HM Treasury

Payments Regulation and the Systemic Perimeter

Consultation Response

August 2023

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Introduction

Recapping the government's proposals

Systemic payments perimeter reform

1.1 In 2022, through its 'Payments Regulation and the Systemic Perimeter' consultation,[1] the government sought views on proposals to reform the Bank of England's ("the Bank") systemic payments perimeter commensurate to the evolution of financial stability risks spread across payments networks.

1.2 The government recognised that significant transformations have taken place across the payments landscape since the Banking Act's ratification in 2009, facilitated in part by pro-innovation legislation designed to promote competition, and further enabled by wider technological development and evolving user preferences. In this regard, the government reiterated its vision for the sector, ensuring that new and existing firms remain free to innovate and introduce new technologies, with means to promote greater competition and choice for businesses and consumers.

1.3 However, the government also recognised that as payment chains – the set of activities necessary for a payment to be made – continue to unbundle and grow to include a greater number of new activities and services, regulation should remain agile and capable of ensuring that material and emerging financial stability risks are effectively identified and proportionately mitigated. As a wider array of payments entities perform increasingly systemic activities, so too the potential that their own disruption could pose material risks to the UK's financial system or wider economy.

1.4 Commensurate with the pace of this change, the government set out its view that it was unlikely that systemic risk would remain contained to the Bank's existing perimeter supervising over systemically important payments systems and their specified service providers, and therefore proposed reforming the Bank's perimeter to reflect a more holistic assessment of systemic risk across the payments sector.

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[1] 'Payments Regulation and the Systemic Perimeter: Consultation and Call for Evidence', HM Treasury, July 2022

‘Same risk, same regulatory outcome’

1.5 The consultation explained the government’s support for the reform principle of ‘same risk, same regulatory outcome’: that in place of focusing on an entity’s form, regulation should reflect the risk posed by an entity’s activities and its relationship to other market participants and the wider economy. This approach was widely welcomed by respondents to the government’s 2020 ‘Payments Landscape Review’. [2]

1.6 The government emphasised that it considers the essential design of the Bank’s current systemic payments perimeter within Part 5 of the Banking Act 2009 to be well established, proportionate, and appropriate for any reformed perimeter; entities should be examined and recognised as systemically important directly by HM Treasury (“the Treasury”) on a case-by-case basis, and against clear criteria. In doing so, any reformed systemic perimeter would remain reserved only for those payments entities that – through any deficiencies in their design or any disruption to their operations – had the potential to threaten the UK’s financial stability or have wider economic consequences.

Effectively supervising systemically important payment activities

1.7 To achieve this revised perimeter, the government consulted on what reforms it would make to enable this framework within existing regulation.

1.8 Firstly, it proposed introducing an additional category of ‘service provider’ within Part 5 of the Banking Act to allow for the recognition of payments providers that pose systemic risks in their own right. The distinguishing feature of this category being that the source of risk would be in relation to the provider itself, not its relationship with an already-recognised payment system, as the Banking Act operates today. This approach is principally similar to that legislated for to enable the recognition of future systemically important stablecoins used as a means of payment (referred to as ‘digital settlement assets’) in the Financial Services and Markets Act 2023 (FSMA 2023).[3]

1.9 Alongside this, the consultation set out proposals to narrow Part 5’s S.206A to explicitly remove non-payments related critical third parties from regulation through the Banking Act. The intention of this proposal was to provide clarity as to the scope of Part 5, as the government separately commenced a new, specific critical third parties regime established within FSMA 2023.[4]

1.10 On the Bank’s powers themselves, the government proposed enhancements to its ability to gather relevant information from market

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2 ‘Payments Landscape Review: Call for Evidence’, HM Treasury, July 2020

3 S.21-22 and Sch.6 of the ‘Financial Services and Markets Act 2023’, UK Parliament, June 2023; the government’s consultation on its regulatory approach towards stablecoins is available here

4 See S.18-19

participants, in recognition that crucial data connected to assessing systemic risk may no longer solely be held by or accessible through the supervision of systemic payment system operators alone. Reforms would allow the Bank to source relevant data from unsupervised, non-systemic firms operating within relevant payment chains.

1.11 The government made clear that it would also further clarify the Bank's existing regulatory toolkit, codifying its powers in legislation, and making clear which aspects of a recognised entity's operations the Bank may exercise its broad supervisory powers over. This included clarifying the Bank's power to set limits on a business activity where appropriate to manage financial stability or serious economic risk, and its ability to mandate a firm's location within the UK.

1.12 To provide clarity regarding the dual regulation of any already-authorised systemic payment services providers (PSPs) or e-money institutions (EMIs) under the Financial Conduct Authority's (FCA) remit, the consultation set out the government's expectations for how the Bank and FCA would co-supervise any future systemic payments firms, including the need for a clear transition process and a Treasury-held power to disapply relevant regulator rules. The consultation broadly proposed extending the agreed-upon approach for systemic digital settlement assets, whereby the Bank would lead on prudential matters, and the FCA on conduct. In cases of insolvency, systemically important PSPs or EMIs would migrate from coverage under the Payments and Electronic Money SAR overseen by the FCA and into the Financial Market Infrastructure SAR overseen by the Bank.

1.13 Finally, the government sought views on extending the Future Regulatory Framework (FRF) Review's enhanced accountability framework to apply to any revised systemic payments perimeter, holding the Bank's supervision of payments accountable to equivalent or similar standards and rules as for its remit over central counterparties and systemic central securities depositories, as legislated for in FSMA 2023.[5] This would include a secondary innovation objective, renewed regulatory principles and means through which the Treasury, Parliament and stakeholders could scrutinise over the Bank's supervisory approach.

Other proposals made in the consultation

1.14 Beyond reforms to the Bank's systemic payments perimeter, the government made proposals in three other areas of existing payments regulation.

1.15 Firstly, the consultation set out the government's proposals for providing the FCA with relevant rulemaking powers and the Payment Systems Regulator (PSR) the necessary powers of direction in relation to their retained EU law covering payment services. This would enable the regulators to set rules and generally applicable requirements as the

[5] See S.9-12 and Sch.10-11

government repeals retained EU law and builds a Smarter Regulatory Framework for financial services that is tailored to the UK.

1.16 Secondly, the government sought views on the Senior Managers & Certification Regime (SM&CR), and its application to systemic payments systems and their specified services providers, as well as FCA-authorised PSPs and EMIs.

1.17 And thirdly, the government proposed enhancements to elements of the PSR's domestic legislative regime within the Financial Services (Banking Reform) Act 2013 (FSBRA), to better enable the PSR in its duties, and resolve recognised ambiguities within its regulatory framework. The consultation set out various proposals to: simplify the PSR's framework for supervising payment system access; improve its ability to vary or revoke existing directions; clarify users' routes of appeal against PSR decisions; introduce a fining power for firms that knowingly provide misleading information to the PSR; and establish a means for the PSR to redress victims of malpractice.

The government's response and next steps

Implementing a reformed systemic perimeter

1.18 This document represents the government's response to its 2022 consultation on the proposals laid out above. It considers the feedback received from the 23 respondents to the consultation and provides relevant clarifications or detail in relation to the perspectives, questions and issues raised.

1.19 Feedback to the consultation is examined in the next section. The feedback was largely positive concerning the government's assessment of the evolution of systemic risk, and the principle to reform the Bank's systemic payments perimeter. A clear majority agreed with the government's principles to reforming this perimeter to ensure that the Bank's capacity to mitigate acute financial stability risks kept pace with the evolution of the payments sector at large. Almost all agreed that doing so via Part 5 of the Banking Act, where the Treasury retained control over who entered the Bank's perimeter, was the most proportionate and effective means for enabling any revised perimeter.

1.20 Where there were specific questions or concerns, these were largely seeking to understand the practical effect of any legislative change placed on the sector, including how the Bank would assess systemic risk across payments activities and communicate with the sector in identifying these risks.

1.21 It is important that the practical effect of legislative change is clear and well understood by affected parties, and the government notes that it will be for the Bank itself, as the competent authority, to articulate how it intends to supervise over this reformed perimeter.

1.22 The government is committed to taking forward these reforms to the Bank's systemic perimeter at a future legislative opportunity. Legislation to enact these changes will require an Act of Parliament.

