 2017) sets out the **key risks** to achieving this:

- Payment systems are not open, transparent and accessible.
- Payment systems are not fast, easy to use, secure, reliable and do not provide value for money.
- Payment systems are not responsive to current and future needs and do not promote innovation and competition.
- There is no improvement in the representation of the people and organisations that rely on services provided by payment systems.
- Payment systems do not function in the best interests of the people and organisations that use them and the services they support.
- Consumers are not satisfied with the quality and outcomes of the PSR's work.

"The PSR is going in the right direction. They provide a much more open, honest forum for the industry."

Authorised payment/e-money institution

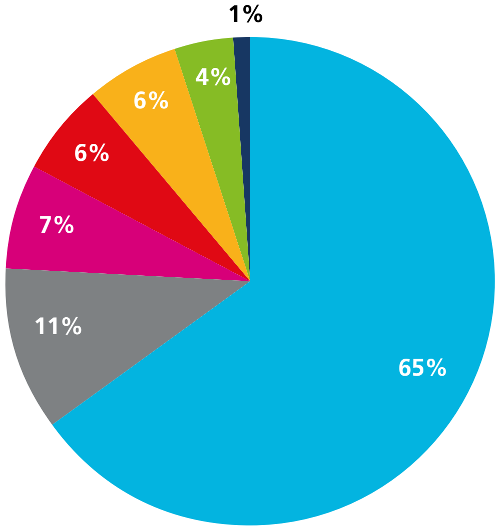
Table 1: Results for the year[1]

	2017 £'000	2016 £'000	Increase/ (decrease) £'000	Change %
Total income	10,256	28,111	**(17,855)**	
Staff costs	(7,087)	(6,601)	**486**	7.4%
Administration costs	(3,795)	(3,960)	**(165)**	-4.2%
Total operating costs	**(10,882)**	**(10,561)**	**321**	**3.0%**
(Loss)/Surplus	**(626)**	**17,550**	**(18,176)**	

1 Note that 2015/16 income includes recovery for set-up costs incurred in 2014/15 of £12.3 million.

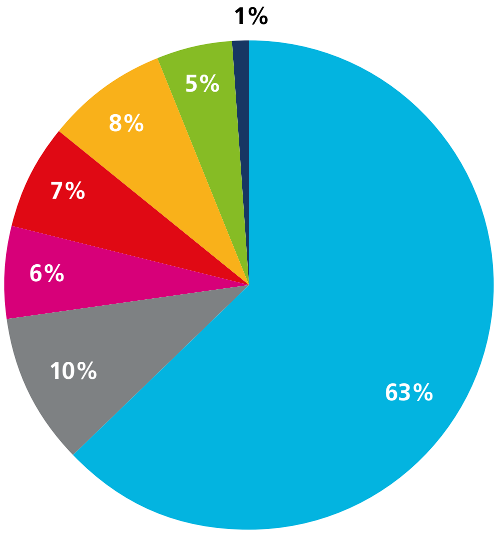
Table 2: Analysis of operating costs by year

2017



- Staff costs – £7,087,000
- Professional fees – £1,248,000
- Accomodation and office services* – £798,000
- Travel, training and recruitment – £642,000
- FCA staff recharges* – £634,000
- Information technology* – £391,000
- Other non-staff costs – £82,000

2016



- Staff costs – £6,601,000
- Professional fees – £1,107,000
- Accomodation and office services* – £683,000
- Travel, training and recruitment – £750,000
- FCA staff recharges* – £803,000
- Information technology* – £479,000
- Other non-staff costs – £138,000

*These costs include operational support from the FCA through a provision of services agreement. This aims to maximise value from the FCA's existing resources and infrastructure, enabling the PSR to operate efficiently and effectively. The PSR is co-located in the FCA's building.

