Payment Systems Regulator

Expanding variable recurring payments

Non-confidential stakeholder submissions to call for views (CP23/12)

August 2024

Contents

Names of individuals and information that may indirectly identify individuals have been redacted.

American Express

American Express response to the PSR's Call for Views on Expanding Variable Recurring Payments (CP23/12)

American Express (Amex) welcomes the opportunity to comment on the PSR's interim report and is supportive of initiatives to promote competition in the payment sector.

As the PSR is aware, American Express competes with Visa and Mastercard both as a three-party card scheme alternative to the dominant card schemes and, since 2019, as a payment initiation service provider (PISP) by offering our Pay with Bank transfer (PwBt) product. American Express therefore plays an important role in bringing competition, innovation and increased consumer choice.

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.

Yes, we feel the principles deliver a long-term and sustainable model to foster growth and market confidence in CVRPs without unfairly disadvantaging any party in the supplier chain. The five pricing principles provide a balanced foundation that enables the TPP community to invest in developing a CVRPs service, that offers end clients a competitive alternative to existing payment services and ensures long-term stability.

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.

Yes, we agree that an MLA ensures timely accessibility to the service, ensure consistent treatment and fairness of all parties, and allows scalability within the eco-system and is an approach that has been used to successfully to achieve these same outcomes for other alternative payment services. We also believe it ensures competitive pricing and ensures ubiquitous access across the eco-system for TPPs without unnecessary complexities. The MLA structure will also allow CVRPs to scale quickly by simplifying the legal structure, especially if operated via a central body with a vested interest such as Pay.UK.

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.

Yes, we agree that Pay.UK is best positioned to operate the MLA given its years of experience in operating national payment schemes, its established MLA with ASPSPs and its existing capabilities, especially those for Faster Payments, that could be effectively and efficiently extended to develop and operate a MLA for CVRPs in the desired timescales. We also believe that Pay.UK is uniquely positioned to enforce what is laid out in the MLAs in a consistent and fair manner.

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 agree with the PSR's evaluation of the current and potential forces in respect to a sending firm's position and influence on the market. However, we all recognise that the sending banks also have the ability to restructure its consumer banking model and introduce fees for the sending of faster payments as means to recover lost card revenue.

We believe the PSR's conclusion of a misalignment between ASPSP, TPPs and end clients who ultimately bear the costs when premium APIs are commercialised and the respective incentives each firm is seeking is valid. We also agree that the primary payment instruments that would be replaced in Phase 1 are not revenue generating for the sending firms (i.e., direct debits, bank transfers) and there is added value to the sending banks that should incentivize them to be a willing and cooperative participant and not impose fees that create the bottleneck monopoly mentioned.

When evaluating any mitigations in respect of ASPSP lost interchange revenue it should be recognised that ASPSPs are not prohibited from developing innovative open banking services for end users that use CVRPs and as such, are not excluded from accessing these alternative revenue streams should they wish to do so. The same is true for the relevant sending banks.

An objective of PSD2, and the subsequent introduction of open banking, was to open up the payments market and as such, the nature of this objective should remain at the forefront when considering ways to mitigate or overcome misaligned incentives. We believe that a successful CVRP launch will prove exceptional value to the end consumer and become a true differentiator for consumer banking proposition should the sending banks not make this available.

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

We believe the costs identified are reflective are aligned to the pricing principles is respect to cost recovery of directly attributable incremental costs of supporting CVRPs.

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.

We assume that the removal of the sending fee, will alleviate some concerns and commercial downside for sending firms.

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?

We feel that consideration should be given to switching the fee to the receiving bank as it may prompt ASPSPs to evaluate their fees for their business banking services and as such, there is a risk that the businesses are disadvantaged from price increases for receiving faster payments into their accounts.

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

We have not identified any additional costs.

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

We believe the commercial model proposed is the more effective and timely solution to succeed in market adoption.

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.

We believe that a sufficiently large consumer base is just one of the perquisites to incentivise PISPs and merchants to invest in offering CVRPs. Another key factor is a competitive pricing structure compared to the payment options that are currently presented and projected to be replaced by CVRPs.

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.

Critical mass is required by merchants before they offer a new payment service to their end users and from our discussions with merchants, the service must be available to at least 90% of their customer base.

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

We strongly believe that the CMA 9 should be mandated to participate in all phases of VRP to attain long term merchant investment in offer CVRPs.

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?

Without mandating CMA9 we do not believe there will be a sufficiently large consumer base throughout Phase 1 that makes CVRPs a viable payment service that will be attractive to merchants, this in turn will challenge the business case for TPPs investment. The CMA9 banks may not prioritize the work quickly enough without a mandate to ensure a sufficient population of accounts within the planned timescales, and momentum may be lost.

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?

We feel that one of the main risks to mandating participation is that of banks only developing and operating to the minimum requirements. To mitigate this the minimum requirements should reflect a more than acceptable level of service for all parties – end service user, TPP, merchant/business to ensure from the outset that VRPs provides an enhanced offering to that of other payment methods.

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

We do not see any additional advantages associated to other models.

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?

We agree with the PSR's evaluation of the risks to ASPSPs promotion, standard of service and timescales, we also consider that operational support to TPPs and Merchant is also a risk factor unless adequately defined through the MLA and operating rules by the introduction of SLAs and a code of conduct.

One such example where parties need to collaborate is when a consumer makes a faster payment directly to a merchant (outside of open banking) that carries an open banking transaction ID/reference.

This is a known scenario where the merchant accepts banks transfers and publishes their bank detail on their remittance, it is therefore possible that a consumer will use the open banking reference from a previous open banking payment to make a stand-alone payment.

These reconciliation issues do not have a means being resolved without multiple parties inputting into the events that transpired. This is particular risk for the utility use case feel could become increasingly significant as more billers adopt open banking.

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 consider it beneficial for a desk-based costs benefits analysis of the higher risk use cases to also be progressed so that a wider cost benefits analysis can be generated to inform speed and priority at which future phases are developed. For example, other recurring payment models that are very similar in structure and purpose to utilities (i.e., recurring fees such as insurance premiums, subscription-based payments, etc.) are relatively low risk and would follow very similar business models to those proposed for inclusion. We believe there is an opportunity to expand the utility segment beyond the proposed industries to other relatively low risk options should there be interest. It would also add incentive for the sending banks (outside of the mandated CMA9) to participate as it adds available use cases for their customers.

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

We agree with the assumptions outlined as reasonable and informed. We would also consider that opportunity costs (forgone or missed opportunity) are also considered in the 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?

In addition to the benefits identified we believe the following are also potential benefits.

Consumers

Benefit	**Measured By**
Reduced costs to payees due to late or misdirected payments, through improved payer financial management	Volume of missed/late payments Total cost savings to consumers of avoidance of late/missed payments
Access to new payment offers. Many billers offer payment incentives for longer term commitments that are enacted through	Volume of new payment incentives developed

direct debits. Merchants can establish similar incentives via VRPs to consumers who are reluctant to enter a direct debit arrangement.	Volume of consumers using new payment service Savings realised by consumer
Greater, easier, and more flexible control of payments to billers	Qualitative end user research User conversion away from VRP to another payment method with merchant

Merchants/businesses/Billers

Benefit	Measured By
Improved cost base (processing and operational)	Savings made from migration from other payment channels Cost analysis of operational support
New customer acquisition	Volume of new customers acquired on VRP
Longer customer retention period	Duration of customers using VRP compared to other methods
Increased customer value earned by targeting specific pain points	Commercial value from customer using VRP versus other payment methods
Improved customer support offering through unique and specific applications	Type and volumes of support calls received Speed to resolution of support calls Consumer ratings Social media commentary analysis

PSO (Pay.UK)

Quantitative Data on adoption of new A2A services to inform NPA roadmap	Volume, value, and frequency of VRPs over time
Learnings to inform data / message content for NPA	

PISPs

Benefit	Measured By
New merchant acquisition	New merchants won from offering VRP service
Commercial performance	Volume of VRPs processed earning new revenues
Upsell to existing merchants	Volume of sales to existing merchants

Sending ASPSP

Benefit	Measured By
New services enabled	Volume of new services offered
Adoption of new services	Consumer usage of new service
Customer satisfaction	Customer satisfaction ratings

Receiving ASPSP

Benefit	**Measured By**
Commercial performance	Volume of incremental payment processed earning a fee

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?

[Redacted]

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

We feel the approach outlined provides the most protection, however, specific operational rules and customer experience guidelines should be considered to further support people with protected characteristics.

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.

We believe one risk to the scaling of the VRP beyond Phase 1 would be if new pricing policy was adopted that was not commensurate with the risks, costs, and benefits of extending the use cases.

We feel that the principles set out are scalable for all uses cases in combination with an additional commercial approach to cater for risk and any additional operational costs would support the scaling of the service to other market sectors and use cases.

Apple

[redacted]

Open Banking: Merchant Feedback on VRP Working Group Blueprint

Apple

May 2024

[redacted]

Apple’s Feedback as Merchant on VRP Working Group Blueprint

Apple welcomes the opportunity to respond to the Variable Recurring Payments (“VRP”) Working Group's blueprint for rolling out non-sweeping VRP (i.e. payments between a customer and a business), published in December 2023.