Consequently, the government will issue a further public statement setting out its legislative approach as it determines a suitable vehicle for enacting these reforms. The Bank will be expected to set out its approach for how it will supervise over its expanded remit after legislation taking forward these reforms is published.

Progressing consulted-on policies beyond the Bank's perimeter

1.23 The government received unanimous support in consultation concerning its intentions to provide the FCA and the PSR with relevant powers over their respective retained EU law for payment services. The government has since laid its statutory instrument to provide these powers to the FCA and PSR following the Chancellor's July 2023 Mansion House address.[6]

1.24 The Treasury has also since announced the first two tranches of its Smarter Regulatory Framework programme, which will include the Payment Services Regulations 2017 and Electronics Money Regulations 2011. Following April's closure of its 'Payment Services Regulations Review and Call for Evidence',[7] the government will provide further detail on its approach to replacing these regulations in response to its call for evidence later in 2023.

1.25 As part of the Edinburgh Reforms, the government additionally committed to launching a review into the Senior Managers & Certification Regime (SM&CR).[8] The government launched its call for evidence concerning the current legislative framework of the SM&CR in March, alongside a joint discussion paper from the Prudential Regulation Authority (PRA) and FCA considering the regime's regulatory framework.[9] Both reviews closed in June. The government's review sought stakeholders' views on how, if at all, it can more effectively and efficiently deliver the key aims of the SM&CR, while meeting the government's commitment towards high international standards.

1.26 The Treasury is currently processing responses it received, which it will consider in conjunction with the regulators, and intends to set out next steps in due course. The government – through the 'Payments Regulation and the Systemic Perimeter' consultation – already sought industry's views on the extension of the SM&CR to both recognised systemic payments entities and authorised PSPs and EMIs. The government will set out next steps regarding the future, consulted-on extensions to the Bank or FCA's remit over payments after its broader review of the SM&CR has been concluded.

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6 'A Smarter Regulatory Framework for financial services', HM Treasury, July 2023

7 'Payment Services Regulations Review and Call for Evidence', HM Treasury, January 2023

8 'Financial Services: The Edinburgh Reforms', HM Treasury, December 2022

9 'Senior Managers & Certification Regime: a Call for Evidence', HM Treasury, March 2023

1.27 Finally, separate to these ongoing priorities, the government will also bring forward secondary legislation to reform the PSR's payment system access framework, as consulted on in last year's consultation. This will entail revoking the access framework within Part 8 of the Payment Services Regulations 2017 (R.102-104), leaving the PSR to apply its framework within Part 5 of FSBRA in all cases. Respondents were supportive of the government's principal aim of reforming the PSR's system access framework to simplify the current dual regime governing fair access, provided this was handled in a way that was clear and nondisruptive, and retained popular elements of the Payment Services Regulations' framework, such as the proportionate and non-discriminatory ('POND') criteria. This feedback, as well as further detail as to how the government intends to reform this framework, are set out further in Chapter 2.

1.28 Taking forward other consulted-on reforms to the PSR's framework in FSBRA will similarly require an Act of Parliament. The government intends to return to these proposals as part of a future policy statement at a future legislative opportunity.

Chapter 2

Detailed review of responses

Approaching reforms to the Bank's systemic perimeter

Principles guiding reform

2.1 Having explored evolutionary trends within the payments sector, Chapter 1 of the government's consultation set out the regulatory principles that would guide reforms to the Bank's systemic payments perimeter within legislation.

2.2 The government made clear that its approach would be informed by the reform principle of 'same risk, same regulatory outcome': that regulation should provide the means for the holistic assessment of financial stability risk agnostic of its source; that is to say, irrespective of the type of payments entities, payments activities or underlying technologies.[10] This principle has been championed within industry, as it promotes agile, relevant, and proportionate regulatory standards. For the government, this approach provides for an efficiently futureproofed statutory perimeter, with means for ensuring regulators can effectively supervise within the context of an increasingly interconnected and evolving financial services landscape.

2.3 For payments, the government therefore proposed to move from an entity-defined systemic payments perimeter, in which the Bank's precise remit was clearly demarcated within statute, to an end-to-end perimeter. Rather than adding new, specific types of payments entities into the Bank's perimeter for consideration as systemically important, the government set out its intention to give the Bank freedom to monitor stability risks across payments chains and recommend for recognition by the Treasury any payments entity that met systemic thresholds of risk.

2.4 The government set out its preference to enable such a reformed perimeter through Part 5 of the Banking Act 2009, where the Bank's current systemic payment systems remit is established. The government's view was that the essential design of the Banking Act was well understood and remained appropriate for any future systemic payments entities that the Bank might supervise over. The government

[10] Further thinking on this principle's application to payments was initially explored by the Bank of England in its Financial Stability Report in December 2019

also recognised that industry feedback had previously indicated a desire to see a period of regulatory continuity in the frameworks that made up regulation of the UK's payments sector.

2.5 In practice, this meant that the essential design of the Bank's systemic payments perimeter would remain unchanged when following reform to its scope: legislation would set out a clear, high-bar recognition criteria through which the Bank would be required to assess systemic risk, and the Treasury would be responsible for formally recognising future entities as systemic, through consultation with the Bank and the entities themselves. Whilst the Bank's perimeter would be reformed to allow for risk assessment across the sector, such a design would ensure that entry into Bank supervision would therefore remain preserved for only those few entities that operated at a systemically important scale.

Question 1: Do you agree that in line with the principle of 'same risk, same regulatory outcome', the Bank of England should have responsibility for supervising systemic actors within payment chains?

Question 2: Do you agree with the government's approach that the existing architecture of Part 5 of the Banking Act 2009 should be reflected in any expansion in the scope of Bank supervision – with criteria to determine systemic importance, and recognition by the Treasury?

2.6 Responses to this approach were at-large positive. There was clear support indicated for the principle of 'same risk, same regulatory outcome', and a recognition of the need to avoid iteratively returning to legislative reforms to the Banking Act as new entities or activities presented systemic risks, and instead moving to a principles-based perimeter. One respondent felt unable to judge the effectiveness of a principles-based perimeter until it was clear exactly which entities or activities the government considered were systemically important and going unsupervised.

2.7 All respondents supported retaining the Banking Act – including its high bar recognition criteria and Treasury-led recognition process – as the framework through which any revised perimeter would be enabled. Several respondents noted the need for systemic criteria to be updated in legislation to reflect new or unique factors within payments activities that may not yet be attributable against the existing criteria list in Part 5. There were also calls by some to see the recognition process, its costs, and expectations for engaging the Bank and the Treasury be made more transparent and adaptable for firms being brought into (and potentially being taken out of) Bank supervision.

2.8 Nearly half of respondents called for more detail on how the Bank would triage risks across new types of payments activities within its remit, recognising that aspects of the systemic criteria would hold different weight depending on the activity. For instance, a few respondents recognised the role competitive substitutability plays in offsetting other stability risks, where end-users interact with multiple

competitors performing the same activity and can switch providers without disruption at a systemic scale. Several also noted the difference between entities that facilitate payments, and those that hold store-of-value functions, noting that the former would not hold the same liquidity risks associated with their disruption.

2.9 Beyond how the Bank would assess if a firm is systemic in practice, a number of respondents made clear their hesitation towards the potential burdens of systemic recognition on smaller payments entities should they be considered systemic. Some noted that obligations stemming from supervision should not undermine entities' capacity to innovate and grow their product offerings for the benefit of end-users. Two respondents also emphasised the need for consistency in the treatment of systemic entities against their non-systemic competitors (i.e., if several similarly systemic direct competitors would enter the Bank's perimeter at the same time).

2.10 Several respondents wanted to see the systemic criteria be quantified by the Bank in guidance to make clear to firms when they would be liable for consideration. Within this, several observed that an implied systemic ceiling might disincentivise non-UK firms from choosing to enter and operate within the UK's payments market. In doing so, two responses stated an alternative preference to see the FCA take on some form of role for supervising over stability risk within payment services instead, or there being a form of 'entry lite' model with lower attributed costs or burdens associated with recognition.

2.11 Finally, one respondent argued that non-bank e-money and payment institutions should automatically gain access to Bank of England settlement accounts if they were recognised as systemically important.