Key environmental and operational risks

The PSR and FCA have shared key risks:

- **Environmental risks:** These include risks associated with the operating environment for the PSR, in particular, political, legislative or socio-demographic changes. While it is set out in statute that the FCA and PSR are operationally independent organisations, the PSR remains subject to changes in legislation and scope by the UK government that can ultimately affect its size, activities and complexities. The government's decision to trigger Article 50, setting in train the UK leaving the European Union, may affect the scope and scale of the PSR's activities from April 2019.
- **Internal operational risks:** Like any organisation, the PSR faces significant operational risks that may result in financial loss, disruption, or both. For the PSR these risks are summarised below:
  - **People risks:** These include risks associated with, and potential instability arising from, further changes to the PSR's senior leadership team; key person risk associated with the potential loss of detailed and specific technical skills or knowledge; attrition risk; and risks around staff morale and engagement. The PSR continues to mitigate these risks as part of its people strategy.
  - **Governance risks:** These include inadequate or failed internal processes and controls. The introduction of the Senior Managers and Certification Regime internally across the PSR aims to strengthen governance, controls and decision-making.
  - **Systems risks:** These include the availability, resilience, recoverability and security of core IT systems. Cyber risk continues to be a major focus for both organisations, with a significant increase in investment, as we respond to the rapidly evolving threat level.
- **Public confidence risks:** The risk of damage to the reputation of the PSR where it limits or affects both organisations' credibility and constrains their ability to deliver against their objectives. This also incorporates inappropriate judgements, decisions and actions taken (or inaction) that stakeholders may perceive as inappropriate; inconsistent or inaccurate messages being communicated externally; and clearly defining the PSR's objectives and remit so that public expectations are set and managed appropriately. Value for money is also a key area of focus for the PSR.

As far as **financial risk** is concerned, the PSR has adequate resources (cash liquidity and the support from the FCA) to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing the annual report and accounts.

Directors' report

The directors present their report for the year ended 31 March 2017.

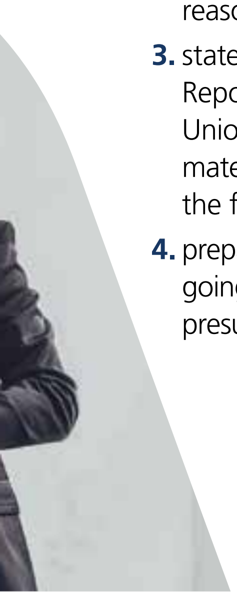
The directors use the strategic report (page 8) to explain how they have performed their duty to promote the success of the PSR under section 172 of the Companies Act 2006.

Directors' responsibilities in respect of the annual report and accounts

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

1. select suitable accounting policies and then apply them consistently
2. make judgements and estimates that are reasonable and prudent
3. state whether applicable International Financial Reporting Standards, as adopted by the European Union, have been followed, subject to any material departures disclosed and explained in the financial statements
4. prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business



The directors are responsible for keeping proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and for taking reasonable steps to prevent and detect fraud and other irregularities.

As far as the directors are aware:

1. there is no relevant audit information of which the company's auditor is unaware
2. the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information

The directors are responsible for maintaining and ensuring the integrity of the corporate and financial information on the company's website. UK legislation which applies to preparing and distributing financial statements may differ from legislation in other jurisdictions.

Qualifying indemnity provisions

Qualifying third party indemnity provisions for the purposes of section 234 of the Companies Act 2006 were in force during the course of the financial year ended 31 March 2017 and remain in force at the date of this report.

Auditor

The Financial Services (Banking Reform) Act 2013 (FSBRA) requires the company's accounts to be examined, certified and reported on by the Comptroller and Auditor General. Accordingly the National Audit Office was auditor throughout the year.

By Order of the Board on 21 June 2017
S Pearce
Secretary
23 June 2017

Corporate governance

Corporate governance statement for the year ended 31 March 2017

Introduction

This section of the report explains the board's composition and governance structure and how we are governed. It also explains the board's role and membership, its performance, ongoing professional development and succession planning.

We are committed to meeting high standards of corporate governance. This report sets out how we are governed in line with the principles of the UK Corporate Governance Code (the Code). The board considers that we comply with the Code as far as is appropriate.

We are funded by the regulated payments industry through statutory fee-raising powers. We are independent of government, but accountable to government and Parliament through obligations set out in FSBRA. We consult with users and participants on general policies and practices and how our objectives may be best achieved, including through engagement with the PSR Panel (see page 44).

