

## INTRODUCTION

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**4.1** In establishing a new regulator for payments systems the Government is keen to strike the right balance between competition, consumer protection and financial stability. This chapter sets out how the Government intends to achieve this through ensuring the OFT, in dealing with payment systems, has the right **primary objective** and ensuring that in carrying out its functions it is required to have regard to appropriate **regulatory principles**. It then goes on to explain the new **powers and functions** of the OFT along with a description of the **appeal process** the Government intends to put in place. The chapter concludes with an examination of the formal relationships between the OFT and the **Bank of England**, the **FSA** and the **Financial Ombudsman Service**.

## PRIMARY OBJECTIVE

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**4.2** The central role of the new regime is to ensure there is effective competition in the provision of payment services. However, the goal is not competition for its own sake but effective competition which will feed through to real benefits for consumers. This issue has recently been considered in the context of the regulation of energy markets. The Utilities Act recently established the new Gas and Electricity Markets Authority, with a principal objective to protect consumers through the promotion of effective competition:

to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed.

to protect the interests of consumers in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.

**4.3** The focus of the OFT in dealing with payment systems will be in promoting competition for the benefit of all end users of payment services rather than a more direct role for protecting individual consumers which is the responsibility of the FSA and others. This is reflected in the fact that the OFT will focus on competition in the underlying payment networks rather than in the provision of retail payment services.

**4.4** The Government therefore proposes to give the OFT a primary objective in relation to the new regime which is aimed at protecting the interests of consumers wherever appropriate by promoting effective competition in payments systems. The intention would be to define the term consumers widely to include personal retail consumers, and both small and large businesses – in other words, all end users of payment services. The exact wording of the objective will need to be considered in due course in bringing forward legislative proposals. At this stage, as with the other issues raised in this document, the Government would welcome views on what the legislation should seek to achieve rather than suggestions for the actual drafting of the legislation.

*Q1. Should the primary objective of the OFT in relation to the new regime be aimed at protecting the interests of a broad range of consumers wherever appropriate by promoting effective competition in payments systems?*

## REGULATORY PRINCIPLES

**4.5** The Cruickshank report suggested that in developing any new framework, the first task should be to establish the key principles against which specific proposals can be assessed. It proposed that any regulations and their enforcement should follow the principles of:

- competitive neutrality;
- proportionality and cost effectiveness;
- transparency;
- flexibility; and
- accountability.

**4.6** The Government accepts that these principles should be applied to the OFT in its pursuit of its primary objective in relation to payment systems. **Competitive neutrality** is at the heart of the new regime and as set out in the next chapter, it is the Government's intention that new rules should only affect in practice those firms which are capable of contributing to the problem which the rules are designed to address.

**4.7** The Government agrees that the new rules should adopt the principles of **proportionality and cost effectiveness**. It is important, for example, that the OFT strikes the right balance between promoting effective competition and promoting financial stability. It would therefore seem appropriate for the OFT to be required to take account of financial stability issues. In practice, it seems unlikely that there would be serious incompatibility between encouraging competition and ensuring financial stability – after all there would be little point in the OFT opening up access to a payment system to new entrants who were likely to pose a real threat of bringing the system down. It will be in everyone's interest to ensure that the smooth operation of payment systems is not jeopardised.

**4.8** The Government therefore proposes to require the OFT to have regard to the principle that, in carrying out its payment systems functions, it should avoid any material adverse effects on financial stability. Such a principle would sit alongside a requirement on the OFT to take account of the Bank of England's advice on financial stability issues (see below).

*Q2. Should the OFT be subject to a regulatory principle in carrying out its payment systems functions aimed at avoiding any material adverse effects of its actions on financial stability?*

**4.9** The Government believes there may be merits in giving the OFT other regulatory principles aimed at facilitating innovation and promoting efficiency.

*Q3. Should the OFT be subject to regulatory principles in carrying out its payment systems functions aimed at facilitating innovation and promoting efficiency?*

**4.10** There may also be benefits in requiring the OFT to ensure its actions are consistent with the principle of proportionality. For example, under the Financial Services and Markets Act, the FSA must have regard to 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.

