FINANCIAL CONDUCT AUTHORITY
PAYMENT SYSTEMS REGULATOR™

Penalties Guidance

March 2015

1. Introduction

1.1 Under section 73(1) Financial Services (Banking Reform) Act 2013 (FSBRA), we may require a participant in a regulated payment system to pay a penalty in respect of a compliance failure.[1]

1.2 A 'compliance failure' means a failure by a participant in a regulated payment system to comply with:

- a direction given by us under section 54 FSBRA; or
- a requirement imposed by us under section 55 or 56 FSBRA.

1.3 This document contains our statement of the principles which we will apply in determining (a) whether to impose a penalty; and (b) the amount of that penalty. We are required to prepare this statement of principles under section 73(3) FSBRA. Details of the procedures that we will generally apply in relation to our regulatory functions under FSBRA, including rights of appeal, are set out in our Powers and Procedures Guide.

1.4 We will have regard to this statement of principles:

- in respect of any compliance failure which occurred, or is continuing, on or after 1 April 2015
- in deciding whether to impose a penalty
- in determining the amount of any penalty.

1.5 We will apply this statement of principles in respect of all participants. This does not imply that the same compliance failure would necessarily result in the same financial penalty across and within different categories of participant.

1.6 We may, from time to time, revise this statement of principles. In so doing we will liaise with other relevant regulators to ensure that this statement reflects current best practice as appropriate to our regulatory functions and the payments industry. Any revised statement will be issued for consultation and published.[2]

[1] In this document references to a 'participant' shall have the same meaning as defined in section 42 FSBRA.
[2] Except insofar as the context requires, words or expressions will have the meaning assigned to them in the PSR's relevant directions and requirements, and otherwise any word or expression will have the same meaning as it has in FSBRA.

2. Deciding whether to impose a penalty

2.1 We will consider the full circumstances of each individual case when determining whether or not to impose a financial penalty.

2.2 Set out below is a list of factors that may be relevant for this purpose. The list is not exhaustive, and not all of these factors may be applicable in a particular case. There may also be other factors, not listed here, that are relevant in an individual case. The factors we may consider include:

- The nature, seriousness, duration, frequency and impact of the compliance failure.
- The behaviour of the participant after the compliance failure has been identified.
- The previous disciplinary record and compliance history of the participant.
- Our guidance and other published materials: we will not generally take action against a participant for behaviour that we consider to be in line with guidance, our regulatory principles or other materials published by us pursuant to our statutory functions and duties, and which were current at the time of the behaviour in question.
- Action taken by us or a relevant regulator (i.e., another relevant domestic or international regulatory or competition authority) in previous similar cases.
- Action taken by a relevant regulator: where a relevant regulator proposes to take action in respect of the compliance failure which is under consideration by us, or one similar to it, we will consider whether the other regulator's action would be adequate to address our concerns, or whether it would be appropriate for us to take our own action.
- The extent to which the compliance failure in question may relate to a novel issue which has not been the subject of previous guidance or statements by the PSR or another relevant regulator.

2.3 Where we impose a financial penalty, our normal practice will be to also publish details of the compliance failure.[3]

2.4 In deciding whether it is appropriate to publish details of a compliance failure (instead of imposing a financial penalty), we will consider all the relevant circumstances of the case. The key factor is the nature and seriousness of the compliance failure, but other considerations include the following non-exhaustive factors:

- whether or not deterrence may be effectively achieved by publishing details of the compliance failure
- if the participant has derived an economic benefit (including made a profit or avoided a loss) as a result of the compliance failure, this may be a factor in favour of a financial penalty, on the basis that a participant should not be permitted to retain any benefit from its compliance failure

[3] Under section 72(1) FSBRA we may publish details of a compliance failure by a participant in a regulated payment system.