2.12 Concerning the relevance of the existing recognition criteria, the government's view is that the criteria in S.185(2) of the Banking Act are already suitably broad to apply to other types of systemic payments entities. When recognising a payment system as systemic, the Treasury is currently required to consider the volume, value and nature of the payments processed, the substitutability of the system in question, its relationship with other systems within the payment chains it serves, and if the Bank itself depends on the system.

2.13 These criteria are cast intentionally broad in legislation and remain relevant when assessing other entities operating with payments chains that might operate at similarly systemic thresholds. The government agrees with respondents who emphasised that the Treasury should (as it already does in consultation with the Bank) weigh the relevance of each of these elements on a case-by-case basis at the point of making a recognition order.

2.14 The government agrees that clear guidance setting out how systemic importance is assessed would be helpful. The government will work with the Bank to consider when such guidance should be provided.

2.15 The government recognises, however, that establishing quantified systemic thresholds – either in legislation or guidance – is ultimately likely to be difficult, as an assessment of financial stability risk is likely to reflect a combination of factors, relevant context, and the evidence available. The government believes, however, that clear guidance setting out how the Treasury and the Bank engage with prospectively systemic entities, and the steps involved in recognition, would provide valuable transparency.

2.16 As for wider concerns raised regarding the regulatory burdens associated with an end-to-end systemic payments perimeter, it remains the government's ambition to ensure that the payments sector is given sufficient freedom to innovate, compete and grow to the benefit of their end-users. The purpose of these reforms does not, in the government's view, undermine its objectives in this regard. Rather, they are designed to ensure that financial stability risks across payment chains can be holistically monitored and effectively mitigated through Bank supervision as the sector continues to evolve.

2.17 It is also important to emphasise that the government expects these reforms' practical regulatory effect on the overall sector will be limited. The Treasury itself holds the responsibility for determining against criteria, set out in legislation, which firms enter the Bank's remit, based on a consideration of a firm's systemic role to the financial system or wider economy. No entities will automatically enter Bank regulation following the reforms themselves.

2.18 The government disagrees with the suggestion to instead give the FCA an enhanced role supervising over payments entities' stability. The structure of systemic supervision has, through reforms to financial services regulation following the 2008-09 financial crisis, intentionally established that stability risks should be analysed and monitored primarily by the Bank of England.

2.19 Finally, concerning access to Bank of England settlement accounts, the Bank currently accepts applications for direct access from FCA-authorised e-money institutions and payment institutions that meet the relevant eligibility criteria.[11] It is for the Bank itself to determine its policy for eligibility to access central bank settlement accounts.

Ensuring effective supervision across the payment chain

2.20 Further to its principles to reform, the consultation set out in its Chapter 2 how the government envisaged enabling such a perimeter within Part 5 of the Banking Act.

2.21 Today, Part 5 allows the Treasury to recognise payment system operators and their associated service providers for Bank supervision. The regulation of 'associated' service providers is set out in S.206A and

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11 'Access to UK Payment Schemes for Non-Bank Payment Service Providers', Bank of England, December 2019

enables the Treasury to recognise providers performing critical functions constituting a direct part of a payment system already recognised for systemic supervision. This is to ensure that the Bank has suitable grip over all aspects of the operations upon which a systemic payment system depends.

2.22 The consultation made clear that the government considers this existing framework to be broadly suitable for approaching other types of payments 'providers' – i.e., entities or actors operating within a payment chain. In this vein, and so as to not disrupt the existing perimeter as it is established, the government proposed to introduce an additional category of payments provider that allowed for the consideration of those that pose systemic risk in their own right, but which may or may not have a direct relationship with an already-supervised payment system.

2.23 The purpose of this additional category was intended to mitigate sources of risk in relation to the providers themselves, not based on their relationship with an already-recognised payment system. This additional category would allow for the supervision of any payments entities that perform an essential role across payment chains, where such a provider's disruption or outage would not necessarily affect the stability of a specific, already-supervised entity, but could itself have material adverse impacts on the financial system or economy through its relationship with multiple entities or otherwise. This is similar to the approach taken, for example, in relation to associated digital wallet providers that provide access to digital settlement assets (systemic stablecoins), as set out in FSMA 2023.

2.24 To account for the current structure of the Banking Act, this approach would result in the following expanded scope for a systemic payments perimeter within Part 5:

- systemic payment systems where these are judged to be likely to threaten the stability of, or confidence in, the UK financial system or have serious economic consequences for the UK (already in scope)
- associated service providers to the above (already in scope)
- providers in their own right, where these are judged to be likely to threaten the stability of, or confidence in, the UK financial system or have serious economic consequences for the UK (new)
- associated service providers to the above (new)

2.25 Beyond the establishing of an additional type of systemic payments provider, the government proposed to specifically narrow the scope of S.206A to remove its existing reference to its application over telecommunications and IT services, to make clear that 'providers' only refers to those performing payments-related activities within payment chains. Doing so removes a regulatory overlap for certain suppliers (such as cloud providers) whose services to the financial sector might be overseen under the regulators' new critical third parties regime.

Question 3: Do you agree with the government's approach to supervising different types of systemic service provider described above?

Question 4: Do you agree that general IT and technology firms should typically fall within the critical third party framework instead of the Banking Act, and do you have views on if the current reference to these entities in the Banking Act should be modified, and how?

2.26 Feedback on these proposals was broadly supportive. Respondents were largely agnostic as to how the government enabled a reformed perimeter in the Banking Act, provided it was accompanied by Bank-issued guidance clarifying the scope of its powers. All respondents were supportive of proposals to remove overlapping references to the Act's application over non-payments-related service providers, on the basis that providers of technology not specifically related to payments could be overseen through the new critical third parties regime.

2.27 On this specifically, several respondents raised a question over what would happen if a technology provider designated as a critical third party chose to offer payment services in the future, and how and if they would then fall into the scope of the Banking Act instead.

2.28 The government recognises that there will at times be a blurred line between technology providers and payments providers. Where a recognised systemic payments entity was found to also meet the statutory criteria for designation as a critical third party, the Treasury would need to assess (with the input of the regulators) which potentially applicable regime or regimes would be most appropriate taking into account the services the entity provides to the sector and their risks.

2.29 Conversely, were a designated critical third party to specifically begin offering payment services that were believed to be of systemic significance to the UK financial system, the Treasury would need to assess with the Bank whether separate recognition under the Banking Act's regime would be required, given the differing powers available to the regulators under the two regimes.

Providing powers for the Bank's role in supervising over a revised systemic payments perimeter

2.30 Questions 1-4 of the consultation sought feedback from respondents concerning the principles and overall approach to reforming the Bank's systemic payments perimeter in Part 5 of the Banking Act. Following this, the consultation then set out aspects of the Bank's current regulatory toolkit that the government felt needed clarification or enhancement to ensure the Bank was capable of clearly, effectively, and proportionately supervising over its revised perimeter. It explored changes to how the Bank may request and require information from firms relevant to its role for horizon scanning across

the sector; the scope of the Bank's regulatory toolkit – i.e., how it issues binding codes of practice and makes directions to supervised entities over their operation or management; the terms of the Bank's specific powers to mandate a UK presence or set limits over a payment entities' processing; and how the Bank would co-supervise payments entities already authorised by the FCA, including in circumstances concerning insolvency.

Enhancing the Bank's ability to gather relevant information

2.31 S.204 of the Banking Act provides the Bank with the ability to gather information relevant to it carrying out its functions in supervising over systemic payment systems. The Bank's scope to collate information is two-fold: it may request information from or in connection with already-recognised payment systems or associated service providers as part of their ongoing supervision or in relation to its financial stability objective, or from any person where it considers certain information would help the Treasury in deciding whether to recognise an entity as systemic as part of a recognition order.

2.32 The consultation explored how, as payment chains have evolved to include new activities and a greater number of market actors, it was reasonable to expect that information that would assist the Bank in adequately assessing and monitoring for emerging financial stability risks may be held by those outside of its recognised perimeter.

2.33 The government made clear its view that, if the Bank were to be taking on greater responsibilities for assessing risks across payment chains end-to-end, there was clear rationale for providing it with broader information gathering powers, to ensure the Bank could effectively spot trends and assess risks holistically.

2.34 The consultation noted that there is existing precedent for such powers in FSBRA's S.64 and S.81, introduced some years after the Banking Act, to enable the PSR to effectively 'keep markets under review' as part of its general functions.

