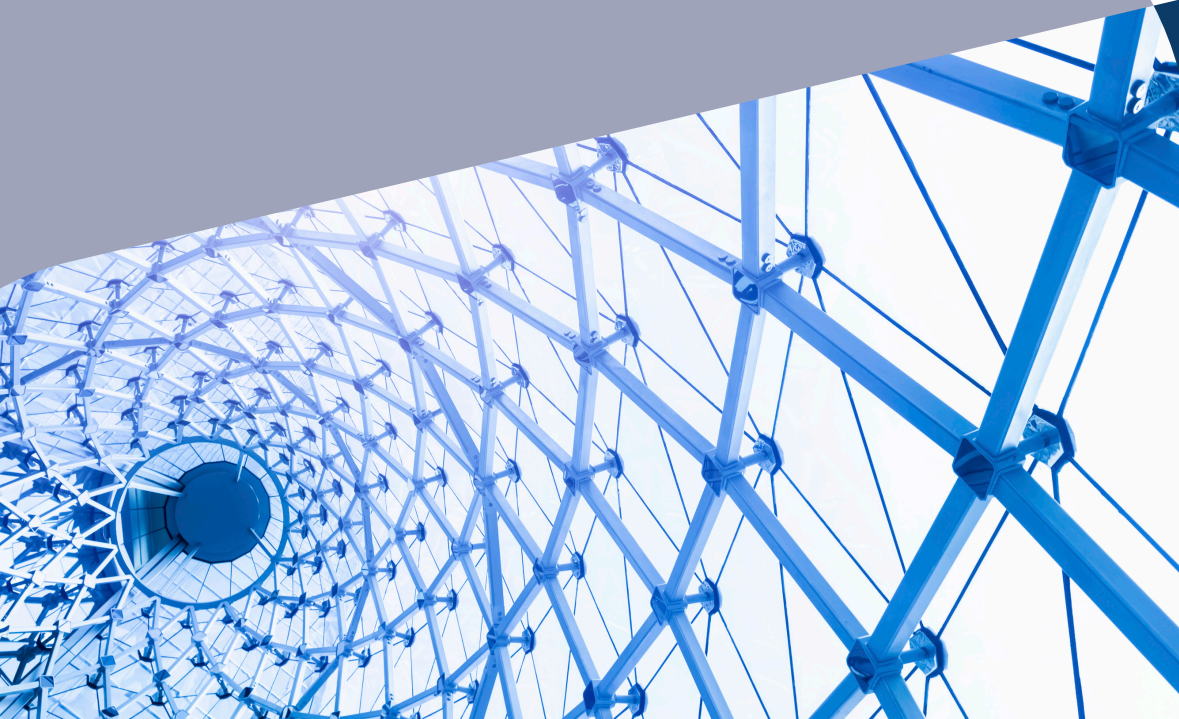


Consultation paper

CP16/5

# The Payment Systems Regulator's Financial Penalty Scheme

Consultation on the Financial Penalty Scheme for  
the use of the retained amount from PSR regulatory  
penalty receipts



We are asking for comments on this consultation paper by 5pm on 13 January 2017.

You can send your comments and responses to our consultation questions by emailing us at [finpenaltyscheme@psr.org.uk](mailto:finpenaltyscheme@psr.org.uk)

If you email us, we would be grateful if you could provide your response in a Word document (rather than, or in addition to, a PDF).

You may respond in writing to the address below (although we ask you to respond electronically wherever possible):

Payment Systems Regulator Limited  
Financial Penalty Scheme team  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

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. Stakeholders who wish to claim commercial confidentiality over specific items in their response should identify those specific items which they 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. Any decision we make not to disclose a response is reviewable by the Information Commissioner.

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# 1. Overview

In this consultation paper we are seeking views on our draft Financial Penalty Scheme, which sets out our proposed method for allocating the money we retain from penalty receipts.

We have developed the Financial Penalty Scheme to ensure that we use this money for the benefit of participants in regulated payment systems. We propose to use the money to reduce the regulatory fees we receive from payment service providers (PSPs).

We welcome responses to our consultation questions, which we will consider when finalising the Financial Penalty Scheme.

## The purpose of this consultation

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- 1.1** We are seeking views on our proposed method for allocating the money we retain from financial penalties that we have imposed. We propose to use this money to reduce the regulatory fees we receive from payment service providers (PSPs) the following year.
- 1.2** We will use the responses to this consultation to finalise our approach.
- 1.3** As part of our enforcement powers, we have the power to impose penalties for compliance failures on regulated persons. We are required to pay any penalty payments we receive to the Treasury, after deducting an amount to cover our relevant enforcement costs (the retained amount). The Treasury may give directions to us on how we do this.
- 1.4** We are required to prepare and operate a scheme (the Financial Penalty Scheme) for ensuring that these obligations are met, and that the retained amount is applied for the benefit of participants in regulated payment systems. The same legislation also requires that regulated persons who have become liable to pay a penalty during a financial year do not benefit from the scheme in the following year.
- 1.5** The draft Financial Penalty Scheme explains our proposed approach to using the retained amount. We are required to consult publicly on the scheme details before adopting it, which we are doing in this consultation paper.
- 1.6** This document is structured as follows:
  - **Chapter 1** is this overview.
  - **Chapter 2** outlines our proposed approach to the use of the retained amount, and other options that we considered but rejected.
  - **Chapter 3** sets out the next steps (subject to the outcome of the consultation).

