Payment Systems Regulator

Revised penalty statement

Non-confidential stakeholder submissions to March 2023 consulation (CP23/2)

October 2023

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Names of individuals and information that may indirectly identify individuals have been redacted.

HSBC UK Bank plc

HSBC UK BANK PLC

PAYMENT SYSTEMS REGULATOR

PROPOSED REVISED PENALTY SCHEME

RESPONSE TO CONSULTATION DATED MARCH 2023

26 April 2023

PUBLIC

COVER SUBMISSION

HSBC UK Bank plc ('**HSBC UK'**) is grateful to have the opportunity to review and respond to the consultation paper for the proposed revised penalty statement.

For the avoidance of doubt, HSBC UK has the firm intention to remain compliant with regulatory requirements and to support the PSR's statutory and policy objectives.

HSBC UK welcomes the Payment Systems Regulator's ('**PSR**') consultation and is supportive of the proposals. We believe that it is appropriate to combine the three penalty statements into one, to simplify the PSR's approach to penalty statements.

HSBC UK also supports the proposed introduction of the percentage scale on which the chosen percentage will be set. The proposed scale set out in paragraph 3.16 of the proposed revised penalty statement introduces a clearer foundation on which the PSR can impose a penalty, without removing the flexibility required for the PSR, to review the individual circumstances of each case.

Penalty Framework

We welcome the concept of also retaining flexibility on the use of revenue as a starting point for the penalty calculations. HSBC UK agrees that revenue may normally offer the appropriate mechanism by which to assess the harm, or potential harm caused by the compliance breach, particularly for commercially regulated organisations. However, we agree that there may be circumstances where an alternative metric to revenue could provide a better proxy to inform the penalty calculation. Our primary concern regards not-for-profit payment system operators who are regulated by the PSR, particularly as a financial penalty in that circumstance would have to be paid for by a levy on participants. It is unclear in the statement how an alternative metric would be derived in this circumstance. However, we 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.

We are working on the assumption that any financial penalty would be levied just in respect of the relevant revenue, or alternative metric, for the specific business activity, where the regulatory breach has occurred. We welcome the clarification in paragraph 3.13 that relevant revenue or alternative metric would be limited just to the UK business line, which has suffered the compliance breach. For Financial Institutions subject to the requirements of the Financial Service Banking Reform Act (2013), we are assuming that the impact of a compliance breach in one UK legal entity of a banking group would be limited to that specific firm and other revenue from another UK firm in the Group, independently managed and governed would not be included in any calculation. In other words, the impact of a compliance breach in one UK legal entity of a banking group would be limited to that specific firm and other revenue from another UK firm in the

Group, independently managed and governed would not be included in any calculation. Specifically in this regard, HSBC UK versus HSBC Bank plc and vice-versa.

Senior Management

The clarification on senior management (paragraphs 3.36 – 3.43 and section 3.18(2)) is also helpful, along with the additional context for when a compliance failure could be classified as reckless or deliberate. HSBC UK understands that the proposed list of relevant facts (section 3.18 (4) and (5)) is not exhaustive, but does offer helpful background.

Nationwide Building Society

Nationwide
Building Society

PSR Consultation: Proposed Revised Changes to Penalty Statement (CP23/2)

Response from Nationwide Building Society, 27 April 2023

Thank you for the opportunity to comment on this consultation regarding proposed changes to the PSR's Penalty Statement.

We are supportive of the PSR simplifying the penalty statements by way of consolidating three into one and of the provision of additional guidance. In this short response, we suggest additional opportunities for the PSR to improve clarity to firms, including by aligning their approach more to that taken by the FCA in similar topics, as follows:

1. Penalty calculation: The proposal to move to indicative bandings based on revenue generated during the period of non-compliance (rather than the preceding 12 months) aligns to the FCA's approach in this area. However, given that in long-running cases a higher amount of revenue will now likely be caught, we believe the PSR should consider introducing a greater number of bandings between 0-20%. Adopting 5 bandings, as utilised by the FCA, instead of the 3 proposed, will give firms more clarity and certainty and the PSR greater optionality to reflect the circumstances around the breach.

