UK payments regulatory update

2022

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2022 has shaped up to be a transition year for the UK's payments landscape. Major infrastructure programmes are gathering pace, regulators are considering how to enhance competition by driving take-up of account-to-account payments, and the government is preparing the regulatory frameworks for cryptoassets.

We have largely learned to live with the Covid-19 pandemic, with the number of payments made in the UK returning to pre-pandemic levels – 40.4 billion in 2021 compared with 35.6 billion in 2020[1]. However, we are facing into global supply issues and a more challenging economic outlook. The government, regulators and payment services providers must respond to the changing environment and continue to ensure that UK payments work well for everyone.

Infrastructure development

In the UK, two major infrastructure projects are in train, for both retail and wholesale payments. From their beginnings circa five years ago as initiatives that were far away on the horizon, in 2022 they are significantly closer to implementation. Both have needed to evolve and flex to ensure they meet future payments needs and harness the benefits of new technology. Interoperability with other payment systems, continued resilience and the transition to a low carbon economy are key considerations as we face into a more complex global landscape.

The New Payments Architecture

The New Payments Architecture (NPA) is a next-generation payments platform that will replace the UK's retail interbank payment systems. It is intended to fix current challenges and enable innovation via adoption of the ISO 20022 enhanced messaging standard and the provision of overlay services, whilst being robust and resilient. Importantly, the NPA will include provision of an instant payments type, which will require a near real-time response from recipients.

This year, significant progress has been made on the design of the NPA by the operator Pay.UK. The UK's Payment Systems Regulator (PSR) has mandated that Pay.UK must procure the centralised services for the NPA in a competitive manner, with a compliance deadline of July 2026. In 2023, Pay.UK will share the outcome of its procurement exercise and announce the vendor.

1 https://www.ukfinance.org.uk/policy-and-guidance/reports-and-publications/uk-payment-markets-2022

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> Access to cash has ongoing importance to the daily lives of millions of people across the UK, and protecting it is a priority for myself and this Government. Following the Government's commitment to legislate, I am pleased to see firms working together to develop new initiatives to support continued access to cash.

David Postings
Chief Executive, UK Finance,

Pivotal moment as banks, consumer groups, Post Office and LINK join forces to help protect cash services | Insights | UK Finance

Real-Time Gross Settlement service renewal

The Bank of England is renewing the Real-Time Gross Settlement (RTGS) service, which holds accounts and moves money for banks, building societies and other institutions. The renewed RTGS is intended to increase resilience and access, offer wider interoperability, improve user functionality and strengthen end-to-end risk management. Like the NPA, it will also include adoption of the ISO 20022 messaging standard, in April 2023.

This year, the Bank consulted on how RTGS can support the future of payments once it has delivered the new RTGS core settlement engine in spring 2024. The Bank's ambition beyond 2024 is for new ways of connecting, innovative and flexible services and world-class resilience.

Access and choice

The Payment Systems Regulator has said in in its 2022 strategy document that, overall, it thinks that most users, most of the time, have access to payment methods that meet their needs. But it considers that some groups might be under-served, and that changes might lead to some users having fewer options.[2]

Cash

Whilst the use of cash has declined, it remains the second most frequently used payment method in the UK behind debit cards, with many consumers continue to prefer it to other payment methods. Recognising the importance of cash to these consumers the government and regulators have committed to protecting the future of cash and ensuring it continues to be available for those who wish to use it. The Financial Services and Markets Bill 2022 includes the much-anticipated legislation to protect access to cash.

The Financial Conduct Authority (FCA) is appointed as the lead regulator with HM Treasury (HMT) able to designate firms that will be subject to FCA oversight for cash provision. Whilst the end of lockdown restrictions has no doubt had an impact[3], it is possible that some consumers are moving to the comfort provided by cash in a more constrained economic environment, to support personal budgeting.

In collaboration with consumer and business groups, the industry has an ongoing programme of work to ensure communities have fair access to cash. Shared banking hubs are being rolled out alongside free ATMs, enhanced Post Office Services and cashback without purchase[4].

Open Banking

Open Banking is the UK's ecosystem that enables customers to share their financial data with regulated third parties and access new and innovative payments propositions via Application Programming Interfaces (APIs). It also enables compliance with some of the key aspects of the Payment Services Regulations 2017 (PSRs) introduced via the second Payment Services Directive (PSD2). The Open Banking roadmap ends in 2022, with the last major deliverable for the 'CMA9' banking groups (including Lloyds Bank) being payments sweeping functionality for "me to me" payments.