*Q4. Should the OFT be subject to a regulatory principle in carrying out its payment systems functions aimed at ensuring its actions are consistent with the principle of proportionality?*

**4.11** The primary objective and regulatory principles would not apply to the OFT in the exercise of its other functions, including its general competition functions. This is consistent with the approach taken with the sectoral regulators' duties and their concurrent powers under the Competition Act 1998.

**4.12** Rules should only be imposed where there is a clear benefit from doing so and should take account of all the costs. The Government therefore proposes to require the OFT to conduct **cost benefit analyses** on all major policy proposals and on all proposals to modify the rules imposed on payment service providers. However, it would not be appropriate to require cost benefit analyses to be conducted in relation to enforcement decisions. Such a requirement would be disproportionate and would not necessarily lead to efficient decision making by the OFT. This is particularly the case since individual decisions will be able to be appealed and since, as described above, the OFT could be required to have regard to the principle of proportionality.

**4.13** The Government also believes that **transparency** should be key to the new regime. It therefore intends to require the OFT to **publish guidance** on its approach to the application of the rules and on how these rules would be enforced. The Government also proposes to require the OFT to give **reasons for its decisions** in exercising its statutory decision making powers.

**4.14** It is intended that **flexibility** will be built into the regime from the start. The OFT will be able to propose modifications to the rules, as set out below, and will be able to modify its guidance in light of developments. Finally, the OFT's **accountability** will be ensured through the transparency requirements and appeal process (also set out below).

## POWERS AND FUNCTIONS

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**4.15** The Government intends that the OFT will have a range of powers and functions to:

- conduct competition investigations into the provision of payment services;
- investigate complaints about competition in payment services;
- collect information in relation to payment services;
- enforce rules, make determinations and impose financial penalties;
- publish information and advice;
- publish an annual report;
- establish advisory bodies; and
- exchange information with other regulators/government bodies.

### Competition investigations

**4.16** The OFT will be able to conduct competition investigations either on its own initiative or following a complaint from a third party. In relation to complaints, it is envisaged that market participants will be encouraged to reach agreement with each other wherever possible so that intervention by the OFT is only necessary where deadlock has been reached.

**4.17** The OFT will be given appropriate powers to enable it to properly investigate complaints. This will include powers to require the production of documents, information and data along the lines of s.26 of the Competition Act 1998. Having similar procedures and processes for both sector-specific and Competition Act powers should minimise duplication and be less burdensome for both the OFT and those who are subject to those powers.

**4.18** The Government also believes it would be appropriate to give the OFT the power, in defined circumstances, to enter premises in the course of an investigation for the purposes of obtaining information. Under the Competition Act, the OFT has powers to enter premises provided certain safeguards are met. The Government would welcome views whether such powers should also be available in investigating the breach of sector-specific rules.

*Q5. Should the OFT's information-gathering powers in relation to the new regime include powers to enter premises?*

## Enforcement of rules

**4.19** In taking enforcement action, it is proposed that the OFT will have an explicit **power to specify measures** which parties must put in place in order to bring a rule breach to an end. So, for example, in a dispute about whether access to a payment system was on fair, reasonable and non-discriminatory terms it would be possible for the OFT to determine the actual terms and conditions, including price, at which access should be provided in that particular case. In many cases, having the power to specify measures and determine terms should provide a sufficient incentive to the parties concerned for them to be able to reach agreement without the need for intervention by the OFT. As such, these determination powers could be viewed as fallback powers. The power of determination would be discretionary so that the OFT could, where more appropriate, require the party concerned to bring forward its own measures for remedying the rule breach.

**4.20** A further measure to encourage compliance with the sector-specific rules is the power to impose financial penalties. Currently, the FSA, Ofgem and the Office of the Rail Regulator all have powers to impose financial penalties in respect of rule or licence breaches. Similarly, the OFT has powers to impose financial penalties under the Competition Act. Such powers to impose penalties are normally counterbalanced by a requirement for the regulator to publish guidance on the appropriate levels of penalties and by an appeals mechanism. The Government would propose to adopt both safeguards in this case. The Government would welcome views on this issue and in particular on the limits placed on the level of financial penalties such as the limit of 10% of annual turnover under the Competition Act.

