Payment Systems Regulator

A subsidiary of the

Financial Conduct Authority

Payment Systems Regulator Stakeholder event: 10 April 2014

Summary of comments and discussion

Introduction

On 1 April 2014, the Payment Systems Regulator came into existence. On 10 April we held our first stakeholder engagement event where we started to explore the key challenges for the payment systems market.

We are very grateful for the engagement of all our stakeholders, and in particular the high quality of the debate and interaction at the event. Your input will help us develop the PSR priorities. Here we summarise the key themes coming out of the very rich debate in the breakout groups covering **Innovation**, **Competition** and **Access**.

Innovation: four key themes

1. Participants identified **barriers to innovation** as a concern. Five key barriers were discussed, representing different points of view:

    - Some parties felt that **capacity for innovation** is limited by the long list of mandatory requirements that banks and schemes have to comply with.
    - There was a view that effective adoption of innovation requires ubiquity and reachability and therefore agreement and collaboration between participating parties is essential.
    - It was considered that the **regulatory framework** could usefully be updated, with more guidance and a proactive approach helping to promote innovation.
    - The **existence of multiple legacy systems** in financial institutions inhibits change and innovation.
    - **Access to markets** is important, with some believing that incumbents restrict the ability for new entrant innovators to operate in the market.

2. The **drivers of innovation** with a focus on the future role of the new PSR.

    - Some consider that the UK payments **market is already innovative**, particularly in merchant payments and in the interaction between the merchant and the end consumer. There was a view that innovation does not have to come from completely new ideas – very often successful innovations are small incremental changes that **solve real problems** for the end-users.
    - Innovation is not driven by the regulator but by **market forces**. So the PSR should not try to innovate but should provide the structure and framework for innovation (e.g. by promoting common standards across the industry). The PSR should also ensure that industry innovations do not move at the pace of its slowest participants.
    - On the other hand, some would like the PSR to play a more **active role** in acting as an incubator for innovation and in promoting cooperation between the involved parties.

- Others suggest the PSR should help the industry **prioritise** between different innovations based on a rigorous cost / benefit analysis.
- The need to maintain **the balance** between the rate of innovation and the robustness and resilience of the underlying payments infrastructure was also discussed.

3. The need to **learn from other markets, industries and countries**.

- It was noted that regulators historically tend to focus inwards. Given the **global** nature of payments, it is fundamental that the PSR covers both domestic and international payments and that it looks at external markets and other industries.
- The PSR could look at payments **innovation internationally** and capture ideas that could be implemented in the UK.

4. The **need to align with other regulators.**

- It would be sensible for the PSR to look outside of the UK and work closely with regulators in other markets and industries. It was noted that some global payments companies operating in the UK are already regulated by other authorities.
- The next round of innovation in the payments markets could come from a sector that is already regulated by a different authority, for example, data protection.

Competition: six key themes

Competition is a significant subject and at least six themes emerged from the breakouts. The discussions also mentioned governance and ownership of payment systems, and inevitably overlapped with discussions on access. The desirability of **balancing competition and collaboration** ran through most themes.

1. **Competition between schemes.**

- There was a view that there is active competition **within the cards industry** between card schemes and card companies, and increasingly between card schemes and automated clearing house interbank schemes.
- Some thought that similar competition between interbank schemes should be encouraged. Others felt this type of competition is not there because the existing schemes are set up to serve different payment sectors e.g. BACS for direct debits, CHAPS for high value payments, and it would be inefficient to promote such competition.
- There was also a view that competition in real time gross settlement payments would **not be beneficial**. This is because of insufficient volume in high value wholesale UK payments to sustain a competitor to CHAPS. And the central role of CHAPS in the **stability of the financial system** should not be compromised.

2. **Infrastructure competition.**

    - There was a view that competition at the infrastructure level would not be desirable if it compromised the **stability, resilience and security** of the underlying payments infrastructure.
    - There was also a comment that there is a natural incumbency advantage due to the scale and scope of investment and the size of the market.
    - And it was suggested that competition should be used to drive better **use of existing infrastructure**, to use it to run new schemes and to allow existing schemes (e.g. for ATMs) to run on alternate infrastructures.

3. **Access competition** emerged strongly and some of this overlapped with the access breakout discussions.

    - There is choice for indirect participants to access payment systems through **agency banks**, but a view that competition appears limited. Some suggested this could be improved through greater **transparency** of terms, conditions and prices for access, while others thought this information was already accessible. The cost of switching agency arrangements also limits competition.
    - Other issues raised on access include **service levels** from agency banks, the difficulty in using agency banks for **Faster Payments** (due to its real-time nature), and the different needs of **international banks vs. domestic banks** where there was a view that domestic competition measures should not impact international trade.

4. **Competition for end-user services.**

    - Many commented that **consumer choice** should drive competition. And some were of the view that this aspect of the market is already competitive and is not inhibited by the existing payments systems market.
    - An alternative view was that the existing interbank schemes limit consumer choice, and that more innovative competing schemes are needed. It was suggested that free banking may cause the lack of new schemes; few retail schemes generate revenue, and often only through penalising customers, e.g. penalties for insufficient funds to cover direct debits.
    - The lack of a good alternative to direct debits (e.g. electronic bill presentment and payment) was cited as an example of how existing schemes limit competition in services to end-users.