- if the compliance failure is more serious in nature or degree, this may be a factor in favour of a financial penalty, on the basis that the sanction should reflect the seriousness of the compliance failure; other things being equal, the more serious the failure, the more likely we are to impose a financial penalty

- if the participant has brought the compliance failure to our attention, this may be a factor in favour of only publishing details of the compliance failure

- if the participant has admitted the compliance failure and provided full and immediate cooperation to us, and has taken steps to put in place effective remedial action, this may be a factor in favour of only publishing details of the compliance failure, rather than also imposing a financial penalty

- if the participant has a poor disciplinary record or compliance history this may be a factor in favour of a financial penalty, on the basis that it may be particularly important to deter future cases

- the approach of the PSR or other relevant regulator in similar previous cases (where appropriate, we will seek to achieve a consistent approach to our decisions on whether to impose a financial penalty or to publish details of a compliance failure) and

- the impact on the participant concerned, although it would only be in an exceptional case that we would be prepared to agree to only publish details of the compliance failure, and not impose a financial penalty, if a penalty would otherwise be the appropriate sanction.

2.5 Where we impose a financial penalty, our normal practice will be to also publish details of that financial penalty as set out under section 72(2) FSBRA. We will only refrain from publishing details of a financial penalty in exceptional circumstances.

3. Determining the appropriate level of the financial penalty

3.1 Our penalty-setting regime is based on the following general principles:

- *disgorgement* – a participant should not benefit from any compliance failure
- *discipline* – a participant should be penalised for wrongdoing; and
- *deterrence* – any penalty imposed should deter the participant who committed the compliance failure, and others, from committing further or similar compliance failures.

3.2 The total amount payable by a participant subject to enforcement action may be made up of two elements: (i) disgorgement of the benefit received as a result of the compliance failure; and (ii) a financial penalty reflecting the seriousness of the compliance failure. These elements are incorporated in the following framework.

- *First element:* the disgorgement of any economic benefits derived directly from the compliance failure (see paragraphs 3.6-3.8).
- *Second element*: the financial penalty, calculated as follows:
    - *Step 1*: in addition to any disgorgement (see first element), the determination of a figure which reflects the seriousness of the compliance failure and the size and financial position of the participant (see paragraphs 3.9-3.10)
    - *Step 2*: where appropriate, an adjustment made to the Step 1 figure to take account of any aggravating or mitigating circumstances (see paragraphs 3.11-3.12)
    - *Step 3*: where appropriate, an upwards adjustment made to the amount arrived at after Steps 1 and 2, to ensure that the penalty has an appropriate and effective deterrent effect (see paragraph 3.13); and
    - *Step 4*: if applicable, one or both of the following factors may be applied to the figure determined following Steps 1, 2 and 3:
        - a settlement discount (see paragraphs 3.14 and 5.1-5.7)
        - an adjustment based on any serious financial hardship which the PSR considers payment of the penalty would cause the participant, or if the penalty could adversely impact the stability of or confidence in the UK financial system (see paragraphs 3.15 and 4.1-4.7).

3.3 For the avoidance of doubt, any settlement discount does not apply to disgorgement of any financial benefit derived directly from the compliance failure (under the first element of paragraph 3.2).

3.4 We recognise that the overall penalty arrived at pursuant to our framework approach must be appropriate and proportionate to the relevant compliance failure. We may decrease the level of the penalty which would otherwise be determined following Steps 1 and 2 if we consider that it is disproportionately high having regard to the seriousness, scale and effect of the compliance failure. In determining any deterrence uplift at Step 3, we will also ensure that the overall penalty is not disproportionate.

3.5 The factors and circumstances relevant to determining the appropriate level of penalties set out below are not exhaustive. Not all of the factors or circumstances listed will necessarily be relevant in a particular case and there may be other factors or circumstances not listed which are relevant.

Our framework for determining the level of penalties

First element – disgorgement

3.6 We will seek to deprive a participant of the economic benefit derived directly from, or attributable to, the compliance failure (which may include any profit made or loss avoided) where it is practicable to quantify this. We may also charge interest on the disgorgement.

