Title: The Regulation of Payments Networks **IA No:** n/a **Lead department or agency:** HM Treasury **Other departments or agencies:**	**Impact Assessment (IA)**
	Date: 12/05/2012
	Stage: Development/Options
	Source of intervention: Domestic
	Type of measure: Primary legislation
	Contact for enquiries: Graham Hunt, HM Treasury 020 7270 4326

Summary: Intervention and Options

RPC Opinion: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
-£21.2m	-£5.16m	£0.53m	Yes	IN

What is the problem under consideration? Why is government intervention necessary?

The regulation and governance of payment networks does not enable them to respond to current and future challenges in the most effective way. Given the fundamental importance of the money transmission system to the economy, any inefficiency has a significant impact on economic welfare. The Government has accepted the recommendations of the Treasury Select Committee to extend regulation in this area, so that decisions that affect everyday users of payment services, for example, a decision to phase out cheques, takes account of their interests.

What are the policy objectives and the intended effects?

The Government considers that there are weaknesses in the current governance and decision-making process of UK payment networks, and that these weaknesses present obstacles to the realisation of the Government's vision for the future of the payments industry.

The Government wants the UK to have world-class payments networks that are stable, reliable and continuously improving, and which meet the needs of payment service providers, business-users and individuals for the benefit the wider economy.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1 is to seek to work with the grain of the current self-regulatory structure. This entails seeking to negotiate voluntary changes to the governance and operation of the industry-run Payments Council.

Option 2 is to create a new public sector body to coordinate payments strategy and make recommendations to the payments industry. It would work closely with the payments industry to realise the Government's vision and ensure that the needs of end-users are taken fully into account. This is the preferred option;

Option 3 is to create a new utility-style regulator to license and oversee the development of payment systems and services, and full powers of direction extending to infrastructure investment and wholesale pricing. There is no 'do-nothing' option, however doing nothing represents a zero baseline.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 11/2012

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro No	< 20 No	Small No	Medium Yes	Large Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			Traded: N/A		Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: M Hb Date: 14 5 12

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -4.33

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional	1	Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0.03		0.48	**4.33**

Description and scale of key monetised costs by 'main affected groups'

The main costs are incurred by seeking to broaden the industry membership of the Payments Council by around 250 more firms, and effecting changes to improve transparency and accountability. The main affected groups are those who will have an increased say in the governance of the Payments Council, including new associate members of the Payments Council, and an observer seat for the Financial Conduct Authority.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	n/a		n/a	**n/a**

Description and scale of key monetised benefits by 'main affected groups'

There are qualitative benefits (see below) that cannot be quantified. In view of the massive volume and value of payments handled by payment networks, which is measured in trillions of Pounds (see table 1.1 in the evidence base) the smallest marginal improvement in efficiency or effectiveness will have significant economic welfare benefits.

Other key non-monetised benefits by 'main affected groups'

The principal benefit is that the Payments Council will become a more representative and publicly accountable body. The governance of payments networks will be strengthened and better progress can be expected in driving forward or promoting innovation.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: 0.47	**Benefits:** n/a	**Net:** -0.47	No	OUT

Summary: Analysis & Evidence

Policy Option 2

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: -19.05	**High:** -21.19	**Best Estimate:** -21.19

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	2.20	1	1.87	**19.05**
High	2.45		2.08	**21.19**
Best Estimate	2.45		2.08	**21.19**

Description and scale of key monetised costs by 'main affected groups'

The costs relate mainly to the creation of a new public sector body, including the cost of new staff and supporting infrastructure, The new body will be funded by an annual levy on firms in the payments industry.

Other key non-monetised costs by 'main affected groups'

There will be some additional costs to business from further reporting to the new body.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	n/a		n/a	**n/a**

Description and scale of key monetised benefits by 'main affected groups'

There are substantial qualitative benefits (see below) that cannot be quantified. In view of the massive volume and value of payments handled by payment networks, which is measured in trillions of Pounds (see table 1.1 in the evidence base) the smallest marginal improvement in efficiency or effectiveness will have significant economic welfare benefits.

Other key non-monetised benefits by 'main affected groups'

Weaknesses in current Payments Council model of self-regulation will be removed. Decisions on how to develop payment systems and services will be subject to external oversight by an independent body for the first time. The measures will generate qualitative benefits to the payments industry and to end users through better prioritisation of development projects, and ensure that any barriers to entry and competition are addressed.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5

As this option is the preferred option, optimism biases, ranging from 5% to 15%, have been applied to guard against the tendency to make overoptimistic estimates of costs. These inform the low and high estimates.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: 0.53	**Benefits:** n/a	**Net:** -0.53	No	OUT

Summary: Analysis & Evidence

Policy Option 3

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -77.27

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	1	Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	9.19		7.56	**77.27**

Description and scale of key monetised costs by 'main affected groups'

The key costs arise from the setting up of a new regulator, licensing and compliance costs for firms and ongoing administrative costs. The regulator's costs will be funded by an annual levy on regulated firms.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	n/a		n/a	**n/a**

Description and scale of key monetised benefits by 'main affected groups'

There are substantial qualitative benefits (see below) that cannot be quantified. In view of the massive volume and value of payments handled by payment networks, which is measured in trillions of Pounds (see table 1.1 in the evidence base) the smallest marginal improvement in efficiency or effectiveness will have significant economic welfare benefits

Other key non-monetised benefits by 'main affected groups'

Weaknesses in current Payments Council model of self-regulation will be removed. Decision-making and collaboration between payment service providers and payment systems will be subject to external audit and direction by the regulator. Effective regulation will constrain the ability of the bigger banks to use payment systems as barriers to entry to downstream activities. These measures will generate substantial qualitative benefits to the industry and to end users, and competition oversight.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0.67	**Benefits:** n/a	**Net:** -0.67	Yes	IN

Evidence Base (for summary sheets)

Evidence base

"Competition in retail banking: A report to the Chancellor of the Exchequer". Don Cruickshank. March 2000.
"Final report of the Payment Systems Task Force". OFT. February 2007.

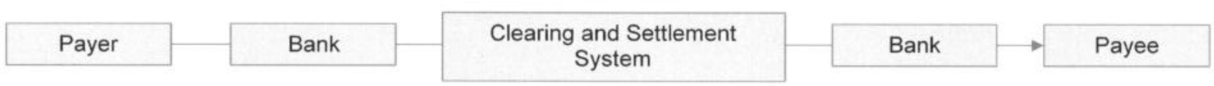
"Review of the operations of the Payments Council: A follow-up to the work of the Payment Systems Task Force". OFT. March 2009.

"The future of cheques: Eighteenth Report of Session 2010–12 Volume I: Report, together with formal minutes, oral and written evidence". Treasury Select Committee. HC 1147 24 August 2011.

"The future of cheques: Government and Payments Council Responses to the Eighteenth Report from the Committee Twenty–third Report of Session 2010–12". Treasury Select Committee. HC 1645. 16 November 2011.

Background: Payment networks

The money transmission system can be considered in the same way as any public infrastructure like water, gas and electricity distribution. The mechanisms by which money is transmitted between payers and payees are known as payment systems and the whole end-to-end process constitutes the payments network.