The role of the board

The board is our governing body. It sets our strategic direction and ensures our long term success. Consistent with the obligations set out in FSBRA, the board liaises with the FCA to take such steps that are necessary to ensure that the PSR is, at all times, capable of exercising its functions and that the necessary financial and human resources are in place.

The board's role includes:

a. determining the matters that should be reserved to it for decision, which includes the exercise of our functions of giving general directions and imposing generally imposed requirements under sections 54 and 55 of FSBRA respectively, and other matters as set out in the Schedule of Matters Reserved to the Board from time to time

b. making strategic decisions affecting our future operation

c. overseeing the discharge by the executive management of our day-to-day business

d. setting appropriate policies to manage risks to our operations and the achievement of our regulatory objectives

e. seeking regular assurance that our system of internal control is effective in managing risks in the manner it has approved

f. maintaining a sound system of financial control

g. taking specific decisions, outside those specified in the Schedule of Matters Reserved to the Board, which the board or executive management consider to be of a novel or contentious nature, or to be of such significance that they should be taken by the board

h. maintaining high level relations with other organisations and authorities, including the government, the FCA, the Prudential Regulation Authority, the Bank of England and the PSR Panel

i. establishing and maintaining arrangements to ensure accountability regarding decisions of committees of the board and executive management, through periodic reporting

We are not formally subject to the Senior Managers and Certification Regime, which came into force in March 2016, but we are committed to upholding the highest professional values. We have therefore set out a formal description of the core responsibilities of our board members and those carrying out Senior Management functions. Our website has more details on our regime: www.psr.org.uk/about-psr/psr-governance/senior-managers-regime.

Members of our board

Aspects of membership of the board are stipulated by FSBRA and, consistent with those requirements, the board currently comprises:

- the chair, appointed by the FCA with the approval of the Treasury
- two executive directors, including the managing director, who was appointed by the FCA with the approval of the Treasury
- five other members, who are all non-executive directors (NEDs), appointed by the FCA

Table 3: Directors and dates of service

Name	Original appointment date	Expiry of current term
Andrew Bailey Non-Executive Director	01/07/16	30/06/19
Carole Begent Executive Director – Head of Legal	01/07/15	30/06/18
Amelia Fletcher Senior Independent Director	01/04/14	31/03/19
Bradley Fried Non-Executive Director	01/04/16	31/03/19
Noel Gordon Non-Executive Director	01/05/16	30/04/19
John Griffith-Jones Chair	01/04/14	31/03/18
Hannah Nixon Executive Director – Managing Director	14/07/14	13/07/17*
Christopher Woolard Non-Executive Director	01/04/14	31/03/20

* The FCA, with approval of the Treasury, has extended Hannah Nixon's appointment for three years after her current term ends. The new term will expire on 13/07/20.

All directors are appointed for a three-year term. Andrew Bailey and Bradley Fried were appointed as NEDs with effect from 1 July and 1 April 2016 respectively. Noel Gordon also joined the board as an independent NED with effect from 1 May 2016.

In addition, a number of our board members' first terms of office come to an end in 2017. This includes Hannah Nixon, whose term of office is due to conclude on 13 July 2017. The FCA has extended, with approval of the Treasury, her appointment for a further term of three years when her current term expires. Amelia Fletcher's and Christopher Woolard's terms of office concluded on 31 March 2017. The FCA has agreed to renew each of their appointments: Amelia Fletcher for a further term of two years to align with her appointment as a director of the FCA, and Christopher Woolard for a further term of three years.

The FCA has extended, with approval of the Treasury, John Griffith-Jones' term as Chair until 31 March 2018, to align with his appointment as Chair of the FCA.

A majority of our board members are NEDs. Our NEDs bring a variety of skills and experience that are appropriate for the requirements of the PSR. All NEDS are considered independent. Amelia Fletcher was appointed as the Senior Independent Director with effect from 1 April 2016.

The board is committed to ensuring that diversity remains a central feature of its membership. It pays particular attention in the recruitment process to ensure the board consists of a variety of members with the appropriate balance of relevant skills and experience. Our female membership meets the 33% target figure for the boards of UK FTSE 350 companies proposed by the Hampton-Alexander review.

