CP23/12: Expanding variable recurring payments – Call for views

Pay.UK response

Version 1.0
February 2024
Classification: Public

Contents

1 Executive summary

We welcome the Payment Systems Regulator's (PSR) call for views on the phased expansion of Variable Recurring Payments (VRP), with a focus on Phase 1 and the use cases that the PSR is proposing.

As an overview of our response:

- We support the creation of a multilateral agreement (MLA) as the appropriate vehicle for the expansion of VRPs, as it ensures cross-industry coordination and consistent consumer outcomes across the industry. The MLA will need to ensure end-to-end coverage of a transaction under a single set of agreements and rules
- As the recognised operator and standards body for the UK's retail interbank payment systems, we have the appropriate experience and expertise to operate the relevant elements of the MLA
- We think it is important for the PSR to provide a full options analysis and explanations of how it has reached each of its policy conclusions in the next Phase of this work. This will help industry stakeholders to understand PSR perspectives and make implementation more efficient.
- In particular, it would be beneficial for the PSR to explain its preference for removing the Faster Payment System charge and the analysis that supports this policy preference
- If the PSR wants to remove the sending bank charge, we would want to recover the cost from within the VRP product, so from the receiving bank. This would prevent cross-subsidisation by other Faster Payment System transaction types and other services.
- We can make the technical adjustment to facilitate a zero sending bank charge, if that is the PSR's decision
- We think that there is a need for a minimum share of Personal Current Account customers for the pilot to be successful. Mandating participation is one way to achieve that, however, it should be a final step and it is worth first considering if there is still potential for a smaller group of willing stakeholders to deliver Phase 1. This smaller group may mean a more responsive and efficient Phase 1.
- The delivery timeframe of October 2024 appears challenging given the ongoing consultation and in the context of a busy programme of regulatory initiatives. We will provide a detailed delivery plan for the end of Q1, in line with the PSR's request, and will ill engage with the PSR and stakeholders as we develop this plan.

We are keen to contribute our knowledge, expertise and perspectives throughout the development of VRPs and beyond Phase 1, and we are happy to support our continued engagement with Joint Regulatory Oversight Committee (JROC).

2 Response to questions

2.1 The pricing principles

Question 1: Do you think the pricing principles as published in June 2023 support delivery of a sustainable commercial model for Phase 1? Please explain the reasons for your answer.

The high-level pricing principles seem appropriate to guide the delivery of a sustainable commercial model. However, to fully assess the efficacy of the principles, further detail on their operation and implementation is required. For this, a clear outline of what a successful Phase 1 looks like, is required.

It is likely that there will be trade-offs or contradictions between the principles during implementation. It does not appear that these trade-offs have been explicitly considered for Phase 1 and guidance on how the PSR has approached this case, would help to understand how the PSR intends to manage these trade-offs, and prioritise the principles in specific cases.

Finally, it is not apparent how the principles have been incorporated into the PSR's suggestions for the commercial model. We, and the industry, would benefit from the PSR further explaining its thinking on how its proposals for Phase 1 align with the pricing principles, and how this could develop beyond Phase 1.

2.2 Contractual design for Phase 1

Question 2: Do you think that cross-industry coordination is necessary for Phase 1 and that an MLA is the appropriate vehicle to achieve this? If not, please explain what approach you think is more appropriate and why.

We agree that cross-industry coordination is required to ensure the delivery of Phase 1. An MLA would ensure that there is consistency in areas critical to the safe and resilient expansion of VRPs, and encourage stability, security, and consistent consumer outcomes. At a minimum, the MLA should include setting the scope of transactions covered, access criteria, operational and functional specification, dispute resolution, change management and pricing.

Whilst the benefit of not operating with cross-industry coordination may be speed, in our view, this does not supersede or outweigh the benefits of operating with coordination. In the longer term, an MLA will help to reduce costs and establish consistent outcomes for consumers.

It is important that the MLA includes appropriate parties. This should include both sending and receiving banks to ensure end-to-end coverage of a transaction under a single set of agreements and rules. This will be particularly important for supporting dispute resolution and exception handling.

