



HM TREASURY

Opening up UK payments

March 2013



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Contents

	Page
Chapter 1 The consultation process	3
Chapter 2 Introduction	5
Chapter 3 Proposed new economic regulation regime	7
Chapter 4 Operation of the regulator	15
Annex A List of questions	21

1

The consultation process

The subject of this consultation

1.1 The regulation and governance of payments systems in the UK.

Structure of the consultation

Chapter 2: Introduction

Chapter 3: Proposed new regulatory regime

Chapter 4: Operation of the regulator

Annex A: List of questions

Who should read this

1.2 This consultation invites views on options for reforming the regulation and governance of payments systems in the UK. It should be read by those with an interest in the future development and strategy of payments systems and the users of those systems: this includes banks, building societies and other payments service providers, the owners and operators of payment systems, businesses, trade bodies, consumer groups and other interested parties.

How to respond

1.3 The Treasury invites responses on the specific questions raised. The questions can be found throughout the document and are listed in full at annex A.

1.4 This consultation will run from Tuesday 26 March 2013 – Tuesday 25 June 2013.

1.5 Please send responses to:

Payments Consultation
Banking & Credit Team
Floor 1, Red
HM Treasury
1 Horse Guards Road
London,
SW1A 2HQ

Email: PaymentsConsultation@hmtreasury.gsi.gov.uk

Confidentiality

1.6 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the Freedom of Information Act 2000 (FOIA).

1.7 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must

comply and which deals, among other things, with obligations of confidentiality. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.

2

Introduction

2.1 In July 2011 the Treasury Select Committee (TSC) published *The future of cheques*¹, its final report into the decision by the Payments Council to set a target date of 2018 for the abolition of cheques. Following pressure from the Government and the TSC, the Payments Council ultimately reversed this decision. Nonetheless, in its report the TSC expressed serious concerns about the governance of payment systems, describing the Payments Council as industry-dominated and lacking effective public accountability. One of the TSC's key recommendations was that the Treasury should bring the Payments Council formally within the system for financial regulation.

2.2 The Government accepted the TSC's recommendations, and as a result in July 2012 issued a consultation, *Setting the strategy for UK payments*² ("*Setting the Strategy*"), which set out two options for improving the way that payments strategy is made in the UK. The two options were:

- 1 To build on the present approach to UK payments strategy by making a series of changes to the governance of an operation of the Payments Council.
- 2 To introduce a new public body, the Payments Strategy Board (PSB), to set strategy across the UK payments industry.

The Government also noted, but did not offer as a developed option, an alternative approach of creating a new economic regulator with responsibility for payment systems.

2.3 In *Setting the Strategy*, the Government said that its favoured approach was Option 2, the introduction of the PSB. Since the publication of that document, however, a number of developments have occurred that have led the Government to conclude that Option 2 would not deliver its aims as set out in that document, and that these would be best achieved by pursuing an alternative approach of bringing payment systems under a new regime of economic regulation. The Government's reasons for coming to this conclusion are set out in chapter 3.

2.4 The Government is now proposing to proceed with bringing payment systems under economic regulation, and establish a new competition-focused, utility-style regulator for retail payment systems. The rest of this consultation sets out the Government's response to the outcome of the previous consultation and its proposal for a new regulatory system, details how the Government envisages the new regulatory regime functioning, and lists the consultation questions.

¹ *The future of cheques*, House of Commons Treasury Committee, July 2011

² *Setting the strategy for UK payments*, HM Treasury, July 2012

3

Proposed new economic regulation regime

The Government's aims

3.1 In *Setting the Strategy*, the Government made clear that it wishes to create an environment where payment systems' end-users, including consumers, and the wider economy benefit to the fullest extent from payments systems. The document noted that this means having:

- UK payments systems that operate for the benefit of end users including consumers;
- a UK payments industry that promotes and develops new and existing payment systems;
- UK payments systems that facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms; and
- UK payment systems that are stable, reliable and efficient.

3.2 The Government also made clear that the current system of governance for UK payment systems is not adequately meeting these objectives.

3.3 On operating for the benefit of end users, *Setting the Strategy* noted that the Payments Council had not done enough to respond to the needs of payment system users, including consumers. A key example of this was the decision, later reversed, to set a target date to abolish cheques, without first considering the potential impacts or developing adequate alternatives.

