Legal & Regulatory Working Group

Payments Innovation Forum (PIF) 2024

Competition Law Notice

Meeting participants are reminded that this meeting must adhere to competition law rules and as such no confidential or commercially sensitive information must be shared directly or indirectly between competitors.

Please do not share any confidential or commercially sensitive information and please do not ask questions that could lead to other participants to sharing confidential or commercially sensitive information about their organisation.

A written agenda has been circulated in advance and all discussion must keep to the agenda.

Please read our **Competition Law Guidelines** for further information:

[Competition Law Guidelines - Payments Innovation Forum]

Agenda – 22 February 2024

1. Strong Customer Authentication (SCA) replacement – update on FCA policy development
2. Consumer Duty – ‘Good practice and areas for improvement’
3. Confirmation of Payee (CoP) – Specific Direction 17 Extensions and Exemptions
4. FCA Authorisations operating service metrics 2023/24 Q3
5. FCA progress on reducing and preventing financial crime
6. A.O.B.

1. FCA policy development on Strong Customer Authentication (SCA) replacement

FCA policy development on SCA replacement

- **Background**
  - → In Autumn Statement, HM Treasury announced its intention to repeal the Strong Customer Authentication technical standards (SCA). These standards currently set requirements on payment service providers in relation to authentication of their customers, in order to enhance payments security and reduce fraud
    - *"The government is also committed to growing the UK's world-leading retail payments sector…including repealing prescriptive EU-derived payments authentication rules allowing industry to better prevent fraud and improve the customer payments experience. The FCA will review the rules with a view to* ***adopting an outcomes-based approach*** *and* ***will specifically consider the contactless limits****."*[1]
  - → The FCA is therefore considering its approach to replacing SCA using its rule-making powers as enabled by the Smarter Regulatory Framework legislation
  - → As part of this, the FCA is reviewing the SCA standards Regulation 100 and related definitions in the PSRs
  - → **Open Banking policy elements of SCA** – principally Chapter 5 of the technical standards, **are out of scope of this review** and will be considered separately through the long-term regulatory framework programme in due course
  - → As part of the initial SCA policy development, the FCA is seeking views on the impact of the existing SCA RTS, and on the direction of regulation going forward ahead of a **formal consultation will be launched later in 2024**. The FCA is particularly keen to see **data** that illustrates the impact of the existing SCA RTS

[1] Autumn Statement 2023 - GOV.UK (www.gov.uk)

FCA policy development on SCA replacement

Call for member views:

→ **Fraud Prevention, Payments Friction and Payments Accessibility** – how has SCA impacted on unauthorised payment fraud (and where applicable, authorised fraud), payments friction (including abandonment) and accessibility to consumers with different needs?

→ **Competition and Innovation** – how has SCA impacted on competition and innovation in payment services, and associated authentication and transaction risk monitoring solutions?

FCA policy development on SCA replacement

- **Initial Member Feeback**
  - ✓ Cases of ‘friendly fraud’ have decreased - customers often retract claims when presented with evidence that SCA was used
  - ✓ Consumers have grown accustomed to SCA and should view friction positively – technology is evolving to keep it as simple as possible
  - ✓ Promotes consumer confidence, especially among vulnerable consumer groups – SCA provides some reassurance to customers of what is place to keep their funds safe
  - × Costly and often ‘unnecessary’ in low-risk environments – significant amount of time has been spent understanding and interpreting the SCA RTS and then attempting to ‘shoe-horn’ the requirements into often complex user journeys and use cases – often in situations where fraud was already very low
  - × In certain use cases, the level of friction created by SCA is inappropriate to both payment service users and payment service providers, e.g.
    - Single use prepaid cards – loaded with low amount of funds but insufficient for the low value exemption
    - Corporate insurance payouts – e.g., where cards/virtual cards are not issued to a named cardholder
    - Purchasing/expense cards – that are used by many/not specific to an individual
    - Vulnerable consumers/digitally excluded – no or limited access to a smartphone to allow for apps/push notifications

FCA policy development on SCA replacement

- **<u>Initial Member Feeback</u>**
  - × Payment friction in certain scenarios may drive users to unregulated payment services e.g. cash, gift cards resulting in poor consumer outcomes
  - × SMS as a fallback solution is a backward step and its ‘lazy’ implementation is some cases provides tools for fraudsters to operate using interception techniques

➢ It is payment service providers (PSPs) who best understand detailed use cases and who are financially and operationally incentivised to minimise fraud. PSPs should be able to choose which journey is most appropriate to the payment service user/payment service whilst balancing the risk of fraud, in a market-led way.

