Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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

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By email: Paymentslandscapereview@HMTreasury.gsi.gov.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to HM Treasury's Payments Landscape Review: Call for Evidence

The Financial Services Consumer Panel is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK.

The payment system is of vital importance to the United Kingdom; every part of society depends on and requires access to it, and without it our economy would grind to a halt.

Payment systems are in constant evolution, but there has never been a time of more intense change in payments – whether that be in the way we *can* pay, the way we *are* paying; *who* is providing our payment services or how they are charging for them. This change brings benefits for consumers and business, but also introduces new risks and exacerbates existing ones. It is therefore particularly timely that HM Treasury is undertaking this review and we welcome the opportunity to respond.

Access to Cash

First and foremost, we would like to raise some pressing issues around access to cash which have been recognised for some time and remain unresolved. Whilst a move away from cash dependency is desirable in many ways, for some people non-cash payments are impractical, undesirable or impossible. Research shows that over 8 million adults would struggle to cope in a cashless society[1] and cash was used for 23% of all payments made in 2019[2].

Needless to say, the current pandemic has impacted on access to and use of cash. But the transition away from cash has been ongoing in the UK for some time and many of the side-effects were both foreseeable and foreseen. Disappointingly, these effects remain unmitigated. Costs and frictions have risen and continue to rise whilst cash acceptance

[1] https://www.accesstocash.org.uk/media/1087/final-report-final-web.pdf
[2] https://www.ukfinance.org.uk/press/press-releases/cards-used-half-payments-first-time-last-year

and distribution has fallen. The most vulnerable are bearing the brunt of this. HM Treasury must remember that to fulfil its core function the UK payment system must allow money to move between *every* part of society. To enable those cash-dependent consumers and businesses to (continue to) participate in the payments system on an equitable and accessible basis, remedies are urgently needed.

The Bank of England's Future of Finance report published in June 2019 set out a clear recommendation that the potential merits of a utility and/or state supported cash distribution system should be explored. **We would strongly encourage the Treasury to prioritise its work on access to cash and to consider whether temporary measures can be put in place to ensure that cash remains accessible, affordable and acceptable.**

Complexity and Risk
Whilst recognising the huge advances that innovation has brought and believing that competition in the payments sector can help improve consumer outcomes, we would caution that innovation and competition can lead to confusion and or poor consumer understandings. While this applies to all products and services, payments – unlike many other parts of finance - touch every one of us. We all need to understand the risks and costs of paying, as well as the protections we are afforded by our payment instruments.

The explosion in payment instruments has increased choice and (at least at the front end) increased competition, but it has also resulted in an array of different risk profiles. Two consumers using the same payment instrument offered by two different payment providers may benefit from entirely different levels of protection. Similarly, two consumers using the same payment provider, but different payment instruments, will again benefit (or not) from different levels of protection. **We therefore strongly encourage HM Treasury to consider the implications that increased choice and innovation have on consumers' understanding, bearing in mind that not all consumers are financially literate.**

Financial literacy and education
Improvements in financial literacy and greater transparency can go some way to improving consumer awareness and understanding. On the one hand, providers should be clear and transparent – around pricing, speed, certainty, risk, security and liability - but financial literacy remains a pressing issue. Handling notes and coins is a visible and tangible means of paying and so introduces an educational component to the act of paying. But we can now pay using cards, phones and watches. While this brings undeniable benefits, it also presents challenges in educating consumers about payments, and can induce overspending.