3.4 In terms of promoting and developing payment systems, *Setting the Strategy* noted the slow pace of innovation in payment systems, which in some cases may have led to significant losses to the UK economy. For example, development of the Faster Payments Service (FPS) began in 2005, driven by the Treasury and the Office of Fair Trading (OFT). While it was originally expected that FPS would take two years to develop, the project was subject to multiple delays. The full benefits of the system only became available to consumers in January 2012, in accordance with a provision in the Payment Services Regulations 2009, requiring that payments must reach the recipient's account by close of business on the day after they are initiated (the FPS system in fact allows for payments to be made significantly quicker than this, in near real time). Similarly, a project to develop a mobile payments system had been under consideration virtually from the creation of the Payments Council; a firm decision to proceed was only finally taken in December 2011.

3.5 On competition and open access, it was noted that, while evidence of distortion was not clear cut, a lack of transparency of the arrangements within the sector makes it extremely difficult to gauge whether there are genuine problems. Among "agency" arrangements, whereby institutions with lower payment volumes access the payment systems via a larger institution, complexity, information asymmetries and lack of transparency put larger institutions in an influential position. They also make it difficult to assess the competitiveness of the market. For institutions who are considering direct access to the payment systems, the cost and process of achieving direct access may not be clear, and agent institutions are in a strong position to dictate terms of indirect access.

3.6 The aim of maintaining UK payment systems that are stable, reliable and efficient has been adequately met by the existing regime. The Bank of England has existing statutory authority for overseeing payment systems that are recognised by the Treasury as of particular importance to the stability of the UK financial system, and performs this oversight with a view to protecting and enhancing financial stability. The stable operation of payment systems has been maintained, notably throughout the financial crisis.

Problems with the current system

3.7 Many of the issues relating to the payment systems stem from the fact that a number of large banks dominate the industry at every level. These banks dominate the decision-making process of the Payments Council; own the payment schemes; operate as direct users offering services to consumers; and operate as agents for smaller financial institutions who do not want, or cannot obtain, direct access to the schemes. Because of their involvement at each level of operation, there is considerable opportunity for these banks to manipulate their involvement in the process for their own benefit.

3.8 In *Setting the Strategy*, the Government identified the reasons why the current regime has not adequately met three out of four of the Government's aims for UK payment systems.

3.9 First, the Payments Council has not been able to adequately perform its advisory and strategy-setting function in a way that is reflective of the needs of all stakeholders, including end-users. This stems from the strong position of the UK's largest banks, which are the joint owners of the major payment scheme companies and the dominant force in Payments Council decision-making. This has led to decisions being taken by the Payments Council that do not take fully into account the needs of stakeholders beyond the large incumbents. Projects that would be to the wider benefit of society but not in the narrow interests of the banks have been blocked, and progress has been made at the pace of the slowest.

3.10 Second, the Payments Council has found it difficult to secure agreement to effectively deliver projects. The Payments Council operates by consensus, and it has been unable to compel individual members to co-operate with developments that are not in their immediate commercial interests; this has led to project delays and inefficiencies that have been detrimental to the wider economy. The Payments Council has also had difficulties in ensuring that stable funding is provided for projects.

3.11 As a result of these problems, the Government set out two options for reform:

- 1 To build on the present approach to UK payments strategy by making a series of changes to the governance of an operation of the Payments Council.
- 2 To introduce a new public body, the Payments Strategy Board (PSB), to set strategy across the UK payments industry.

3.12 The Government's favoured option was to introduce a new public body, the PSB, to set strategy across the UK payments industry (Option 2). The consultation document therefore focussed mainly on this option, setting out in detail how the Government intended the PSB to work. The majority of the responses to the consultation supported the Government's favoured option, agreeing that improving the self-regulation of the Payments Council (Option 1) did not go far enough. These responses have now been published on the Treasury's website, and this document constitutes the Government's response.

3.13 In *Setting the Strategy*, however, the Government did not fully explore the alternative approach of creating a new economic regulator with responsibility for payments systems. At the time of publication, the Government considered that a PSB might well go far enough in

addressing the problems identified with the governance of the payments industry, without needing to impose the extra costs and regulatory burden that would be associated with a full utility-style regulator.