3.7 Where the success of a participant's business model is dependent on failing to comply with regulatory obligations related to payment systems and services provided by payment systems, and the compliance failure is at the core of the participant's activities related to payment systems and services provided by payment systems, we will seek to deprive the participant of all the financial benefit derived from such activities.

3.8 Where a participant agrees to carry out a remedial programme (which may include redress to compensate those who have suffered a loss or not realised a profit as a result of the compliance failure), or where we decide to impose a redress programme, the PSR will take this into consideration. In such cases the final penalty might not include a disgorgement element, or the disgorgement element might be reduced.

Second element – the penalty

Step 1 – the seriousness of the compliance failure

3.9 As noted in paragraphs 3.2-3.3, the penalty is calculated separately from, and in addition to, any disgorgement. We will determine a figure for the penalty that reflects the seriousness of the compliance failure. In many cases, the amount of revenue generated by a participant from a particular business activity is indicative of the harm or potential harm that its compliance failure may cause. In such cases the PSR will determine a figure which will be based on a percentage of the annual gross revenues derived by the participant from the business activity in the United Kingdom to which the compliance failure relates.[4] Where appropriate the PSR may have regard to a participant's "billings" (i.e. the revenues invoiced to third parties) in respect of the relevant business activity, for example where revenues information is not available or differs from billings.

[4] Annual revenues realised in the year prior to the PSR's final decision notice or termination of the relevant compliance failure, whichever is earlier.

3.10 The following factors may be relevant to determining the appropriate level of financial penalty:

- *Deterrence:* when determining the appropriate level of penalty, we will have regard to the principal purpose for which we impose sanctions, namely to promote high standards of regulatory behaviour by deterring participants who have committed compliance failures from committing further compliance failures and helping to deter other participants from committing similar compliance failures.

- *The nature of the compliance failure:* the following considerations may in particular be relevant:

    - the nature of the requirement imposed on, or the direction given to, the participant which was not complied with

    - the duration and/or frequency and/or repetition of the compliance failure

    - the extent to which the participant's senior management were aware of the compliance failure, the nature and extent of their involvement in it, and the timing and adequacy of any steps taken to address it.

- The impact or potential impact of the compliance failure on the following may in particular be relevant:

    - competitiveness of and competition in the market for payment systems or the markets for services provided by payment systems

    - innovation in the market for payment systems or the markets for services provided by payment systems or the markets for infrastructure to be used for the purposes of operating payment systems

    - the interests of those who use, or who are likely to use, services provided by regulated payment systems.

- The extent to which the compliance failure was deliberate or reckless.

Step 2 – mitigating and aggravating factors

3.11 We may increase or decrease the amount of the financial penalty arrived at after Step 1 (but not including any amount to be disgorged as set out in paragraphs 3.6-3.8) to take into account factors which aggravate or mitigate the compliance failure.

3.12 The following list of factors may have the effect of aggravating or mitigating the compliance failure:

- the behaviour of the participant in bringing (or failing to bring) quickly, effectively and comprehensively the compliance failure to our attention (or the attention of other relevant regulators, where appropriate)

- the degree of cooperation the participant showed during the investigation of the compliance failure by us, or any other relevant regulator working with us, and the impact of this on our ability to conclude our investigation into the compliance failure promptly and efficiently

