

## **LINK's response to the Payment Systems Regulator's call for views on "Our Approach to Supervision"**

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### **Executive Summary**

1. LINK Scheme Holdings Ltd (LINK) seeks to maintain strong collaborative and strategic relationships with all of its regulators and has always appreciated the Payment System Regulator's (PSR) general support and engagement. While not convinced that it is required, LINK will co-operate fully with this new supervision framework.
2. LINK notes that the legislation governing the PSR already includes a set of regulatory principles (included as an appendix for ease of reference). The PSR's proposed framework refers to "principles for regulatory expectations". LINK is not clear how the PSR has mapped these two concepts to each other and believes this would be a useful exercise for the PSR to undertake.
3. LINK notes that the Financial Conduct Authority (FCA) and the Bank of England (Bank) both have supervisory principles which are broadly consistent with each other and concentrate on how these regulators will exercise their supervisory functions (included as an appendix for ease of reference).
4. Section five sets out how the PSR will supervise and is very high level, for example when compared to the supervisory principles set out by the FCA and the Bank. LINK suggests that there could be merit in the PSR following an approach closer to that of the FCA and the Bank.
5. The PSR's proposed approach to supervision appears to blend the concepts of regulation and supervision. The PSR's proposed "principles for regulatory expectations" of the institutions it supervises are not related to supervision but rather are policies that it would like Payment Systems Operators (PSO) to follow. LINK is not clear how these are relevant to supervision.
6. The PSR is proposing to assess the performance of each PSO by reference to its own strategic objectives. The proposal is that each year the PSR will give its assessment to a PSO of how that operator is performing in respect of the PSR's objectives. However, there is no requirement for a PSO to respond to this or any consequences for remaining unaligned. Given that PSOs are not currently set up to act as delivery organisations of the PSR this assessment, while potentially interesting, appears to have no practical effect.

## **About LINK**

7. LINK manages the UK's main cash dispenser (ATM) network and is a central part of the UK's cash infrastructure. It is a not-for-profit organisation with an independent Board that acts in the public interest.
8. LINK's network connects the vast majority of ATMs (both free and charging) in the country, and allows customers of banks and building societies (card issuers) who are LINK Members to make cash withdrawals and balance enquiries with their payment card at almost every ATM. All major card issuers and ATM operators currently choose to become Members of LINK. This helps ensure that consumers in the UK have good free access to cash.
9. LINK also supports general community access to cash in its role as a voluntary industry co-ordinating body. LINK is notified by participating banks of their intention to close branches and assesses the impact on these communities. LINK also receives requests from communities to review cash access. Where certain criteria are met, LINK recommends new cash facilities such as shared banking hubs and deposit services. Responsibility for implementing the recommendations is with a bank-owned infrastructure company called Cash Access UK (CAUK).
10. Cash is in long-term decline in the UK and LINK ATM transactions are falling by about 5% per year. LINK is managing the network through this decline in order to protect free access to cash for as long as it is needed.
11. The LINK network is based on a highly resilient real-time high-volume infrastructure, currently supplied by Vocalink. LINK is the network operator, and the systemic risk manager.
12. LINK is regulated by the PSR, and by the Bank as a systemically important payment system and is designated as such by the Treasury (HMT). If LINK is designated by HMT as an industry co-ordination body, LINK will also be subject to the FCA's Access to Cash Sourcebook and supervision by the FCA.

## **Analysis of the PSR's Proposals**

### *Alignment with the Financial Services (Banking Reform) Act 2013 and with Other Regulators*

13. In reviewing the PSR's proposals, LINK has taken as a starting point the legislation under which the PSR operates – the Financial Services (Banking Reform) Act 2013.
14. Section 53 of the Act sets out the regulatory principles (these are included with this paper as an appendix for ease of reference).
15. It is also instructive to look at the published supervisory principles of the other two financial regulators, the FCA and the Bank (these are also included with this paper as an appendix for ease of reference).
16. LINK takes regulation to refer to the setting of rules, and supervision to refer to the enforcement of rules. However, the distinction is rather blurred in the PSR's proposals. For example, in Question 2, which refers to regulatory expectations rather than supervisory principles. The Act is silent on supervisory principles, but the regulatory principles are a useful reference point.

17. LINK is not clear how the PSR has mapped its proposals to its statutory regulatory principles and believes this would be a useful exercise for the PSR to undertake.
18. LINK also suggests that there could be merit in the PSR following an approach closer to that of the FCA and the Bank.

