Financial Data and Technology Association
c/o The University of Edinburgh
13-15 South College Street
Edinburgh
EH8 9AA

20 October, 2020

Payments Landscape Review
Payments and Fintech Team
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Sent via email to: paymentslandscapereview@HMTreasury.gsi.gov.uk
cc'd:

RE: FDATA Europe Resonse to HM Treaury's Payment Landscape Review Call for Evidence

Dear Payments and Fintech Team,

On behalf of the membership of FDATA Europe, please find our response to the questions set forth in the Payments Landscape Review Call for Evidence, 2020.

Should you have any question relating to the response, please do not hesitate to ask.

Warmest Regards,

Ghela Boskovich
Regional Director, Head of FDATA Europe

FDATA Europe Response: Payment Landscape Review Call for Evidence

Question 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?

Response 1:

Although the government has made considerable progress in delivering end-consumer benefits through the cap on card interchange fees, and banning surcharges, it still has a way to go to break through the virtual monopoly the card schemes have in the e-commerce space.

The card schemes cost the end users a significant amount to use: small businesses across the UK, in particular, are subject to commission rates for card acquirers, can wait days for settlement for card transactions, and lose sight of their actual cash positions, while liquidity management remains inefficient for the entire market.

Even before the current health pandemic, the growth of e-commerce was expected to rise. However, more than one-third of consumers shop online weekly since the pandemic started, and globally online spending is seeing upwards of 77% increase year-over-year from 2019, which has accelerated e-commerce growth four to six years faster than experts had anticipated.

However, there is still little competition for card schemes, and the promise of alternative digital payment options has not yet been delivered. There are still too many limitations on Payment Initiation Service Providers (PISPs) to make it an attractive alternative to the card schemes; those limitations constrain merchant and consumer adoption. We expound on these limitations below.

Additional support from the government would help break the card-scheme monopoly, and deliver additional benefits stemming from the full realisation of Open Banking to all segments of consumers across the UK market.

Question 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?

Response 2:

First and foremost, poor bank APIs continue to have a knock-on impact on the ability of open banking firms to provide reliable and quality payment initiation services to end-users and to make PIS a competitive payment option.

- The FCA should take transparent enforcement action against banks who effectively lock end-users out of open banking for extended periods by operating inadequate APIs which suffer from outages and errors. This will help to build trust and confidence in UK open banking and deliver a satisfactory service to end-users.

- As required under SCA-RTS Article 32(2), the FCA should monitor the major retail banks to find out whether the level of support provided for their dedicated interfaces (APIs) continues to be equivalent to the support provided for their own online channels (as required under SCA-RTS Article 32(1)).

- The FCA should create a permanent dedicated open banking supervision team whose role will be to spot the worst performing banks, and work with individual bank supervisors to take necessary action.

Secondly, Open Banking digital payment option delivery should be expedited in the OBIE roadmap. There are a number of payment use cases that are still under review, and those functionalities are further down the roadmap. Accelerating these use cases will mean that a number of very common payment scenarios will finally be possible, and practical, under Open Banking.

These use cases require certain functionalities, and we expand upon each in subsequent responses, however, they include:

- Refund/Reverse payments functionality
- Expanded industry offering of Confirmation of Payee
- Payment Guarantees/two-way notification
- Decoupled authentication (myriad authentication routes)
- Request to Pay
- Variable Recurring Payments

By expediting these use cases and functionalities, government can ensure that end users reap the full benefits of both the UK payment networks and Open Banking.

Question 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?

Response 3:

We believe that a robust and efficient infrastructure has been developed. However, more can be done to encourage more real-time payments as an alternative to debit card use.

In order to create confidence in PIS and direct payment options, similar functionalities and capabilities to those offered by card schemes must be established, including refund and reverse payment capabilities and a robust customer redress system. Unless more functionality is brought to market, via the OBIE roadmap, that allows PIS to deliver more marketable PIS services to bear, the promotion and complete development of a UK payments network falls short of meeting the government's objectives.

Government is in a position to support Open Banking as the 'instructional layer' of the payment network. PSD2 and Open Banking essentially created an 'instructional layer' in payments, consisting of firms such as PISPs, which could instruct payments on the underlying infrastructure on behalf of end-users, without having direct participation in the payment execution (i.e., without coming into possession of funds). This instructional layer in the network requires additional development, and must be supported by government and regulators to ensure it can work effectively.