   The Penalty Statement also talks about revenue from the "business activity" relating to the breach, whereas the FCA's equivalent standard refers to the "products or business areas". We would ask the PSR to clarify if there is intended to be a difference between the two concepts and if so, what this is.

2. 'Senior Management': Additional guidance on who constitutes a 'senior manager' is welcome, but the proposed guidance at para 3.18(2) of the Penalty Statement suggests that someone could be a Senior Manager by dint of being part of a group tasked with making decisions relating to the development and/or implementation of policies and systems enabling compliance. That potentially catches a very wide range of employees, sitting on decision-making forums regardless of their seniority. Can the PSR clarify that this factor will be read alongside the individual's seniority and other factors listed (i.e., it will not itself mean an individual is a Senior Manager)?

   A simpler, clearer option would be for the PSR to reflect the existing Senior Manager Certification Regime approach. We note the PSR says it is disinclined to do so because some of the firms it supervises are not FCA-authorised, which is understandable, but for those firms who are dual-supervised by the FCA and PSR it is not clear why alignment could not be adopted. In a dual supervision and concurrent investigation scenario, there would be efficiencies for both the PSR and firms in aligning with the FCA's approach.

3. 'Recklessness': Again, additional guidance on what the PSR considers to be recklessness is welcome, but in extending this concept to situations where the senior manager ought to have known or ought to have appreciated the risk of non-compliance, the PSR appears to be departing from the existing recognised standard of recklessness (which is a solely subjective assessment as to whether the individual appreciated the risk or wilfully closed their eyes to it). Introducing an objective element to this test would be a significant change, which runs contrary to the FCA's approach in this area and potentially creates significant additional complexities and dispute risks in individual cases.

   The consultation document explains that the PSR is minded to do so in order to disincentivise senior managers from "turning a blind eye". However, we suggest that the introduction of an objective element is unnecessary to achieve this as:
   - Firstly, the revisions to the penalty calculation already create sufficient disincentives for such conduct; and
   - Secondly, turning a blind eye to apparent risks would generally amount to wilful disregard anyway under the traditional common law concept of recklessness.

   This change, when coupled with the expanded guidance on who amounts to a 'senior manager', represents a potentially significant expansion of scenarios where recklessness might be found. This does not appear to be the PSR's intention from the consultation document.

We hope that this input is helpful. Please do contact us via the submitting contact details should you have any questions on the comments above.

NatWest Group

CP23/2: Proposed revised penalty statement

NatWest Group (NWG) appreciates the opportunity to provide input to the Payment Systems Regulator's (PSR) consultation on proposed changes to its penalty statements. We welcome the move from the regulator to simplify the approach to future penalty statements and agree that combining what are currently three separate statements into one makes sense and will aid firms in better understanding its approach in future. We also support the PSR's move in taking this opportunity to provide greater clarity around some of the terms and methodologies within the statement.

Having reviewed the proposed new, consolidated penalty statement please see below NWG's views on the overall approach and, where appropriate, specific language used by the PSR:

- The inclusion of a documented 'percentage scale' within the new statement, to help evidence the basis for the fee attributed to a particular penalty notice, would likely improve transparency and therefore is something that NWG would support.
- However, PSR states that this standard percentage scale would only be used in circumstances where revenue is used as the starting point for Step 1 of its four-step process, noting that if revenue is not used, it may use an alternate percentage scale, or different methodology altogether. Whilst appreciating the need for flexibility, we would welcome clarity around the circumstances when revenue would not be deemed as an appropriate staring point, to further improve transparency.
- The move to use revenue realised during the entire period in which a compliance failure occurred sounds perfectly sensible, and we would agree that this allows for a penalty which is more reflective of the compliance failure.
- NWG is supportive of the move to both distinguish between, and provide clarity around, what the regulator deems to be 'deliberate' and 'reckless' in relation to compliance failures, given that these terms may directly influence the financial penalty attributed. We also agree that a non-exhaustive list of factors that may point to a reckless or deliberate compliance failure would be beneficial and help firms to better understand how the regulator reaches certain conclusions.
- Given that it is the PSR's view that the extent to which senior management were aware of an infraction is key in deciding the seriousness of a compliance failure and therefore the level of financial penalty awarded, it is appropriate that the term 'senior management' is clearly defined. NWG welcomes the proposals to include a non-exhaustive list of factors that may indicate someone holds a senior management position. However, we would ask that the regulator reconsider plans to disregard the definitions set out in the Senior Managers Certification Regime entirely. We appreciate that SMF functions may not be