By November 2021, there were more than 2.5 million Open Banking payments being made each month, compared to 320,000 in the whole of 2018[5]. Government and regulatory focus is now on the future of Open Banking. Driving up adoption of open banking further is a way of providing more choice in the market.

2 https://www.psr.org.uk/publications/general/the-psr-strategy/

3 https://www.ukfinance.org.uk/policy-and-guidance/reports-and-publications/uk-payment-markets-2022

4 https://www.ukfinance.org.uk/press/press-releases/pivotal-moment-banks-consumer-groups-post-office-and-link-join-forces-help-protect-cash-services

5 https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/future-strategy-open-banking-payments

> For account-to-account payments to work in retail, we need a commercial and pricing model that ensures all parties receive sufficient compensation for the services they provide, and can continue to invest in new products and further innovation.

Kate Fitzgerald
Interim Head of Policy, PSR,
June 2022

Unlocking account-to-account retail payments I Payment Systems Regulator (psr.org.uk)

Improved flexibility

The PSR is keen that users have access to payments with appropriate flexibility. It has identified direct debits and direct credits as two payment types that could be more flexible to better meet user needs. Pay.UK has developed a Request to Pay service to give users greater control over the payments they make for bills and other services, and consideration is being given to how to drive market take-up[6].

Ensuring current payment systems work well for all

Enhanced customer protections

The PSR has committed to improving competition in retail payments through the increased take-up of account-to-account payments. Related to this, it is expected that Open Banking will be increasingly utilised in retail payments. Consideration is being given by the regulator and industry as to what additional protections are needed for account-to-account payments to drive consumer confidence and ensure consumers are appropriately protected if something goes wrong. Considerations include how the liability model will be designed and operated, additional purchase protections and how disputes will be handled.

Authorised Push Payment scams

Authorised Push Payment (APP) scams happen when a person or business is tricked into sending money to a fraudster posing as a genuine payee. Currently, there are protections available to some consumers via voluntary arrangements, including where their bank is a member of the Contingent Reimbursement Model Code, of which Lloyds Banking Group is a signatory. In 2021, £583.2 million was stolen through APP scams in the UK[7].

In the UK's climate of a high degree of customer protection for banking and payment services, HM Government (HMG) has introduced legislation to enable the PSR to require reimbursement of victims of APP scams from banks and other payment service providers where a consumer is not at fault. The PSR has confirmed that a regulatory requirement will be imposed within six months of the legislative changes coming into effect per the HMG deadline[8]. The PSR is expected to publish a consultation by the end of 2022 to require reimbursement of APP scam victims.

Given that most APP scams start outside of the financial services sector, including via social media and telecoms firms, the banking and payments industry is strongly in favour of other sectors taking their fair share of responsibility. The Online Safety Bill, expected to be progressed later this year, includes a standalone duty requiring some categories of online services to take action to minimise the likelihood of fraudulent adverts being published on their service. The government states that this duty will make it harder for fraudsters to advertise scams online, and that if these services fail to take adequate action, they could face enforcement action[9]. This provision is welcomed but more is needed across sectors.

Pay.UK as the retail scheme operator is developing blueprints for supporting services including pre-payment prevention, at-payment prevention and post-payment reimbursement, which will also be delivered into the NPA. Plans are also in place to enable a Fraud Mitigation Overlay Service, intended to use network data to better identify potential fraud at point of payment. Enabling controlled data-sharing between payments participants for "common good" purposes is vital for the development of fraud prevention services, noting the maxim that it takes a network to defeat a network.

6 https://www.requesttopay.co.uk/about-us
7 https://www.ukfinance.org.uk/news-and-insight/press-release/cross-sector-action-needed-criminal-gangs-steal-billions
8 https://www.psr.org.uk/publications/general/psr-response-to-digital-payments-initiative-report/
9 https://www.gov.uk/government/publications/online-safety-bill-supporting-documents/online-safety-bill-factsheet

Confirmation of payee

From 2020, the PSR ruled that the UK's six largest banking groups, including Lloyds Banking Group, had to implement the Confirmation of Payee (CoP) service. This is an Open Banking API that lets payers check the payee's name before they send a payment via Faster Payments or CHAPS. CoP offers important customer benefits in providing peace of mind and confidence, as well as mitigating some types of misdirected payments. It is also likely to have some impact on reducing some types of APP fraud. Industry figures show there are now around 1.5 million CoP checks made each day, up from around 1 million in 2020.