We recommend support in the following areas:

Remove barriers to entry:
Under PSD2, PISPs are considered low risk businesses as they do not come into possession of funds, and are only able to pass on instructions from end-users, rather than being able to fully execute payment transactions. Despite being so low risk and acting within the instructional layer only, PISPs are still being considered for additional rules designed for direct payment systems participants. These additional rules and requirements are significant barriers to entry for PISPs. These additional requirements include:

- Inclusion in the scope of AML regulations
- Consideration for inclusion in the Contingent Reimbursement Model (CRM)
- Consideration for inclusion in Confirmation of Payee (CoP)

Contingent Reimbursement Model:
It is important to detangle the Open Banking journey, which enables PIS, from the CRM liability framework. While we support the CRM as a voluntary bank staked initiative, we do not support any requirement for PISPs to be included in the programme, as PSD2 already provides a proper and comprehensive liability framework for customer redress.

At the moment, to initiate a payment, the PISP obtains an end-user's permission, and then redirects the end-user to their bank. The confirmation and execution of the payment happens inside the bank's digital real-estate. Because PSD2 calls for this to be done inside the bank, the bank is clearly liable. This liability framework is already provided for under current regulation.

PSD2 and Open Banking created an instruction layer for payments: they initiate and instruct the bank on behalf of the end user. Banks are solely accountable for executing the payment. It is because of this instruction layer, that PISP should remain outside of participation in the CRM. The costs of applying new requirements designed for direct users of the payment systems to PISPs should be measured against the barriers that these requirements create.

Confirmation of Payee:
Requiring PISPs to apply CoP only makes sense where PISPs are enabling peer-to-peer

payments, for example where an end user can pay an independent contractor/trades person

or friend by inputting their sort code and account number into the app. However, the system would need to be developed and implemented to ensure that where a PISP undertakes CoP, this is not then duplicated by the end-user's bank. Duplication of CoP by the bank not only inconveniences the end user, it can create confusion and result in dropped and abandoned PIS payments.

Nor does CoP make sense when PISPs and online merchants have a partnership. Starting the payment inside the online merchant's real estate, end users who use 'pay-by-bank' options have already indicated the payee. If the PISP were required to conduct CoP in this instance, the end user would be asked to confirm if they are paying the merchant, despite having initiated the payment from within the merchant's real estate.

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

Response 4:

Currently, there are major limitations to PIS regulations, which constrain merchant and consumer adoption. These payment and authentication standards, and the accompanying transaction unit economics, favour high-value, customer present, e-commerce scenarios.

There is a misalignment of incentives across the ecosystem that also prevents the promotion of alternative digital payments, PIS in particular: banks derive income from card payment schemes, whereas Faster Payments is a cost to banks. Conversely, small businesses benefit greatly from faster payments, including the savings from having to pay commission to card schemes, whereas faster payments with instant settlements means real-time insight into their cash positions. This misalignment also extends to merchants: PIS is attractive to merchants because the issuer bank pays for the cost of payment processing; whereas issuer banks prefer card payments because merchants pay the cost of processing.

Striking the right balance that encourages banks to find better ways to recoup return on investment into Faster Payments - including realising efficiencies in better liquidity management due to Faster Payments and lower settlement and reconciliation costs – while also encouraging them to promote their own PIS offerings may help better realign incentives.

Promoting the adoption of new payment networks and payment types also requires that industry, regulators, and government work together to:

- Establish a better framework for customer redress for PIS

- Deliver refund capabilities for PIS
- Establish framework for PIS that mirrors similar card scheme consumer protection functionalities

Financial Data and Technology Association

- Encourage the expansion of agency/indirect offering for settlement accounts for non-bank PSPs.

Question 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?

Response 5:

At the moment, PIS unit costs on Faster Payment rails are the same regardless of whether the transaction value is £10 or £500. However the majority of retail payments as a whole is overwhelmingly towards the lower end of this scale. Conversely, card fees are ad valorem, reflecting a percentage of the total value of the transaction. Merchants and retailers have a skewed, reduced economic incentive to invest in PIS acceptance for lower value transactions. This is already evident in the market with early examples of PIS mostly focused on high-value use cases.

This is a meaningful constraint which will limit merchant adoption of PIS beyond a narrow set of scenarios. The knock-on effect of this is lower customer awareness and adoption. It is important to address the question of fixed unit costs of PIS vs. ad valorem card card fees, with an eye on alternative pricing models for faster payment PIS pricing, reflective of lower costs for lower transaction volumes.

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

Response 6:

Question 7: What do you think industry, regulators and government should do in order to remove these barriers?

Response 7:

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

Response 8:

Question 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?

