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Payment Services Call for Evidence
Payments & Fintech
HM Treasury
1 Horse Guards Parade
SW1 2HQ

Non-Confidential

7 April 2023

Dear Sir/Madam,

Re: Payment Services Regulations Review and Call for Evidence

We welcome the opportunity to respond to the Consultation published by HM Treasury in January 2023: Payment Services Regulations Review and Call for Evidence (the **"Consultation")** and we would be pleased to discuss our response with HM Treasury in more detail.

The Payments Innovation Forum (**"PIF"**) is a not-for-profit industry body representing providers of innovative payment products and services for consumers, businesses and public sector organisations. Formed over 15 years ago, PIF represents the interests of a diverse range of firms from large electronic money institutions (EMIs) and payment institutions (PIs), including indirect access providers (IAPs) and smaller payment service providers (PSPs), many of whom

are providing products and services that address a specific payment need. It is in this capacity that we submit our response to the government's Call for Evidence.

The views expressed in our response are based on feedback from our members and may not necessarily reflect the views of all of our members.

We have provided our answers to the questions contained in HM Treasury's Call for Evidence below and take this opportunity to thank HM Treasury for taking our comments into consideration.

Yours faithfully

Diane Brocklebank

Executive Director

Payments Innovation Forum Ltd

General questions

1. How should the payment services framework evolve – and what should be the government's priorities – to better promote the following government objectives for payments regulation:

   a) Achieving agile and proportionate regulation, which facilitates the international competitiveness of the UK economy through growth and innovation in the UK payments sector
   a) Ensuring appropriate trust and protection for consumers
   b) Ensuring the resilience and integrity of the UK's payment market
   c) Fostering competition, in the interests of consumers

In answering the above, the government would welcome concrete reflections from stakeholders for future policy, rather than the principles which should underpin regulation/regulatory change.

PIF response:

The broad nature of this question makes it very difficult to provide "concrete reflections". We therefore have some general comments which is based on feedback from our members (i.e., EMIs, partners of EMIs and service providers to the payment service community) and which reflects their experience of operating in the UK payments market:

- Future payments policy needs to strike the right balance to ensure that one or more of the government's objectives is not met at the expense of another. We are concerned that the government and regulator drive to meet one or more of the government's objectives is being done so without adequate consideration of the businesses impacted. For example, consumer protection is a fundamental objective that all parties (government, regulators and firms) want to pursue, but over-zealous rules such as the Payment Systems Regulator's (PSR) mandatory reimbursement requirements will make it very difficult for firms to compete in the interests of consumers. We are concerned that 'blanket regulation' applicable to all firms (PIs, EMIs, banks, investment advisors etc.) operating in the retail market can give rise to asymmetric impacts such that **imposing a "one size fits all" approach makes it difficult for firms to enter and/or remain in the UK payments sector.**

- The range of firms in the payments sector is broad and the products they provide are diverse and typically provided to a niche market, for example, for corporate transactions or for particular groups of consumers. **The contribution that EMIs and PIs make to the UK payments market should not be underestimated**. The introduction of EMD2 and PSD2 has been transformative, enabling the introduction of innovative new products and services to the existing banking market, providing solutions where none existed or were costly and/or too complex to use, and providing payment facilities for many individuals and businesses who had hitherto been unable to access, or were priced out of, using financial services. This success is primarily down to the lighter touch regulatory framework EMIs and PIs operated in. Such an approach is appropriate for the payment sector; for example, firms providing payment services (acquirers and payment facilitators) to other payment service providers and who do not have direct contact with consumers. And in return for this lighter touch, there are statutory restrictions on the activities that they can carry on (e.g., a prohibition on the use of customer funds for investment and lending). We strongly believe that **the future regulatory framework for UK payments should be applied to firms in a proportionate and appropriate manner and be based on the nature of the product/service provided and the market served.**
- EMIs and PIs operate on a low margin basis, typically relying on customer numbers and transaction volumes to be viable. Consequently, the structure and assets of these types of firms are different to other firms operating in the payments market, i.e., banks. **This should not be forgotten**. EMIs and PIs are less likely to have extensive capital reserves to fund initiatives such as the PSR's mandatory reimbursement requirements. This initiative is of particular concern to our members, many of whom provide products to vulnerable individuals. If such measures are introduced (on a mandatory basis), government and regulators must consider how such initiatives will be financed, i.e., whether, ultimately, it will be the payment service user (including vulnerable individuals) who pays for such additional protections in the form of product usage fees. It is very important that regulatory initiatives resolve an existing or potential concern. **In the case of the mandatory reimbursement requirements, our view is that they amount to a "sticking plaster" covering the symptom, and unfortunately do not address the root cause of the problem**. They are likely to have financial inclusion implications, with firms moving away from customers who are perceived to be more likely to be defrauded

(i.e., vulnerable customers). In our view, **education** would be a far more appropriate way to deal with this before fraudulent activity evolves to blight users lives in another way.