This year, the PSR proposed to mandate that around 400 other payments firms join the service across 2023 and 2024. Lloyds Banking Group supports this, particularly given there is some evidence that APP fraud has migrated to payments firms that haven't implemented CoP. The CoP service may also facilitate data sharing between payments firms, which should also support fraud prevention.

Consumer duty

The FCA has confirmed that from July 2023 the UK financial services industry, including payment service providers, will need to comply with a new consumer duty[10]. This requires firms to take an outcomes-focused approach to ensure their products and services are fit for purpose and offer fair value, and to help consumers make effective choices. The FCA explains that, in the payments industry, the consumer duty will apply across the distribution chain and will apply to all payment services providers where their activities can determine or have a material influence over retail customer outcomes.

Importantly, the consumer duty can apply in circumstances where a payments firm does not have the direct or primary relationship with the customer. Whilst payments providers, particularly credit institutions, have long been familiar with high regulatory standards for customer treatment, the consumer duty requires a fresh consideration of how good customer outcomes are delivered.

Effective competition

The PSR has a mandate to promote competition between and within payment systems. It is now focusing on promoting competition between payment systems, with the aim of ensuring better and more affordable services for payments participants and end-users. In particular, the PSR is looking to support the growth of account-to-account payments via Open Banking to provide additional competition to the card schemes.

In the cards market, the PSR this year issued its provisional decision following its card-acquiring market review[11]. The PSR has proposed three key remedies – summary boxes to help merchants compare prices, trigger messages to prompt merchants to shop around and a maximum duration of 18 months for point-of-sale terminal lease and rental contracts.

10 https://www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty

11 https://www.psr.org.uk/publications/consultations/cp-22-3-card-acquiring-market-review-remedies-provisional-decision/

> **The ongoing upgrades to national payments infrastructure can help enable the private sector to deliver improved payment services. But the financial system is global. With cross-border payments set to total £250 trillion by 2027, many of the most important issues require collaboration between jurisdictions.**

Victoria Cleland
Executive Director for Banking, Payments and Innovation, Bank of England, March 2022

The road to enhanced payments - speech by Victoria Cleland | Bank of England

Also this year, the PSR announced the details of two card fee market reviews[12]. The first focuses on scheme and processing fees and the second cross-border interchange fees. The PSR is seeking to ensure card payments work well for consumers and merchants and will complete a market review to determine whether steps are necessary to protect consumers and promote competition.

The future of payments

Innovation in the payments space should be harnessed to ensure payments are safe, secure, resilient and facilitate innovation for the benefit of customers. Regulators, government, and standard setters expect consumers to have access to digital payments and recognise the importance of financial inclusion.

Open Banking and account-to-account payments

Open Banking was designed to encourage competition and innovation in retail banking and payments. More than four years after Open Banking was introduced, HMT, the Competition and Markets Authority (CMA), FCA and Payment Systems Regulator (PSR) have formed a Joint Regulatory Oversight Committee (JROC) to further develop the ecosystem[13]. This decision-making body is responsible for establishing a long-term regulatory framework and expects to set out a vision statement for the future of Open Banking in early 2023.

JROC has the potential to bring the industry together and ensure that the desire for innovation is balanced with the need to ensure the framework functions well for participants and consumers. It has committed to considering Open Banking's functional capability, dispute processes, access and liability and a sustainable funding model. There is a some crossover into the UK's Faster Payments Service and, in the future, the NPA, which are the rails used for Open Banking payments. It is therefore important that there is a holistic consideration.

In July, the PSR responded to the PSR Panel's May Digital Payments Initiative recommendations[14] including moving beyond the current mandated payments sweeping functionality for "me to me" payments. The PSR has recognised the need to consider appropriate consumer protections and an effective commercial model to ensure it is a sustainable system. Ahead of reaching conclusions on next steps the PSR intends to wait for JROC to have begun its work.