➢ PSPs are inherently invested in the development of systems and controls to minimise fraud (and costs) whilst optimising the user journey

➢ Self-regulation is key, not prescriptive broad-brush rules

FCA policy development on SCA replacement

- **<u>Wider industry views:</u>**
  - → SCA has not been in force for long, so change for change's sake should be avoided – change should be guided by evidence, e.g., UK Finance data indicates that the **risk of fraud is four times greater with OTPs sent to a mobile device** than in-app authentication
  - → SCA regime should allow for **future flexibility** to allow PSPs to stay ahead of fraudsters
  - → SCA future policy should **allow for PSPs to depart from the strict requirements where this would achieve a better outcome**, e.g., UK Finance data indicates that it is much easier for fraudsters, through social engineering, to work around the Knowledge and Possession factors *[currently, the requirements preclude PSPs from using 2 Inherence factors (they can use a 2nd Inherence factor, 'layering' this on top of another e.g. Knowledge or Possession factor, but it cannot be used to meet the SCA requirement). To do this, either the definition of SCA should change in the PSRs, or an exemption is permitted to allow a risk-based approach, or a PSP to use a 2nd Inherence factor instead of Knowledge or Possession].*
  - → **Rigidly defined SCA poses a real challenge to vulnerable customers**
  - → PSPs and their service providers, e.g., acquirers and gateway providers used in transactions should be able to agree between themselves when liability shifts from the issuer to the merchant via the acquirer, e.g. for the purposes of compensating the payer under regulation 77(4). This might mean, e.g., that the requirement in regulation 77(6) should not apply in these instances and/or the obligation on the issuer in regulation 100 should be switched off – i.e. ,making it less prescriptive
  - → Fraud targets should be linked to a TRA that is **outcomes based** and not based on value thresholds outlined in the SCA RTS

FCA policy development on SCA replacement

- **Wider industry views:**
  - → A specific exemption from SCA should be introduced for Electric Vehicle charging (Article 12 of the SCA RTS already provides an exemption for unattended terminals for transport and parking). Either extend this exemption or introduce a new one.
  - → The Article 5 dynamic linking requirements create friction when applied in a corporate context – allowing the corporate exemption to apply to dynamic linking would overcome this.
  - → The Article 3 audit requirements should be removed. It may have been useful from the outset, but other parts of the payments services regime/COB requirements are not subject to specific audit requirements.
  - → 5 minute rule – PSPs should be able to determine for themselves the appropriate inactivity period based on the customer profile and a risk-based approach

FCA policy development on SCA replacement

- **FCA Next steps**
  - → The FCA will continue to develop policy, including **identifying the parts of SCA where reform could have the highest beneficial impact**
  - → A Cost Benefit Analysis will be published alongside the policy – **having supporting evidence and data to assess impacts and justify the changes will be crucial**
  - → The FCA will consult on replacement rules later this year
- **Additional questions for members:**
  - → Should the contactless limit increase?
  - → Should there be more prescription around data sharing for the purposes of fraud prevention?
  - → Do we have real-world data/evidence to illustrate the positive/negative impact of SCA?

2. Consumer Duty – ‘Good practice and areas for improvement’

- [Consumer Duty implementation: good practice and areas for improvement | FCA]

Consumer Duty implementation: good practice and areas for improvement

- The FCA has set out what firms are doing well and what they could do better – some firms are "lagging behind"
- The FCA's findings cover:
    - Culture, governance and monitoring
    - Consumers in vulnerable circumstances
    - Products and services
    - Price and value
    - Consumer understanding
    - Consumer support

