

Call for views

Our approach to supervision

April 2024

We welcome your views on [this consultation]. If you would like to provide comments, please send these to us by **5pm on 7 June 2024**.

You can email your comments to **supervision@psr.org.uk** or write to us at:

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Payment Systems Regulator
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We will consider your comments when preparing our response to this consultation.

We will make all non-confidential responses to this consultation available for public inspection.

We will not regard a standard confidentiality statement in an email message as a request for non-disclosure. If you want to claim commercial confidentiality over specific items in your response, you must identify those specific items which you claim to be commercially confidential. We may nonetheless be required to disclose all responses which include information marked as confidential in order to meet legal obligations, in particular if we are asked to disclose a confidential response under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request. Any decision we make not to disclose a response can be reviewed by the Information Commissioner and the Information Rights Tribunal.

You can download this consultation paper from our website:

www.psr.org.uk/call-for-views-approach-to-supervision-apr-2024/

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1 Executive summary

- 1.1** This document sets out our proposed approach to supervision.
- 1.2** We have established a Supervision team to set out our regulatory expectations of payment systems operators (PSOs) and manage our relationship with them. Our Supervision team will provide a new way of working within our existing regulatory framework.
- 1.3** Our primary focus will be upon our regulatory relationship with PSOs. In the future, we may find it necessary to manage the relationship with other strategically important stakeholders.
- 1.4** Our Supervision team will be responsible for managing relationships with supervised firms. We will provide clear routes for communication and predefined engagement schedules for our supervised firms. This will be complementary to the engagement between us and supervised firms on specific projects.
- 1.5** We propose a set of principles that describe our regulatory expectations of supervised PSOs. How firms meet those expectations will vary and we intend to be flexible in applying these principles. We understand that the organisations that we intend to supervise have diverse aims and needs.
- 1.6** Our call for views will be open for six weeks following publication. We include some questions which stakeholders may choose to use to structure any feedback they send us. We welcome feedback from all stakeholders on any matter related to our proposals. After considering the feedback we receive, we will publish a final document describing our approach later this year.

2 Establishing our approach to supervision

- 2.1** Our Supervision team will build on our continuing relationship with key stakeholders to promote our strategic aims.
- 2.2** We recognise that our work as a regulator of payment systems will sometimes require a sustained, long-term approach if we are to achieve our aims. We have a strong record of improved outcomes in payment systems and the markets they serve. We normally approach our work as a series of projects intended to deliver particular outcomes through the use of targeted formal interventions. For example, many projects involve issuing specific directions to payment system participants.
- 2.3** While some elements of the payments industry are dynamic and subject to change, the PSOs we work with have largely stayed the same. Payment systems do not change as often as payment services or individual service providers. The Treasury has the function of designating payment systems to us for oversight under the Financial Services (Banking Reform) Act 2013 (FSBRA). At present, there are eight payment systems designated to us. During our lifespan as an organisation, one payment system has been removed from our oversight and another has been added.
- 2.4** Our relationships with the firms we regulate therefore last beyond the timeframe for our projects. This is common in regulated fields. Regulators across many sectors establish supervision or relationship management teams to promote their regulatory aims and manage the risks and opportunities involved in these long-term relationships.
- 2.5** Our Supervision team will provide us with a new set of regulatory tools to achieve our long-term strategic aims. The supervisory relationships that we build with key stakeholders will allow us to better understand the strategies of those we supervise and assess whether they are aligned with the outcomes we are trying to achieve in the PSR Strategy. In doing so, if we decide that we need to step in to secure better outcomes for payment system users or to tackle strategic risks, we will not always need to use our formal powers to accomplish this.
- 2.6** We hope to receive comments and feedback on this call for views from a broad range of stakeholders, irrespective of their role in the payments sector. We would be interested to hear stakeholder views on these questions in particular:

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

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?