3.14 In the period between the consultation on *Setting the Strategy* closing and today however, there have been a number of developments which have led the Government to decide that full utility-style regulation of the payments industry has become a necessity. The developments that have led the Government to this view are set out in paragraphs 3.15-3.17 below.

Self-regulation and banking

3.15 The LIBOR revelations are the latest in a series of high profile examples where the self-regulation of financial services, favoured by the last Government, has been discredited. The Wheatley Review, which the Government set up in response to the announcement of the original findings against Barclays, recommended that the British Bankers' Association should transfer responsibility for LIBOR to a new administrator. Against this background, the Government has decided that a PSB, which would have been open to strong industry influence, is no longer a sustainable approach to tackling the problems it has identified with payment systems.

Competition in banking

3.16 Additionally, in the period since *Setting the Strategy* was published, the Government has become increasingly concerned about the difficulties faced by both new entrants and existing small challengers in the UK banking market. In July 2012, the Government asked the Financial Services Authority (FSA) to take forward a comprehensive review (*Barriers to Entry and Expansion in Retail Banking*, published today) to address regulatory barriers to entry and expansion in retail banking in the UK. As this review has progressed, it has become clear that there are significant concerns around the potential for the terms on which competitors can access the payment systems to act as a barrier to entry in retail banking. The nature of the market, with its strong network effects, means that this issue can only be addressed effectively by establishing a new system of economic regulation. Given the importance the Government attaches to improving competition in UK banking, this means that the balance of arguments now lie in favour of a full utility-style regulator.

3.17 A significant potential barrier to competition in this area, both in terms of competition between payment systems, and in banking more widely, is the ownership of a number of the payment systems by an overlapping group of the big incumbent banks, which are also the largest users of those systems. There is the potential for the banks to use their ownership stakes to inhibit competition at several levels, for instance by:

- acting to prevent competition between payment systems where this might otherwise be feasible, and blocking innovation and development;
- erecting unnecessary barriers to direct membership of the payment systems; and
- failing to offer indirect access to the payment systems on fair and transparent terms.

Again, the Government believes that the introduction of a regulator is needed to set a regulatory framework that will ensure that potential ill-effects of this vertical integration and shared ownership are tackled, and to monitor whether structural reform is necessary to make the market function effectively.

Payments Strategy Board

3.18 Many of the responses to *Setting the Strategy* suggested that the Payments Strategy Board would need regulatory powers in order to tackle the problems in payment systems highlighted by the Government. Having given this matter full consideration, the Government agrees that regulatory powers would have been needed to make a Payment Strategy Board effective. Giving regulatory powers to a body that would be susceptible to strong industry influence risks a return to the system of self-regulation in financial services; this is not a path which this Government intends to follow.

The Government's proposal for reform

3.19 The three developments set out above have driven the Government's view that only a formal system of utility-style regulation can adequately address the problems in UK payments. The Government is therefore consulting on these proposals, with a view to legislating to create such a system at the earliest achievable opportunity.

3.20 The Government will create a new economic regulation regime for UK payment systems. The regulator will operate according to the established institutional model for economic regulation, and will act to ensure that the Government's aims for the payment systems are met. In particular, it will seek to ensure that the governance and operation of the payment systems is not a barrier to competition in the provision of payment services, and in the wider UK financial services market. It will also ensure that decisions about the operation and development of UK payment systems are made with the views of all stakeholders, including end-users, being properly taken into account, and that adequate investment is made to act on the results of these decisions.

3.21 The Government has considered whether measures need to be taken to address the ownership structure in payment systems, and has decided not to take formal government action at this point. However, given the clear potential for owners of the payment systems to use their position to stifle innovation and competition, the regulator will be given powers to address ownership structures, if it deems it appropriate to do so. This is set out in more detail in chapter 4.

3.22 The Government has considered three options for the body to which the regulatory role will be given:

- a new stand-alone regulator;
- the Financial Conduct Authority (FCA); and,
- one of the existing economic regulators.