## Who does this consultation affect?

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**1.7** This consultation will affect:

- participants in regulated payment systems under the Financial Services (Banking Reform) Act 2013 (FSBRA)
- regulated persons under the Interchange Fee Regulation (IFR)

This includes:

### FSBRA

- a. PSPs that are direct members of Bacs, CHAPS, Cheque and Credit (C&C), Faster Payments Scheme (FPS), LINK or Northern Ireland Cheque Clearing (NICC).
- b. Acquiring or card-issuing PSPs operating in the UK that are members of MasterCard or Visa.
- c. The operators of the regulated payment systems (Bacs, CHAPS, C&C, FPS, LINK NICC, MasterCard and Visa).
- d. Other participants in regulated payment systems under FSBRA such as payment infrastructure providers.

### IFR

- e. Acquiring or card-issuing PSPs operating in the UK that are members of card payment systems subject to the IFR, and the operators of such card payment systems.
- f. Other persons that the IFR regulates.

## Is this of interest to consumers?

**1.8** This consultation paper contains no material directly relevant to retail financial services consumers or consumer groups.

## What do you need to do next?

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**1.9** Please consider our proposals and send us your comments on the questions in this consultation paper by 5pm on 13 January 2017. You can email us at [finpenaltyscheme@psr.org.uk](mailto:finpenaltyscheme@psr.org.uk) or write to us at the following address:

Payment Systems Regulator Limited  
Financial Penalty Scheme team  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

## 2. Proposed Financial Penalty Scheme

### Overview

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**2.1** When we collect monies as penalties, we retain an amount to cover our relevant enforcement costs (the retained amount) before paying the balance to the Treasury. Under our Financial Penalty Scheme we are required to ensure the retained amount is used for the benefit of participants in regulated payment systems.

**2.2** We have examined two options which we believe are available to us:

1. Return the monies to the industry.
2. Use the monies for special projects commissioned by the PSR.

Each of these options could be implemented in a number of ways, which we discuss in more detail below.

We propose to take option 1. We would return the retained amount to the industry through a reduction in our fees, while ensuring that PSPs that have become liable to pay a penalty do not get the reduction.

**2.3** Our proposed approach is set out in detail in the draft Financial Penalty Scheme, published alongside this consultation. In this chapter, we look at:

- our reasons for proposing this approach
- the alternative option we have considered, which we rejected as the benefits were not clear

### Policy proposal: Return the monies to fee payers through a reduction of fees

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**2.4** Our proposed approach to using the retained amount involves reducing our regulatory fees in any year following a year in which we have received penalties. We would reduce the fees by the amount that we retained. Regulated persons who have become liable to pay a penalty in one year would not be eligible to benefit from the following year's fee reduction.

**2.5** This would mean that, in effect, some of our enforcement costs would be funded from the penalties imposed, rather than through fees paid by those who have not become liable to pay any penalties in the previous year. We consider that this is a fair approach as entities that followed our directions and regulations do not need to pay for all our relevant enforcement costs.

**2.6** The exact amount of our enforcement costs which will be retained and returned depends on the costs we incur and the penalties we impose; the maximum amount we can retain depends on the level of penalties we have imposed. The Financial Penalty Scheme applies to penalties imposed under our regulatory powers, but not our competition powers under the Competition Act 1998. The scope of the Financial Penalty Scheme, in relation to the types of penalties and enforcement costs to which it applies, is set out in more detail in our draft Financial Penalty Scheme.

- 2.7** This approach leads to a number of detailed implementation questions, particularly regarding who will benefit from a reduction in fees. This is complicated by the fact that our powers to impose penalties apply to a wider group of persons than the fee payers, as we only collect fees from direct PSPs.

**Question 1: Do you have any views on the proposed PSR Financial Penalty Scheme?**

## Policy considerations

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### Our proposed approach – practical scenarios

- 2.8** We have considered a number of scenarios covering the types of situation we might encounter during the year. Our detailed policy recommendations for each scenario are in the draft Financial Penalty Scheme. We set out the reasons for our proposed approaches to each situation below, along with our consideration of alternative approaches.

#### Scenario 1

- 2.9** Under the first scenario, only individual direct PSPs became liable to pay penalties during a financial year (Year 1). Our chosen approach is to return the retained amount to all fee payers in the following year (Year 2), not including any fee payer who was liable to pay a penalty in Year 1. Where a fee payer who was liable to pay a penalty in Year 1 pays a fee in respect of multiple payment systems, we will not reduce its fees for any of them.
- 2.10** For example, PSP1 is a direct member of FPS and Visa, and therefore pays fees in relation to both. It has become liable to pay a penalty for a compliance failure in relation to FPS. We would not reduce its fees with respect to either system as a result of us returning the retained amount.
- 2.11** Our proposed approach is to treat the retained amount from all penalties in any financial year in the same way. If we impose penalties on two or more fee payers, none of them will have their fees reduced the following year.
- 2.12** We consider that our proposed approach best aligns with the intent of the legislation under which we have set up the Financial Penalty Scheme, in particular the requirement to ensure that no person who became liable to pay a penalty in a particular year should benefit from the Financial Penalty Scheme in the following year.
- 2.13** We considered and rejected two possible alternative approaches to this scenario, as we do not believe they are in line with the intent of the legislation:
1. If a PSP that has become liable to pay a penalty pays fees in respect of multiple payment systems, we could reduce its fees for systems that are unrelated to the compliance failure.  
  
