

Payment Systems Regulator Limited

Annual report and accounts

2015/2016



Payment Systems Regulator Limited

Annual Report and Accounts 2015-2016
(for the year ended 31 March 2016)

Presented to Parliament pursuant to paragraph 8(3) of Schedule 4 of the
Financial Services (Banking Reform) Act 2013

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Foreword

Since the Payment Systems Regulator came into existence, the payments landscape has begun to change. We are making a positive difference to users of payment systems by encouraging competition and innovation throughout the sector.

The UK payments sector is seeing a high level of change driven by technological opportunities, consumer demands for better and more innovative services, and regulatory changes designed to improve outcomes for consumers. I am committed to the PSR continuing to deliver our programme of work, including our market reviews and the work of the Payments Strategy Forum, to help deliver further improvements for customers. The innovations we are seeing are an exciting opportunity for customers to see real benefits, while payment services remain resilient and secure.

We have already done a great deal of research, engagement and evaluation to help us understand where and how we should act, and have made important changes. There is more to come, and I look forward to seeing a continuing evolution in the industry.

Looking forward, the UK has just voted to leave the European Union (EU), which clearly has significant implications. Some of the regulatory activity within our remit derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for government and Parliament. The longer term impact of the decision to leave the EU on the overall regulatory framework will depend in part on the relationship that the UK seeks with the EU in future. We will work closely with the government and the FCA as those arrangements are confirmed.



John Griffith-Jones
Chairman



Our first operational year has been a busy one. As the only payment systems regulator in the world, we have established ourselves as an organisation and begun the important work we were created for – making payment systems work well for the people and organisations that use them by promoting competition and innovation.

We've encouraged the industry to develop a mindset where users' interests are always taken into account. We've been bold where we needed to make changes to improve innovation, collaboration and competition, but careful not to stifle them with unnecessary intervention. It's surely no coincidence that, alongside our regulatory actions, the industry is launching new initiatives of its own and making it easier for new participants to join payment systems – which should lead to more effective competition to the benefit of users.

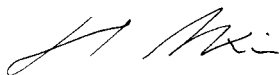
Our directions are helping to open up access to payment systems, and we're already seeing the market expand, with several new payment service providers expected to join Faster Payments. We've also seen the time and cost of connecting to Faster Payments come down, aided by new technology and easier onboarding procedures.

Our market reviews have demonstrated our evidence-based approach to regulation, making sure our actions are appropriate to the situation; we proposed major changes in infrastructure provision for interbank systems, but are giving existing industry initiatives a chance to take hold in indirect access services for those systems. We will watch these developments carefully to make sure they help us advance our objectives. We have taken a similar approach to card systems, where innovation is already prevalent.

We are also continuing to build our organisation, recruiting the right people to help us move forward with our work. And we will continue to scan the horizon so we are ready to respond to the latest developments in the payments world.

This year we've taken our first steps as a regulator. We are still new and our work is taking shape; as we move into our second year of operation, we should see the industry continue to change for the good of all those who rely on it.

I look forward to working with all our stakeholders to get these changes right.



Hannah Nixon
Managing Director



Strategic report

This is our second annual report. It covers our activity in 2015/16, our first operational year, and reports on how we have met the aims and priorities we set out in our 2015/16 annual plan and policy work programme.



After consulting widely to produce our initial policy statement in 2015, the past 12 months have seen the first effects of our directions on access and governance. Among the changes we have already seen is a reduction in the time it takes to join a payment system. It can take up to 18 months to join a payment system, but one operator, Faster Payments Scheme Ltd, can now potentially onboard a new direct access member in as little as nine months.

We're analysing two areas of payment systems in extensive detail in our market reviews. Our interim report for the indirect access review shows significant progress in improving indirect access offerings for financial institutions, reflected in the number of banks who intend to enter the market to offer indirect access. In our review of the provision of infrastructure services to interbank systems, we found barriers to effective competition and innovation. We proposed remedies including competitive and transparent procurement processes; common messaging standards; and significant changes to the ownership of VocaLink, the infrastructure provider to Bacs, Faster Payments and LINK.

We've also produced guidance in relation to new EU legislation in the UK, and established the Payments Strategy Forum to develop an industry-led approach to collaborative innovation. Our guidance for the Interchange Fee Regulation explains how we intend to enforce the first part of this regulation, which includes provisions capping the interchange fees charged for debit and credit cards. We will publish our guidance for the second part of this regulation in autumn 2016. We continue to work closely with stakeholders representing industry and users to help us develop our policies and maintain a deep understanding of the payments world.

Our directions on direct access to payment systems require operators to have transparent and objective access requirements, which permit fair and open access, leading to more expressions of interest from potential direct participants. We have recently seen Raphaels Bank announce its entry as a direct participant intending to offer indirect access services, and expect a number of other new direct participants in the coming year.

Last year we said we would develop ways to measure our performance and be open and transparent about how much we've achieved. As part of this work, at the turn of the year we commissioned a survey of stakeholders to understand their perception of how things are changing. You will see charts showing some of the key results of this survey throughout this annual report. These generally reflect areas where we have already made a policy intervention (such as on direct access and governance) or where we have been able to measure our operational performance.

In our 2015/16 annual plan and in line with our statutory objectives, we said our key aims for the period were to:

- promote competition in payment systems in the interests of service-users
- promote innovation in payment systems in the interests of service-users
- promote the interests of service-users
- continue to build our organisation

We outlined how we would pursue those aims in the annual plan and corresponding work programme, and in our March 2015 policy statement.

We have met the commitments we made in those documents, and explain our work in these areas in more detail over the following pages.



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competition
authority

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legislation

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organisation

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Strategic report



Our functions and duties under FSBRA

In broad terms, the PSR exists to make sure payment systems work well for the people and organisations that use them. Specifically, the Financial Services (Banking Reform) Act 2013 (FSBRA) requires us to advance one or more of three statutory objectives in our work under FSBRA. These are to:

- promote the development of, and innovation in, payment systems
- promote the interests of service-users (those that use or are likely to use the services that payment systems provide)
- promote effective competition in payment systems and in the services they provide

We carry out our work under FSBRA with these objectives in mind. In our first year we've run several projects that advance them in different ways.

Innovation



Service-users



Competition



Innovation



The payments industry is at an exciting point in its development. New technology and innovative processes are evolving rapidly, challenging conventions and assumptions about how the industry can and should work. Customers are using payment options such as contactless much more than they did only a couple of years ago, and new payment options, such as through mobile phones, are regularly being introduced. These changes are also presenting new options to the industry itself, such as aggregators providing technical access for Faster Payments – improving the choices for many indirect access users so they can offer better services to their customers.