The Government is considering how to enhance the ability of the payments industry to deliver the type of payments networks that the Government would like to see in the UK. This impact assessment is concerned with payment networks in the UK, and how they respond to the changing needs of the UK economy. The principal networks depend on rules and clearing and settlement systems run by:

- The LINK interchange network for ATM transactions;
- Plastic card schemes for debit, credit, prepaid and charge cards;
- BACS, for bulk transfers like direct debits and standing orders;
- CHAPS for large value payments;
- Faster payments – for automated real time electronic payments;
- The Cheque and Credit Clearing Company – for cheques and paper credits.

The scope of the proposals does not therefore extend to commercial trading platforms, like CREST.
There are other niche players providing retail money transmission services to UK customers. They include, for example, money remitters and bill payment service providers. As these operators account for a very small proportion of money transmission in the UK (under 0.5%) they are not considered further in this impact assessment.
In 2010, the principal payment networks handled the following volume and value of payment transactions (table 1.1):

Table 1.1

Volume and Value of payment transactions in 2010		
	Volume Bn. transactions	Value £ billion
Interbank clearing (BACs, CHAPs, Faster Payments and cheques)	6.97	66,609.4
Plastic cards	11.6	651.0
ATM withdrawals	2.8	185.8
Source: UK Payment Statistics. Payments Council. 2011. Tables 1.1; 6.2; 6.3 and 22.1		

What is the problem under consideration?

There has been a long standing view among stakeholders in the payments industry that the Payments Council, the strategy setting body for the payments industry, is not working optimally. These concerns were brought into the spotlight when the Payments Council took the decision to abolish cheques. Considerable concerns were raised that this would have a disproportionate impact on older people and small businesses, including charities, which continued to use cheques.

In its report on the future of cheques[1], the Treasury Select Committee said "The Payments Council is an industry-dominated body with no effective public accountability. It should not have unfettered power to take decisions on matters, such as the future of cheques that are of vital personal importance to millions of people. The Treasury should make provision in the forthcoming Financial Services Bill to bring the Council formally within the system of financial regulation."

The Payments Council is currently the body that sets the strategy for UK payments. The Payments Council is a voluntary membership body, with payment service providers reaching threshold volumes of payments eligible for full membership. The Payments Council also offers associate membership (at lower cost, but with correspondingly fewer rights) to organisations with an interest in the payments industry.

In its response to the Treasury Select Committee's report on the future of cheques[2], the Government broadly accepted the Treasury Select Committee's recommendation. Setting the strategy for the future path of payments networks is assuming increasing importance because the payments landscape is changing more quickly than at any time in the past. Payment networks must anticipate and respond to the growing demands of the economy, particularly for new digital services, and to new competitors that are throwing up new challenges to incumbents. The needs of the end-users of payment services (the public, private and third sectors and individuals) continue to expand and evolve. Strategy setting and the future development of payments networks (where collaboration between the participants is essential) must be put in a condition to satisfy these diverse needs and wants; and they must take into account the interests of all constituencies when taking strategic, wide reaching and long term decisions.

The Government therefore wants to place the regulation and governance of payment networks on a footing that will enable payment networks to respond to current and future challenges in a more effective way for the benefit of individuals, businesses and the economy as a whole.

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[1] "The future of cheques: Eighteenth Report of Session 2010–12 HC 1147 24 August 2011

[2] The future of cheques: Government and Payments Council Responses. Twenty–third Report of Session 2010–12. HC 1645

The Case for Change

The Government considers that there are weaknesses in the current governance and decision-making process of UK payment networks, and that these weaknesses present obstacles to the realisation of the Government's vision for the future of the payments industry.

The Government wants the UK to have world-class payments networks that are stable, reliable and continuously improving, that meet the needs of payment service providers, business-users and consumers, and benefit the wider economy. The Government wants to;

- respond to the governance and decision-taking problems identified by the Treasury Select Committee;
- help meet the growing demands of payments end-users; and
- support the UK's competitive advantage in the internet economy, which is expected to grow at an annual rate of 11 per cent, compared with a projected 5.4 per cent in the US, 4 per cent in Germany and 3.4 per cent in France[3].

There are two key areas of concern that need to be addressed:

(i) The independence of the Payments Council and the responsiveness of payment networks to the needs of their users.

The Treasury Select Committee has said that: "The Payments Council is dominated by the banks and other payment industry members . . . Consumers are entitled to be suspicious of the motives of a body with such a composition proposing measures that are in the financial interests of its members." The Government agrees with the TSC's findings that the voice of payment service users, including consumers, should be given greater weight in setting the strategic direction of payment networks. They have a major stake in strategic decisions about the future development of the payments industry. The Government would also like to see a greater range of players, including challenger banks, smaller institutions and innovative, non-bank players helping to shape future strategy to a greater extent than they currently do;

(ii) Decision-making and collaboration

the Government is concerned that the governance of payments networks has not been as effective as it could have been in driving forward or promoting innovation, when institutions have to collaborate in the development of payment systems and services. There are a number of reasons for this. The Payments Council currently works by consensus which slows development, and has no effective enforcement mechanisms once decisions have been taken. In practice this means that one or two institutions that oppose or are slow in complying with a decision can hold up progress for the rest of the industry. Slow progress can be a significant cause of detriment for end-users and the economy as a whole. Funding for specific development projects can also pose difficulties. For example, much Payments Council funding is on a short term footing which may make long term project planning more difficult.

The Government considers that together these areas of concern, highlighted by the Treasury Select Committee, present a strong case for reforming the governance of payment networks, and the operation and structure of the Payments Council. In particular, that there is a case for bringing the strategy setting functions currently undertaken by the Payments Council under regulation.

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[3] Boston Consulting Group

Policy options

Option 1 is to seek to work with the grain of the current self-regulatory strategy setting structure. This entails seeking to negotiate voluntary changes to the governance and operation of the industry-run Payments Council. The potential changes are set out in the assessment of costs and benefits section for option 1 below.

Option 2 is to create a new public sector body to coordinate payments strategy and make recommendations to the payments industry. It would work closely with the payments industry to realise the Government's vision and ensure that the needs of end-users are taken fully into account. This is the preferred option;

Option 3 is to create a new utility-style regulator to license and oversee the development of payment systems and services, and full powers of direction extending to infrastructure investment and wholesale pricing.

There is no 'do-nothing' option, however doing nothing represents a zero baseline for this impact assessment.

Option 1:

Self-regulatory: negotiate voluntary changes to the governance of the industry-run Payments Council

Summary

Table 1.1

Summary of option 1 nominal costs		(£000)	
Measure		Transitional cost	Ongoing annual cost
(i)	Address conflicts of interest	0	0
(ii)	New remit	0	0
(iii)	Transparency, accountability	25	25
(iv)	Board changes (FCA costs)	6	6
(v)	Funding model	0	0
(vi)	User councils	0	0
(vii)	Powers	0	0
(viii)	Broader membership	0	535
Total		31	566
The PV of these costs discounted over 10 years at 3.5% is shown in the summary page for option1 Transitional costs include any costs incurred in year 0.			

