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Payment Systems Regulator
Submitted by email to: a2a@psr.org.uk

2 February 2024

Dear Account to Accounts Retail Transactions team,

EMA response to CP23/12: Expanding variable recurring payments - Call for views

The EMA is the EU trade body representing electronic money issuers and innovative payment service providers. Our members include leading payments and e-commerce businesses worldwide, providing online payments, card-based products, mobile payments, merchant acquiring services, and increasingly payment initiation services (PIS) and account information services in the UK and globally. A list of current EMA members is provided at the end of this document.

We welcome the opportunity to respond to the PSR's call for views on expanding the use of Variable Recurring Payments (VRP) beyond sweeping. We share the PSR's ambition to move forward at pace, and appreciate that the PSR's proposals are focused on driving momentum in the market. However, we note a number of challenges that the proposals do not yet fully address; particularly regarding aligning incentives across the market to create a balanced and sustainable ecosystem for commercial VRPs (cVRPs).

I would be grateful for your consideration of our comments and concerns that we have set out in our response below, and we are available to discuss in more detail at your convenience.

Yours sincerely,

Dr Thaer Sabri
Chief Executive Officer
Electronic Money Association

EMA responses

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.

We do consider that the pricing principles as published in June 2023 set a clear policy direction for the ecosystem to develop a sustainable commercial model for Phase 1 for cVRPs. However, as we discuss in more detail under Q5, we are not yet clear on how the PSR's application of these principles to develop the proposed pricing structure will lead to a fair and sustainable pricing model for <u>all possible participants</u> in the Phase 1 ecosystem.

In particular, we would welcome the PSR's further clarification and analysis on the assumption that the FPS fee is the only incremental cost that sending firms incur to execute Faster Payment transactions, and the feasibility of zero Faster Payments transaction fees being applied to sending firms that are <u>not direct participants</u> of Faster Payments. Unless the initial pricing model can be applied equally to all possible sending PSPs who could participate in Phase 1 there is an inherent risk of restricting the viability of participation from the outset.

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.

The EMA believes that cross industry coordination is needed to drive forward with Phase 1, and that in order for compelling, and importantly, consistent cVRP proposition for customers to emerge, a multilateral framework approach may be appropriate. Equally, a multilateral approach would form the foundation for expanding to other use cases at pace as the market identifies viable opportunities.

Nonetheless, we query whether an all-encompassing MLA is required for Phase 1 based on the scope of the contractual relationship that the PSR envisage (para. 4.2 of the consultation) i.e. to encompass the required functionality, arrangements for pricing, dispute resolution, and liability. The functional requirements for VRP are established in the OB Standards, adopting the PSR proposed pricing arrangements and liability would be amendments to the Faster Payment scheme, leaving only dispute resolution as an area required to cover the whole ecosystem.

We believe that if Phase 1 is considered to be a true 'pilot' phase, then with a well-defined but limited scope, the provisional MLA could be minimal and operated by Open Banking Limited as an extension of the sweeping VRP rollout. Thus, supporting the PSR's timescales for moving forward with cVRP, and also providing the ecosystem wih the opportunity to work with the PSR to develop a viable, balanced, longer term commercial model.

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 appreciate the practicality of the PSR's suggestion that Pay.UK is the operator of the MLA for Phase 1, given their existing expertise. However, we believe there are potential risks to the long-term success of Phase 1 and cVRP of selecting Pay.UK as the operator of the MLA.

Firstly, Pay.UK's current governance and operating structure mean that many PSPs (acting as both sending PSPs and PISPs) may have limited influence on the design and development of the multilateral framework as they do not have a direct relationship with Pay.UK. Even if a broad representation of the market is given equal participation in working groups and discussions as Pay.UK develop the MLA, PSPs may not be able to participate in Pay.UK's ultimate internal governance and decision-making process for finalising the MLA, and might only be able to influence the arrangements <u>after</u> the MLA is in place (i.e. by becoming participants). Nor can they participate in any follow-on decisions in relation to the Faster Payment scheme itself, given the possible implications of setting transaction fees to zero for Phase 1.

This could risk 'baking-in' an unlevel playing field to the cVRP MLA from the start, and affect TPP and billers' ability to participate and see cVRP as a long-term sustainable investment. Particularly because, in all likelihood, Pay.UK would become the defacto operator of cVRP's MLA beyond Phase 1, given the cost and disruption that changing operator would likely cause the live market which emerges.