Apple’s feedback is provided in its capacity as a merchant in the UK.

Commercial Model

As a merchant, Apple believes it is acceptable and would be aligned with market practice to pay for the provision of payment services associated with next generation VRP payments. However, in exchange for payment, merchants would expect the services to support the following key features:

- Competitive fees
- Instant settlement of transactions
- Support for a variety of merchants and e-commerce use cases for physical and digital goods, including: split shipments, pre-orders, subscription, free trials
- Commercial structure for all lines of business, including high and low price points
- Effective fraud and risk management
- Seamless customer experience

Provided that the above principles are met, it would be acceptable and fair for merchants to pay a competitive fee for the provision of VRP payment services.

Functional Requirements

By enabling maximum limits for users (via either payment dimensions or time durations), the impacts to merchants will be significantly more far reaching if the same or similar requirements were to be proposed for e-commerce. Such limitations can interrupt and negatively impact recurring payments and card-on-file use cases, particularly when a threshold is reached during the time of transaction, as resolution of the interruption requires payer interaction to increase or adjust values at a time when the customer may not be present. Instead, the onus should be on merchants to capture purchase approval and provide transparency to users for every buy, as well as predefine mandate limits.

Consumer Protection/Risk

Whilst consumer protection is paramount to next generation VRP, such provisions should not encourage or exacerbate first party misuse or refund abuse by customers. Refund initiations should incorporate processes to avoid use cases where the payer is the fraudster or when a payer requests a refund for goods/services without first contacting a merchant acting in good faith.

Barclays Bank

BARCLAYS

Payment Systems Regulator

Expanding variable recurring payments

Call for views

(CP23/12)

Response on behalf of Barclays Bank UK plc and Barclays Bank plc

February 2024

Submission by Barclays

Barclays is a universal consumer and wholesale bank with global reach, offering products and services across personal, corporate and investment banking, credit cards and wealth management. With over 330 years of history and expertise in banking, Barclays operates in over 40 countries and employs approximately 85,000 people. Barclays moves, lends, invests and protects money for customers and clients worldwide.

Executive Summary

Barclays welcomes the opportunity to respond to the Consultation on the proposed extension of variable recurring payments ("VRPs") to additional, commercial use cases ("cVRPs") and reiterates its continued, full support for Open Banking. Barclays has been a consistent and vocal advocate of the advantages that Open Banking will bring to consumers and SMEs, and has worked hard to ensure that we are helping to build a resilient, trusted, and transparent framework. Barclays is keen to explore the best way forward in extending the foundations of Open Banking to other solutions to the benefit of consumers and the wider UK economy.

The ecosystem now finds itself at a critical juncture, and it is crucial that these first steps beyond the scope of the Open Banking requirements under the CMA Order[1] are taken in a way that ensures market participants at all levels are incentivised to produce the most effective, pro-competitive and enduring solutions. These next steps should align to the emerging National Payments Vision, to allow the ecosystem to progress towards the "North Star" needed to harness the existing capabilities and build on them to introduce new methods of payment to consumers.

Support for an industry-led, voluntary, and commercially sustainable model

Barclays believes that the best way of ensuring the long-term sustainability of the Open Banking ecosystem is by regulators creating the conditions for a competitive and innovative market that responds to consumers' and merchants' needs, and creates value for all participants in the value chain.

For cVRPs, we believe that this next step should be to allow industry to continue with the creation of an industry-led Multi-Lateral Agreement (MLA) – ensuring that a sustainable commercial model is put in place, with those who are (voluntarily) signing the agreement directly involved in its negotiation.

Good progress is being made on this by industry, building on foundations industry participants had discussed with their regulators. We had understood that this strategic aspiration was shared by policy makers and would encourage them to consider how their proposal can be reframed, so as to help deliver this.

Concern with this Consultation's proposal, and its impact on ongoing industry-led approach

However, the Consultation's proposal does not align with this anticipated direction of travel, raising both strategic and implementation issues. As JROC will appreciate, significant work has been

[1] The Retail Banking Market Investigation Order 2017 (the "CMA Order").

undertaken to create a blueprint for the delivery and long-term success of cVRPs - notably through the recommendations of the VRP Working Group and Blueprint Drafting Committee, which provided a substantially detailed recommendation based on collaboration between industry (ASPSPs and TPPs, as well as industry bodies), at the request of JROC.

Barclays is surprised therefore that the content of this blueprint has narrowed in so quickly to one recommendation, without consideration of impact on the already ongoing bilateral engagements between ASPSPs and PISPs, and the wider industry led work. Furthermore, Barclays has partially funded and is participating in an industry group which is creating a set of 'model clauses' for agreements between industry participants on cVRPs. This is a concrete step to take forward some of the actions set out in the VRP Blueprint.

[REDACTED]

<u>Legal basis</u>

Separate to these commercial considerations, the legal basis for the Consultation's proposal is unclear. Specifically, it is unclear under what jurisdiction the PSR is proposing to "mandate" a subset of sending firms (the CMA9) to participate in Phase 1, with no detail provided as to the requirements of such a mandate, or how it would be enforced, to enable sending firms to understand the implications or risks this could create for those firms. We outline our legal concerns further below.

We would encourage JROC to ensure that due process is followed, including fully considering submissions made in response to this Consultation, before taking any steps to seek to mandate new requirements on Barclays.

All of this considered, Barclays is and remains supportive of launching cVRPs in a controlled, safe, and sustainable way. However, Barclays is concerned that the proposed approach to cVRPs set out in this Consultation appears to be taking a step backwards and risks hindering the progress of Open Banking and competition in the sector on a long-term basis, which could lead to irrevocable unintended consequences.

<u>Constructive engagement</u>

We remain eager to work with JROC in order to help agree and deliver a solution which both delivers against the short-term objectives of progress, alongside creating a longer term proposition which is viable and sustainable for all participants in the value chain. **[REDACTED]**

To aid JROC's reading we have summarised our key arguments and considerations in the following section. We then follow this with our response to JROC's specific questions.

<u>Barclays' Key Perspectives and Recommendations</u>

1) **We support an industry led approach that delivers a commercially and competitively viable MLA for all market participants that would allow participants to voluntarily introduce a strong and sustainable new payment mechanism into the UK, aligning to the recommendations of the Future of Payments review.**

Barclays has been an advocate of introducing an MLA to get VRPs to the market quickly. To support this, we – like others – are participating in the industry led working group that is drafting model clauses as a steppingstone to an MLA. We believe that the work conducted to date by industry has been progressive and encouraging and is already well advanced.

To succeed here industry must be allowed to continue developing this solution together, which fits the needs of all of those within the value chain – from customers, to merchants, to PISPs and ASPSPs. Tech development will be required across the payment journey, to build in the necessary design features to make this solution simple and intuitive for both merchants and consumers. The cost of this work should be shared equitably across participants, so all have a stake in the innovation cost, as well as the benefit, going forward.

An industry led MLA that allows participants to agree upon the terms within it would ensure that risks and gaps could be addressed effectively. Specifically, this would allow participants to enter a market in which they are incentivised to create innovative solutions and mitigate risks – rather than to be mandated, at significant and non-recoverable cost, to agree to a set of terms that doesn't match their risk appetite, provides no incentive for improvement beyond the minimum necessary for the mandate and/or could cause harm to their customers due to the lack of consumer protections, relative to similar payment types such as Direct Debits.

In order to achieve the above, there should therefore be a suitable commercial incentive for all across the value chain. **[REDACTED]** the Future of Payments review, in which Garner states "*Without a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure investment. Open Banking's current economics create no incentive for their providers to drive, invest and support it, and no margin to invest in consumer protection*."[2] **[REDACTED]** approach would be transparent to participants; they would understand what they were being charged and why. Supporting the APIs, channels, fraud mitigation, monitoring and customer disputes are just some of the costs associated with such a nascent payment method. The set-up costs, and ongoing run costs should be fairly recovered by sending firms, as well as incentivising them to invest further in customer journeys and support channels that encourage adoption; a zero cost approach would not enable this.

There is a distinct misalignment between the JROC proposal and the recommendations in Joe Garner's Future of Payments Review, which states that there should be the opportunity for banks to recoup the costs of their investment in open banking thus far, as well as being able to charge for new propositions such as VRP. Failure to do so will only slow progress in the UK, and cause issues going forward for merchants and consumers. Garner notes that the current economic model for Open Banking is not sustainable, and specifically that free access led to cross-subsidisation and a lack of incentive for firms to drive, invest and support the ecosystem. A solution for which the sending firms are, by mandate, not allowed to charge, runs contrary to Garner's recommendations, whereas an industry-led solution that allows firms to compete for business on the level of cVRPs through competition on price and innovation is a much more viable, long-term proposition.

Therefore, a commercial model that considers the set up costs, service run costs, and refund/dispute handling for merchants/PISPs, is integral to support the view of a sustainable future for Open Banking.