3.23 The option of creating an entirely new, stand-alone regulator would have the advantage of offering a fresh start, with a single-focus regulator. The Government's view, however, is that this option would face significant difficulties. In particular, this option would leave the new regulator unable to take advantage of synergies with existing functions and expertise; as a result, this would be a more expensive way of proceeding. This option would also be more difficult and take longer to set up. There would therefore be an extended period before anticipated benefits for consumers and the economy would be delivered. There would also be a prolonged period of uncertainty for the industry, which could result in planning blight.

3.24 For these reasons, either the FCA or one of the existing economic regulators will be given the role of regulator for the UK payments industry. The Government believes that there are good arguments in favour of each of these options, and is therefore seeking views on whether giving this role to the FCA or one of the existing economic regulators would most effectively achieve the Government's aims.

3.25 The FCA has a pre-existing relationship with the members of payment systems, including being, in part, funded by them via their levy, but does not have an analogous relationship with the payment system operators. It also has pre-existing channels for consultation with the other bodies involved in the regulation and oversight of payment systems, particularly the Bank of England, which will be necessary for the payments regulator to ensure stability concerns are fully taken into account. However, the FCA has no prior experience of utility-style regulation, so this capacity would have to be built up from nothing and be maintained as a somewhat separate function from the remainder of its role. Equally, the FCA does not have any experience of using concurrent competition powers, or links with the EU competition directorate. There are, however, precedents that point to the possibility of setting up a new system fairly quickly, and doing so within an organisation whose focus is not exclusively, or even predominately, on economic regulation.

3.26 The situation of the existing economic regulators is, in some ways, a mirror image of this. They have significant experience of utility regulation in industries which, like payment systems, exhibit strong network effects (tending to natural monopoly). They also have experience of using concurrent competition powers. However, they have no pre-existing relationship (or funding arrangement) with the intended regulated population (payment system operators and their direct members/participants). They also lack pre-existing lines of communication with other supervisory bodies in this space. In deciding whether to give this function to one of the economic regulators, the Government will want to take into account the effect on their existing role and workload.

3.27 Regardless of which body takes responsibility for the regulatory function, the Government will take measures to ensure that payment systems issues are given appropriate attention within the regulator's overall workload. These will include:

- specific duties in relation to payment systems issues;
- an office-holder of an appropriate-level of seniority with responsibility for day-to-day work on payment systems;
- separate reporting and decision-making procedures;
- separate budgeting for payment systems work; and
- a separate annual report.

Question 1

Would giving the role of payment systems regulator to the FCA or to one of the existing economic regulators be most likely to deliver the Government's aims in the payment systems sector? Are there other options for the regulator that would better deliver these?

The existing regulatory regime

3.28 The existing regulatory regime for payment systems was described in *Setting the Strategy*. As that document noted, this area is complex, with a number of bodies having some responsibility for payment systems regulation and governance. The existing system provides roles for the Treasury, the Bank of England, the Financial Services Authority (which from 1 April 2013 will move to the FCA) and the OFT. The Payments Council, an industry body, is responsible for strategy-setting in UK payments. This section describes how the roles of these bodies will change under the new regulatory regime.

3.29 The Treasury is responsible under the Banking Act 2009 for designating payment systems as “recognised systems”, where the Treasury is satisfied that any deficiencies in the design of the system or disruption to its operation would be likely to:

- threaten the stability of, or confidence in, the UK financial system; or
- have serious consequences for business or other interests throughout the UK.

Once a system is recognised, it is brought within the formal oversight of the Bank of England. Currently, Bacs, CHAPS, CLS Bank International, the Faster Payments Service and the payment systems embedded in the Crest, Ice Clear Europe and LCH Clearnet systems are recognised in this way. Under the new regime, the role of the Treasury will remain unchanged.

3.30 The Bank of England is responsible for the formal oversight of recognised payment systems, and has a role in considering applications for the designation of payment systems. The Bank also has a role in clearing sterling payments across its balance sheet, through its operation of the Real-Time Gross Settlement System, as well as its provision of final multilateral net settlement facilities for a number of payment systems. Finally, the Bank is also an operational user of some of the payment systems, in its role as a provider of banking services to its customers. The Government intends that the Bank will continue to operate in these roles under the new regime.