Background

Option one sets out the changes that could be carried out within the existing self-regulatory governance framework. It presents a non-legislative solution that would maintain a high degree of self-regulation while delivering substantial improvements and avoiding new regulatory burdens on business. The Government would seek to agree some or all of these changes with the Payments Council and the wider payments industry on a voluntary basis.

The changes would aim to reconstitute the Payments Council to make it more independent from the big banks, more responsive to end users, and better able to develop and take forward its own agenda.

Reforming the Payments Council – costs and benefits

The Government would expect a reformed Payments Council to have a new constitution. This is needed in order to carry out fundamental structural changes to:

(i) Address conflicts of interest within the Payments Council

by separating out the Payments Council's dual roles as both a strategy setting body for the payments industry and a trade body. In practice, many technical functions (such as work on common standards) are predominantly directed at the Payments Council's members. It is not envisaged that these need to be separated out, as they are not thought to generate conflicts of interest. The functions that potentially need to be separated out are those that create, or may give the appearance of, a potential conflict of interests. These would include dual roles undertaken by Payments Council officers in other trade bodies and institutions, common directorships, and external representation by the press office where there is a lack of clarity over when the Payments Council is representing its own views as an independent strategy setting body or promoting the industry's interests as a trade body. This would strengthen the Payments Council's role as an independent strategy-setting body. This separation could be achieved by a clearer functional separation of roles, reporting lines and accountability within the Payments Council, removing the present conflicts of interest. The Government will invite views on this and then seek to negotiate any necessary changes with the Payments Council and its members.

Cost:

- Reassigning roles within the Payments Council, and relinquishing common directorships that may generate a conflict of interest is a straightforward one-off transfer cost. There are no ongoing costs once the posts have been reassigned. The posts will be filled by alternates or alternative industry representatives at no extra ongoing costs (they are unlikely to be advertised for example). The one-off transition costs can be minimised by an appropriate transition period and succession planning. The appointment costs are therefore negligible. The net one-off cost is therefore near zero. There are no ongoing costs;

(ii) Set a new remit.

A new remit and focus for the Payments Council should support the Government's vision that the UK should have world-class payments networks that are stable, reliable and continuously improving, that meet the needs of payment service providers, business-users and consumers, to the benefit of the wider economy. The Government will invite views on this and may then seek to negotiate any necessary changes with the Payments Council and its members.

Cost

- The updated remit is an evolution of the present remit. It is predicated on no increase in costs. All projects would need to pass a cost benefit test, as they do now. The effect will be to give greater weight to prioritising economically desirable development projects that meet the needs of end-users. The net one-off cost is therefore nil. There are no ongoing costs.

(iii) Improve transparency and accountability

The Payments Council should be open, transparent and accountable. It should publish reports annually on progress against its objectives and undertake regular, independent performance reviews. The Government will invite views on this and may then seek to negotiate any necessary changes with the Payments Council and its members.

Cost

- The Payments Council already publishes Board agendas and minutes, and a National Payments Plan, together with reports on specific work streams. The principal change envisaged here is that the Payments Council will also commission external reviews of its performance, Based on the costs of the Payment Council's own internal review in 2012, the net costs of an independent annual performance review will be £25,000 pa. This would be an initial and on-going annual cost.

(iv) Changes to the board of the Payments Council

The Financial Conduct Authority could be invited to take an observer seat on the board of the Payments Council, alongside the Bank of England, which already sits on the board as an observer. The members of the Payments Council would continue to make board appointments, but the FCA or the Bank of England should be able to raise concerns before a board decision, if necessary.

The Government will also invite views on whether the composition of the Payments Council board, voting powers and strengths needs to be updated (for example whether non-executive directors might be empowered to block decisions more easily, and whether the board membership criteria ensure a representative mix of interests). It may then seek to negotiate any necessary changes with the Payments Council and its members.

<u>Cost:</u>

- Changes to the composition of the Payments Council are cost neutral. They would be phased in over a transition period through careful succession planning.

- The cost of attendance at board meetings by a mid-level FCA representative is likely to be around:

  Attendance 1 x 0.5 days per month + 0.25 days preparation/ follow-up work per month = 9 days pa at the FCA all-in costs of a senior level manager of c£500 per day <u>= £4,500 pa</u>

- The costs to the Bank of England of seeing and approving board appointments and other papers is assumed to be zero, on the basis that the Bank of England already reviews this information.

- The costs to the FCA of seeing and approving board appointments (estimated at 1 per year) and corporate strategy papers (12 per year), based on the daily wage of one FCA associate of £125 is estimated at 13 days pa x £125 <u>= £1,625 pa</u>

- The total costs (£4,500 + £1,625 = £6,125 pa) are rounded to £6,000 in the costs summary table 1.1. This represents the opportunity cost to the FCA of expending resources on this activity compared to other activities.

(v) Funding

The funding of the Payments Council is agreed between it and its members. However, the Government believes that there is a case for replacing the existing ad hoc annual funding model with sustainable, long term funding arrangements consistent with the Payments Council's role as a long term strategy body undertaking long term projects. Stable funding, and control of budgets, is also critical for the independence of a reformed Payments Council. The Government will therefore invite views on whether and how the funding of administration and development budgets can be put on a long term independent basis, and how and on whom this should be levied, for example, whether the Payments Council should have a three or five year funding settlement, and whether it should have greater powers to borrow to fund developments. It may then seek to negotiate any necessary changes with the Payments Council and its members.

<u>Cost:</u>

- This measure is likely to produce administrative savings, as the annual budget round will be placed on a sustainable long term basis. However, it is difficult to estimate this prior to the conclusion of the consultation, and this assessment therefore assumes that the measure will be <u>cost neutral.</u>

(vi) User councils

The Payments Council currently has three "user forums" , chaired by Non-Executive Directors, to consult payments end users such as businesses and individuals on specific questions put to them. The Government considers that the role and functioning of the user forums could be significantly enhanced to better represent end-user interests and views. The Government envisages that existing user forums could be developed into more independent User Councils or groups. User Councils should be able to set their own agendas and work programmes as well as developing their own strategic views on payments to feed into Payments Council board decisions. The Government will invite views on this and may then seek to negotiate any necessary changes with the Payments Council and its members.

Cost

- The current budget for existing user forums is in the region of £250,000 pa. There is expected to be no increase in the budget as a result of this measure, but instead a redeployment to more independent user councils which will have more control over the budget. The net one-off and ongoing costs cost are therefore nil.

(vii) Powers

Full members of the Payments Council currently agree to be bound by its rules and decisions, unless they have been granted a specific waiver. Some payment schemes also contract with the Payments Council and are also bound to accept its decisions. However, there are no sanctions for failing to comply, short of expulsion. This forces the Payments Council to operate by consensus, with concomitant delays and blockages of proposals. The Government will invite views on how a reconstituted Payments Council could be given the means to enforce majority decisions more effectively.

Cost

- The net one-off and ongoing costs cost are nil;

(viii) Membership of the Payments Council

The membership base of the Payments Council should be broadened to ensure that it is representative of all its stakeholders. It should also be opened to payment service users and organisations with an interest through the creation of different categories of membership. The Government is consulting on how the membership base can be broadened most effectively and may then seek to negotiate any necessary changes with the Payments Council and its members.