Moreover, we query the impact that Pay.UK adopting the role of operator of the Phase 1 MLA will have on the wider payments ecosystem with the proposed implementation timescale. Such as possibly diverting resources from the NPA programme, Confirmation of Payee rollout, or the implementation of the APP scams reimbursement mechanism, and ultimately in the long-term increase the costs of participating in existing payment schemes to recover cVRP costs (which could also undermine the viability of cVRP).

Without a clear set of requirements, both in terms of scope, governance, and deliverables for the operator of Phase 1 it is not possible to assess whether Pay.UK can meet those requirements without unintended consequences which could affect the future success of cVRP, and potentially impact the whole payments ecosystem.

We also note that understanding the outcome of the PSR's discussions with Pay.UK regarding the impact of removing the marginal costs of FPS charges for sending firms (as reference in para. 4.17 of the consultation) will be a key factor in understanding the impact on the wider payments' ecosystem, and if Pay.UK is the right body to operate Phase 1.

We believe that the operator of Phase 1 should be an independent body with equitable participation from account providers (sending PSPs) and TPPs. Ideally, this would be Future Entity currently being designed by JROC, but as we suggest in our response to question 2, given Open Banking Limited's central position within the OB ecosystem they are well placed to initially take on this role.

The structure, funding and operation of an industry-led working group for the design and development of the EPC's SEPA Account Access (SPAA) scheme demonstrates that there could be appetite on both the supply and demand side of the market to support such an independent body, but we recognise the impact of this option in possibly slowing progress.

Should Pay.UK remain the PSR's strategic choice for the operator of cVRP, then we call on the PSR **to fully address** the imbalance of representation and participation given Pay.UK's existing governance structure, and to provide an assessment of the impact on in-flight payment initiatives and full transparency of the delivery plan for Phase 1 of cVRP. Finally, the PSR must **fully explore and disclose** the consequences of recovering cVRP costs from the wider payments ecosystem in its final recommendations.

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?

We recognise the market structure that the PSR sets out and agree that there is a risk that sending firms may seek to protect other payment method revenue streams when commercializing VRP.

However, we note that the PSR's analysis does not consider the **receiving PSP position** in the market dynamic. Yet it is clear that the PSR does intend that firms leverage their position as receiving firms to "*innovate ..to commercialise VRPs further*"[1]. And as explicitly set out by Chris Hemsley in his speech on 25th January 2024[2] "*Particularly on the receiving side, where the costs of VRP can be recovered from users. By targeting cost recovery at the receiving end – through the provision of business banking accounts….*".

The fees which billers may be charged for receiving Faster Payments into their bank account can already be significant. To then factor in a possible regulator sanctioned increase in cost for receiving cVRPs to recover transactions costs, seems wholly counter to the PSR's objective of reducing costs to billers and could risk that billers find that cVRP is not a viable alternative payment method, or narrow the potential market for cVRP use significantly. All of which will not support the PSR's intention of increasing competition and payment choice with the rollout of cVRP.

Both JROC[3] and the recent HMT Future Payments review[4] consider that enabling OB payments as an alternative to cards is key to increasing competition in payments. To this end the PSR refer to their concerns regarding market pricing of cVRP to compensate for loss of interchange revenue (para. 4.10 of the CP). However, we note that the target Phase 1 use cases are likely to reduce the use of Direct Debit (DD) not cards (on-file), but the PSR has not fully considered the impact of DD replacement in their analysis.

We urge the PSR to consider the full end to end market structure of the transactions which will likely form part of Phase 1 when contemplating intervention in the pricing model to ensure that unintended consequences do not arise, and we suggest that the PSR discount the option to switch sending fees to the receiving PSP side which will ultimately undermine the key objective of increasing choice and competition.

[1] Para. 4.12 of CP23-12
[2] https://www.psr.org.uk/news-and-updates/speeches/speeches/chris-hemsley-speech-at-the-payments-regulation-and-innovation-summit-2024/
[3] Para. 2.15, JROC Recommendations for the next phase of Open Banking Report (April 2023)
[4] HMT Future Payments Review (November 2023)

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

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.

Question 7
Our current preference is to remove FPS '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 response to questions 5-7:

The EMA supports finding a pricing model which creates an investment path for all potential cVRP participants, and we recognise that removing the Faster Payment (FPS) transaction fees for sending firms could act as an incentive for some firms. However, we consider that there are gaps in the current proposals which mean it is not yet clear if removing FPS fees in return for zero- fees paid by PISPs for Phase 1 may create a sustainable model to base cVRP in the longer term.

