

UK Payments Regulatory update 2021



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We're at an important time for payments. While more of us are using digital payments, there's still more for us to understand about what works for people and business, what prevents them from using digital payments.



Chris Hemsley
PSR Managing Director
July 2021

This time last year when we wrote our Payments Regulatory Landscape review, we couldn't have known that 12 months on, the pandemic impacts would continue to be far reaching.

Whilst regulators and the payments industry has worked together to ensure payments flow through the ecosystem as normal, we have had to really understand and focus on customer needs, ensuring that new developments are truly inclusive and accessible for all those that wish to use them.

In this year's edition we will look at the payments industry regulatory response to changing customer needs whilst continuing to tackle the big infrastructural changes to the payments landscape. Updates focussing on how we are working hard to ensure customers are better protected when making payments whilst acknowledging the similarities in European payment developments are also hot topics. A look to the year ahead is always a good place to wrap up this update but let's get into our first topic.

Responding to changing customer behaviours and preferences

Customer preferences and behaviours have changed; and the pandemic has undoubtedly accelerated the use of digital payments which continues to increase with the online purchases of goods and services. Digital commerce has

grown; over 90% of adults transacted online in 2020 and as a result we have seen double digit growth in e-payments as customers have moved away from physical transactions.

Payments profiles are changing across the payments landscape, but they have done so against a backdrop of reducing payment volumes because of the pandemic. Although overall UK payment volumes reduced last year by 11% (40 billion payments in 2019 versus 35.6 billion in 2020)¹, it is too early to be certain of the level at which payment trends (shown in the payments statistics below) will stabilise as the economy recovers.

Payment trends are changing

- Card payments accounted for over half of all the payments in the UK in 2020, a quarter of these were contactless card payments.¹
- 72% of UK adults used online banking and 54% used mobile banking.¹
- Reliance on cash continues to reduce but still represents 17% of all payments.¹
- Cheque volumes continued falling in 2020 and are now less than 1% of payments made in the UK.¹

¹ <https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/uk-payment-markets-2021>



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Cash still accounted for
17% of all payments
made in 2020

- The Faster Payment System broke the record in 2020 for the number of payments processed in a single year – £2.1 trillion transferred in 2020 versus £1.9 trillion in 2019.²
- The number of people choosing to share their data through open banking has tripled since the start of the pandemic (research published by Experian in May 2021) and more than half (54%) now regularly use apps powered by open-banking technology.

These changing customer behaviours drive the need for increased regulatory and industry focus on payments resilience and robust end-to-end business processes.

Access to cash

Ongoing collaboration is vital to develop and progress the right initiatives to support customers. For those customers choosing to use cash, BritainThinks (an independent research company commissioned by the PSR)³ has undertaken some independent analysis which tells us that access to free cash is still widely available. The analysis confirms the supply of cash is good and estimates that 95% of the UK population is within 2km of a free cash access point and that 99% of us are within 5km.

Whilst these statistics are hugely reassuring, it is still important to ensure that we continue to make cash available for those that need it. The Treasury is currently seeking views on whether the government should legislate to further protect access to cash in the future.

From Lloyds Banking Group's perspective, we carefully consider a community's particular cash and banking needs such as where our customers shop, work, live and bank. We have several initiatives in place to support our customers in whichever way that they wish to transact. We provide alternative face-to-face options in addition to our branches such as utilising the Post Office, Bank Hubs,

mobile branches (50 routes covering 232 communities) and retail cashback pilot schemes.

Our telephone banking is utilising the latest telephony innovation, such as voice biometrics, making it easier for our vulnerable customers to complete transactions from home. We also have dedicated support teams for those affected by cancer, domestic abuse, and bereavements. It doesn't stop there; we remain committed to help customers access devices and digital skills support.

More widely, industry focus is looking to the implementation of cashback without a purchase. This will not only provide a flexible and convenient alternative for customers who need cash, it also provides wider benefits for merchants who will be able to recycle the cash in their tills – a great example of sustainable payments in action.

Furthermore, later this year we will be increasing the contactless card limit from £45 to £100. We are listening to customer feedback and recognise that an increased contactless limit is daunting for some; we're working on giving our customers the ability to make a choice that will suit them in this regard.

As well as keeping customer needs at the heart of payments activity, our regulators are maintaining a close oversight on the wider developments affecting the UK payments infrastructure, let's look at this.