12 https://www.psr.org.uk/our-work/market-reviews/market-reviews-into-card-fees/

13 https://www.gov.uk/government/publications/joint-statement-by-hm-treasury-the-cma-the-fca-and-the-psr-on-the-future-of-open-banking

14 https://www.psr.org.uk/publications/general/psr-response-to-digital-payments-initiative-report/

> The extension of the regulatory framework to encompass the use of crypto technologies must be grounded in the iron principle of 'same risk, same regulatory outcome'. The starting point for regulators should be to apply the same regulation to the risks inherent in the provision of a financial service no matter how it is provided.

Sir Jon Cunliffe
Deputy Governor, Bank of England, July 2022

Some lessons from the Crypto Winter – speech by Sir Jon Cunliffe I Bank of England

The Future Regulatory Framework (FRF) review and payments

The government has launched a consultation and call for evidence on Payments Regulation and the Systemic Perimeter, which proposes extending the scope of the Banking Act to cover more systemic entities in the payments market, beyond payment systems and entities that provide services to payment systems. The Banking Act framework enables the authorities to supervise and respond to risks posed to UK financial stability. The consultation also sets out the intended approach to EU-retained legislation to payments and how this links with the Future Regulatory Framework (FRF) review. The government proposed changes including modifying retained EU law to enable the FCA to have a general rulemaking power for payments and e-money. This will enable the UK to diverge from the EU and we can expect to see future consultations from the FCA about the nature and scope of this divergence.

Digital currencies

Since the launch of Bitcoin in 2009, interest in digital currencies has continued to grow with crypto assets taking on different forms, new models created and use cases adopted. Governments, regulators, and central banks around the world have taken note with many countries establishing legislative and regulatory frameworks to protect consumers and markets from the risks of this emerging group of potential payment instruments to developing central bank digital currencies arguably in opposition to crypto assets.

This year, the government has set out a vision for the UK as a global hub for crypto asset technology. It has also introduced legislation to bring stable coins used for payments pegged to fiat currency within the payments regulatory perimeter. The FCA will consult later this year on the regulatory regime for these stable coins largely based on the existing Electric Money Regulations 2011 and the Payment Services Regulations 2017. The government is expected to consult on regulation of wider crypto assets, used primarily as retail investments and the growth of decentralised finance, later in 2022 to broaden the scope of regulation.

Following a series of BoE publications focussed largely on the potential for a retail CBDC, HMT and the BoE have continued to consider the case for a retail CBDC and intend to publish a joint consultation by the end of 2022. The consultation will set out the case for a retail CBDC and consider design, opportunities, benefits, and implications for users setting ahead of setting out further considerations around an operational and technical model for a UK CBDC. If a decision is made to issue a CBDC, it is expected it would not be until the latter half of the decade.

> **Our data and analytics capability, and our digital leadership will drive personalised engagement, offers, pricing and credit risk decisions. Payments will be a key anchor to drive greater engagement.**

Lloyds Banking Group Annual Report and Accounts 2021

Annual report and accounts 2021 (lloydsbankinggroup.com)

Conclusion

The UK's payments regulatory landscape continues to evolve and change, prompted by the desire to encourage effective competition, ensure adequate user protection and foster innovation that supports better customer outcomes. If 2022 is a transition year as we develop new payment systems and capabilities, the 2020s could be seen to be a transition decade. Reaching the 2030s, we could see vastly enhanced payments data to support business and consumer activities in the wider economy, continued growth of account-to-account payments that offer businesses and consumers even greater choice, and perhaps the development of a UK CBDC. Interoperability of payment systems could move from being an aspiration to a given.

As new technology is adopted, and innovative use cases developed, the regulatory environment must continue to adapt. As the payments industry grows in complexity and new risks and dependencies emerge, regulation must keep pace in line with the "same risk, same regulatory outcome" principle. Consumers must be able to access the right protections for their needs, and other sectors must also take appropriate responsibility for customer protection, with particular relevance to scams. Related to this, we are pleased to see the regulatory focus on payment systems being sustainably funded. Lloyds Bank will continue to work closely with the government, regulators, central bank and standard setters to ensure payments function well for our customers and wider society.

At Lloyds Bank, our vision is to be a UK customer-focused digital leader and integrated financial services provider, capitalising on new opportunities, at scale. We will create a more sustainable and inclusive future for people and businesses, shaping finance as a force for good and supporting a just transition to net zero. Ensuring safe, fast payments, with the right data and customer protections, is a key enabler of our Lloyds Bank strategy.

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