PSR Payment Systems Regulator

Response paper

Proposed revised penalty statement

Response to consultation CP23/2

October 2023

RP23/1

Contents

1 Introduction and executive summary

This chapter gives an overview of the proposals set out in our recent consultation paper (CP23/2), the responses we received from industry, and our final decision on changes to our penalty statement.

It also provides an overview of the structure of this publication.

Executive summary

1.1 This paper sets out our decisions on changes to our penalty statement, following careful review of the responses to our recent consultation paper *Proposed revised penalty statement* (CP23/2).

1.2 We consulted on five changes to our penalty statement:

1. Combining our three penalty statements into one.
2. Changing how we consider the duration of a compliance failure, and how we take account of revenue when calculating penalties.
3. Clarifying what we mean by 'senior management'.
4. Further clarifying when we consider a compliance failure to be deliberate or reckless.
5. Reinforcing the principle that penalties should disincentivise compliance failures.

1.3 We would like to thank all respondents who took the time to respond to our consultation.

1.4 Having considered all responses to the consultation, we have decided to implement all but one of our proposed changes. The exception is our proposal to introduce an objective element to the assessment of when a compliance failure is reckless (see paragraphs 2.52 to 2.54).

Background

1.5 We have the power to impose financial penalties on bodies[1] who fail to comply with obligations we enforce. We also have powers to publish details of failures to comply and the penalties we impose.

1 We do not have the power to impose financial penalties on individuals.

1.6 We are legally obliged to publish a statement of the principles we use when deciding whether to impose a financial penalty and when determining its amount. Currently, we have three penalty statements that fulfil that purpose:

- *Penalties Guidance*
- *Guidance on the PSR's approach to monitoring and enforcing compliance with the Interchange Fee Regulation* ('IFR guidance')
- *The Payment Services Regulations 2017 – the PSR's approach to monitoring and enforcement* ('the PSRs 2017 guidance')

1.7 We must, from time to time, review our penalty statements and, if appropriate, revise them to ensure we have an appropriate framework for imposing penalties. Having reviewed our penalty statements, we consulted from 16 March to 27 April 2023 as CP23/2.

1.8 We received five responses[2] from industry, which showed broad support for proposals 1 and 5. Proposals 2, 3 and 4 received a more mixed response, with differing views. Two stakeholders strongly opposed our proposal to introduce an objective element in our assessment of awareness of risk in establishing recklessness. Developments in case law caused us to reconsider our position on this point. The Upper Tribunal handed down judgment in the case of Seiler[3] in June 2023, in which it rejected a similar argument advanced by the Financial Conduct Authority (FCA).

1.9 We carefully considered all the responses from industry, and, in light of the feedback, as well as developments in case law, have decided to proceed with all but one of the proposed changes. We have removed our proposal to introduce an objective element into our assessment of when a compliance failure is reckless. Our primary reason for not proceeding with this proposal is the clear decision of the Upper Tribunal in the Seiler[4] case, which was handed down after we consulted.

1.10 We will keep our revised penalty statement under review and may revise it again in future, if necessary.

The structure of this publication

1.11 The remainder of this document is structured as follows:

- Chapter 2 details the responses received to CP23/2, and our views.
- Chapter 3 details other points raised by respondents to CP23/2, and our views.
- Chapter 4 outlines our decisions on the proposed changes to our penalty statement.

2 We received responses from NatWest, HSBC, Nationwide, Pay.UK and Simmons & Simmons.

3 HM Courts & Tribunals Service and Upper Tribunal (Tax and Chancery Chamber), *Thomas Seiler, Louise Whitestone and Gustavo Raitzin v The Financial Conduct Authority [2023] UKUT 00133 (TCC)*.

4 *Ibid.*, at paragraphs 44 to 46.

2 Responses to our consultation, and our views

This chapter summarises the responses we received to our recent consultation paper CP23/2, and our views on those responses.

Proposal to combine our three penalty statements into one

2.1 We considered that a single document – one setting out all the principles we will apply when determining penalties in any context – would be an improvement on the current three. We therefore proposed to combine our current three penalty statements into one.

Consultation responses

2.2 Four of the five respondents submitted comments on this proposal, and all were in favour. The fifth respondent did not comment on this proposal.

2.3 One stakeholder said it welcomed the simplification, which it thought would help firms understand our approach.

2.4 Another agreed that this would help firms understand our methodology, and that it would also enable a consistent approach on our part.