3.31 The FCA will, from 1 April 2013, inherit the role of the Financial Services Authority as the competent authority for Authorised Payment Institutions and registered Small Payment Institutions (firms providing payment services) under the Payment Services Regulations 2009. The Regulations implement Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market. The Directive established an authorisation regime for non-bank payment service providers, such as money remitters and non-bank credit card issuers, and sets out conduct of business rules for all firms providing payment services, including banks and payment institutions. Under the new regulatory regime, this function will remain with the FCA, regardless of the choice of regulator.

3.32 The OFT is responsible for enforcing the Competition Act 1998 and Part 8 of the Payment Services Regulations, which aim to ensure fair access to UK payment systems. Part 8 does not apply to payment systems that are designated as systemically important under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 – which includes CHAPS and Bacs. Some UK payment systems do fall within the scope of Part 8, including card systems like Link, Visa and MasterCard. The Government is proposing that the functions under Part 8 should transfer to the new economic regulator once it is established, as they will clearly fall within its core role. As part of its programme of work on retail banking, the OFT will be conducting a short exercise gathering evidence from a number of stakeholders concerning competition and innovation in payment systems in the UK. This will inform the OFT’s response to the consultation and the work of the payments regulator.

3.33 There is also a significant role for EU institutions in the regulation of UK payment systems. The new regulator will co-operate with relevant EU-level bodies, and the Government will ensure that its powers and functions are designed to accommodate any developments in this area.

3.34 The Payments Council is a self-regulatory body, established in 2007, with responsibility for setting the strategy for UK payments. Originally, the Payments Council was created as a fall-back solution, given the decision of the then-Government not to follow through on the recommendations of the Cruickshank Report by establishing a utility-style regulator. As has already been noted, however, the Payments Council suffers from significant weaknesses. Its lack of independence undermines its ability to develop a credible strategy taking into account the needs of all users of payment systems. Its lack of enforcement powers leaves it unable to consistently drive through projects that are not in the immediate interests of one or more of its members.

3.35 Given that the Government is now proposing to establish a system of economic regulation for payment systems, it does not see a formal role for the Payments Council in the new regulatory structure. The strategy-setting role currently played by the Payments Council will operate via the payment scheme companies developing their strategy subject to the approval of the new regulator. However, the Payments Council is not established in statute. It is an industry membership organisation that undertakes a number of industry coordinating and representative functions. Decisions on its future constitution and functions are therefore a matter for its members, as with other trade bodies.

Question 2

Is the Government's proposed positioning of the role of the payments regulator in relation to the other regulatory bodies in the sector the best way to achieve its aims?

4

Operation of the regulator

4.1 As set out in Chapter 3, the Government is consulting on whether the regulatory function should sit with the FCA or one of the existing economic regulators. These are organisations with very different histories, functions and approaches. Once a decision is taken on which organisation should be given the regulatory function, the Government intends that these functions will be assigned to the regulator in a way that is, so far as possible, complementary to its existing role and powers. This chapter therefore sets out the proposed regulatory model in a principles-based way, without going into the detail of exactly how the role will be prescribed in legislation.

Regulatory model

4.2 The proposed model for the new regulatory system is based on the prevailing institutional model of utility regulation, as displayed in the cases of Ofcom, Ofgem, Ofwat and other sectoral economic regulators. A key principle of this model is that the regulator must be independent of government, in order to provide certainty and stability for market participants.

4.3 The Government intends that the regulator should have powers over UK retail payment systems, and their direct members. The Government proposes that, in the first instance, this will cover the cheque clearing systems; automated payments systems (Chaps, Bacs, Faster Payments); the LINK ATM network; and three and four-party card schemes. The Government does not propose to extend the scope to payment systems that are embedded in securities trading systems, clearing houses or central counterparties such as CREST, LCH Clearnet and ICE Clear Europe, nor to messaging services like SWIFT. However, as and when new retail payment systems are developed, they will be considered for inclusion under the new regulatory regime.

4.4 The Government intends to include in statute an appropriate definition to capture the relevant payment systems. The Treasury will have the power to amend this definition through secondary legislation, in order to ensure that new developments do not result in the regulatory system catching entities it is not designed to regulate, and that those entities it is designed to regulate cannot evade regulation by gaming the criteria. The Treasury will also have the power to exclude payment systems falling within this definition from regulation.