- We urge the government to keep in mind that **EMIs and PIs are necessarily focused on monitoring and preventing fraud occurring**. This is because fraudulent activity can have devastating consequences on both the payment service user and the firms involved.
- We strongly support a framework which enables regulations to be amended as the market develops. We advocate an outcome/principles-based framework rather than prescriptive rules that can be rigid and hinder tech/market development. The key to such a framework is that **if regulators are given power to adapt the regulations, they must do so in consultation with the payments industry and with due regard to the regulatory framework(s) outside of the UK**. Our members predominantly operate in a digital environment, which does not have geographical limitations. The way in which firms do business has changed dramatically over the past 10 years, and it is continuing to evolve. In our view, it makes good sense to have in place a regulatory framework that can be amended to reflect developments in the marketplace, whether that is to encompass new products, and/or to address the manner in which customers are engaged.

2. To what extent would you support rationalising and/or removing the distinctions in regulation between payment institutions and electronic money institutions – in effect, combining the two sets of legislation? Would this be easier for the sector to navigate and/or lead to better outcomes?

PIF response:

In principle, we support rationalising the e-money and payment service regulations. The e-money and payment service market has evolved significantly over the last 15 years and there is often little distinction between an e-money account and a payment account or even a current account. And since e-money operations are subject to the conduct of business rules in the PSRs, it makes sense to combine the two sets of regulations.

Furthermore, Brexit has highlighted the different regulatory treatment of firms operating in both the UK and EU. For example, a firm may be viewed as an EMI in the UK, whereas in the EU, a regulator can view the same firm (carrying on the same activities) as a PI. This creates unnecessary complications for the firm from a commercial and compliance perspective, for example in connection with the different capital requirements, safeguarding and communications with its users.

Careful consideration also needs to be given to the definition of e-money. Is it equivalent to fiat currency or rather a payment instrument i.e., to be treated as a service rather than money?

Scope and definitions

3. Are (a) the definitions and (b) the scope of the regulated activities in the payments services and e-money framework clear and do they capture the right actors and activities within regulation?

PIF response:

(a) Definitions

We propose the following terms are clarified:

“e-money” what is it? The e-money definition itself is difficult to interpret particularly given we are increasingly digital in the payment space. Also, use of the term “issued” in receipt of funds in the definition is difficult to interpret in this context.

The Limited Network Exclusions (PSRs, Schedule 1, Part 2(k)) should be clarified:

- Use of the term “payment instrument” in this exclusion. The FCA confirms in its guidance (PERG 15.3 Q40) that products such as gift cards, which typically fall within this exclusion would not be classified as a “payment instrument”. The use of this term is misleading and should be amended so that products in this exclusion are distinguished from the regulated activity of “issuing payment instruments” (under PSR Schedule 1, Part1(e))

- Part 2(k)(i) "issuer's premises" should be amended to make it clear that this means both the physical (bricks & mortar) and online/digital (website) premises (as confirmed by the FCA in PERG 15.3 (Q40))
- Part 2(k)(ii) "professional issuer" – this term is not used elsewhere, in the EMRs, or in the payments or retail industry. We suggest replacing it with "issuer" to reflect terminology used for issuer in the rest of Part 2(k).

(b) Scope of regulated activities

- In practice we see an overlap of some of the payment services and we believe that it would be sensible to merge them as appropriate, for example:
  - Merge payment services in Part 1(a) and (b) because the provision of a payment account necessarily involves the provision of both;
  - Merge Part 1(c) and (d) execution of payment transactions as the services are identical save that one applies to funds received with a credit line; and
  - Part 1(e) should be split into two: issuing payment instruments and acquiring payment transactions. These are two distinct payment services.

4. Do the exclusions under the PSRs and the EMRs continue to be appropriate (includes limited network, electronic communication, commercial agent etc)?