Our role in this context is to help create the right conditions for innovation. We can do this in two ways: by removing unnecessary barriers to innovation that can be driven by competition and the industry; and by promoting collective action where innovation requires collaboration.

The Payments Strategy Forum and Payments Community

Our most significant innovation-specific action in our first year was establishing the Payments Strategy Forum (the Forum). We set the Forum up as a collaborative body comprising experts from across the payments industry and representatives of those who use payment systems, such as consumers, retailers and government. Its purpose is to identify, prioritise and develop strategic initiatives that promote innovation that requires industry collaboration; something the industry has, in the past, found difficult to coordinate. Its work is intended to benefit those who use payment systems and is not a substitute for market-led innovation.

We also established the Payments Community (the Community) to support the Forum's work. This is a group of around 300 stakeholders representing the industry and service-users – from consumer groups and retailers to banks and infrastructure providers. The Community helps shape the Forum's work through participation in working groups, roundtables and other forms of engagement.

We established the Forum to explore areas where the conditions for innovation can best be generated by collaboration within the industry, rather than through competition or regulatory intervention. Its remit is to discuss and agree strategic priorities to support this kind of collaboration, to be delivered within 12 months of its first meeting.

We provide secretariat support to the Forum and the chair; the secretariat also maintains the Community's engagement activities to support the Forum's process of establishing a set of strategic initiatives. The Financial Conduct Authority (FCA) and the Bank of England participate as observers. We continue to monitor the Forum's work closely, and work with its members and the chair so we can be confident it will deliver a high-quality strategy to promote collaborative innovation within the payments sector.

The Forum met for the first time in October 2015 to decide how it would deliver the outcomes we had set for it. It has agreed its success criteria and strategic objectives, stating that all its proposed initiatives must be:

- secure and resilient
- versatile and responsive to user needs
- efficient

It also agreed a 12-month work programme, and a set of problems faced by service-users to assess. It established four working groups to analyse these problems in detail and identify potential solutions.

The Forum has gained significant momentum and is entering the final stages of independent evaluation. It has raised the level of discussion and debate around the issues it's tackling, and has identified a number of possible collaborative initiatives that together could significantly improve innovation within the payments sector. We expect it to publish its draft initiatives in July 2016, followed by a short consultation. It should publish the final agreed initiatives in the autumn. We will consider whether the final strategy meets the Forum's objectives. If the process has not been effective, or if the industry's delivery of agreed initiatives is too slow, we may take regulatory action if appropriate.

payments
strategy
forum

Working Groups

End-user
needs

Focused on how to improve outcomes for customers making payments. This includes new payment options like expanding request-to-pay and payment verification.

Simplifying
access to
markets

Focused on simplifying direct and indirect access to interbank payment schemes. This includes considering how to remove unnecessary differences in the process for gaining access to different payment schemes.

Financial
crime, data
and security

Looking at ways the payments sector can work together to improve the security of payments, and the customer experience when verifying information to make payments.

Horizon
scanning

Looking at technological and regulatory developments that may provide collaborative solutions to improve outcomes in the payments sector.

Strategic report

Other supporting projects

As described in our 2015 work programme, we've established and engaged with other supporting projects to deepen our understanding of current innovations in the payments industry, and to ensure that they properly consider the interests of the people and

organisations that use payment systems. These include work with the FCA on its Project Innovate initiative, and establishing our innovation horizon scanning project. This is where we identify innovations in payments so we can understand their impact on the market and our approach to regulation, and monitor their development.

Perceptions survey

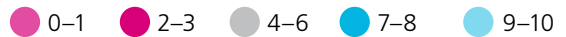
Stakeholders reacted positively to our work on innovation

By the end of 2015 we'd taken several steps to promote innovation, including establishing the Payments Strategy Forum. Over 40% of our respondents thought we'd already made good progress in this area.

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



Total 0-3: 13%

Total 7-10: 46%

Sample size: 96. Excludes respondents who answered 'don't know'.

Our perceptions survey

In this annual report we have included charts showing some of the results from our perceptions survey, which was aimed at stakeholders that were familiar with the work of the PSR and the payments industry. The data used for the graphs was collected by BritainThinks, an independent market research company, via a telephone survey in November and December 2015. The exact sample used in each question varied depending on the type of question asked. For some questions, a larger group of payment service providers (PSPs) were interviewed to improve the significance of the sample. We explain the sample alongside each measure.

Delivery of our commitments

This page shows how we met the commitments relating to our innovation objective that we made in our 2015 annual plan and work programme.

What we said we'd do

Payments Strategy Forum

Set up the Forum and the Payments Community.

What we've done

The Forum is active and in the process of forming its strategy for collaborative innovation. We are giving secretariat support, which also maintains the Payments Community, and work with members and the chair to guide the Forum's work and help it deliver a high-quality strategy.



What we said we'd do

Innovation horizon scanning

What we've done

We have established an ongoing internal process to identify developments and understand their impact. We present technology updates to the board and the PSR Panel.



Service-users



Our service-user objective is central to our overriding purpose – to make sure payment systems work well for the people and organisations that use them. Our aim in our work on competition and innovation is to improve the choice, value and products available to service-users – but we’ve also run a number of projects which focus specifically on service-user interests.

Our governance directions

During our initial consultations before we became operational, we concluded that operators weren't taking enough account of service-users' interests in their decision-making. In March 2015 we issued directions that require interbank system operators to make their governance arrangements more inclusive and transparent. Operators have made changes in response and we have seen:

- greater transparency on how operators' boards make decisions
- better representation of service-users' interests when the operators' governing bodies make decisions

So far the operators' progress on governance has been encouraging. None of the operators' board members have directorships on major infrastructure suppliers. They have also all put in place procedures to publish minutes of their board meetings. And all operators have told us in detail about their efforts to operate their systems in the interests of all service-users.

However, in our first report on access and governance we explained that, while the operators' initial progress was welcome, we expect them to continue to improve a number of aspects of their service-user representation, including the range of users they engage with and the way their views are represented in board discussions.

The PSR Panel

The Panel is an independent statutory body set up to provide input into our strategy and policy development. It is a group of sector experts, including representatives of individuals and businesses that use payment systems and services as well as economists, operators and

service providers. We consult the Panel on our policies, our practices, and how our objectives may be best achieved. We have met the Panel four times in our first year and discussed a range of issues including our forward work plan, the Forum and our early thinking on our market reviews.

Consumer redress

We have examined the scope of consumer redress in the event of a temporary failure of a payment system, which we committed to do in our 2015 indicative policy work programme. We have not identified any gaps in existing arrangements that require the PSR to take action to protect consumers. Therefore, we have closed this project. In the event of a temporary failure of a payment system, consumers should contact their payment service provider in the first instance.