The executive members of the board have a continuous employment contract with the FCA, subject to notice periods set out in Table 4.

Table 4: Notice periods

Director	Notice period
Carole Begent	3 months
Hannah Nixon	6 months

Board meetings and activities of the board

There is a clear division of responsibility between the running of the board and the executive running of the organisation. John Griffith-Jones, as Chair, leads the board and ensures its effectiveness, and Hannah Nixon, as Managing Director, is responsible for developing and delivering the strategic objectives agreed with the board.

The board has a formal schedule of matters reserved to it, and meets regularly in order to discharge its duties effectively. It held eight meetings during the year and two additional meetings to deal with specific matters which required attention between scheduled meetings. Details of the number of meetings held and attendance at those meetings are set out in Table 5.

During the year, our NEDs met privately both with and without the Chair and without members of the executive present.

The Chair and Company Secretary ensure that the board's agendas are set in line with our priorities and review papers before they are circulated to members to ensure that information is accurate and clear. Papers for board and committee meetings are normally circulated one week before meetings.

Board members rigorously challenge each other on strategy, performance, responsibility and accountability to ensure that the decisions of the board are robust.

A record of the board's activities can be found in our published minutes on our website: www.psr.org.uk/about-psr/psr-governance/board-minutes.

Table 5: Attendance at board meetings

Name	Scheduled board meetings	Additional board meetings
Andrew Bailey	5/5	1/1
Carole Begent	6/6	2/2
Amelia Fletcher	6/6	2/2
Bradley Fried	5/6	2/2
Noel Gordon	6/6	2/2
John Griffith-Jones	6/6	2/2
Hannah Nixon	6/6	2/2
Christopher Woolard	5/6	2/2

Company Secretary and independent advice

Each director has access to the advice and services of the Company Secretary, who also advises the board on governance matters. The Company Secretary is also responsible for providing access to external professional advice for directors, if required.

Under FSBRA, we have the benefit of an exemption from liability in damages for anything done or omitted in relation to the exercise or purported exercise of our statutory functions. This is supplemented with indemnities given by the FCA for the protection of individual employees, including directors. Accordingly, we do not currently purchase Directors and Officers Liability Insurance.

Board induction and training

On joining the board, directors are given background information describing the PSR and our activities. Meetings are arranged with a range of key people from across the organisation on a structured basis to assist with induction. Members of the board also receive ongoing briefings on relevant issues.

During the year the Chair met individually with our NEDS to review their performance.

Board effectiveness

During the year, the board reviewed its composition with a view to ensuring its ongoing effectiveness. As a result, a process to recruit an additional NED was initiated in March 2017. An appointment is therefore expected later in the year.

Conflicts of interest

All directors are required to declare relevant interests, and where a potential conflict of interest arises during the year the board takes appropriate steps to manage it. The Company Secretary maintains a register of interests.

Governance and committee structure of the PSR

The PSR is a wholly owned subsidiary of the FCA. We share operational functions and operational support with the FCA via a service agreement, which is reviewed annually. All PSR staff are employees of the FCA. The functions of the PSR's Audit Committee, Nominations Committee and Remuneration Committee are carried out by the members of the relative FCA committee in the context of the group.

During the year, Ruth Kelly was Chair of the FCA Audit Committee and Baroness Hogg Chair of the FCA Remuneration Committee. The FCA Nominations Committee is chaired by John Griffith-Jones.

Information on the issues considered by the committees can be found in the FCA's annual report.

The board as a whole reviews the external risks to the PSR on a regular basis. The board reviewed our risk framework and approach, responsibilities and reporting mechanisms. Further information on the principal risks and uncertainties facing the PSR can be found in the financial overview (page 36).

Our website has more details on our governance arrangements:

www.psr.org.uk/corporate-governance-psr-limited

The PSR Panel

The PSR Panel (the Panel) is independent of the PSR. It contributes towards the effective development of our strategy and policy and offers advice and early input on our work.

The Panel comprises members drawn from payment system operators, payment service providers, infrastructure and technology providers, and service-users, including representatives of consumers and large and small businesses.