Benefiting payment systems, participants and users

- 2.7** Our relationships with those we supervise should allow for clear communication. Our Supervision team will become our primary point of contact for those we supervise. It will ensure that our supervised firms can access us when needed, and that we can provide clarity on our aims and priorities. It will also serve as the first point of contact for parties who wish to discuss matters relating to those firms with us.
- 2.8** This does not mean that the Supervision team will be the only means through which we engage with regulated firms. The relevant divisions will continue to handle other forms of engagement, such as consultations on policy initiatives. The Supervision team's role is to provide greater coordination and coherence to our engagement.
- 2.9** The payments landscape will change over time, and it is important that participants in payment systems and regulators remain agile and adaptable. We aim to establish relationships of openness and mutual trust with those we supervise. The Supervision team will improve our ability to present our views and reactions to changes in the environment as they emerge. This will help those we supervise to make informed decisions. We expect that open discussion should allow for earlier resolution of issues, earlier access to our emerging policy or strategic positions, and a more collaborative approach to problem-solving. This will complement rather than replace any appropriate legal and compliance advice a participant may seek. We do not intend to give such advice ourselves through our supervisory engagement.
- 2.10** The Supervision team will also complement rather than replace more targeted work intended to achieve specific outcomes. When we do need to carry out projects intended to reach targeted goals, we should be able to spend less time establishing a picture of the context that we operate in. We hope that the Supervision team's work will improve our understanding of the perspectives of the firms we oversee.

Working within our remit and regulatory framework

- 2.11** Our new, complementary method will work within our existing remit and under our existing powers. FSBRA states that when discharging our general functions, we should act so far as possible to advance one or more of our statutory objectives. These are to promote competition, innovation and the interests of service users of payment systems.
- 2.12** Our supervision work will take account of these objectives. We are also obliged to adhere to the regulatory principles described in FSBRA, and to take account of matters such as, but not limited to, the need to utilise resources efficiently and economically. We must consider the proportionality of the actions we take. Our work will also be guided by our assessment of progress against the strategic outcomes set out in our Strategy:
- 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.
- 2.13** The supervisory relationships we hope to establish will not replace our functions under FSBRA and other relevant legislation. There will still be circumstances in which we consider it appropriate to exercise formal powers – for example, issuing directions or requirements. Our engagement with stakeholders has shown that they sometimes prefer the clarity and specificity of actions we take using these powers.
- 2.14** We aim to use our new approach to identify areas where payment systems will not provide the outcomes we wish to see. We will then assess whether those outcomes can be achieved through collaborative ways of working. There may be occasions when this approach cannot succeed within a timescale we consider appropriate. If our Supervision team attempts to address topics or issues but cannot make sufficient progress, we may need to use our powers to issue specific directions or requirements.
- 2.15** Our approach to risk management will inform these decisions. This identifies risks to our strategic outcomes and helps us decide how to mitigate or manage those risks. Our Supervision team will play a key role in helping us manage risk and influence others to prevent those risks from materialising. It will also help to build our understanding of market-wide risks and opportunities to help inform the future direction of our regulation.

3 The wider context of payments regulation

- 3.1** We think that the approach that we propose will bring benefits both inside and outside of our organisation. We do not intend our Supervision team to directly replace any of the ways that we currently work. We are introducing a new method to help us achieve our aims, complementing our existing and planned project work. We will always need to carry out project-based work that is focused on achieving specific outcomes. We will also continue to rely upon specialist skills for our work, and so will need to refer some matters to other teams in the PSR before they can be concluded.
- 3.2** The team that carries out our supervision work will share leadership with two others: Compliance Monitoring and Enforcement. We see a distinction between these functions. Compliance Monitoring is tasked with assessing the degree of compliance achieved against specific obligations on payments firms. Enforcement manages investigation where there are circumstances suggesting a firm has failed to comply with its obligations and where we decide that the appropriate response is to take enforcement action.

Working alongside other regulators

- 3.3** Along with our powers under FSBRA, we may also exercise competition law powers. We share powers to enforce competition law in payment markets with the Competition and Markets Authority.
- 3.4** We work in a broader context of financial services regulation. Where necessary, we take account of the role of other authorities and regulators, such as the Financial Conduct Authority (FCA) and the Bank of England. We do not intend to duplicate either the FCA's oversight of payment service providers or the Bank's supervision of payment systems as financial market infrastructure.
- 3.5** We will look for opportunities to share information with other regulators in line with the applicable legal framework. Our Supervision team will improve efficiency by working alongside other regulators and ensuring our activities do not overlap with theirs.