PIF response:

The limited network and commercial agent exclusions are commonly relied on by a number of our members:

- We believe that the **limited network exclusion** continues to be appropriate as it provides a framework for products (typically gift cards) that are limited in value and used for a specific purpose. The gift card and stored value solutions market is valued at £7billion (source www.gcva.co.uk). These are valued products, by retailers and customers, as an engagement tool between the retailer and new and existing customers, and to provide the user with access to goods/services easily and quickly. Gift card use cases are broad and can be brought to market quickly in response to

demand. For example, they were invaluable in providing a mechanism for individuals to purchase food and drink (such as the school meal voucher scheme during COVID-19), as a tool to provide food and drink in an emergency (for example, at airports when flights are delayed or cancelled), for insurance payouts (to be spent within a limited network of shops), to be used in a particular geographical area (for example, to support shop local schemes) and to enable vulnerable consumer groups to have access to goods and/or services (i.e., to buy a limited range of goods from limited stores).

- The **commercial agent exclusion** is, in our view, also still appropriate because it is used to enable businesses to accept payments on behalf of third parties as part of a broader commercial relationship.

The regulatory treatment of payment services and e-money

5. How, if at all, might the framework for the authorisation of payment institutions and electronic money institutions be reformed?

PIF response:

Our comments specifically relate to the management of authorisations by the FCA, as follows:

We understand from FCA feedback that there is a lack of understanding and/or knowledge gaps in the applications submitted to them. The FCA have also commented on the widespread use of templates for policies and other documents provided with applications. We accept that an understanding of the law and the FCA's supervisory approach is fundamental for a firm seeking authorisation/registration and that their documentation should reflect their business model.

However, based on reports from our members of their experience, **we are concerned about a lack of consistency in the application reviews by the FCA from one case officer to another and a lack of understanding of the business models in the payments sector**. Understanding business models is fundamental to the FCA understanding the firm seeking authorisation/registration and the operators in the payment market so they can review the application appropriately.

To address these concerns, we would suggest the implementation of the following steps as part of the application process to assist both the applicant firm and the FCA in understanding the business and the expectations of the FCA:

- 'pre-submission meetings' with the FCA prior to firms submitting their application. This would facilitate discussion of the business model, application expectations (infrastructure and policies), timeframes to hiring key individuals, entering into outsourced arrangements and putting safeguarding arrangements in place;
- a 'handholding' period post-authorisation/registration, with a specified time period for firms to get up and running in order to meet FCA expectations; and
- appointing an FCA representative for the applicant firm to contact pre-application (before a case officer is appointed) and post-authorisation to deal with post-authorisation queries.

We strongly believe that building in this additional contact time is vital, particularly prior to applications being started as this would likely improve the quality of applications lodged with the FCA, the time required to deal with each application and, we would hope, result in a higher authorisation rate.

A similar principle could also be applied to firms submitting notifications of change in control and a variation of permission. Timing is often critical, particularly with change in control notifications, because they may be linked to certain financing arrangements, and/or to capitalise on market conditions. **A smooth, consistent process that allows both the firm and the FCA to better understand the business and the change in circumstances should be an expectation rather than a wish.**

6. How, if at all, might the framework for the registration of small payment institutions and small electronic money institutions be reformed?

PIF response:

In our experience, registration of small PIs (SPI) and small EMIs (SEMI) is limited; being registered as a SPI/SEMI is a good idea in theory, for example, to pilot a new business proposition, but it is not widely used because it is not practical to operate within the regulatory limitations. The financial transaction limit is reached quickly, which means that a business has a limited scope when operating under it. The process to transition from a

SPI/SEMI to authorisation as a PI/EMI, is not quick (a separate application is required) which means that a firm's operations are restricted significantly until such time authorisation is provided. The long timeframe for authorisation (particularly over the last 24 months) places pressure on the operations and ongoing viability of the SPI/SEMI. In practice we see new products/pilots being operated in partnership with established PSPs where the new provider is typically appointed as an agent/distributor of the PSP.

7. How, if at all, might the registration requirements for account information service providers be reformed?

PIF response:

Our members have not provided any comments in relation to the information requirements for AISPs.

8. Does the regulatory framework for payment initiation service providers (PISPs) and account information service providers (AISPs) sufficiently support the growth of this sector, and ensure a level playing field, and fair access to payment accounts, to support competition and growth?