First, it is not clear how long the PSR intends this model to be in place for the selected Phase 1 billers. Nor is there any indication on the number of expected billers and volume of transactions that could be supported under Phase 1. To provide certainty for all Phase 1 participants we suggest that the PSR consider a more prescribed 'pilot' scope for Phase 1 which includes time-boxing the phase and setting out clear objectives and expectations. This will also support the development of a roadmap beyond phase 1 to future use cases based on a suitable commercial model.

Secondly, we are concerned that a pricing model which does not allow for sending PSPs to receive compensation will impact on their incentives to provide good quality cVRP services to support wide-spread usage by payers and billers. Ultimately, this will lead to poor adoption rates in Phase 1 and no clear path to further rollout.

Thirdly, as we mention under question 1, the proposals to remove FPS fees for sending PSPs does not yet indicate whether the PSR intend that Direct Faster Payment participants will be required to pass on the FPS cost saving for cVRPs initiated by indirect participants. If they do not, there is a clear disincentive for indirect PSPs to participate in Phase 1, or extend coverage to these billers in later stages, and sets a precedent for latter stages of rollout to other use cases.

Finally, as we discuss above, the prospect of shifting FPS fees to the receiving PSP to recover the cost of cVRP transactions could impact the viability of biller and PISPs cVRP propositions because the charges for receiving faster payment transactions can already be high, and only the largest billers may be able find a price point which would support an investment case for adopting cVRPs. This proposal also seems entirely at odds with the PSR's objective of reducing costs to billers.

Without any indication of the impact on the wider payments ecosystem of removing FPS charges in Phase 1, it is impossible to determine whether it is a desirable option. We are concerned that overall, the cost of FPS transactions could increase and the impact this would have on smaller UK PSPs, and ultimately longer term cVRP use cases ever developing. Full transparency by the PSR and Pay.UK on their analysis of the implications of removing the FPS transaction fees for Phase 1 **is essential.**

Question 8
Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.
No comment

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

We agree with the PSR's position that regulatory guardrails on bilateral arrangements and replicating revenue from other payment methods will likely not deliver a sustainable commercial model for Phase 1.

We also recognise the PSR's pragmatism on trying to move the market forward at pace. But we consider that ultimately cVRP is likely to be more successful if the baseline pricing model is established to ensure commercial viability for all participants. At the moment, it is not clear that the proposed zero PISP fee/zero Faster Payment fee model would deliver that outcome for Phase 1, and provide enough incentive for participants to expand to further use cases, such as e-commerce.

All participants must be incentivised to invest and deliver a robust cVRP proposition from the outset. A market price that is attractive to billers to create competition with other payment methods, but more than zero to incentivise sending PSPs, will be needed to be created to build a sustainable ecosystem, and allow the UK to keep pace with other jurisdictions already exploring commercial models.

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.

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.

In response to questions 10-11:

Consumer coverage will be a key factor in enabling PISPs to develop viable VRP propositions, and to support billers in making a decision to invest in VRPs. However, the number or share of consumer accounts that support VRP that is required for Phase 1 largely depends on the scope and objectives that the PSR determine for Phase 1.

For instance, a time-boxed "pilot" of cVRPs (as discussed above) with a selection of billers may require fewer consumer accounts to fully test the proposition. But if Phase 1 is defined as "rollout" to the targetted sectors then it will be essential that a high percentage (>90%) of consumer accounts can use cVRPs.

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

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?

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?

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

In response to questions 12-15:

Given the market inertia in developing cVRP so far, and that coverage will be key to driving consumer and biller adoption, we understand the PSR's case for mandating CMA9 participation. However, experience from the CMA Order demonstrates that mandating participation may inevitably, risk leading to some of the same issues arising – a compliance driven approach to API services, limiting functionality and performance, and ultimately impacting user experience of cVRP and biller's willingness to offer it as a payment method. All leading to no incentive for the market to promote cVRP use and extend beyond the mandated use cases.

We consider that mandating participation in Phase 1 requires a trade-off between which banks are mandated and the commercial model to fully set the foundations for a successful cVRP ecosystem. For instance, the PSR could determine participation in Phase 1 based on metrics such as share of Faster Payment transaction volumes in return for market-led pricing (with possible restrictions set by the PSR). This approach, coupled with no barriers to voluntary participation, would ensure sufficient coverage for Phase 1 whilst also genuinely testing the commercial viability of cVRP.

