PSR Payment Systems Regulator

Nicky Morgan MP
Treasury Committee Chair
House of Commons
Committee Office
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7 March 2019

Dear Nicky

Thank you for your letter of 19 February following the PSR's appearance before the Treasury Committee on 12 February. Please see below the information you requested.

Professional Fees

Each year we forecast our 'professional fees' expenditure in our annual plan and budget. Professional fees include expenditure related to all professional services, for example: research; legal services; publications; and professional consultancy. The use of third party consultants enables the PSR to access specialist or flexible resources more cost-effectively than maintaining larger permanent in-house resources.

The PSR is a relatively young organisation. While we were building the organisation and recruiting permanent staff in FY2014/15 and into FY2015/16, we anticipated a high level of professional fee expenditure on consultants to provide specialist knowledge and cover the in-house resource gap while it was being filled. We then anticipated that these professional fees would decrease to a more stable year-on-year level as the organisation matured and we moved from focusing on building the organisation to spending professional fees in areas where it is not efficient to keep permanent expertise in-house, particularly economic advisers and very specialist legal counsel.

In reality, we did not need the level of professional fees anticipated, partly because of our early push to recruit permanent staff. This resulted in our actual expenditure on professional fees being lower than predicted in our annual plan each year (see table below). Each year, we have lowered our estimate of the professional fees whilst still allowing for a budget that acknowledges that we continue to need professional services to assist the work of the PSR.

	14/15	**15/16**	**16/17**	**17/18**	**18/19** **(To Feb 19)**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Professional fees <u>budget</u>	3,700	6,000	3,270	2,500	2,000
Professional fees as a % of total PSR budget	33%	38%	21%	21%	13%
Professional fees <u>actual</u>	2,163	1,107	1,248	1,254	882
Profession fees as a % of total actual expenditure	19%	10%	11%	12%	9%
of which Consultancy	1,747	977	731	725	392
Consultancy expenditure as a % of <u>total PSR</u> expenditure	15%	9%	7%	7%	4%

Board Minutes

The Committee correctly stated that the PSR Board's policy regarding publication of its minutes is to publish them within two weeks of approval at the next meeting.

The PSR Board has adhered to this policy since it was adopted in March 2018 with the one exception of the minutes of the June 2018 meeting. Board meetings ordinarily take place at intervals of two months. However, the June and July meetings were separated by only ten working days as the June meeting was convened out of sequence, primarily for the purpose of approving the annual report and accounts. The process of preparing the minutes for approval includes fact-checking and quality control reviews and as the papers for the July meeting were circulated to the Board one week before the meeting, only five working days later, this process was not completed in time for the minutes to be approved at the July meeting. The minutes were therefore approved at the next Board meeting in September alongside the July minutes and published within the following two weeks.

In the hearing and in your letter, you asked about guidance to designated Payment System Operators regarding publication of their Board minutes.

We have not made any changes to General Direction 6 relating to the publication of board minutes since it was made. General Direction 6 currently requires operators of interbank payment systems to publish minutes of their governing bodies *as soon as reasonably practicable*. In the guidance accompanying the Direction, we state that we would typically expect publication of the minutes within eight weeks after the relevant meeting. As such, the eight-week period is a recommendation and not a requirement.

We are currently reviewing our General Directions to ensure they remain proportionate, targeted and fit for purpose. We hope to release our policy statement, alongside the proposed draft Directions for public consultation, in the next few weeks.

Brexit

The Interchange Fee Regulation (IFR) introduced caps on domestic and cross-border card transactions in the EU from 9 December 2015.[1] The caps currently apply to consumer card transactions where the issuer and acquirer are both located in the EEA.

In the event of a no-deal Brexit, the scope of the on-shored IFR (which has now been adopted by statutory instrument) will be narrowed so that the caps would only apply where the point of sale (i.e. merchant location) and both the issuer and the acquirer are located in the UK. The PSR will continue to be responsible for enforcing these caps.

This means that, for example, where a card is issued in the UK but the acquirer and merchant are located in the EEA, the interchange fee caps will no longer apply. This is because (i) the caps in the on-shored IFR will only apply to transactions where all the parties (issuer, acquirer and merchant) are located in the UK and (ii) the UK's withdrawal from the EU means that the EU IFR will not apply because the issuer is not located in the EEA. The same would be true where a UK issued card is used at a UK merchant but the acquirer is located in the EEA.

[1] In due course, the IFR will also apply across the EEA once the IFR has been incorporated into the EEA Agreement.

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If the caps no longer apply to such transactions, there is a significant risk that interchange fees may increase for these transactions, making it more expensive for EEA merchants to accept UK issued cards (and for UK merchants to accept EEA issued cards).

The precise impact on interchange fees will depend on how the card schemes set the level of interchange fees for UK-EEA cross-border transactions in the event of a no-deal scenario. It is possible that interchange fees for these transactions could be higher than today. We will continue to liaise with the operators of Visa and Mastercard on this important issue.

Market review into the card-acquiring services

Our market review will collect detailed data on the scheme fees that card scheme operators charge to acquirers and how they have changed. We want to understand how the charges that merchants pay to acquirers have been affected by changes to scheme fees, interchange fees and acquirer fees (the three main elements that make up the fee the merchant pays to its acquirer). We will also examine how merchants' transactional activity (such as the types of card transactions they accept) determines the scheme fees component of the charges they pay to acquirers. However, we will not, at this stage, specifically examine whether the scheme fees the acquirer pays are excessive or justifiable.

We decided to prioritise card-acquiring services for two reasons.

First, we consider that a number of concerns raised with us by stakeholders about card payments indicate that the supply of card-acquiring services may not be working well for UK merchants, and ultimately consumers. This includes concerns that acquirers have not passed on the savings they made from the interchange fee caps introduced by the Interchange Fee Regulation to smaller merchants. Interchange fees typically make up the largest portion of the merchant's bill.

Second, we consider our market review to be an appropriate first step in examining stakeholders' concerns about card payments. We expect any problems related to card payment systems that affect merchants to materialise largely through the fees they pay to and services they receive from providers of card-acquiring services. It follows that should we identify significant issues that sit outside the scope of this market review, we will consider undertaking further work to investigate.

Expenses and expenditure

We have noted your comments regarding our current format for publishing expenses. As part of the Annual Report and Accounts process which began in December, changes to the way both the PSR and FCA disclose expenses are due to be considered by the Audit Committee shortly. We will inform you of the outcome of those discussions.

You asked about the costs of the PSR refreshing its brand identity in 2017/2018. We carried out this work to reflect our organisational change and development since the PSR started work in 2015.

Our previous brand had been developed in 2014 (before we became operational) as a stop-gap measure, at no cost, in house by the FCA.

Through our annual perceptions survey, staff surveys and via direct stakeholder feedback, it became clear that the dual FCA/PSR brand was confusing - not least because it included the FCA name and FCA colours prominently. Some people thought they were talking to, or interviewing for, the FCA. Stakeholders told us they wanted us to be bolder and set out a clear identity for the organisation and our role in delivering change in the industry; our people wanted to have a clear sense of who they were working for, a clearer sense of purpose and what they were trying to achieve.

The brand changes were planned to ensure costs could be coordinated with the Stratford move to deliver better value for money. The cost for the brand changes was £50,080 plus VAT**.**

I am grateful for the opportunity to discuss the work of the PSR with you and the Committee members. I hope the information outlined is useful for you and the Committee. I would be happy to answer any additional questions on these specific matters or on the broader work of the PSR. I will continue to keep you and the Committee updated on any developments.

Yours sincerely

Hannah Nixon
Managing Director