PIF response:

We would recommend that all AISPs and PISPs access payment accounts of a payment service user via a dedicated interface rather than use a modified customer interface. Technology has moved on significantly since the PSRs came into force. Using a dedicated interface designed to access account information is more secure than a modified customer interface which may not have been designed for such access by AISPs and PISPs.

We also suggest a clear liability framework for ASPSPs, distinct from PISPs/AISPs to help/stimulate growth in the sector.

9. How, if at all, might the registration requirements or wider regime for agents be reformed? Information requirements for payment services

PIF response:

The process for registering agents with the FCA has become protracted. The delay in registration can have a detrimental impact on both the PSP and the proposed agent's activities. Under both the PSRs and EMRs, PSPs remain responsible for anything done or

not done by any of its agents with respect to issuing, distributing or redeeming e-money or provisions of payment services on the PSP's behalf, so there is no consumer protection issue. We would suggest that PSPs should be responsible for carrying out appropriate due diligence regarding its proposed agents and notify the FCA of its agents under a notification regime (e.g., mirror the procedure for distributors) rather than wait for FCA registration to occur.

10. Is the current framework for the provision of information to payment service users effective? If not, how should its scope change?

PIF response:

We have no comment to make regarding the provision of information to payment service users.

11. Are there particular changes that you would advocate to the Cross-border Payments Regulation in relation to the transparency of currency conversion, and what would these entail?

PIF response:

We have no comments to make in relation to the Cross-Border Payments Regulation.

Rights and obligations in relation to the provision of payment services

12. What has been the experience of a) providers and b) users/customers in relation to the termination of payment services contracts? Does the existing framework strike an appropriate balance of rights and obligations between payment service users and payment service providers, including but not limited to a notice period applying in such cases?

PIF response:

We do not have any particular issues regarding the notice period for terminating contracts.

13. With reference to paragraph 31 of the accompanying review, do stakeholders have any feedback on the government's view:

- that, as a general principle, a notice period and fair and open communication with a customer must apply before payment services are terminated?
- that the regulations and wider law operate here as set out under paragraph 29?

PIF response:

We have no comments.

14. How and when do providers cease to do business with a user, and in what circumstances is a notice period not applied?

    PIF response:

    There are limited circumstances in which notice periods are not applied, namely when a payment service user does not comply with the product T&Cs and/or if there is suspicion of, or actual occurrences of, fraud or other illegal activity.

15. How effective are the current requirements in the Payment Services Regulations, notably under Regulations 51 and 71 – are these sufficiently clear or would they benefit from greater clarity, in particular to ensure that notice-periods are given and customer communication is clear and fair? Should there be additional protections for payment service users against the termination of contracts? Should anything be specific to protect their freedom of expression – e.g. to ensure that adequate (or longer) notice is given in such cases, and what communication requirements should apply?

    PIF response:

    Achieving a balance between the rights of payment service users and the right of a payment service provider can be tricky in one set of arbitrary rules that apply to a broad range of payment service products. We do not believe the requirements need to be changed, but it is a matter for the PSP to ensure that their communications and agreements with their users are set out in a form and using such words that their customers can see and understand. We believe it is important to maintain freedom of contracting for both the payment service and the PSP and for the parties to agree whether/how to terminate in different circumstances.

<u>Wider considerations in relation to the provision of payment services</u>

16. What provision, if any, should the regulatory framework make regarding charges for payment services?

    PIF response:

    We believe that charges should be clearly disclosed to the payment service user as part of the pre-contractual information (T&Cs) provided to the payment service user.

17. Does the existing framework strike an appropriate balance of rights and obligations between:

    - Sending and receiving payment service providers?
    - Account servicing payment service providers and payment initiation service providers/account information service providers?

PIF response:

The requirement for a PSP to safeguard funds until such funds are paid out to the payee or the payee's PSP can give rise to the payer's PSP having to safeguard more funds than actually issued. The FCA Approach Document guidance states: *"the funds must be safeguarded by the PSP for the benefit of the payer or payee; it is not sufficient for the funds to be safeguarded for the benefit of another institution in the payment chain".* Where a transaction involves the transfer of funds to another PSP before being received by the payee (or their PSP), the payer's PSP must safeguard a duplicate amount, regardless that the funds will also have to be safeguarded by the intermediary PSP. **We question why the duplicate safeguarding should apply in such circumstances and support a more balanced approach** in that the PSP holding the funds i.e., the payer, intermediary or payee PSP be subject to the safeguarding obligation.