4.5 The Government also proposes to apply licence conditions on the direct members and direct participants of the licensed payment systems where necessary to ensure that they do not take actions in their capacity as members and participants, that would inhibit the system from adhering to its licence conditions.

4.6 The Government does not intend that the regulator will have direct powers over infrastructure providers in payment systems, whether the privately-owned providers, or the Bank of England, in its capacity as the provider of the Real Time Gross Settlement infrastructure. While the Government recognises the importance of infrastructure providers in delivering the required outcomes for payment systems, the Government foresees their contractual relationship with the payment schemes as the main means of the regulator influencing their development. While it would be possible for the Government to licence infrastructure providers and apply obligations to them directly, this would risk inadvertently diminishing competitive pressures, which currently appear to have more chance of functioning effectively in this part of the market.

Question 3

Is the proposed scope of regulation appropriate to achieve the Government's aims?

Regulator's duties

4.7 In common with existing utility regulators, the payment systems regulator will have duties, set out in statute, which will guide its use of its powers. The regulator's primary objective will be focused on promoting the interests of current and future end-users of payment systems, where appropriate by promoting competition and innovation, and to ensure that the payment systems are adequately funded to achieve it. This will be subject to a requirement to avoid actions that would have a material negative impact on financial stability.

4.8 The regulator will also be subject to a range of secondary duties, to which it must have regard. The Government proposes that these cover the following, in line with the Better Regulation Principles set out by the Department for Business, Innovation and Skills:

- transparency;
- accountability;
- proportionality;
- consistency; and
- keeping the regulatory burden under review.

In addition, the new regulator will operate in accordance with the Government's Principles for Economic Regulation¹.

4.9 As set out in the previous chapter, the regulator will also be required to ensure that it co-ordinates appropriately with the Bank of England, and that its actions are consistent with the Bank's regulatory remit of preserving financial stability.

Question 4

Are the proposed duties for the regulator appropriate to achieve the Government's aims?

Competition powers

4.10 The Government proposes that, in common with other utility regulators, the payments regulator will have concurrent competition powers over payment systems, under the Competition Act 1998 and Enterprise Act 2003.

4.11 As a result, the payments regulator will have powers to:

- enforce the prohibitions on anti-competitive agreements and abuse of dominant position and,
- refer the market, or a subsection of it, to the Competition Commission for a full Market Investigation.

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf

4.12 The Government believes that having a dedicated regulator with concurrent competition powers in this area is necessary. The nature of the market provides both significant incentive and opportunity to take actions that would inhibit competition and is technically very complex. A specialist regulator will have a deep understanding of the market and its participants, the issues that prevail at any particular point in time and an obligation to keep the functioning of the market under review. It will therefore be well placed to assess the market and consider any potentially anti-competitive features. As with other utility regulators, the opportunity to consider the relative appropriateness of taking competition or regulatory action is an important feature of the proposed regulatory regime.

4.13 Apart from the competition functions that the Government is proposing to give to the payments regulator, the OFT² will retain its responsibility for overall competition in financial services, and will be required to consult with the payments regulator where these responsibilities overlap.

Question 5

Do you agree that the payments regulator should have concurrent competition powers over the market for the provision of payment services? Is the proposed scope of these powers appropriate to best achieve the Government's objectives?

Licensing regime

4.14 Operators of payment systems and their direct members will be statutorily required to be licensed by the payment systems regulator. Licence-holders will be required through statute to adhere to principles on:

- Efficient and transparent pricing
- Non-discriminatory access
- Good governance.
- Maintaining and developing the payment system.
- Co-operation.

4.15 The licence conditions will provide the detail of the requirements with which licence-holders must comply. The regulator will have statutory powers to enforce the licence-conditions, as set out in paragraphs 4.22-4.23, below.