*Q6. What safeguards or limits should be placed on the OFT's ability to impose financial penalties for breaches of rules?*

## Publication of information and advice

**4.21** The Government proposes to require the OFT to publish the following material:

- guidance on the approach it will take to application and enforcement of rules;
- guidance on the approach it will take to financial penalties; and
- an annual report.

**4.22** Price transparency is often the key to ensuring properly functioning markets. Whilst it is proposed that there will be specific rules dealing with transparency of retail prices for consumers and businesses, the Government believes there may be merits in giving the OFT powers to collect and publish the terms and conditions, including prices, of retail payment services. There may also be merits in enabling the OFT to publish information on wholesale prices and terms and conditions to improve transparency and competition. These issues are dealt with in Chapter Five below.

## Disclosure of information

**4.23** Whilst there will be general restrictions on the disclosure of confidential information by the OFT, the Government proposes that there be exemptions from those restrictions to enable the OFT to share information with a limited number of other bodies for specific purposes. A range of regulatory authorities both here in the UK and abroad have an interest in payment systems:

- the Bank of England;
- the FSA;
- the Financial Ombudsman Service;
- the Competition Commission;
- the European Commission; and
- other authorities who regulate those who provide payment services in the UK.

**4.24** The Government proposes to allow the OFT to share information with these bodies in relation to specified functions or powers for specified purposes. The Government would welcome views on which bodies the OFT should be able to share information with and for what purposes.

*Q7. With which bodies should the OFT be permitted to share information and for what purposes?*

## Advisory bodies

**4.25** The OFT will be given a power to establish advisory bodies in relation to its payment systems functions. In other regulated sectors, the legislation normally makes provision for the establishment of consumer councils which, in many cases, have powers to investigate complaints. The structure is different, however, when it comes to financial services given the existing role of the Financial Ombudsman Service. Furthermore, as referred to above, the OFT will focus on competition in the underlying payment networks rather than on the provision of retail payment services.

**4.26** However, the OFT will have a general role in protecting the interests of consumers through promoting effective competition and more specifically through promoting price transparency. It may also wish to investigate future trends in technology with a view to reviewing its policies where necessary. It may therefore wish to establish advisory bodies for various purposes. The Government proposes to give it a power to do so.

## APPEALS PROCESS

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**4.27** It is important for the OFT's new powers to be balanced by a strong and effective appeals process. The Government would expect to introduce a similar appeals process to that under the Financial Services and Markets Act 2000 and the Competition Act 1998 since currently most providers of payment services are authorised financial institutions and are therefore already familiar with and subject to such appeal procedures. Such an approach would also be consistent with the requirements of the Consolidated Banking Directive. Under such a process, an appeals body would be able to confirm or set aside the OFT's decision or any part of it which was the subject of the appeal, and would be able to:

- remit the matter back to the OFT;
- impose or revoke, or vary the amount of, a penalty;

- vary any conditions or obligations in a determination made by the OFT;
- give such directions or determinations, or take such other steps, as the OFT could itself have given or taken; or
- make any other decision which the OFT could itself have made.

**4.28** Except in the case of an appeal against the imposition, or the amount, of a penalty, it is intended that the making of an appeal would not suspend the effect of the decision to which the appeal relates. The Government envisages that decisions of the appeal body could themselves be appealed on points of law and so far as they relate to the amount of financial penalties.

**4.29** Given the specialist nature of the enforcement decisions the OFT will be taking, some thought needs to be given as the body to which appeals should be made in the first instance. It is unlikely for example, that the High Court (or the Court of Session in Scotland) would have the necessary expertise. In the case of the Financial Services Authority a special Financial Services and Markets Tribunal has been appointed and in relation to the Competition Act there is the Appeals Tribunal within the Competition Commission. As stated above, the Government sees merits in mirroring the Competition Act process to minimise the need for unnecessary duplication. However, the rules relating specifically to payment systems will be supplementary to the general rules of competition law and this would need to be recognised in the appeals process. Subject to this qualification, the Government believes there would be merits in having the Competition Commission Appeals Tribunal as the appeals body from the OFT's individual enforcement decisions and would welcome views on this.