Cost

- 30 credit institutions are currently full members of the Payments Council. The population of eligible financial institutions (as at April 2012) is:

Table 1.2

Eligible financial institutions	
Name	No
Authorised credit institutions	441
Authorised payment institutions	183
Authorised electronic money institutions	18
Total	642

This data excludes an additional 1,450 small financial institutions that are also eligible for membership, but are likely to wish to be excluded from membership, or may wish to be represented by another body. This is because many of these firms are sole traders or employ very few people. They do not have the resources to participate effectively.

New voting members are likely to pay subscriptions in the region of £20,000 pa (based on the current rates for voting members with a relatively low level of payments business compared to the big five banks). New associate members (a non-voting category of membership) currently pay subscriptions of £3,500. This assessment assumes that an increase in the number of members would raise the Payments Council's costs, and that those costs would be met by subscriptions payable at the current rates. This is a very conservative assumption which does not recognise that membership fees per firm may fall as the number of members rises.

It is not possible to estimate with any certainty what the potential take up of membership by financial institutions might be, though many may find that the benefits of membership increase if the Payments Council were to undertake these changes.

The Government believes a realistic target is for between 10% to 40% of the current population of large financial institutions to find it in their interests to join a reconstituted Payments Council. This suggests that the potential number of additional members (total population less current members) is in the region of:

> Potential number of new members:
> Lowers bound 612 x 10% = 61;
> upper bound 612x 40% = 245
>
> The additional costs of membership are therefore in the region of
> 61 x £3,500 = £213,500
> 245 x £3,500 = £857,500
> Midpoint = £535,500 (in the summary cost table 1.1)

These costs are assumed to arise after year 1, once governance and other changes have been made, and a membership drive undertaken. They are annual ongoing costs. Other bodies that are not financial institutions may also wish to join. It is expected that a new category of associate (non-voting) membership can be offered to them free.

BENEFITS

The benefits of option 1 are that it delivers on many of the Government's objectives:

i) It responds to the governance and decision-taking problems identified by the Treasury Select Committee. The Payments Council will become a much more representative body, able to represent the views of the industry more effectively than at present;

ii) It will also be better able to demonstrate that it takes the interests of all its stakeholders into account. For example, updating the Board structure and voting powers, and upgrading the user forums will make it be less likely that decisions on matters, such as the future of the cheque, that are vitally important to millions of people, can be made without adequate consultation;

iii) the governance of payments networks will be strengthened, for example by removing conflicts of interest and reconstituting the Payments Council's Board;

iv) better progress can be expected in driving forward or promoting innovation, when institutions have to collaborate in the development of payment systems and services. This will help to meet the growing demands of payments end-users. However there is a question mark over how far this agenda can be driven

These are qualitative benefits that cannot be quantified. In view of the massive volume and value of payments handled by payment networks, which is measured in trillions of Pounds (table 1.1) the smallest marginal improvement in efficiency (for example, more timely decision making by the Payments Council) or effectiveness will have significant economic welfare benefits.

Equalities Impact

It is not proposed to seek any changes that may extend or reduce the scope of the work that the Payments Council does on financial inclusion. The equality impact from the proposed voluntary, self-regulatory changes is neutral.

Small firms

1,450 small financial institutions are eligible for Payments Council membership, but are likely to wish to be excluded from membership, or may wish to be represented by another body. This is because many of these firms are sole traders or employ very few people. They do not have the resources to participate effectively. There are therefore negligible cost implications for small firms.

Competition

The Payments Council's activities are focused on the non-competition space where firms must collaborate to ensure that payments can flow across accounts held by different firms (the interoperability of payment networks). It does not have a competition remit, but it must have regard to competition law when formulating payments strategy, and it has made clear that its decisions must not impede competition. Option 1 does not therefore have an impact on competition.

Option 2

Advisory: create a new public sector body (the Payments Strategy Board) to coordinate payments strategy and make recommendations to the payments industry.

This is the preferred option.

The Government may also implement this option together with some or all of the voluntary changes in option 1. As no decisions have been taken about this, however, and it is subject to consultation, option 2 is considered as a free standing option in this impact assessment.

Table 2.1

Summary of option 2 nominal costs		(£000)
	Transitional	Ongoing annual
Staffing, training	1,000	915
Accommodation	315	315
IT	30	15
Firms costs	600	600
FCA, HMT's costs	250	370
Total	2,195	2,215
The present value of these costs discounted over 10 years at 3.5% is shown in the summary page for option 2		

Background

This option seeks to secure the Government's policy objectives by creating a new strategy setting, public sector, body - the Payments Strategy Board. The Board would act as an advisory body to monitor, report on and make non-binding recommendations to the payments industry (defined as the payments systems and their direct and indirect participants such as banks and building societies, payment service providers and electronic money institutions).These recommendations would be made public and the payments industry would need to accept them or demonstrate why they could not be implemented. This would bring decision-making into the open. The Payments Strategy Board would also report on, and hold the industry to account for its decisions and performance.

The Payments Strategy Board would be led by a part-time board composed of a balance of senior industry and non-industry figures, and independent directors. The Bank of England and the Financial Conduct Authority may also be invited to sit on the board as non-voting observers. The board would be supported by a small permanent staff with advisers brought in on short term contracts when necessary. The exact make-up of the Board and decision making process is subject to consultation.

The Government will also consult on whether the Payment Services Board should have an information gathering power.

This option moves away from the self-regulatory model in option one. The Financial Conduct Authority would be responsible for establishing the Payments Strategy Board, making appointments, overseeing its governance and funding, and ensuring that the Board was capable of exercising its functions. The Board's budget would be funded through the Financial Conduct Authority's annual levy on a specified class of firms that would include payment systems, and firms participating in payment systems. The FCA would have the power to approve the Payments Strategy Board's budget and fees levied on relevant firms. The FCA would also be responsible for approving the Board's annual business plan. The Payments Strategy Board would be consolidated in HM Treasury's accounts for Parliamentary reporting purposes.

Optimism bias

As this is the Government's lead option, it is important to ensure that optimism bias does not make the costs and benefits appear more favourable than merited. When considering this option, the costs have been broken down into confidence levels. Where there is high confidence in the accuracy of the costs, they have been increased by 5% to correct for any optimism bias, and by 15% for estimates where there is less confidence. The range of 5-15% has been selected on the basis that there is a reasonable level of certainty, based on recent experience of setting up other bodies, such as the Money Advice Service, the Office of Budget Responsibility and others.

Table 2.2 compares the nominal costs of option 2 and the costs adjusted for optimism bias. The average ongoing annual optimism bias is around 11%. Extended over a 10 year period, including the transitional costs in year 0, the numbers in table 2.2 suggest an average annual cost of £2,119,000 adjusted for optimism bias, compared to £1,905,000 without bias – or a 10 year average bias of around 11.3%.