Similarly, the profusion of different modes of point-of-sale borrowing can do the same by enticing spend at the point of purchase. Whilst many of these are no different in essence to credit card borrowing, their increased prevalence, coupled with the ease with which they enable borrowing and the cost of that borrowing, could lead to unmanageable levels of debt. The Woolard Review on the future regulation of the unsecured credit market should pay particular attention to the blurring of the boundaries between spending and borrowing, and closely examine the underlying business models.[3] **In supporting the transition to modern payments, the authorities must ensure it is accompanied by strong levels of funding and support – most particularly education and advice.**

The regulatory perimeter

In addition, we believe that **both the FSCS and the FCA's regulatory perimeter should be extended to include all consumer payment types.** For providers, the same level of risk should attract the same level of regulation. For consumers, the same protections should apply, irrespective of the instrument. Lowering barriers to entry for providers in the interest of competition should not mean lowering protections for consumers. We believe this work is all the more urgent in the light of the pandemic and should be pursued as a priority. Not only is the move away from cash forcing consumers to use new payment types and providers (some of whose services afford consumers little, if any, protection), but many of these providers may be facing difficulties owing to the current economic circumstances. It is likely to be the most vulnerable consumers that suffer the most.

Before we answer the questions posed in the call for evidence, we would like to take this opportunity to set out our view of what a well-functioning payments landscape looks like for UK consumers. As in all areas of financial services, we believe payments firms should have a duty to act in the best interests of consumers. The market should also be guided by the following principles:

- **Accessibility -** All UK consumers must be able to pay and be paid. The system must be accessible to all.
- **Fairness and affordability -** The cost of making payments should not exclude particular consumers, businesses of transaction types. It should not cost more for the poorest to pay.
- **Reliability -** Individual payment systems must be robust and reliable with appropriate redundancy measures in place to ensure continuity of service in case of need.
- **Sustainability –** The Payment System should be operated on an economically sustainable basis. The failure of individual payment systems should not result in consumer losses.
- **Safety, security and consumer protection –** Individual payment systems must be safe and secure. The Payment System should offer at least a minimum level of protection to consumers, including against fraud and losses as a result of firm failure.
- **Transparency –** Individual payment systems' costs and protections must be clear and easily understandable. Individual payment systems should offer full transparency about how end users' data is used, by whom and to what end.

Our response to the specific questions posed is included at Annex A below.

Yours faithfully,

Wanda Goldwag
Chair, Financial Services Consumer Panel

[3] https://www.fca.org.uk/news/press-releases/christopher-woolard-chair-review-unsecured-credit-market-regulation

Annex A - Response to questions

Q1. 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?
Since its establishment, the Payment Systems Regulator ('PSR') has overseen a change in the way the main UK retail payment systems are owned and governed, and opened up access and enabled greater competition. As observed above, the UK payments market has benefitted enormously from the resulting innovation and competition. We would, however, caution that it is not clear that the resulting increase in choice and complexity is well understood by consumers. We are concerned that this lack of understanding, coupled with the mix in protections afforded by different payment instruments, is leading to consumer harm.

Whilst we understand and support the policy intent behind the cap on interchange fees and the surcharge bans, we are not in a position to understand the true benefits of the two measures without seeing a sound economic analysis of the landscapes before and after these measures were introduced. The ban on surcharges could (and anecdotally has) resulted in higher prices overall, while the cap on interchange fees may well have resulted in greater pricing pressure between card issuers, while reinforcing the already strong positions of the networks themselves. We would encourage HM Treasury to undertake further research on the impact of the measures, looking at all parts of the payment chain.

Q2. 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?
It is vital that the UK payments system is accessible, reliable, secure, fair, and sustainable. This requires individual payment providers, including network, communications and other providers in the payments ecosystem, to operate their businesses in a manner that upholds these objectives. To be sustainable a payment provider has to generate a profit, but it should not do so by causing consumer harm. We would encourage regulators to assess payment providers' business models in the light of both these objectives. They should award licences to operate accordingly, remembering that while payment providers may be private businesses, the payment system is a public good.

Q3. 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?
No comment.

Q4. What do you think industry, regulators and government should do in order to further promote and develop new and existing payments networks?
No comment.

Q5. 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?
No comment.

Q6. Are there further barriers preventing open access to participants or potential participants on reasonable commercial terms?
No comment.

