



Payments Landscape Review

Response from the Emerging Payments Association

Abstract

This paper sets out the Emerging Payment Association's response to HM Treasury's Review of the Payments Landscape in 2020.

It contains recommendations on how to ensure the UK's payments industry becomes progressive, world-leading and secure, and effective at serving the needs of everyone who pays and gets paid.

With special thanks to members of the EPA Project Regulator Team and the original author of the responses, Robert Courtneidge, EPA Advisor, robert.courtneidge@emergingpayments.org

FOR MORE INFORMATION ABOUT THE EPA, VISIT WWW.EMERGINGPAYMENTS.ORG

Introduction

The Emerging Payments Association welcomes the opportunity to contribute to HM Treasury's Payments Landscape Review published in July 2020 ("HMT Paper"). The community's response contained in this paper reflects views expressed by our members. As the EPA's membership includes a wide range of companies from across the payments value chain, and diverse viewpoints across all job roles, this response cannot and does not claim to represent the views of all members fully.

We are grateful to the EPA's Project Regulator team of volunteers, who have contributed to this response, drafted and coordinated by Robert Courtneidge, one of the EPA's longest standing advisors. We hope it advances our collective efforts to ensure the UK's payments industry becomes progressive, world-leading and secure, and effective at serving the needs of everyone who pays and gets paid.



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Director General of the EPA

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About the Emerging Payments Association

EPA Responses

The section numbering below corresponds to the numbering of the questions in the HMT Paper.

1. To what extent do you consider that the Government's objective that UK payments networks operate for the benefit of end-users has been met?

The UK Government's decision to move power away from the self-regulating Payments Council, an organisation perceived by many to be run by the major banks largely for their own protection, and its decision to bring payment systems under formal regulation with the formation of the Payment Services Regulator (PSR), was a good decision for the industry.

The PSR was given a broad range of statutory powers to tackle issues within the payments industry. Since its inception in April 2015, we believe it has had limited but good success. This is because significant change in an industry such as payments takes time. As highlighted in the HMT paper, one of the key areas of reform was the establishment of Pay.UK and the merging of Bacs, Faster Payments and the Cheque and Credit Clearing Company into a single Payment Systems Operator and the establishment of the Payments Strategy Forum.

In parallel with this, the introduction of the EU-wide Interchange Fee Regulation (IFR) has brought significant benefit to major merchants in the marketplace. Merchant acquiring businesses' fees to the small- and medium-sized merchants have not changed significantly despite IFR implementation. However, the European Commission's recent conclusion is that there is currently no need to revise the IFR at the moment and that the focus in the coming years will be on monitoring compliance and enforcing the regulation.

So far, the benefits of the regulator's interventions in interchange across the EU have not yet been widely experienced by medium-sized and smaller merchants. However, the market will in time drive new payments initiatives, services and schemes, and consumers and merchants should be able to choose appropriate payment solutions for themselves in response to the best value services available. The EPA believes the Government's role is to be an enabler of a competitive environment in which payments innovators thrive while protecting users' interests.

In conclusion, we believe that the Government is meeting its objective but that more can be done over time to create an even fairer playing field for all end-users.

We ask HMT to take this opportunity to make more payment choices available based on creating inclusive, equitable and accessible digital payment options for all in society.

2. What do you think industry, regulators and Government should do in order to further ensure that UK payments networks operate for the benefit of end-users?

To benefit end-users, payments needs to keep things simple, flexible and universally accessible. 'Open Banking,' where payments are made account-to-account rather than via the payment schemes, can deliver these benefits. From the start made with PSD2, we are beginning to see the evolution of a more Open Banking environment, where new Fintechs are able to operate alongside the big banks, enabling consumers to use Open Banking to access their accounts and provide new solutions tailored to their preferences and spending history. It is critically important for the industry, regulators and Government to continue to educate, build trust and protect (from fraud and identity theft) end-users. As the reach of internet-based services grows, access to payment systems should improve and, as a consequence, financial exclusion should fall. The new services of PISPs and AISPs need to be cemented into the standard banking infrastructure to enable new players to have access and their end-users to have the best services.

Meanwhile, we are seeing pressure on issuer margins with payments made using the three- and four-player card schemes as well as the neo-bank solutions accessing faster payments, Bacs, CHAPs, and other banking services. For issuers, neo-banks and their programme managers (start-up or smaller ones in particular), the loss of interchange at a reasonable level and the continued increased costs of regulation and compliance make margins tight. If these businesses fail, competition will reduce, and innovation will suffer. A combination of the above reductions in interchange and increase in compliance costs, together with fees and floats required by the payment system operators (often passed on to a program manager with an additional margin) can end up removing all but the slightest of profits from the end of the payments value chain.

We strongly recommend that the Government looks at new developments overseas, such as in QR code-based solutions in China (such as WeChat Pay and Alipay) and consider how such approaches could be nurtured in the UK. Such solutions are a simple route to market for micro-merchants and, if done correctly, can enable a very cheap form of payments to those that need it most. Currently there is little incentive to those operating today's transaction recognition system, such as contactless and NFC, to adopt a more nimble alternative, as the costs sunk into the current POS system are significant.

The lines between online and offline are blurring too. Products from digital payment players should meet customers at the point at which they buy and sell. This could be an EMI scheme at point-of-sale, for example, providing an extended monthly payment programme. To leverage this ecosystem of products, payment acceptance points should be completely open. In such a 'network-of-networks', a transaction can start on one network and end on a different one. We believe that all end-users should be able to use their preferred payment service at whatever payment terminal and acceptance point they prefer.