Competition Decisions Committee

The Competition Decisions Committee (CDC) acts as the decision-maker in any particular investigation arising where we propose to impose a sanction under the Competition Act 1998. In individual cases, a CDC Panel comprising three CDC members will be appointed to decide on behalf of the PSR on whether there has been a competition law infringement, whether to impose a penalty, and whether to give directions.

Enforcement Decisions Committee

The Enforcement Decisions Committee (EDC) acts as decision-maker in any particular investigation arising where we propose to impose a sanction under other legislation (for example, FSBRA or the Interchange Fee Regulation).

In individual cases, an EDC Panel comprising three EDC members will be appointed to decide on behalf of the PSR whether there has been a compliance failure and whether to impose a financial penalty and/or publish details of the compliance failure.

Remuneration report

Directors' remuneration (audited)

The table below sets out the remuneration paid or payable to any person that served as a director during the years ending 31 March 2017 and 2016. The remuneration figures shown are for the period served as directors.

The PSR follows the same remuneration principles as the FCA. Further information is available in the FCA's annual report.

	Basic salary		Performance-related pay		Other benefits		Total remuneration (excluding pension)		Pension		Total remuneration	
	2017 £'000	2016 £'000	**2017 £'000**	2016 £'000	**2017 £'000**	2016 £'000	**2017 £'000**	2016 £'000	**2017 £'000**	2016 £'000	**2017 £'000**	2016 £'000
Chairman												
John Griffith-Jones[5]	**–**	–	**–**	–	**–**	–	**–**	–	**–**	–	**–**	–
Executive Directors												
Hannah Nixon[1]	**222**	220	**36**	38	**24**	23	**282**	281	**22**	29	**304**	310
Carole Begent[1,2]	**155**	109	**16**	21	**21**	16	**192**	146	**16**	18	**208**	164

	PSR Fee Paid 2017 £'000	PSR Fee Paid 2016 £'000
Non-Executive Directors		
Andrew Bailey[4]	**–**	–
Amelia Fletcher[3,6]	**7**	–
Christopher Woolard[5]	**–**	–
Bradley Fried[3,6,7]	**7**	–
Noel Gordon[8]	**14**	–

1 Hannah Nixon and Carole Begent are members of the FCA Pension Plan. They chose to have £10,000 of their employer pension contribution paid into the Pension Plan, and the remaining employer contribution is paid as a non-pensionable cash supplement. The amount is included under 'Pension' in the table above.

2 Carole Begent was appointed to the PSR Board on 1 July 2015. Carole's full year equivalent salary for 2016 was £145,000.

3 The FCA is responsible for determining the remuneration of NEDs. The fee for NEDs has been set at £15,000 per annum for 2017, except for NEDs on both the FCA and PSR Board for whom the fee is £7,500 per annum. No fees were paid to NEDs prior to 1 May 2016.

4 Andrew Bailey was appointed as a NED of the PSR on 1 July 2016. Andrew does not receive a fee for this role. His full remuneration is included in the FCA Annual Report.

5 John Griffith-Jones and Christopher Woolard did not receive a fee for their NED roles on the PSR Board. Their full remuneration is included in the FCA Annual Report.

6 Amelia Fletcher and Bradley Fried received a fee of £6,875 for their role on the PSR Board. Their full remuneration is included in the FCA Annual Report.

7 Bradley Fried was appointed as a NED of the PSR on 1 April 2016.

8 Noel Gordon was appointed as a NED of the PSR on 1 May 2016.

The PSR board

John Griffith-Jones
Chairman

Hannah Nixon
Executive Director

Carole Begent
Executive Director

Andrew Bailey
Non-Executive Director

Amelia Fletcher OBE
Non-Executive Director

Bradley Fried
Non-Executive Director

Noel Gordon
Non-Executive Director

Christopher Woolard
Non-Executive Director

Financial statements

For the year ended 31 March 2017

Company Number: 8970864

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the Payment Systems Regulator for the year ended 31 March 2017 under the Financial Services (Banking Reform) Act 2013 (FSBRA). The financial statements comprise: the statements of comprehensive income, financial position, cash flows and changes in equity; and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union. I have also audited the information in the remuneration report that is described in that report as having been audited.