- any remedial steps the participant has taken or has committed to take since the compliance failure was identified, how promptly they were or will be taken, and their effectiveness
- whether the participant has arranged its resources in such a way as to enable or avoid disgorgement and/or payment of a financial penalty
- whether the participant had previously been informed about our concerns in relation to the issue or behaviour in question
- whether the participant had previously undertaken to us or another relevant regulator not to perform a particular act or not to engage in particular behaviour which relates to the compliance failure, or has undertaken to perform a particular act or to engage in particular behaviour which relates to the compliance failure
- the extent to which the participant concerned has complied with our requests or requirements or those of another relevant regulator relating to the issue
- the previous disciplinary record and general compliance history of the participant in relation to us or another relevant regulator
- action taken against the participant by another relevant regulator that is relevant to the compliance failure in question
- whether our guidance or other published materials had already raised relevant concerns, and the nature and accessibility of such materials
- whether adequate steps have been taken by the participant to achieve a clear and unambiguous commitment to compliance with our regulatory requirements throughout the organisation (from the top down) – together with appropriate steps relating to regulatory risk identification, risk assessment, risk mitigation and review activities[5]
- whether the failure is due (in whole or in part) to the actions of a third party and whether the participant was or ought to have been aware of it, and took or ought to have taken reasonable steps to avoid the compliance failure.
- the size, financial resources and other circumstances of the participant on whom the penalty is to be imposed.

Step 3 – adjustment for deterrence

3.13 If we consider that the figure arrived at after Step 2 is insufficient to deter the participant who committed the compliance failure, or others, from committing further or similar compliance failures, then we may increase the penalty. Circumstances where we may do this include (but are not limited to):

[5] The mere existence of compliance activities will not be treated as a mitigating factor. The participant will need to demonstrate that the steps taken were appropriate to the size of the business concerned and its overall level of regulatory risk. It will also need to present evidence on the steps it took to review its compliance activities, and change them as appropriate, in light of the events that led to the investigation at hand. We will not, subject to some exceptions, ordinarily regard the existence of a compliance programme as a factor to warrant an increase in the amount of the penalty to be imposed against that participant for the compliance failure. The exceptions include situations where the purported compliance programme had been used to facilitate the compliance failure, to mislead us or another relevant regulator as to the existence or nature of the compliance failure, or had been used in an attempt to conceal the compliance failure.

- where we consider that the value of the penalty is too small in relation to the compliance failure to meet our objective of credible and effective deterrence

- where previous action by us or another relevant regulator in respect of the same or similar issues has failed to improve the relevant behavioural standards of the participant which is the subject of our action and/or relevant industry behavioural standards; and

- where we consider that there is a risk that similar compliance failures will be committed by the participant or by other participants in the future in the absence of such an increase to the penalty.

Step 4 – discounts

3.14 The PSR and the participant on whom a penalty is to be imposed may seek to agree the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the PSR and the participant concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated under the first element, pursuant to paragraphs 3.2-3.3. Details of the PSR's policy on settlement discounts are provided at paragraphs 5.1-5.7.

3.15 Details of our policy on serious financial hardship are provided at paragraphs 4.1-4.7.

4. Serious financial hardship

4.1 Our starting point is that we consider that it is only in exceptional cases that we would grant a discount to a penalty based on a claim of serious financial hardship for the reasons set out in paragraphs 4.2-4.4.

4.2 We note that many Payment Service Providers (PSPs) authorised by the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA) are subject to their own prudential requirements.

4.3 In the context of penalties imposed on a participant for a compliance failure, we expect in particular that Operators[6] or Central Infrastructure Providers[7] organised as not-for-profit entities should have in place effective arrangements with their owners, shareholders, guarantors or direct participants (as the case may be) to call upon such persons to contribute sufficient funds from time to time in order to enable the Operator or Central Infrastructure Provider to meet its current and future debts and liabilities as they fall due. This would cover a debt owed to us as a penalty for a compliance failure.

4.4 With respect to any claim that a decision to impose a penalty on a participant could adversely impact the stability of, or confidence in, the UK financial system, or where we consider that such a risk exists, we will liaise with the Bank of England before taking such a decision.