Table 2.2

Nominal ten year cost estimates adjusted for optimism bias				(£000)
	Transitional	Ongoing annual	Transitional	Ongoing annual
	Steady state		*Adjusted for optimism bias*	
Staffing	1,000	915	1,100	1,007
Accommodation	315	315	362	362
IT	30	15	32	16
Firms' costs	600	600	690	690
FCA, HMT costs	250	370	263	389
Total	2,195	2,215	2,447	2,464

<u>Costs</u>

The main additional costs of establishing a Payments Strategy Board are:

(i) transitional administrative set-up costs for the new body;

(ii) ongoing administrative costs for the new body;

(iii) ongoing compliance costs for firms.

(i) Transitional set-up costs for the Payments Strategy Board

The costs incurred in setting up the PSB will be recovered through the FCA's fee structure, payable through an annual levy on a specified class of firms that would include payment systems and firms participating in payment systems. It is assumed that the payment systems, and their participants, that will be fall within the scope of the Payments Strategy Board will be LINK; BACs; Cheque and Credit Clearing; CHAPS, Faster Payments and the card schemes like Visa and MasterCard.

In the short run, the transition period will involve some expense to the FCA on staff recruitment, accommodation and IT systems. There would need to be a small interim office established with secondees from public administrations and the private sector to prepare the way for the launch. Longer term resource requirements will depend on the evolution of the Board.

This is a consultation stage impact assessment only and many uncertainties regarding the final shape and structure of the PSB remain to be clarified as a result of the consultation. Subject to that, the main year 1 cost elements are estimated to be:

Staffing

A part time Chair and 10-15 part-time board members meeting for two days per month, supported by around 10 -15 full time staff, composed primarily of industry experts and researchers, with some legal and admin support. Staff numbers would necessarily fluctuate year on year depending on the work program. The Board may instead decide to employ consultants to carry out research and give advice. As the work programme cannot be known at present, it is assumed that the budget arising from the estimated staff costs may be spent in other ways of generating analysis and advice, but that this is not expected to exceed the costs represented by the proposed structure, and estimated staff costs, which should be considered as the expected budget ceiling.

Table 2.3 itemises the costs of the proposed staffing structure that the Government consulting on. The costs have been derived by closely following the model of the Payments Council's current board structure and secretariat. The pay grades are indicative. They are broadly comparable to other organisations in this field. For example, average CEO pay of the Money Advice Service, Financial Services Compensation Scheme and the Committee on Climate Change is £223,000.

Year 1 recruitment and staffing cost:

Table 2.3

Year 1 recruitment and staffing cost		
Staff		Cost
Chair	24 days @ £175,000 pa	£11,500
Directors	(10 to 15) x 24 days @ £100,000	£66,000 to £99,000
5 FTEs	5 x £80,000	£400,000
5 FTEs	5 x £50,000	£250,000
5 FTEs	5 x £30,000	£150,000
Basic total		£877,500 to £910,500
Add recruitment costs (15%)		£131,625 to £136,575
Total		£1,009,125 to £1,047,757
The total is rounded to £1 million in the summary cost table at 2.1. The adjustment for optimism bias is shown in table 2.2. Optimism bias factor: 10% not included in this table, it included in table 2.2..		

These estimated staff costs are within the average range of costs of comparable organisations such as the Money Advice Service, Financial Services Compensation Scheme and the Committee on Climate Change.

Optimism bias factor: 10%

Accommodation

The Payments Strategy Board will need to be physically located close to the key payments institutions and regulators in the City. This is essential to secure the participation of senior industry members and maintain relationships with firms in the City.

It is assumed that the PSB will require c200 square feet of office space per full time employee. The Board may expect to pay in the region of £45 per square foot for accommodation, based on City rents. This is based on a conservative assumption that the Board will not able to share office space and accommodation costs with the FCA, which would generate scale economies.

The estimated year 1 and on-going accommodation cost is therefore:

200 square feet x 15 FTEs x £45 = £135,000 pa.
Services such as business rates, gas, electricity, telephone, and other infrastructure, as well as insurances may add a further £12,000 per employee per year.

15 employees x £12,000 = £180,000.

The total annual accommodation costs are therefore:

Table 2.4

Annual accommodation costs	
	Cost
Office rental	£135,000
Office services	£180,000
Total	£315,000

Optimism bias factor: 15%

IT costs

It is not envisaged that the Payments Strategy board will need to develop bespoke software systems. However, it will need a full suite of office, database and publishing applications.

It is estimated that IT hardware and software can be provided at a set-up cost of around £2,000 per employee on a purchase and installation basis, based on IT firms advertised estimates.

15 employees x £2,000 = £30,000.

Optimism bias factor: 5%

Set up costs incurred by the FCA and the Treasury

FCA costs: there would need to be a small interim office established with secondees from public administrations and the private sector to prepare the way for the launch. The FCA would incur these costs, mainly the costs of staff recruitment, accommodation and IT systems. At this early stage, ahead of the consultation, it is not possible to separate out the year 0 costs to the FCA from the first year costs to the Payments Strategy Board. The approach taken in this impact assessment is therefore to bring forward the expected annual budget of the Payments Strategy board to the beginning of year 0, on the assumption that this will represent the maximum cost that the FCA might incur in establishing an interim office ahead of the formal launch of the Payments Strategy board. As shown in the summary table, these costs are £1 million staffing, £315,000 accommodation and other services, and £30,000 IT costs.

HM Treasury costs: the Treasury's costs are expected to be confined to the cost of preparing the primary legislation and taking it through Parliament, together with any subsequent secondary legislation. These costs will be absorbed by reassignment of internal roles, at no additional cost. The resources are expected to be around 5 staff (junior, mid-level staff and lawyers) in managing the legislation for six months. This carries an opportunity cost. This is costed at £250,000 based on the estimated staff costs.

Optimism bias factor: 5%

(ii) Ongoing administrative costs of the Payments Strategy Board

The ongoing administrative costs are assessed on the same basis as the year 1 costs, less any one-off costs. These are:

Table 2.5

Ongoing administrative costs	
	Cost
Staffing (10 to 15 part time board members + 15 FTEs as in Table 2.4)	£877,500 to £910,500
Training (15 FTEs x £1,000)	£15,000
Accommodation and services as in Table 2.4	£315,000
IT (depreciation and maintenance £15 x £1,000)	£15,000
Total	£1,222,500 to £1,255,500
These numbers are shown in summary table 2.2 as Staffing £915; Accommodation £315	

Optimism bias factor: 15%

(iii) <u>Ongoing compliance costs for regulated firms.</u>

There are two main types of ongoing costs for payment firms, as well as payment systems, that may be affected by recommendations made by the Payments Strategy Board:

(a) Meeting regular and ad hoc information reporting requirements;

(b) Following recommendation made by the Board.

The population of potentially affected firms is as follows:

Table 2.6

Population of potentially affected firms	
Firm type	No
Payment systems (CHAPs, BACs, CCL, FPS, Link)	5
Credit institutions participating in the above payment systems	200
Authorised payment institutions	183
Authorised electronic money institutions	18
Total	406

Small electronic money institutions and small payments institutions will not be affected because they do have access to payment systems, other than as end users. They are not included in table 2.6 above.