Failure to set up a sustainable commercial model from the outset would have significant ramifications to the future development of VRPs. A multi-tiered charging model could emerge, with Phase 1 use

[2] Future of Payments Review, Joe Garner, November 2023

cases having a different commercial model and consumer proposition to Phase 2 onwards. This could lead to consumers having certain protections for some use cases, and not for others.

Furthermore, when considering anticipated costs and potential risks associated with this new payment type, we can look to direct debits, given the comparable constructs of them both being out-of-context payments. For example, it should be recognised that mistakes do take place within the Direct Debit landscape: customers are sent requests for payments earlier than expected, and can also be debited twice. These can have implications for the customer, including going into their overdraft, or incurring penalties for missed payments. Fortunately, within the Direct Debit Guarantee, there are models and processes in place to reduce these errors and correct them when they do happen. However, VRPs don't have any of these at present, and our data indicates that the "low risk" use cases will still fall foul of these errors – however there is no mechanism for redress. Industry must therefore be able to collaborate on how to resolve (and fund) necessary and comparable consumer protections prior to launching a pilot, so that consumers are equally as protected when making a VRP payment.

To ensure that sending firms meet their regulatory obligations under Consumer Duty (the Duty), they must take all reasonable steps to avoid causing foreseeable harm, offer products and services suitable for customers and provide clear information about products, terms and conditions so it is easy for customers to make informed decisions. Bringing cVRPs to market and presenting it to customers as an equivalent to existing payment methods without a fully formed consumer protection framework would be difficult for firms to reconcile with their obligations under the Duty.

Focussing on the billers, there are unclear expectations on merchant adoption to test the pilot phase and make appropriate changes. Adequate merchant coverage is paramount, however through client engagement we have found that cost is not the only factor that merchants consider when integrating a new payment type. Merchants equally care about customer experience, complaints, checkout clutter, customer drop out, as well as the actual implementation cost/benefit case to implement a new payment method. Creating a solution which meets all of those expectations and requirements will require upfront investment in innovation and design, to ensure that the proposition is attractive for merchants to adopt. A sustainable commercial model will therefore be required in order for firms to invest in this innovation from the outset.

This leads onto our concerns with the JROC's perception that there is little to no cost for sending firms supporting this functionality. The Consultation significantly underestimates the costs involved in setting up the proposed cVRPs and oversimplifies how it can be implemented, which we will address further in response to Q5. There is no guarantee of the costs being at the currently anticipated level, even after making these adjustments. Indeed, the CMA's original proportionality assessment in 2016 was undertaken on the basis of an industry cost of £20m, which is 1% of the £2bn already spent on Open Banking by industry.

The PSRs proposal takes a backwards step as the industry looks to take Open Banking through its transition phase into its Future State. Barclays is keen to ensure that the significant work of the past is leveraged in order to create a sustainable future. Moving onto a Future Entity that supports sustainable models for all in the ecosystem would allow for fair participation in a growing market. Barclays has previously shared with JROC pragmatic proposals relating to the creation of a Future Entity. We maintain that this would be the optimal, and indeed only viable way to take industry work relating to Open Banking forward.

2) We have significant concerns about the proposed approach to mandate a subset of firms to participate in this Phase 1, as well as the competition law implications of the proposals and of statements made within the Call for Views.

We are not aware of any detailed competition law assessment undertaken by the PSR or JROC more broadly to determine the potential competition law impact of these proposals, and would welcome clarification or further discussion on this, given the significant competition law issues they raise.

2.1) There is no legitimate basis for any mandate or requirements to be placed only on the CMA9

The concept of the 'CMA9' is a construct stemming only from the CMA Order. The banks in question were subject to the remedies set out in the CMA Order in relation specifically and only to the issues identified by the CMA.[3]

Non-sweeping VRPs are recognised in the Consultation as being beyond the regulatory requirements and funding arrangements of the Order.[4] It is therefore concerning that the Consultation proposes that the PSR is "*therefore considering whether* [it] *might need to follow the precedent of the CMA Order and mandate the CMA9 banks to participate in Phase 1*".[5] The proposals in the present Consultation cannot be based on the CMA Order, and any suggestion to rely on a 'precedent' set by that Order to mandate non-Order actions is unfounded.

[REDACTED]

2.2) Assertions made relating to market power of sending firms and "bottleneck monopolies".

The Consultation includes a number of unsubstantiated statements around the market power allegedly held by Barclays and the other sending firms.

Indeed, statements in the Consultation around a perceived "bottleneck monopoly" held by the sending firms over the initiation of payments from their customers' accounts[6] are unfounded and appear to be based on unevidenced assertions[7] and without further reasoning. These assertions appear to have been made without any underlying examination, or engagement with the parties against which these statements were levied.

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[3] Barclays was confirmed in January 2023 to have completed its implementation of open banking under the CMA Order.

[4] Paragraphs 3.23 – 3.25 and (in particular) footnote 5 of JROC "Update on actions to enable the next phase of open banking in the UK", December 2023

[5] Paragraph 4.26 of "Consultation paper: Expanding variable recurring payments: Call for views, December 2023"

[6] Paragraph 4.9 of "Consultation paper: Expanding variable recurring payments: Call for views, December 2023"

[7] including concerns expressed by participants in the SWG sprints: "*that ASPSPs – who are gatekeepers of access to a customer's account and associated data – may be able to use this market power to charge a higher price to those* [TPPs] *who want to access the data*"; JROC "Principles for commercial frameworks for premium APIs", June 2023

The pricing principles more generally refer to comments from "*ecosystem participants*" that sending firms use their position as "*gatekeepers of their customers' accounts*" to set prices which may "*disincentivise investment and adoption*".[8] **[REDACTED]**

Further, the regulators have expressed their concerns in these areas such that sending firms "*may*" have a "*bottleneck monopoly*" that they consider will "*likely*" need intervention, but with no explanation of the analysis undertaken or opportunity for parties to be consulted. **[REDACTED].** We would urge the PSR to consider the implications and adverse consequences of this approach.

Barclays and others had raised repeated concerns about this type of assertion in the course of the cVRPs working group discussions, which we had understood had been accepted by the PSR. We were therefore surprised that these statements were included in the call for views without proper consultation.

The Consultation appears to suggest that the "bottleneck monopoly" relates also to VRPs that require access beyond the existing Open Banking arrangements under the CMA Order. We would remind JROC that payment initiation is not a bottleneck monopoly, but rather a necessary ancillary action to the services offered by the ASPSPs, required to make VRPs and other elements of OB work. It is not possible to separate payment initiation services from the accounts to which they relate such that a third party could provide this service currently provided by ASPSPs; rather these are simply a function that is required to be provided alongside the account offering. To the extent the Consultation documents seek to link market power to payment initiation, this would be to say that any company in any market that provides a necessary service alongside its commercial offering has a monopoly over that service. Notwithstanding the concerns around a lack of reasoning or justification for these findings, as a matter of principle this cannot be a logical conclusion.

Barclays requests that JROC clarifies its position in this regard and ensure that any future public statements as to the market power of sending firms are properly assessed and substantiated.

2.3) The proposals in the Consultation are not conducive to competition or innovation in the sector, and may be harmful to competition

If Barclays and other ASPSPs are mandated to provide free access to TPPs, the undue advantage provided to TPPs would lead to a distortion of competition, to the detriment of acquiring and the direct debit system, both of which have a pivotal societal purpose. As noted above, we would welcome clarification on any assessment undertaken by the PSR or JROC more broadly to determine the potential competition law impacts of these proposals.

Such an approach would disincentivise competition between sending firms in the market and would be likely to have actively anti-competitive results, for example:

- price-setting by JROC is inconsistent with the approach taken in other competition law remedies and/or pricing reviews conducted by other sectoral regulators, and would completely remove price competition;
- **[REDACTED]**

[8] Paragraph 3.1 of "Consultation paper: Expanding variable recurring payments: Call for views, December 2023"

- if certain banks outside the CMA9 are not signed up, this will also actively disincentivise switching by consumers to sending firms outside the CMA9 that have not implemented the capabilities.

There is no evidential or legal basis for mandating sending firms to support TPPs at all costs. Even in other highly regulated industries in the UK where companies have been found to clearly hold market power, and where the regulators conduct in-depth and regular investigations before mandating new requirements on industry, they do not impose set prices or mandate the provision of services for free. The basis on which the PSR proposes to take such an unprecedented action in the face of clear distortions of competition which will follow - as opposed to creating the conditions for a competitive and innovative market that responds to consumers' and merchants' needs, and creates value for all participants in the value chain – is unclear, but warrants further consideration.

Consultation Questions

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 reiterate our significant concerns on the lack of legal basis for the various competition law-related assertions made in the pricing principles set out above in section 2. We would also appreciate JROC clarifying the legal basis on which it relies both in order to set out and enforce these principles. We are concerned that the principles as currently set out, and their application, could have unforeseen impacts on competition and innovation that do not at this stage appear to have been considered and consulted upon.

Notwithstanding these concerns, Barclays considers that there are certain fundamental flaws with the pricing principles, which if implemented would be detrimental to the ecosystem.