Question 3: Do you think Pay.UK is best placed to operate the MLA for Phase 1? Please explain your rationale and whom you think might be better placed if you disagree.

We are the recognised operator and standards body for the UK's interbank payment systems: the Bacs Payment System, the Faster Payment System and the Image Clearing System. This is alongside the delivery of ancillary products related to payments, such as the Current Account Switch Service, Confirmation of Payee and Request to Pay. This positions us at the heart of the interbank payments' ecosystem, and in a strong position to operate the MLA and provide central coordination, where required. Our experience in operating this technology, and implementing rules and standards and associated controls and policies, also provides us with the appropriate expertise to operate the MLA.

However, before taking on an extended role operating the MLA, we must ensure that:

- We have an opportunity to substantively feed into responsibilities we have under the MLA
- We have the capacity and capability to deliver these additional responsibilities to agreed timeframes (including for both current responsibilities and other new activities/change programmes)
- The new role has a sound legal basis and is within our organisational risk appetite
- Set-up and running costs are appropriately funded
- We are not necessarily responsible for completing all the activities within it (e.g. we could have overall ownership, but other parties could be responsible for certain elements)
    - For instance, operating a comprehensive dispute resolution process will require collaboration with Open Banking (OB) as the payments are initiated using OB standards.

As we have described to the PSR in our previous engagement, we think the following elements of the MLA would not be for us as the Payment System Operator (PSO) to decide, and could considerably delay delivery if we were required to take them forward:

- Setting the level of consumer protection (if required) – we think this is for regulators and government, as is the case for other retail payment instruments
- Pricing and commercial models across the value chain – we think that if central intervention is needed, then regulators are better placed to own this. This is a highly contentious issue for the various JROC stakeholders and we think it is unlikely it can be agreed by consensus. However, we will need to provide input on pricing to ensure that our costs of operating are recovered
- Mandating firms to join (if it is not voluntary for all) – we believe this is for regulators. We do not have the power to compel firms to join an MLA
- Adjudicating liability disputes between parties –this is not a role we currently occupy, although we can advise parties on the correct interpretation of the dispute rules. Any new role for us in adjudicating liability disputes, would need to be evaluated and approved by our board.

2.3 Possible price intervention in Phase 1

Question 4: What do you think of our current view of the market structure and sending firms' position in it? What do you think we could do to mitigate risks or overcome misaligned incentives?

No response.

Question 5: Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.

Whilst the Faster Payment System charge has been appropriately identified as a cost, there are further costs directly associated with being part of an MLA that have not been considered. For example, onboarding costs in joining an MLA, and costs associated with the development of legal agreements and the compliance mechanisms, required to support them. Similarly, implementation of a dispute resolution processes will incur an additional cost. These costs will fall not only on sending firms, but also on Third-Party Payment Service Providers (TPP) and receiving firms.

Question 6: Do you think allowing sending firms to charge for FPS related costs or removing the costs where possible is a better approach? Please explain why.

The consultation paper does not contain the PSR's policy thinking, or the analysis, that has led it to propose the removal of Faster Payment System costs for sending firms. It would be important for the PSR to share detailed thinking with stakeholders as it takes forward the development of its proposals on the commercial model. In the time available, and in the absence of detailed analysis by the PSR, we have not been able to complete a full competition and legal analysis of the impact of this change and its potential consequences, and therefore feel unable to respond fully to this question.

We note however that removing the cost for sending firms would necessarily result in a reallocation of costs onto other firms (e.g. receiving firms), resulting in a cross-subsidy between different market participants. As mentioned in the answer to question 1, clarity on how this would be consistent with the pricing principles set out by JROC, would be helpful. As part of its further analysis we would expect the PSR to consider the distributional impact of such a pricing structure (e.g. whether costs could disproportionately fall onto a specific segment(s) of payment service providers (PSP)). Overall, more analysis is required concerning the potential market distortions and impact on different parties.

The alternative of passing the Faster Payment System cost to TPPs, would be consistent with existing pricing practices, and would reduce the amount of change that must be implemented. We encourage the PSR to set out its thinking more explicitly on why a change from this approach is justified, against the additional complexity that implementing this change may introduce.