4 The firms we will supervise

- 4.1** We will initially focus on supervising PSOs. However, we may later find it necessary to establish similar relationships with other types of firm.
- 4.2** Payment systems require operational rules and standards to establish common processes and govern how participants act when using them. The firms that control these rules and standards fall within FSBRA's definition of PSOs.
- 4.3** We think that our work will be most effective if we focus on those organisations with responsibility for the strategic direction of the payment systems we oversee. The actions of PSOs determine how well payments work for consumers and businesses. PSOs control rules, standards or agreements that determine, for example:
- which products, functions and services their system supplies
 - which firms may participate in their payment system
 - the costs associated with using their payment system
 - the technical messaging standards used within their system
 - the management of financial risk and liabilities across their system
- 4.4** PSOs' performance in these areas will affect how their system aligns with our strategic outcomes. To achieve our objectives, it is critical that we have an open and constructive relationship with the PSOs. Establishing effective ways of working with the PSOs will be the first priority for our Supervision team.
- 4.5** We recognise that other organisations, such as payment service and infrastructure providers, also hold significant influence within payment systems. It may also benefit these firms to establish clear lines of communication with us. Our Supervision team may therefore need to have regular contact with firms that are not PSOs.

5 How we will supervise

- 5.1** The Supervision team will be responsible for managing our relationships with the firms we supervise.
- 5.2** We have grown in size and scope over the last few years, as we have developed our Strategy and policy programme. We think there is an opportunity to make our communications with stakeholders more efficient. We will provide named contact points to supervised firms. We will ensure that those we supervise understand routes for escalation if required.
- 5.3** We will work across the organisation to ensure that our Supervision team is equipped to accurately represent our views and priorities. We want to make it easier for firms to understand our perspective and our likely reactions to their decisions. We sometimes hear that while stakeholders appreciate our open approach to discussion, it is difficult to distinguish between our settled positions and our emerging views. Our supervisors will work to provide greater clarity. Our ability to do this is likely to depend on firms engaging with us openly and transparently.
- 5.4** Where it is helpful to do so, we will convene representatives from across the sector to provide insights and views on relevant issues, or on potential risks and opportunities.
- 5.5** We will assess firms over established review cycles. At the end of each cycle, we will set the supervisory priorities for the next. These cycles may differ from firm to firm, depending on their characteristics. We will provide each supervised firm with our assessment of its performance.
- 5.6** We intend to use two criteria to inform our assessment of the PSOs we supervise:
- our understanding of the PSO's influence on risks and opportunities for our strategic aims
 - the PSO's performance on our principles for regulatory expectations
- 5.7** If our supervisory relationships later expand to firms that are not PSOs, we will consider how to supervise them on a case-by-case basis. We will take into account the fact that the expectations we set out here are focused on the role of PSOs.

Ensuring regular contact with supervised organisations

- 5.8** At the beginning of each supervision period, we propose to provide engagement schedules to the organisations we supervise. This will help set out our expectations and allow firms to plan accordingly. We expect to hold regular, scheduled discussions with firms' representatives. Over time, we may increase or decrease the frequency of these meetings according to our understanding of relevant risks.

Evidence-based supervision

- 5.9** Building on discussions with the parties we supervise, we want to develop a more structured and planned approach to reporting. We think this will improve efficiency for us and the firms we regulate. It will allow us to target our efforts to the areas of greatest need, while improving our understanding of the impact of our regulation on payments.
- 5.10** As we establish each supervisory relationship, we propose to ask supervised PSOs for documentation to allow us to understand their business better. These documents are likely to include:
- the rules, standards and membership models of the payment system
 - high-level descriptions of business units or functions within the PSO
 - publicly available accounts
 - lists of current participants
 - standard participation contracts
 - governance documents – business plan, strategy, board minutes, etc.
- 5.11** This list may later be complemented by specific requests to help us understand the organisation and ensure we are taking informed views of how it is meeting our expectations and where we may need to prioritise our supervision.
- 5.12** To reduce the burdens of duplicated requests, we will try to ensure other PSR teams can access this information where relevant. We may need to disclose information to people outside the PSR in line with the applicable legal framework. Where appropriate, we will ask firms to specify whether the information they provided to us is confidential.