The recommended pricing model for phase 1 does not incentivise investment and innovation for sending firms. A lack of charging does not support a sustainable and long-term return for sending firms, compensating for risks, and rewarding innovation. There is a very real risk that it could hinder investment in innovation, which could impact adoption, given merchants don't only consider price when determining whether to integrate a new payment solution, but also factors that are driven through investment in innovation such as development in customer experience and solution design.

Pricing being set at zero to support adoption is only mandated for sending firms in Phase 1. There is nothing to suggest that PISPs are reducing their pricing to promote adoption based on the pricing principles.

Barclays' view is that there can be suitable commercial models that can operate in the market, which are equitable for all participants, aligning to the recommendations made within conclusion 7 of Joe Garner's Future of Payments review. We believe the greatest catalyst for innovation and adoption within Open Banking is for JROC to enable this sustainable and equitable model as quickly as possible.

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.**

While Phase 1 could be delivered through a series of bi-lateral arrangements, Barclays sees value in appropriate cross-industry coordination and agrees that a cross-industry approach would be more efficient and improve outcomes for consumers in the long-term.

While Barclays supports a cross-industry approach, it is important that this approach is driven by the industry itself and not imposed upon it. Participants in the payments industry have a wealth of knowledge and experience and each participant organisation is best placed to understand the needs of their own customers. As such, any solution which is created centrally and imposed on the industry runs the risk of not delivering an arrangement which works for consumers and participants.

An MLA could be an effective vehicle to achieve the right level of cross-industry coordination, however industry participants must have the ability to define the contents of the MLA and must be able to decide whether they are willing and able to sign up to the MLA and participate in cVRPs themselves based on their own incentives, cost, and risk profiles.

A situation where participants are mandated to sign-up to an MLA which they have had no ability to influence or negotiate would not be appropriate, could not properly be defined as an 'agreement' and would not be in line with the principles of contract law (and would be subject to legal challenge).

While a comparison may be drawn between the proposed MLA and scheme rules which participants are required to agree to for other payment schemes, in those other schemes participants or prospective participants are able to choose whether they participate in the scheme before the scheme rules are imposed upon them, whereas with the PSR's proposal the CMA9 will not have a choice whether to participate on the terms set out in the MLA.

If the proposal to mandate participation was due to concerns that industry is not progressing proactively, then these concerns can be dispelled, given there is already industry led coordination in progress, with UK Finance leading a "Model Clauses" working group, which Barclays has committed funding to.

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.**

It is unclear to us what 'operating' the MLA would entail. It is important to note here that cVRPs would not operate in the same way as the existing payment schemes. cVRPs will not have central technology infrastructure but would rather be a series of connections directly between TPPs and ASPSPs. For example, both BACS and FPS rely on central technology systems which are pivotal to the scheme working; each of these have multiple participants which all interact with the single, centrally managed system. For BACS and FPS, it is a necessity that there is a payment system operator because there is a central payment system which needs to be managed and overseen. The same is not true for cVRPs as there would be no technical payment system for the payment system operator to operate. While Pay.UK is responsible for maintaining the technical stability of FPS, for example, they cannot do the same for cVRPs where each participant has their own technology and is separately responsible for the resilience and stability of it.

If 'operating' the MLA is intended to cover the creation of the MLA and the ongoing enforcement of the obligations set out within it, then we would question why an operator is required at all. If the MLA is to be an agreement, then there are remedies which already exist in law for the enforcement of its contents. If, however, the PSR seeks to impose a set of non-negotiable rules on participants and to put in place a body to oversee and enforce these, we would argue that the proposal is not for an MLA but is for a set of scheme rules. If that is the case, the documents and proposals should be named as such, and further information should be provided regarding the basis on which these will be enforced and the obligations and implications for those against which the mandate is put in place.

[REDACTED]

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 would reiterate our views set out above in section 2.2 on the lack of foundation for the statements made on market structure. We would welcome detail of any competition law assessment that might have been undertaken to support these assertions, noting how far the market has moved on since the CMA's final report in the Retail Banking Market Investigation in 2016. We would recommend that JROC reconsiders this approach which could have significant detrimental impacts on competition and innovation, and ultimately on the success of cVRPs.

We have highlighted in section 1 the more effective, pro-competitive ways in which JROC's ambitions could be achieved.

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

Yes, Barclays believes that there are a wide range of additional costs which have not been considered. Some examples of these costs are technology development, customer support (including fraud, as well as merchant administrative errors), service management, and developing the customer experience itself; these can be classed "set up" and "enduring" costs. The PSRs currently point much of the dispute resolution towards the sending firm, and in order to resolve these issues it takes significant investment of time and resource. The JROC Consultation appears to overstate and oversimplify the ability of those ASPSPs which have implemented sweeping to easily convert to cVRPs – these are not comparable in terms of technology or capacity/scale.

[REDACTED]

There are also costs associated with the work PayUK intend to complete to support VRPs being identifiable in the Faster Payments Service (FPS). This will in turn have a knock-on impact on sending and receiving firms, in that they will need to make technical changes to core infrastructure to support the identifier. Further, there is no guarantee of the costs being at the currently anticipated level, even after making these adjustments. Indeed, the CMA's original proportionality assessment in 2016 was undertaken on the basis of an industry cost of £20m, which is 1% of the £2bn already spent on Open Banking by industry.

In order to provide a great customer experience, monitor and mitigate an array of consumer protection issues that are outstanding, incentivised sending firms (those that can recover wider costs as previously mentioned) could invest into their Banking Apps and create a far greater customer experience and support adoption across the industry.

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.**

We do not support the removal of FPS costs for VRPs. We see three issues with this approach.

The first issue is that if the costs of FPS were removed for cVRPs, these costs would need to be recovered from all FPS participants on a mutualised basis. These costs would fall primarily to a small number of sending firms **[REDACTED].**

The second issue is the substantial risk that this causes of market distortion. Sending firms have fixed costs attached to the provision of other payment methods, scheme fees for BACS and interchange for card payments are unavoidable costs to sending firms. This means that it would be impossible for sending firms to price these methods of payments in a way which could compete with cVRPs if they are mandated to be offered for free (despite incurring costs to the sending firms). While we fully support the introduction of cVRPs and welcome the additional choice which this will provide to consumers, that choice needs to be driven by there being a selection of competitive propositions in the market.

Finally, the entry into the ecosystem **[REDACTED]** further complicates the position and creates additional risk in mandating that certain firms subsidise other market participants at cost. [9]

[REDACTED]

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?**

As set out above, our view is that sending banks should be able to charge for the provision of cVRPs and as such the FPS charge could be covered through that charge. If the 'price per click' was removed for cVRPs and recovered across FPS users, the FPS costs of cVRP would still be borne by the sending firms **[REDACTED].**

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

Any standards uplift that is required by OBL for VRPs should be covered by the ecosystem as a whole, and not just the CMA9 banks, regardless of whether the amount is deemed "significant" or not. Given the gaps in functionality to address some consumer protections, the work OBL would need to complete would go beyond what is currently suggested, and leveraging existing standards would not

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[9] E.g., from Garner report - "*Big Tech's ambitions for person-to-person payments remain unclear. Some major players – even those that offer person-to-person payments in other countries – were clear that they had no ambition to do so in the UK. It appears that triggering a higher level of regulation is currently a barrier to some technology firms moving deeper into payments. By contrast, some other firms talked openly about their desire to "close the loop" on payments. While the position is unclear, we could speculate that if the UK does not proactively improve the person-to-person payment journey in the UK, sooner or later, Big Tech may fill the gap.*

be sufficient. There is clear understanding that this workstream is non-Order related, and therefore any work relating to it should be funded and treated as such.

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

[REDACTED]

Sustainable commercial models benefit all across the ecosystem as investment can be made in the payment infrastructure itself, addressing many of the issues that merchants have presently, such as certainty of payment.

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.**

While account coverage will clearly be an important component, it isn't the only driver of adoption and as a stand-alone, we do not believe that it will drive billers and PISPs to invest in VRPs.

Biller adoption will be driven by the creation of a compelling proposition. One that works at least as well as the existing payment methods, provides meaningful consumer protections and improved flexibility and control for consumers and for billers. It is *non sequitur* that having a large number of accounts which support VRPs will result in a large number of account holders using VRP.

Unless VRPs are as good as or better than the existing payment methods, it is difficult to see why an account holder would use them or why a biller would invest in integrating them.

Barclays view is that TPP and biller adoption is likely to be hindered by rushing an offering to market without it being fully developed. Once a compelling cVRP proposition has been created, account coverage will follow quickly, as good products drive consumer demand which firms then respond to. A good example of this phenomenon is the introduction of the 'Pays' (e.g., Apple Pay and Google Pay, which provide the ability to make card payments through NFC enabled mobile device). The introduction of the Pays was not mandatory, but there has been extensive adoption across ASPSPs driven primarily by the fact that it was what their account holders wanted.

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.**

As we have set out in the answer to question 10, we do not believe that account coverage is going to be enough of an incentive to drive PISP or Biller adoption.