Q7. What do you think industry, regulators and government should do in order to remove these barriers?
No comment.

Q8. To what extent do you consider the government's objective for UK payment systems that are stable, reliable and efficient has been met?

The payments system in the UK is complex – and complexity brings risks. It is modern and cutting edge at the front end but behind that is substantial legacy infrastructure on which all payments ultimately depend. In the last several years the focus has been on front-end innovation and competition and the resulting effects of underinvestment – or insufficient focus – on the legacy and invisible underlying infrastructure has become apparent. There have been several high-profile outages by various providers – all of which were systemic to their own customers, and some of which could have been far more systemically consequential had they persisted. So, whilst the UK industry has invested heavily in systems and the UK regulators have placed significant and laudable focus on stability and reliability, more still needs to be done. As the industry's technological dependence continues to intensify, the interlinkages between systems and networks mount and the complexities need to be understood, weaknesses addressed and, where appropriate, redundancies put in place. Again, the Panel would urge the Treasury to prioritise focus on these issues – over and above work it might be considering on competition.

Q9. What do you think industry, regulators and government should do in order to further ensure UK payment systems that are stable, reliable and efficient?

As mentioned, the industry necessarily needs to invest in its systems to ensure their ongoing stability, reliability and efficiency. The Panel does have some concern that the increase in competition and the explosion in technical possibilities, coupled with the current economic circumstances and low interest rate environment, could be compromising firms' abilities to reinvest. Should this be the case, consumers would suffer significant harm – whether through data losses, system outages, cyber weaknesses or otherwise. Industry, government and regulators' utmost priority should be placed on systems' stability. While the Panel is mindful that it is the largest infrastructures and payment providers that pose the most systemic risk, it would remind government and regulators that *all* payment providers are systemic to their users.

Q10. 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?

The Panel believes that all payment schemes should have comprehensive rules to deal with dispute resolutions and liability. The move to speed up account-to-account payments and to open up the means by which related payment instructions can be initiated, together with increased cyber and fraud risk, makes the development of such rules all the more urgent. Consumer confidence in payments could be seriously compromised by the absence of such rules and we would encourage the industry – and if not, the regulators or government – to ensure these are implemented swiftly.

Q12. 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?

Consumer payment habits are hard to change, absent any particular increase in benefit. As payment initiators, consumers will sometimes – but not always – see benefits in their payments moving fast. Greater accessibility and ease of use (for instance through alias addressing mechanisms) could make the system more attractive to users, however, without rules on disputes and redress supporting Faster Payments, such moves could cause more harm than good. We would again urge all concerned to address these issues.

Q13. 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?

First and foremost, there should be solid, enforceable rules around consumer protection, redress, liability and dispute resolution encompassing everything from fraud to cyber risk. Consumer education will also be key to ensuring appropriate usage of such services.

Q14. 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?
The advent of Payment Initiation Services makes it all the more urgent that the aforementioned rules are put in place. Consumers should not be left to carry the risk that the industry has failed to address itself.

Q15. 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?
Account-to-account real time payments have flourished in some countries, most notably in India. There public and private sectors have come together to drive industry-wide, open solutions and enabled the domestic system to grow at an unprecedented pace. The system enables interoperability at multiple levels, is supported by a wide range of easy-to-use addressing mechanisms and has allowed an ecosystem of wallet and apps to flourish. This has delivered huge improvements in the domestic payments experience. Enabling such ease of access necessitates serious consideration be given to security issues and liability and redress issues to be addressed *ex ante*. But it could significantly increase competition in the payments landscape with positive benefits for consumers – benefits that could ultimately translate into lower costs.