4.5 Subject to paragraphs 4.1-4.4, our approach to determining penalties is intended to ensure that financial penalties are proportionate to the compliance failure. We recognise that penalties may affect participants differently, and that we should consider whether a reduction in the proposed penalty is appropriate if the penalty would cause the subject of enforcement action serious financial hardship, and/or if this could adversely impact the stability of, or confidence in, the UK financial system. Where a participant claims that payment of the penalty proposed by us will cause it serious financial hardship, we will consider whether to reduce the proposed penalty (resulting from Steps 1, 2 and 3) only if:

- the participant provides verifiable evidence that payment of the penalty will cause them serious financial hardship and/or could adversely impact the stability of or confidence in the UK financial system; and

- the participant provides full, frank and timely disclosure of the verifiable evidence, and cooperates fully in answering any questions asked by us about its financial position.

4.6 The onus is on the participant to satisfy us that payment of the penalty will cause it serious financial hardship and/or that this could adversely impact the stability of, or confidence in, the UK financial system.

[6] As defined under s.42(3) FSBRA, in relation to a payment system, Operator means any person with responsibility under the system for managing or operating it; and any reference to the operation of a payment system includes a reference to its management.
[7] An Infrastructure Provider who provides Central Infrastructure to an Operator under a contract. Central Infrastructure means a package of systems and services provided under contract to an Operator for the purpose of operating the relevant payment system, and specifically the processing of payment transactions and funds transfers. The package must include at a minimum the provision of hardware and software (including related ancillary support services). It may include additional services such as secure telecommunications networks, facilities, physical security or support staff. Central Infrastructure may be provided to the Operator by an external provider, or internally.

4.7 There may be cases where, even though the participant has satisfied us that payment of the financial penalty would cause serious financial hardship, we consider the compliance failure to be so serious that it is not appropriate to reduce the penalty. We will consider all the circumstances of the case in determining whether this course of action is appropriate, including whether (as applicable):

- an individual who has the ability to exercise control or material influence over the management or operation of the participant (Individual Controller):
    - directly derived a financial benefit from the compliance failure and, if so, the extent of that financial benefit
    - that individual acted fraudulently or dishonestly with a view to personal gain
- previous action by us in respect of similar compliance failures has failed to improve industry standards
- a participant or Individual Controller has spent money or dissipated assets or otherwise used financial structures in anticipation of enforcement action by us or another relevant regulator with a view to frustrating or limiting the impact of action taken by us or other regulators.

5. Settlement discount

5.1 As set out in paragraph 3.3 and for the avoidance of doubt, any settlement discount does not apply to disgorgement of any financial benefit derived directly from the compliance failure (under the first element of paragraph 3.2).

5.2 Participants subject to enforcement action may be prepared to agree the amount of any financial penalty and other conditions which we seek to impose by way of such action. We recognise the benefits of such agreements, in that they offer the potential for securing earlier protection for service-users and the saving of costs to the participant concerned in contesting the financial penalty and to the PSR itself. The penalty that might otherwise be payable in respect of a compliance failure by the participant concerned will therefore be reduced to reflect the timing of any settlement agreement.

5.3 In appropriate cases our approach will be to discuss with the participant concerned to agree in principle the amount of a financial penalty having regard to our statement of principles as set out here. This starting figure (resulting from Steps 1, 2 and 3) will take no account of the existence of the settlement discount. Such amount (A) will then be reduced by a percentage of A according to the stage in the process at which agreement is reached. The maximum percentage reduction shall be no more than 30% of A. The resulting figure (B) will be the amount actually payable by the participant concerned in respect of the compliance failure. However, where part of a proposed penalty specifically equates to the disgorgement of any profit accrued, or loss avoided, then the percentage reduction will not apply to that part of the penalty.

5.4 In certain circumstances, the participant concerned may consider that it would have been possible to reach a settlement at an earlier stage, and argue that it should be entitled to a greater percentage reduction in penalty. It may be, for example, that we no longer wish to pursue enforcement action in respect of all of the acts or omissions previously alleged to give rise to the compliance failure. In such cases, the participant concerned might argue that it would have been prepared to agree an appropriate penalty at an earlier stage and should therefore benefit from a greater discount. Equally, we may consider that greater openness from the participant concerned could have resulted in an earlier settlement.