Barclays believe that a voluntary approach would be much more suitable, as sending firms can play a key role in the mitigation of some risks highlighted through VRPWGs. Innovating approaches to addressing consumer protections and supporting consumer adoption through the user experience and consumer education around this new service, will only happen when there is suitable incentive to do so.

As previously mentioned, coverage shouldn't be the main driver for any decision around whether a mandatory approach is suitable. An MLA that supports adoption, and a level of ubiquity will inevitably give confidence and incentive to sending firms to adopt.

Phase 1 should test the effectiveness of the solution and uncover any gaps that can be closed through innovation. Higher coverage is a very risky approach to enter a market that has such an array of key issues to be resolved. It's important to get this right for consumers, and where that cannot be achieved initially, the impact/coverage should be intentionally controlled.

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

As already stated, Barclays has serious concerns on the nature of the approach being recommended (please refer to section 2 above). For clarity, we do not believe it to be appropriate, nor necessary, to mandate that a subset of sending firms (the CMA9) participate in Phase 1 VRPs.

It is also unclear what mandating this will actually mean for sending firms and what the implications and risks to the sending firms will be as a result of such a mandate; as there is no basis in legislation or remedy that highlights any requirement or issue in the market that this is seeking to address. Furthermore, sending firms have a complex customer base, not all of which are, for example, in scope for the existing regulation that's being referenced for previously identified issues under the CMA Order.

As mentioned previously, this directly contradicts the view given in the Future of Payments report, and also the "Levelling Up" activity that Open Banking Limited are running to address the two-step system Open Banking in the UK has today.

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?

As set out above, creation of a compelling product with good consumer protections and clearly defined benefits to account holders and billers will be the key to driving adoption. We strongly recommend that these elements are defined and built out before any cVRP offering is brought to the market.

Barclays feel that coverage isn't the issue at this stage. The extensive investment already made by sending firms in the UK means that there is already significant account coverage in the UK for most of the use cases in Phase 1. The only difference being that they would be single-immediate payments, rather than VRP. For many 'card' type payments, including those to government, utility, and financial institutions there is already significant coverage for merchants to come to the market. However, given the consumer protection and liability gaps there is no reason for merchants to take the chance at this stage. We understand that there is suitable appetite in the market from a number of sending firms, and they were working bilaterally with TPPs to bring this solution to market.

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?**

Please refer to section 1 above which sets out the key risks to the ecosystem if participation in Phase 1 is mandated.

We note that mandating any requirements on a set of participants significantly restricts their ability to innovate, and partner with other market participants. As we've seen with existing mandatory participation, it comes at a significant cost to deliver, maintain, and supply reporting to ensure requirements are being met.

There is significant risk, that through mandating the offering, an MLA could be rushed, the solution (journey) is minimal, and there is serious detrimental impact to those customers that use the service. This could result in a layering effect (as seen in open banking) in which more and more functionality is added over time, to retrospectively address gaps found in the 'basic' solution that's being suggested for Phase 1.

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

Yes, for the reasons set out above we see significant advantage in a model which is driven by the creation of a leading payment offering which is better for consumers and for billers. This consumer demand driven model is more likely to create long term adoption and behavioural change.

A large number of sending firms have already been working on the voluntary delivery of VRPs, this was being done on the basis of there being a commercial model which would create fair value across the value chain and incentivise firms across the payments industry to build out a proposition which would compete with Direct Debits and Card Payments, not just on pricing, but on functionality and consumer protection too.

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?**

We refer you to our previous answers above.

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

The use cases being included in Phase 1 have been proposed for a long time, however there is no clear evidence that there are merchants/billers that see a requirement for VRPs in this space. For any phased rollout there must be clear benefits, and adoption plans for each use case, so that cost/benefit analysis can be completed effectively. There is a real risk that there is a mandatory requirement to build functionality by Q3 2024, and no plans from merchants/billers to adopt VRPs in the same timelines.

The assumption that "payment methods that we deem to be alternatives to VRPs in Phase 1 will not significantly improve in functionality or benefits to billers and/or sending firms during the ten-year period" [10] has no evidence to back it up and would suggest that VRPs are the only option available to merchants/billers over the next 10 years. Innovation in digital wallets, Digital ID, NPA and A2A payments as a whole would suggest that there could be many other alternatives available to the market in the coming years. There is a danger that the assumptions being made suggest a significant gap in the market that needs addressing as soon as possible; this should be backed up with evidence from billers/merchants and end users. Alternatives may drive innovation, but industry should ensure that any alternative offers sufficient consumers protections and allow each party in the distribution chain to meet their Consumer Duty requirements.

There should be awareness of the risks associated with the "low risk" use cases, in that some are being used as vectors for APP fraud presently.

Furthermore, these "low risk" use cases use Direct Debit as their main payment collection method at present – but this comes with its own issues. These companies, in the recent past, have been known to cause significant issues due to early collections, and duplicate payment collection. This goes to highlight that regardless of the method of payment, mistakes can happen, especially when the customer is out of context and "pull" payments are made.

The Direct Debit liability model and operational processes prevent many of these issues causing detriment to customers, on occasion when an error is detrimental to a customer there are rules and processes in place to minimise the impact of error to consumers. This includes pre-notification, retries, and direct debit indemnity to support disputes. As the liability is clear and the operational processes are known and many are automated, the risks and costs for paying banks for dealing with such errors is low.

Presently, there is no such model in place for VRPs or Faster Payments as a whole. This further highlights our view that appropriate time and investment must be made by all parties to VRPs, ensuring that payment error is minimized in the first instance, but recovery of funds, and consumer dispute resolution can be completed efficiently and effectively. There is no evidence to suggest that these use cases are "low risk"; mistakes can, and do happen, so having effective redress mechanisms from the outset should be prioritised.

During their webinar on 15th January the PSR stated that Telco would be included in Phase 1, but this isn't detailed in the paper. This should be clarified by the PSR, as there is a concern that all types of payments could fall into this space, such as subscriptions, and one-time (ecommerce) payments.

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

There is no evidence or reason to suggest that this alternative payment method will create a "reduced need to make payments via credit"[11]. Ultimately if a customer is replacing an alternative payment

[10] Consultation paper 4.35
[11] Consultation paper – 4.36

method, then the funds are coming from the same place (current account for direct debits, and card payments), so if the customer has insufficient funds, they will still need to seek credit to make the purchase.

There is also no evidence to suggest that there will be reduced cost to payers for late or misdirected payments, this is down to biller/merchant discretion. The assumptions around transparency to the payer are also unclear, as the presentation of the payment across merchants/billers is not standardised/known. Direct Debits and card payments are well adopted and known across the UK. It's important to highlight these assumptions as areas of opportunity, rather than clearly defined benefits of an, as yet unknown customer journey.

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?

There is the potential for each component of the value chain to benefit from the implantation of VRPs, if done effectively.

As previously mentioned, and outlined in the Future of Payments review, there should be a clear commercial benefit to all across the value chain, and each party should have a part to play.

Consumers could be more informed, have quicker settlements, better foresight of spend to enable budgeting, and better flexibility when paying their bills. In order for this to happen, there would need to be significant investment from both sending firms and billers/merchants to support the customer journey and help with understanding.

Merchants could potentially see benefits with cheaper billing. However, without commercial value across the distribution chain, then costs could potentially be recouped elsewhere (noting JROC's suggestion that receiving firms could charge clients/customers for receipt of payment to counter the FPS fee).

PISPs benefit from VRPs as they have the ability to market new payment functionality to billers/merchants and have a wider scope for revenue streams.

With the recommendations being made regarding mandatory participation and no commercial incentive, there isn't any clear benefit or incentive for sending firms in phase 1.

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?

Consumers shouldn't see any direct costs associated with VRPs and shouldn't be charged to use them, however there is nothing to stop billers/merchants recouping the costs to deliver VRPs through the consumers of the service. Additionally, as things stand, consumers would not have protections in place equivalent to those within the Direct Debit guarantee, for example. Therefore, there could be costs to some consumers if things go wrong, or at the least it could be more challenging for consumers to seek redress if they do experience issues with the service.

Billers/merchants will have significant implementation costs to deliver VRPs and integrate this new payment method; they will also need to have fallback mechanisms in their journeys. Key consideration should be given to the readiness of the market to adopt VRPs by Q3 2024. During a cost-of-living crisis, it could be seen as an inappropriate time to make strategic investment in a new payment method. Merchants would be starting from the ground up to build and offer this solution, including staff training, customer journey, changes to cash flow etc. There are many costs that may dissuade participation whilst VRPs are in this nascent stage.

There is a cost to PISPs to integrate with merchants and sending firms, however these costs could be recouped in their commercial modelling.

