Payments Innovation Forum
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By email to: appscams@psr.co.uk

Non-Confidential

Dear Sir/Madam,

Re: CP22/4 - Authorised push payment (APP) scams: Requiring reimbursement.

We welcome the opportunity to respond to the Consultation published by the Payment Systems Regulator ("**PSR**") in September 2022: "Authorised push payment (APP) scams: Requiring reimbursement" (the "**Consultation**"). We would be pleased to discuss our response with the PSR in more detail.

The Payments Innovation Forum (**"PIF"**) is a not-for-profit industry body representing providers of innovative payment services for consumers, businesses and public sector organisations. PIF members range from large e-money and payment institutions, including indirect access providers (IAPs) and smaller PSPs, many of whom are indirect participants in Faster Payments. It is in this capacity that we submit our response.

We would like to thank the PSR for taking our comments into consideration.

Yours faithfully

Diane Brocklebank
Executive Director
Payments Innovation Forum Ltd

<u>Introduction</u>

PIF and its members recognise the importance of tackling APP scams which can result in severe consequences for consumers, and which pose a challenge for the payments and e-money sector. Innovation and competition in payments can only thrive if payment service providers earn the confidence of payment service users. PIF members are, therefore, deeply committed to ensuring that their products and services are not used for illicit purposes.

However, PIF and its members do not agree that making reimbursement mandatory will achieve the PSR's intended aims. We feel strongly that the PSR's proposals, if implemented, will have a negative impact on consumers and negative implications for innovation and competition in UK payments which we expand on below

<u>General observations</u>

In our view, the proposals amount to a 'Cheaters' Charter' – APP scams will go up, not down

We are extremely concerned that the proposed measures will encourage, rather than tackle, APP scams. Apart from making the sector more attractive to organised criminal gangs, there is a very real possibility that mandatory reimbursement will result in increased levels of first-party fraud. The House of Lords Fraud Act 2006 and Digital Fraud Committee report "Fighting Fraud: Breaking the Chain" (November 2022)[1] supports this view, i.e., that a blanket reimbursement policy "**<u>may lead to increased levels of moral hazard and fraud</u>**" and "may even lead directly to **<u>new avenues for APP-reimbursement frauds</u>**." We elaborate on this point further in our response.

The proposals expect very little of consumers

The proposals seem to overlook the vital role consumers can, and should, play in preventing APP scams from happening in the first place. The Contingent Reimbursement Model (CRM) places expectations on consumers to "pay attention to warnings given to you by your bank" and "always think carefully before making a payment". In other words, the CRM expects consumers

[1] Fighting Fraud: Breaking the Chain (parliament.uk)

to have a reasonable basis for believing the payment transaction is “genuine” and “legitimate”. Conversely, the PSR’s proposals seem to expect very little of consumers.

In our view, it would be more effective for the PSR to focus on educating consumers, ensuring they understand the types and risks of fraud, and how to keep themselves protected. **Customers must understand their responsibility** in deciding when and to whom to make payments.

The advantages of a comprehensive, joined-up approach to tackling APP scams have been underplayed

We welcome that the communications and technology sectors are likely to be impacted by measures in the Online Safety Bill to combat user-generated fraud, but, as far as we are aware, there are no plans to require these sectors to contribute to APP scam victim reimbursement costs.

That the cost of reimbursing APP scam victims should sit solely with PSPs, and not the sectors that enable fraudsters to freely reach potential victims by way of scam text messages, fake websites, or fraudulent advertisements on social media, is, in our view, very difficult to comprehend. We acknowledge that the communications and technology sectors are not within the PSR’s remit, but it is disappointing that there is no attempt at an ecosystem-wide approach to tackling APP scams.

We again refer to the House of Lords Fraud Act 2006 and Digital Fraud Committee report which maintains that as “**banks are the last link in the fraud chain**” they “**cannot be expected to foot the fraud bill alone**”.

Further, we question the basis for the proposals when Strong Customer Authentication (SCA) under the Payment Services Regulations 2017 (PSRs) was intended to make payments more secure, and which has been implemented by PSPs at significant cost. The PSR’s proposals seem to suggest that SCA under the PSRs has not achieved its intended aims. If this is the case, it would be more appropriate to address why SCA has not worked, rather than implement an unrelated reimbursement mechanism for the customer.