4.16 On efficient and transparent pricing, the requirement will be that prices are set at the appropriate level to benefit current and future end-users of the payment system. Licence-holders will be required to ensure that their pricing structures are transparent to their users, and that they are derived through a fair and transparent methodology. This will apply both at the level of payment system operators and their direct members and direct participants, where they offer indirect access to the payment system to third parties. The Government envisages that each licence-holder will, when requested, present its pricing methodology to the regulator, who will then review it and require amendments as appropriate. Where the regulator is not satisfied that the licence-holder is using an acceptable pricing methodology, and having given it sufficient opportunity to remedy the situation, the regulator will have the power to intervene to directly

² The Enterprise and Regulatory Reform Bill contains provisions for the functions of the OFT and Competition Commission to pass to a new Competition and Markets Authority (CMA). References to the functions of the OFT and Competition Commission should be read as references to the CMA, after the point it assumes these functions.

set prices for (1) direct access to a payment system, (2) indirect access to a payment system via an agency relationship and (3) interchange fees.

4.17 On non-discriminatory access, licence-holders will be required to ensure that the payment systems can be accessed on a fair basis, and that any restrictions on access are justified and proportionate. This will apply to the payment system operators in terms of direct access to the systems, and to those members of payment systems offering indirect access to the systems for third parties, via an agency arrangement.

4.18 On good governance, licence-holders will be required to maintain governance structures, according to guidance from the regulator, such that control of the company cannot be abused, either individually or collectively, in a way that is detrimental to end-users, for instance by erecting unnecessary barriers to entry, or unfairly discriminating between users.

4.19 On maintaining and developing the system, payment system operators will be required, on a regular basis, to submit plans for how they intend to achieve this over the coming period. The regulator will, in accordance with its duties, be able to require amendments to these plans, specific action to deliver them, and a pricing strategy to raise sufficient funds to do so. The Government envisages that this will be the main mechanism by which the regulator will drive innovation in payment systems, by listening to the views of all stakeholders, and taking a decision on the type of progress it is reasonable to require the systems to make over the period. As part of this process, the regulator will be able to require the inclusion of particular types of investment programme in the licence-holders' plans. Direct members of the payment systems will be required to take appropriate actions and make sufficient investments in their own systems as are needed for these plans to be delivered at a payment system level.

4.20 On co-operation, licence-holders will be required to co-operate with each other where there are inter-dependencies, for instance where projects that form part of their strategic plans can best be taken forward by working collaboratively across one or more payment system, although careful consideration will be required to ensure that this does not inhibit competition. For direct members, there will be a requirement to co-operate where needed to deliver the development and good functioning

4.21 The regulator will be required to publish guidance on how it expects licence-holders to demonstrate that they are complying with these licence conditions.

Question 6

Are the proposed licence conditions appropriate for achieving the Government's objectives?

Regulatory powers

4.22 The regulator will have a range of powers set out in statute, in line with the institutional model for existing utility regulators. The regulator will use these powers to set the conditions of the market which are necessary to facilitate effective competition, or remedy problems in the market arising from areas where competition cannot function appropriately, due to inherent features of the market.

4.23 The powers the Government proposes to give the regulator are:

- **Information-gathering powers** – the regulator would have the power to demand to be provided with information from regulated firms, visit their premises, and so on, in line with other economic regulators.

- **Power to remedy a breach of licence conditions** – this would include allowing the regulator to issue enforcement orders that would require a licence-holder to comply with its licence conditions as interpreted by the regulator, in accordance with any issued guidance, require transparency through making information publically available, or specifying contract terms it will require the firms to adopt, including pricing.
- **Power to impose financial penalties for breach** – within appropriate safeguards, the regulator would be able to impose financial penalties on licence-holders that are in breach of their licence conditions.
- **Power to share information** – the regulator would be permitted to set up information gateways with relevant domestic and European bodies.
- **Power to create advisory bodies** – the regulator would be able to set up advisory bodies, for instance on consumer needs or technology.
- **Power to levy the regulated population to fund its own activities** – the regulator will apply charges on the payment system to fund its activities, according to a proportionate charging structure.
- **Power to amend the licence conditions** – the regulator will have the power, in certain circumstances, to change the licence conditions. This power would be subject to suitable protections, including appeals to the Competition Commission.

Question 7

Are the proposed regulatory powers appropriate to achieve the Government's objectives?