Based on the recommendations being made by the PSR, sending firms would have a number of set up costs including implementation of a new API standard, multi-channel journey optimisation, and staff training. As well as ongoing run costs such as fraud mitigation and monitoring, customer traffic to frontline colleagues to support with queries and complaints, service management and capacity to support payment volume projections. All of which the sending firm will have to do to ensure they're continuing to meet other regulatory obligations such as Consumer Duty. Sending firms should be able to provide a high-level view of this cost **[REDACTED]**

The vast majority of these sending firm costs are not mere re-allocations. Some of these costs may be able to be re-allocated internally in the longer term as large volumes of customers move away from existing payment methods to cVRPs, but in the medium term the costs of cVRP would be in addition to the costs of servicing the existing payment methods, not in place of those costs.

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

If the proposed Phase 1 is launched without consumer protections which are at least equivalent to those which a consumer would have when using a card or a Direct Debit, people with protected characteristics may be negatively affected. Both from the Consumer Duty perspective and when considering people with protected characteristics it would be important to ensure, at a minimum, that any differences in consumer protections are simply, clearly, and prominently presented to customers. Our strong preference however is cVRP is launched with the equivalent consumer protections to comparable payment methods.

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.

As previously mentioned, we agree with the view provided in the Future of Payments Review that "new payments approaches can only thrive when they have both a sustainable commercial model and adequate consumer protection. Without a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure investment. Open Banking's current economics create no incentive for their providers to drive, invest and support it, and no margin to invest in consumer protection."[12]. Therefore, the proposals from JROC have no clear articulation of reference

[12] Future of Payments Review, Joe Garner, November 2023

to future phases, or what the success/failure criteria of this phased approach will be. The recommendation sets a difficult marker for all in the market;

- PISPs cannot contract with billers/merchants when there is unknown success criterion, or know what may happen should this not be met.
- Sending firms have no commercial incentive to innovate in this space during phase 1 and this could impact consumer adoption/experience.
- A two-step approach for sending firms could lead to confusion for consumers, as well as impacting wider adoption (there could be a very real scenario in which a customer has 2 VRP mandates with the same firm, but with differing consumer protection models)
- The commercial model is not sustainable for the longevity of the solution, the PSR have stated that VRPs are not going to be free indefinitely. This makes it unsustainable, or at least unpredictable, for merchants, and difficult for them to build into future plans.

British Retail Consortium

BRC response to the JROC consultation paper on expanding variable recurring payments

About the BRC

The BRC's purpose is to make a positive difference to the retail industry and the customers it serves, today and in the future.

Retail is an exciting, dynamic and diverse industry which is going through a period of profound change. Technology is transforming how people shop; costs are increasing; and growth in consumer spending is slow.

The BRC is committed to ensuring the industry thrives through this period of transformation. We tell the story of retail, work with our members to drive positive change and use our expertise and influence to create an economic and policy environment that enables retail businesses to thrive and consumers to benefit. Our membership comprises over 5,000 businesses delivering £180 billion of retail sales and employing over one and half million employees.

Our response to the consultation paper

The BRC is supportive of JROC's ongoing work to progress Open Banking as a payment alternative in the UK. A viable alternative to cards is desperately needed to allow merchants to process transactions through different routes and inject competition into what is currently a very anti-competitive environment.

The initial pilot of variable recurring payments (VRP's) does not include retail use cases, which makes it very difficult to comment on specifics of this pilot, but we certainly agree that expansion is needed and necessary with VRP's before Open Banking payments will be usable by many retailers. Your document outlines that you "*propose to initially enable VRPs for payments to regulated financial services, regulated utilities sectors, and local and central government",* we would appreciate confirmation that this is just for the pilot, and that the plan is to extend VRP's to wider retail use cases (in particular e-commerce) beyond this. The BRC stresses the importance of VRP's being extended to retail use cases.

Request-to-pay

We think it would be advisable for JROC to also consider request-to-pay. One of the negatives of VRP's is the setup process for consumers. In cases where a consumer shops somewhere as a one off, or once or twice a year, for example, they may not be willing to set this up as a VRP. However, request-to-pay would be a great option to ensure that they could still use an account-to-account payment, but without setting up a full VRP. We really believe that enabling request-to-pay will help wider usage of Open Banking payments.

Pricing

We are concerned at discussions surrounding issuers 'recovering lost revenue' from interchange fees, as this will only perpetuate replication of an existing structure that does not work in the interests of all users. The existing structure sees merchants footing the bill for the entire system, and interchange fees were never intended to be a revenue stream for banks and issuers. In order for Open Banking payments to be successful, we must ensure that the card scheme structure is not replicated, and fees for merchants remain low. We are grateful and relieved to see that the principles JROC outline in the paper are much more practical, realistic, and encourage a commercial model that considers innovation, transparency, and incentivisation rather than a replication of what currently exists.

Common name and logo / badge indicating acceptance

We would also like to take this opportunity to reiterate the need for a common logo and name. This is absolutely critical for consumer recognition, and our members have consistently stressed that they see this as essential before they offer it at checkout. A simple 'pay by bank' logo should be prioritised by JROC, as the further along we go the more opportunities will arise, and be missed, to build consumer recognition. Consumer adoption is such a big hurdle to overcome, and unrecognisable provider names are perpetuating the problem. We would love to work with JROC to get this developed, but we believe once developed, the acceptance badge will need to be owned by an organisation such as OBL.

Conclusion

The BRC are keen to continue supporting JROC in the development of Open Banking payments as we truly see any innovation in payments as absolutely necessary, and would like to help uptake with retailers as much as possible by ironing out issues and concerns wherever possible.

We think request-to-pay should be considered in how this works alongside VRP roll-out, especially when considering retail use cases.

We will again stress this urgent need for a single commonly used name and logo ('Pay by Bank', for example) which should be prioritised ahead of the VRP pilot. We would be very happy to assist with the development of this.

BT Group

BT Group Response to PSR CP23/12 Expanding Variable Recurring Payments

Group Regulatory Affairs (Contact: [redacted])

February 2024

BT Group

BT welcomes JROC's and the PSR's intention to expediate steps to extend variable recurring payments (VRPs) to additional low-risk use cases.

The PSR's Call for Views (CP23/12) sets out Phase 1 plans to initially enable VRPs for payments to regulated financial services, regulated utilities and local and central government. We propose that regulated telecommunications providers should be considered as a viable early use case for the initial roll out phases, recognising the similar standards of regulation as for the utilities sector, and the large volume of payments handled by the sector.

There are many benefits for the customer of moving to VRPs for telecoms services. In this sector it is common for a customer to have multiple contract-based and subscription services, which results in holding multiple authorisations for recurring card payments and direct debit mandates for the different services. As well as creating additional friction for customers to authorise changes, it also makes it more challenging for the consumer to have a holistic view of all their regular financial commitments. By shifting towards a single VRP mandate, it would be easier for consumers to manage their billing cycles in line with their needs and rationalise their financial commitments.

More generally, we would like to see the JROC engaging more widely with industry, outside of financial services, to ensure that the operating model for merchants is fit-for-purpose.

The VRP Strategic Working Group were asked to consider whether there are currently any limitations of VRPs which would prevent a successful pilot, however wider industry (in particular, merchants) were not consulted. We would value the opportunity to participate in an industry consultation on this. Our initial assessment has considered the lack of a combined consent journey for AIS and VRP a limiting factor in getting customer buy-in for multiple compelling use cases which require both services, as the requirement for two consent journeys creates significant friction.

If there is the opportunity to participate in any working groups or roundtables on the future implementation of variable recurring payments and/or open banking more generally, we would welcome the chance to get involved.

Regarding the proposed pilot, we would also like to make the following points:

- The success of a pilot will be dependent on multi-bank participation to give sufficient coverage of customer accounts (ideally 70% +) and provide the business case for merchant participation. Insufficient coverage would limit the business case for the merchant investment required to build the capability to accept VRPs for core products. Limited bank participation in the pilot is also likely to have implications for subsequent phases, as non-participating banks will not have sufficiently evaluated the impact and viability of VRPs within their operating model and tech stack, leading to delays in full launch.

- We consider Pay.UK to be an appropriate body to operate a MLA throughout a pilot period, subject to evaluation at the end of the proposed pilot. Any MLA must be compatible with the obligations regulated billers are required to operate within to be viable.

- Similarly, industry coordination in the timing, messaging and operation of Phase 1 VRPs is key to ensure consumers are sufficiently aware and confident to use VRPs as a payment method. Participation by multiple large billers across a range of industries is needed to achieve this.

We hope this response is helpful to you. Should you have further questions or wish to discuss any of the points raised, please do not hesitate to get in touch.

Best regards

BT Group Regulatory Affairs

BT Group

Electronic Money Association

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,

[redacted]

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 all possible participants 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 not direct participants 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 after 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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FastPay Limited

We have been following the news and updates regarding the Payment Systems Regulator's (PSR) plans for the rollout of VRP's soon and would like to express our reservations regarding the pricing proposal for extending Variable Recurring Payments (VRPs), and particularly concerning its potential impact on the market for direct debit.

Our primary concern lies in the potential distortion of the pricing model and its impact on the competitiveness of direct debit. While the Joint Regulatory Oversight Committee (JROC), the PSR, and the Future of Payments Review emphasize the importance of open banking fostering genuine competition against cards, the low-risk use cases within the scope of the PSR's Phase 1 proposals could inadvertently create artificially low-priced competition with direct debit. This is noteworthy, especially considering that no concerns have been raised about the cost-effectiveness or customer experience of direct debit.