The proposals will increase financial exclusion

We represent PSPs who provide payment products and services in support of financial inclusion. If PSPs are required to reimburse every APP scam, they may be forced to create barriers to account opening or worse, exit from the market.

Competition in UK payments will be adversely impacted

It will be very difficult for smaller or leaner PSPs, particularly those with consumer products, to fund the cost of reimbursement under these proposals. They will be unable to compete with larger firms that are better able to absorb the costs.

The proposals will deter investment in UK Fintech

At a time when overseas investment in UK industries is paramount for economic growth, we strongly believe that the PSR's proposals will have negative consequences. Under the PSRs proposals, the UK would be the only country in the world to require reimbursement by PSPs. In our view, the requirement will deter international investors once they know that a significant portion of their investment in a UK PSP is at risk of being lost on reimbursements.

The proposals amount to a sticking plaster

Fraud is complex and comes in all shapes and sizes. Having a blanket requirement does not address the different types of fraud and why they occur. In our view, time and money would be better spent understanding fraud typologies and educating those impacted by APP scams (victims, PSPs, law enforcement, crime prevention agencies) to understand their role in preventing fraud.

Impact of the PSR's proposals on consumers

The Consultation states that "additional friction for a small proportion of payments is proportionate to preventing APP scams". We strongly disagree, not least because the PSR says that it has "not been able to quantify the likely costs of any delayed or declined payments" but mostly because a PSP's fraud prevention efforts are highly likely to result in significant amounts of friction, particularly for higher value payments, given the severe consequences and costs to PSPs should a fraudulent payment be processed.

We do not feel that the PSR has considered the ramifications of PSP's refusing more payment orders than they currently do now. In our view, **the impact on genuine payments and**

legitimate customers will be significant, resulting in reduced, and far from improved, consumer confidence. In developing these proposals, we urge the PSR to investigate further the impact of delayed or declined payments on legitimate customers.

Further, if the cost of reimbursement is to be borne solely by PSPs, then we would expect basic **transactional costs to increase for all customers** as PSPs seek to recover their losses by increasing fees. There is also a risk that the proposed measures will lead to lengthier payment processing times due to PSPs reviewing transactions to mitigate risk. For small business customers, payment delays could arguably be much more serious than loss of funds. This potential delay becomes even more acute if a PSP follows the recommendations set out in a Financial Ombudsman Service case study to “contact the Police who will speak to the customer”[2]

We ask the PSR to consider the impact on those consumers who might be deterred from accessing payment services as a direct result of the new requirements, and who may be **forced to access payment services that do not meet their needs**.

We are also concerned that requiring PSPs to bear the cost of reimbursement will harm the commercial viability of PSPs that offer products and services that aim to help the underbanked. With no appetite to pass on the cost of compliance to these types of consumers, it will become impossible for PSPs to service financially underserved consumers, resulting in **negative implications for financial inclusion in the UK**.

Finally, there is a risk that consumers fall victim to scams where they are encouraged to claim vulnerability. These types of scams can lead to significant financial and other detriment to consumers, such as debt, eviction, and a criminal record. We elaborate on this point further in our response.

Impact of the PSR’s proposals on PSPs

We believe that PSPs in the e-money and payments sector will be disproportionately impacted by the PSR’s proposals, and, in some cases, the consequences will be severe.

[2] https://www.financial-ombudsman.org.uk/decisions-case-studies/case-studies/customer-asked-transfer-money-account-threat

We are extremely concerned that the PSR's proposals **will threaten the existence of PSPs whose entire customer base is classed as vulnerable**. For example, a number of our members provide products and services that are designed to support the most vulnerable, and which support local government authorities in the disbursement of funds. These firms are already taking extra steps to support customers in protecting themselves from fraud, for example, by implementing Confirmation of Payee, by raising awareness of how customers can protect themselves and by monitoring the activity of vulnerable customers in tandem with the local authorities and government agencies with whom they work.

Under the new requirement, PSPs will likely be required to reimburse their customers, **even if they consider them to have acted with gross negligence**. In our view, this is problematic, and it will be very difficult to manage. This requirement assumes that a PSP is aware of changes in a customer's personal circumstances when sometimes they are not, either because the customer does not disclose vulnerabilities or customers themselves may not know they are vulnerable. Knowing whether a customer is vulnerable is subjective and, as such, the likely outcome is that **PSPs will need to treat all customers as vulnerable**. The cost of doing so will make many schemes that are designed in support of financial inclusion no longer viable for these PSPs to continue as a business.

