

Payment Systems Regulator

Review of Board Effectiveness

The PSR Board undertook its first independent effectiveness review towards the end of 2017. The review was undertaken by Independent Audit Ltd and involved interviews with Board members and other senior members of the PSR, review of documentation and observance of Board and committee meetings.

The PSR Board considered the review findings at its meeting in January 2018, at which the report's authors were in attendance.

The report set out various things to consider (termed "things to think about"), which were discussed within the following broad themes:

- The composition of the Board;
- Strengthening links between Board members and the wider organisation;
- Exercising oversight of a broad range of technologically demanding matters;
- Increasing engagement with the relevant sub-committees, that perform duties on behalf of the PSR;
- Maintaining strong collaborative relationships with the FCA.

The Board welcomed the report and agreed that it was a fair reflection of the way it was currently operating. It accepted all of the above broad themes as being areas for potential further improvement and steps are in hand to give effect to many of the suggestions made. Three of the five are already being implemented, for example strengthening links between Board members and with the wider organisation, increasing engagement with the relevant sub-committees and maintaining strong collaborative relationships with the FCA. The others will be discussed further by the Board and with the new Chair when he takes up his role in April, with a view to their adoption once he has had the opportunity to consider them in the context of his leadership of the Board going forward.

THE PAYMENT SYSTEMS REGULATOR

Review of the effectiveness of the Board

9 January 2018

Confidential



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This report is based on the work we have performed in accordance with your supply agreement dated 25 August 2017. Our terms of engagement provide for a limit to our liability to the PSR. We take no responsibility for judgements or decisions made by any other party based on our report and to the fullest extent permitted by law we accept no liability to any party other than the PSR.

What we did

- 1 We have reviewed the effectiveness of the Board of the Payment Systems Regulator (“PSR”). Our work was conducted from September to November 2017.
- 2 This report is based on four strands of work:
 - a review of board and committee papers
 - interviews with all members of the Board, the Company Secretary and a number of executives who attend the Board (12 people in total)
 - observation of a meeting of the Board on 13 September 2017
 - analysis of what we learnt, drafting the report and discussing it with the Chairman and Company Secretary. This did not result in any significant revisions.
- 3 We have compared the practices of the PSR Board to those of corporate boards as well as public sector and other boards. This reflects your own objective of adopting, where relevant, good governance practice as described in the UK Corporate Governance Code. At the same time, we have remained mindful of specific features of the PSR Board’s role.
- 4 The Appendix lists those whom we interviewed. We would like to thank them all for engaging in open and constructive conversations with us.

Introduction

- 5 The PSR is a young regulator which was launched only in April 2015. Its objective is to oversee the way payments systems operate in the UK, with a particular emphasis on innovation and competition. In less than three years, it has become an established component of the regulatory landscape, bringing greater focus to an area which affects many aspects of everyday life. Payments underpin the whole economy.
- 6 It is important for any new subsidiary board to establish a clear agreement with the parent organisation as to its remit and the lines of accountability. The PSR Board, as a subsidiary board of the FCA, is no exception. The modus operandi of the FCA and PSR has gradually emerged and, as the PSR itself has matured, so too has its Board. All participants now note a sense of its processes – and its people – having settled into an established and efficient rhythm. However, the relationship between the PSR and FCA can be expected to continue to evolve, and the Board and executive teams will need to continue to keep it under review.
- 7 The Board is made up of a combination of PSR executives, non-executive directors (NEDs) from the FCA Board and independent NEDs (INEDs). Both the CEO and Director of Strategy of the FCA are also non-executive members of the PSR Board. Overall, this composition provides the PSR with a range of relevant skills and knowledge, and a strong link to the FCA Board and Executive. The Chairman is widely praised for the skilful course that he charts between his two roles as both FCA and PSR Chairman. When the new Chairman takes over in April next year, he will need to ensure both receive sufficient attention.
- 8 The PSR Managing Director (MD) and her team are felt by all NEDs to have shown considerable drive and innovation in the way they have tackled their objectives, in particular as regards the involvement of stakeholders. The organisation benefits from a high level of external credibility, to which the Board and the Chairman have also contributed. Meeting dynamics are constructive, and there is a good quality of debate and discussion.
- 9 Now, the PSR is entering into a further stage of its development as it guides the formation of the new Payment System Operator. This creates challenges for the PSR Executive and Board, particularly as regards overseeing the development of the new payments architecture. Additionally, the PSR is moving with the rest of the FCA to a new location in Stratford next year. Both the FCA and PSR executive teams are using the move as a catalyst for change, and are examining the way people work and interact internally and externally.
- 10 The change of scenery and the change of Chairman give the Board an opportunity to step back and take stock. Now that the start-up phase has come to an end, the composition and functioning of the Board should be kept under review to ensure it remains optimal for the next phase.
- 11 We have highlighted particular strengths in the way you are currently working, which you will want to take care to preserve. The Board has only fairly recently reached a steady state and is, overall, working well, so incremental rather than major changes would seem appropriate. To help you plan these, throughout this report, we have provided a series of “things to think about”, which have emerged in the course of our conversations with you. We believe these would merit further debate and discussion at the Board.