5.5 Arguments of this nature risk compromising the goals of greater clarity and transparency in respect of the benefits of early settlement, and invite dispute in each case as to when an agreement might have been possible. It will not usually be appropriate therefore to argue for a greater reduction in the amount of penalty on the basis that settlement could have been achieved earlier.

5.6 However, in exceptional cases we may accept that there has been a substantial change in the nature or seriousness of the action being taken against the participant concerned, and that an agreement would have been possible at an earlier stage if the action had commenced on a different footing. In such cases the PSR and the participant concerned may agree that the amount of the reduction in penalty should reflect the stage at which a settlement might otherwise have been possible.

5.7 In cases where we apply a discount in the penalty for settlement, the fact of settlement and the level of the discount to the financial penalty that would otherwise have been imposed by us will be set out in the final decision notice.

6. Apportionment

6.1 In a case where we are proposing to impose a financial penalty on a participant for two or more separate and distinct compliance failures, we will consider whether it is appropriate to identify in the warning notice and final decision notice how the penalty is apportioned between those separate and distinct areas. Apportionment will not, however, generally be appropriate in other cases.

7. Payment of financial penalties

7.1 Financial penalties will be paid to the Treasury after deducting our enforcement costs as provided for in Schedule 4 FSBRA, paragraph 10(1).

7.2 Financial penalties must be paid within the period (usually 14 calendar days) that is stated on the final decision notice. Our policy in relation to reducing a penalty because its payment may cause a participant serious financial hardship is set out in paragraphs 4.1-4.7.

7.3 We will consider agreeing to defer the due date for payment of a penalty or accepting payment by instalments where, for example, the participant requires a reasonable time to raise funds to enable the totality of the penalty to be paid within a sensible period. Each case will be treated on its facts and extra time will not be given where the participant could or should have organised its business affairs in order to allow it to pay within the specified time.

7.4 We will remain vigilant to any attempt by participants to seek to avoid or pass on the financial consequences of any penalty to third parties in circumstances where it would be unlawful or inappropriate to do so.[8] In this context, it should be noted that pursuant to section 42(8) FSBRA, the Bank of England is not a participant within the meaning of section 42 FSBRA, and accordingly participants on whom a penalty has been imposed should not seek to pass on any liability for penalties to the Bank of England, whether directly or indirectly as a cost recoverable from the Bank.

7.5 We have a mechanism which enables us to require participants to justify their fees and charges. Section 57 FSBRA enables us to vary any of the terms or fees or charges payable under relevant agreements, including (but not limited to) agreements between a PSP with direct access to a regulated payment system and another person for the purposes of enabling that other person to obtain indirect access to the payment system. It would therefore be open to an Indirect PSP to apply to us under section 57, should there be grounds for concern that the fees charged under their agreement with a Direct PSP to obtain indirect access to a payment system, represent an attempt to indemnify the Direct PSP from the financial consequences of penalties, or to otherwise pass on the effects of such penalties to Indirect PSPs.

7.6 In meeting their obligation to pay a penalty, participants must satisfy themselves that their arrangements are consistent with public policy. For example, those participants who are also subject to Chapter 6 of the General Provisions module of the FCA Handbook (GEN)[9] will be reminded that it contains rules prohibiting a firm or member from entering into, arranging, claiming on or making a payment under a contract of insurance that is intended to have, or has, the effect of indemnifying a relevant party against a financial penalty. We expect participants in a regulated payment system who are subject to GEN to comply with those provisions as relevant for the purposes of financial penalties imposed under FSBRA. We would typically expect participants in a regulated payment system who are not subject to GEN to comply with these general principles.

[8] Including, potentially, any attempt by a participant to withdraw from participation in a payment system as a Direct PSP after a penalty is imposed or when a penalty appears to be reasonably likely in order to avoid meeting liability for penalties imposed or likely to be imposed by us.
[9] See http://fshandbook.info/FS/html/FCA/GEN/6/1