2.35 The government emphasised its desire to see such a power be crafted to ensure that the discharge of an information-gathering request by the Bank be proportionate, and that regulators collaborate and cooperate closely in their requests made to market participants, to avoid duplicative or overlapping requests. Further, while giving the Bank a potential new function relating to market surveillance would ensure it would be possible for the Bank to request information where needed from non-recognised entities, the government made clear that this would not draw non-recognised entities into scope of the Bank's wider powers provided under Part 5.

Question 5: Do you agree with the government's view that the Bank should have the ability to gather information for the purposes of keeping markets under review from the perspective of understanding systemic risk, in the way proposed above? Are there any features that you consider would be important for this to be an effective and proportionate power?

2.36 Respondents supported the government's reflections set out in the consultation, namely that it was important that the Bank had effective means to collate relevant information from across the market, recognising that information could be held by entities outside of its recognised remit. Many respondents prefaced their support for this change, however, with strong calls for the Bank to collaborate with the PSR and FCA in its requests, and for the government to promote greater data-sharing practices between the regulatory authorities as to not create unnecessarily burdensome, overlapping, or duplicate requests. Within this, several respondents noted that the Bank (and all financial services regulators where they already held similar powers) should be targeted in their requests to firms regarding the information they require, one in particular noting the FCA's Digital Regulatory Reporting initiative as a positive example.

2.37 A few respondents questioned the breadth of such a power, calling for safeguards to require the Bank to be strategic with the power's deployment within the market. One asked that its scope be precisely set out in legislation, another proposed that the Bank be required to demonstrate its rationale for the request before proceeding.

2.38 The government welcomes the feedback received on its proposed approach and agrees that with a wider capacity to require information, the Bank should approach the use of such a power in the spirit of collaboration, both with market participants themselves, but also crucially with the PSR and FCA relevant to their overlapping remits in relation to payments. The Bank, FCA and PSR have an existing joint memorandum of understanding (MoU) which sets out a framework for cooperation in relation to payments systems. The government expects this MoU to be updated following legislation enacting these reforms to reflect the Bank's revised capacity to gather relevant information, and how the regulators appropriately coordinate data requests to market participants.

2.39 The government disagrees, however, with calls for placing limitations on the use of this power on the face of legislation. The purpose of this proposed reform is intentionally broad, as to not restrict the Bank to aspects of payments that it ought to be capable of collecting evidence from in relation to systemic risk. The government does recognise, however, that this particular power would provide scope for the Bank to require information from entities that are not formally recognised as systemic by the Treasury for the purpose of its market surveillance and horizon scanning function. This decision is intentional, reflecting a desire to ensure that any power's applicability was effectively futureproofed as the market continues to evolve. The

government does expect however, like the PSR does today, that the Bank proactively engage those it requests information from to set clear expectations on how it is provided, and to what timeframe.

2.40 Respondents should also note the government's proposals to hold the regulators accountable when exercising their functions in relation to engaging with marketplace participants (covered further below), including its intention to place a duty of cooperation on the regulators where co-supervising.

Clarifying the application of the Bank's powers supervising recognised entities' operations

2.41 The Bank already holds broad powers through Part 5 of the Banking Act in relation to systemic payment systems and their associated service providers, allowing it to publish regulatory principles, issue general codes of practice and make directions over those it supervises. At present, the extent of the Bank's overall regulatory and enforcement powers is largely implicit and undefined, with the scope of its mandate to oversee entities' operation and management set out in S.188-202(A).

2.42 The consultation set out the government's desire to make explicit the extent of the Bank's powers, both to give the Bank certainty over the scope of the use of its powers, and to provide greater clarity to the sector – especially those entities recognised as systemic – about which aspects of a firm's operations and management the Bank could exercise its powers in relation to. It proposed to do this in the form of a non-exhaustive list under S.191, to include:

- an entity's legal and operational structure, including its establishment and relationship with the wider group
- its management, governance, risk management and operational processes
- in relation to prudential requirements, including capital and liquidity management, and limitations to business operations or activities where these are necessary

2.43 In particular, the consultation reflected on the Bank's ability to set limitations on a recognised payments entity's business operations or processing. It set out circumstances where such limitations might be valuable, such as where a newly recognised entity were to enter, or an established entity were to exit, a market at-pace and at-scale as to bear financial stability consequences.

2.44 The government made clear that it saw the deployment of this power as exceptional, and that it should not be used as an inhibitor to effective competition or the emergence of new and valuable innovation within payment chains. In this regard, the consultation proposed the terms and use of such power be clearly specified within legislation.

2.45 The consultation then separately considered the government's preferences towards specifying the approach towards mandating establishment requirements in the UK for future, non-UK-based systemic payments entities. It reflected on the existing approach towards establishment in the UK for systemic payment systems and their service providers, whereby the Bank judges the mandating of a legal presence in the UK on a case-by-case basis: it analyses the nature of the activities being performed – including if these activities directly face consumers or provide a store-of-value function – against the legal limits of its scope in relation to the home jurisdiction, the role of an entity's home supervisors, and considers the UK's existing trade agreements and deference commitments.

2.46 The consultation stated the government's preference to use the proposed additional legislative detail to enable a continuation of this approach, in the view that it represented the most proportionate and effective means of promoting both a globally open and interconnected UK payments landscape, whilst ensuring that the Bank was encouraged to exercise its judgement when considering mandating location or applying deference to other local jurisdictions in individual cases.

2.47 The government also used the consultation to explore the relationship between the Bank's power to mandate a presence in the UK, and the existing remit of the FCA's establishment requirements flowing from the Payment Services Regulations 2017 and Electronic Money Regulations 2011, which concern entities that carry out or intend to carry out at least part of their payment services or e-money business in the UK. In particular, the government welcomed feedback from respondents on whether the requirement to operate a UK 'branch' went far enough in relation to authorised EMIs and account information service providers, given that some EMIs in particular have exponentially grown in the provision of their consumer-facing services.

2.48 Given the likes of EMIs could, in future, be considered for systemic supervision by the Bank under its revised payments perimeter, the government sought views on the relationship between the Bank's and FCA's requirements, and if a lack of specificity in the FCA's legislation relating to when business is conducted in the UK created risks in terms of consumer protection.

Question 6: Do you agree with the government's proposal to clarify the Bank's ability to apply limits where necessary for recognised entities within an expanded regulatory perimeter; to specify the circumstances in which they may be relevant; and views on what those circumstances might be?

Question 7: Do you consider that providing greater clarity as to the nature of the Bank's supervisory powers would provide greater transparency? If so, do you have views on how this should be provided, for example directly in the legislation, or as a supplementary annex, or in some other form?

Question 8: Do you agree with the government's proposed approach to requirements for establishment under the Banking Act and the rationale

provided? What are your views on the adequacy of the existing requirements under the Payment Services and Electronic Money Regulations?

2.49 Firstly, consultation responses concerning the government's approach to clarifying the Bank's supervisory powers were almost wholly supportive. Respondents agreed this would provide greater transparency as to the practical scope of the Bank's powers. Many noted that combining this legislative detail with clear guidance from the Bank as to its application over different types of payments activities would provide further clarity.

2.50 A few respondents wanted to see a statutory requirement be placed on the Bank to make a public statement each time it acts against a supervised firm. In this regard, the government believes that the existing publication requirement placed on the Bank through the Banking Act's S.197 is sufficient; the Bank may publish details of a firm's compliance failure, or details of any related sanctions it imposes on a recognised firm for non-compliance.

2.51 As for the government's proposed approach to clarifying the scope of the Bank's ability to set limits, responses were more tentative. Whilst a majority were supportive, at least in principle, a significant number stated some concern about its potential burden and emphasised that its use-case should be restricted within legislation, as the government had proposed.

2.52 Some questioned its purpose entirely. One respondent argued a preference to see the power remain implicit and its potential deployment be set out in Bank-issued guidance alone. Another contended that leaving the power implicit within legislation was itself enough to prevent the Bank overemploying the power through risk of legal challenge. Several stated a desire to see the Bank consult on its use of the power first, and actively consider alternative preventative means in consultation with industry.

2.53 The government recognises the strength of feeling by some towards the potential burden of a limits-setting power. It was in this mind that the government proposed to set out the terms of this power explicitly within legislation, to ensure that both the Bank and those being supervised clearly understood the terms of such a power's use. It is the government's objective to avoid a scenario where such a power might have inhibitive effects on regulated entities' growth and development. It is on these grounds that the government remains of the view that the status quo – whereby the Bank hold this power implicitly and with no clarified limitation – is not the right outcome for either the Bank or the payments entities it could supervise.