HM Treasury, the Bank of England and the PSR should also continue to heed the different risks associated with the operation of different types of payment systems. For example, closed-loop and open-loop systems, card schemes and interbank systems, instant and other payment systems, and systems that support trading in financial instruments may have very different operational models and risk profiles, including different levels of systemic risk in the event of operational incidents or failure. The UK's regulatory rules and supervisory approaches should reflect such differences, particularly in relation to prudential, governance and conduct of business requirements.

Finally, the Government needs to be aware of the benefits and challenges of stablecoins and CBDCs. We ask HM Treasury to set up a consultation about these and all other digital tokens like Bitcoin, reviewing their role in any future regulation of payments.

3. To what extent do you consider the Government's objective for a UK payments industry that promotes and develops new and existing payments networks has been met?

The UK is a global leader in the growth of Fintech businesses and wants to retain that position. The FCA with its Sandbox and open approach to regulation has managed to stay ahead of many other regulators of payments. In addition, the UK's creation of a payments regulator, the PSR, has been unique and has a great deal of potential for good, and the removal of the Payments Council and the creation of Pay.UK as a body not run just for big companies has allowed for greater transparency and independence.

More recently, however, with ongoing pressure due to a number of high visibility corporate failures, the FCA has had to increase its level of supervisory intervention. This has meant that many smaller firms are finding it hard to maintain reasonable margins on their products; their operating costs have increased (to implement Strong Customer Authentication (SCA) and Open Banking, for example); and their revenues have decreased (from reduction in interchange and restrictions on charging, for example). This needs to be addressed in such a way to allow the continued growth of Fintechs.

We ask HM Treasury to ensure that:

1. A proper cost-benefit analysis, which takes into account the effect on smaller Fintechs, is carried out before any new regulatory requirements are introduced; and

2. Necessary changes are made to existing regulations after the Brexit transition period ends on, for example:
 - SCA
 - Accounts subject to Third Party Provider access
 - Equality of charges
 - Disclosure requirements under Cross-Border Payments Regulation

In the wider field of financial services, the move to ISO 20022 standards for messaging will make everything easier on a global basis for all Fintechs to participate with greater interoperability. This enables more businesses to create better solutions, and the EPA endorses this approach.

In relation to the cheque imaging solution, again this opens up additional opportunities to make efficiencies in our paper-based cheque system in order to give greater utility to the end-users. It was an innovative solution to the challenge of adapting a long-established payment instrument for the modern age – thereby meeting a consumer demand. We encourage HM Treasury to consider further enhancements to the use of cheques to ensure the most vulnerable in society who still have the need to use them continue to be catered for.

The opening up by the Bank of England (BoE) in 2017 to allow non-bank participants such as AEMIs (Authorised Electronic Money Institutions) to hold their funds in Real-Time Gross Settlement (RTGS) accounts and hence enable access to the payment scheme including the UK's Faster Payments money transfers has been a great enabler of the Fintech industry. For the first time, non-banks do not have to rely on banks with a settlement account at the Bank of England to allow them to offer such services to their end-users. This has the effect of driving down costs and increasing operational capabilities for this sector, with the ability to create unique user experiences. It is interesting to note that Europe has now followed suit, offering similar access.

We ask HM Treasury to conduct a review of the onboarding requirements and costs/collateral required to see if the bar has been set too high to allow non-bank participants access. There are still only a small number of non-banks that have access to such accounts.

Finally, but probably with the most potential opportunities, we have the Open Banking initiatives brought in as a result of PSD2. Whilst the HMT paper rightly highlights the Competition and Market Authority's involvement, this is an EU-based initiative. The APIs brought in through the European Banking Authority's Regulatory Technical Standards in 2017 enable Third Party Providers access to payment systems. This has brought in a plethora of Fintechs and existing operators to offer innovative new solutions to end-users. The solutions range from account aggregation offerings from credit bureaux (enabling instant applications for the best credit based on your bank accounts and credit to payment initiation services enabling simple checkout services from merchants. At the end of September 2020 there were nearly 260 registered AISPs and PISPs registered in the UK at the FCA. It is clear we are just at the beginning of the journey and expect that many new business solutions will be appearing in this sector in future.

4. What do you think industry, regulators and Government should do in order to further promote and develop new and existing payments networks?

Let's take each of these separately.

1. The industry needs to keep bringing on new participants though organisations like the EPA, fostering competition and collaboration across the sector. The EPA and other similar trade associations act as catalysts, enabling those in new companies to learn from the experience and knowledge of more established companies. The EPA brings together companies to form new collaborations and, by highlighting successes, encourages start-ups and attracts investors. In addition, conferences (such as PAY360) and awards events (such as the Emerging Payments Awards) play an important role in enabling learning and collaboration and showcasing best practice in payments. Such event activity, initially constrained during the COVID-19 pandemic, persists using online tools that enable the industry to be even more inclusive and far-reaching. We encourage UK institutions such as HM Treasury to continue to

support such activities by involving trade associations in the evolution of their policies and to participate in their events.