Composition

- 12 The Board benefits from a group of diligent NEDs, who tell us they enjoy being part of a path-breaking organisation. The Board has two INEDs who are not otherwise associated with the FCA, one of whom joined only in July 2017. They bring specialist expertise in the payments and systems implementation spheres. They both have positions on other public boards and experience of corporate boards. This gives them a broad view of corporate governance, which is helpful to the PSR Board.
- 13 The other five NEDs, including the Chairman, are members of the FCA Board. They bring relevant skills as regards competition, payments and policy development. The cross-directorship with the FCA Board benefits the PSR, not only because it is a subsidiary, but also because the two organisations work together. This may be on particular initiatives or issues that arise, for example responding to a recent Which? super-complaint. Additionally, a strong link is needed on a day-to-day basis as the FCA is supervising the conduct of participants in the payments system, while the PSR is shaping and overseeing the system as a whole.
- 14 The PSR also coordinates closely with the Bank of England. Although there is no spot on the Board for a Bank member, this is felt by all to be unnecessary. Bank officials are invited and attend all relevant discussions of the Board, and PSR executives are regularly invited to attend meetings at the Bank. The relationship overall is said to be a constructive one.
- 15 At nine members, the Board is compact enough for good discussion dynamics with a range of viewpoints and skillsets represented. For this reason, and given the small size of the PSR itself, you would probably not want the Board to increase in size.

Things to think about

- 16 **Would an annual whole-Board discussion of NED succession have merit?** Directors are appointed by the FCA, but as composition is a vital element in the effectiveness of any board, there would be value in the PSR Board ensuring that it forms its own unified view in order to influence the process. At present, the NED succession planning process is not clear to INEDs and executives. Given its size, it would seem unnecessary for the PSR to have a Nominations Committee, but a periodic discussion at the Board would allow all board members to gain a greater understanding of future plans and to make their own contribution to the debate.
- 17 This discussion would be helped by a skills matrix compiled by the Secretariat showing the current make-up of the Board, the dates directors are expected to rotate off the Board and the main skills that it is desirable to cover.
- 18 As part of the discussion on the Board's future composition, there are three interconnected factors worth considering:
 - **What skillsets are needed on the Board in future?** All interviewees agree that the Board will continue to need expertise in spheres such as competition and policy. The degree to which the Board should become more specialised in payments, technology and big projects implementation could be debated further. Despite recent additions, some interviewees feel there may now be a case for adding more technical knowledge.
 - **How many and which executives should be on the Board?** Four executives attend the Board but only two of them are directors. In practice, all four contribute to meetings, and the difference in behaviour between members and attendees is imperceptible. The

attendance of all executives allows the NEDs to see the top team in action, and it does not appear to impact meeting dynamics.

- **How many FCA directors should there be on the Board?** As FCA directors rotate from the Board, replacing them with further FCA directors might limit the pool, especially if particular expertise is being sought. The FCA contingent might, therefore, drop by one or two in future, making way for more independents or executives.
- 19 In considering these factors, the PSR Board and, more importantly, the FCA Board should keep under review whether FCA Board members need to remain the majority of PSR Board members. In its initial start-up phase, the PSR Board's composition has worked well and the FCA understandably wished to exercise close control over its subsidiary. The need for such tight control appears less, however, now that the PSR is more established. The balance might be gradually shifted towards a larger group of PSR INEDs who, by virtue of their independence, may be better positioned to play a role similar to that of INEDs in subsidiaries of regulated entities in balancing the interests of various stakeholders.
- 20 The incoming Chairman is going to take on both the FCA and PSR roles. The current Chairman has carved out time for his PSR duties, and he has taken an active role in stakeholder engagement, which is helped by the contact he has with external stakeholders on FCA business. As the FCA is much larger, however, there is always the danger of it becoming all-consuming, and the new Chairman – who will be getting to grips with the FCA role – will need to ensure that enough time and attention are given to the PSR. In time, he will want to consider the potential merits of a separate PSR Chairman being appointed. This could extend the independence of the Board further, if this is considered desirable. Moreover, a separate Chairman might be able to give the PSR more attention, including more informal engagement. The option of an FCA NED chairing the PSR in future should also be considered.

Dynamics

- 21 The Chairman is widely praised for his leadership of meetings and facilitation of the relationship between the FCA and PSR. Discussions are good-natured and constructive. NEDs contribute well in meetings, and we observed a good level of challenge. Executives note that NEDs ask thought-provoking questions and often help them to see issues through a different lens. The NEDs, for their part, feel the executives respond well to challenge and they unanimously praise the "impressive" achievements of the MD and her team. She has recently been reappointed for a second three-year term.
- 22 An important aspect of maintaining board effectiveness is regular feedback to the Chairman and individual NEDs. At the PSR, the Senior Independent Director collates and provides feedback to the Chairman. Individual feedback to NEDs is provided by the Chairman.
- 23 The Board meets seven times per year. We concur with the view of all interviewees that this frequency allows the Board to cover the ground in enough depth. However, it means that the group does not have as much opportunity to get to know one another as members of other boards who meet more frequently. Moreover, the PSR does not follow the practice of most boards in having an occasional dinner.

Things to think about

- 24 **Could more be done to strengthen the links between the various board members?** Most boards find that a dinner or informal event a couple of times a year is time well spent. It

allows board members to get to know and understand one another better, improving their ability to work together as a team. Such an investment particularly pays off if and when a board needs to come together to deal with a crisis.

- 25 Additionally, the PSR INEDs might be invited from time to time to attend an FCA Board dinner in order to get to know the other FCA NEDs and executives. For any subsidiary board, dialogue and networking with the parent organisation are as important as formal processes in making the relationship a smooth one.
- 26 **Could individual feedback be developed further for standing attendees?** Standing attendees receive only occasional feedback on their contribution to the Board. The future Chairman might, therefore, additionally hold individual feedback sessions with each regular attendee. As well as providing feedback, these sessions provide a good opportunity for the Chairman to solicit views on how directors and attendees feel the Board is working, additional topics they would like to see on the agenda etc.

Focus of the Board – Strategy

- 27 The PSR has a clear focus and remit, which allows the Board agenda to be concentrated around a manageable number of matters. The PSR Executive, with the input and guidance of the Board, has mapped out a well-defined strategy and objectives. The NEDs hold them clearly to account in executing the strategy. The PSR has adopted an innovative approach to creating a new payments infrastructure, setting up a Payments Strategy Forum to involve a range of stakeholders and industry participants in co-designing the future payments landscape.
- 28 Having endorsed the design of the Payments Forum, the PSR Board is now overseeing the development of the New Payment System Operator (NPSO), a body being set up and financed by industry. The Board handles technically complex subject-matter, and this will increase as it oversees how the NPSO selects, develops and implements the technological architecture for the new system.
- 29 The Board has been closely involved in all of these developments, discussing and debating each stage. At a recent extended strategic session, we observed the Board holding a wide-ranging and constructive discussion on the future payments landscape with helpful input from an external speaker. The Board format was varied, with use made of break-out groups, which created a lively dynamic in the room.
- 30 The discussions considered strategic priorities and also the resources which would be needed to meet strategic objectives. Interviewees note that the Board has increasingly been looking at the people and organisational aspects of the PSR, whereas initially the focus was almost exclusively on policy and external stakeholder engagement. A number of interviewees – both non-executive and executive – welcome this shift and would like it to be extended further.
- 31 The Senior Independent Director and some NEDs engage actively with executives between meetings and also attend stakeholder panels. This is appreciated by executives. However, some NEDs have limited contact with executives. Overall, the Board’s engagement with the organisation below executive level appears somewhat lower than at some other boards.

Things to think about

- 32 **How does the Board maintain an appropriate strategic level, while exercising oversight of technologically demanding matters?** As discussed earlier, in reviewing current skills and succession plans, the Board could usefully debate the need to include as members of the Board more technology and major project experts. This may, however, have the disadvantage of weighting the Board too much in that direction, at the expense of the broader viewpoint of more generalist NEDs.
- 33 Another possibility would be to create a sub-group of the Board to examine technical proposals in detail. A key aspect of the NPSO will be the resilience of the new architecture and it will require significant knowledge to be able to understand fully and challenge in this sphere. This sub-group could co-opt members who bring additional expertise without them becoming full board members. The group might also make more use of the FCA's senior advisers, who provide a useful independent challenge to executives at the main FCA Board.
- 34 Rather than receiving formal delegated powers, the group could be charged with challenging executive proposals in depth. They would then bring clear summaries to the full Board for further debate and decision. If such a sub-group is formed, board meetings may become somewhat shorter. Those board members who are not part of the sub-group may need to commit time to technical briefings ahead of important discussions, but these could be provided at convenient times and perhaps by tele-conference.
- 35 **Hold strategic sessions off-site?** Most boards aim to conduct one or two strategy meetings in the course of the year away from the office. This allows executives to immerse themselves in longer-term thoughts, away from the distractions of business as usual. We suggest the PSR follow suit, and also combine an away-day with some informal time.
- 36 **Could NEDs spend more time between meetings interacting with the PSR executives and team?** Executives would welcome more contact, but it can be difficult for NEDs to initiate meetings and break established habits. It may be helpful for the executives to consider if they could be more proactive in inviting NEDs to suitable events and also for informal drop-ins with the team. There is no need for a major increase in the level of current contacts but a handful of informal visits per year from each NED could help strengthen the links of the Board with the wider organisation. It would also give the NEDs further insight into the PSR culture and the "way things are done round here".

Focus of the Board – Risk and controls

- 37 The PSR Board does not delegate responsibility for overseeing risk to a committee, and interviewees feel this works well. The Board regularly discusses the risks identified by the Executive and their mitigation. The Head of Department for Communications and Operations, who attends board meetings, has recently taken on additional responsibilities as Chief Risk Officer. Although new to the role, she works with her counterpart at the FCA who acts as an informal sounding board. She also attends the FCA External Risk and Strategy Committee (ERSC) in order to be aware of aspects of the way the wider FCA is considering risk, which may be relevant for the PSR. Additionally, one of the FCA/PSR NEDs sits on the FCA ERSC.
- 38 The audit responsibilities of the Board are discharged by the FCA Audit Committee (AuditCo). The FCA Internal Audit function is also responsible for audits at the PSR. The accounts of the PSR are relatively straightforward, as are its operations. Therefore, this constitutes only a

small part of the FCA AuditCo's business in the course of the year. The Chief Risk Officer also attends AuditCo meetings and another FCA/PSR NED is a member of the AuditCo. The Chairman and the CEO of the FCA also attend AuditCo and the ERSC, providing a further linkage.

Things to think about

- 39 **Could the interface between the PSR Board and the FCA AuditCo be improved?** Subsidiary boards seek comfort from parent companies that the shared processes on which they depend are sufficiently well controlled. This might be achieved through a "deep dive" at the PSR Board with the involvement of the FCA Director of Internal Audit and AuditCo Chair. Holding such a session would give the NEDs, particularly the INEDs, more visibility over the control environment. The PSR Board would in this way, seek to assure itself that confidence in the FCA procedures is well grounded.
- 40 Particular emphasis might be placed on cyber controls and the upgrading of the IT environment on which the PSR depends. Given the relevant expertise of the two INEDs, the FCA AuditCo might consider inviting them to a deep-dive discussion at the FCA AuditCo. The benefit would be mutual.
- 41 The FCA AuditCo Chair and Director of Internal Audit could also be requested to provide a more formal yearly report on controls which are PSR-specific and controls over processes at the FCA on which it relies. The papers and minutes of relevant AuditCo discussions might also be made more readily available to PSR NEDs.

Focus of the Board – Executive performance and reward

- 42 As is usually the case, the FCA as the parent organisation manages the design and implementation of executive pay arrangements – including those for the PSR executives – on a Group-wide basis. The Remuneration Committee of the FCA Board considers the pay of the two executive board members of the PSR.
- 43 However, given that the quality and performance of the executive team are crucial factors for the success of any subsidiary, they remain a matter of importance to any subsidiary board. Ensuring that objectives and incentives are aligned with the subsidiary board's risk appetite is another important consideration. The PSR Board considers the performance and pay of the executive team to some extent, but the role is less clear than at many other subsidiary boards.

Things to think about

- 44 **Could the PSR Board be more closely involved with the performance review and reward of the MD and other senior executives?** This could perhaps be achieved by the PSR NEDs having a more structured annual discussion on the MD's objectives and subsequently on her performance. This should be extended to consideration of the Head of Legal who is also a board member, and the Remuneration Committee Chair of the FCA could usefully be invited to this session. The aim should be for the PSR NEDs to communicate their views clearly to the FCA Remuneration Committee, and for the Committee to report back on the extent to which the final assessment reflected their views. Feedback from PSR NEDs should have an impact which is clear both to the individual executives and to the NEDs.
- 45 The CEO of the FCA provides feedback to senior executives of the FCA including the MD of the PSR. It is normal and appropriate for a subsidiary executive to have a line of

accountability through the parent organisation at the level either of the CEO or a divisional director. The Chairman might also provide more structured individual feedback to the MD on her board participation and performance, ensuring that he is reflecting consistently the views of the Board and that conflicting messages are not being communicated.

Link with the FCA Board and organisation

- 46 The PSR has benefited considerably from being set up as a subsidiary within the FCA. It has been able to leverage off the larger organisation in terms of facilities, support functions and technology. Employees have the advantage of potential career moves within the FCA, which provides an additional recruitment and retention tool. They also benefit from the training programmes offered by the FCA.
- 47 This set up has allowed the PSR to establish itself quickly. Executives have been able to focus on strategic objectives without having to solve many housekeeping issues themselves. The move to Stratford will provide a new working environment in which the PSR will occupy a central position.
- 48 Occasional tension is almost inevitable in any subsidiary arrangement. Different lines of accountability need to be carefully acknowledged and managed if misunderstandings are to be avoided. The PSR Executive is accountable to the PSR Board but they are also employed by the FCA and a part of the wider FCA. A further layer of complexity is added in the case of the PSR as it is independently accountable to Parliament. Given this complexity, good dialogue is particularly important in balancing the various interests the Executive are serving.
- 49 Some operational issues have arisen which have, at times, required a new way of working. For example, the PSR now has its own dedicated HR manager within the FCA HR team, which allows greater account to be taken of its specific hiring needs and culture.

Things to think about

- 50 **Could the PSR be better integrated operationally with the FCA in future?** In its start-up phase, and as it oversees the launch of the NPSO, the independence of the PSR has been particularly important to maintain the right level of focus. However, in the view of a number of those interviewed, including executives and non-executives, once the NPSO is up and running and the PSR itself is well established, there are likely to be opportunities for greater operational integration of the PSR with the FCA within the legal framework which has been set out. It is common in corporates for a subsidiary to maintain its legal identity while functioning in many respects as a divisional structure. This model may become more relevant to the PSR in the foreseeable future, and the Board should keep it under review.
- 51 In the meantime, there could be benefit in a shift in focus towards maintaining strong collaborative relationships and away from seeking solutions by means of organisational design and processes: these are never sufficient in complex organisations. By working on strengthening relationships further, the PSR and its parent will be better able to take in their stride any tensions which might arise from the subsidiary structure.
- 52 The Board and new Chairman should continue to help the PSR to maintain a suitable level of independence where it needs to, while encouraging dialogue on practical and workable operational approaches.

Support, scheduling and papers

- 53 The Board receives professional support from the Company Secretary who combines the role with that of FCA Company Secretary. He attends all PSR meetings personally and an additional member of his team is dedicated to PSR business. Organisation and scheduling of meetings is said by all to be good, and one NED spoke of a “well-run machine”. The Company Secretariat also arranges a thorough induction for new NEDs and on-going advice as regards any potential conflicts of interest.
- 54 The NEDs appreciate the clear information provided by the Executive in board packs which allows them to track progress against objectives. The papers we reviewed appeared well structured and not too lengthy. They are provided on an electronic portal which is also used by the FCA Board. While some FCA directors find this system inconvenient, most PSR NEDs (including FCA ones) find it works well.

Appendix: List of interviewees

| | |
|---------------------|--|
| Andrew Bailey | Non-Executive Director |
| Carole Begent | Head of Legal |
| Louise Buckley | Head of Department, Communications and Operations |
| Amelia Fletcher | Senior Independent Director |
| Bradley Fried | Non-Executive Director |
| Noel Gordon | Non-Executive Director |
| John Griffith-Jones | Chairman |
| Hannah Nixon | Managing Director |
| Simon Pearce | Company Secretary |
| Simon Ricketts | Non-Executive Director |
| Paul Smith | Head of Department, Regulatory Strategy and Policy |
| Christopher Woolard | Non-Executive Director |

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