2.54 The government does agree, however, that the Bank should provide further detail within its future guidance as to what the power means in practice for those firms it chooses to deploy it over. As the consultation initially set out, the government anticipates its use might, for example, apply to new market entrants that are being prospectively

recognised by the Treasury where regulatory intervention is required in order to ensure new activity scales safely, avoiding risks to the UK financial stability. Its power should not be applied to existing entities that have a proven capacity to operate resiliently at-scale without posing risks to financial stability and that are already supervised by the Bank through Part 5. Rather, the power may, for example, be applied in the rare, unlikely circumstances where an already systemic entity was to cease part of or exit its obligations. The government also recognises that limits might be set to mitigate broader financial stability risks, such as the financial and monetary stability risks posed by new forms of digital money such as stablecoins.[12]

2.55 On the basis that the government intends to legislate to clarify this power's application, the government will consider in consultation with the Bank how best to provide further guidance, as appropriate, on how the power might be used.

2.56 Finally, responses were predominantly positive concerning the government's preferred approach towards establishment requirements. Almost all agreed with the government's view that mandating a UK presence for a systemic payments entity was best considered on a case-by-case basis in relation to its activities performed within the UK's payments market. All welcomed any attempt to make this clearer within legislation or guidance. Additionally, several respondents emphasised support for the UK government's promotion of deference arrangements where they do not undermine the ability of the Bank to effectively mitigate financial stability risks within the UK.

2.57 One respondent was concerned about the potential effect on third party providers, questioning if this approach would disincentivise non-UK-based payments entities from engaging with already-systemically recognised entities through fear of being considered by the Bank as systemically associated themselves and therefore being required to locate within the UK. On this point specifically, the government reiterates the legislative requirements for service provider recognition: that a third party would need to be actively providing services that are critical to a recognised entity's operations to be themselves worthy of consideration as systemically important in the UK. Only one associated service provider has been recognised in this manner to date.

2.58 Separate to this, several respondents reflected on the possible differences in expectation towards establishment for systemic payment system operators compared to the likes of future, systemically important payment service providers, given that system operators are already obligated to multijurisdictional governance arrangements.[13] In

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[12] The Bank itself has explored the use of such a power in relation to new forms of digital money in a 2021 discussion paper

[13] For example, the CPMI-IOSCO 'Principles for Financial Market Infrastructure', issued by the Committee on Payments and Settlement Systems and International Organization of Securities Commissions

this respect, several already-recognised payment system operators that responded emphasised their desire to see the Bank continue to engage through cooperative efforts with other regulators and within international fora as a means for promoting deference over establishment. The government strongly agrees.

2.59 Finally, concerning the question posed by the consultation on the adequacy of the FCA's existing rules within the Payment Services Regulations and Electronic Money Regulations, most of those that responded to this question noted the need for consistent standards in relation to the size of the entity providing services, as opposed to their legal form, and welcomed a chance for making this approach institution agnostic as part of any future review of these regulations. The government will consider this as part preparing its next steps in relation to its now-closed review and call for evidence of these regulations.

Managing co-supervisory responsibilities with the FCA

2.60 Lastly in Chapter 2, the consultation explained the government's desired approach to the future co-supervision of any systemic payment actors between the Bank and FCA. It proposed extending the intended approach towards the co-supervision of systemically important digital settlement assets (systemic stablecoins) as the government had separately proposed in its 2022 stablecoins consultation response document.[14] In short, the government proposed that:

- the regulators would be required to set out how they will work together in the regulation of systemic payments entities in an MoU to reflect their supervisory responsibilities, consistent with existing standards in S.98 FSBRA regarding the dual regulation of investment firms. This would include the setting out of where the Bank would hold primacy over supervising an entity's prudential management, operations or governance matters in relation to financial stability, and where the FCA would retain a role in overseeing their conduct
- a duty of cooperation would be applied to the Bank and FCA, but also including the PRA and the PSR where relevant, when exercising their respective functions over co-supervised payments entities. This improves upon the baseline provided under FSBRA and ensures that cooperation applies consistently across the payments regulatory landscape, including to the FCA's responsibilities for payment services and e-money
- the Bank would be given a power to prevent the FCA from taking action in relation to an entity recognised as systemic, akin to that of S.3I in the Financial Services and Markets Act 2000 (FSMA 2000),

[14] 'UK regulatory approach to cryptoassets, stablecoins, and distributed ledger technology in financial markets: Response to the consultation and call for evidence', HM Treasury, July 2022

where the PRA may require the FCA to refrain from a specified action, if it were to give rise to financial stability concerns, following consultation with the FCA and the Treasury

- the Treasury would grant itself power to make regulations to disapply existing FCA rules that were superseded by the Bank's regime for systemic payments entities. It would also be possible for the Treasury's power to enable transitional regulatory arrangements to apply, for example to support a firm's adjustment in a scenario whereby a systemic entity migrated from solo regulation by the FCA to co-supervision between the FCA and Bank
- where a payments firm currently in-scope of the Payments and Electronic Money SAR (PESAR) were to be recognised as systemically important, they would instead principally fall into the Financial Market Infrastructure SAR (FMI SAR) in cases of insolvency. The government will also explore whether wider reforms to the FMI SAR would be required to better mitigate the associated financial stability risks accruing from the failure of a systemic payment entity, for example, enabling the Bank to direct administrators to prioritise, if appropriate, the return or transfer of customer assets in the case of a systemic entity failing or becoming insolvent.

Question 9: Do you support the co-supervisory model proposed between the regulatory authorities, allowing the Bank of England to take primacy for systemic entities for reasons of financial stability? Do you support the principle of the primacy of the FMI SAR for systemic payments entities?

2.61 Respondents welcomed advice as to how regulatory overlaps would be addressed in the event of a revised systemic payments perimeter. Most accepted the need for Bank primacy towards the supervision of future systemically recognised payments entities, but often requested further advice as to which rules would be switched off, how and when, and by what means entities going through the recognition process would be kept clearly abreast of expectations. Several emphasised the need for the proposed MoU to clearly set out not just which rules and directions from each regulator would apply, but also the need for it to set out an agile and transparent process for entering into a co-supervisory environment, including how the Bank and FCA would communicate with these entities to avoid unintended noncompliance.

2.62 Several respondents also specified a strong preference to see the FCA and PSR's respective statutory objectives – particularly those relating to innovation and growth and international competitiveness – not be undermined or sacrificed where the Bank also holds a supervisory role relating to financial stability risk mitigation, in the interests of continuing to promote innovation and competition with the sector.

2.63 Two responses called for the government to conduct a more holistic review of regulators' respective payments remits, noting that the landscape has evolved to the point where supervisory boundaries were becoming unclear and cumbersome for new entrants to interpret. Related, one also requested confirmation that the government's proposed approach did not affect rules for existing payment system operators that are already supervised for certain aspects by the FCA or PRA. The government's view is that they should not.

2.64 As for views concerning FMI SAR primacy in cases of insolvency of future systemic payments entities, this was widely well received. One response called for these instances to be considered case-by-case, and a few others noted concerns that adding a new objective for returning customer funds to all systemically important payments entities may lead to situations where this was prioritised over ensuring continuity of service to mitigate acute stability risks. There were calls from a few respondents to see the government conduct a wider review of special administration regimes across financial services, and reflections on whether a bespoke resolution regime for payments should be considered over the longer term.

2.65 The government agrees with respondents that any MoU on systemic payments co-supervision should clearly set out which aspects of a payments entity the Bank would have primacy to make directions over; what role the FCA (and where relevant the PSR or PRA) retains in relation to its existing supervisory objectives; how firms are communicated with, and the timings associated with any firm's transition. In practice, the government expects (as is the case today) that the Bank clearly communicate directly with the newly recognised firm throughout the recognition process. As for the application of relevant supervisory objectives, to provide clarity, the FCA would remain bound by their objectives (including their new long-term growth and international competitiveness objective) where they retained aspects of a systemic entity's supervision, such as in relation to consumer protection and conduct issues.