*Q8. Should the first line of appeals from the OFT's enforcement decisions be the Competition Commission Appeals Tribunal? If so, are any special provisions needed to take account of the specific nature of the regime relating to payment systems?*

## ROLE OF THE BANK OF ENGLAND

**4.30** In recognition of the role of the Bank of England in safeguarding financial stability, the Government proposes to require the OFT to consult the Bank where it intends to take a decision which could have an effect on the smooth running of payment systems. It proposes to require that the Bank be consulted on decisions or actions which might have a material adverse impact on financial stability, in particular, on:

- significant policy statements which may affect the sound and efficient running of payment systems;
- guidance the OFT will be required to publish on the approach it will take to applying and enforcing its rules;
- on any proposals to modify the rules; and
- relevant individual enforcement decisions.

**4.31** It is proposed that the OFT will be required to take account of the Bank's advice on these matters. This requirement will be underpinned by the proposal to require the OFT to be subject to a regulatory principle aimed at it avoiding any material adverse effects of its actions on financial stability.

*Q9. In what circumstances should the Bank of England have a right to be consulted in relation to financial stability?*

**4.32** There may be merits in requiring both the Bank of England's advice and the OFT's response to be published. Although it would not be appropriate to publish material if it contained confidential information or could be damaging to financial stability.

*Q10. Should the Bank of England's advice and/or the OFT's response be published where publication would have no material adverse impact on financial stability?*

## **ROLE OF THE FINANCIAL SERVICES AUTHORITY**

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**4.33** The FSA has a wide range of responsibilities in relation to those banks and building societies which are members of UK payment schemes. In relation to the payment schemes themselves and consumer protection issues, then as described above, the Government expects a Memorandum of Understanding will be established between the OFT, the FSA and the Financial Ombudsman Service setting out their respective responsibilities in this area.

**4.34** In terms of financial stability and payment systems, the FSA's role is primarily concerned with the authorisation and prudential supervision of those financial institutions which are direct or indirect participants in payment systems or are dependent on them to carry out their day-to-day activities. As such, it is proposed that the FSA should be consulted by the OFT so far as decisions or actions of the OFT in relation to payment systems might affect these regulatory functions, and for the OFT to be required to take its advice into account.

*Q11. In what circumstances should the FSA have a right to be consulted in relation to its regulatory functions?*

*Q12. Should the FSA's advice and/or the OFT's response be published?*

## **ROLE OF THE FINANCIAL OMBUDSMAN SERVICE**

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**4.35** Not all providers of payment services are involved in the provision of retail banking services, and those which are not therefore fall outside the compulsory jurisdiction of the Financial Ombudsman Service. It would, however, be possible for the Ombudsman to extend its voluntary jurisdiction to include such providers. This would be a matter for the Ombudsman and the FSA but in considering the overall framework for consumer protection the Government would welcome views on the issue.

*Q13. Would there be merits in the Financial Ombudsman Service introducing a voluntary regime for payment service providers?*

## **SUMMARY**

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**4.36** The new framework which the Government is seeking to introduce will build upon the strengths of the current system for sector specific economic regulation and for financial services regulation in the UK. The roles of the key players within this new framework are summarised in Box 4.1 below.

**Box 4.1: The new framework for payment systems**

<b>HM Treasury</b>	<b>Establishes new framework</b>
<b>OFT</b>	<b>Monitors and enforces compliance with the rules May recommend modifications to the rules Has the power to impose financial penalties May apply general competition law to payment services</b>
<b>Competition Commission Appeals Tribunal</b>	<b>Hears appeals against individual enforcement decisions</b>
<b>Competition Commission (Reporting Arm)</b>	<b>Hears appeals against rule modifications</b>
<b>Bank of England</b>	<b>Retains responsibilities for financial stability and the smooth operation of payment systems</b>
<b>FSA</b>	<b>Retains its range of responsibilities in relation to authorised financial institutions including members of UK payment schemes</b>
<b>Financial Ombudsman Service</b>	<b>Handles consumer complaints</b>