ATM interchange fees and LINK

As a new regulator, we carried out some exploratory work to help us better understand the status of the ATM market. In addition, following discussions with us, LINK reviewed its independent governance arrangements in 2015. One of the outcomes was a recommendation for an independent economic review of LINK's interchange fees. In addition, on 1 April 2016 LINK separated from Vocalink, which provides its infrastructure, to form a new legal entity, Link Scheme Limited. We do not see a need to take action at the moment but will keep a watching brief on LINK's work, and will continue monitoring the ATM market for new developments.

Strategic report

Perceptions survey

Operators have started to consider service-users' needs more

The majority of PSPs and end users interviewed through our survey think payment systems are meeting people's needs, with over two-thirds saying this has improved.

Payment systems effectively meeting consumer needs

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

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

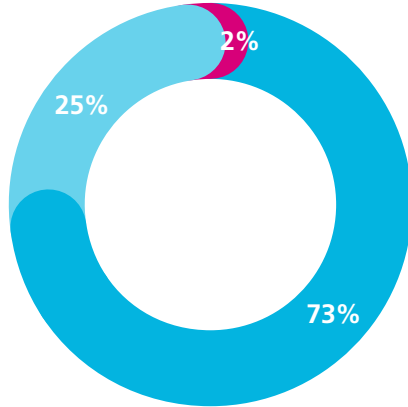


Total 0-3: 1%

Total 7-10: 61%

Change in past 2 years

- Improved
- Same
- Worse



Sample size: 147. All indirect PSPs and end users. Excludes respondents who answered 'don't know'.

Meeting our end-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

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



Total 0-3: 7%

Total 7-10: 59%

Sample size: 94. Excludes respondents who answered 'don't know'.

Delivery of our commitments

This page shows how we met the commitments relating to our service-user objective that we made in our 2015 annual plan and work programme.

What we said we'd do

Regulatory directions on governance

Issue our directions and report on their effect and operators' compliance.

What we've done

Our directions are in place, and the operators have given us their first compliance reports. We published our summary of these in our Access and Governance report in December, showing that there had been good progress but operators had more to do to reflect service-users' interests.



What we said we'd do

PSR Panel

Consult the Panel regularly on regulatory policy.

What we've done

The Panel has met four times in the period, and has provided a range of input to our work, helping us pursue our objectives more effectively.



What we said we'd do

ATM interchange fees

Examine stakeholders' concerns.

What we've done

We've completed our analysis and will continue to monitor the position on interchange fees, including the result of LINK's independent review.



What we said we'd do

Consumer redress

Investigate the scope for redress in case of payment system failures.

What we've done

We completed our investigation and established that we don't need to take action now.

We also published guidance on voluntary redress schemes.



Competition



We want to see effective competition in the payment systems industry: between system operators, between the organisations that provide the infrastructure services that make payment systems work, and between those that provide payment systems services, such as banks and other payment service providers (PSPs). We also want to remove barriers in the payment systems industry that could prevent effective competition in other markets. This benefits everyone who uses payment systems by encouraging innovation, better quality of service and lower prices.

In our first year of operation we've taken steps to improve direct access to payment systems, and are carrying out two major market reviews to understand how competition is working in specific areas and whether it could work better. Collectively, this work is already helping to foster a more competitive payments sector.

Our access directions

Background

One example of the importance of the payment systems industry for competition in other markets can be seen in retail banking, where the Competition and Markets Authority (CMA) has estimated that personal current account customers could save an average of £116 a year by switching current accounts (or £153 a year if they use an overdraft).

Effective competition can be aided by new entry, but challenger banks in the retail market need to offer a high-quality service in order to compete with the established market leaders. For example, a challenger bank will usually want to include 24/7 Faster Payments access in its current account offer.

The quality and price of access to payment systems is therefore important for challenger banks. And because of this, some firms want direct access as they consider that this can help them offer their customers the services they want to.

However, open and fair access to payment systems has been a persistent concern in the payment systems industry. From the Cruickshank Review of Banking Services in 2000, to the Treasury's *Opening up UK payments* consultation in 2013, access has been high among respondents' concerns.

We have taken steps to address concerns about direct access by introducing our directions on access to payment systems, which came into force in June 2015. Through these we introduced the requirement for system operators to make sure that their rules governing access to their systems are objective and risk-based, to permit fair and open access. We also required them

to make these rules publicly available, removing some of the obstacles that have stopped potential direct participants joining the systems in the past. Finally, the operators must submit an annual report to us detailing their compliance with these requirements and including information allowing us to monitor the progress of access issues.

Progress

Stakeholders have told us of several positive developments: they've said it's easier to get relevant information about getting access, it's quicker and cheaper to join a system and more participants are doing it. Significant sector-wide work is underway to widen direct access to interbank payment systems, and there appears to be increasing demand for direct access.

These are encouraging early signs that our access directions are having a positive effect, but operators have more work to do. Having reviewed their first compliance reports, we have identified focus areas where they can make further improvements to ensure their access rules and requirements are reasonable. Our findings are backed up by what stakeholders have told us: although 40% feel access has become easier in the last two years, this leaves a majority who haven't seen an improvement yet.

We published full details of our work on direct access in our report, *Access and governance of payment systems: the operators' progress and areas for ongoing focus* (December 2015).

Strategic report

Perceptions survey

Our access directions are starting to take effect

Our perceptions survey showed that some of the industry thinks access is getting easier, but there's more work to do to before the majority feel this way.

Availability of information about how to access systems directly

Current rating of availability of information about how to access payment systems directly

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

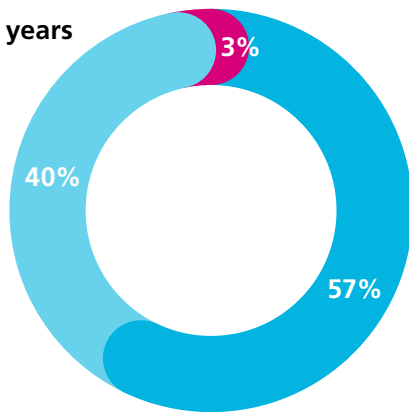


Total 0-3: 16%

Total 7-10: 41%

Change in past 2 years

- Improved
- Same
- Worse

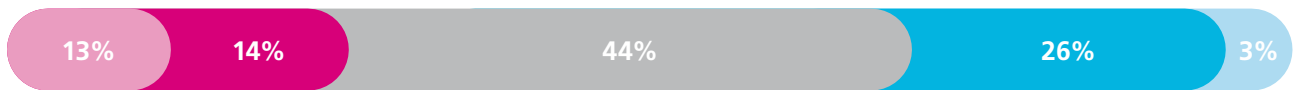


Sample size: 105. All indirect PSPs (includes indirect payment service provider, independent ATM operator and authorised payment institution/e-money institution). Excludes respondents who answered 'don't know'.

