

Draft Financial Penalty Scheme

November 2016

Contents

1	Overview	3
	Introduction	3
	The purpose of this document	4
2	The PSR's Financial Penalty Scheme	5
	The PSR's approach	5
	How we use the retained amount to the benefit of fee payers	5
	Scenario 1: One or more PSPs became liable to pay penalties	6
	Scenario 2: One or more Payment System Operators became liable to pay penalties	6
	Scenario 3: Other regulated entities became liable to pay penalties	7
	Scenario 4: Several different entities have become liable to pay penalties	7
3	Legal framework for the Financial Penalty Scheme	8
	Scope of Financial Penalty Scheme Penalties	9
	Penalties	9
	Enforcement Costs	9

1. Overview

This guidance sets out the Payment Systems Regulator's Financial Penalty Scheme, in accordance with Paragraph 11 of Schedule 4 of the Financial Services (Banking Reform) Act 2013 (FSBRA).

The scheme describes our proposed method for allocating the money we retain from penalty receipts. We propose to use this money to reduce the regulatory fees we receive from payment service providers (PSPs).

Introduction

- 1.1** As part of our enforcement powers under FSBRA, the Payment Systems Regulator (PSR) has the power to impose penalties for compliance failures on persons subject to regulation. We have similar powers under other relevant legislation – for example, in relation to the Interchange Fee Regulation (IFR).
- 1.2** Where we receive relevant penalty payments we are required to pay them to the Treasury, after deducting an amount to cover our relevant enforcement costs (the 'retained amount'). This Financial Penalty Scheme provides information on how we treat the retained amount.
- 1.3** FSBRA requires us to use the retained amount in a way that benefits participants in regulated payment systems, while ensuring that any person who has become liable to pay a penalty in one year does not receive the benefit from it in the next year.
- 1.4** We are required to prepare, consult on and operate a Financial Penalty Scheme to implement this. We have a discretion under FSBRA to decide our own approach, which can include different provisions for different types of participants in payment systems.
- 1.5** We are a cost-neutral regulator; our use of the retained amount does not affect our overall budget.
- 1.6** Our chosen approach is to return the retained amount to fee payers through a reduction in our regulatory fees, while ensuring that fee payers that became liable to pay a penalty do not get the reduction. The Financial Conduct Authority (FCA) has a comparable scheme.¹

¹ <https://www.fca.org.uk/publication/policy/ps16-16.pdf>

The purpose of this document

- 1.7** This document sets out our draft Financial Penalty Scheme.
- 1.8** This draft Financial Penalty Scheme represents our intended practice at the date of publication. We may revise it as appropriate to reflect changes in best practice. We will consult on any material changes to our practice before we implement them. We set out the current scope of this Financial Penalty Scheme in Chapter 3. We recognise that future legislation may extend this scope, but do not expect this would normally require us to consult on amending our practice as set out in this document.
- 1.9** This document will principally be of interest to: payment system operators and the PSPs who have direct access to them; and payment card scheme operators.
- 1.10** The document also describes the legal framework relevant to the development of the Financial Penalty Scheme.

2. The PSR's Financial Penalty Scheme

This chapter describes:

- what a Financial Penalty Scheme is
- our approach to our Financial Penalty Scheme

2.1 Each year that we impose financial penalties, the penalties collected must be paid to the Treasury after deducting an amount to cover certain enforcement costs, which we keep (the retained amount). This document, which constitutes our Financial Penalty Scheme, describes how we will use the retained amount.

The PSR's approach

2.2 We are required under FSBRA to use the retained amount in a way that benefits:

- participants in FSBRA-regulated payment systems
- regulated persons under the IFR

However, any person who has become liable to pay a penalty in one year may not benefit from the Financial Penalty Scheme in the next year.

2.3 Our proposed approach is to return the retained amount back to the industry through a reduction in our regulatory fees, ensuring that if a fee payer was liable to pay a penalty in year X, it does not receive the benefit of this reduction in year X+1.

How we use the retained amount to the benefit of fee payers

2.4 Our chosen approach is to reduce our fees in any year following a year in which we have received penalties. We will reduce the fees by the retained amount. This would mean that, in effect, some of our enforcement costs would be funded from the penalties imposed rather than through fees.

2.5 The exact amount of our enforcement costs which will be retained and returned depends on the costs we incur as well as the penalties we impose; the retained amount reflects only those enforcement costs specifically covered by the relevant legislation. We will only have a retained amount up to a maximum of the level of penalties imposed.

2.6 We identified a number of scenarios of the type of situations we might encounter during the year. Below, we describe each scenario and our proposed approach.

Scenario 1: One or more PSPs became liable to pay penalties

- 2.7** Under this scenario, individual direct PSPs are liable to pay penalties, and no other person has become liable to pay penalties during the same year.
- 2.8** Our approach to this scenario is straightforward. The party who has become liable to pay a penalty is also a fee payer, and under FSBRA we must ensure that such parties do not benefit from the Financial Penalty Scheme.
- 2.9** Our approach would therefore be to return the retained amount to all fee payers except those that were liable to pay a penalty in the previous year. These parties would not get a reduction in fees related to any of the payment systems we regulate under FSBRA and the IFR. Therefore, if a fee payer pays fees in relation to more than one payment system, in the situation where they are liable to pay a penalty, they will not receive a reduction in their fees under any of the payment systems for which they pay fees. Where several fee payers were liable to pay a penalty, none of them will get the reduction in fees in the following year.