relevant in all cases and to all firms, but they do provide a framework well understood by much of the industry and, if taken in conjunction with the PSR's non-exhaustive list, could provide an extra level of clarity as to how the 'senior manager' term is applied in certain circumstances.

- We note that the Financial Services and Markets Bill (FSMB), once it receives Royal Assent and becomes law, will facilitate as appropriate the revocation and restatement of retained EU law (including provisions of the PSRs 2017 and the IFR). We understand that this will require a further review of the penalty statement to reflect any changes. Indeed, to avoid confusion, it may be more appropriate to delay any proposed changes to the current penalty statements until any subsequent FSMB impacts can also be factored in.

--- End ---

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Regulatory Enforcement Team

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27 April 2023

Dear PSR,

Pay.UK response to PSR CP23/2: proposed revised penalty statement consultation

I write in response to the PSR's penalty statement consultation.

Pay.UK supports the PSR's work to increase transparency in its enforcement regime. We recognise that as the payments sector evolves, there will be increased benefits from further clarity in how the PSR could exercise its enforcement powers, including its methodologies for calculating any penalties. It is also helpful given the PSR plans to strengthen its supervisory approach, with an additional focus on supervising designated payment systems, as detailed in its annual plan.

We agree there are benefits of the proposed changes, to help firms more easily understand how the PSR will determine the amount of any penalty imposed. We discuss each change element below.

Combining the three penalty statements into one. We agree that combining the statements into a single document will allow firms to more easily understand the methodology the PSR applies to penalties, and facilitate a consistent approach by the PSR.

Changes to the way in which the duration of a compliance failure and revenue is considered when calculating penalties. We agree that using the starting point for calculating the penalty amount, by use of revenue realised during the period in which a compliance failure occurred, provides a clearer rationale for the penalty amount and reduces the risk of firms being able to act strategically to affect the value of the penalty issued. Additionally, the improved basis for the starting figure should reduce the need to vary the amount during steps 2-4 of the 4-step process. This makes the rationale for the methodology used in issuing the penalty amount clearer for firms, and is a better application of the PSR's stated principles.

Clarifying what is meant by senior management. We agree that introducing guidance about who the PSR might consider senior management when determining the penalty is helpful. We agree that limiting the definition of a senior manager to that in the SM&CR could limit the PSR's ability to consider the individual circumstances of the compliance failing in issuing its penalty.

Adding clarity on whether a compliance failure is considered deliberate or reckless. This has a direct bearing on the penalty, so it is therefore useful for PSR to outline how it could decide whether a firm committed a deliberate, or reckless act. It can also be helpful to firms when considering their own risk controls against compliance failures. Moving away from the consideration of 'the extent to which' an act is deliberate or reckless, to 'whether', is likely to reduce scope for disagreement over subjective assessment.

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Reinforcing the principle that penalties should disincentivise compliance failures. We support the PSR in its aim to reduce compliance failures and recognise the role that penalties can play.

Suggestions for further improvements. We support the aim to help firms more easily understand how the PSR could determine the amount of any penalty it imposes. In line with this we suggest that the PSR could consider providing guidance on the circumstances in which the starting figure would *not* be based on revenues. Additionally, firms would also benefit from further guidance on how the PSR would use steps 2-4 to deviate from the penalty starting figure arrived at in step 1. For example, on how the PSR establishes the penalty amount necessary to act as a deterrent in step 3 and how the PSR establishes whether the value of a penalty is proportionate.