2.66 As for a comprehensive review of regulator's respective remits, the government believes that this MoU should aspire to provide the clarity necessary for clearly demarcating the role of the Bank, FCA and PSR in instances of systemic payments co-supervision. The regulators each already publish public guidance concerning their respective supervisory perimeters over payments, however the government emphasises its desire to see the regulators ensure their guidance remains up to date as any changes to their respective perimeters are enacted, and in response to the evolution of the payments landscape itself.

2.67 Finally, concerning the feedback relating to the approach for managing a systemic payments entity's insolvency, it should be emphasised that any future decision to include an additional return of customer funds objective across the FMI SAR more broadly will need to be balanced against the existing objective of the FMI SAR to maintain

continuity, and the Bank would be expected to make a judgement on this by reference to its financial stability objective. As for reviewing the overall approach to insolvency, the government will continue to work with the regulators to keep the special administration regimes for financial services firms under review, including the existing arrangements for payments systems.

Holding the Bank accountable for its revised systemic payments perimeter

2.68 Commensurate to its revised perimeter, the government proposed to enhance the standards through which the Bank was held accountable for its role in supervising over systemic payments firms. As part of its Future Regulatory Framework (FRF) Review for financial services, the government had set out its intentions to introduce new secondary growth and competitiveness objectives for the FCA and PRA, a number of enhanced mechanisms for accountability, scrutiny, and oversight of the regulators by Parliament and the Treasury, and measures to strengthen the regulators' engagement with stakeholders.

2.69 For the Bank, the government had consulted on and has since proceeded to legislate in order to be able to apply this updated accountability framework to the Bank's regulation of central counterparties (CCPs) and central securities depositories (CSDs), alongside updated statutory objectives and rulemaking powers. In its 2022 payments perimeter consultation, the government invited views on proposals to extend this to also cover the Bank's remit over systemic payments firms, creating consistent accountability rules with respect to its role supervising for financial stability risks across systemic financial market infrastructure.

2.70 FSMA 2023 enacts the following accountability framework with regards to the Bank's remit supervising over CCPs and CSDs:

- the Bank will receive a new secondary objective so that, as it advances its primary financial stability objective, it must so far as reasonably possible facilitate innovation in the clearing and settlement services provided by CCPs and CSDs, with a view to improving the quality, efficiency, and economy of these services
- in advancing its primary objective of ensuring UK financial stability the Bank must also consider the impact the exercise of its functions may have on financial stability in other jurisdictions, and the desirability of exercising these functions in a way which does not discriminate on the basis where service recipients are located
- the existing regulatory principles in S.3B FSMA 2000 will be extended to the supervision of CCPs and CSDs, with minor modifications including a new principle on climate change and the government's commitments to net zero and environmental targets, as well as another to facilitate fair, reasonable, and equitable provision of services

- a new statutory 'FMI Committee' will be established at the Bank to exercise its functions in relation to CCPs and CSDs
- the Treasury will hold new powers to require the Bank to have regard to specific considerations on government policy, as well as a power to require the Bank to review its rules; related, the Bank will be required to consider the effect of its actions on the government's trade and deference commitments, and notify the Treasury where it believes its actions could be incompatible with the UK's international obligations
- the Bank will be given a statutory requirement to notify the relevant Parliamentary select committees when publishing consultations, and to respond in writing to responses to statutory consultations published from Parliamentary committees themselves
- it will also be required to publish a framework for how it conducts cost-benefit analyses and be required to engage a CBA statutory panel to allow for scrutiny of the approach taken to CBAs
- when engaging industry stakeholders, unlike the FCA and PRA, the Bank will not be required to establish a stakeholder panel, given that it maintains direct relationships with the small number of FMI that it regulates. However, it will be required to report annually on efforts it has made to engage with relevant industry stakeholders aside from those it directly supervises

2.71 The government set out its view in its 2022 consultation that these proposals were broadly the right ones for the Bank's remit over payments, including digital settlement assets following their inclusion into the Bank's perimeter flowing from FSMA 2023. Notably, it did question the application of the CCP and CSD-specific regulatory principle on facilitating fair, reasonable, and equitable provision of services (bullet 3), given that the PSR already holds a primary objective to consider fair access to payment systems.

Question 10: Do you consider that the government should apply the FRF accountability framework to the Bank of England in its supervision of a wider payments perimeter?

2.72 Feedback to the proposed extension of this accountability framework was universally supportive across the responses received. All agreed that the Bank should be held to broadly consistent standards across its FMI remit, not just for CCPs and CSDs but also systemic payments entities.

2.73 There were limited views on the extension of the specific regulatory principle on fair, reasonable, and equitable provision of services. Having considered the feedback received, noting that the PSR already holds a primary objective similar to this principle, the

government is not intending to extend this specific principle to the Bank's payments remit as part of these reforms.

2.74 Beyond this, seven respondents made specific interventions on the proposed secondary innovation objective's relevance to payments. Their arguments were broadly as follows:

- where the Bank may be intervening in a competitive and diverse payments sector, its powers should be exercised in such a way that does not harm or hinder a firm's capacity to compete against its direct competitors that are not systemically recognised; firms should not consider systemic recognition as a punishment for success and hindrance to their further growth
- innovation does not provide sufficient depth to require the Bank to consider how competition may foster greater diversity, substitutability and resilience in alternative payments services and technologies
- the number of CCPs and CSDs upon which the market depends is relatively small, and the current objective is focused on supporting innovation *within* these firms, whereas the focus for payments should be facilitating innovation *across* the landscape at-large
- international competitiveness of the UK payments market is particularly important to maintaining the UK's status as an attractive fintech hub, and in supporting UK fintechs seeking to expand into other jurisdictions
- being co-supervised with an FCA with different secondary objectives could lead to conflicting and disconnected regulatory requirements

2.75 Several respondents advocated for the FCA and PRA's long-term growth and international competitiveness objective being extended to the Bank's remit in place of innovation, whilst two others advocated for a bespoke form of competition objective, led by broadly similar justifications.

2.76 The government recognises the strength of feeling put across by a minority of respondents in relation to the adequacy of a secondary innovation objective as drafted for CCPs and CSDs and is sympathetic towards their calls for regulation to not inhibit the sector's ability to remain competitive and world leading.

2.77 The government also emphasises its intention to ensure that regulation of the sector is proportionate and agile, as to continue to foster innovation towards new payments technologies, and to drive effective competition between market participants in the pursuit of quality choice for end-users.

2.78 However, the government disagrees that a form of competition or growth and international competitiveness-related secondary objective would more effectively achieve these outcomes in relation to systemically supervised payments firms.

2.79 The government's intention towards a secondary innovation objective is to require the Bank to consider as part of its supervision – where not undermining its primary objective of mitigating financial stability risks – how to accommodate recognised entities' capacity to continue innovating their products and services. For CCPs and CSDs, this approach was driven by the desire to promote these firms' continued evolution of their technologies in relation to the wholesale services they provide to the rest of the financial sector.

2.80 The government recognises that the payments sector is different to that of CCPs or CSDs. Payments firms are more likely to be consumer, retail-facing services, face greater marketplace competition, and could be more substitutable in the services they provide. In this regard, it should be noted that the current systemic recognition criteria already requires the Bank to consider the mitigating effect that substitutability might play in relation to a firm's financial stability risk.

2.81 However, the government notes that changes to the framing of an innovation objective could more clearly reflect the nature of the sector, with a view to ensure that the Bank be required to consider how it supports continued development in the quality, functionality and evolution of the services provided by any payments entity under its supervision.

2.82 The government will return to the precise drafting of an innovation objective with this feedback in mind and set this out in its future policy statement ahead of future primary legislation. As a whole, however, the government intends to progress this accountability framework to apply to the Bank's systemic perimeter in the Banking Act, including its new scope over systemic digital settlement assets and its existing scope over systemic payment systems.

Considerations of the Future Regulatory Framework Review in relation to payments

2.83 Beyond these proposals put forward through the FRF Review, Chapter 3 of the consultation sought views on the government's intended approach towards its application over the FCA and PSR's respective payments mandates. The government set out that:

- the FRF Review's proposals in relation to the statutory objectives and accountability mechanisms of the FCA and PRA would also largely apply to the FCA with respect to its role supervising payment services and e-money stemming from retained EU law
- these same accountability mechanisms, but not the FRF Review's proposed secondary growth and competitiveness objectives, would also be extended to the PSR; the PSR's existing economic objectives were felt to be already reflective of the intentions of the revised objectives and would otherwise be largely duplicative
- the government would additionally legislate to provide the FCA and PSR with sufficient rulemaking powers and powers of direction

(respectively) in relation to their remit over retained EU payments law. Not doing so would mean that the FCA and PSR would be incapable of setting regulatory requirements to replace retained EU law

Question 11: Do you have views on the government's proposed approach to aligning the FRF Review with the regulatory landscape for payments?