2. We encourage regulators to build the trust of end-users by ensuring the industry is run properly and with probity and integrity. Education, trust, identity and protection are key drivers for the regulators here along with accessibility, inclusiveness and being equitable. Regulators need to show end-users that payment service providers are safe and secure and that, in the event of something happening, there are safety nets to protect the innocent and vulnerable in society from criminals and fraudsters. Protection needs to be proportionate but strong to enable the industry to grow but remain in control. This requires sensitivity by the regulator to the commercial implications of over-vigorous application of the regulations whilst ensuring that standards are not dropped for the protection of end-users. This is a difficult balance to strike but one that UK regulators have achieved to date.
3. The Government should now be forward-looking, working with the likes of UK Finance and its Project Futures initiative to plan for the next changes in the payments landscape. Innovate Finance's Fintech Review initiated by the Chancellor in the March 2020 budget are welcome contributions. We believe that the advent of "Internet of Things" bringing in autonomous payments, the growth of central bank-issued digital currencies to make digital money available to all, and the decline in physical cash due to increased use of cards and electronic wallets, are the key areas that need to be addressed by Government to ensure the UK retains its position at the forefront of the global Fintech industry.

Now that the UK has left the EU, it is more important than ever that we can stand ahead of the world in payments and Fintech, and we seek leadership and funding from the Government to help us achieve this.

5. To what extent do you consider the Government's objective to facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms has been met?

In order to deliver reasonable commercial terms, there needs to be a means of control to prevent banks from exploiting Fintech businesses due to their relative sizes and the limited market for the services. This has in part been facilitated through the Code of Practice (Code) originally created by the Payments Council. The responsibility for the Code is now with Pay.UK in collaboration with the PSR. It has been subscribed to by the 5 clearing banks who offer indirect access to the following Regulated Payment Systems, namely:

- Bacs;
- Faster Payment Service (FPS);
- CHAPS;
- Cheque and Credit Clearing;
- Image Clearing System (ICS); and
- LINK (settlement services only).

This is the way in which the PSR can ensure reasonable commercial terms are provided to Payment Service Providers (PSPs) wishing to offer these services. The Code requires all agreements to include the following components:

1. A definition of the bank's services and any optional additional services they agree with the PSP;
2. The terms on which the bank's services will be provided;
3. The fees for the bank's services, and details of when and how these fees will be applied and reviewed;
4. The duration of the agreement, what will happen at the end of the agreement and any procedures the PSP must follow to request a renewal of the agreement;
5. Any service performance levels the bank has agreed with the PSP that are associated with their services;
6. How any changes to the bank's services will be managed;
7. The normal notice period under which either party may terminate the agreement;
8. The circumstances that would result in a breach of the agreement and the effects for both parties;
9. The circumstances which may result in immediate termination of the bank's services; and

10. Contact details for both the bank and the PSP.

In addition, the bank must have a formal complaint process for the PSP in the event they believe the bank is not compliant with the Code. If this fails, the PSP can escalate it to the PSR who will consider any complaints received in relation to compliance with access provision and act on them as appropriate.

As such, it appears that the Government's objectives are being met in respect of access to these payment systems. However, neither the Card schemes nor SWIFT are part of the code. There is the prohibition on restrictive rules in access to payment systems under Regulation 103 of Payment Services Regulations 2017 but this is high level with no code to back it up. These indirect barriers to access like payment system/card scheme rules may apply equally to all participants but, in reality, have the effect of discriminating against Fintech/innovative payment solutions. Complaints may be made by non-bank PSPs with the PSR with respect to restrictive rules on access to payment systems under Regulation 103 of Payment Services Regulations 2017, but due to confidentiality, the results of any such complaints are not published.

We ask HM Treasury to look at 'access to payment systems' and the use of Regulation 103 to date and see if it is working or whether more detailed regulation or a code are required to enable free and fair competition between all players.

6. Are there further barriers preventing open access to participants or potential participants on reasonable commercial terms?

There will always be commercial barriers to entry. Even if regulation and regulators require open access it will take a long time for this to be a reality. The reason for this is that there can always be conditions for participation and partnership, and they will always favour the incumbents. Until the balance of power in commercial negotiations is made equal then the start-ups and new players will always have difficulty getting reasonable commercial terms.

7. What do you think industry, regulators and Government should do in order to remove these barriers?

The only body that can step in here is the PSR. We can see from public disclosures that it is spending approximately £17 million a year currently. But is this sufficient/being properly utilised? Is the PSR able to carry out the industry research with all the existing players to understand where the inequalities lie? Is it able to use this to work out the best way to balance the system without damaging it or pushing it the other way? It is a delicate balance that is needed to give the Fintechs enough power to get reasonable commercial terms and the access they need to payment systems.

We ask HM Treasury to look at effectiveness of the PSR and its role in order to determine how well it is removing barriers to entry and to support it in removing these barriers.

8. To what extent do you consider the Government's objective for UK payment systems that are stable, reliable and efficient has been met?

There have been many changes for the better in the area of regulation and supervision of UK payment systems. By way of history:

- Payments UK was launched on 29 June 2015 as the successor to the Payments Council
- The regulatory powers of the Payments Council were transferred to the PSR
- Payments UK merged with the British Bankers' Association, the Council of Mortgage Lenders, the UK Cards Association and the Asset Based Finance Association, in November 2015 following a review into financial trade bodies. The resulting organisation, UK Finance, began operating in July 2017

This has resulted in greater reliability and stability in the UK's systemically important payment systems which now include CHAPS, Bacs, Cheque & Credit, Faster Payments, LINK and Visa Europe. One of the key deals to ensure continuity of service was the contract signed in October 2019 between Vocalink and LINK to continue to provide technology services until 2031. Vocalink had been the infrastructure partner to LINK since 1986, providing the technology behind the 60,000 ATMs connected to the LINK network. Almost all the UK's key debit and ATM card issuers and all the main cash machine operators (including banks, building societies and independent ATM deployers) are members of the LINK network.

