



UK Finance

UK Finance response



PSR consultation on approach to supervision

5 June 2024

UK Finance Response

This is UK Finance's response to the PSR's Call for Views on its Approach to Supervision¹.

This response has been sent to supervision@psr.org.uk.

General comments

UK Finance welcomes the direct engagement that the PSR has taken in advance of this consultation, through coordinated stakeholder roundtables with different cohorts of the payments industry. We look forward to continuing to engage with the PSR as it evolves its approach to supervision.

We broadly support the build out of the PSR's compliance and supervisory functions, to ensure the excellent progress that has been made in many areas over the last eight years is sustained. We believe that building out a compliance and supervision arm can help the PSR better understand payments markets, the Payment System Operators (PSOs) and their participants, and therefore address any potential harms on a more informed basis. However, we have some concerns about the proposed approach to supervision, which we set out in more detail below. We also suggest areas where we believe there is scope for more clarity.

1. The PSR's statutory objectives versus its strategy

We recognise the unique position that the PSR holds in being an economic regulator for payments systems. In pursuing its three statutory objectives of promoting competition, encouraging innovation, and ensuring the interests of service users, the PSR has introduced a number of measures that have fundamentally shaped the UK payments market over the last eight years. This includes much improved access, and clearer governance structures for, payment systems.

For example, we recognise the PSR's role in broadening access to payments systems, contributing to a UK payments sector that is more competitive and service-user. The UK payments sector is now served and represented by a dynamic and varied body of firms; which means, as the Future of Payments Review concluded in 2023, *'the UK holds a leading position on the purchase experience of good and services – both in-person and online'*.

While competition is relatively well defined in other markets and in law (in the CMA's remit, for example), the objectives of 'encouraging innovation' and 'ensuring the interests of service users' are probably unique and not as well defined, and we appreciate the PSR does not

¹ <https://www.psr.org.uk/media/af0lh2pf/approach-to-supervision-cfv-apr-2024.pdf>

have an easy task interpreting what Parliament has set out. However, we strongly believe that its supervisory approach should be based on, and supportive of, its core statutory objectives, and not based on its short-term strategic aims, and the particular projects that the PSR pursues to deliver those aims.

2. Supervision versus policy development

Equally, supervision should be about ensuring regulatory requirements are followed rather than setting new (and extremely broad) regulatory requirements. The PSR's supervision proposals seem (at paragraph 2.14) to contemplate a conversion of an "expectation" (that *does not* have any legal effect) that has not been met into a direction (that *does* have legal effect). This would represent a regulatory change that should still follow the usual legislative, policy and consultation framework. We think the PSR needs to be transparent as to how it will enforce its expectations of PSOs/participants in the context of having no enforcement powers (because expectations are not law) and how it will develop a new regulatory requirement when an expectation has not been met.

Participant firms will also want to ensure that the PSR's ability to influence PSOs to make changes voluntarily (because of "expectations" and broad powers) is transparent to participants and that they will be consulted and listened to – and not be faced with a burdensome requirement initiated by the PSR via the "back-door" of influencing/requiring a PSO to change a scheme rule.

3. Relationship-building, supervision and regulatory overlap

In general, the PSR has not had a focus on ongoing relationship management and sometimes this has led to difficulties from individual firms being able to find the right person to speak to on a specific issue. We therefore support the PSR getting to know markets and participants on an ongoing basis, in addition to project-led work.

PSOs versus participants

It has not been clear historically what other participants in the payment chain can expect from the PSR; and it remains unclear under the new approach as set out. There is a possibility that building of relationships with non-PSO firms could be construed wrongly as supervision, or will look very much like it. The principles refer to PSOs and firms somewhat interchangeably. We think a clearer distinction is required between relationship management of participants and supervision of PSOs.

Regulatory overlap

There is also a risk of regulatory overlap with the PSR building out its supervision arm. To a degree, the combination of a statutory objective of 'promoting needs of end users' and a supervision approach, brings the PSR more into the remit of the FCA as a conduct regulator. It risks creating inefficiencies if market participants are dealing with multiple direct supervisors. We believe this risk can be managed by agreed and clear communication by

the regulators on roles and responsibilities; for example, on the overlapping resilience remits between the Bank of England and the PSR.

Data exercises

There should be an evidence-based approach to regulatory intervention. It would be helpful for the PSR to use its relationship management and supervisory approach to more clearly set out what harm it is concerned about, rather than ‘fishing expeditions’. It could consult informally with industry about what data may be readily available to prove or disprove a hypothesis. In the past, we have seen some data requests that were disruptive and inefficient, causing significant manual re-work to present data not readily available. This could be mitigated by establishing a proportionate baseline of information to be regularly provided by PSOs or participants, allowing firms to automate in an orderly way. Similarly, an enhanced relationship and supervisory focus should enable the PSR to more reasonably take into account PSOs’ and participants’ concerns on the timing and extent of the data actually required to investigate any hypothesis of harm. We recommend that the PSR further develops (and consults on) principles around how the PSR may require both regular and ad hoc data.