2.84 Feedback on these proposals was supportive. Respondents reiterated their broad support towards the government's overall approach towards establishing a FSMA 2000-style regulatory framework, whereby the general framework, objectives, principles, and accountability of the financial services regulators would be set in statute, leaving firm-facing rules to be established within regulator rulebooks. The government has since legislated to extend these accountability frameworks and regulatory objectives to the FCA and PSR as part of FSMA 2023.[15]

2.85 Several respondents additionally called for clarity as to the timing and prioritisation of the government's intended review of the relevant retained EU payments law, including the Payment Services Regulations 2017, the Electronic Money Regulations 2011, and the Interchange Fee Regulation 2015. There were calls for the government to ensure that it actively engage the sector as part of reviewing these regulations and consider whether a staged revocation of these regulations would be most effective and least disruptive towards market participants.

2.86 The Payment Services Regulations and Electronic Money Regulations will be considered within Tranche 2 of the government's Smarter Regulatory Framework programme, on which the government intends to make significant progress by the end of the year.

2.87 Respondents were similarly supportive towards the government's intention to provide relevant powers to the FCA and the PSR in relation to their remits over retained EU payments law, which will allow them to set regulatory requirements when these parts of retained EU law are repealed as part of building a Smarter Regulatory Framework. The government has since legislated to establish these transitional rulemaking powers following the Chancellor's July 2023 Mansion House address.[16]

2.88 Several responses also noted a longer-term desire for the government to eventually migrate payments regulation and regulator rulemaking into FSMA 2000. The government intends to carefully consider the merits of this approach as part of building a Smarter Regulatory Framework.

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15 'Financial Services and Markets Act 2023', UK Parliament, June 2023

16 'A Smarter Regulatory Framework for financial services', HM Treasury, July 2023

Extending the Senior Managers & Certification Regime to payments

2.89 Chapter 4 of the consultation considered the role of the SM&CR and its application in relation to payments.

2.90 The government had already consulted in 2021 on the application of the regime over the Bank's existing perimeter over payment system operators.[17] It used its 2022 consultation to confirm that the SM&CR would be expected to apply consistently to any systemic payments entities that were to enter the Bank's perimeter as a consequence of the government revising its scope beyond payment systems and their associated service providers. In effect, the outcome would be that any systemically recognised payments entity would be subject to conforming with the SM&CR.

2.91 The consultation also asked an open question concerning the applicability of the SM&CR in relation to the FCA's remit over payment services and e-money firms, noting that their regulation outside of FSMA 2000 meant that these firms were currently not in-scope of the SM&CR, but that it might be proportionate to extend the regime to strengthen requirements associated with these providers' individual accountability and governance with means to drive higher standards and mitigate risks of consumer harm.

Question 12: Do you think that the Senior Managers & Certification Regime should apply to recognised payments entities within the Bank of England's regulatory perimeter, including if this is expanded?

Question 13: Do you consider that a SM&CR regime would be beneficial within the FCA's sphere of supervision, and on what basis?

2.92 Concerning the approach taken towards systemic payments firms being subject to the SM&CR, responses were largely supportive in-principle, provided the approach taken in the application of the regime was ultimately proportionate in considering an entity's structure, size and existing internal accountability and governance structures. Several respondents were more strongly against the proposal on this basis, arguing that a one-size-fits-all approach would be overly burdensome, and that requirements for governance arrangements would ultimately differ between a payments entity that provided business-to-business functions, such as a payment system, compared to those that were consumer facing. One respondent noted that payment system operators are also already subject to internationally agreed governance principles set by the Committee on Payment and Market Infrastructures at the Bank for International Settlements.

2.93 As for the SM&CR's scope over payments and e-money firms, responses were more mixed. Most felt that a carte blanche application

17 'Senior Managers & Certification Regime (SM&CR) for Financial Market Infrastructures (FMIs): consultation', HM Treasury, July 2021

of the regime across a large sector of authorised firms would be largely disproportionate to the risks posed and be costly for these firms. Others felt that automatic recognition – often the case for FSMA-regulated activities – would put the UK in position with the highest standards but may in doing so make it too difficult for small payments firms or fintechs scale successfully due to the burdens associated with the regime.

2.94 Several others commented that, beyond payments, those already subject to the SM&CR had reported the FCA were slow to engage firms on approvals relating to senior managers in the past and would like the government to explore making improvements to the regime first.

2.95 As noted in the Introduction, as part of the Edinburgh Reforms the government committed to reviewing the SM&CR. The government launched a call for evidence to help build an evidence base assessing how effectively and efficiently the core objectives of the regime are currently being met. This evidence base is informed by those firms operating within the regime and other interested stakeholders, which will help the government and the regulators to identify what, if any, reforms should be considered.

2.96 As the government is reviewing the legislative framework of the SM&CR, it intends to set out its position on the proposed extensions of the regime to payments after these reviews have concluded.

Making enhancements to the Payment Systems Regulator's legislative framework in FSBRA 2013

2.97 Whilst the consultation mostly considered changes to the Bank of England's statutory framework, its Chapter 5 demonstrated the government's intent to ensure that the PSR's own legislative framework, located in the Financial Services (Banking Reform) Act 2013 (FSBRA), was also reviewed for its effectiveness. The government proposed a number of updates to the now ten-year-old framework to ensure that the PSR maintained capacity to carry out its functions with clarity and efficiency within an evolving payments sector.

Reforming the PSR's system access regime

2.98 The consultation's principal proposal for reforms to FSBRA concerned making changes to improve the PSR's payment systems access regime. Today the PSR is responsible for overseeing direct and indirect [fair] access to payment systems (referring to direct participation in a system, or access to a system via a pre-existing participant). Its means for doing so are spread across two different regulatory frameworks: Part 5 of FSBRA, in which the PSR is responsible for safeguarding access to systems, with powers to intervene in market practices by the eight systems designated by the Treasury as under its supervision, and Part 8 of the Payment Services Regulations 2017, which sets out rules and principles for how system operators, and those offering indirect access, must provide access (including on a

proportionate, objective, and non-discriminatory basis – 'POND'). Part 8's framework does not provide the same intervention and direction-setting powers as FSBRA. Rather, the PSR's role is restricted to ensuring compliance with the criteria set out above.

2.99 Whilst this dual regime – where access requirements are set out in both domestic statute and in retained EU law – has assisted in improving outcomes for access to the UK's payment system architecture, it has also created anomalies as to which regime or provisions takes precedence in a given scenario. As a prior consequence of the primacy of EU law, the UK disapplied FSBRA's access regime (under S.108) where the Payment Services Regulations' regime applied. Additionally, which provision of the Payment Services Regulations' regime that applies itself depends on whether or not a system is designated under the Financial Market and Insolvency (Settlement Finality) Regulations 1999. This duplicative and often unclear regulatory structure has at times led to perverse outcomes where similar market actors may be subject to different access provisions purely as a result of designation under the Settlement Finality Regulations, and has risked an unlevel playing field within regulation. Responses to the government's 2020 'Payments Landscape Review' frequently called for consideration as to the effectiveness of this current dual regime structure.

2.100 In response, the government proposed last year to revoke the Payment Services Regulations' system access framework in its Rs.102-104, leaving FSBRA's framework to apply in all cases where the PSR held scope over designated payment systems. The government, however, asked respondents which aspects of the retained EU regime, including well-established concepts such as its POND criteria, merited retention under the FSBRA regime.

Question 14: Do you agree with the government's proposals to simplify the regulatory regime governing access to payment systems?

2.101 Responses to this question were positive. Almost all who responded agreed with the government's ambitions to reform the PSR's access framework into just FSBRA, with many noting that a single regime would provide greater clarity for both users of payment systems and operators themselves as to how the regime applied, and how access disputes should be settled.

2.102 Most agreed that the POND criteria were beneficial to retain under FSBRA, giving clarity as to the standards systems were to be held to.