#### *The PSR's Proposed Supervisory Principles*

19. The PSR's proposed supervisory principles are set out in section 5 of the consultation document. In brief they are:
  1. *We will assess firms over established review cycles. At the end of each cycle, we will set the supervisory priorities for the next. These cycles may differ from firm to firm, depending on their characteristics. We will provide each supervised firm with our assessment of its performance.*
  2. *At the beginning of each supervision period, we propose to provide engagement schedules to the organisations we supervise. This will help set out our expectations and allow firms to plan accordingly. We expect to hold regular, scheduled discussions with firms' representatives.*
  3. *We propose to ask supervised PSOs for documentation to allow us to understand their business better.*
20. It is stated that the documentation "*is likely to include*":
  - *The rules, standards and membership models of the payment system.*
  - *High-level descriptions of business units or functions within the PSO.*
  - *Publicly available accounts.*
  - *Lists of current participants.*
  - *Standard participation contracts.*
  - *Governance documents – business plan, strategy, board minutes, etc.*
21. This is a very high-level description and LINK thinks some more detail would be useful. The proposed documentation is also unrelated to data to evidence compliance with rules. LINK suggest that further thought be given to what might be required to evidence compliance with regulation.

#### *The PSR's Proposed Expectations*

22. The PSR overlays its supervisory principles with a set of expectation for "*those we supervise*":
  - *PSOs should allow for wide access and participation.*
  - *PSOs should work to address the needs of users and participants.*
  - *PSOs should monitor and manage risk to compliance with payment system rules and standards.*
  - *PSOs should coordinate cross-market change effectively.*
  - *PSOs should build and maintain the trust and confidence of their users and participants.*
  - *PSOs should limit opportunities for abuse in payment systems.*
  - *PSOs should design to enable innovation.*
  - *PSOs should ensure the payment systems they operate are efficient and sustainable.*

23. There are three “expectations” that are particularly problematic for LINK:
- **PSOs should co-ordinate cross-market change effectively.** It is not clear what “cross-market change” means. LINK is concerned that, in the competitive market that it operates in, cross market co-ordination may not be possible in the way that the PSR is suggesting. Greater detail would be helpful in assessing this risk.
  - **PSOs should design to enable innovation.** LINK accepts responsibility for innovation in respect to access to cash. It has for example managed a successful financial inclusion programme. But this is about to become the responsibility of the FCA. In relation to the PSR’s remit on infrastructure, Specific Direction 4 largely limits LINK’s ability to innovate as it only allows for a competitive tender at the end of the current contract with Vocalink. As this is unlikely to be possible given declining volumes and rising technology upgrade costs, LINK is effectively required to wind down rather than innovate.
  - **PSOs should ensure the payment systems they operate are efficient and sustainable.** LINK cannot “ensure” that it is sustainable given the reduction in the use of cash.
24. Some aspects of paras 5.5 and 5.6 of the consultation document appear inappropriate:
- 5.5. We will assess firms over established review cycles. At the end of each cycle, we will set the supervisory priorities for the next. These cycles may differ from firm to firm, depending on their characteristics. We will provide each supervised firm with our assessment of its performance.*
- 5.6. We intend to use two criteria to inform our assessment of the PSOs we supervise:*
- *our understanding of the PSO’s influence on risks and opportunities for our strategic aims*
  - *the PSO’s performance on our principles for regulatory expectations*
25. It is entirely reasonable for the PSR to assess a “*PSO’s influence on risks*”. This is consistent with the approach of other regulators. For example, the Bank’s assessment of a PSO’s risks to the stability of the UK financial system.
26. An assessment based on “*the PSO’s performance on our principles for regulatory expectations*” appears inappropriate. This suggests that the PSR is intending to judge PSOs’ performance, something it is not qualified to do, bearing in mind that much of the activity of PSOs, and certainly of LINK, does not come within the PSR’s remit.
27. It will also be noted that the PSR intends to judge PSOs on their performance against its strategic aims. PSO’s like LINK are not set up to achieve the objectives of the PSR. LINK has its own objectives which are about the provision of access to cash across the UK, operating in a competitive market with other PSOs with their own objectives. By attempting to align PSOs with its own objectives, the PSR risks treating PSOs as its delivery arm. This might work with a nationalised payments industry, but it is incompatible with a competitive PSO market.
28. The consultation uses the terms “strategic aims”, “strategic outcomes” and “strategic objectives” interchangeably. Only “strategic outcomes” is defined. It may be helpful to use just one defined term, assuming that they all are intended to mean the same thing.