Separately the Bank of England's has continued to develop its RTGS system which now allows non-bank PSPs (AEMIs and APIs) access to Faster Payments. There are three routes:

- Indirect participation
- Directly connected non-settling participation
- Direct participation

By doing this, the BoE is enabling greater efficiencies in the payment systems and hence a better service for end-users. In addition, the move from ISO 8583 to the global ISO 20022 messaging format facilitates this modernisation and adds data richness.

The development by the PSR of Confirmation of Payee (CoP) has given additional security to the system and protects consumers and businesses from Authorised Push Payment (APP) scams.

As noted above, there have been a lot of positive changes in the last few years. However, Pay.UK is responsible for developing a New Payments Architecture (NPA), with a vision for the future development of the UK's shared retail payment infrastructure as envisaged by the Payments Strategy Forum. But despite considerable investment of time and resource, the NPA seems far from implementation and confidence in the likelihood of NPA being adopted by many members of the EPA is waning. The NPA has the potential to transform the UK payments landscape, enabling more decoupling, extending payment chains, embedding payments into more use cases and providing greater insight to end-users and small businesses. So we encourage a further push on the establishment of the NPA.

In conclusion, we believe the Government, through its initiatives, and alongside the financial stability brought in through the BoE, has made a good start towards meeting its objectives here.

9. What do you think industry, regulators and Government should do in order to further ensure UK payment systems that are stable, reliable and efficient?

The UK's success in payments is based on an effective, co-ordinated and joined up triangle of institutions (BoE / PSR / HMT). The industry must continue to collaborate and be the best in the development of new and innovative payment solutions for end-users. The regulators must properly supervise the industry to ensure the best standards are met, but also to ensure that competition thrives in a fair and level playing field. The PSR is ideally situated to do this latter whilst the FCA and PRA can ensure the former. Finally, the Government through initiatives like this must listen to the industry, listen to the regulators and work together to provide the best legislative framework to ensure that the UK stays at the forefront of Fintech and payments.

The EPA welcomes the initiatives and reviews taken up by the Government to further promote the industry such as this Payment Landscape Review, the Fintech review led by Ron Kalifa at Innovate Finance and the Open Finance Review by the FCA, and will continue to support them with thorough analysis and insight from its members.

10. What is the impact of not having comprehensive scheme rules to deal with how participants should collectively act to resolve disputes and assign liability when a Faster Payment goes wrong?

This is both the reason for such a fluid and efficient payment system and its biggest flaw. The card schemes, with their chargeback process, have created a good framework to deal with issues in respect of errors and fraud occurring using the card scheme networks. Clearly, Faster Payments could look to that as a starting point for the resolution of disputes and the assignment of liability. Whatever the solution is, it needs to be effective and to reimburse those that are subject to fraud. Finally, initiatives like voluntary Contingent Reimbursement Model Code (CRMC) and the implementation of Confirmation of Payee (CoP) by the main banks could be mandated across the whole industry to ensure greater consistency and end-user protection.

11. Are additional scheme rules needed to ensure opportunities for person-to-business payments over the system can effectively compete with major card schemes? If so, how could scheme rules achieve this?

The EPA welcomes the efforts by the PSR and industry to improve the level of protection provided to end-users through CRMC and CoP. However, only the 6 major UK banks have adopted these rules so far. In practice this will only work when all banks and non-banks regulated entities adopt these rules, so focus should be on making this applicable to all such entities.

As noted in the HMT paper, these are not sufficient to enable person-to-business (P2B) payments in order to compete with card schemes. P2B payments cover the purchase of goods or services and prior to Faster Payments would have been carried out using debit or credit cards, or, occasionally cheques. All of these have dispute mechanisms built-in – you can ‘stop’ a cheque and you can ‘chargeback’ on a card transaction. However, Faster payments, like paying with cash, has limited options and can generally only be solved directly with the merchant providing the goods or services. To build in similar rules for Faster Payments would require a set of rules to be created and imposed on all Faster Payments participants. However, as the merchants are simply payees under Faster Payments, it would be very difficult to impose rules on them. The rules would have to build in rights to pull back payments from the bank of the payee in these situations. This will be cumbersome to implement as well as adding time, friction, cost and a lack of certainty.

(Note: Payment Initiation Services (PIS) under Open Banking also rely on Faster Payments. As noted in question 13, customer protection and refund rules and processes are required to make PIS work for end-users. Having a comprehensive scheme like rules built into Faster Payment would also implicitly improve PIS.)

We ask HM Treasury to look at the options available to create a solution perhaps based on ‘post’ events or ‘pre’ events checks to ensure end-users have proper protection whilst not adding to greater friction to the system. Until the commercial aspects of refunds and fraud prevention costs have been resolved, widespread adoption of bank-to-bank payments will be constrained.

12. Why are payments with a longer clearing cycle still used and what are the barriers to moving these payments to a platform with faster clearing, e.g. Faster Payments?

As the payments volumes chart in the HMT Paper shows, BACS Direct Debit usage is stable and will grow steadily over the coming year. However, Faster Payments has taken over as a preferred method over Bacs Direct Credit from 2018 onwards and this is projected to decline further in coming years. Payment Initiation Services (PIS) will further increase the usage of Faster Payments.

Variable Recurring Payments (VRP) within the PIS will make the end-user journey similar to card-on-file and will enable more use cases. VRP is already piloted by Open Banking under very restricted scenarios. The CMA has also included this in its Open Banking order, but only for ‘account sweeping’ use cases.