Moreover, concerns have been expressed to us that regularly requiring board minutes, business plans and strategy documents (particularly for global organisations) goes beyond the PSR’s remit. Access to those sorts of confidential information should only be provided in the context of a specific purpose within the PSR’s powers.

Technological change

Firms find that directions are often issued with an underappreciation of technological impacts. Conducting technological change to payment and customer platforms must be done safely and securely. Firms plan their “tech stack” many months (often at least one to two years) in advance. Change windows are locked in and coordinated to minimise resiliency risks, impacts on users, costs and resources. A key objective of relationship-building and broader supervision should be for the PSR to better understand firms’ approaches to technological change, thus making the the end to end compliance journey more effective.

4. The supervisory principles and a ‘one size fits all’ approach

We welcome the approach to strike a balance between ‘*clarity and unnecessary prescription*’ and the principles, as thematic outcomes taken in isolation, are difficult to disagree with. However, thematic outcomes are not the same as regulation, running the risk that PSOs will not have sufficient clarity or legal certainty to enable them to ensure they are meeting the outcomes, or their subjective assessment does not align with the PSR’s assessment, or the assessment of another regulator. Broad principles combined with very broad powers, run the risk of regulatory actions not being effectively targeted or proportionate and becoming a “catch-all” where there is no regulatory rule or requirement.

The broad principles could be used in an informal or private way to influence PSOs in one way or another – who may be reluctant to have the issue escalated to a market study or

enforcement. This approach risks there being insufficient industry and public scrutiny, or consultation. We think there needs to be some clarity over the parameters and evidence required for the PSR to intervene in a bilateral, private way.

Different types of PSO

The broad set of principles adopts a “one size fits all” approach, but there are significant differences both between the PSOs (global v domestic networks, commercial versus utility, ownership and control) and between the payment types and protections (e.g. chargebacks versus direct guarantee versus PSR 2017s protections) and use cases (discretionary retail purchase versus regular bill payments versus account to account transfers etc). Of course, use cases for each “rail” are developing and open banking represents an opportunity to expand the use case for Faster Payments/NPA into retail purchases and direct debits. It may be the case that not all of the principles would be an area of focus for all of the PSO networks all of the time. It would be helpful if the PSR might lay out its area of focus for each PSO network or use case, so that the PSO and its participants can develop specific and targeted approaches rather than very broad (and thus potentially undeliverable) principles.

Global considerations

Clearly where a PSO operates globally, the PSR does not have extra-territorial jurisdiction but it is important that targeted UK-only actions do not have unintended consequences for the PSOs or their participants, many of whom also have operations (and facilitate payments to and from) outside the UK. While the PSR has the power and should be able to make UK specific actions, their implementation consequences for PSOs and their participant PSPs should be proportionate to the harm identified in the UK, weighed against likely non UK impacts. Care needs to be taken to ensure remedies are not designed in a vacuum, without proper cost benefit analysis and consideration of the broader impacts of that change. A UK policy or remedy runs a number of risks such as forcing changes globally, or forcing a UK only change placing the UK as a significant outlier, or requiring UK participants to incur material investment that may outweigh perceived benefits, or forcing UK PSPs to operate materially differently in the UK from their international operations. The risks are heightened if the PSR can act upon a broad principles that are much less detailed than legislation or directions. For example, the principle to ‘design to enable innovation’ could call into question the neutrality of PSOs standing in the middle of a multi-party system.

Question 1: Will the approach that we set out in this document allow us to better mitigate risk to our strategic aims?

The PSR’s strategic aims as set out in its Strategy are:

- ***Everyone has access to payment services that meet their needs***
- ***Users are adequately protected when using payment systems and services, so they can use them with confidence***
- ***Payment systems enable effective competition in the provision of payment services***
- ***Payment systems are efficient and commercially sustainable***

In general, we agree that building out supervision functions will help the PSR to maintain and monitor the outcomes of its remedies and interventions. However, as noted above, we believe that the supervision approach the PSR adopts should be based on its statutory objectives, and not on its short term strategy. In addition, we would prefer to see the PSR aligning with the National Payments Vision work that was announced by HM Treasury in the October 2023 Budget.

We have been working with our members and the wider ecosystem to identify core outcomes and pre-conditions for the National Payments Vision to ensure that UK payments remain world leading and meet UK customer needs and use cases. These are set out below, with examples of how these relate to the PSR's own objectives.

The four customer outcomes our members support are:

- Confidence
- Resilience
- Value & Choice
- Accessibility

The pre-conditions set out below should apply when taking forward any regulatory initiative:

- Clear regulatory framework and strategic decision-making with the industry
- Future-looking payments infrastructure
- Credible use cases and sustainable, investible commercial models
- Excellent delivery and execution capabilities

Resiliency

While we appreciate that resilience is not the PSR's core focus, resiliency should be a principle to which the PSR must have regard – to ensure that its requirements upon industry are not inconsistent with resiliency (e.g. risks caused by an intervention or an unduly short time frame where deadlines compromise development and testing).