For example, PSP1 pays fees in relation to both FPS (under FSBRA) and Visa (under FSBRA and the IFR). PSP1 pays a penalty for a compliance failure in relation to FPS. PSP1 would receive no reduction in its fee in respect of the FPS system, but would receive a reduction in its fees in respect of the Visa system.
  2. We could distinguish between FSBRA and IFR: continuing with our example from alternative 1 above, we would reduce PSP1's Visa IFR fees, but not its FSBRA fees in respect of either FPS or Visa.

## Scenario 2

- 2.14** Under the second scenario, one or more payment system operators have become liable to pay penalties. Our chosen approach under this scenario is to rebate all fee payers, including in relation to a payment system whose operator has become liable to pay a penalty.
- 2.15** We considered an alternative approach whereby if an operator has become liable to pay a penalty, no PSP should receive a reduction in fees in relation to that payment system. On balance we do not consider this to be appropriate as the PSPs may have had little or no ability to prevent the compliance failure. No PSP has sole control of the operators and not all direct PSPs have significant influence over the operators' governance. However, under our proposed approach the PSPs still have a strong incentive to put pressure on the operator not to incur further penalties, as the operator will recover the cost of the penalty by charging the direct PSPs within its system.
- 2.16** We consider our proposed approach to be in line with the relevant legislation, as the operator who was liable to pay a penalty does not derive any direct benefit from the Financial Penalty Scheme.

## Scenario 3

- 2.17** Under the third scenario, one or more other persons (for example, infrastructure providers or indirect PSPs) became liable to pay penalties. Our chosen approach is to reduce fees for all fee-payers, whether or not they have any relationship with the penalised person.
- 2.18** We considered whether we could devise a way to take into account ownership or contractual links between fee payers and a person who has become liable to pay a penalty in this scenario. However, given the multitude of potential situations, this would be very complex. We also do not consider this would be appropriate as it could deprive some fee payers of the benefit of the Financial Penalty Scheme even where they could not control the risk of the compliance failure.

**Question 2: Do you have any comments on our proposed approach, or the alternatives, under each of the scenarios we have considered?**

## Other alternative – special projects

- 2.19** We considered an alternative option for using the retained amount: using the monies to promote our innovation objective. For example, we could use the monies to fund special projects outside those we commit to in our annual plan. We consider it unlikely that this option is practicable given the uncertainty around the size and timing of penalties and the probable small size of any retained costs. This would mean any such approach would be very uncertain and unlikely to bring significant benefits. In fact, the administrative costs are likely to be higher than any benefits.

**Question 3: Do you have any comments on the alternative option that we considered but rejected?**

**Question 4: Are there any other options you think we should consider?**

## Practical considerations

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- 2.20** In this section we detail a set of practical considerations in relation to how we will calculate the relevant enforcement costs and subsequently allocate the retained amount between PSPs.
- 2.21** We will allocate the reduction in fees in proportion to each eligible PSP's overall fee liability. We consider this approach to be simple and clear, and thus proportionate to the sums likely to be involved.



**2.22** To minimise the administrative burden, we will implement this by:

- reducing the fees collected across all fee payers by the retained amount that will be returned to fee payers
- requiring the operators, as our collection agents, to adjust the invoices for PSPs that are not eligible for the reduction to ensure that these pay the full fee

This approach is aligned with the Financial Conduct Authority's (FCA's) approach and removes the need to individually refund those PSPs that have not become liable to pay a penalty, which we expect to be the vast majority in any year. The way we set our budget and annual funding requirement (AFR) will not be affected by this policy. We will still set out our budget and AFR in the usual way, without regard to any retained amount.

## 3. Next Steps

- 3.1** This consultation closes on 13 January 2017. We will use the responses to this consultation to finalise our policy on the Financial Penalty Scheme.
- 3.2** The Financial Penalty Scheme will come into effect immediately after the publication of its final version.
- 3.3** If we collect any penalties in any financial year, any retained amount will be distributed to the fee payers through a fee reduction in the following financial year in accordance with our Financial Penalty Scheme. We will publish the final amount to be returned to the industry together with our consultation paper on fee rates, which we publish annually around April as part of our annual fees cycle.

### **Consultation questions:**

**Question 1: Do you have any views on the proposed PSR Financial Penalty Scheme?**

**Question 2: Do you have any comments on our proposed approach, or the alternatives, under each of the scenarios we have considered?**

**Question 3: Do you have any comments on the alternative option that we considered but rejected?**

**Question 4: Are there any other options you think we should consider?**

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