Scenario 2: One or more payment system operators became liable to pay penalties

- 2.10** Under this scenario, one or more payment system operators are liable to pay penalties, and no other person has become liable to pay a penalty during the same financial year.
- 2.11** In this scenario, the person who has become liable to pay a penalty is not a fee payer. Therefore, under our recommended approach of using the retained amount to reduce fees, no person who has become liable to pay a penalty directly benefits from the Financial Penalty Scheme (as the operators do not pay PSR fees).
- 2.12** Our approach under this scenario is to reduce the fees for all fee payers, including those related to a payment system whose operator has become liable to pay a penalty.
- 2.13** We note that some card system operators also act as PSPs within their own system and under our fees rules pay the entire fee for the system themselves. We propose to treat these operators as PSPs within our Financial Penalty Scheme, so that if they are liable to pay a penalty they will not get a reduction in fees for the next year, regardless of whether the penalty related to their role as a PSP or their role as an operator.
- 2.14** We consider that this best fulfils the legal requirement to ensure that no person who has become liable to pay a penalty in one year benefits from the Financial Penalty Scheme in the next year. We are also planning to apply this approach to any system in which all PSPs fall below the minimum thresholds for liability to pay fees; this is another case where the operator pays the full fees for its system.

Scenario 3: Other regulated entities became liable to pay penalties

- 2.15** Under this scenario, one or more other regulated entities (for example, infrastructure providers or indirect PSPs) are liable to pay a penalty, and no other person has become liable to pay a penalty during the same financial year.
- 2.16** In this scenario, the person who was liable to pay a penalty is not a fee payer. Therefore, under our approach to the Financial Penalty Scheme of using the retained amount to reduce fees, no person who was liable to pay a penalty directly benefits from the retained amount.
- 2.17** Our approach under this scenario would be that all fee-payers receive a reduction in fees, whether or not they have any relationship with the penalised person. For example, if we impose a penalty on a central infrastructure provider for a payment system, fee payers would get a reduction in fees related to that system regardless of their ownership of or contractual links with the infrastructure provider.

Scenario 4: Several different entities have become liable to pay penalties

- 2.18** When both a PSP and a payment system operator (or other regulated entity) have become liable to pay penalties during the same financial year then we would combine the above approaches. Any fee payer who was liable to pay a penalty would not get a reduction in fees under any payment system, but all other fee payers would get a reduction.

3. Legal framework for the Financial Penalty Scheme

This chapter describes the legal framework under which we have developed our draft Financial Penalty Scheme.

- 3.1** We regulate designated payment systems operating in the UK, and have a range of regulatory powers under FSBRA. We also have functions under the IFR pursuant to the Payment Card Interchange Fee Regulations 2015 (the PCIFRs – SI 2015/1911). We also have certain functions under the Payment Services Regulations 2009 (PSRs09 – SI 2009/209), which implement the Payment Services Directive (PSD1).
- 3.2** This Financial Penalty Scheme applies to any penalties we impose under these regulatory powers.
- 3.3** We also have concurrent competition powers under the Competition Act 1998 (CA98) and the Enterprise Act 2002 (EA02). This Financial Penalty Scheme does not apply to any penalties we impose under these competition powers.
- 3.4** Since 18 September 2016, we have functions under the Payment Accounts Regulations 2015 (the PARs – SI 2015/2038), which implement the Payment Accounts Directive 2015. These functions are outside the scope of this Financial Penalty Scheme.
- 3.5** We have powers to impose a penalty under the relevant legislation, set out in paragraph 3.1 to 3.3 above. We may, for example, impose a penalty for a compliance failure under section 73 of FSBRA (for example, a failure to comply with one of our directions). We are required, under paragraph 10(1) of Schedule 4 of FSBRA, to pay the amounts received as penalty payments to the Treasury after deducting an amount to cover our enforcement costs (the retained amount), as defined by FSBRA.
- 3.6** We must use the retained amount for the benefit of participants in regulated payment systems, and regulated persons under the IFR (by virtue of Regulation 15 of the PCIFRs). Under FSBRA, no person who became liable to pay a penalty in any financial year may benefit from our use of the retained amount in the following year. We have a discretion in deciding how to use the retained amount, and may make different provisions for different classes of participant in regulated payment systems.
- 3.7** This Financial Penalty Scheme is made under paragraph 11(1) of FSBRA. Interested parties should refer to the text of that legislation for a complete description of our statutory functions and powers, and treat the text of the legislation as paramount. In the event of any inconsistency between the legislation, as updated from time to time, and this Financial Penalty Scheme, the legislation takes precedence.

Scope of Financial Penalty Scheme Penalties

Penalties

- 3.8** The Financial Penalty Scheme covers penalties we impose:
- a. for compliance failures under section 73 of FSBRA
 - b. under regulation 6 of the PCIFRs, in accordance with regulation 15(e)(i)
 - c. Penalties imposed under regulation 105 of the PSRs09
- 3.9** The scheme does not cover penalties we impose under CA98, EA02 or the PARs.

Enforcement Costs

- 3.10** Paragraph 10 of Schedule 4 of FSBRA sets out the categories of relevant enforcement costs which we may retain from any penalties paid to the Treasury. The Treasury may give directions to us in respect of the matters that are, or are not, to be regarded as enforcement costs. The Treasury may also specify enforcement powers for us, in addition to those set out in FSBRA itself, so that the costs incurred in exercising those powers are captured by the provisions relating to the Financial Penalty Scheme. The Treasury has done this by specifying certain powers in the Payment to Treasury of Penalties (Enforcement Costs of the Payment Systems Regulator) Order 2015 (SI 2015/487). The enforcement costs which are currently covered by the relevant legislation are:
- a. certain enforcement costs related to FSBRA and IFR compliance failures
 - b. certain enforcement costs under CA98
 - c. certain enforcement costs under EA02
 - d. enforcement of an order to dispose of an interest under section 58 of FSBRA
 - e. certain enforcement costs related to the PSRs09, which implement PSD1
 - f. the investigation and prosecution of certain offences under FSBRA, CA98, EA02 and the PSRs09