It appears counterintuitive for regulatory action to negatively impact a payment product without the identification of a market failure. Direct Debit works fine for most businesses in the UK so why the need for this potential option which comes with many potential risks

The PSR's own strategy prioritizes "unlocking account-to-account payments," where direct debit already plays a crucial role. We believe regulatory measures should align with these strategic objectives.

Additionally, we are apprehensive about the potential substitution of direct debit functionality with VRPs by some merchants. The irreversible nature of such a switch raises concerns about the inability of merchants to revert to the status quo if the experience with VRPs proves sub-optimal. The absence of mechanisms for merchants to 'bulk switch' VRPs back to Bacs or another provider exacerbates this concern and would likely cause much turmoil to business cashflow.

We recommend that the PSR conducts a more in-depth analysis to determine an appropriate price for banks to charge PISPs for commercial VRPs. However, it is crucial to emphasize that this pricing should not be set at zero. We believe that a fair and balanced pricing model will contribute to a healthier and more competitive payment ecosystem.

Financial Data and Technology Association

Financial Data and Technology Association
c/o The University of Edinburgh
13-15 South College Street
Edinburgh
EH8 9AA

FDATA Response to PSR Call for Views:
Expanding Variable Recurring Payments, January 2024

Q1.
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.

In general, yes, however there is no indication that a long-term sustainable commercial model is being set up as part of this exercise because payment processing pricing is set at zero.

Absent any indicative payment processing pricing for the pilot, there is no gauge to measure appetite for ASPSPs to offer VRP beyond the required pilot participation. As proposed, the VRP pilot does not set up incentives to move beyond the pilot itself. It is short sighted, and although it seeks to expedite the pilot itself, it does not address the long-term viability of the commerciality of VRP.

Because the pilot is so narrowly focused on rapidly scaling VRPs, it misses the opportunity to address the broader need to stand up commercial arrangements for data only commercial use cases/premium APIs. The proposal overlooks the chance to meaningfully contribute to the development of sustainable commercial models that move the ecosystem towards open finance and smart data.

It was generally understood that VRP would be the first test case for premium APIs in the UK, and that it would set precedent, and create a replicable template for other premium API use cases. As outlined, the current proposal is too narrow to meet that goal.

Q 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.

Yes. An MLA or rulebook approach is needed for VRPs as well as all other premium API use cases. This pilot is a good first step in hastening an consistent MLA/rulebook for future use cases.

Q3. 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.

No, because Pay.UK is not in a position to operate other data and data+payments use cases, for which this pilot exercise is supposed to serve as a template and replicable model.

VRP is inextricably linked to the open banking standard, over which Pay.UK has no control, influence, or gift. Giving over the MLA to Pay.UK risks creating operational complexities, as well as deviations from the OB standard. It would better serve the ecosystem to have OBL/Future Entity coordinate with Pay.UK to manage the VRP MLA. As noted in recommendations in the JROC exercise on the Future Entity, the FE is naturally best placed to manage premium API MLAs. Giving the VRP MLA over to a completely unrelated entity (Pay.UK) puts the development of other MLAs at risk, and fragments the harmonisation and orchestration of all other open banking and finance use cases.

We strongly recommend that the OBL/FE should lead on operating the VRP MLA, with contribution from Pay.UK.

Q4. 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 acknowledge the PSR's view of the sending firms' dominant position has merit, and there is some risk of discriminatory PISP access as a result of that position of strength.

We also acknowledge that regulatory intervention is needed to catalyse any VRP rollout, given the entrenched nature of other payment methods. Successful payment methods require universal availability, and without regulatory intervention here, there is no chance of VRPs being universally available.

Additional regulatory intervention in relation to ensuring fair access to payment systems may also be needed to mitigate risks and overcome misaligned incentives, specifically rules requiring access to infrastructure be made available to authorised participants on a proportionate, objective, and non-discriminatory basis; this also includes costs of access.

Q5. Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.

We recommend the VRP pilot also serve as an exercise to identify related sending firm costs not yet obvious in the initial modeling, for example, related additional dispute resolution or consumer protection costs. An adaptable, evolving price setting model that accommodates for currently unidentified costs (the known unknown), would be best.

We also suggest a closer examination of the EPC SPAA rulebook precinct approach, which has wide market participant support, and is based on independent economic evaluation.

Q6. 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.

Cost recovery pricing is the better approach, as it sets precedent up front rather than relying on defrayed (re-distributed) costs and artificial subsidisation. It also avoids the frustration of introducing a significantly different pricing model once VRPs have gained market traction.

Q7. 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?

Sending bank costs are not the only costs incurred in the value chain, and any additional costs built into the FPS settlements for VRP will impact the economic attractiveness of VRP as a viable alternative to cards and direct debits.

Q8. Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.

We understand that per the agreed arrangements, all non-order OBL activities are forecasted and tracked. Any additional OBL related costs incurred during the pilot would be treated similarly.

Q9. What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

An artificially suppressed pricing model for Phase 1 brings the risk of significant price shock for Phase 2, to the potential detriment of wide scale adoption of VRPs. A long term, sustainable pricing model includes an element of cost recovery for the ASPSPs. While full cost recovery need not be built in from day one, it is an important element to include in a flexible, adaptable pricing model (as recommended in Q5). This principle is also critical for any premium API use case, as the incentive for ASPSPs to invest in open banking (and its expansion) is not built into the mandatory requirement. We recommend looking at the SEPA SPAA rulebook pricing models as an alternative. The SPAA rulebook has the advantage of a general value-added premium API model, rather than the narrow VRP model being considered in the UK.

The UK commercial model needs to address myriad future premium services, not just VRP. VRP alone is a tactical move, whereas a broader agnostic premium service approach is strategic. The UK market would be better served with strategy instead of short-term tactics.

Q10. 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.

Successful adoption of a payment instrument requires that instrument be universally available. Availability is not a matter of PISP and billers investing in offering VRP, it is a matter of it being offered by every ASPSP in the market. In this case, demand does not necessarily equate to supply being built. If half of the ASPSPs in the market do not invest in building supply because it is not economically feasible to recover costs, no amount of demand will compel those ASPSPs to build the capability.

Demand has already been proven: PISPs and billers want VRP. It is a supply side question.

Q11. 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.

The VRP Working Group Blueprint suggests that supply side coverage from 60-70% would be sufficient to incent adoption. We support this finding.

Q12. Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.

We believe the pilot does require mandating banks to participate, but to limit it to just the CMA9 is short sighted, especially in light of the JROC objective of leveling-up of the entire market. Instead any ASPSP who has the technical capability for sweeping VRPs by the pilot start date should be required to participate.

In light of the VRP Working Group blueprint suggestion that 60-70% market coverage is needed for VRPs to gain traction, an alternative approach is to mandate ASPSP participation based on market share of current accounts, which would go beyond the ring fence of just the CMA9.

Q13. 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?

We believe a mandate is necessary, but that mandate should extend to include non-CMA9 banks as well.

Q14. 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?

There are none, not for those who already offer (mandated) sweeping VRPs.

Q15. Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.

Commercially driven, rather than regulatory imposed, open banking is needed for the expansion of both services and adoption in the market. We must go beyond being just a competition remedy, and move into an economic incentive driven market. This first exercise in delivering a premium API needs to align participation incentives. Failure to do this diminishes the value of the pilot itself, as well as the replicability of the outputs for a broader set of commercial APIs.

Q16. 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?

As noted in previous answers, the primary risk of this approach is the opportunity cost of applicable lessons to the broader set of premium/commercial API MLAs that come with the very narrow focus of this pilot, and its sole management by Pay.UK.

Q17. Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis? Please provide reasons for your response.

The three use cases are appropriate.

It should be noted that use case 3 (payment to FCA regulated firms) is very similar to mandated sweeping VRPs; there is a risk that if not managed properly, there may be divergence between the functionality and customer experience of sweeping and non-sweeping VRPs.

Q18. Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response.

No comment.

Q19. 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?

The VRP Working Group blueprint has outlined the benefits for each actor in the value chain; we agree with that assessment. We suggest part of the pilot exercise is to identify the mechanisms to measure these benefits.

Q20. 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?

One objective of the pilot should be to identify and measure these key costs.

Q21. How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?

We do not believe that the PSR's proposal disadvantages those with protected characteristics.

Q22. Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.

FDATA has concerns that the approach proposed is at odds with JROC's ambition to develop a sustainable commercial model as a foundation for the evolution of open banking.

The VRP use case is unique in that it relies on a separate, commercial, third party for its delivery (Pay.UK), which adds a layer of complexity when it comes to standards and scheme management. Unlike data-only premium use cases, of which there are many, this pilot and the outputs from this exercise have limited utility in terms of replicability, and the commercial arrangements cannot be re-used or templated easily.

From a cost/pricing perspective, this approach is also limited. It creates a true-up sticker shock, since cost recovery - which is an essential part of a sustainable commercial model - is not accounted for from the beginning. The Garner Report also notes that without a sustainable commercial model, there is little incentive for ASPSPs to invest and support open banking. This means any cross-subsidisation in the cost model is at odds with JROC's objectives.