Ease of gaining direct access

Current rating of ease of gaining direct access to designated payment system operators

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

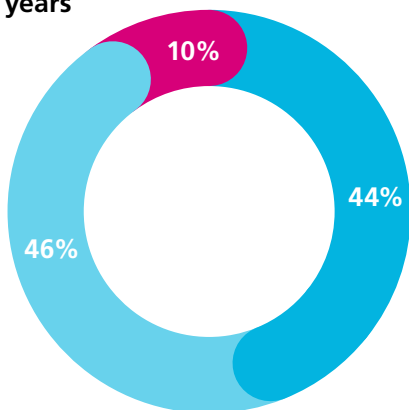


Total 0-3: 27%

Total 7-10: 29%

Change in past 2 years

- Improved
- Same
- Worse



Sample size: 102. All indirect PSPs (includes indirect payment service provider, independent ATM operator and authorised payment institution/e-money institution). Excludes respondents who answered 'don't know'.

Our market reviews

We conduct market reviews where we want to investigate how well aspects of the market for payment systems, or markets for services provided by payment systems, are working for service-users. Our first two market reviews are progressing in line with our projected timelines; we published the interim reports following extensive engagement with stakeholders and expect to publish the final reports after a period of consultation.

Infrastructure: background

Our review of payment systems infrastructure is considering competition in the provision of infrastructure services for the three main interbank payment systems (Bacs, Faster Payments and LINK), and the ownership of infrastructure providers.

Progress

We published our interim report in February and have initially found that competition in this area is not effective. We have proposed a package of potential remedies to make the market work better. Notably, these include competitive and transparent procurement processes, and requiring the PSPs that own an interest in VocaLink (a group which includes large banks) to dispose of that interest.

We are consulting on our proposals for infrastructure and expect to publish our final report in the summer. We will consult on remedies in the autumn.

Indirect access: background

Our review of indirect access to payment systems is looking at whether market conditions support effective competition, focusing on choice, service quality and the ability of indirect PSPs to switch providers.

Progress

We published our interim report in March. We found that, although competition in the supply of indirect access is producing some good outcomes for PSPs that access systems this way, we have some specific concerns about choice, quality and switching.

Our interim view is that there are significant recent, current and likely developments that should address these concerns – particularly entry by new indirect access providers, new forms of access arrangement and our own existing work on access. We have proposed to allow time for the impact of these developments to become apparent before deciding whether we need to take further action ourselves.

We are consulting on our proposals for indirect access and expect to publish our final report in the summer.

Strategic report

Our card payment systems programme of work

In this programme we monitor trends and issues in the card payments sector, including the impact of new EU legislation such as the Interchange Fee Regulation (IFR) (see page 26).

We published a call for inputs in June 2015. We analysed the information we received and considered the current state of indirect access to and governance of

card payment systems. In April 2016 we announced our decision not to impose any new directions in these areas at the moment, as we consider that this would not lead to any significant benefits over what the industry is already delivering alongside the IFR and other changes in the regulatory environment. We will keep this position under review.

Perceptions survey

Half of our stakeholders think we have already had a positive impact in promoting competition

Meeting our competition objective

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

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



Total 0-3: 10%

Total 7-10: 49%

Sample size: 96. Excludes respondents who answered "don't know".

Delivery of our commitments

This page shows how we met the commitments relating to our competition objective that we made in our 2015 annual plan.

What we said we'd do

Market reviews

Carry out market reviews of infrastructure and indirect access.

What we've done

We've published our interim reports and are consulting on our proposals, in line with our projected timeline. We've proposed significant potential remedies in the infrastructure market review aimed at improving competition and innovation. We are proposing to monitor the indirect access market as increased access options could improve competition without intervention.



What we said we'd do

Sponsor bank Code of Conduct

Facilitate and approve this industry-led development.

What we've done

The Code was implemented by the industry in September 2015, and should improve service quality and clarity about services for PSPs. We will monitor its effectiveness.



What we said we'd do

Card payment systems programme of work

Examine concerns about access, transparency, governance and service-user representation.

What we've done

We've examined the issues and believe the industry's own initiatives will advance our objectives. We intend to monitor the market rather than impose new directions at this point.



What we said we'd do

Regulatory directions on access

Issue our directions and report on their effect and operators' compliance.

What we've done

Our access directions came into effect in June 2015. We published our report on access and governance in December 2015. We found that the operators had made good initial progress against our directions, there was more demand for direct access, and costs and onboarding times were being reduced. We have highlighted areas where the operators have more to do and will assess their progress annually.



Our role as a competition authority

In addition to our duties to promote competition under FSBRA, we are a designated competition authority and have concurrent competition powers with the CMA in relation to participation in payment systems. These powers enable us to carry out investigations and enforcement under both the Competition Act 1998 (CA98) and European competition law. They also give us powers to conduct market studies under the Enterprise Act 2002 (EA02), and to make market investigation references concerning persons and activities relating to participation in payment systems.

During the last year we've taken various steps to ensure we're ready to exercise our powers and work effectively with other competition authorities. We now have the resources to detect, deter and enforce against anti-competitive behaviour related to participation in payment systems in the UK, with a good number of staff with experience of working on investigations using competition powers.

We've published guidance on our procedures for CA98 investigations, EA02 market studies and market investigation references, and market reviews under FSBRA. This explains how we'll use our competition powers effectively and efficiently.

In December 2015 we agreed a Memorandum of Understanding (MoU) with the CMA regarding our

competition powers. This outlines general principles of cooperation between the two organisations, and deals specifically with matters such as case allocation, sharing information and pooling resources.

We participate actively in the UK Competition Network (UKCN) and European Competition Network (ECN). We provided information for the CMA's Annual Concurrency Reports in 2015 and 2016, and for the National Audit Office as part of its review of the concurrency regime.

In addition, we have adopted our version of the CMA's guidance on the approval and enforcement of voluntary redress schemes for infringements of competition law relating to payment systems, following a consultation with the industry.

Delivery of public commitments

Policy statement commitment

Publish our concurrent competition guidance.

Progress

Published 13 August 2015, giving us a framework for competition investigations.



Policy statement commitment

Work with the CMA and participate in the UKCN and ECN.

Progress

Attended regular meetings of the UKCN.
We signed an MoU with the CMA and attended quarterly meetings.
We signed up to the ECN on 19 June 2015.
These actions help us work efficiently with concurrent competition authorities.



Our work under European payments legislation

In addition to our work under FSBRA and the commitments we made in our 2015/16 annual plan and work programme, we have been appointed as a competent authority in the UK in relation to two pieces of European payment systems legislation: the Interchange Fee Regulation (IFR) for payment cards and the Payments Accounts Directive (PAD). This is in addition to our current functions in relation to access requirements under the existing Payment Services Directive (PSD).