Our views

2.5 Our view remains that combining our three penalty statements will simplify our approach. We have therefore decided to proceed with this proposed change.

Proposal to change how we consider the duration of a compliance failure, and to change how we take account of revenue when calculating penalties

2.6 We proposed changing how we consider the duration of a compliance failure by using revenue realised during the entire period in which a compliance failure occurs. This is a change from previously, when we used either the final year before the end of the compliance failure or the year prior to our decision notice, whichever was earlier.

2.7 We also proposed incorporating a percentage scale of 0% to 20% into our penalty statement, with three bandings of seriousness: 0% to 6%, 7% to 13%, and 14% to 20%, representing lesser, moderate and high seriousness respectively.

Consultation responses

2.8 Most responses were broadly in favour of both proposals.

2.9 However, several points were raised, which are addressed below.

Alternative metrics to revenue

2.10 In our consultation paper we said that in most cases we will use revenue as a starting metric for penalty calculations, as it tends to approximately reflect the harm or potential harm caused by a compliance failure. However, we recognised that in some cases other metrics might do this more accurately.

2.11 Three respondents sought further clarity or guidance on when revenue may not be an appropriate starting point and what an alternative metric might be. One respondent suggested that a possible alternative metric for Interchange Fee Regulation (IFR) cases would be to attribute a certain value to each card linked to the breaches.

Not-for-profit payment system operators (PSOs)

2.12 One respondent expressed a concern about the not-for-profit PSOs that we regulate, as a financial penalty in that case would have to be paid for by a levy on participants in the payment system, rather than by the PSO itself. The respondent said it was unclear how an alternative metric would be derived in this circumstance.

Bandings in the percentage scale

2.13 One respondent suggested we align our percentage scale with the Financial Conduct Authority's (FCA) to make it clearer for firms. It said that adopting five bandings, as used by the FCA, instead of the three proposed would give firms more clarity, as well as allowing us to more precisely describe the circumstances of the breach.

Meaning of 'gross revenue'

2.14 One respondent asked us to clarify the term 'gross revenue'. The respondent also suggested giving guidance on the types of fees included in the calculation of gross revenue in a case involving a breach of the Interchange Fee Regulation (IFR).

Alternative scale for cases involving breaches of the IFR

2.15 One respondent said that a scale of 0% to 20% over the entire period of the compliance failure would often result in disproportionately high figures for IFR cases, where revenue is taken from the entire issuing or acquiring business.

2.16 The same respondent also said that such a scale could produce disproportionately low figures where revenue is based on the specific cards linked to the breaches.

2.17 Therefore, the respondent suggested that we should either apply an alternative scale of 0% to 3% for cases involving breaches of the IFR (1% for lesser seriousness, 2% for moderate seriousness and 3% for high seriousness) or make greater use of alternative metrics.

Our views

2.18 Our responses to the points raised by respondents are as follows:

Alternative metrics to revenue

2.19 Having considered these responses, we propose setting out when we might use an alternative metric at a high level – that is, when metrics other than revenue better reflect the harm or potential harm caused by the compliance failure. We do not consider it necessary or appropriate to go into further detail, however, as we wish to retain flexibility in the penalty statement.

2.20 Regarding an alternative metric for IFR cases, we consider that detailing alternative metrics for specific types of compliance failure is not helpful in a generally applicable penalty statement. The benefit of having one penalty statement that can be applied to a variety of compliance failures would be lost if we delved into the minutiae of specific metrics for specific compliance failures.

Not-for-profit PSOs

2.21 We do not consider it appropriate to speculate on particular cases. Our approach would depend on the specific facts and circumstances of the case, and we wish to retain the flexibility to use either revenue or some other alternative metric in such a case.

2.22 The respondent who raised the question of not-for-profit PSOs did acknowledge this point, saying that they 'recognise that the objective is to retain flexibility for any such circumstances that might arise where revenue is not an appropriate starting point for penalty calculations, and we support that principle'.

Bandings in the percentage scale

2.23 We have carefully considered this suggestion, but judge that the three proposed bands of lesser, moderate and high seriousness should be most appropriate for the cases we face.

Meaning of 'gross revenue'

2.24 While we have carefully considered this suggestion, we do not consider it appropriate to go into this level of detail in a broadly applicable penalty statement. How gross revenue is calculated in any particular case will depend on the business in question.

2.25 The Upper Tribunal has been clear that 'to embark on an exercise of departing from gross revenue on the basis of the details of a particular firm's business model would involve complexities that would effectively destroy the usefulness of adopting revenue as a starting point'.[5]

2.26 We consider that this principle applies equally in the case of defining gross revenue in our penalty statement.

5 HM Courts & Tribunals Service and Upper Tribunal (Tax and Chancery Chamber), *Linear Investments Ltd v The Financial Conduct Authority: [2019] UKUT 0115 (TCC)*, paragraph 20.

Alternative scale for cases involving breaches of the IFR

2.27 Having carefully considered this proposal, we do not consider it necessary or appropriate to have a separate, distinct scale for a specific type of case. As the respondent recognises, it may be complicated to have multiple percentage scales.

2.28 We also do not want to commit to considering alternative metrics in particular types of case. As we said in CP23/2, the revised penalty statement has adequate flexibility to allow for this when relevant.

Proposal to clarify what we mean by 'senior management'

2.29 Our current penalty statements explain that the role of senior management is relevant to the seriousness of any compliance failures, which affects penalty amounts. Senior management's role includes their awareness of the failure, the nature and extent of their involvement in it, and the timing and adequacy of any steps they took to address it.

2.30 We do not currently define the term 'senior management', nor provide any guidance on who should be regarded as holding a senior management position.

2.31 We considered it would be useful to clarify what we mean by senior management. We proposed amending our penalty statements to include a non-exhaustive list of factors that may indicate that a person holds a senior management position within a firm.

2.32 We considered whether a senior management position could be defined by the person performing senior management functions, as defined in the FCA's Senior Managers and Certification Regime (SM&CR). We judged that this interpretation might be unduly restrictive.

Consultation responses

2.33 Four of the five respondents were in favour of our proposals to clarify what we mean by 'senior management'. The fifth did not comment specifically on this proposal but did mention senior management in commenting on our assessment of recklessness in compliance failures.

2.34 Two respondents suggested we reconsider our position on the SM&CR. One said that although senior management functions may not always be relevant, they provide a widely understood framework.

2.35 Another respondent said a simpler, clearer option would be for us to mirror the existing SM&CR approach, particularly where a firm is both authorised by the FCA and regulated by us.

Our views

2.36 We have given due consideration to the SM&CR. We consider that a person's status under the SM&CR should not determine whether they are senior management for the purposes of the penalty statement.

2.37 As we said in our consultation paper, we think that limiting our interpretation of senior management in this manner may be unduly restrictive. There can be scope for people who do not perform senior management functions to make decisions that we consider relevant to a firm's compliance.

2.38 Equally, we recognise that in some situations, firms we are investigating may not be authorised by the FCA or the Prudential Regulation Authority.

2.39 We consider that following the SM&CR approach risks individuals avoiding classification as senior management only because they do not have 'senior management functions'. This would limit our ability to account for the role of senior management in evaluating the seriousness of a compliance failure.

Proposal to further clarify when we consider a compliance failure to be deliberate or reckless

2.40 Our penalty statements stated that deliberateness and recklessness were relevant when determining the level of compliance failure penalties. However, we did not distinguish between or define 'deliberate' and 'reckless' or identify any factors that would suggest a failure was one or the other.

2.41 We considered that clarifying these terms would increase transparency and help stakeholders understand our penalty process.

2.42 We therefore proposed separating recklessness and deliberateness into two distinct concepts, and then listing some factors we could use to identify them.

2.43 The penalty statements also did not state which individuals should be taken to represent the actions of the firm itself, when judging recklessness and deliberateness. We considered this should be 'senior management or a responsible individual'.

2.44 We also proposed introducing an objective element to the assessment of whether a compliance failure was reckless, to capture what a firm ought to have known.

Consultation responses

2.45 All five respondents were in favour of providing additional clarity around when we consider a compliance failure to be deliberate or reckless, saying additional guidance is welcome.

2.46 One stakeholder agreed this would increase transparency and assist stakeholder understanding.

2.47 Another said it was supportive of the move, given that these terms could directly influence the financial penalty given.

2.48 However, two respondents strongly opposed our proposal to introduce an objective element into the assessment of whether a compliance failure is reckless.

2.49 One said this would be a significant change, running contrary to the FCA's approach, and could create additional complexities and dispute risks in individual cases.