(a) Meeting regular and ad hoc information reporting requirements

The vast bulk of the information required by the Payments Strategy Board is already collected by the Payments Council. Most of it is provided by the main payment schemes, rather than individual members of those schemes.

However, it is conservatively assumed that firms may need to make some fairly minor admin changes to staffing, processes and systems in order to meet additional, precise, identifiable reporting requirements such as information returns. It is intended to minimise these impacts by requiring the Payments Strategy Board to coordinate and share information with other financial services regulators and industry bodies. The additional information that may be required is not thought to exceed the information that firms already provide to the Payments Council and to existing regulators. In the absence of any new reporting processes having been developed, this impact assessment assumes that firms will not be asked to provide any information that they currently provide to other recipients.

As the specific requirements are uncertain at this stage, this impact assessment sets aside a provisional sum per firm. Based on the methodology in Option 3, in the section on reporting costs and keeping license conditions up to date, this may absorb in the region of 20 hours of mid-management time per firm per year:

406 firms x £75 per hour x 20 hours = £609,000

This is rounded to £600,000 pa in the costs summary table.

Optimism bias factor: 15%

(b) Implementing recommendations made by the Board.

This is hard to assess ahead of the forthcoming consultation, or of knowing the approach that the Payments Strategy Board may take. The key consideration is that it is expected that the Board will influence relative priorities in strategic decision making, and will ensure that decisions are taken through proper governance arrangements that take the decisions of all stakeholders into account. This impact assessment therefore assumes that firms' existing investment budgets will not need to be increased. The preliminary assessment is that there will be no additional costs.

(c) Costs to the Financial Conduct Authority and HM Treasury

The Financial Conduct Authority would be responsible for making appointments to the the Payments Strategy Board, overseeing its governance and funding, and ensuring that is was capable of exercising its functions. The Board's budget would be funded through the Financial Conduct Authority's annual levy on a specified class of firms that would include payment systems or any class or type of participant in a payment system. The FCA will have the power to approve the PSB's budget and set the levy, and provide for its distribution between relevant firms in the FCA's rules.

Based on the costs to the FCA in fulfilling a similar role for the Money Advice Service (including HR, legal, financial planning, reporting and audit services), the FCA's ongoing costs are estimated to be £350,000 pa.

Assuming optimism bias of 15% this might rise to c£400,000 pa.

The Treasury would incur some costs through the consolidation of the Payments Strategy Board in the Treasury's accounts for Parliamentary reporting purposes. On an ongoing basis this is expected to absorb about 3-4 weeks per year of a junior level official to undertake the consolidation of the Board's accounts into the Treasury's accounts, and a half day every 6-8 weeks for a mid-level official tasked with oversight and relationship management (in the financial/governance sense) of the Payment Services Board.
These costs will be absorbed by reassignment of internal roles, at no additional cost. The opportunity cost is estimated at £20,000 pa based on the estimated staff costs.

One in One Out Regulatory costs

Fees levied by the FSA on behalf of the bodies that it has established (such as the Money Advice Service and the Financial Ombudsman Service) are classified as a tax on firms. They do not therefore count towards the calculation of One-In-One-Out costs. The costs of this option are therefore out of scope of the calculation of One in One Out Regulatory costs.

BENEFITS

It is expected that the principal benefits would be:

(i) Weaknesses in the current Payments Council model of self-regulation would be removed. The Payments Strategy Board would enhance the responsiveness of payment networks to the needs of their users. The Board would ensure that the views and needs of all payments users are taken into account, rather relying solely on industry bodies like the Payments Council;

(ii) Decisions on how to develop payment systems and services would be subject to external oversight by an independent body for the first time. This would provide effective reporting and accountability which is currently missing;

(iii) Recommendations to the industry would be public, bringing increased transparency to the market and ensuring that issues are addressed by the industry. Recommendations would be an effective way to hold the industry to account, and would fulfil the public commitment to enhance the regulatory framework for payments in the UK. This approach recognises that the industry is a major stakeholder, and ensures that decisions on development projects and investment decisions would remain with the institutions that will pay for them.

Taken together, these measures would generate qualitative benefits to the payments industry and to end users through better prioritisation of development projects and greater transparency. Given the massive volume and value of payments handled by payment networks, which is measured in trillions of Pounds (table 1.1), even a small improvement would have a significant impact.

These effects cannot be measured in advance of the consultation. However, for illustrative purposes, an improvement of 0.001p in the efficiency or price of an automated payment transaction (currently measured in pence) is likely to generate aggregate savings of £7 million pa. These benefits would accrue in the first instance to the participants in payment systems, and might be expected to be passed onto to end-users, particularly businesses that are charged for the payment services where any gains are generated.

<u>Equalities Impact</u>

This option is intended to ensure that the views of all users of payment services are heard and taken into account.

There are known issues affecting the use of specific payment methods by those who suffer from social or physical barriers, such as the elderly, those reliant on carers, on carers themselves, and those who are physically impaired (cf The Way we Pay by Age Concern 23 June 2011). For example, some people cannot use ATMs, or payment cards that require a PIN number to be entered. Others may depend on carers to withdraw money or make payments. Migrants, travellers or those with no fixed address, or who live chaotic lives, may also experience difficulties and may be financially excluded altogether.

Religion, gender, pregnancy and maternity, race and sexual orientation are not thought to generate significant payments issues.

The Government expects that the Payments Strategy Board v ensure that the views of these groups was adequately represented. It would be able to ensure that all views were more systematically taken into account.

The equalities impact of this option is therefore positive.

Small firms

Small firms are not expected to be directly affected because they do have direct access to payment systems, other than as end users.

Competition

The Payments Strategy Board's activities would be focused primarily on the non-competition space, where firms must collaborate to ensure that payments can flow across accounts held by different firms (the interoperability of payment networks).

However, the Board would be expected to ensure that its recommendations promoted access to payments systems and promoted competition. For example, it would ensure that barriers to entry of new challenger banks, and other barriers to competition, were addressed.

OPTION 3

Regulatory: create a new utility-style regulator to license and oversee the development of payment networks.

Table 3.1

Summary of option 3 nominal costs £000		
	Transitional	Ongoing annual
Regulator admin costs		
Staffing and operations	7,000	6,200
Accommodation	1,900	1,900
IT	200	90
Firms costs		
License application	90	9
Reporting and compliance	0	750
Total	9,190	8,949
The present value of these costs discounted over 10 years at 3.5% is shown in the summary page for option 3		

Background

This option would create a new independent economic regulator for payment systems, and participants in those payment systems. The precise details have not been fully considered and the Government will consult on whether or not to explore a full regulatory model further.

This option presents a significant change in the regulatory environment from the current regime. It is not the Government's preferred option at this time. However, the Government will consult on whether this type of model is desirable or a more effective way to deliver the Government's objectives, over and above the reforms set out under the preceding two options. It would refine and develop the model in response to the consultation before taking it forward.

The option could establish a licensing regime for designated payment systems. HM Treasury would designate payment systems that met the conditions for designation (essentially payment systems handling a significant volume of transactions). A new regulator would issue a license and monitor compliance with license conditions.