Response 9:

Question 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?

Response 10:

A lack of a comprehensive customer redress model does impact the market, however, given the FCA's guidance on how PSD2 already provides for the liability framework and customer redress, this impact is minimised. The liability model for credit transfers, including faster payments, as specified by PSD2 is clear and appropriate, and does not need to be supplemented any further than it already has been in the UK.

We are concerned that the additional regulatory initiatives of the **Contingent Reimbursement Model (CRM)** and **Confirmation of Payee (CoP)** - led by the Payment Systems Regulator - have the potential to further frustrate and clutter the customer authentication journey under Open Banking, rendering both Account Information Services and Payment Initiation Services unattractive to customers. This would undermine the objectives of PSD2 and the CMA Order; it would also be detrimental to PIS adoption as an alternative to card schemes, rendering the payments landscape much less competitive.

It is important to detangle the Open Banking journey, which enables PIS, from the CRM liability framework. While we support the CRM as a voluntary bank staked initiative, we do not support any requirement for PISPs to be included in the programme, as PSD2 already provides a proper and comprehensive liability framework for customer redress.

PSD2 and Open Banking created an instruction layer for payments: they initiate and instruct the bank on behalf of the end user. Banks are solely accountable for executing the payment. It is because of this instruction layer, that PISP should remain outside of participation in the CRM.

Development of further scheme rules to re-assign liability and bring faster payments closer to the card scheme model may increase the cost of faster payments for both direct (banks) and indirect (PISPs) participants, as banks would seek to recover the cost of payouts and compliance.

There is a burgeoning market of PISPs and other payment service providers which leverage the speed and low costs of faster payments to great effect; changes that increase the costs of faster payments would likely increase barriers to entry for this type of business, and those additional costs would likely be borned by non-direct participants, including PISPs and end users. This would have detrimental impact on competition and innovation, and of course, the end user.

We are also concerned that there is fractured oversight in how CRM and CoP are unfolding; our members have expressed dismay at not having an opportunity to provide feedback via formal consultation, despite them - and their end-users - being most affected by these developments. We suggest that the FCA and/or the PSR formally consult on how CoP and CRM be treated in Open Banking customer journeys.

Question 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?

Response 11:

Yes.

We would include **Payment Guarantees**, or two-way notification for PIS. Banks should provide accurate, real-time status updates until the point that the payment enters the Faster Payment scheme for processing. At the moment, acceptance of a payment initiation request holds no guarantee of payment. If the bank does not make the payment, there is also no notification to the PIS that the payment initiation has been rejected. According to OBIE's analysis in their API Evaluation Working Group, the lack of meaningful status updates from banks to the PIS is a key limitation in delivering payment initiation services. That analysis shows that most banks are only providing 'pending' status in order to meet the regulatory requirement for an immediate response; but that notification does not indicate that the payment has actually entered the Faster Payment scheme for processing. For Faster Payments to support PIS, either payment guarantees or a broadened notification framework is required.

Question 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?

Response 12:

Question 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?

Response 13:

We reiterate our point that poor bank APIs continue to negatively impact the ability for PIS firms to provide reliable and quality payment initiation services. Barring consistently good performance and availability, no Open Banking payment is likely to be competitive to card scheme. This also extends to Modified Customer Interfaces, the exemption to providing APIs some banks in the UK have opted for; we recommend that the FCA act to migrate all banks to APIs to address the issue of unattended access (which is not possible via an MCI) can be addressed, and screen scraping can be discontinued consistently across the UK Open Banking maket.

That being said, security is already central to PIS offerings.

Under PIS, businesses never collect card information, nor is any security information required for financial transactions collected. It is already inherently safe. When using PIS, the customer is passed to their bank's website or app for the payment; they benefit from the bank's security – including multi-factor authentication. It is in the bank environment into which customers input this information. The business making the sale never sees any of this. The business never risks losing the information it never collects.

However, this security paired with the requirement for authentication – where PIS requires customers to individually approve every single PIS transaction - adds additional friction to the journey, and has an impact on adoption. It is therefore necessary to bring a wider array of **authentication** options to bear, including:

- Decoupled authentication: where the customer can initiate payment on one device, and authenticate on another device
- Deferred authentication: where payment authentication takes place at a later, more convenient time for the customer
- Delegated authentication: where authentication is delegated to the merchant (if a merchant has securely registered its customers via FIDO (Fast Identity Online), the login to the merchant's customer account can be used as authentication for payment transactions, and is PSD2 compliant when leveraged with the 3-D Secure 2.2 protocol).