18. Are consumers adequately protected from evolving fraud threats under the existing legislation – is further policy needed to ensure this, and how should that policy be framed?

PIF response:

Fraud is forever evolving, identifying the easiest targets and weakest security points. The increase in use in digital payments is also marked by an increase of online/digital fraud.

We are very concerned that the regulatory approach to protecting consumers is framed around requiring the PSPs to fund/reimburse consumers who have been a victim of fraud. Our members take fraud very seriously; it causes untold damage to the victim, mentally and financially, and reduces their confidence in the services provided by their PSP. It also has a significant detrimental impact on the PSP; on its confidence in its customers and on its business financially. **The current approach to increase the protections for consumers in the PSR's mandatory reimbursement proposal will not**

address this issue. Whilst we advocate a regulatory framework that promotes appropriate transaction monitoring and systems to help detect and, where appropriate, block suspicious transactions, **the primary focus should be on educating the users of financial services of types of fraud taking place and how they can protect themselves**. We strongly believe that education through the joint efforts of government, regulators, PSPs and stakeholders is the only way to tackle this. Placing the burden (education and financial risk) for consumer fraud on PSPs is not the answer. The mandatory reimbursement proposal provides for an unrealistic and unsustainable expectation that the consumer is financially protected by their PSP from fraud events and from a fraudster's perspective that there is no consumer victim (because the PSP will fund any losses the consumer suffers), and the mistaken belief that such losses can be financially borne by the PSP**. There is a very real risk of PSPs withdrawing products from the market unless there is collective action and supportive action to combat fraud.**

19. In relation to payment transactions which payment service providers suspect could be the result of fraud, is there a case for amending the execution times for payments to enable enhanced customer engagement? What requirements should apply here to ensure the risk to legitimate payments is minimised and that such delays only apply to high-risk, complex-to-resolve cases?

PIF response:

We believe that it does make sense to allow additional time or delay the execution time for suspicious payments to enable enhanced customer engagement. However, the requirements that should apply require further thought and must involve further discussion with the payments industry. We do not believe that a delay should only apply to high-risk, complex-to-resolve cases. Many frauds take place because they appear to be legitimate but on closer inspection seem out of character for the payment service user to make. A framework for enabling the PSP to investigate further and delay the payment (for a maximum period) should apply regardless. Where the PSP discovers the matter is more complex, then they should be permitted to extend the delay or suspend it for a longer period. In all such cases, the suspicions of the PSP, the action/engagement undertaken with the payment service user and the outcome should be documented.

20. In relation to fraud, whether unauthorised or authorised, is there a need to a) complement rules with data sharing requirements; and b) for further reforms be made to make Strong Customer Authentication work more effectively and proportionately?

PIF response: We have no comments to make at this time.

Issuance and redeemability of electronic money

21. Are the requirements regarding issuance and redemption of electronic money still appropriate?

PIF response:

- Issuance and redeemability: We support aligning e-money issuance and redemption requirements with those that apply to payment service activities under the PSRs. Many e-money products (e-money accounts) overlap considerably with payment accounts and there is little difference (especially to the user) between the two.
- Holding funds following termination of the agreement: In our experience, the level of redemption by e-money holders of funds in their closed accounts (during the 6-year period following e-money account closure) is very low.
- Prohibition of interest: In addition, unless there is a compelling reason to retain it, the prohibition on payment of interest or any other benefit related to the length of time during which an electronic money holder holds electronic money, can also be removed. This prohibition does not apply to funds held in a payment account.

Miscellaneous

22. Noting the intention to commission an independent review in due course, do you have any immediate observations on the efficacy of the operation of the Payment and Electronic Money Institutions Insolvency Regulations to date?

PIF response: We have no comments to make on these regulations at this time.

23. Finally, do you have any other observations relating to the payments framework not encompassed above, and how this could be further improved, in line with the government's objectives?

PIF response:

The success of the UK payments regulatory framework depends on the interaction of industry regulators with the payments market. In principle, we support the proposals put forward in this Call for Evidence. However, **the legal framework and implementation of regulations by regulators will only be successful if the regulators understand the impact on the firms subject to them, and the wider implications for payment service users**.

This is an opportunity to put a communication framework in place between regulators and the payments community to allow each to learn from the other and help the payments sector to evolve responsibly whilst maintaining confidence in the market.

Payments Innovation Forum Ltd

7 April 2023