The definition of a 'payment system' would capture not only the current scheme companies (like the Cheque and Credit Clearing Company Ltd), but also the participants in the payment system, ranging from payment service providers to infrastructure providers. The license conditions would be designed to ensure price transparency, good governance, non-discriminatory access, efficient wholesale pricing and fair trading. They would also ensure that payment systems and their participants respond more effectively to the rapidly evolving needs of end-users, and protect their interests.

In this model, the regulator would have substantial powers to set the future strategy for the industry in place of the Payments Council. It could regulate prices, direct investment decisions, undertake investigations, and exercise powers under the Competition Act and Enterprise Act. There could be provision for a super-complaint process by designated bodies. The new regulator could also have product intervention powers akin to those of the FCA (for example over the rules relating to direct debits), as far as permitted by European law. However, it is not envisaged that payment systems would need to come under the jurisdiction of the Financial Ombudsman Service (as they do not deal directly with end users), nor the Financial Services Compensation Scheme (for the same reason). Payment service providers are already subject to the jurisdiction of the Financial Ombudsman Service as well as rules for safeguarding customers' funds.
The license conditions could set out the principles for safeguarding effective competition, a breach of which would put a firm or a payment system in breach of its license conditions. This would include conditions to prevent a firm, or group of firms, with significant market power from controlling a payment system. This

implies that the present ownership structure of several UK payment scheme companies may need to change, as they are owned and controlled by a small group of banks.

Effective regulation in this area would constrain the ability of the biggest banks to use payment systems as barriers to entry to downstream activities (for example in the development of ATM services) and would remove the checks on innovation created by the current ownership and governance structure. This could promote more competition, leading to lower prices and innovative new payment services.

This option extends regulation to a narrow area of financial services that is not currently regulated. However, there is already an oversight regime for systemically important payment systems, operated by the Bank of England under Part V of the Banking Act 1999. This oversight regime is confined to weaknesses in risk management and operations that could have a major potential impact on stability of the financial system as a whole. The regime therefore applies to 'recognised' interbank payment systems which are designated as such by the Treasury. CHAPs, BACs and FPS are currently overseen by the Bank under this regime, as well as a number of commercial trading payment systems. The Act includes requirements for the operators of recognised systems to have regard to principles published by the Bank of England, and confers a power of direction on the Bank, powers to collect information and enforcement powers.

The FSA also supervises the conduct of credit institutions and payment service providers under the Payment Services Regulations 1999. The Office of Fair Trading is responsible for enforcing the competition rules in this area.

The new regulator would assume the role of the OFT, and focus on the collaborative space where firms come together to agree on the rules for the provision of payment services – with the emphasis on achieving the best outcomes for end users. It is not therefore intended to disturb the present oversight regimes operated by the Bank of England and the FSA, although it will clearly be essential for each authority to coordinate effectively with the others, in order to share information and prevent unnecessary or avoidable burdens on firms, and to ensure that issues are not missed because they fall between the regulatory cracks. It is envisaged that the regulators would be under a statutory duty to coordinate, and to consult each other before making rules. Priority in decision making would be accorded to considerations of financial stability.

Costs

The main additional costs are:

(i) transitional administrative set-up costs for the new regulator;

(ii) ongoing administrative costs for the new regulator;

(iii) initial licensing costs for payment systems;

(iv) ongoing compliance costs for regulated firms.

(i) <u>Transitional set-up costs for the regulator</u>

The costs incurred by the regulator would be recovered through fees or levies paid by regulated persons. The regulated persons would be the owners and operators of payment systems; and direct and indirect participants in the operation of payment systems who are mostly banks and building societies. It is assumed that the payment systems that would be brought into regulation are LINK; BACs; Cheque and Credit Clearing; CHAPS and Faster Payments. It would be a matter for further consultation whether card schemes should be brought wholly or partly within scope, given the international nature of the card schemes.

In the short run, the transition period would involve significant expense to the new regulator on staff recruitment, premises and IT systems. There would need to be an interim office established with secondees from public administrations and the private sector to prepare the way. Longer term resource requirements would depend on the evolution of the regulatory model. Underlying these uncertainties are open questions on the legislation that would establish the regulator, which may have implications for its size and the complexity of its remit.

Subject to that, the main year 1 cost elements (based on the existing structure of the Payments Council and other regulators) are estimated to be:

Staffing

Table 3.2

Staffing: a board supported by around 80 staff as follows	
CEO, directors	10
Secretariat	5
Strategic developments (policy)	5
Research and analysis	8
EU and global	4
Standards and regulatory developments	12
Monitoring and enforcement	12
Information management	6
Communication, publications	8
Legal	4
Accountancy, audit	4
Support	10
Total	88

Year 1 recruitment and staffing cost (FTE all in cost inc NICs, pensions, bonus etc) by notional salary bands:

Table 3.3

Recruitment and staffing cost by notional salary bands		
Band	Salary	Implied cost
Band A	£175,000	£1,750,000
Band B	£100,000	£1,000,000
Band C	£80,000	£1,600,000
Band D	£50,000	£1,000,000
Band E	£30,000	£540,000
Band F	£20,000	£200,000
Total salary		£6,090,000
Add recruitment costs (15%)		£913,500
Total		£7,003,500
The total is rounded to £7 million in the summary cost table 3.1		

Accommodation

The new regulator would need to be physically located close to the other regulators and payment systems and firms in the City.

It has been assumed that 200 square feet per person will be required. The regulator may expect to pay in the region of £45 per square foot for accommodation in the City or Docklands.

The estimated year 1 and on-going accommodation cost is therefore:

200 square feet x 88 persons x £45 = £792,000 pa (rounded to £800,000).

Services such as business rates, gas, electricity, telephone, and other infrastructure may add a further £12,000 per employee per year.

88 employees x £12,000 = £1,056,000 (rounded to £1,100,000).

The total annual accommodation costs are therefore:

Table 3.4

Annual Accommodation Costs	
	Cost
Office rental Office services	£800,000 £1,100,000
Total	£1,900,000

IT costs

It is not envisaged that the regulator will not need to develop bespoke software systems, at least not initially. This will be an economic regulator, so it will need to collect detailed, commercially sensitive information. In year one, however, It will need a full suite of office, database and publishing applications.

It is estimated that IT hardware and software can be provided at a set-up cost of around £2,000 per employee on a purchase and installation basis.

£88 employees x £2,000 = £176,000 (rounded to £200,000).

(ii) Ongoing administrative costs for the regulator

The ongoing administrative costs are assessed on the same basis as the year 1 costs, less any one-off costs. They are based on the existing cost structure of the Payments Council and other regulators. These are:

Table 3.5

Ongoing administrative costs	
	Cost
Staffing (88 FTEs £6,090,000 + training £88,000) Accommodation and services IT (depreciation and maintenance £88 x £1,000)	£6,178,000 £1,900,000 £88,000
Total	£8,166,000
These amounts are rounded to £6.2m; £1.9m and £0.9m in the summary costs table 3.1	

(iii) Transitional costs to the owners and managers of payment systems, and participants in payment systems.