Interchange Fee Regulation (IFR)

The IFR caps the fees that acquirers pay to card issuers for payment card transactions, which are passed on to merchants as part of the merchant service charge. We are the lead UK regulator and a competent authority in relation to the IFR.

In December 2015 we published our draft IFR guidance for consultation – the first regulator in Europe to do so – covering the IFR provisions that were in force by 9 December. We issued our final guidance on these provisions in March 2016.

We are following the same process for the second phase of provisions, which came into force in June 2016, and we are consulting before issuing our final guidance in autumn 2016.

Our guidance gives clarity to market participants about the approach we will take to monitoring and enforcing the IFR, and it has informed market participants taking actions to become compliant with the IFR. For example, acquirers have taken it into account when finalising the way they provide transaction-level information to their merchant customers.

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 and provides the legal foundation for an EU single market for payments, to establish safer and more innovative payment services across the EU. The objective was to make cross-border payments as easy, efficient and secure as 'national' payments within a Member State.

We currently have functions relating to the PSD's requirements regarding access to certain payment systems. The updated version of the PSD, known as PSD2, was adopted in 2015 but has yet to be implemented into UK law.

PSD2 will update the rules put in place by the PSD and is intended to stimulate competition in the electronic payments market, by providing the necessary legal certainty for companies to enter or continue 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 competent authorities under PSD2 have also yet to be appointed. The Treasury will consult on the draft regulations this year and we will then consult on our enforcement approach.

Payment Accounts Directive (PAD)

The Payment Accounts Directive (PAD) was implemented into UK law by the Payment Accounts Regulations 2015 (the PARs). Under the PARs the Treasury has appointed us as the competent authority for the designation of

alternative account switching schemes in the UK. In March 2016 we published our consultation on our approach to implementing, monitoring and enforcing compliance with the provisions that we are responsible for.

Delivery of our work under European payments legislation

Work area

Interchange Fee Regulation

Progress

We've published guidance on the implementation of the first phase of IFR provisions in the UK, giving clarity to the market and allowing participants to design the processes accordingly.



Work area

Payment Services Directive 2

Progress

PSD2 should lead to more and better choice of payment services and providers for consumers. We are in discussions with other authorities regarding its implementation.



Work area

Payment Accounts Directive (PAD) and Payment Accounts Regulations (the PARs)

Progress

We are consulting on our proposals for designating alternative account switching schemes, as the competent authority in the UK.



Building our organisation

In our 2015 annual plan we said we would continue to refine the way we operate and take whatever measures we needed to ensure we are an efficient and effective regulator. We are still a new organisation, and are creating a structure and approach to suit our role. This will inevitably evolve further as we establish relationships and practices internally and externally.

We have met all of the commitments made in our annual plan and policy work programme. We have continued to recruit and develop the people we need to be an effective regulator, and following our initial 'start-up' phase have been able to appoint full-time staff rather than contractors to many roles.

We've also worked closely with colleagues in other authorities, in particular the FCA, the Bank of England 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. This is linked to our competition powers under CA98 and under Articles 101/102 of the Treaty on the Functioning of the European Union (TFEU).

Measuring performance

In this annual report we've set out the progress we made during 2015/16 against both our annual plan and policy work programme commitments. We said we would develop ways to measure our performance and be open and transparent about how much we've achieved. We have already considered the key questions

that we will need to ask ourselves in order to assess our success – we've set these out in the table on page 31.

We can collect data that helps us to understand these questions and measure our performance. We have started to do this by including various success measures within this first operational report. These generally reflect areas where we have already made a policy intervention (such as on direct access and governance) or where we have been able to measure our operational performance.

We plan to include relevant success measures in future annual reports, to show the impact of our interventions. This approach allows us to focus on specific measures that we think are important based on our work to date. Over time we plan to refine these measures to produce a small set of key metrics which could give us a consistent way to measure our performance.

Working with other authorities

We have a legal duty to coordinate with the other UK financial regulators – the Bank of England, the Prudential Regulation Authority (PRA) and the FCA. There are significant benefits to collaborating with other authorities: we improve our knowledge and approach to regulatory issues, and can potentially work more efficiently. And, through our work with international stakeholders, we can lead the thinking on regulation of payment systems, and learn about payments innovations that may benefit the UK.



Strategic report

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

- We engage regularly with the Bank of England, the PRA and the FCA on issues connected to the payments industry. We share information and expertise and regularly consult, where appropriate, on our decisions. For example, we had extensive discussions with the FCA on anti-money laundering issues as part of our indirect access market review; and in our wider work on access we consulted the Bank of England on issues relating to financial stability. A memorandum of understanding between the UK financial regulators is in place and is reviewed annually.
- We participate at both senior and working levels in the UK Regulators Network and the UK Competition Network sharing best practice, ideas and experience and coordinating our functions under the concurrency framework. We also participate in the European Competition Network.
- Members of our staff have been seconded to both the FCA and the Bank of England 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 members of the Organisation for Economic Cooperation and Development’s (OECD’s) Network of Economic Regulators, which advises the OECD Regulatory Policy Committee.

Our staff

We have continued to recruit staff with the skills and experience to make us an efficient and effective regulator. Our team is now the right size, although we would naturally expect to add or remove a few roles as our operational needs dictate. Our team includes economic, policy, legal, regulatory, communications and operations experts, alongside our payments industry specialists. We can also draw on the experience and operational support of the FCA and the Bank of England as appropriate. We believe we now have the right balance of skills and experience to deliver our work and advance our objectives.

Perceptions survey

The industry has a good impression of us as a professional organisation in our first operational year

Our professionalism

Agreement that the PSR conducts itself professionally as an organisation

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



Total 0-3: 1%

Total 7-10: 88%

Sample size: 100. Excludes respondents who answered 'don't know'.

Assessing our success

Our objectives under FSBRA

A. Competition	How has competition changed in the payment systems industry and related markets?
B. Innovation	What impact have we had on innovation?
C. Service-users	Are service-users' interests being better served?

Our role as a competition authority

D. Concurrent functions	Have we discharged our legal obligations as a concurrent competition authority?
E. Cases	Have we successfully opened, run and concluded competition cases?

Other important factors

F. Our knowledge	Are we seen as knowledgeable on the payment systems and associated markets?
G. Delivery and enforcement	Are we, and others, delivering what we say?

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 Financial Conduct Authority's (FCA's) building at Canary Wharf and is operationally supported by the FCA through a Provision of Services Agreement (PSA). The aim is to use the FCA's existing resources and infrastructure to enable the PSR to operate efficiently and effectively.