Yours faithfully,

David McPhee

Director, Regulatory Engagement and Policy

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27 April 2023

Regulatory Enforcement Team
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By email to:
penaltyconsultation@psr.org.uk

Our ref /OPEN/-1/AJC1
Your ref CP23/2

Dear Sir / Madam

Simmons & Simmons LLP's response to CP23/2: Proposed revised penalty statement

We welcome the Payment Systems Regulator's ("**PSR**") proposed amendments to its penalty statement as set out CP23/2 (the "**Consultation Paper**") and consider that, taken as a whole, the changes will help firms to more easily understand how the PSR determines whether to impose a penalty and the amount of the penalty imposed.

However, there are two areas where we have some concerns, being: (i) the changes to how the PSR proposes to assess the duration of a compliance failure in Step 1 of the penalty calculation; and (ii) the PSR's proposals regarding when the PSR considers a compliance failure is 'deliberate' or 'reckless'. In addition, we ask that the PSR considers clarifying the meaning of 'gross revenue' in its revised penalty statement.

We have expanded on each of those points below. Where appropriate, we have suggested amendments to the PSR's proposed revised penalty statement.

This letter is sent on behalf of our clients in general and is not attributable to or to be taken as the position of any one firm.

1. **Change to how the PSR considers the duration of a compliance failure at Step 1 of the penalty calculation**

1.1 We welcome the PSR's proposals to incorporate a percentage scale into its penalty statement. We agree that this will provide greater clarity and certainty around the PSR's process for calculating the Step 1 figure.

1.2 However we consider that the proposed percentage scale of 0-20% (applied over the entire period in which the compliance failure occurs) will often result in Step 1 figures that are disproportionately high for cases involving a breach of the Interchange Fee Regulations ("**IFR**") where relevant revenue may be based on the revenue from a payment service providers' entire issuing or acquiring businesses.

1.3 We are concerned that, in such cases, the result of this proposal will be that the Step 1 figure in many cases is disproportionately high because payment service providers' issuing and acquiring businesses tend to be large business units that record significant revenue.

Alternatively, where relevant revenue is based on the revenue from the specific cards linked to the breaches, the Step 1 figure could be disproportionately low.

1.4 This is an existing issue with the current percentage scale of 0-60%, applied over a 12 month period. For example, relevant revenue has been based on the revenue:

(A) from the relevant bank's entire acquiring businesses in which case the Step 1 figure was disproportionately high and required significant adjustment. In that case, the Step 1 figure was £338,700,000 (based on a moderate seriousness level of 40%), which was increased by 10% at Step 2 to £372,570,000 on account of aggravating factors, and then ultimately reduced to £12,000,000 (a reduction of approximately 97%) at the end of Step 2 because the figure was "*disproportionately high having regard to the seriousness, scale and effect of the compliance failure*". [1]

(B) the revenue from only the cards linked to the breaches in which case the Step 1 figure was disproportionately low and required significant adjustment. In that case, the Step 1 figure was £376,494 (based on a moderate seriousness level of 40%), which was increased by 35-40% at Step 2 to £526,453 on account of aggravating factors, and then ultimately increased to £2,600,000 (an increase of approximately 500%) at Step 3 because the Step 2 figure was "*insufficient to meet the PSR's objective of credible and effective deterrence on the facts of this particular case*". [2]

1.5 Applying such significant discretionary reductions and increases negates the purpose of the Step 1 calculation and we do not consider that the PSR's proposals will remedy this issue.

1.6 We therefore consider that the PSR should either: (i) apply a different (lower) percentage scale for cases involving IFR breaches where revenue is calculated based on the revenue from the payment service provider's entire issuing or acquiring businesses; or (ii) make greater use of alternative metrics where, if applying the revenue metric, the PSR would otherwise need to apply a significant discretionary reduction or increase later in the calculation.