Shaping secure and resilient payments infrastructures

Regulatory focus is rightly tuned in to ensure that the needs of customers and users of payment systems are met. Change is often a trigger for increased regulatory focus and with this in mind, the delivery and regulation of major infrastructure programmes such as the New Payments Architecture and the Real Time Gross Settlement system (RTGS), where operational resilience is vital, have

² <https://newseventsinsights.wearepay.uk/data-and-insights/faster-payment-system-statistics/>

³ https://www.psr.org.uk/media/x5odg242/psr_consumer-research-2020_external-summary-report_final_25-11-20.pdf



There are 12 months to go until we move to a new, global standard for payments messaging, ISO 20022 – the payments industry must work together to build a payments infrastructure for future generations.



Victoria Cleland
BoE Executive Director for
Banking, Payments, and
Innovation
City Week Speech June 2021



Open Banking

The Open Banking ecosystem already benefits nearly 4 million people.

a robust assurance regime wrapped around developments. This ensures we maintain payment systems that are stable, reliable, and efficient. Let's explore some examples.

ISO20022

Global Financial markets are moving to the introduction of ISO20022 (the standard introduced by the International Organisation for Standardisation) which will underpin the development of the UK payments rails to ensure payments are interoperable and fit for the future.

The Bank of England will lead the charge (RTGS renewal from June 2022 where we will see participants go live with ISO20022 on a like for like with CHAPS) and the European Central Bank will follow quickly thereafter with ISO2022 implementation for SWIFT, T2 and SEPA.

New Payments Architecture

Developments this year have shaped and reduced the scope and objectives of the NPA programme to ensure that delivery risks are lowered. The NPA programme will be simplified, and scope of the procurement exercise (for the central infrastructure services) narrowed to focus on single-push payments (FPS) which will also be ISO20022 enabled. Pay.UK will provide regular updates to the PSR so that progress can be closely monitored.

We acknowledge that further urgent consideration is needed around consumer protections and fraud frameworks, and we are working closely as a payments industry with our regulators to galvanise the actions required.

RTGS Renewal

In the same way that the PSR is focussing on the development of the NPA, the Bank of England has developed a strong vision for RTGS renewal. It is of no surprise that we see many common themes between the two programmes – increased resilience, strengthened end-to-end risk management, wider interoperability, and improved functionality.

Open Banking

We will see continued further developments for Open Banking using these domestic payments rails which will provide new propositions for customers. We will be introducing variable recurring payments in 2022 which will support several use cases such as the ability to move surplus funds between accounts to earn a higher rate of interest.

Whilst safe, efficient, and resilient payments are vital, it is also important to make sure that payment systems of the future have customer considerations designed in. Let's look at this more closely.

Consumer protections in payments

We understand the impact that fraud can have on customers, and we are committed to protecting our customers from all types of fraud and financial crime as well as when making payments more generally. We have heavily invested in our defences and continue to work with the industry to find new ways of combatting economic crime.

However, it is important that all parties in the payment's ecosystem work together to help ensure customers are not induced to make payments and lured into complex scams and purchasing fraudulent services and products. Let's look at the key focus areas over the last 12 months.

Strong Customer Authentication

A new set of measures, being implemented in the coming months to help customers confirm their identity when making purchases on-line to reduce the possibility of fraud in the card schemes.

Confirmation of Payee (CoP) and Authorised Push Payment (APP) Scams

Around 90% of the UK's Faster Payments and CHAPs payment by volume are now covered by CoP checks, we are very proud that Lloyds Banking Group was the first bank to go live in March last year.



Confirmation of Payee

Over 500 million checks have been made since the service went live.



Payments are an essential part of daily life – we want to make sure that everyone has a fair choice about how to make and receive payments; that our payment systems are fit for the future; and that we can all use them with confidence and in the knowledge that we are protected.



Genevieve Marjoribanks
PSR Head of Policy
Westminster eForum Policy
Conference
June 2021

- We have committed to further developments around secondary reference data and making it easier for new participants to join CoP. There are also further opportunities being examined to share data to prevent fraud and keep our customers safe.
- We will also be looking at further change and development around scheme rules to make sure we see the right level of re-imburement when things do go wrong.
- In the meantime, it is encouraging to note that we have also seen the number of payments made in error reducing when customers have performed a CoP check before sending a payment to a new recipient.
- The industry, led by UK Finance, is working on a new two-year strategy which will renew our efforts for a more holistic cross-sector approach to tackling APP Fraud.