Respective responsibilities of the directors and auditor

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with FSBRA. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Payment Systems Regulator's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Payment Systems Regulator; and the overall presentation of the financial statements.

In addition I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Payment Systems Regulator's affairs as at 31 March 2017 and of the surplus for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by European Union;
- the financial statements have been properly prepared in accordance with the Companies Act 2006

Opinion on other matters

In my opinion:

- the parts of the remuneration report to be audited have been properly prepared
- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements and these reports have been prepared in accordance with the applicable legal requirements
- in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the strategic report or the directors' report

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff, or
- the financial statements and the part of the remuneration report to be audited are not in agreement with the accounting records and returns, or
- I have not received all of the information and explanations I require for my audit, or
- the governance statement does not reflect compliance with relevant guidance

Report

I have no observations to make on these financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General

Date: 27 June 2017

National Audit Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Statement of comprehensive income for the year ended 31 March

	Notes	**Total 2017 £'000**	Total 2016 £'000
Income			
Fee income		10,208	28,101
Other income		48	10
Total income	**4**	**10,256**	**28,111**
Operating costs			
Staff costs	5	(7,087)	(6,601)
Administrative costs	6	(3,795)	(3,960)
Total operating costs		**(10,882)**	**(10,561)**
Total comprehensive (loss)/surplus for the year		**(626)**	**17,550**

Statement of changes in equity for the year ended 31 March

	£'000
At 1 April 2015	(11,533)
Total comprehensive surplus for the year	17,550
At 1 April 2016	**6,017**
Total comprehensive loss for the year	(626)
At 31 March 2017	**5,391**

Statement of financial position for the year ended 31 March

Company Number: 8970864

	Notes	**Total 2017 £'000**	Total 2016 £'000
Current assets			
Cash and cash equivalents	7	13,280	7,539
Trade and other receivables	7	25	10
Total assets		**13,305**	**7,549**
Current liabilities			
Trade and other payables	8	(7,082)	(865)
Intragroup payable	8	(832)	(667)
Total liabilities		**(7,914)**	**(1,532)**
Total assets less total liabilities		**5,391**	**6,017**
Accumulated surplus		**5,391**	**6,017**

The financial statements were approved and authorised for issue by the board on 21 June 2017, and were signed on 23 June on its behalf by:

John Griffith-Jones Chairman

Hannah Nixon Managing Director

Statement of cash flows for the year ended 31 March

	Notes	**Total 2017 £'000**	Total 2016 £'000
Net cash generated by operating activities	**3**	**5,695**	**7,658**
Investing activities			
Interest paid on borrowings		–	(130)
Interest received on bank deposits		46	10
Net cash generated/(used) in investing activities		**46**	**(120)**
Net increase in cash and cash equivalents		**5,741**	**7,538**
Cash and cash equivalents at the start of the year		7,539	1
Cash and cash equivalents at the end of the year		**13,280**	**7,539**

Notes to the financial statements

1. General information

The Payment Systems Regulator (PSR) was incorporated in the United Kingdom under the Companies Act 2006 on 1 April 2014 as a private company, limited by shares (a single share with a £1 nominal value, wholly owned by the Financial Conduct Authority (FCA)). The nature of the PSR's operations is set out in the financial overview.

The registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS.

The financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the PSR operates.

2. Core accounting policies

a. *Basis of preparation*

The financial statements have been prepared on a going concern basis, under the historical cost convention in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The principal accounting policies applied in preparation of the financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

b. *Changes in accounting policy*

There are no new or amended IFRS or International Reporting Interpretations Committee (IFRIC) interpretations that have been adopted.

c. *Retirement benefit costs*

Money Purchase Section (defined contribution)

The PSR is a member of the Money Purchase Section of the FCA Pension Plan, a defined contribution plan where the company pays contributions at defined rates to a separate entity.

Payments to the Money Purchase Section of the Plan are recognised as an expense in the statement of comprehensive income, as they fall due. Prepaid contributions are recognised as an asset to the extent that a cost refund or a reduction in future payments is available.