Question 7: Our current preference is to remove the Faster Payment System 'price per click' charges from sending firms for VRPs. Do you think this charge should be switched to the receiving side or recovered through wider Pay.UK charging, and why?

In the event that the PSR decides that the Faster Payment System charge should be removed from sending firms, we would want to ensure that the pricing is fair for senders/receivers of VRP transactions and all Faster Payment System users. We therefore think this cost should then be allocated to the receiving firm. This means that cost recovery is kept within an end-to-end VRP transaction, and avoids a cross-subsidy by other Faster Payment System transaction types and other services. Reallocation of the cost of VRPs to other payment types within the Faster Payment System would mean cross-subsidisation between products, and potential market distortion.

In order to make either model operational, we would need to have confidence that participants consistently flag the VRP transactions, using the new VRP markers, for example, by introducing sample checking and assurance activity to ensure that firms have implemented these flags appropriately. We are on track to develop the new VRP marker and roll it out to customers. In parallel, we will work up assurance mechanisms for this new requirement.

Question 8: Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.

No response.

Question 9: What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

The final commercial model chosen should reflect the full VRP transaction life-cycle and costs, rather than focus on the initiation of the transaction alone. For example, it would be important to consider costs to the biller in the adoption of this arrangement, and not only those which arise from its relationship with the TPP holding the VRP mandate. The commercial model should align stakeholder interests, including those of merchants, consumers and the various sectors within banking, payments and financial services. This will incentivise investments and encourage consumer and merchant adoption, which will in turn drive sustainable growth and competition within the payments industry.

2.4 Possible mandated participation in Phase 1

Question 10: Do you think that a large number of consumers with accounts that support VRPs in Phase 1 will sufficiently incentivise PISPs and/or billers to invest in offering VRPs? If not, please explain why.

Our research and experience suggest that merchants/billers will need to adopt a payment method first, so that a consumer can make a choice about how they wish to complete a transaction. This choice is usually dictated by convenience and ease of use. Consumers do not typically work in organised groups and a large number of consumers with VRP capable accounts, doesn't immediately mean high use rates. As such, consumer focused user experience awareness and control tools need to be provided by the banks and billers to deliver 'best outcomes' for consumers, to encourage use. This would require investment.

Merchants/billers would be better incentivised by lower overall cost of payment processing, and making higher revenues by attracting new sources of customers. Therefore, wider ecosystem considerations are also required to achieve the network effects, in addition to just consumer bank accounts that are VRP capable.

Our experience of Pay By Bank (PbB) style solutions is that the merchant will 'steer' the consumer journey towards PbB, due to the benefits of reduced costs for the merchant at higher average transaction values. If billers were to take a similar approach for VRPs, then this may achieve the desired outcome.

Question 11: What number or share of consumer accounts do you think need to support VRPs in Phase 1 to incentivise sufficient PISP and/or biller investment to realise network effects? Please explain your rationale.

No response.

Question 12: Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.

We understand there to be support for taking this work forward from a number of PSPs and Payment Initiator Service Providers (PISP) (as evidenced by the UK Finance work on model clauses). From a competition and innovation perspective, it may be preferable to allow a smaller group of willing stakeholders to take this work forward and reap the reward of being first movers, rather than compelling a wider less committed group. However, we also note the possible scalability concerns and the potential likelihood of merchant / biller dissatisfaction, if consumers cannot use a promoted payment method because their preferred current account provider has not taken part. Our engagement with PSPs also indicates ecosystem concern regarding mandating participation.

Question 13: If we do not mandate the CMA9 banks, how do you think we can ensure a sufficiently large number of customer accounts will support Phase 1 to realise its full potential?

Ensuring good consumer outcomes stem from the control and management of the more flexible mandates that VRP could offer.

This brings associated investment and management costs: Banks, merchants, and billers need the use case to be compelling, and recognise the benefit in order to invest in the capability above that protects both themselves and consumers. Consumers need to be able to experience added convenience if they are to be persuaded to take up an alternative payment method.