## The Effect of the Proposals

29. The proposal is that each year the PSR will give its assessment to a PSO of how that operator is performing in respect of the PSR's objectives. However, there is no requirement for a PSO to respond to this or any consequences for remaining unaligned. Given that PSOs are not currently set up to act as delivery organisations of the PSR this assessment, while potentially interesting, appears to have no practical effect.

## Answers to the PSR's Two Questions

To assist the PSR, we have summarised our analysis against the two questions posed in the consultation below.

### Question 1: Will the approach that we set out in this document allow us to better mitigate risk to our strategic aims?

30. The proposal is that each year the PSR will give its assessment to a PSO of how that operator is performing in respect of the PSR's objectives. However, there is no requirement for a PSO to respond to this or any consequences for remaining unaligned. Given that PSOs are not currently set up to act as delivery organisations of the PSR this assessment, while potentially interesting, appears to have no practical effect.

31. LINK is not clear how the PSR has mapped its proposals to its statutory regulatory principles and believes this would be a useful exercise for the PSR to undertake.

32. LINK also suggests that there could be merit in the PSR following an approach closer to that of the FCA and the Bank.

33. The PSR's proposed supervisory principles are set out in section 5 of the consultation document. In brief they are:

1. *We will assess firms over established review cycles. At the end of each cycle, we will set the supervisory priorities for the next. These cycles may differ from firm to firm, depending on their characteristics. We will provide each supervised firm with our assessment of its performance.*
2. *At the beginning of each supervision period, we propose to provide engagement schedules to the organisations we supervise. This will help set out our expectations and allow firms to plan accordingly. We expect to hold regular, scheduled discussions with firms' representatives.*
3. *We propose to ask supervised PSOs for documentation to allow us to understand their business better.*

34. It is stated that the documentation "is likely to include":

- *The rules, standards and membership models of the payment system.*
- *High-level descriptions of business units or functions within the PSO.*
- *Publicly available accounts.*
- *Lists of current participants.*
- *Standard participation contracts.*
- *Governance documents – business plan, strategy, board minutes, etc.*

35. This is a very high-level description and LINK thinks some more detail would be useful. The proposed documentation is also unrelated to data to evidence compliance with rules. LINK suggest that further thought be given to what might be required to evidence compliance with regulation.

**Question 2: Do the principles for regulatory expectations set out in section 6 below reflect the appropriate priorities for our supervision of PSOs? If not, how should they be changed?**

36. The PSR overlays its supervisory principles with a set of expectation for “those we supervise”:

- *PSOs should allow for wide access and participation.*
- *PSOs should work to address the needs of users and participants.*
- *PSOs should monitor and manage risk to compliance with payment system rules and standards.*
- *PSOs should coordinate cross-market change effectively.*
- *PSOs should build and maintain the trust and confidence of their users and participants.*
- *PSOs should limit opportunities for abuse in payment systems.*
- *PSOs should design to enable innovation.*
- *PSOs should ensure the payment systems they operate are efficient and sustainable.*

37. There are three “expectations” that are particularly problematic for LINK:

- **PSOs should co-ordinate cross-market change effectively.** It is not clear what “cross-market change” means. LINK is concerned that, in the competitive market that it operates in, cross market co-ordination may not be possible in the way that the PSR is suggesting. Greater detail would be helpful in assessing this risk.
- **PSOs should design to enable innovation.** LINK accepts responsibility for innovation in respect to access to cash. It has for example managed a successful financial inclusion programme. But this is about to become the responsibility of the FCA. In relation to the PSR’s remit on infrastructure, Specific Direction 4 largely limits LINK’s ability to innovate as it only allows for a competitive tender at the end of the current contract with Vocalink. As this is unlikely to be possible given declining volumes and rising technology upgrade costs, LINK is effectively required to wind down rather than innovate.
- **PSOs should ensure the payment systems they operate are efficient and sustainable.** LINK cannot “ensure” that it is sustainable given the reduction in the use of cash.