1.7 As to (i), we would suggest that the PSR applies a percentage scale of 0-3% (1% for cases for cases representing lesser seriousness; 2% for cases representing moderate seriousness; and 3% for cases representing high seriousness) for cases involving IFR breaches and where revenue is calculated based on the revenue from the payment service provider's entire issuing or acquiring businesses. This would follow the FCA's approach of applying a reduced percentage scale of 0-0.8% for cases involving breaches of the CASS rules.

1.8 We would not propose that the PSR applies an increased percentage scale for cases involving IFR breaches where revenue is calculated based on the revenue from the specific cards linked to the breaches because it may be overly complicated to have multiple percentage scales, and also because (based on the penalty calculations in the two published Notices it is likely that the Step 1 figures in these cases will be more proportionate than in cases where revenue is based on the revenue from the payment service provider's entire issuing or acquiring businesses.

1.9 As to (ii), the Consultation Paper notes that the PSR recognises that in some cases there may be metrics more suitable than revenue which more accurately reflect the harm or potential harm that the compliance failure caused. We would welcome guidance around the

[1] https://www.psr.org.uk/media/miakuw0t/psr-decision-notice-to-barclays-bank-plc-2-dec-2022.pdf.

[2] https://www.psr.org.uk/media/3uwosy0g/decision-notice-psr-investigation-into-natwest-group-banks-non-compliance-with-the-interchange-fee-regulation_clean.pdf

circumstances in which revenue may not be considered an appropriate starting point for Step 1, and what alternative appropriate metrics may be.

1.10 One possible alternative metric for determining the Step 1 figure for cases involving IFR breaches is to attribute a certain value to each card linked to the breaches. This would follow the FCA's approach in cases involving misreported or non-reported transactions (in such cases the FCA attributes a value of £1.50 to each misreported or non-reported transaction). We would encourage the PSR to consider whether applying this metric is likely to result in more proportionate Step 1 figures than applying a percentage scale.

2. **Adding further clarity to when the PSR considers a compliance failure is 'deliberate' or 'reckless'**

2.1 We welcome the PSR's proposals to clarify what is meant by the terms 'deliberate' and 'reckless'. We agree that this will increase transparency and assist stakeholder understanding.

2.2 However we do not agree with the PSR's proposal at paragraph 3.30 of the Consultation Paper to introduce an objective element to the assessment of whether a compliance failure was reckless, which does not depend on the particular knowledge the individual may or may not have of the risk in question.

2.3 We consider that this approach departs from the existing case law (as set out below) on the meaning of recklessness, which depends on an individual being subjectively aware of the risk in question, would be manifestly unfair and would be subject to challenge.

2.4 In Tinney v FCA [2018] UKUT 0435 (TCC), the Tribunal held (at paragraph 14) that a person acts recklessly if he is aware of a risk that something will occur and it is unreasonable to take that risk having regard to the circumstances as he knows or believes them to be:

> *"The Tribunal in* ***Allen v FSA*** *(2009) adopted the view of the Tribunal in Vukelic that to turn a blind eye to the obvious and to fail to follow up obviously suspicious signs is a lack of integrity. We agree with the views expressed in Vukelic and Allen but note that 'recklessness' is a difficult concept that is not defined in the FSMA or Statements of Principle produced by the FCA. In* ***R v G [2003] UKHL 50, [2004] 1 AC 1034*** *, the House of Lords construed 'recklessly' in the Criminal Damage Act 1971 as meaning that a person acts recklessly when he is aware of a risk that a circumstance exists or a result will occur and it is, in the circumstances known to him, unreasonable to take the risk. The House of Lords based its interpretation on the definition proposed by the Law Commission in clause 18(c) of the Criminal Code Bill annexed to its Report on Criminal Law: A Criminal Code for England and Wales and Draft Criminal Code Bill, Vol 1 (Law Com No 177, 1989). A similar definition of recklessness was included in a draft Bill for reforming the law of offences against the person, which the Government published in 1998 but did not take forward. The definition was quoted by Lady Hale and Lord Toulson, in a joint judgment, in* ***Rhodes v OPO & Anor*** *[2015] UKSC 32 at [84] . They pointed out that recklessness is a word capable of different shades of meaning and presents problems of definition. However, they set out the definition proposed by the Law Commission in a scoping consultation paper on Reform of Offences against the Person (LCCP 217, 2015):*
>
> > *"A person acts recklessly with respect to a result if he is aware of a risk that it will occur and it is unreasonable to take that risk having regard to the circumstances as he knows or believes them to be."*

We adopt that proposed definition as an appropriate standard of recklessness in this case."