5. **Collaboration** in key aspects of the payments systems market ran through many of the discussions.

    - One view is that collaboration is **essential** to payment networks and payments competition is not a suitable objective. This is particularly because collaboration will ensure the stability, resilience and security of payments while competition in some parts of the system could compromise this.

- Another view is that it is the technical standards and rules that are essential – these require industry collaboration, but once they are in place, they **enable competitive** services and offerings.
- There was also a view that the need for collaboration should not be a reason to prevent **competitive entry** if a market participant wanted to compete for example on the infrastructure level.

6. **Barriers to competition** in the market.

- Many considered that the Bank of England control over settlement accounts for payments and proposed ring-fencing rules (which will impact agency banking) were barriers to competition.
- Other barriers cited included **costs** to merchants of complying with card scheme rules, **costs and feasibility** of displacing existing infrastructure providers, **costs** of providing agency services, and **costs** of adopting new payment schemes (e.g. for merchants to install new software and hardware).
- One example of a barrier was the difficulty for new entrants to serve the under-served/under-banked sector with innovative products and services tailored for them, due to the high **cost of access** to payment systems.

Access: Five key themes

Five themes emerged from the discussion in the access breakouts, with some overlap with other discussions.

1. The first theme was an **appetite for greater access** from some of the smaller/ non-UK centric banks.

- Although other banks do have options for gaining indirect access, the number of providers of access could be higher, and a question was raised whether the market is truly competitive.
- It was noted that **direct access**, which some participants would like, comes with significant costs and complexities.
- Some participants like payments institutions, credit unions, non-bank PSPs, money service providers were interested in better **indirect or agency access** to the payments systems.
- In some cases, the inability to even open a bank account was raised as an issue.

2. **Barriers to access** − this clearly overlapped with some of the competition breakout discussions. There was a range of views on which barriers to access are real or material.

- There is no a **single set** of consistent standards that defines the complete requirements for direct and indirect access across various payments schemes.

- **Contractual terms** (e.g. length of agreement, pricing, minimum volume commitment, service levels) with direct member banks may be restrictive in nature.
- **Faster Payments** cannot always be delivered in near real-time (end-to-end) for indirect participants, because of high technical standards. An argument was made that indirect access for Faster Payments is not currently a real problem.
- The **complex set-up** requirements for some schemes make it difficult for indirect participants to **switch** between suppliers.
- It was felt that the Bank of England reserve account requirement sets the bar very high. Also, the mechanics of the Bank of England settlement process introduces risk for the direct members on behalf of indirect members.
- Certain AML requirements on banks make it very hard for some of the money service providers operating internationally to gain access.
- Merchant **data** held at scheme level is not shared with new entrants, innovators or retailers. A counterargument was that the data should rightfully be controlled and restricted due to its sensitive nature.
- The **fees** to access card schemes are sometimes unjustified and vary between providers.
- One view was that most of the access barriers are not deliberate; they are merely essential standards critical to ensuring the **financial stability** of the UK economy. These can be perceived as barriers, but they are **barriers of necessity.**

3. **Proportionality** – or **'not One Size Fits All'**

- The starting point for the approach to access should be whether the **right outcomes** are currently delivered for end-users. And there were multiple views about what type of access is needed, at what levels and how it should be classified, for example:

Direct technical access vs Direct scheme membership	Cards / international payments vs UK sterling schemes	Challenger banks vs Other payments service providers

- There is an opportunity to **clarify** the definition of 'access'.

4. **Scheme structures** with a particular focus on **governance and ownership**.

- Scheme **consolidation** is not the obvious solution or answer to enhancing access; different schemes should co-exist and compete (as card schemes do) to allow banks and consumers to have broader choices.
- The counter-argument was that schemes **do not actually compete**, but merely provide different services to meet different customer needs (e.g. cheques are not necessarily competing with Faster Payments).
- Governance and ownership of schemes and systems and their effect on customer interests and innovation should be investigated, particularly since the banks are the owners and this could skew the investments they are making.

- A counterargument was that payment systems are rightfully **natural monopolies** that could not be allowed to fail or become bankrupt.

5. Standards and risks

- The PSR is well placed to investigate key questions around standards and risks. And standards defined for UK payment systems need to be continually reviewed as the **fast-moving market** evolves.
- Direct member banks must manage the inherent risk of processing payments on behalf of an indirect participant. With greater access there must be greater clarity on accountability for different types of risk.
- The UK should use the same standards as the rest of the world; but on the other hand, standards are already governed and overseen by the Bank of England and benchmarked against international standards.
- Some key questions raised were:
  - Are current technical standards too high?
  - What are the risks and trade-offs involved in changing standards?
  - Are cash and collateral requirements too high?
  - And, could they be achieved in a different way?