The Request-to-Pay service under Pay.UK will work well for end-users once it has been fully implemented. The benefits of Request-to-Pay include providing payment optionality for customers, complementing instant payments from a liquidity utilisation perspective and accelerating incomings for banks, in comparison to longer settlement times for cards. Combining Request-to-Pay with VRP will provide an alternative to card-on-file and complement Direct Debit service as continuous authority over Faster Payments.

In respect of those payments with longer clearing cycles like batch push/pull payments, they will still have a role to play with their post-submission/pre-election checks for fraud, duplicates, errors etc. giving security whilst still offering simultaneous debit/credit on the day of value.

At the end of the day, payments will naturally fall into the desired settlement/certainty and don't have to be real time. We ask HM Treasury to look at the clearing cycles for all forms of payment in the UK to ensure the best and most efficient methods are retained rather than always believing that, 'Faster is better'.

13. What is required to enable Payments Initiation Services to take off in the UK in a way which is safe and secure for the consumer?

The European Banking Authority's RTS under PSD2 compliance makes online card payments (when card details are not already stored by the merchant) an experience on a similar level to PIS. However, it still doesn't have the same high standard service availability and lacks many functionalities compared to card schemes and other payments services. Indeed, it is worse, because using PIS means end-users lose many of the protections they have from using a scheme-branded payment solution and even more if they were to use a credit card with its added statutory protections. Of course, many consumers do not know this and can therefore become victims of fraud or unscrupulous sales with no access to recourse from their payment provider. Whilst this is true, banks and card issuers would rather not take on the cost of their customers' mistakes – the UK Government has given consumers these rights since 1974 when the first Consumer Credit Act became law. PIS needs to have a similar level of customer protection and refund mechanism built in. That's the bare minimum required to kick-start consumer adoption.

PIS will only become prolific and widely adopted by end-users if wider user cases are promoted and if PIS match the functionalities of the card schemes and other payment services. For example, Variable Recurring Payments (VRP) would make the customer journey similar to card-on-file and would enable a lot more use cases. VRP is already piloted by Open Banking under very restricted scenarios. CMA have also included this in their Open Banking order but only for account sweeping use cases.

Another example is decoupled payment journeys within PIS which, combined with IoT solutions, would be transformational for end-users and will enable cutting-edge use cases where payments need to be initiated automatically. Finally, IoT solutions will need to be provided by third parties (it is unlikely to be their bank) and hence it is a perfect match.

Account Information Services (AIS) under Open Banking already enables customers to compare financial products as well as utility providers for cable, electric, gas phone etc. However, a combined AIS and PIS journey would enable auto-switching services to save more money for end-users and increase the competition among service providers. A combined AIS and PIS would also enable an end-user journey where both verification of the customer and payment is required.

In summary, the items to make PIS fly in the UK are:

1. Customer protection
2. Refund mechanism
3. VRP
4. Decoupled payment journeys
5. Combined AIS and PIS Journey
6. Simplified and engaging end-user experience giving real value to them

The final potential barrier to the growth of PIS in the UK is the lack of comprehensive regulatory guidance on the scope of the regulated payment service under the UK Payment Services Regulations 2017 (PSRs). While the FCA's guidance at Perimeter Guidance (PERG) 15.3 is a helpful starting point, some firms – particularly in the B2B payments sector – have struggled to determine whether services involving intermediation between a payment service user and another payment service provider would be treated as a PIS within the scope of the PSR. Similar points apply in relation to AIS. We also note that there are significant divergences across the market in respect of when firms consider that they are operating a “payment account”, and under what circumstances, and to what extent, such account is “accessible online” for the purposes of Regulations 68, 69 and 70 of the PSRs.

We ask HM Treasury to consider providing clarification on the scope of PIS and AIS to ensure they provide the solutions anticipated by PSD2.

14. How does the advent of Payment Initiation Services through Open Banking interact with your answer as to whether additional rules are needed as part of Faster Payments?

Open banking simply enables non-banks to participate in PIS backed by Faster Payments and does not add any additional rules. It does mean that the EBA's RTS under PSD2 will apply, which should ensure the proper level of internet security is in place to ensure end-user confidence but that would not give rise to the same rules that the card schemes have for chargebacks, for example. As noted in questions 11 and 13, customer protection and refund rules and processes are required to make PIS work for end-users. Having a comprehensive card scheme type rules built into Faster Payment would also implicitly improve PIS.

On 24 September 2020 the European Commission released: *Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and The Committee of the Regions - on a Retail Payments Strategy for the EU*, which stated:

“The Commission recalls that, when providing instant payment services, payment service providers must ensure that they have in place appropriate and real-time fraud and money laundering/terrorist financing prevention tools, in full conformity with existing legislation.

“In order to be more attractive to consumers, instant payment services should offer features that put them on an equal footing with other payment instruments (e.g. cards) that offer chargebacks, i.e. the return of credit card funds used to make a purchase to the buyer in certain cases (e.g. mistakes).

“If instant payments are to become the new norm, the Commission considers that it would be appropriate that the charges of both regular and instant credit transfers should be the same.”

This confirms the EPA's views on this area.

15. Will Open Banking deliver (and go beyond) the developments in account-to-account payments seen internationally? What are the lessons from international experiences that should be adopted in the UK, and what are the costs and benefits of doing so?

Yes, there are many examples of P2P payments around the world that have been successful. Indeed, the forerunner of PIS in PSD2 came from iDEAL in Holland. The use of P2P payments to pay merchants is a highly efficient method of paying for goods and services for both merchant and end-users. That said, it has limitations compared to card payments where the card scheme has member rules which apply and make the system work.