2.5 In *R v G* [2004] 1 AC 1034, Lord Bingham held (at paragraph 41):

> *"A person acts recklessly … with respect to - (i) a circumstance when he is aware of a risk that it exists or will exist; (ii) a result when he is aware of a risk that it will occur; and it is, in the circumstances known to him, unreasonable to take the risk."*

2.6 The FCA Handbook at DEPP 6.5A.2G (9) rightly reflects this position and sets out that factors "*tending to show the breach was reckless*" include:

> *"(a) the firm's senior management, or a responsible individual, appreciated there was a risk that their actions or inaction could result in a* breach *and failed adequately to mitigate that risk; and*
>
> *(b) the firm's senior management, or a responsible individual, were aware there was a risk that their actions or inaction could result in a* breach *but failed to check if they were acting in accordance with the firm's internal procedures."*

2.7 For a breach to be considered as reckless in an FCA case there is therefore a requirement for awareness of that risk from the firm's senior management or a responsible individual. The is the position in accordance with the law and the position ought not to be, as is proposed in the Consultation Paper, that a firm can be considered to have acted recklessly because it did not know something that it ought to have known on an objective basis.

2.8 The requirement for awareness encompasses wilful blindness where the relevant risks are understood but put to one side on a subjective basis. The application of an objective test is neither required nor permissible.

3. <u>Clarifying the meaning of 'gross revenue'</u>

3.1 Under both the current and proposed revised penalty statements, the Step 1 relevant revenue figure is calculated with reference to a firm's gross revenue. The application of gross revenue is an integral part of the Step 1 calculation but it is not clear how it should properly be calculated and there are different methods which could be validly applied. Accordingly, we would welcome clarification from the PSR on how gross revenue should be calculated.

3.2 We appreciate that it would be difficult to give general guidance on how gross revenue is calculated because it is dependent on the business in question. However we consider that it would be possible to provide meaningful guidance with relevant and specific examples in the context of issuing and acquiring businesses and that such guidance would be very helpful for firms and their advisers as well as the PSR.

3.3 In particular, we would welcome guidance on the types of fees that should be included in the calculation of gross revenue in an IFR context. The PSR's card-acquiring market review - final report - November 2021[3] sets out (at paragraphs 3.17-3.19) the main flow of fees between parties in a four-party card payment system, being: interchange fees, scheme fees, merchant service charge and cardholder fees.

3.4 It seems to us that:

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[3] https://www.psr.org.uk/media/p1tlg0iw/psr-card-acquiring-market-review-final-report-november-2021.pdf

(A) Following Linear v FCA [2019] UKUT 0115 (TCC), at paragraph 21, it is relevant to have regard to a firm's "filed accounts" and therefore its accounting policies when determining which sums fall within relevant revenue; and

(B) Following the Carphone Warehouse Final Notice [2019] paragraph 17, sums to which the firm is not contractually "*entitled to these payments … and did not earn or receive them … do not fall within the definition of relevant revenue*".

3.5 If the PSR took an approach that was consistent with the FCA then sums which were recognised by the firm as contra-income (e.g. fees that were paid to the firm but then onwardly paid to another party in the card-payment system), would be excluded from relevant revenue. We would welcome guidance to clarify the PSR's approach to the calculation of gross revenue.

Yours faithfully

Simmons & Simmons LLP

Simmons & Simmons LLP

PUB REF: CP23/2 Submissions

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