6 Our expectations of those we supervise

- 6.1** We are proposing to provide PSOs with a set of principles which set out our expectations.
- 6.2** We take a broad interest in payment systems, the markets in which they operate and the firms that participate in them. As an economic regulator, our role differs from that of other financial services regulators. Rather than establish an extensive rulebook, we have in the past made targeted interventions to achieve specific aims. But this may mean that PSOs have less guidance in understanding our immediate priorities or our broader expectations. We want to help by providing greater transparency and accessibility for firms.
- 6.3** We recognise that introducing a new form of engagement demands clarity. If after consultation we adopt these or similar principles, we do not propose to change them frequently, but will keep them under review to ensure they continue to meet our needs. We want to strike a balance between clarity and unnecessary prescription, and between tailored oversight and common standards.
- 6.4** The firms we intend to supervise are a diverse group of organisations whose business models, services and customers all differ. Nevertheless, we think that some risks to good outcomes for users may be common to all PSOs. For example, payment systems normally have wide networks of participants and service users. Therefore, it is difficult to achieve consensus, and there is a consequent risk that customer expectations are not managed and change is not communicated effectively.
- 6.5** We also recognise that different PSOs may present different levels of possible impact on our ability to achieve our strategic aims. We do not intend to apply the same measures where the same risks do not apply. We propose to use the suggested principles to assess whether a particular area needs further attention. It is possible that, in practice, intervening under one of our principles will conflict with another. We understand that we will sometimes need to make trade-offs, but we will consider these on a case-by-case basis, as different considerations will apply to different PSOs. We think that setting out our supervisory priorities at the beginning of each review cycle should reduce ambiguity.
- 6.6** The supervised firms are the primary audience for these principles, but we also think that making our assessment guidelines public will help users and participants of payment systems understand our aims. Wherever we think it appropriate, we will try to allow firms flexibility to consider how best to achieve our regulatory expectations. We may decide that it is useful to share further supporting guidance or examples of good practice.

Our proposed principles

- PSOs should allow for wide access and participation.
- PSOs should work to address the needs of users and participants.
- PSOs should monitor and manage risk to compliance with payment system rules and standards.
- PSOs should coordinate cross-market change effectively.
- PSOs should build and maintain the trust and confidence of their users and participants.
- PSOs should limit opportunities for abuse in payment systems.
- PSOs should design to enable innovation.
- PSOs should ensure the payment systems they operate are efficient and sustainable.

6.7 These proposed principles are intended to allow discussion of recurring issues in payment systems that affect our statutory objectives or our strategic outcomes. These issues are discussed in Chapter 3 of our Strategy, which sets out some common features of payment systems both in general and in the specific context of the UK market.

6.8 These principles aim to connect:

- the structure and operation of payment systems
- our legal framework
- our role in promoting innovation, competition and the interests of end users
- our Strategy

6.9 These principles aim to help both us and the PSOs to assess how well PSO performance aligns with our strategic objectives.

6.10 These principles will underpin our approach to supervision and will help structure the engagement we have with supervised firms. Each principle is of equal priority, but we may choose to focus on one or more of them in any review cycle. We are likely to decide to focus on different principles with each PSO. Our risk assessment and information analysis will enable us to take decisions on where to target our efforts. We will tell firms where we will focus and why. We think it likely that firms will be assessed against all principles over a maximum of a five-year period. The firm's own analysis of its performance will be key to our assessment. We propose to ask PSOs whether they have identified gaps or opportunities for improvement and the plans they have put in place to address these.

6.11 In the sections that follow we discuss each of these proposed principles and why it is important to us.

PSOs should allow for wide access and participation

- 6.12** We want firms that wish to offer payment services to be able to access payment systems appropriately, to maintain competition in other markets for financial services. Much of the recent innovation in payment services has come from new entrants. For example, new entrants have offered new services for personal current accounts.
- 6.13** Sometimes PSOs offer services that do not need to be restricted only to participants that take part in core clearing and settlement services. The rules governing access to a service should be proportionate to the nature of the service in question.