Ownership of payment systems

4.24 As noted above, a number of the most important inter-bank payment systems are owned by slightly differing combinations of the big UK incumbent banks. As a result, the UK has a situation where a group of the most powerful users of a system are also its owners. This means that smaller players and new entrants to banking must seek access, whether directly or indirectly, to systems that are jointly-owned by a number of their competitors.

4.25 Where incumbents control a vital shared network, it could create perverse incentives and/or opportunities for the incumbents to create barriers to entry, for instance by creating unnecessarily burdensome conditions for access, or giving preferential service to owners. In other regulated industries, these problems have sometimes been addressed by structural solutions: for instance, in the electricity network, National Grid, as the transmission network owner, is not permitted to act as a supplier or generator, and in telecoms BT Openreach, as the owner of the UK's only fixed copper network, is required to maintain functional separation from BT's retail arm.

4.26 The Government is concerned that the ownership structure in UK payment systems could create similar opportunities. The ownership structure in payment systems is more complicated than in some other markets, however, as an overlapping group of banks own several of the payment systems. While the nature of the market may mean that there is limited scope for these systems to compete with each other, any incentive for them to do so, whether by pursuing innovations or driving efficiencies, is likely to be blunted by their common ownership.

4.27 While the payments regulator will have a full range of powers to tackle potential abuses of ownership, these may not be enough to ensure that all potential ill effects of vertical integration

and common ownership are tackled, given existing ownership structures. Therefore, the regulator must be in a position to end the ownership of payment systems by their users, if it sees this as the most appropriate and proportionate way to tackle any problem it believes it must address.

4.28 If the regulator were to conclude that, in spite of the exercise of its other enforcement powers, the market in payment systems was still not functioning effectively, it would have two broad means of addressing this.

4.29 First, the regulator could use its competition powers to refer the market to the Competition Commission. The Competition Commission would then conduct a thorough market investigation. If it found that there were problems in the market, it has far-reaching powers to address these, including the power to order the banks to divest their ownership stakes in the payment systems.

4.30 Second, the regulator will have the power to impose additional requirements on a regulated payment system, should it regard this as necessary to promote effective competition. This could include a range of mandatory actions relating to the governance of the payment systems to increase their independence from their owners (possibly by making them directly accountable to a wider group of stakeholders) and address any abuses of ownership. Alternatively, where the regulator was satisfied that this was justified, this would include the regulator having the power to take steps that would result in the divesting from the banks of their stakes in the payment systems. The Government envisages that the exercising of the power to take these steps will be subject to the approval of the Treasury.

Question 8

Are the Government's proposals on ownership of payment systems sufficient to address the potential ill effects of vertical integration and common ownership in the payment systems market?

Appeals

4.31 The appeals mechanism for the new regulatory system will mirror that for existing utility regulators. As a result:

- Decisions made by the regulator under its concurrent competition powers will be subject to the appeals process set out in the Competition Act 1998 and Enterprise Act 2002.
- Licence modification decisions will be appealable to the Competition Commission.
- Other regulatory decisions will not be subject to appeal, but will be subject to judicial review, in line with decisions from other public bodies and utilities regulators.

Question 9

Do the proposed appeal powers provide sufficient safeguards for owners and participants in the payment systems sector?



List of questions

Question 1

Would giving the role of payment systems regulator to the FCA or to one of the existing economic regulators be most likely to deliver the Government's aims in the payment systems sector? Are there other options for the regulator that would better deliver these?

Question 2

Is the Government's proposed positioning of the role of the payments regulator in relation to the other regulatory bodies in the sector the best way to achieve its aims?

Question 3

Is the proposed scope of regulation appropriate to achieve the Government's aims?

Question 4

Are the proposed duties for the regulator appropriate to achieve the Government's aims?

Question 5

Do you agree that the payments regulator should have concurrent competition powers over the market for the provision of payment services? Is the proposed scope of these powers appropriate to best achieve the Government's objectives?

Question 6

Are the proposed licence conditions appropriate for achieving the Government's objectives?

Question 7

Are the proposed regulatory powers appropriate to achieve the Government's objectives?

Question 8

Are the Government's proposals on ownership of payment systems sufficient to address the potential ill effects of vertical integration and common ownership in the payment systems market?

Question 9

Do the proposed appeal powers provide sufficient safeguards for owners and participants in the payment systems sector?

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This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

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