We also believe that additional functionalities and capabilities will improve the uptake for PIS across the market, making it more comparable to current card schemes.

We include **Payment Guarantees**, as previously mentioned in our answer to Question 11.

One aspect that would improve the PIS offering is **Refunds/Reverse Payments**. If refunds are not possible under all payment initiation journeys, Open Banking PIS is unlikely to become a mainstream payment option, especially for e-commerce. Lack of refund functionality for PIS preserves the card-centric status quo, which also comes with a significant cost burden on small businesses that accept cards, despite the capping of interchange fees. PIS activity and adoption is frustrated by the functional inability to efficiently process Reverse Payments.

OBIE has already thoroughly evaluated Reverse Payments, and recommended its delivery be expedited in its final Trustee Roadmap Proposal to the CMA in February, 2020.[1] At the moment, only banks and e-money providers can offer PIS refunds, because the only method of offering refunds is by holding the customer's funds, which is limited to entities who hold additional regulatory permissions. However, with Reverse Payment functionality, PISPs would be able to offer refunds as well, seamlessly, and without the need for a fund holding account. Moreover, the CMA Order requires that Reverse Payments be included in Open Banking delivery.

Request to Pay (RtP) is another functionality that would improve PIS adoption across the UK market. For small businesses across the UK, especially those who rely on low-volume payments, RtP reduces costly interchange fees, reduces long processing times, reduces the risk of fraud, and simplifies complex reconciliation. RtP can help diminish cost by replacing commission-based intermediary card acquirer fees and ensure that funds are received instantly, while also ridding businesses of long processing periods and the associated risk of non-payment. Pay.UK has also noted that it will eliminate significant billing costs for businesses, and gives consumers more flexibility in paying their bills.[2] This also has an

[1] https://assets.publishing.service.gov.uk/media/5e398d5840f0b609278cd388/Trustee_Roadmap_Proposal_to_CMA__FINAL__-_200203.pdf

[2] https://www.wearepay.uk/wp-content/uploads/2019/09/Pay.UK-RtP_Ipsos-report1.pdf

added benefit to improving UK bank liquidity positions, primarily in comparison to longer settlement times required for card payments.

FDATA and its members also support the emergence of **Variable Recurring Payments** (VRP), and encourage its application beyond Sweeping use cases. VRP ought to be a mandatory implementation under the CMA Order given that it is the only effective way of delivering Sweeping payments. VRPs enable third parties to use customer data to monitor the account and initiate a payment when certain conditions are met (for instance, a threshold for surplus funds in an account is met, so money is automatically moved into a savings account). The OBIE has noted that this type of payment arrangement is fundamental to approximately 38% of the consumer value from Open Banking.

In many ways VRP, an enduring consent allowing for payee-initiated payments within agreed limits, promises to address some of the limitations of PIS account-to-account payments today: specifically where customer present SCA is required, or where redirect authentication is in place for point-of-sale transactions. However, VRP goes beyond sweeping use cases, and those use cases would exist as 'premium' services for which banks would charge. Such additional premium services would inhibit merchant adoption. We support VRP delivery as included in the scope of PSD2. However, we also recognise that the fixed unit costs associated with PIS is up against pricing for card fees which are ad valorem - and concluded that an alternative pricing model for fast payment pricing, with lower costs for low value payments, should be explored.

We also agree with the OBIE's conclusion that the value of VRPs could be undermined if there is not sufficient consumer protection built into their design. It is critical that these protections be in line with those offered by the card schemes, and that there are regulatory limits on their use for debt repayment. However, under the CMA Order, VRPs that meet the Sweeping use case are dependent upon the application of Secure Customer Authentication (SCA) exemptions (in particular the exemption for Trusted Beneficiaries), and therefore SCA in relation to VRP must be re-examined.

Under SCA rules, consumers have the right to 'whitelist' trusted beneficiaries - i.e., businesses they trust - with their bank/PSP, which allows banks to exempt the transaction from SCA requirements. But without a common way to communicate whitelist statuses outside of 3D Secure 2.0, there will be variations from scheme to scheme on how these whitelists are created and maintained. Implementation to support whitelisting is also likely to be sporadic, making it a potentially unreliable path to avoid SCA for merchants, especially early on in the delivery of such an exemption. Until there are uniform standards in place, there is too much uncertainty for merchants to rely solely on trusted beneficiary exemptions, and this uncertainty will do little to improve PIS competitiveness against the card schemes.

Question 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?