PSOs should work to address the needs of users and participants

- 6.14** PSOs do not offer their core services directly to end users, yet the services they supply have a direct effect on end users' experience. Payment service providers (PSPs) may be unable make changes to benefit their customers as they cannot change the central rules or infrastructure of the system. This makes it even more important that PSOs show that they understand where user needs are not being met, and make changes to provide better outcomes.
- 6.15** It is also important that PSOs are responsive to PSPs. PSOs should be able to show that they take into account their members' needs and interests when making any changes to normal operations.

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

- 6.16** We expect PSOs to know and communicate accurately how often their rules or standards are breached. They should also understand how breaches of their rules affect outcomes for businesses or consumers. They should have defined and effective procedures for managing the consequences of breaches of their rules and standards. They may need to apply disincentives to reduce breaches. We expect these disincentives to be fairly applied and proportionate.
- 6.17** PSOs' rules and standards usually include those intended to ensure operational and technical resilience. The Bank's Financial Market Infrastructure Directorate supervises the same set of firms on these issues. We do not intend to duplicate this work within our supervisory relationships.

PSOs should coordinate cross-market change effectively

- 6.18** The pace of innovation in services provided by payment systems is constrained by factors such as the difficulty of coordinating across large networks of participants. Other barriers include the difficulty of initiating a positive change that will not provide commercial benefit to a specific firm, but requires universal support across the network to be effective.
- 6.19** PSOs should work to promote change when needed. They should understand material risks and dependencies across their entire change programmes. They should clearly communicate any change programmes that affect the way participants operate in sufficient time to allow them to plan effectively. Where PSOs cannot effectively promote a change that they feel is required, they should talk to us and explain the obstacles they have encountered.

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

- 6.20** PSOs must retain the confidence of their members and participants to work effectively. Participants and users should be able to expect high standards of expertise and professionalism from them. We expect PSOs to ensure that they retain staff with sufficient expertise and experience to fully understand the implications of their work for the whole sector.
- 6.21** PSOs should be able to demonstrate that they have a good understanding of the payments sector, including the commercial implications of their work. This should be reflected in low rates of avoidable errors in specifications or plans. PSOs should build strong relationships with their participants and other organisations in the payments sector.

PSOs should limit opportunities for abuse in payment systems

- 6.22** Both consumers and businesses rely on payments functioning safely. PSOs cannot entirely prevent all losses or bad outcomes, but they should consider how best the system can protect against abuse.
- 6.23** We do not expect all PSOs to take identical approaches to all payment services or use cases. We think PSOs should understand whether their systems are abused by bad actors, and whether changes to their operational rules or standards could reduce bad outcomes. PSOs may be able to enable system-wide approaches to the detection and prevention of fraud, or to increase the end users' control when making payments.

PSOs should design to enable innovation

- 6.24** Payment systems need common rules and standards for their operation. Standardisation allows each participant in the payment system to understand how others will act. When establishing rules and standards for payment systems or the services that they offer, PSOs should consider whether meeting those standards will act as an unnecessary barrier to entry for new providers of financial services. However, PSOs must also keep in mind the safety and efficiency of the system, along with factors such as management of liability assignment. We expect PSOs to carefully consider whether functions or services are best provided centrally or whether their aims can be met by allowing participants space to innovate.
- 6.25** Some services may be best provided by PSOs but need not be a required feature of the payment system. Some services may require accreditation to reduce risk to the network as a whole. PSOs may need to undertake research and development to understand the future needs of the sector, so that they can take these strategic decisions.

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

- 6.26** PSOs should understand the impact of their decisions on participants' ability to process payments efficiently. For example, participants may be able to achieve greater efficiency if they can rely upon commonly used and interoperable messaging standards and similar conventions for settlement. This should influence PSOs when setting out standards for new services.
- 6.27** Commercially, PSOs should understand the impact of their participation models and agreements on individual participants' business models, and on the system as a whole. PSOs may need to balance pressure to reduce operating costs against the need to fund future services or technical upgrades. PSOs should ensure their services are cost-effective, and should not privilege one type of payment firm at the expense of another.

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