We recognise the possible impact on implementation timescales for Phase 1 of this approach. But it also presents the advantage of moving the market forward, based on a model which is commercially sustainable and scalable.

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?
Please see our responses throughout.

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.

We agree that building on the conclusions of the JROC VRP Working Group and quantifying the cost benefit of the lower risk use cases identified is likely to support an initial launch phase for cVRP. We particularly welcome that the PSR has included payments to all financial institutions in scope as this presents opportunities for PSPs to leverage the benefits of VRPs in their propositions.

As discussed in our previous responses, we do believe that the scope of Phase 1 should be limited and seen as an expansion of the rollout of VRP for Sweeping. We note that the PSR intend to take a cautious approach to the cost benefit analysis (para.34 of the CP) and would suggest that the analysis could be used as the basis for establishing the scope of Phase 1 to ensure that the sectors, billers, and types of payments for Phase 1 will provide the maximum opportunity for the ecosystem to test and develop a long-term path for cVRP.

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

We note that a 10-year time horizon for cost/benefits analysis for innovative product launches seems quite long. For instance, in developing the commercial model for the European SEPA API (SPAA) scheme, a shorter payback period was considered for launching new products/services. Likewise, we don't fully agree that alternative payment methods won't significantly improve within a 10-year period, as this doesn't reflect the reality of pace of innovation in payments which has been demonstrated in the last 10 years. The 10-year time-span seems more appropriate for the comprehensive rollout of cVRP across a variety of use cases, rather than a limited Phase 1 launch.

Regarding the impact of the NPA migration costs – we consider that the method for recouping the NPA migration costs from payment scheme members (and ultimately the whole ecosystem) could very well impact on the pricing of Faster Payments, which in turn may impact on the viability of cVRP beyond the envisaged Phase 1. All of the initiatives currently being implemented by Pay.UK have to be considered as having the potential to influence the pricing of each payment scheme and cVRP cannot be considered in isolation (regardless of whether or not Pay.UK is the assigned PSO).

We note that as FPS volumes increase, the price remains fixed (and as above will likely increase), this will always discourage adoption of cVRP in the market unless it is addressed. The inherent impact that Faster Payments (FPS) pricing has on the potential for cVRP to succeed has to be factored in to the PSR's evaluation.

We would appreciate more details on the origin of the PSR's assumptions in the next phase of the cost/benefit analysis.

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?

	Key Benefits
Consumers	- Easier, more convenient recurring payment set-up - Greater control, and ease of cancellation - Greater choice in payment method
Merchants	- Easier recurring payment set-up - Lower cost of payment acceptance - Wider payment choice for customers - Faster settlement speed; - Reduced recurring payment failures (as compared to card on file)
PSO	- Wider customer base and participation

	- Opportunity to offer supporting services - (possible) increased transaction volume
PISPs	- Expand existing OB services/propositions - Increase merchant/customer base - Develop new, innovative payment propositions - Increase on-going revenue
Sending firms	- Leverage investment in regulatory APIs/infrastructure - Reduced fraud risk of FPS transactions - Decreased payment set-up costs (improved mandate set-up) - Route map to replace ageing DD infrastructure - Reduce own cost of accepting third party payments

The operator of the MLA could be tasked with monitoring the success of Phase 1 within the given parameters set by the PSR. Moreover, the collection of data from the ecosystem on the performance of the rollout of VRP should be a requirement of the operator of the MLA.

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?

We broadly agree with the PSR's cost "buckets" identified in the consultation, but we note that the PSO costs have not been considered at all. As we discussed in previous questions, the likely costs to Pay.UK of developing and operating the MLA have to be considered so that the wider impact of the fee proposals on the whole payments market can be assessed.

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

No comments.

Question 22
Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase1? If so, please explain why.

Please see our responses to Questions 1, 3, 5, 6, 7, and 12 to 15.

We believe that if regulatory intervention for Phase1 is not carefully calibrated there is a risk that cVRP goes down a cul-de-sac, and cannot beyond the initial scope of Phase 1 because the MLA and pricing approach does not provide the incentives to deliver a compelling cVRP proposition, or the foundation for investing in long term solutions for all market participants.

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