2.50 Another said it would be a departure from the existing case law, manifestly unfair, and subject to challenge.

Our views

2.51 Given the positive feedback and our prior judgements, we continue to see merit in further clarifying how we identify deliberateness and recklessness. We will therefore proceed with our general proposals to add clarity.

2.52 However, we have decided not to introduce an objective element to the assessment of awareness of risk in establishing whether a compliance failure is reckless.

2.53 Since we published CP23/2 proposing this change, the Upper Tribunal has dealt with this precise issue in the Seiler case.[6] In a judgment handed down in June 2023, the tribunal rejected the FCA's proposition that subjective awareness of the relevant risk is not a prerequisite of a finding of recklessness.[7]

2.54 In light of the tribunal's clear stance on this point, we are no longer proposing that awareness of the risk can be assessed on an objective basis.

Proposal to reinforce the principle that penalties should disincentivise compliance failures

2.55 We proposed some minor amendments to emphasise that disincentivising compliance failures is one of the key underlying objectives of the penalty statement.

Consultation responses

2.56 We did not receive any specific comments from respondents on this proposed change.

Our views

2.57 As we said in our consultation paper, it is very important that our penalty statement enables us to disincentivise organisations from failing to comply with the obligations we enforce.

2.58 Therefore, we remain of the view that it should form part of the general principles underpinning our penalty-setting regime and have included wording to this effect at paragraph 3.1 of our revised penalty statement.

6 Seiler, Whitestone and Raitzin v FCA [2023] UKUT 00133 (TCC).

7 *Ibid.*, paragraph 45.

3 Other points raised by respondents, and our views

In this chapter we set out other points raised by respondents to CP23/2, and our views.

Delay changes to our penalty statement pending the Financial Services and Markets Bill coming into force

3.1 One respondent noted that the Financial Services and Markets Bill (FSMB) (as it then was) will facilitate, as appropriate, the revocation and restatement of retained EU law, including provisions of the Payment Services Regulations (PSRs) 2017 and the IFR. The respondent suggested delaying any changes to the current penalty statements until any subsequent FSMB impacts can also be factored in.

3.2 We acknowledged this point in CP23/2 and indicated we would review the impact of the FSMB in due course, but we do not consider it necessary to delay making these changes now. The changes we are making are not specific to retained EU law but apply more broadly to how we impose penalties.

3.3 We consider that the increased transparency and clarity of these changes outweighs the possible need to revise the penalty statement in due course.

Clarify what we mean by 'business activity'

3.4 One respondent noted that we refer to revenue from a particular 'business activity', whereas the FCA's equivalent standard refers to 'products or business areas'. The respondent asked us to clarify whether any difference between the two concepts is intended, and, if so, what it is.

3.5 Our penalty statements have always referred to revenue generated by a particular business activity, rather than products or business areas. We consider that this more accurately reflects the nature of the firms we regulate and their activities in relation to payment systems.

4 Our decision

In this chapter we set out our final decisions on our proposals, in consideration of the responses received and considered in Chapters 2 and 3. We also explain the subsequent amendments we will make to other published guidance documents that flow from our changes to the penalty statements.

Proposal to combine our three penalty statements into one

Our decision

4.1 We have decided to implement this proposal. We will make the necessary amendments to our FSBRA Penalties Guidance, IFR guidance, the PSRs 2017 guidance and *Powers and Procedures Guidance* to refer to the new revised penalty statement.

Proposal to change how we consider the duration of a compliance failure and how we take account of revenue when calculating penalties

Our decision

4.2 We have decided to implement the proposal and have amended paragraphs 3.13 to 3.16 of our penalty statement to that effect.

Proposal to clarify what we mean by 'senior management'

Our decision

4.3 We have decided to implement the proposal and have amended paragraph 3.18(2) of our penalty statement to that effect.

Proposal to further clarify when we consider a compliance failure to be deliberate or reckless

Our decision

4.4 We have decided to implement the general changes and have amended paragraph 3.18(4) of our penalty statement to that effect. We have decided not to proceed with our proposal to introduce an objective element into the assessment of whether a compliance failure is reckless, and have deleted the proposed wording at paragraph 3.18(4).

Proposal to reinforce the principle that penalties should disincentivise compliance failures

Our decision

4.5 We have decided to implement the proposal and have added wording at paragraph 3.1 of our penalty statement to that effect.

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