Further, the PSR proposes that the cost of reimbursement should be borne equally between the sending PSP and the receiving PSP. This effectively imposes liability on receiving PSPs **even where they have no power to prevent the transaction from occurring**. We question the "default" 50:50 sharing of responsibility which the PSR indicates could be amended by contractual agreement between PSPs. In a market of over 400 operators, where the overwhelming majority of transaction 'initiations' will be carried out by just a handful of retail banks, negotiating a change from the default will, in our view, be very difficult in practice.

We also question whether the lower payment threshold and the (maximum) excess is set at a high-enough level to genuinely incentivise legitimate consumers to exercise caution and heed warnings they receive from their PSPs, leaving the PSP to bear the brunt of consumer inertia.

In our view, the PSR's proposals introduce significant operational costs which will be difficult, if not impossible for newer pre-profit PSPs, to absorb. We are very concerned that the **cost of reimbursement will impact the ability of both new and established PSPs to remain**

commercially viable. These costs will have severe implications for innovation and competition in UK payments, and severe implications for digital financial inclusion.

A 'Cheater's Charter'

PIF and its members are extremely concerned that fraudsters will exploit the reimbursement requirement to operate fraudulent schemes to steal money, safe in the knowledge that a PSP is required by law to reimburse the funds, and that the risk of being investigated by law enforcement is, probably, very low. According to the National Audit Office (NAO), fewer than 1 in 200 cases of fraud lead to police charges, with bank and card fraud the most common type. We reiterate our disappointment that no attempt has made at an ecosystem-wide approach to tackling APP scams, corroborated more broadly by the NAO which concludes that **"tackling fraud is a complex issue that requires coordinated action from government, bodies across the public and private sectors, and the public**"[3].

We would like to highlight direct debit scams where fraudsters have created campaigns on social media promoting, for example, an opportunity for housing association residents to claim cash back on direct debits already paid for council tax, rent and other payments with the fraudster taking a fee. The scams are typically advertised as an easy, hassle-free way to claim money back from your bank with no consequences. The reality is that victims could be left in debt, facing eviction or receive a criminal record. With the liability placed on PSPs under the PSR's proposals, we foresee similar scams circulating on social media, where consumers are encouraged to claim vulnerability with no consequences. Shifting the liability to PSPs **will create a new opportunity for fraudsters resulting in severe implications for firms** who, unlike larger financial institutions will be unable to absorb the cost of reimbursement

Finally, it is likely that the reimbursement requirement would be widely publicised to the general public. Rather than educating consumers on the decisions they take and the payments they make, it reinforces a belief that their funds are protected regardless of the decisions they take. This encourages a more carefree and careless attitude to payments. **It is a very dangerous precedence to set, and it is not sustainable by the payments and e-money sector.**

[3] [Progress combatting fraud (nao.org.uk)]

<u>Further observations</u>

Finally, PIF and its members have identified several other issues which we urge the PSR to take into consideration:

The PSR's proposals, if implemented, will obscure the true levels of APP scam fraud

The administration required to investigate fraud versus reimbursement means that **<u>it will be more cost effective for a PSP to pay out than properly investigate the case</u>**. This will impact on the true amount and value of APP scam fraud taking place.

Existing approach to customer onboarding is not conducive to preventing fraud

Customer Due Diligence requirements are inconsistently applied across all firms, i.e., banks and non-bank PSPs. If they are consistently applied, then the sector would have a better chance of rooting out fraudsters who steal or create false identities and preventing them from opening an account.

Working with crime prevention agencies

PIF members have cited several issues when it comes to working with crime prevention agencies. Cifas, for example, is known to have issues in the way it reports third parties submitting fraud information, which creates problems for APP scam victims wishing to use the Financial Ombudsman Service to seek redress. Members are also concerned about the lack of response from law enforcement in cases of card or account fraud – this does not assist the victim or the PSP. Fraud prevention efforts are also hampered by the National Crime Agency's (NCA) lack of resource; it would be beneficial to have much closer engagement between the NCA and PSPs.

In closing, we strongly believe that if implemented, the PSR's proposals will be detrimental to both consumers and PSPs. The firms we represent are spearheading the development of innovative payment products and services, many of which are designed to support the most vulnerable, as well as to help consumers and businesses mitigate cost-of-living increases.

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