The population of potentially affected firms is as follows:

Table 3.6

Transitional costs to the owners and managers of payment systems	
Firm type	Cost
Payment systems (CHAPs, BACs, CCL, FPS, Link)	5
Credit institutions	200
Authorised payment institutions	183
Authorised electronic money institutions	18
Total	406

Small electronic money institutions and small payments institutions will not be affected because they do have access to payment systems, other than as end users. They are not included in table 3.6 above.

(a) Payment systems: The present ownership structure of the 5 UK payment scheme companies may perhaps need to change, as a condition of receiving a license, because they are mutually owned and controlled by a small group of banks (not the same banks in each case). The 5 firms are not for profit and do not have substantial assets, but they may hold some intellectual property. However, any divestment requirement would be a decision for the regulator. This impact assessment assumes that any future divestment that may need to be made as a condition of a license is for market value and will be a one-off transfer between firms that does not impose new costs on business. There would be no loss of profits or opportunity costs.

The main transitional costs to payment systems would be the cost of preparing and submitting license applications. The principal elements would be submitting documentation about the ownership and management, including systems and controls, and vetting of the owners and managers of payment systems by the regulator.

Based on feedback from consultants on the costs of submission of an application by a payments institution to be authorised by the FSA (the nearest cost equivalent in the absence of any information about the new regulator's procedures and requirements), it is estimated that the costs of submitting a licence application would average 60 hours of senior management time and 120 hours of mid-level management time.

Using information from the "Real Assurance Risk Management report on the Estimation of FSA administration burden", June 2006 – the hourly rate is c. £140 for a senior manager and £75 for a mid level manager, after adjustment for inflation and overhead costs.

The cost of applying for licenses is therefore likely to be in the region of:

Table 3.7:

Cost of applying for licenses	
5 payment systems x £140 per hour x 60 hours	£42,000
5 payment systems x £75 per hour x 120 hours	£45,000
Total	£87,000
The total is rounded to £90,000 in the summary table 3.1.	

(b) The participating firms (listed in table 3.6) will not be required to apply for a new license. They will be included in a Class license issued to each payment system. They would therefore be grandfathered into the new regulatory regime at no additional cost beyond the annual fee that would be levied by the regulator on participating firms to meets its costs.

(iv) Ongoing compliance costs for regulated firms.

There are three main types of ongoing costs:

(i) Keeping license information up to date;

(ii) Meeting regular and ad hoc information reporting requirements;

(iii) Implementing decisions made by the regulator relating to the development of payment systems (for example, adhering to certain standards or guidelines).

Keeping license conditions up to date for example entails notifying changes to board membership or systems and controls. Based on the methodology in table 3.7 this is likely to absorb 24 hours of mid-management time per year:

5 payment systems x £75 per hour x 24 hours = £9,000

Meeting regular and ad hoc information reporting requirements

Firms might need to make some fairly minor admin changes to staffing, processes and systems in order to meet precise, identifiable regulatory requirements such as information returns. It is intended to minimise these impacts by requiring the new regulator to coordinate and share information with other financial services regulators. The additional information that the new regulator might require is not thought to exceed the information that firms already provide to the Payments Council and to existing regulators. In the absence of any new regulatory processes having been developed, this impact assessment assumes that firms would not be asked to provide any information that they currently provide to other recipients. Nonetheless there might be some duplication of reporting or some additional costs in meeting the regulator or reformatting existing information.

This is hard to estimate in the absence of new regulatory reporting requirements. This impact assessment therefore sets aside a provisional sum per firm. Based on the methodology for keeping license conditions up to date (above), this may absorb in the region of 24 hours of mid-management time per firm per year:

406 firms x £75 per hour x 24 hours = £730,800

This is rounded to £750,000 pa.

Implementing decisions made by the regulator relating to the development of payment systems (for example, adhering to certain standards or guidelines).

This is hard to assess without any sense of what specific legislation may require, or the approach that the regulator may take. The key consideration is that it is expected that the regulator will not impose additional new investment decisions on firms, impose price controls or expensive new obligations. Instead the regulator might wish to direct relative priorities in strategic decision making, and would ensure that decisions were taken through proper governance arrangements that took the decisions of all stakeholders into account. This impact assessment therefore assumes that firms' existing investment budgets would not need to be increased. The preliminary assessment is that there would be no additional costs.

BENEFITS

This option will fill in a gap in the current regulatory framework. It will address weaknesses in the current governance of UK payment networks and remove obstacles to effective collaboration on the future development of payment networks.

The principal benefits are:

(i) Weaknesses in current Payments Council model of self-regulation would be removed. This would enhance the responsiveness of payment networks to the needs of their users;

(ii) Decision-making and collaboration between payment service providers and payment systems would be subject to external audit and direction by the regulator. This would also provide an effective enforcement mechanism, once a decision had been taken, with the result that a small number of firms would no longer be able to hold up the progress of the rest.

(iii) Effective regulation in this area would constrain the ability of the biggest banks to use payment systems as barriers to entry to downstream activities (for example in the development of ATM services) and will remove the checks on innovation created by the current ownership and governance structure. This would promote more competition, leading to lower prices and innovative new payment services.

Taken together, these measures would generate substantial qualitative benefits to the payments industry and to end users. There are likely to be substantial efficiency and effectiveness gains from more timely and more effective decision-making, and better prioritisation of development projects. Given the very large volume and value of payment flows, even a small improvement would have a significant impact. These effects cannot be measured in advance. However, for illustrative purposes, an improvement of 0.001p in the efficiency or price of an automated payment transaction is likely to generate aggregate savings of £7 million pa.

One in One Out Regulatory costs

The potential new regulator has not been classified by the ONS. This impact assessment therefore assumes that this option falls within the scope of the One In One Out calculation of new regulatory burdens

Equalities Impact

This option is intended to ensure that the regulator is responsible for enforcing equalities law as the law applies to regulated firms.

As with option 2, this option is also expected to ensure that the views of all users of payment services are heard and taken into account.

There are known issues affecting the use of specific payment methods by those who suffer from social or physical barriers, such as the elderly, those reliant on carers, on carers themselves, and those who are physically impaired (cf The Way we Pay by Age Concern 23 June 2011). For example, some people cannot use ATMs, or payment cards that require a PIN number to be entered. Others may depend on carers to withdraw money or make payments. Migrants, travellers or those with no fixed address, or who live chaotic lives, may also experience difficulties and may be financially excluded altogether.

Religion, gender, pregnancy and maternity, race and sexual orientation are not thought to generate significant payments issues.

The Government expects that this option would ensure that equalities law was policed effectively, and that all views were more systematically taken into account. The equalities impact of this option is therefore positive.

Small firms

Small firms are not expected to be directly affected because they do have direct access to payment systems, other than as end users.

Competition

The new regulator would assume the role of the OFT. It would focus on the collaborative space where firms come together to agree on the rules for the provision of payment services – with the emphasis on achieving the best outcomes for end users. The transfer of responsibility from the OFT to the new regulator is not expected to have any cost impacts, but a dedicated regulator can be expected to take a more systematic approach to supervising the industry than the OFT, for example through more regular market studies and reports.