38. Some aspects of paras 5.5 and 5.6 of the consultation document appear inappropriate:

*5.5. We will assess firms over established review cycles. At the end of each cycle, we will set the supervisory priorities for the next. These cycles may differ from firm to firm, depending on their characteristics. We will provide each supervised firm with our assessment of its performance.*

*5.6. We intend to use two criteria to inform our assessment of the PSOs we supervise:*

- *our understanding of the PSO’s influence on risks and opportunities for our strategic aims*

- *the PSO's performance on our principles for regulatory expectations*

39. It is entirely reasonable for the PSR to assess a "*PSO's influence on risks*". This is consistent with the approach of other regulators. For example, the Bank's assessment of a PSO's risks to the stability of the UK financial system.
40. An assessment based on "*the PSO's performance on our principles for regulatory expectations*" appears inappropriate. This suggests that the PSR is intending to judge PSOs' performance, something it is not qualified to do, bearing in mind that much of the activity of PSOs, and certainly of LINK, does not come within the PSR's remit.
41. It will also be noted that the PSR intends to judge PSOs on their performance against its strategic aims. PSOs like LINK are not set up to achieve the objectives of the PSR. LINK has its own objectives which are about the provision of access to cash across the UK, operating in a competitive market with other PSOs with their own objectives. By attempting to align PSOs with its own objectives, the PSR risks treating PSOs as its delivery arm. This might work with a nationalised payments industry, but it is incompatible with a competitive PSO market.
42. The consultation uses the terms "strategic aims", "strategic outcomes" and "strategic objectives" interchangeably. Only "strategic outcomes" is defined. It may be helpful to use just one defined term, assuming that they all are intended to mean the same thing.
43. Section five sets out how the PSR will supervise and is very high level, for example when compared to the supervisory principles set out by the FCA and the Bank. LINK suggests that there could be merit in the PSR following an approach closer to that of the FCA and the Bank.
44. The PSR's proposed approach to supervision appears to blend the concepts of regulation and supervision. The PSR's proposed "principles for regulatory expectations" of the institutions it supervises are not related to supervision but rather are policies that it would like Payment Systems Operators (PSO) to follow. LINK is not clear how these are relevant to supervision.

## **Appendix: The PSR's Regulatory Principles and the Supervisory Principles Used by the FCA and the Bank**

### **Legislation governing the PSR.**

Section 49 of FSBRA states that –

- In discharging its general functions relating to payment systems the Payment Systems Regulator must have regard to—
  - (a) the importance of maintaining the stability of, and confidence in, the UK financial system,
  - (b) the importance of payment systems in relation to the performance of functions by the Bank of England in its capacity as a monetary authority, and
  - (c) the regulatory principles in section 53.

Section 53 sets out the regulatory principles –

- (a) the need to use the resources of the Payment Systems Regulator in the most efficient and economic way;
- (b) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
- (c) the desirability of sustainable growth in the economy of the United Kingdom in the medium or long term, including in a way consistent with contributing towards achieving compliance by the Secretary of State with section 1 of the Climate Change Act 2008 (UK net zero emissions target) and section 5 of the Environment Act 2021 (environmental targets) where the Payment Systems Regulator considers the exercise of its functions to be relevant to the making of such a contribution;
- (d) the general principle that those who use services provided by payment systems should take responsibility for their decisions;
- (e) the responsibilities of the senior management of persons subject to requirements imposed by or under this Part, including those affecting persons who use services provided by payment systems, in relation to compliance with those requirements;
- (f) the desirability where appropriate of the Payment Systems Regulator exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons subject to requirements imposed by or under this Part;
- (g) the desirability in appropriate cases of the Payment Systems Regulator publishing information relating to persons on whom requirements are imposed by or under this Part, or requiring such persons to publish information, as a means of contributing to the advancement by the Payment Systems Regulator of its payment systems objectives;
- (h) the principle that the Payment Systems Regulator should exercise its functions as transparently as possible.



### **The FCA's supervisory principles are:**

- Our supervisory principles form the basis of our supervisory approach. These principles complement the Principles for Business which outline our expectations of firms.
- Our approach to advancing our objectives is judgement-led, informed by 5 key principles of being:
  - forward looking
  - outcomes-focused
  - proportionate and evidence-led
  - transparent, and
  - integrated and co-ordinated
- Our approach aims to put right systemic harm that has occurred and stop it happening again.

#### **Forward looking:**

- We aim to pre-empt poor conduct so that the risk and any associated harm does not materialise.
- We assess firms' business models and strategies both against current and future risks, to identify emerging risks and try to reduce or prevent them.
- Our strong understanding of firms' business models means we can identify poor alignment between firms' conduct and the interests of consumers and markets functioning well.

#### **Outcomes-focused:**

- Where we see systematic harm, we will move quickly to stop the harm occurring using a range of powers. We then work to ensure that the firm addresses the drivers of harmful culture and its business model and strategy to prevent a recurrence.
- Where we judge it necessary, we will refer firms for an enforcement investigation.
- We want to get redress for affected customers, either by requiring a redress scheme, engaging directly with the firm, or by working with other authorities such as the Financial Ombudsman Service.

#### **Proportionate and evidence-led:**

- We focus our work on the key drivers of conduct likely to cause harm, and particularly on firms we judge pose the greatest risk to our objectives.
- We also look at the drivers of culture which underpin a firm's conduct. These include the firm's purpose, the attitude, behaviour, competence and compliance of the firm's leadership.
- We approve and hold to account the most senior individuals whose decisions and personal conduct have a significant effect on the firm's conduct. As part of the Senior Managers and Certification Regime (SM&CR), we also expect firms to take responsibility for certifying the competence and integrity of business-critical staff.
- We systematically use intelligence and information from a broad range of sources to target our actions. These include consumer feedback, data and intelligence from firms and their trade associations, insight from with other regulatory organisations, information from MPs and from whistle blowers, and our firm and consumer contact centre.

#### Transparency:

- We engage directly with consumers and their representatives to understand issues they face and target firms that may be causing harm.
- We engage with industry, firms and other market participants to understand how they are responding to market-wide events, firm-specific events and/or the regulatory framework and to adjust our approach where appropriate.
- We are clear with firms and individuals about good and poor practice that we observe.
- We are as transparent as possible about our work and our priorities for the coming year.

#### Integrated and co-ordinated

- We ensure our teams work closely across all our functions to reach robust decisions, share information and provide consistent messages.
- We share intelligence with other regulatory bodies such as the Bank of England, the Prudential Regulatory Authority, the Payment Systems Regulator, the Financial Ombudsman Service, the Pensions Regulator, the National Crime Agency and the National Economic Crime Centre.
- As a supervisor of global firms and global markets, we work with international regulators to supervise firms, markets and issues which are common across jurisdictions.

### **The Bank of England has separate principles for banks and insurance companies, recognising the differences between banking and insurance.**

#### **Its principles for banking supervision are:**

To advance our objectives, our supervisory approach follows three key principles – it is: (i) judgement-based; (ii) forward-looking; and (iii) focused on key risks.

#### Judgement-based

28. Our approach relies significantly on judgement. Supervisors reach judgements on the risks that a firm is running, the risks that it poses to our objectives, whether the firm is likely to continue to meet the Threshold Conditions, and how to address any problems or shortcomings.

29. Our supervisory judgements are based on evidence and analysis. It is, however, inherent in a forward-looking system that, at times, the supervisor's judgement will be different to that of firms. Furthermore, there will be occasions when events will show that the supervisor's judgement, in hindsight, was wrong. To minimise such outcomes, our strategies and judgements are subject to regular review by those independent from supervising the firm in question, and our major judgements and decisions involve our most senior and experienced staff and directors.

30. We also engage with the boards and senior management of firms in forming our judgements, using this dialogue both to ensure that we take account of all relevant information, and to clearly communicate the rationale for our judgements. Firms should not, however, approach their relationship with us as a negotiation.

## Forward looking

31. Our approach is forward-looking. Through our horizon-scanning work, we assess firms not just against current risks, but also against those that could plausibly arise further ahead. And where we judge it necessary to intervene to mitigate the risks a firm is creating; we seek to do so at an early stage. To support this, firms should be open and straightforward in their dealings with us, taking the initiative to raise issues of possible concern at an early stage. We will respond proportionately. In this way, trust can be fostered on both sides.

## Focused on key risks

32. We focus our supervision on those issues and those firms that, in our judgement, pose the greatest risk to the stability of the UK financial system. Consistent with our objectives, we aim to concentrate on material issues when engaging with firms. As outlined further in Section 3 below, our assessment of the risk that any firm poses will take into account both the gross risk derived by their relative scale, complexity and business model, and any mitigating factors and controls that have been put in place. Our assessment is based on a set of supervisory core assurance activities (the frequency and depth of which are proportionate to the potential impact assessment of any given firm). This can include both firm-specific reviews and horizontal assessment of risks across a sector or peer group.