Response 14:

Rather than attempt to create equivalent in consumer redress between faster payments and card schemes in order to spu adoption of PIS, Government should focus on ensuring banks enable similar *functionality* between payment types. These functionalities are detailed in our answer to Question 13.

FDATA membership comprises Third Party Providers (TPPs) who deliver account aggregation and payment initiation services to the market. They are AISPs and PISPs, who in good faith have received FCA licenses in order to bring the fruits of Open Banking to the UK market.

Aside from quality performing APIs across the market, one critical component is missing in the UK market for Open Banking to flourish: a UK digital identity scheme. As noted in this consultation, other markets have wider adoption of digital payments than does the UK; underpinning those markets is a national digital identity programme: DigiID (Netherlands), Swish/Swedip/BankID (Sweden), and Aadhaar (India).

At the moment there are upwards of 16 different digital identity initiatives being explored in the UK. Better coordination across these initiatives, and alignment across the industries in which they are being fostered, is paramount. The UK financial services industry has a vested interest in how digital identity takes shape, and payments is one of the first use cases that would be impacted by the results of these digital ID initiatives; payments also would be one of the first adopters of digital identity, especially in person-to-person/person-to-business payments.

FDATA recommends that government use the Open ID Foundation working group on eKYC as a platform to bring the various competing UK financial services digital identity schemes together into a common interoperable technical standard. The Open ID Foundation is an international not-for-profit working on the technical design of APIs to improve security and trust. Their experience and neutrality gives the UK the best chance of aligning identity systems and making them interoperable across market verticals. (This will also make it easier for international firms to enter the UK market, and for UK domiciled firms to internationalise their offerings.)

Our members are anxious for additional Open Banking functionality to be delivered, especially sweeping payments, variable recurring payments, reverse payments, and payment guarantees/two-way notifications. If additional rules are needed to bring these functionalities to the market, and if a UK-wide identity scheme supports the delivery of these functionalities – and future use cases under Open Finance - in general, our members support this.

Question 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?

Response 15:

Yes, Open Banking can deliver benefits beyond account-to-account payments, especially as it lays the foundation for Open Finance to include additional verticals like savings, credit, and investment in its scope. As this consultation points out, there are lessons to be learned from India, the Netherlands, and the Nordics in relation to how to facilitate building that foundation and ensuring a robust infrastructure to support it. The first lesson across the three markets previously mentioned is the need for a standard digital identity.

Although there seems to be little ambition in the UK to support a state mandated biometric identity system like India's Aadhaar, such a system would have significant long-term advantages to improve security and convenience, and go a long way to reducing financial exclusion. In the absence of such ambition, a Federated Financial Services ID for the UK economy seems like the obvious candidate to fill the void.

In the Nordics, such a system exists – BankID/Swish - and is widely adopted, enabling the identity testing requirements that have been created to combat money laundering to be reused in easing customer onboarding with new financial relationships and to sign into existing relationships, and facilitates the use of PIS across the market. These services are based on having an interoperable federated identity system.

Lessons from these other markets lead us to conclude that for the UK to be successful in developing a federated digital identity, rules for digital identity need to be centrally mandated, with standardisation and interoperability as guiding principles.

It seems reasonable for UK Government to pass the development of these Rules, to the Joint Anti Money Laundering Steering Group (JAMLSG), who has led the industry guidance on permitted standards for identifying a customer for many years. It seems that now is good time to codify these guidelines and make their acceptance mandatory; in short, make some draft rules for a new federated identity system, publish them and consult on them.

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

Response 16:

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

Response 17:

Question 18: What opportunities and/or risks do these trends in new service providers and payments chains pose?

Response 18:

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

Response 19:

Question 20: Do you think any changes are needed to payments regulation to ensure it keeps pace with the changing technological landscape? Response 20: We note that additional technical expertise and resources need to be in place at the FCA. To ensure that payments regulation is a success, we believe regulators need to be better equipped and resourced to supervise Open Banking. Currently there is no evidence of a team at the FCA which is specifically assigned to the Supervision of bank APIs. This means action is rarely taken, when evidence is provided to the FCA of poor performance. This is a significant constraint that negatively impacts the success of Open Banking, and ultimately the efficacious delivery of PIS on the Faster Payments rails.
Question 21: What further trends do you expect to see in cross-border payments in the next 10 years? Response 21:
Question 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? Response 22:
Question 23: Are there other opportunities and risks not captured by the questions elsewhere that you wish to highlight? If so, what do you believe the role is for government, regulators, and industry in responding to them? Response 23: