



LexisNexis®

*This article was first published on Lexis®PSL Competition and Lexis®Library on 15 April 2015. Click for a free trial of [Lexis®PSL](#) and [Lexis®Library](#).*

## **Increasing competition in the payment systems industry**

15/04/2015

Competition analysis: How will the Payment System Regulator (PSR) carry out its objective to promote competition in the payment systems industry now it is fully operational? Marta Garcia, partner, and Joseph Del-Greco, associate at Stephenson Harwood, examine the PSR's planned approach to promoting competition in the industry and the actions it can take.

### **What is the PSR and who will it regulate?**

Incorporated in April 2014 and a subsidiary of the Financial Conduct Authority (FCA), the PSR is an independent economic regulator with its own objectives and governance. It is armed with strong concurrent competition and regulatory powers with a focus on ensuring the market for payment systems and payment services is working well for service users. It has three objectives: to promote competition and innovation, and to ensure payment systems are focused on the interests of service users. Its vision is 'to have payment systems in the UK that are accessible, reliable, secure and value for money'.

The PSR regulates 'designated' payment systems as stipulated by HM Treasury--ie those considered to be the 'largest and most important payment systems which, if they were to fail or to be disrupted, would cause serious consequences for their users'. These include:

- o six interbank systems--Bacs, Cheque & Credit Clearing, CHAPS, Faster Payments, LINK and Northern Ireland Cheque Clearing, and
- o two card payment systems--MasterCard and Visa Europe

For each designated payment system, all the participants will fall under the PSR's remit--that is to say, the payment system operator, the payment services providers (PSP) using that system and the infrastructure providers to the payment system. HM Treasury will assess on an annual basis whether any payments systems should be added or removed from the list of designated payment systems.

### **What are the main ways in which the PSR intends to promote competition in the payment systems industry?**

A key stated aim of the PSR is the promotion of competition in the market for payment systems and to increase access to payment services and remove any barriers to new entrants and market stakeholders. The PSR expects that more competition will increase the quality of existing services and the provision of new services, which will benefit those individuals and businesses that use payment systems and services.

The PSR has identified a number of key ways in which it intends to promote competition in the payment systems industry in its Annual Plan for 2015/16, which is accompanied by a Policy Work Programme that sets out some more detail on the planned works.

Briefly (as a number of these measures are discussed below):

### *Regulatory directions for access*

The PSR will require providers of direct access (ie direct agreement between the PSP and operator of the payment system) and indirect access (ie where a PSP accesses the system through a PSP with direct access--the PSP with direct access is known as the sponsor bank) to publish certain information (eg access requirements) for the benefit of direct and indirect PSPs. These are intended to ensure that requirements for access to payment systems do not unnecessarily or disproportionately act as a barrier to entry for PSPs.

### *Code of conduct*

The PSR will engage with sponsor banks to develop a code of conduct which will set out a range of responsibilities that sponsor banks commit to when providing indirect access to PSPs and will provide a minimum contractual framework the sponsor banks will be expected to meet. The aim is to give PSPs more confidence and certainty when choosing indirect access, and to invest and develop the services they offer to individuals and businesses. This should allow them to compete more effectively with other PSPs.

### *Market reviews*

The PSR has opened two market reviews into the supply of indirect access to payment systems and the ownership and competitiveness of infrastructure provision to support payment systems to see if the markets are working properly. The PSR has published terms of reference for these market reviews.

### *Card payment systems programme of work*

The PSR will consider concerns about governance arrangements for card system operators including:

- o the level of transparency surrounding the structure of fees and other terms and conditions
- o the effectiveness of service-user representation, and
- o the level of transparency of decision-making in card payment systems

The PSR will also investigate whether there are any concerns about access to card payment systems. This work will enable the PSR to consider whether or not to intervene at some future date, given its decision not to impose directions on card operators relating to representation of service users' interests and transparency through publication of board minutes (see below).

### *Best practices*

Through the UK Regulators Network, the UK Competition Network, the European Competition Network and the International Competition Network, the PSR will share its experiences and develop best practices on regulatory and competition matters.

### *Payments Strategy Forum*

The PSR is in discussions to set up a Payments Strategy Forum. The aim of this will be to develop a long-term vision for how payment systems should develop and identify priority areas for the industry to work together where appropriate to deliver this vision.

Through these measures the PSR hopes to encourage, rather than force, competition (say by the imposition of any penalties) while striking a balance with the need for cooperation with the industry. It is questionable, however, whether in fact incumbents will necessarily make changes to facilitate innovation and competition. Nonetheless, to date it appears that banks have so far responded positively and it is hoped that they will act in the consumers' best interests.

## **What competition powers does the PSR have and what action is it able to take where it sees anti-competitive behaviour?**

As of 1 April 2015, the PSR has concurrent competition powers:

- o under the Competition Act 1998 (CA 1998) to enforce the prohibitions on anti-competitive behaviour and abuse of a dominant position, and
- o under the Enterprise Act 2002 (EnA 2002) to carry out market studies and make market investigation references to the Competition and Markets Authority (CMA)

These competition powers will be exercised concurrently with the CMA and extend to participants in any payment system (ie, they are not limited to participants of the designated payment systems that the PSR regulates under the Financial Services (Banking Reform) Act 2013 (FS(BR)A 2013)). The concurrent competition powers are also in addition to the PSR's regulatory powers under FS(BR)A 2013.

Anti-competitive agreements (and/or abusive conduct) by participants in payment systems may breach regulatory obligations under both FS(BR)A 2013 and CA 1998. As a result, the PSR may take enforcement action under FS(BR)A 2013 (eg give directions, require an operator with direct access to grant access, to change the fees related to an agreement, to require the disposal of an interest in the operator of a regulated payment system, etc) as well as CA 1998 (eg order the infringing conduct be stopped, fine infringing companies up to 10% of their worldwide turnover), in parallel or sequentially. The PSR will also have the power to seek competition disqualification orders.

However, before exercising certain of its FS(BR)A 2013 powers, the PSR has a duty to consider whether it would be more appropriate to exercise its concurrent competition powers under CA 1998. The PSR will look at a variety of factors, such as the potential harm to competition raised by the conduct in question, resource and timing implications of the actions available to it and the potential outcomes and deterrent effect of those actions.

### **What market studies reviews is the PSR conducting and what action can it take if a market is not functioning properly?**

The PSR has not yet launched any market studies under its EnA 2002 powers. However, as explained above, it has opened two market reviews under its FS(BR)A 2013 powers in relation to:

- o the ownership and competitiveness of infrastructure provision in the payments systems market with a view to ensuring that such infrastructure is able to support new developments and innovation at all levels, including both the system and service levels--it will also examine potential infrastructure models and ownership structures that could be developed in the future, and
- o the supply of indirect access to payment systems to gain a better understanding of the economics of indirect access and to consider ways of improving the balance between the risks and rewards of offering indirect access

If the PSR concludes (following a market review or study) that a market could be made to work better, then it has a range of powers to introduce appropriate remedies (eg directions and requirements, publishing general guidance, proposing enhanced industry action, etc). Alternatively, the PSR can make a market investigation reference to the CMA for detailed investigation (this power applies whether or not the PSR has conducted a market study).

The PSR has also indicated that over the next year it will collaborate with the FCA on its credit card market study and with the CMA on its retail banking market investigation. In terms of pipeline projects, the PSR has also mentioned that it has in mind to look at ATM interchange fees, implementation of the cheque imaging project and consumer redress in the future.

### **To what extent will the PSR's proposed rules in relation to transparency and access requirements help to increase openness and help new entrants?**

A number of concerns have been raised that the governance of payment systems, the criteria for gaining access, the decision-making and payment processes are opaque, time-consuming and known only to select few banks that own the payment systems. As a result, this is hampering the ability of new providers to enter the payment systems and services markets and compete.

The PSR has at its disposal the following principal quick fixes which are expected to increase transparency, improve direct and indirect access as well as help new entrants enter the marketplace:

*Ownership, control and governance of payments*

The PSR has issued a general direction to the interbank operators (ie not Visa and MasterCard) to ensure all service users' interests are represented in the decision-making process of the regulated payment systems. This will enable service users to assess whether interbank operators are appropriately considering their interests when taking decisions and understand the reasons why decisions have been taken. This is intended to address concerns about the governance of payment systems, including that the interests of indirect participants are not taken into account in interbank payment system decision-making or in the card systems that merchants and acquirers' interests are not adequately considered. Interbank operators must comply with this direction by 30 September 2015 and report compliance annually. The first report is due on 31 October 2015. The PSR has also made a general direction requiring the interbank operators, from 30 April 2015, to publish board minutes and votes as well as identify and address conflicts of interest (see LNB News 16/03/2015 127).

#### *Direct access*

The PSR has issued a general direction (known as its 'Access Rule') that applies to Bacs, Cheque & Credit Clearing, CHAPS and Faster Payments. It requires them to provide access on an objective, risk-based, fair and open basis, and publicly disclose their access requirements. This will mean that in future, banks and innovative PSPs will be able to gain direct access to payment systems on fair terms. The application process should be quicker, simpler and not distort competition (ie not act as a barrier to entry and expansion for new and emerging PSPs). LINK, MasterCard and Visa are already subject to a similar access requirement under the EU Payment Services Directive 2007/64/EC, art 28 (PSD). All payment system operators will have to report annually showing how they are complying with their relevant access rule--the first report is due by 31 July 2015. In addition, they are required to publish their access requirements from 30 June 2015.

#### *Indirect access*

To ensure greater transparency for those seeking indirect access to interbank systems, the PSR is requiring the four primary sponsor banks (ie Barclays, HSBC, Lloyds and RBS) to publish 'clear and up-to-date' information on their access criteria and process to enable those wanting to use these services to compare them. This data will be published on their websites and provided to the PSR and updated regularly. The PSR has given the sponsor banks until 30 June 2015 to comply. As explained above, the industry will also develop a new PSR-approved code of conduct to address concerns about the security of supply of indirect access provided by sponsor banks. It anticipates that it will be in place by 30 June 2015.

These measures should improve transparency and openness, removing some of the major obstacles facing new and emerging payment service providers when seeking direct or indirect access to payment systems. In the event operators do not step up to the market, the PSR has made clear that it will take action and use powers to issue directions, impose fines and impose obligations that will force individual players to act differently.

### **What influence may the EU have on the PSR's regulation and promotion of competition?**

Ultimately, the PSR can only operate in accordance with EU legislation. The PSR will work with HM Treasury, FCA and the Bank of England to ensure it plays an active and vocal role in Europe so that any new EU requirements that intersect with the PSR's regime take account of the PSR's objectives and ensures the PSR is in compliance with EU rules.

For example, a revised version of the PSD is currently under negotiation (PSD2) and is expected to introduce further measures to develop an effective and competitive European payments market. The PSR will interpret PSD2 (when finalised) and ensure the approach it takes is compliant with PSD2--undoubtedly the approach it takes will have a significant impact on the UK payments industry.

Likewise, on interchange fees, the EU Regulation on Interchange Fees for Card-based Payment Transactions (IFR) will be entering into force shortly. The PSR will look to see how the IFR may apply in the UK and what changes will be required in the UK. The PSR is expected to be appointed as the competent authority for monitoring and enforcing the IFR.

*Interviewed by Camilla Cardozo.*

*The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.*