Consumer Duty implementation: Areas for improvement

- Examples of poor practice:
  - → The Consumer Duty being driven primarily by risk and compliance teams and not discussed at Board level
  - → Firms being complacent in relation to data and monitoring strategies and assuming they can just repackage existing data
  - → Firms waiting to see if the FCA will intervene to address an issue rather than tackling it themselves
  - → Charging customers for a service they are not benefiting from
  - → Being unclear about what charges apply and when – this could be improved by e.g., providing worked examples of product and service costs
  - → Automatically assessing all consumers over a certain age as vulnerable – age is relevant to vulnerability but such a generalised approach risks firms not tailoring support to reflect individual needs
  - → Asking customers to identify themselves as vulnerable and then unnecessarily requesting evidence of this – the FCA has also see firms telling those who identify as vulnerable that it might affect their ability to receive the service
  - → Asking customers to repeatedly disclose their additional needs or personal circumstances when passed between teams – firms need to consider the impact of being asked to do so on a consumer's mental wellbeing and ability to engage with their provider

3. Confirmation of Payee – SD17 Extensions and Exemptions

- SD 17 Extensions | Payment Systems Regulator (psr.org.uk)
- SD 17 Exemptions | Payment Systems Regulator (psr.org.uk)

CoP – SD17 Extensions and Exemptions

- The Payment Systems Regulator (PSR) has published two forms to facilitate requests from directed firms or an extension or exemption to SD17
- Firms should complete the relevant form if they believe they qualify for extension to the October 2024 deadline or an exemption to the requirements to provide a CoP system under SD17 (Group 1 and **Group 2 PSPs**).
- For **exemption requests**, firms should state their reasons for applying, explain any factors which have affected their ability to have and use a CoP system, confirm the expected volume of customers that they consider would be impacted if the PSR were to grant and exemption, and whether the exemption would apply to all parts of the business or only impact one business line. Firms also need to state if they have any plans to merge with another PSP that already provides a CoP service, have plans to exit the UK market, or are (or expect to be) insolvent, or have any plans to decommission any channels/accounts/products that are currently in scope.
- For **extension requests,** firms should indicate how long they require an extension for, state the expected volume of customers that would be impacted, explain any factors which have impacted their ability to have and use a CoP system, and whether the proposed extension would apply to all or just one part of the business. Firms are also asked to explain what steps they have taken to mitigate any factors set out in their answer to question 2 (length of extension), whether the delay is linked to the timelines for the proposed aggregator model for CoP. The PSR will also need to know if the firm applying for an extension is using a third-party supplier which is insolvent, or if the firm has been restricted from onboarding by Pay.UK.

4. Update on other legal and regulatory developments

FCA Authorisations operating service metrics 2023/24 Q4

- The FCA has published its quarterly authorisations metrics to provide greater transparency of its performance. The latest data cover the period from October to December 2023
  - → 97.8% of applications across all metric areas were determined within the statutory deadline.
  - → Six metrics are 'amber', including new firm authorisations, change in control, and authorisations under the EMRs and PSRs
  - → Most applications are determined 'significantly ahead of the statutory deadline'
  - → 'complete and comprehensive' applications are likely to be determined in 'good time', but more complex cases may mean that statutory targets are not met
  - → The FCA continues to see 'too many' poor-quality and incomplete applications

FCA progress on reducing and preventing financial crime

- The FCA has published an update on progress made over the last 18 months: [Reducing and preventing financial crime | FCA]
- **“Shifting the dial on financial crime”** – the FCA has identified 4 areas where further collaborative action can help shift the dial decisively on reducing and preventing financial crime:
    1) Data and technology – suggested question’s for firms’ boards to ask include: *Does my firm know how criminals are likely to be using new technology to target our customers and business? Does my firm have a way of keeping updated on new techniques or typologies?*
    2) Collaboration – the FCA strongly encourages firms and cross-sector partners to participate in data sharing initiatives and explore the latest advances in data sharing technology to improve collaboration
    3) Consumer awareness – suggested questions for firms’ boards to ask include: *Is my firm raising awareness among our customers of the fraud risks relevant to the business we do with them?*
    4) Metrics – measuring effectiveness – the FCA wants to create greater confidence in financial services by being transparent about the outcomes achieved. Following the first year of the FCA’s 3-year strategy, internal metrics highlighted increased scam detection capability and improving consumer awareness.

PIF Anti-Fraud Working Group

- PIF has established a new Anti-Fraud Working Group to facilitate non-commercial discussion and raise awareness of known and emerging payment fraud threats, trends and enablers. A key objective is to engage with fraud prevention stakeholders to development a holistic and consistent view of fraud in the payments/e-money sector
- A preliminary meeting of members was held on 21 February – a discussion summary and proposed next steps will be circulated w/c 26 February.

Any questions?