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 its powers to levy fees to recover the PSR's costs under the Financial Services (Banking Reform) Act 2013 (FSBRA).

Analysis of performance during the year

The PSR had an **accumulated surplus of £6.0 million** at 31 March 2016. 2016 was the PSR's first year of operation, which meant that its work programme was inherently more variable as it established itself. The underspend reflects an overestimation of the costs it was believed the organisation would incur to fulfil its regulatory duties and develop as an organisation, plus a contingency budget for potential urgent regulatory investigations that never materialised. The PSR continues to pay due regard to the costs of regulation and offering value for money. The PSR will retain £1 million as reserves and provide a rebate to fee payers of £5 million in 2017.

The PSR surplus of £17.6 million for the year ended 31 March 2016 (2015: loss of £11.5 million), summarised in Table 1, was a result of **£28.1 million** in fees received in the year to 31 March 2016 (2015: nil) for prior-year forecast set-up costs of £12.3 million and current year budgeted operational run costs of 15.8 million.

Overall operating costs have reduced by £1 million (8.4%) to £10.6 million (2015: £11.5 million). This was driven by **one-off costs incurred** in 2015 for PSR set-up which were offset by an **increase in staff costs**

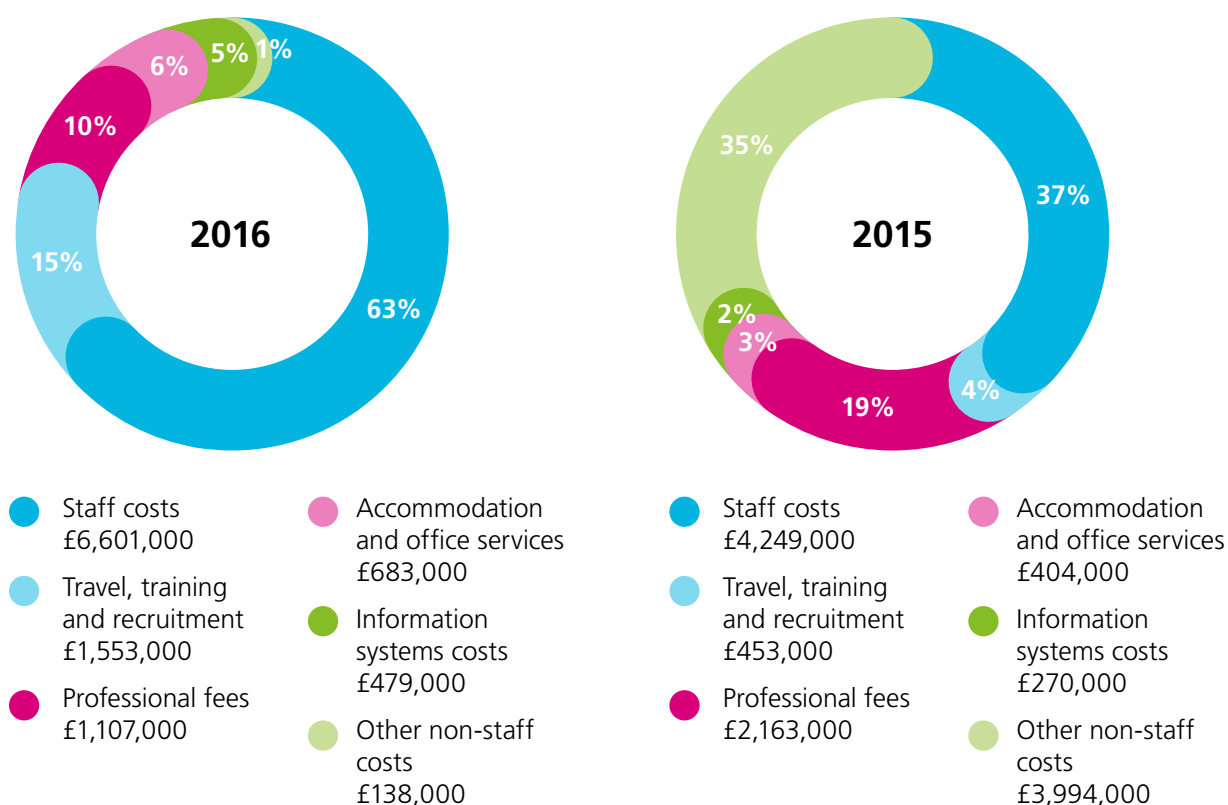
as the PSR recruited permanent employees needed to bring the team up to full strength. The PSR had an average of 44 full-time equivalent employees during the year (2015: 19).

We provide further analysis of the PSR's **operating costs** in Table 2. The decrease in **other non-staff costs** is a result of 2015 including costs recharged from the FCA for employees working on the set-up, and **professional fees** for consultant costs on set-up.

Table 1: Results for the year

	2016 £'000	2015 £'000	Increase/ (decrease) £'000	% change
Total income	28,111	–	28,111	
Staff costs	(6,601)	(4,249)	2,352	55.3%
Administration costs	(3,960)	(7,284)	(3,324)	-45.6%
Total operating costs	(10,561)	(11,533)	(972)	-8.4%
Surplus/(loss)	17,550	(11,533)	29,083	252.2%

Table 2: Analysis of operating costs by year



Financial overview

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 2016/17* 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.

Other key risks

The PSR and FCA have shared key risks:

- **Environmental risks:** These include risks associated with the operating environment for the PSR, particularly political, legislative or socio-demographic changes. While it is set out in statute that the FCA is an operationally independent organisation, it remains subject to changes in legislation and scope by the UK Government that can ultimately affect the size, activities and complexities of the PSR.
- **Internal operational risks:** Like any organisation, the PSR faces significant operational risks which may result in financial loss or disruption. In summary, for the PSR these are:
 - **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 Manager Regime (SMR) 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 the PSR.
- **Public confidence risks:** The risk of damage to the reputation of the PSR where it limits or impacts the organisation's credibility and constrains its ability to deliver against its objectives. This also incorporates inappropriate judgements, decisions and actions taken (or inaction) which stakeholders may perceive as inappropriate; inconsistent or inaccurate messages being communicated externally; and not 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 2016.

The directors use the strategic report 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 232 of the Companies Act 2006 were in force during the course of the financial year ended 31 March 2016 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 22 June 2016

S Pearce
Secretary
27 June 2016

Corporate governance

Corporate governance statement for the year ended 31 March 2016

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 and ongoing professional development.

The PSR is committed to meeting high standards of corporate governance and 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 the PSR complies 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 the Financial Services (Banking Reform) Act 2003. 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.