Alongside the focus that we apply in tackling fraud today, we must also look ahead, anticipate customer needs, and ensure that interbank payments are fit for the future by having customer protection measures built into the process.

The use of e-payments will only grow further as customers are now using faster payments more to pay for the provision of goods and services. This presents a challenge as Faster Payments weren't designed for the changing use cases that are now developing. The payments industry must pull together to understand how we can better protect our customers when things go wrong. There is more to be done, but we are beginning to look at the art of the possible. As we do so, we must be mindful to develop a commercially sustainable interbank payments model that encourages and incentivises all parties to join us in the fight against fraud prevention.

In doing so, we do acknowledge that a 'one size fits all' approach to customer

protections is unlikely to be achievable or desirable given the complexities of different payments methods today. For example, if you buy a coffee, you are less likely to need or want to have that payment protected; however, if you are buying a car, expectations will be significantly higher, and you are much more likely to want the reassurance that this transaction is protected.

Our European colleagues are similarly focussed on ensuring that payments meet the needs of customers in the future, let's look at this more closely.

European payments

We worked hard behind the scenes so that payments were unaffected once the UK left the European Union (EU) and there was close regulatory interest and monitoring to oversee this. The UK now needs to look and consider European payments in a different way and there is an ongoing need to keep close to European developments which affect and impact payments in the future, initiatives such as:

ISO20022 development

This richer message content will importantly bring great benefits particularly for our commercial customers both domestically and internationally.

European Payments Strategy

The European Commission (EC) has published its Payments Strategy which mirrors our domestic position and promotes retail payment solutions that are safe and efficient. Also looking to the future, the EC is working hard to encourage SEPA Credit Transfer (SCT) scheme participants to join the SCT Instant scheme. It is likely that European Central Bank may mandate Euro Instant payments in the future to support greater interoperability, acceptance and take up.

European Retail Payments Strategy

Following a similar theme, the Eurosystem has also published its retail payments strategy which promotes European retail payment solutions that

are safe and efficient. It supports the creation of a pan-European solution for retail payments from the point of the sale/transaction. Broad reaching, covering physical shops as well as e-commerce, it looks to fully deploy instant payments, improve cross-border payments, and harmonise electronic identity and electronic signature services for use in retail payments.

European payments initiative
(Effectively the response to the strategy) – where European banks have committed to set up a dedicated company aiming to create a pan-European payment system and interbank network to rival card schemes using push payment rails. It could eventually replace national European payment schemes so is something that we are staying close to as market launch commences in 2022.

Anti-Money Laundering (AML)
The European Commission has developed a package of legislative proposals to strengthen the EU's anti-money laundering and counter terrorism financing rules, including the proposal for the creation of a new EU supervisory authority to fight money laundering. The package (Beating Financial Crime) aims to create a more consistent framework, which also takes account of the new and emerging challenges linked to technological innovation.

The UK now has the autonomy to set our own AML standards and with this in mind, HM Treasury (HMT) has published a Call for Evidence on a review of the UK's AML / Counter Terrorist Finance regulatory and supervisory regime. Whilst European regulators are no longer providing our domestic regulatory pipeline, we now can consider our own domestic position and develop UK payments regulation – time will tell if this will be more of a convergence or divergence with the Europeans. In the meantime, we do need to consider European regulation, all be it in a different

way, and must keep close to these developments so that our cross-border payments continue to flow efficiently.

As we look back to the UK, we see many similarities and consistencies between the European and UK regulatory outlooks.

UK Payments Strategy

This is front of mind as innovation in payments continues at pace. Our regulators acknowledge that they will need to continue to respond and adapt their supervisory approach and its therefore not a surprise that our regulators have found time to pause and consider their organisational strategies.

We see common themes around access to stable, reliable, and efficient payments which are innovative, competitive, and sustainable. Our regulators are keen to point out the close working relationships for the benefit of UK payments and both the PSRs five-year strategy and the HMT landscape review provides strong evidence of this. UK Finance and Pay.UK also follow these key themes in their visions and publications.

Much of what we have looked at has focussed on UK and European payments, but it would be remiss not to mention payments from a global perspective.