Expediating system access framework reforms via secondary legislation

2.103 As set out in the Introduction, whilst the rest of its proposed reforms to FSBRA will require primary legislative change, the

government will prioritise a statutory instrument that reforms this access framework in the shorter-term, using powers provided to the Treasury under FSMA 2023. The government will return to the remainder of its proposed changes to FSBRA as a future primary legislative vehicle is determined.

2.104 The government expects to revoke Rs.102-104 of the Payment Services Regulations and S.108 of FSBRA. The government notes that the PSR already imposes a requirement for POND access criteria under its General Direction 2. The government expects that the PSR continue this approach and consider following revocation of the Payment Services Regulations' regime how to reflect POND principles in cases of dispute over indirect access.

2.105 The government will set out in more detail on its approach to achieving these reforms at the point of which it publishes a draft statutory instrument in Parliament.

Remaining proposals to enhance FSBRA

2.106 Beyond clarifications to the PSR's system access regime, the government proposed a number of other changes to FSBRA to better enable the PSR within its existing remit. These were to:

1. give greater discretion as to the powers the PSR may use in response to an application made under S.56 or S.57

2. remove the phrase 'primary purpose' from S.41, which sets out the scope of payment systems capable of being designated as under PSR supervision by the Treasury; the government's view being that some system operators may primarily perform other commercial functions than only operating a payment system, which would otherwise arbitrarily remove these operators from potential future designation

3. align the PSR with the ability of the FCA and Competition & Markets Authority to vary or revoke an existing direction; in practice, allowing the PSR to make minor changes to existing general or specific directions to ensure their continued effectiveness without the need for complete re-consultation

4. provide powers to allow the PSR to fine designated entities that, for example, knowingly or repeatedly provide misleading or incomplete information, akin to powers already held by the FCA

5. clarify routes of appeal against PSR decisions, confirming that PSR decisions to either intervene or not intervene are equally challengeable to the CMA within two months from the date appellants are notified

6. introduce a means of redress for service users, providing powers for the PSR to ensure restitution of affected users where relevant, similar to the FCA

7. confirm in statute that the PSR is in scope of rules requiring regulators to make arrangements for the investigation of complaints made against them, as set out in the Financial Services Act 2012; the PSR already voluntarily submits to this regime

Question 15: Do you consider that there is merit in the PSR being able to impose a penalty on designated systems and their participants for 'misleading information', e.g. where a person knowingly or recklessly provides the PSR with false or misleading information? Do you have any views on what would be a fair and effective route of appeal?

Question 16: The government would welcome views on any of the issues identified above in relation to the operation of FSBRA.

2.107 Considering feedback across the proposals made, responses suggested industry were largely in favour of the changes the government had proposed. There were some notable qualifications, caveats, or dissentions worth exploring, however.

2.108 Proposals to improve the efficiency of S.56-57 (item 1), to allow the PSR to vary and revoke existing directions (2), to provide clearer means for appeal against PSR decisions (6) and to apply statutory requirements on complaints processes (7) were all almost unanimously supported.

2.109 Respondents did note that they did not wish to see the PSR using any new power to vary or revoke existing directions being used to undermine the process of effective stakeholder engagement achieved through a formal consultation process. The government agrees with this feedback and expects the PSR to use this power to make necessary qualifying corrections to its directions to ensure they remain relevant, clear, and agile in their effect.

2.110 Further, the government expects that the application of the FRF Review's accountability framework to the PSR – notably requiring the PSR to establish a clear cost-benefit analysis process and means for engaging with stakeholders – should in fact bolster requirements on the PSR to ensure that it engages the sector effectively, whilst these changes to FSBRA ensure it can be generally more effective and efficient with its resources when making directions.

2.111 As for the proposal to clarify routes of appeal, several respondents argued in favour of longer timeframes than the two months suggested, including three or six-month alternatives. The government will take this into account, with a view to ensuring that appeals can be effectively investigated, and that there is consistency in timeframe in the appeals process against the regulators.

2.112 Concerning the government's proposal to remove the phrase 'primary purpose' from FSBRA's S.41 (item 2), feedback largely supported the proposal, with one notable exception. Most agreed with the government removing the term, reflecting a natural evolution of the sector at-large, and that systems that performed other commercial

functions beyond being a system operator could in future be deserving of designation under the PSR's remit. One respondent however was strongly against the proposal, led by concerns that the bar for designation would be lowered to consider other types of payments entities that held a role in relation to payment systems but who were not primarily payment system operators.

2.113 On this point, the government would like to emphasise that – like with changes to the Bank's payments perimeter – the objective is to ensure that the Treasury can adequately consider operators that perform payment system functions for designation under the PSR, regardless of their legal or technological form. The intention behind this change is to ensure that operators that perform other functions alongside providing payment system operations are not therefore arbitrarily removed from possible consideration by the Treasury. Given the government itself is responsible for designating systems under the PSR's remit, it does not expect that this change will affect the test of significance set out in the designation criteria in S.44 FSBRA.

2.114 In relation to the government's proposal to provide the PSR with a capacity to fine those found, for example, to provide misleading or incomplete information knowingly or repeatedly (item 4), feedback was more tentative. Most respondents could see the benefit of putting the PSR on the same footing as the FCA, provided a clear route of appeal against unreasonable requests was possible. Others questioned if the PSR really required this power to act effectively. Several noted that the PSR had at times placed unrealistic burdens on designated system operators to provide large sums of data to inform the regulator's work, and the PSR should be pushed to be more targeted should it be given any power to issue fines.

2.115 Two respondents noted that the PSR's General Direction 1 already expects firms to engage with them on a fair and transparent basis, or that FSBRA's S.81 requires designated firms to provide accurate information. Several others prefaced their support for this proposal provided the PSR seek to engage more collaboratively with the FCA or the Bank of England in the information collected from system operators.

2.116 The government is cognisant of the feedback received on this proposal and agrees with respondents that the PSR should – as it expects all regulators to – act proportionately and collaboratively with those it regulates, be considerate of the effects of its directions or requests and seek to engage with other regulators where there is overlap.

2.117 The government intends to provide the PSR with the ability to issue fines, as a means for ensuring it can act more effectively and decisively as part of its investigations in relation to market access and competition practices. The government will, ahead of any legislative change, carefully consider how the PSR may be allowed to this power in proportion to its narrower scope compared to the FCA, including as to

how those in receipt of fines may appeal requests where needed (including to whom).

2.118 Finally, concerning the proposal to introduce a process for the PSR to provide redress for affected service users (item 6), responses were often more cautious. Most that answered on this point noted the need for careful calibration on the effect of such a power, in consideration of the potentially large number of users of payment systems that might be in-scope of such restitution, and the impact this could have on the financial liquidity and continued stability of the system operator themselves.

2.119 Others noted that some system operators already have insurance or redress processes in relation to either participants in the system, or end-users themselves, and that the PSR should not be given means to undermine existing policies – particularly in the payment cards space – where these policies are already considered to work effectively.

2.120 Several explicitly welcomed the proposal, noting that it would make the PSR ultimately more effective in providing for good outcomes for consumers, albeit in expectantly rare circumstances. Others directly disagreed, arguing that the PSR's duty was in relation to service users of the systems (i.e., participants), but not end-users themselves.

2.121 The government recognises the breadth of the feedback received to this proposal. The government also recognises that there is a wider policy question to be considered as to whether the right outcome is to provide the PSR itself with means for compensating victims where it has intervened, or if clearer and potentially more stringent requirements on system operators to provide their own means of redress would be more effective and proportionate. Ultimately, the government supports the principle of ensuring that both participants of payment systems – but also their end-users – have means for fair and adequate compensation. Continuing to reflect on the feedback received, the government will consider this further in consultation with the PSR and industry before it determines whether to progress reforms in legislation to enable redress for users of payment systems.

Annex A
List of respondents

The following respondents made representations to this consultation:

American Express

Barclays

Circle

CLLS Regulatory Law Committee

CLS Bank

Euroclear

Fnality

HSBC UK

Innovate Finance

LINK

Lloyds Banking Group

Mastercard Europe

Modulr

Pay.UK

PayPal

Payment Systems Regulator

Santander UK

The Electronic Money Association

The Payments Association

UK Finance

VISA Europe

Which?

WorldPay (FIS Global)

HM Treasury contacts

This document can be downloaded from www.gov.uk

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