The role of the board

The board is the PSR's 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 the PSR's functions of giving general directions and imposing generally-imposed requirements under sections 54 and 55 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 the future operation of the PSR

- (c) overseeing the discharge by the executive management of the day-to-day business of the PSR
- (d) setting appropriate policies to manage risks to the PSR's operations and the achievement of its regulatory objectives
- (e) seeking regular assurance that the 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

Board membership

Aspects of membership of the board are stipulated by FSBRA and, consistent with those requirements, the board is made up of:

1. a chair, appointed by the Financial Conduct Authority (FCA) with the approval of the Treasury
2. two executive directors, including a managing director who was appointed by the FCA with the approval of the Treasury
3. three other members, who are all non-executive directors, appointed by the FCA

Corporate governance

Table 3

Name	Expiry of current term/ date membership ceased
Amelia Fletcher	31/03/17
John Griffith-Jones	31/03/17
Hannah Nixon	13/07/17
Brian Pomeroy	31/03/16
Martin Wheatley	13/09/15
Christopher Woolard	31/07/17
Carole Begent	30/06/18
Mark Falcon	08/09/15
Noel Gordon	30/04/19
Bradley Fried	31/03/19

Table 3 shows the expiry dates of board members' current terms.

Carole Begent and Mark Falcon were appointed to the board as executive directors in July 2015. Mark Falcon and Martin Wheatley subsequently resigned from the board in September 2015 and Sir Brian Pomeroy left the board when his term ended with the FCA in March 2016.

Bradley Fried, who is also a member of the FCA board, was appointed to the board with effect from 1 April 2016. Noel Gordon was appointed as an independent external non-executive with effect from 1 May 2016.

All directors were appointed for a three-year term. The executive directors had a continuous employment contract with the FCA, subject to the following notice periods:

Director	Notice period
Hannah Nixon	6 months
Carole Begent	3 months
Mark Falcon	3 months

Table 4

Name	Attendance at scheduled board meetings
Amelia Fletcher	8/8
John Griffith-Jones	8/8
Hannah Nixon	8/8
Brian Pomeroy	7/8
Martin Wheatley	2/3
Christopher Woolard	8/8
Carole Begent	6/6
Mark Falcon	1/1

In order to discharge its duties effectively, the board met regularly during the year. Details of the number of meetings held and attendance at those meetings are set out in Table 4.

In March 2016, the Senior Managers and Certification Regime came into force. It is a formal description of the core responsibilities of members of our board and those carrying out Senior Management Functions. The aim of the Regime is to raise standards of governance and increase individual accountability.

The board is committed to ensuring that diversity, in its broadest sense, 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 is significantly above the 25% minimum target figure for the boards of UK FTSE 100 companies.

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 non-executive directors have a variety of skills and experience that are appropriate for the requirements of the PSR.

The company secretary maintains a register of interests. All directors are required to declare relevant interests and the board decides how to manage the conflicts. Where a conflict of interest arose during the year, appropriate steps were taken to ensure the independence, integrity and impartiality of the board's decision-making.

The chair and company secretary ensure that the board's agendas are set in line with the PSR's priorities. Papers for board and committee meetings are normally circulated one week before meetings.

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

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

Under FSBRA, the PSR has the benefit of an exemption from liability in damages for anything done or omitted in relation to the exercise or purported exercise of its statutory functions. Accordingly, the PSR does not currently purchase Directors and Officers Liability Insurance.

The PSR was incorporated on 1 April 2014 and received its statutory powers in April 2015. During the year, the board has reviewed its performance and identified areas for clarification with regard to its composition and information flows.

Governance and committee structure of the PSR

The PSR is a wholly owned subsidiary of the FCA. The PSR shares operational functions and operational support with the FCA via a services agreement and all PSR staff are employees of the FCA. The functions of the PSR's Audit Committee and the Remuneration Committees are carried out by the members of the Audit Committee and Remuneration Committee of the FCA in the context of the group.

During the year, Brian Pomeroy was chair of the Audit Committee and John Griffith-Jones a member of the

Remuneration Committee. Ruth Kelly replaced Sir Brian as the chair of the Audit Committee from 1 April 2016. Baroness Sarah Hogg replaced Amanda Davidson as chair of the Remuneration Committee.

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

The board as a whole reviews the risks to the PSR on a regular basis. The board reviewed the risk framework and the organisation's approach, responsibilities and reporting mechanisms. Further information on the principal risks and uncertainties facing the PSR can be found in the financial overview (page 34).

Competition Decisions Committee

The board has authorised a pool of persons to be appointed to the Competition Decisions Committee (CDC) that can act as decision-makers in any particular Competition Act 1998 investigation. In individual cases, a CDC Panel comprised of 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.

The committee was established during 2015 following an exercise to recruit and train a pool of members. The committee has not yet met.

Enforcement Decisions Committee

The Enforcement Decisions Committee (EDC) acts as decision-maker in any particular case arising where the PSR proposes to impose a sanction under FSBRA. The EDC decides whether to impose a financial penalty and/or publish details of the compliance failure.

Remuneration report

This section of the remuneration report is not subject to audit.

The directors' remuneration table (page 40), sets out the pay, incentives and other benefits for the directors. The table and its supporting notes have been subject to audit.

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

Corporate governance

Directors' remuneration

The following table is provided in accordance with statutory and/or regulatory requirements. The information set out in pages 42 to 49 has been audited by the National Audit Office. The table sets out the remuneration paid or payable to the directors for the years to 31 March 2016 and 2015. Except where otherwise stated, the remuneration figures shown are for the period served as directors.

	Basic Salary		Performance-related pay		Other benefits		Total Remuneration (excluding pension)		Pension		Total Remuneration	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Chairman												
John Griffith-Jones ⁴	–	–	–	–	–	–	–	–	–	–	–	–
Executive Directors												
Hannah Nixon ¹	220	144	38	26	23	15	281	185	29	19	310	204
Carole Begent ²	109	–	21	–	16	–	146	–	18	–	164	–
Mark Falcon ³	57	–	–	–	5	–	62	–	4	–	66	–
									PSR Fee Paid 2016 £'000		PSR Fee Paid 2015 £'000	
Non-Executive Directors												
Amelia Fletcher ⁴											–	–
Sir Brian Pomeroy ⁴											–	–
Christopher Woolard ⁴											–	–
Martin Wheatley ⁵											–	–

Executive directors

- Hannah Nixon was appointed as an executive director (Managing Director) on 14 July 2014. Hannah's full-year equivalent (FYE) salary increased from £200,000 to £220,000 per annum on 1 April 2015. Hannah is a member of the FCA Pension Plan.
- Carole Begent was appointed to the PSR board on 1 July 2015. Carole's FYE salary is £145,000 per annum. Her bonus relates to the period since 1 July 2015 when she was appointed to the board. Her full year bonus was £27,550. Carole is a member of the FCA Pension Plan.
- Mark Falcon joined the PSR on 2 March 2015, was appointed to the PSR board on 1 July 2015 and resigned on 8 September 2015, with a final leave date of 30 September 2015. In accordance with his contractual notice period Mark was paid £24,304 in lieu of notice. Mark's full-year equivalent salary was £130,000 per annum. During his period of employment he was a member of the FCA Pension Plan.