Q16. Do you agree with the trends in new service providers and payments chains identified?
AND
Q17. What further trends do you expect to see in payments chains in the next 10 years?
AND
Q18. What opportunities and/or risks do these trends in new service providers and payments chains pose?
AND
Q19. What do you think industry, regulators and government should do in order to realise these opportunities and/or address these risks?
The Panel agrees with the trends identified by HM Treasury in terms of the new service providers and payment chains. In the short term, we expect that some of those involved in the chains may experience financial distress and we would expect some to exit the market and others to be taken over. Concentration within the sector has been rife for the past several years and we would expect this to intensify given the current economic circumstances. We would therefore stress our earlier points that 1) all payment providers are systemic to their customers, irrespective of size and 2) all payment instruments should be protected under the Financial Services Compensation Scheme.

The regulators should keep a close eye on the effects that concentration may have on the competitive landscape and take remedial measures where necessary to ensure these do not cause harm.

Q20. Do you think any changes are needed to payments regulation to ensure it keeps pace with the changing technological landscape?
The FCA's regulatory perimeter should be extended to capture all providers of payment services and supervision of the overall payments value chain on a risk-based approach. Equivalent risk should meet equivalent regulation (regardless of the form of legal entity that is providing the service), and consumer protections should apply to all categories of payment, regardless of type. In particular, we believe that the Financial Services Compensation Scheme should be extended to cover those categories of payment that are not currently in scope. Should the industry fail to agree on redress, liability and compensation measures in short order, the regulators should step in.

Q21. What further trends do you expect to see in cross-border payments in the next 10 years?
There has been significant progress in cross border payments at retail, SME and high-value payments levels, particularly within Europe and on busier payment corridors. This has translated into greater speed, more transparency around fees, exchange rates and predictability of timing, as well as lower overall costs. At the same time, payments to less frequented corridors and/or to riskier jurisdictions have remained costly and opaque. Very often these are the corridors used by immigrants and lower-paid workers and the costs for these transactions remain high. Given the associated compliance risks involved and the risk-reward ratio we would expect banks (and other payment providers) to continue retreating from some of these markets. Even though banks are rarely the first-order providers of remittance payments, we would expect this retrenchment to result in higher costs as the front-end providers such as Western Union, MoneyGram and others ultimately need to balance their books through the correspondent banking system.

Another likely trend is an explosion in cross-border payments and cyber fraud. While to date there has been significant focus on the high value interbank frauds, such as that perpetuated in Bangladesh in 2016, there is a very real incentive for fraudsters to target victims overseas and or to move the proceeds of fraud overseas immediately after they receive them. The increased speed of both cross-border and domestic payments highlights the need for the industry to address the wider issues – delinquent and mule accounts, failures in KYC, AML and other related measures – as well as the consumer redress, liability and compensation issues raised earlier. Whilst the UK industry alone cannot solve these cross-border issues, it could play a leading role in addressing them – but only if it can come up with domestic solutions first.

Q22. What do you think industry, regulators and government should do in order to improve the functioning, speed and cost of crossborder payments for consumers taking into account the G20 work?
The G20 is rightly addressing the functioning, speed and cost of retail consumer cross-border payments and the UK should seek to play an important role in this given the relatively high frequency of cross-border payments into and out of the UK. Improvements to cross border payments can benefit UK consumers by reduced costs, but also through access to wider markets – an important point in the Brexit context.

In its work on payments, HM Treasury should bear in mind that the UK remains strongly interlinked with the European economic bloc and reliant on the economic flows between the UK and EU (and the rest of Europe) which in turn depend on efficient payment flows. The UK should thus have keen regard to the work on payments being undertaken by the European Commission, ensuring that UK consumers continue to profit from the positive benefits brought about by EU regulation. Also, and where possible, it should consider aligning systems, standards and rules to those being put forward by the EU, thereby affording scale economies that the UK alone cannot provide.

Q23. 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?
As mentioned in our introductory points, we would stress the need for ensuring that the ongoing transition to a modern payments system is accompanied by sufficient advice and education. Funding will be needed to ensure the necessary improvements in financial literacy, cyber security, digital enablement and sufficient advice, most notably on consumer debt.