Whilst critical mass is required for scale, mandating the CMA9 to participate does not necessarily lead to consumer adoption, enthusiasm to use VRPs or best customer outcomes. As noted above, a smaller group of willing stakeholders may result in better outcomes. Adoption of new payment methods is not typically consumer-led. However, in line with our answer to Question 12, it could be difficult to achieve a successful pilot outcome and learnings without sufficient scale of consumer participation.

Question 14: What do you consider to be the main risks and costs of mandating participation in Phase 1? How could such risks and costs be mitigated?

No response.

Question 15: Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.

An alternative participation model could entail beginning Phase 1 with willing participants as opposed to mandating CMA9 participation. This may mean that willing stakeholders will be keen to develop VRPs further than mandated participants. This may also act as a 'point of difference' for consumers between merchants (supported by TPPs) and between account providers, encouraging competition and innovation.

Similarly, as noted, mandating CMA9 participation risks Phase 1 moving at the pace of the slowest - a smaller group of willing participants may mean a more responsive and efficient Phase 1. However, we recognise that such an approach will need to be managed against the requirement for sufficiently large enough mass, to ensure the utility and insightfulness of Phase 1.

Question 16: Do you think there are additional risks associated with our proposed commercial model that we should consider? Do you have additional insight on how we best mitigate the risks identified or any additional risks you may want us to consider?

By operating a different price for VRP transactions from other OB initiated transactions, and from other broader Faster Payment System transactions, there is a risk of adverse selection which may have unintended impacts. For example, a receiving firm may prefer Non-VRP transactions over VRP ones, and may set acceptance parameters, and fees to merchants and billers, accordingly. The final commercial model should be subject to a market analysis and competition law review to ensure that it is not creating a competitive distortion.

2.5 Costs, benefits, and equality impacts

Question 17: Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis? Please provide reasons for your response.

No response.

Question 18: Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response.

No response.

Question 19: What do you think are the key benefits of VRPs for each of the components of the value chain: consumers, merchants, the PSO, PISPs and sending firms? How should or could these be measured?

No response.

Question 20: What do you think are the key costs of VRPs for each of the different components of the value chain: consumers, merchants, the PSO, PISPs and sending firms? How should or could these be measured?

As a PSO, we will incur additional costs in supporting the operation of VRPs. These costs include:

- Central infrastructure costs
- Costs associated with managing an MLA and MLA customers

- Development costs
- Costs associated with Phase 1 and subsequent phases.

These costs will need to be recovered as part of any funding and pricing model and we would engage with customers to support this.

The costs incurred by the remaining components of the value chain are better explained by the appropriate parties.

Question 21: How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?

It is difficult to accurately determine the impact that these proposals will have on people with protected characteristics. However, as part of Phase 1, a monitoring process should be included through which these impacts can be better understood, allowing for the interests of people with protected characteristics to be better served in subsequent phases.

2.6 Beyond Phase 1

Question 22: Do you think our current policy proposals pose any risks to the scalability of VRPs and Open Banking beyond Phase 1? If so, please explain why.

The long-term success and scalability of VRPs and open banking beyond Phase 1 is critically dependent on a clearly articulated funding and governance model and coordinated strategy on how the PSR intends to proceed beyond Phase 1. We are keen to lean into work on funding and governance as we believe it is essential to ensure that the structures put in place are scalable. Without this, there is a risk that the expansion of VRPs (or account-to-account (A2A) payments, more widely) may not be effective in introducing a widely adopted alternative payment method, both by consumers and banks.

At a consumer level, there appears to be market consensus building for the development of a standardised acceptance mark or brand, in order to help build awareness, confidence and trust with end users. This will enable a consistent consumer journey, regardless of the method of initiation and who the consumer banks with. Recent consumer research conducted for us suggests that 55% of respondents would be more likely to use an A2A wallet if there was a branded logo appearing for payments, via a bank. This rises to 71% for 18-24 year-olds and 69% for 25-34 year-olds. Likewise, our experiences with PayM also indicate that a gap here could jeopardise the success of VRPs. Although it is not currently on the agenda for the Phase 1 pilot, we recommend adding this as a requirement for the MLA.