G20 Targets for Addressing the Four Challenges of Cross-Border Payments

The G20 (the intergovernmental forum of the EU & 19 other countries) has made several recommendations to address the key challenges in cross-border payments (cost, speed, transparency, and access) – aimed at international financial stability for cross border payments.

Enhancements to cross-border payments cannot be fully realised without collaboration across all sectors, the Bank of England is actively involved in this ambitious work, which has been welcomed by the UK payments industry.

Closer to home, Lloyds Banking Group is addressing these challenges with the development of our international payments' technology through our Lloyds Bank Gem® platform technology – to provide low cost-efficient processing for our customers. The platform is designed to accelerate straight through processing (speed) which is ISO20022 enabled so that the necessary customer data is used proactively to provide the appropriate notifications in the payment journey (transparency - GPI tracking). It will provide easy access into the UK for the receipt of our cross border instant payments.

Payments Innovation and developing technology

As payments evolve, we recognise the importance of encouraging competition between payment rails and ensuring low barriers to entry for new players. We all share the need for a service which is fast, simple, and convenient for customers as well as resilient and secure.

The environmental sustainability of payment systems is also an important topic and something that we must consider so that payments of the future are developed in a sustainable way.

Before we wrap up this year's regulatory update, let's look some developing areas of interest that we haven't yet mentioned.

Central Bank Digital Currency and Digital Currencies

We see interest and demand growing for new forms of digital currency globally and as a result the BOE has issued a discussion paper to broaden the debate around new forms of digital money and emerging thoughts in the UK. Whilst no decisions have been made as to whether the UK will adopt and issue a Central Bank Digital currency, HM Treasury and the BOE have established the CBDC Taskforce to coordinate the exploration of a potential UK CBDC.

There are many interesting use cases from around the world and we are keen to understand how we can learn from these, for example the launch of the Sand Dollar (digital version of the Bahamian Dollar) project by the Central Bank of The Bahamas last year was hugely successful in enhancing financial inclusion for citizens across The Bahamas.

Innovation is at the core of our organisation, building a solid foundation which will allow us to move at pace in the light of changing customer behaviours and wider technological landscape. In 2019 we invested in Finality⁴, founded to create a network of decentralised Financial Market Infrastructures (dFMIs) to facilitate international payments using digital cash assets to settle tokenised transactions. Finality will do this by utilising both blockchain and distributed ledger technology, and we are exploring the opportunities for our business and our clients as the digital currencies market matures.

These services intend to bring the benefits of smart contracts to the wholesale markets as well as providing efficiencies and risk reduction benefits through atomic settlement and simplified transactional processes. The use cases developed in our wholesale markets may be a precursor for the wider adoption of new forms of digital currency for retail customers.

Cloud technology

This is key to future developments in payments and provides alternatives for those PSPs who do not wish to develop their own internal infrastructures. Lloyds Banking Group is developing a Cloud based gateway for our faster payments processing, which will enable us to be more flexible with both scale and liquidity.



CBDC

More than 60 Central Banks have been exploring CBDCs since 2014 and in April 2020 Mainland China became the world's first major economy to pilot a digital currency.

4 <https://www.fnality.org/about-fnality>

In 2020 we announced our strategic partnership with Form3⁵, a cloud-native payment technology FinTech, to accelerate our transformation and enhance the digital experience for customers. The partnership represented a significant milestone to update our payments architecture and payments transformation projects, utilising C-based capabilities and readying the Group for the move to the New Payments Architecture.

Whilst Cloud technology undoubtedly provides exciting opportunities by opening the door to consider further cloud-based payments as a service options in the future, we can of course expect to see close regulatory oversight to safeguard and protect end-to-end payments resiliency. We will work with the regulators to ensure safe secure and resilient processing is maintained and we expect to see ongoing and developing interest in the provision of payment services.

Reflecting on this year's regulatory update, we have seen the payments industry pull together to respond to changing customer needs and behaviours. In turn, our regulators are looking carefully to ensure that the regulatory approach in the UK is fit and adaptable to the challenges of the future.

In these uncertain times, we can be sure that our customer needs will continue to be at the heart of everything as we develop new products and services to help Britain recover from the effects of the pandemic.

5 <https://www.lloydsbankinggroup.com/media/press-releases/2020/lloyds-banking-group/lloyds-banking-group-enters-strategic-partnership-with-fintech-form3.html>



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