By researching the P2P systems around the world and pulling out all the things that work well and all the areas that cause friction or damage to the integrity of the system, the EPA are sure that the UK will be able to create a solid regulatory framework and develop a best of breed solution that works for all users.

Account-to-account payments using PIS in the UK have not provided the same level of operational service compared to similar services in other countries. For example, PIS APIs provided by the banks under CMA9 have frequent downtimes and upgrades, making them less reliable for the end-user. In addition, there is no option of stand-in systems to cover for downtimes. Payments under the dual PSD2/CMA framework are 'initiation' only. The execution of the payment order, properly authorised, may take place synchronously with its initiation, but there is no guarantee of this. Payment initiations are exposed to the risk of another charge being applied to the account and hence causing the payment to fail. Open Banking will need to get overall service levels improved for PIS to make it reliable enough to achieve the same success seen internationally for similar services.

Currently, there is no incentive for banks to provide an improved PIS under the CMA order as it reduces their income on issuing fees. A better alternative would be to have commercial APIs under a commercial framework whereby banks also get a share of charge from the usage of PIS APIs but, in order to work in the competitive marketplace of payments, it must be cheaper and easier than paying by card.

16. Do you agree with the trends in new service providers and payments chains identified?

The EPA concurs with the trends identified and the emergence over the last 10 years of non-banks into the payments sector. We further agree that they have brought more competition and innovation into the industry driving down the cost and increasing the utility for end-users of payment services.

That said, it has not been an easy journey and many of the new players have come and gone due to:

- An increase in the compliance and regulatory burden
- An increase in competition
- An increase in cost of dealing with cyber security pressure
- Closing of accounts by the incumbent Financial Institutions
- COVID-19/Lockdown changes in end-user behaviour
- The reduction in margins across all areas from interchange and foreign exchange (FX) to product charges and interest rates

All of the above contribute to making this industry more complex and tighter to find profits in. The growth of the Fintech unicorns with big investments and even bigger annual losses makes the smaller and start-up players struggle further to find their place and find a means of generating revenues.

17. What further trends do you expect to see in payments chains in the next 10 years?

To a large extent this is dealt with in the final section of the paper looking at crypto assets and CBDCs. There will continue to be pressure on the market to produce better solutions at less cost and with less friction and

with the advent of quantum computing we can expect the industry to accelerate once again. In addition, the EPA sees further growth in the use of inclusive, accessible, equitable, trustworthy, economic, stable and secure payment solutions integrated into the new marketplace generation across, inter alia, social media and in-gaming apps. This includes swipe 'up' to pay or 'down' to receive and other ingenious ways to build payments into the usual user experience.

18. What opportunities and risks do these trends in new service providers and payments chains pose?

As with anything new in financial services and technology, there will be some failures and there will be those who are targeted by fraudsters and organised crime. Ensuring good governance and compliance alongside 'best in breed' fraud protection is needed. Education of new players is key and an area that the EPA sees itself as being well-suited. In order to 'professionalise payments', the EPA has recently teamed up with an eLearning company to produce a complete set of eLearning modules for its members to use for staff training. It has also teamed up with Visa to run a programme of free training courses on compliance and risk management. This approach to education needs to become the norm, with every new player ensuring its staff understand the industry, its products, regulations and compliance, which is now a part of everyday life. There are no players, however big, who could not benefit from ensuring all their staff understand the industry in which they are working. Without such a widespread commitment to education, the payments industry risks being unable to navigate through the waters of technology innovation and changing regulation without encountering financial crime and corporate failure.

19. What do you think industry, regulators and Government should do in order to realise these opportunities and/or address these risks?

To realise the opportunities the industry needs to work together through organisations like the EPA to create the best environment for growth. The big banks need to follow 'Open Banking' and properly open up to the new Fintechs (in a controlled and secure way) to enable change and adaptation to new market environments. The Regulators need to continue to increase the level of supervision on the whole market but especially the new players and continue to do it in a co-operative way. The regulators should not close down the firms that are not, in the first instance, following the requirements but should work with them to ensure they do follow the requirements through education and nurturing. We believe that the UK Fintech industry is the best in the world and in order to stay there the regulators need to promote opportunities like the 'FCA Sandbox' and create new initiatives for collaboration and ensure best practices are showcased and rewarded.

20. Do you think any changes are needed to payments regulation to ensure it keeps pace with the changing technological landscape?

Regulation always follows technology and innovation and plays catch-up. However, regulation can look ahead and try to future-proof each next step. In the past, working on a European directive platform has meant that, by the time new UK laws are in place, there is at least six years since the original discussions were held that brought them in. After the Brexit transition period, we have an opportunity to work faster and create new laws when they are needed rather than waiting for the EU institutions to pass a directive.

Ideally, we want the Europeans to follow the UK's lead and hence we need to continue to look forward and produce the best regulation (note the EPA through its "Voices of the EPA" series promotes this). Please see further our response to Question 23 in relation to the European Commission's recent package of regulatory proposals.

Fintech has broadly reduced barriers to the cross-border provision of payment services. Subject to regulatory requirements, it is now possible for a firm to provide well-functioning payment services to UK customers

without having any of the physical infrastructure or the customer-facing or support functions for that business located in the UK. The UK's pragmatic approach to regulation, including the territorial application of its rules, has helped maintain its reputation as a business-friendly jurisdiction and spurred its rise as a global leader in Fintech.