3. Notes to the cash flow statement

	Notes	**Total 2017 £'000**	Total 2016 £'000
(Loss)/surplus for the year from operations		(626)	17,550
Adjustments for:			
Interest received on bank deposits		(46)	(10)
Interest payable on borrowings		–	130
Operating cash flows before movements in working capital		**(672)**	**17,670**
Increase in receivables	7	(15)	(10)
Increase/(decrease) in payables	8	6,382	(10,002)
Net cash used by operations		**5,695**	**7,658**

4. Income

FSBRA enables the FCA to raise fees on behalf of the PSR to recover the costs of carrying out its statutory functions. Fee income represents the annual periodic fees receivable for the financial year and is recognised in the year it is levied and measured at fair value.

	Total 2017 £'000	Total 2016 £'000
Fee income	10,208	28,101
Interest on bank deposit	46	10
Other income	2	–
Total income	**10,256**	**28,111**

5. Staff information

	Total 2017 £'000	Total 2016 £'000
Gross salaries and taxable benefits	4,816	4,041
Employer's national insurance costs	565	479
Employer's defined contribution pension costs	413	361
Permanent staff costs	**5,794**	**4,881**
Temporary	–	5
Secondees	–	21
Contractors	1,293	1,694
Short term resource costs	**1,293**	**1,720**
Total staff costs	**7,087**	**6,601**

The average number of full-time-equivalent employees (including executive director and fixed-term contractors) during the year 31 March 2017 was 58 (2016: 44).

As at 31 March 2017, there were 60 (2016: 52) full-time-equivalent employees and 11 (2016: 11) short-term resources.

6. Administrative costs

The administrative costs for the period ending 31 March 2017 have been arrived at after charging the following:

	Total 2017 £'000	Total 2016 £'000
Professional fees	1,248	1,107
Accommodation and office services	798	683
Travel, training and recruitment	642	750
FCA staff recharges	634	803
IT costs	391	479
Other non-staff costs	82	138
Total	**3,795**	**3,960**

Auditors

The Comptroller and Auditor General was appointed as auditor on 1 April 2014 under FSBRA. The auditor's total remuneration for audit services is set out below:

	Total 2017 £'000	Total 2016 £'000
Fees payable to the National Audit Office for the audit of the financial statements	22	22

7. Current assets

	Total 2017 £'000	Total 2016 £'000
Cash at bank	10,280	7,539
Cash deposits	3,000	–
Cash and cash equivalents	**13,280**	**7,539**
Prepayments and accrued income	25	10
Total current assets	**13,305**	**7,549**

Cash and cash equivalents comprise cash and short-term fixed-rate bank deposits with a maturity date of 12 months or less. The carrying amount of these assets approximates to their fair value.

8. Current liabilities

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

	Total 2017 £'000	Total 2016 £'000
Fees in advance	6,080	–
Trade creditors and accruals	1,002	865
Trade and other payables	**7,082**	**865**
Intragroup payable – FCA	832	667
Total current liabilities	**7,914**	**1,532**

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade payables is 33 days (2016: 24).

Intragroup payable is based on a provision of services agreement between the FCA and PSR which sets out the services that are supplied and their respective costs. These costs are based on charges the FCA incurs without margins.

9. Related party transactions

Remuneration of key management personnel

	Total 2017 £'000	Total 2016 £'000
Short-term benefits	518	300

There are no held directorships or other transactions with key management personnel in either year.

Transactions with the FCA

Included in administrative costs is the operational support provided by the FCA through a provision of services agreement. This aims to maximise value from the FCA's existing resources and infrastructure, enabling the PSR to operate efficiently and effectively. The PSR is co-located in the FCA's building. Summarised as:

	Total 2017 £'000	Total 2016 £'000
Accommodation and office services	782	680
Staff costs	634	592
IT costs	351	302
Other costs	202	47
Interest on borrowings	–	130
	1,969	**1,751**

As at 31 March 2017, the inter-company payable due from the PSR to the FCA is £0.8 million (2016: £0.7 million) as set out in note 8 above.

10. Events after the reporting period

There were no material events after the reporting period.

FINANCIAL CONDUCT AUTHORITY
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