Non-executive directors

- John Griffith-Jones, Martin Wheatley, Christopher Woolard, Amelia Fletcher and Sir Brian Pomeroy were all appointed non-executive directors of the PSR on 1 April 2014. They did not receive a separate fee for their non-executive director roles on the PSR board. Their full remuneration is included in the FCA annual report.
- Martin Wheatley resigned from the PSR board on 13 September 2015. Brian Pomeroy's term ended on 31 March 2016 when he left the PSR board.

The PSR board



John Griffith-Jones



Hannah Nixon



Carole Begent



Amelia Fletcher



Bradley Fried



Noel Gordon



Christopher Woolard

Financial statements

For the period ended 31 March 2016
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 2016 under the Financial Services (Banking Reform) Act 2013 (FSBRA). The financial statements comprise: the Statements of Comprehensive Income, Financial Position, Cash Flows, 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 and strategic 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 2016 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 the European Union
- the financial statements have been properly prepared in accordance with the Companies Act

Opinion on other matters

In my opinion:

- the part of the remuneration report to be audited has been properly prepared
- the information given in the financial overview and directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements

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 2016

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

Financial statements

Statement of comprehensive income for the period ended 31 March

	Notes	Total 2016 £'000	Total 2015 £'000
Fee income	4	28,101	–
Other income	4	10	–
Total income		28,111	–
Operating costs			
Staff costs	5	(6,601)	(4,249)
Administrative costs	6	(3,960)	(7,284)
Total operating costs		(10,561)	(11,533)
Total comprehensive surplus/(loss) for the year		17,550	(11,533)

Statement of changes in equity for the period ended 31 March

	£'000
At 1 April 2014	–
Total comprehensive loss for the year	(11,533)
At 1 April 2015	(11,533)
Total comprehensive surplus for the year	17,550
At 31 March 2016	6,017

Statement of financial position for the period ended 31 March

Company Number: 8970864

	Notes	Total 2016 £'000	Total 2015 £'000
Current assets			
Cash and cash equivalents	7	7,539	1
Trade and other receivables	7	10	-
Total assets		7,549	1
Current liabilities			
Trade and other payables	8	(865)	(502)
Intragroup payable	8	(667)	(11,032)
Total liabilities		(1,532)	(11,534)
Total assets less total liabilities		6,017	(11,533)
Accumulated surplus/(deficit)		6,017	(11,533)

The financial statements were approved and authorised for issue by the board on 22 June 2016, and were signed on 27 June 2016 on its behalf by:

John Griffith-Jones Chairman

Hannah Nixon Managing Director

Statement of cash flows for the period ended 31 March

	Notes	Total 2016 £'000	Total 2015 £'000
Net cash used by operating activities	3	7,658	55
Investing activities			
Interest paid on borrowings		(130)	(54)
Interest received on bank deposits		10	-
Net cash used in investing activities		(120)	(54)
Net increase in cash and cash equivalents		7,538	1
Cash and cash equivalents at the start of the year		1	-
Cash and cash equivalents at the end of the year		7,539	1

Financial statements

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 the 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 IFRSs 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 2016 £'000	Total 2015 £'000
Surplus/(deficit) for the year from operations		17,550	(11,533)
Adjustments for:			
Interest received on bank deposits		(10)	–
Interest payable on borrowings		130	54
Operating cash flows before movements in working capital		17,670	(11,479)
Increase in receivables	6	(10)	–
(Decrease)/increase in payables	7	(10,002)	11,534
Net cash used by operations		7,658	55

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 2016 £'000	Total 2015 £'000
Fee income	28,101	–
Interest on bank deposit	10	–
Total income	28,111	–

5. Staff information

	Total 2016 £'000	Total 2015 £'000
Gross salaries and taxable benefits	4,041	1,574
Employer's national insurance costs	479	182
Employer's defined contribution costs	361	143
Permanent staff costs	4,881	1,899
Temporary	5	114
Secondees	21	129
Contractors	1,694	2,107
Short-term resource costs	1,720	2,350
Total staff costs	6,601	4,249

As at 31 March 2016, there were 52 (2015: 33) full-time equivalent employees and 11 (2015: 10) short-term resources.

6. Administrative costs

The administrative costs for the period ending 31 March 2016 have been arrived at after charging the following:

	Total 2016 £'000	Total 2015 £'000
Travel, training and recruitment	1,553	453
Professional fees	1,107	2,163
Accommodation and office services	683	404
IT costs	479	270
Other non-staff costs ¹	138	3,994
Total	3,960	7,284

¹ 2015 includes costs of £3,939,000 recharged from the FCA for employees working on the set-up of the PSR as set out in the provision of services agreement.

Financial statements

Auditors

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

	Total 2016 £'000	Total 2015 £'000
Fees payable to the National Audit Office for the audit of the financial statements	22	23

7. Current assets

	Total 2016 £'000	Total 2015 £'000
Accrued income	10	–
Cash equivalents	7,539	1
Total current assets	7,549	1

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 2016 £'000	Total 2015 £'000
Trade creditors and accruals	865	502
Intragroup payable – FCA	667	11,032
Total current liabilities	1,532	11,534

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade payables is 24 days (2015: 26).

Intragroup payable is based on a provision of services agreement between the FCA and the PSR which sets out the services that are supplied and their respective costs. These costs are based on charges the FCA incurs.

9. Related party transactions

Remuneration of key management personnel

The remuneration of key management personnel is set out below in aggregate for each of the categories specified in IAS24 Related Party Disclosures. Key management personnel include executive board members. This includes senior management acting in the role of director for more than three months.

	Total 2016 £'000	Total 2015 £'000
Short-term benefits	300	199
Post-employment benefits	–	20
	300	219

Transactions with the FCA

The FCA provides certain services to the PSR, which are set out in the provision of service agreement. Below are the transactions with the FCA.

	Total 2016 £'000	Total 2015 £'000
Staff costs	639	3,939
IT costs	302	160
Accommodation and office services	680	404
Interest on borrowings	130	1
	1,751	4,504

As at 31 March 2016, the inter-company payable due from the PSR to the FCA is £0.7 million (2015: £11 million) as set out in note 7 above.

10. Events after the reporting period

The vote to leave the EU is likely to lead to uncertainty about the future of UK payment systems regulation, which may continue while the UK negotiates its future relationship with the EU.



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REGULATOR

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