Commercial sustainability

We suggest that the PSR, in addition to the PSOs, also recognises the principle of commercial sustainability of the payment system for its participants. Payments have to be paid for - ideally within or mostly within the payments ecosystem itself. Fair returns for all within payments ensures that challenger bank/fintech type organisations can compete with others and bring new solutions to market, and allows for investibility in innovation, to the benefit of customers.

Question 2: Do the principles for regulatory expectations set out in section 6 below reflect the appropriate priorities for our supervision of PSOs? If not, how should they be changed?

Please see our general comments above. We provide detailed comments on each principle below.

PSOs should allow for wide access and participation

The PSR has already had significant success in this area. Due to the PSR's market review into direct and indirect access to payment systems, the number of indirect access providers has doubled from four to eight since 2015. This has provided a significant improvement in the choice of access options for Payment Service Providers, in turn allowing more innovation on these rails.

We note PSR's General Direction which covers access:

“An operator of a regulated payment system which is not subject to Regulation 103 of the PSRs 2017 must have publicly disclosed access requirements which:

- *are proportionate, objective and non-discriminatory*
- *do not prevent, restrict or inhibit access or participation more than is necessary to safeguard against specific risks (such as settlement risks, operational risk”.*

It is not clear how a PSO is to regard the access principle in any way other than complying with General Direction 2, General Direction 3 and PSRs Reg 103. We think this principle is unnecessary and duplicative of existing regulatory requirements.

PSOs should work to address the needs of users and participants

As noted above the thematic outcome is one that many would support, but the pragmatic reality is that payment networks do not interact directly with consumers or businesses – they work with financial institutions who hold customer relationships. For commercial type PSOs, this could lead to inappropriate and significant interference with commercial, risk or resiliency operations or force PSOs to develop products and services in the UK that they do not wish to develop. For some “utility” type PSOs, many of our members feel somewhat disenfranchised from some of them and do wish to have a greater say in operations and the governance of the development roadmap.

One could interpret this principle as permitting supervisory influence to commence or increase consumer protection on any given payment type. This would be an area that should necessitate consultation and new directions or legislation.

Paragraph 6.15 notes that PSOs should be able to show they take into account their members' needs and interests. It is not clear how the PSOs would demonstrate compliance. Further there appears to be no recognition of the diversity of, or competing, needs and interests, nor of the balancing act required in establishing and maintaining a network.

PSOs should monitor and manage risk to compliance with payment system rules and standards

Again this is a laudable outcome but might not be pragmatic. Take for example the card schemes that require merchant acquirers to flow down certain obligations and rules to merchants. It is unrealistic to assume that the merchant acquirers, let alone the card schemes, will, or ever could, know of every single breach.

We agree with the approach set out regarding having defined and effective procedures for managing breaches, understanding their impact on users and ensuring that disincentives for breaches are fairly and proportionately applied.

PSOs should coordinate cross-market change effectively

Conceptually, we agree with the approach (particularly on communication and timing of changes), although the other requirements/statements do not seem to be readily testable or suitable to be raised as a regulatory requirement.

PSOs should build and maintain the trust and confidence of their users and participants

The PSR has already had significant success in this area. As a result of the PSR's 2015 general directions, the operators of Bacs, Faster Payments, Cheque & Credit and LINK are now required to make transparent decisions, consider service-users' interests in their decision-making processes, and publish forward-looking annual reports on stakeholder engagement activities. They are also required to take all reasonable steps to avoid conflicts of interest between operators of the systems, and the underlying infrastructure providers. For example, Pay.UK which runs three of the systems, has a board with over 50% independent NEDs and over 40 guarantors representing different part of the ecosystem. It is not clear however, how this principle is to be applied in practice, or what is expected of PSOs compared to how they operate today.

PSOs should limit opportunities for abuse in payment systems

System integrity is of course important. That said, the principle does not set out how a PSO would meet the objective or what assessment criteria would apply (or how it would be developed on a PSO-by-PSO basis).

PSOs should design to enable innovation

This principle recognises the importance of the network effect of setting requirements and providing services centrally. However, the commentary around when it may be appropriate to allow or not allow innovation by individual participants is potentially an expansion of General Directions 2, that ought to have more objective criteria. Enabling (rather than requiring) innovation by participants is something we would support, but this must be balanced against the other principles set out, such as efficiency and co-ordinating cross market change.

Where this principle relates to R&D, it may be better targeted at "national infrastructure" / monopoly PSOs rather than commercial PSOs that have competitors.

PSOs should ensure the payment systems they operate are efficient and sustainable

We agree that PSOs should ensure their services are cost-effective and should not privilege one type of payment firm at the expense of another (e.g. a PSP payment institution versus a banking institution). We also agree that PSOs should have a view to commercial sustainability of the payment system for its participants as noted in our response to Question 1.