However, in an increasingly cross-border sector, in which a single service offering may involve data processing and operations in multiple jurisdictions, we would encourage HM Treasury and the FCA to continue to issue formal guidance on the territorial application of UK regulation. For example, the FCA's guidance on the territorial application of the PSRs at PERG 15.6 is extremely helpful for firms. However, guidance on the territorial application of the Electronic Money Regulations 2011 at PERG 3A.6 is far less extensive, and there is very limited regulatory guidance on the territorial scope of these regulations or the Financial Services and Markets Act 2000 in the context of crypto assets.

We ask HM Treasury to consider the cross-border aspect for the provision of payment services to create greater clarity and understanding in this complex area.

21. What further trends do you expect to see in cross-border payments in the next 10 years?

The HMT paper highlights the report presented to the G20 in April 2020 to enhance cross-border payments by the Financial Stability Board (FSB). Within this report, the EPA fully endorses and concurs with the 19 'building blocks' identified. However, moving from a paper to a globally accepted solution is a big task and we need to look at the different solutions being proposed and created today.

The most compelling is the development of SWIFT's GPI service which deals with the opacity of cross-border payments enabling the sending Financial Institution (FI) to follow the transfer between FIs to the final destination. By doing this it puts pressure on each FI in the path to move it quickly so it cannot be seen to be delaying the payment.

The other revolutionary solution under development is RTGS Global, which in collaboration with Microsoft has created a solution that brings real time domestic gross settlement to a global level. RTGS Global locks in the available liquidity between the two transacting banks based on their real time availability of liquidity.

Towards the end of the FSB 'building blocks' both 'stablecoins' and CBDCs are referenced. In the EPA's view, outside the two above initiatives, these are the two most likely initiatives to transform cross-border payments. Already Bitcoin and other crypto tokens trade peer to peer on a borderless blockchain and with the advent of these two, less volatile and more regulated, tokens it is clear that cross-border 'bankless' transactions can flow.

22. What do you think industry, regulators and Government should do in order to improve the functioning, speed and cost of cross-border payments for consumers taking into account the G20 work?

The industry must continue to innovate and work together across borders to create global workable solutions.

Regulators must talk to their counterparts in other territories to ensure a consistent interpretation of key areas like AML/TF enabling international cross-border payments to flourish. They also need to work with the industry and its initiatives to give them the ability to work in a safe and secure regulatory environment.

The Government must continue to listen to the industry and empower the regulators to embrace Fintechs that can break down legacy systems and bring on new, better, transparent, real-time, compliant and safe solutions for end-users to freely transfer funds cross-border as if they are a home state transaction.

23. Are there other opportunities/risks not captured by elsewhere that you wish to highlight? What do you believe the role is for Government, regulators, and industry in responding to them?

Firstly, we would like to present our recent EPA white paper: 'The future of payments regulation: voices of the EPA',¹ published in March 2020. The EPA paper sets out areas in which EPA members believe legislation should address in future iterations of payment services regulation. It specifically looks at the need for e-money as currently defined when a payment account is the same; the need for reforms in the way safeguarding is done and how it can be improved; SCA and 'Open Banking' initiatives; and the importance of customer education in payments. We also present our recent paper, 'Unleashing the Potential of Open Banking'², which contains the association's recommendations for what is required to get Open Banking widely adopted.

Secondly, we would like to highlight the key areas from the recently published European Commission Retail Payments Strategy and Digital Finance Strategy. The retail payments strategy focuses on the following four key pillars, which are closely interlinked:

- Increasingly digital and instant payment solutions with pan-EU reach;
- Innovative and competitive retail payments markets;
- Efficient and interoperable retail payment systems and other support infrastructures; and
- Efficient international payments, including remittances.

The EPA endorses and concurs with the Commission's strategy to undertake a PSD2 Review to take into account:

- Any new risks stemming from unregulated services, especially technical services ancillary to the provision of regulated payment or e-money services, and to assess whether and how these risks can best be mitigated, including by subjecting the providers of ancillary services or outsourced entities to direct supervision. This could be done by bringing certain activities under the scope of PSD2 where justified;
- Align the PSD2 and Electronic Money Directive (EMD2) frameworks by including the issuance of e-money as a payment service in PSD2;
- In the proposal for a Regulation on markets in crypto assets, subject issuers of electronic money tokens to additional provisions complementing EMD2.

The Commission plans to present a legislative proposal for a new 'Open Finance' framework by mid- 2022. Where feasible, the Commission expects the relevant payment system operators, in particular where the recipient jurisdiction has also adopted instant payment systems, to facilitate linkages between European systems such as Target Instant Payment System (TIPS) or RT1 and instant payment systems of third countries - as long as the latter benefit from an appropriate level of consumer protection, fraud and ML/TF prevention and interdependencies risks mitigation measures.

The EPA also supports these activities:

- The Commission calls for the implementation, at the latest by end 2022, of global international standards, such as ISO 20022, which facilitate inclusion of richer data in payment messages
- The Commission encourages payment service providers to use SWIFT's Global Payment Initiative (GPI) which facilitates the tracking of cross-border payments for participating institutions in real time
- The Commission will assess, in the context of the PSD2 review, the appropriateness of requiring that the maximum execution time in 'two-leg' transactions also applies to 'one-leg' transactions. The Commission is following with interest the ongoing work carried out in the framework of the European Payments Council on possible further harmonisation of business rules and messaging standards for one-leg transactions. The Commission will assess whether it is necessary to make these mandatory

¹ https://www.epasites.com/app/uploads/sites/7/2020/04/Future_Payments_Regulation_Report.pdf

² <https://www.emergingpayments.org/whitepaper/unleashing-the-potential-of-open-banking/>

In order to ensure that the UK remains a competitive market for innovative new services in the payments and Fintech sector, it will be important for HM Treasury to monitor these EU regulatory developments and to assess carefully whether and when to adopt similar reforms. We submit that it will generally be in the interests of the users and providers of such services in the UK for the UK to continue to align its regulatory rules, in broad terms, with those adopted by the EU. This will help to ensure a level playing field and to limit prospective barriers to the provision of services from the UK into the EEA.

In determining whether and how to continue to align with such rules, we ask HM Treasury to review the public responses to the EU consultations on these topics, including any market feedback on the proposed form and scope of new requirements. Further, we hope HM Treasury will take into account the particular needs of the UK market and seek to encourage the continued growth of the UK's Fintech sector by implementing robust principle-based regulation that maintains technological neutrality and does not create undue barriers to new market entrants or to international businesses.

Thirdly, de-risking by banks continues to be a major barrier for new and existing payment/financial services market participants who invariably need access to bank accounts in order to run their business. Other than for their own operational purposes, EMIs and PIs also need bank accounts for the purposes of safeguarding customer funds. Safeguarding by way of placing funds in a safeguarding account with a bank remains - in part due to lack of viable alternatives - the most common safeguarding method used to meet their regulatory safeguarding requirements. Access to bank accounts is also crucial for those payment service providers who are looking to gain indirect access to payment systems. Regulation 105 of the Payment Services Regulations 2017 requires banks to grant existing and applicant EMIs and PIs access to account services on an objective, non-discriminatory and proportionate basis. It also requires banks to tell the PSR when they refuse or withdraw access to such bank accounts. According to the PSR's Annual report 2019/20³, the number of notifications on the refusal/withdrawal of access to such accounts has more than doubled in 2019 – 391 of these notifications were made in 2019, up from 197 notifications in 2018. Access to bank accounts also continues to be a hurdle for providers engaged in services falling outside of regulated payment services (for example, some digital asset related services). There is no regulatory regime equivalent to Regulation 105 with respect to accessing bank accounts by such non-payment service providers.

Banks may have valid reasons for restricting access to bank accounts, which has sometimes led to their withdrawal of services from an entire segment of market participants. The often-cited reasons relate to higher actual or perceived money laundering risks associated with providing services to such payment or other service providers. This requires greater resources and attention from banks to manage and reduces the commercial viability of such account offerings.

Yet non-bank payment service providers and other Fintechs are reliant on having access to bank account services in order to be able to run their businesses. The ability to gain and maintain access to these accounts on viable commercial terms (as well the general lack of choice between banks who are willing to provide such services) continue to be major hurdles for new entrants. This in turn hinders innovation and reduces choice for end-users as well competition in the market.

The persistent nature of de-risking means that more needs to be done by the Government and regulators alike to address the problem. This could be done, for example, via regulatory intervention to appropriately incentivise banks to offer accounts to particular market segment participants, such as PIs and EMIs. In addition, greater clarity on, and delineation of, AML-related responsibilities and liabilities between banks and non-bank regulated customers that are equally subject to AML regulatory obligations, could be helpful in abating the underlying reasons for de-risking.

Fourthly, we encourage the Government to work on ensuring end-user journeys are not only safe, but also consistent. We already have in-app SCA in the UK. There will soon be payment SCA, by Sept 2021. The risk is

³[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916822/PSR_Annual_report_and_accounts_2019-20 .pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916822/PSR_Annual_report_and_accounts_2019-20.pdf)

that we end up with too many end-user journeys. For the same user we could have in-app SCA journeys on the one hand, and different payment SCA journeys on the other hand (for example: OTP by SMS + other factors).

The complexity will be multiplied by the fact that several debit cards are owned by one end-user in the UK, with slightly different customer experiences with each. Complexity is an opportunity for fraudsters and a reason for caution by users. To some extent, end-user education will mitigate this, but will only go so far. HM Treasury and the regulators have a role to play in making sure that the industry keeps the (in-app and payment) end-user journeys as consistent as possible, while ensuring end-user safety.

Finally, looking at the roles of the industry – to collaborate but also to promote fair competition to get the best from all players; the regulators – to facilitate and enable change but properly supervise and protect end-users from the bad players; and the Government – to listen and deliver good law and regulation.



About the Emerging Payments Association

The Emerging Payments Association (EPA), established in 2008, sets out to make payments work for everyone. To achieve this, it runs a comprehensive programme of activities for members with guidance from an independent Advisory Board of 15 payments CEOs.

These activities include a programme of digital and (when possible) face-to-face events including an online annual conference and broadcast awards dinner, numerous briefings and webinars, CEO Round Tables, and networking and training activities. The EPA also runs six stakeholder working groups. More than 100 volunteers collaborate on the important challenges facing our industry today, such as financial inclusion, recovering from Covid-19, financial crime, regulation, access to banking and promoting the UK globally. The EPA also produces research papers and reports to shed light on the big issues of the day and works closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the Payment Systems Regulator, Pay.UK, UK Finance and Innovate Finance.

The EPA has over 130 members that employ over 300,000 staff and process more than £7tn annually. Its members come from across the payments value chain including payments schemes, banks and issuers, merchant acquirers, PSPs, retailers, TPPs and more. These companies have come together to join our community, collaborate, and speak with a unified voice.

The EPA collaborates with its licensees at EPA EU and EPA Asia to create an interconnected global network of people passionate about making payments work for all.

See www.emergingpayments.org for more information.

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