The risk of divergence from the standards, as well as the customer experience guidelines, for both sweeping and non-sweeping VRPs is great, especially if Pay.UK is given the sole management of the MLA. This also is at odds with JROCs clear vision to ensure the Future Entity has the capability to manage data and data+payment MLAs for other premium/commercial use cases. VRP is just one use case, to treat its MLA as an exception to OBL/Future Entity management and orchestration is shortsighted, and comes at an opportunity cost of other MLAs being expedited.

Financial Services Consumer Panel

Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: [redacted]

Email: enquiries@fs-cp.org.uk

Payment Systems Regulator
12 Endeavour Square
London
E20 1JN

30 January 2024

By email: a2a@psr.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to PSR Call for Views: Expanding variable recurring payments

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of financial services policy and regulation in the UK. Our focus is predominately on the work of the FCA, however, we also look at the impact on consumers of other bodies' activities and policies where relevant to the FCA's remit, which includes protecting consumers. We are therefore responding to this Call for Views from the Payment Systems Regulator (PSR) because it is important the right protections are in place for consumers taking up this new payment option.

We welcome the opportunity to respond to this Call for Views on expanding the use of variable recurring payments (VRPs). We know the Joint Regulatory Oversight Committee (JROC) and the VRP Working Group (VRPWG) have undertaken significant work already looking at VRPs and this consultation is an important first opportunity for consumer-focussed groups to input into the discussion.

Our comments are grouped into four areas:

1. Concerns about the wider context, in terms of firm conduct and the regulatory framework, that Phase 1 would take place in.
2. The importance of sufficiently considering consumer outcomes during Phase 1.
3. Suggested foundational principles for Phase 1.
4. Comments on the PSR's proposals in relation to the scope, governance and pricing of Phase 1.

Our overall position is that we do not believe there is such a thing as a "low risk" use case for commercial non-sweeping VRPs given the proven poor conduct of payments firms, intrinsic incentives on firms and billers, shortcomings in the overall regulatory regime for payments (all covered in section 1 below) and risks specific to financial services (see section 4). We therefore believe that the PSR needs to implement stronger guardrails surrounding Phase 1.

1. The wider context VRPs would be entering into

As a Panel we are gravely concerned about the quality of many firms in the payments sector which, according to the FCA's Dear CEO letter of March 2023, fall short in fundamental areas of prudential and conduct management (including operational resilience, reconciliation and safeguarding, fraud and financial crime controls and governance and leadership). One way to improve the conduct of payment firms would be to strengthen the regulatory framework that applies to them. We believe there should be an overhaul of the Payment Services Regulations and the Electronic Money Regulations to create a regime that is aligned to that created for other financial services firms by the Financial Services and Markets Act 2000. This should precede the scaling up of VRPs and other open banking payments, otherwise the scaling up will likely increase harm to consumers. In particular, we believe this is the only way regulators could reliably prevent the market adopting VRPs in other use cases ahead of the completion of Phase 1.

In our view the PSR should run a controlled pilot with the typical controls and protections a pilot offers e.g. entry criteria, ongoing monitoring arrangements and data collection, close regulatory oversight and an evaluation phase. However, we recognise that the regulatory regime for payments makes it difficult for UK authorities to create a properly controlled "sandbox" environment to trial commercial VRPs. Therefore, we would encourage the PSR to create features of a full pilot wherever possible – importantly an evaluation based on Phase 1 – before sanctioning any further phases.

2. Focussing on consumer outcomes

Throughout Phase 1, and in any future phases, regulators must maintain focus on the outcomes use of VRPs deliver for consumers.

The JROC agenda, which has driven work on VRPs so far, is industry-focused and based on the business strategies of Payment Initiation Service Providers (PISPs), in an environment of low understanding and limited choice for consumers. There has been some acknowledgement of the benefits of VRPs for consumers - such as convenience and flexibility – and we would add to this the benefits on offer for SMEs, including reduced transaction costs, reduced settlement time and therefore greater certainty and lower risk. However, insufficient consideration has been given to the discretion VRPs afford to billers (who, after all, are the primary group whose interests PISPs will seek to serve). Rules on consent and cancellation journeys, visible dashboards, clear standardised descriptions of VRPs on statements and banking apps, including identifying billers, will be crucial to ensuring consumers get safety, control and value from VRPs.

The phasing and regulatory oversight described in the Call for Views is welcome, but still not as secure for consumers as a full pilot would be under a more robust and coherent regulatory regime (as outlined in section 1 above). In our view, the proposals, and the VRPWG's blueprint itself, are the output of a producer-dominated process and regulators need to be highly assertive around the conduct of Phase 1 to safeguard consumer outcomes and ensure the sustainable success of VRPs.

3. Foundational pre-conditions the Phase 1

Given our concerns outlined in section 1, we believe PISPs should be required to demonstrate to regulators (the PSR and FCA) that they can meet the following conditions in order to enter and remain in Phase 1:

a. Prescribed point-of-transaction information for consumers comparing the features and protections of VRPs with alternatives on offer
b. Standardised language and terminology
c. Rules protecting consumers from default parameters or behavioural manipulation in payment choices and VRP consent journeys which will give undue power to billers
d. Enhancements to dashboards to ensure VRPs are consistently displayed, easy to change and cancel
e. Rules for notifying consumers of forthcoming payments and changes in time for them to take action (as is the case with Direct Debits)
f. Dormancy rules stipulating that VRPs will lapse and data be deleted after a specified time, unless explicitly reauthorised.
g. Rules ensuring consumers can identify VRPs, billers and individual transactions on statements and online banking apps
h. Watertight dispute resolution, repayment and liability rules, so consumers know what to do if something goes wrong, including in the event that a PISP fails, and can be confident of how and when they'll be made good. PISPs should be liable if they on-board bad actors.

i. The establishment – as part of Phase 1 – of a pilot purchase protection arrangement with participating billers.
j. The construction by regulators of a full evaluation framework for Phase 1, involving detailed data capture from firms where necessary. Decisions on whether there are lessons from Phase 1 that need to be acted on should not be left to industry.

We note that some of these are conditions are noted as "pre-pilot" requirements in the VRPWG blueprint, but too many are not. The blueprint also assigns too many of the actions to resolve "pre-pilot requirements" to industry (PISPs and industry groups, such as UK Finance). Regulators must closely and actively supervise industry's completion of these actions to ensure that consumers' interests are safeguarded. Consumer representation in the work would be helpful, though given the resource constraints on consumer advocates, it is unlikely this alone will be sufficient.

4. Comments on the PSR's proposals

Scope of Phase 1

We welcome the exclusion of unregulated investments from Phase 1 and suggest this is expanded to include high-risk products and investments, such as crypto, Long Term Asset Funds and Money Market Funds, which have a higher potential for harm and unexpected losses for consumers.

We would also like to see debt recovery excluded because of the vulnerability of the consumers in this space and the potential for significant and long-lasting negative consequences should the use of VRPs go wrong. This is not unlikely as VRPs have been deemed to be a type of Continuous Payment Authority (CPA). There are specific rules mitigating some potential harms from CPAs in the high cost short term credit market, but not elsewhere. and we think the best way of avoiding harms from VRPs is to exclude debt collection from phase 1[1].

The Call for Views deems regulated finance services as a "low risk" use case because of the protections that exist by virtue of regulation. As we argue throughout this response, we do not think there is such a thing as a "low risk" use case and in addition to the broader points made under Section 1

[1] In the case of Safety Net Credit, for example, the combination of CPAs and access to consumer account information via Open Banking allowed the firm to make unaffordable collections from customers. This case should be examined for lessons to be learned, including, if necessary, clarification of the CMA guidance on the use of sweeping VRPs for debt collection. Lessons should be learned before commercial, non-sweeping VRPs are allowed in this space.

above, bring to the PSR's attention the following risks of VRPs specific to financial services:

- Biller verification – the idea seems to be that in financial services PISPs can mitigate the risk of the payee being a "bad actor" by cross-referencing with the Financial Services Register. We have longstanding concerns about the usability of the Register which may hinder PISPs' ability to verify firm names, especially where similar names are used and/or when fraudsters clone the name of a legitimate firm. It is important that where errors are made, firms bear liability for the error and not consumers.
- Switching – it is our understanding that VRPs will not be included in the Current Account Switching Service. This could be confusing for consumers who may (reasonably) view VRPs as being the same as Direct Debits, which are included. This increases the risk that consumers do not make alternative arrangements to switch their VRP to a new account and therefore may incur additional costs for failed payments. Should this problem prove to be widespread, it could also undermine overall consumer trust in VRPs (and we have consistently argued that trust in payment systems is vital to their utility).

Governance

The Panel supports a centralised multilateral agreement (MLA) for Phase 1 and urges regulators to retain this option for future phases. If regulators did not intervene, the expanding use of VRPs would likely maximise commercial interests d with little or no consideration of consumer interests.

The PSR's intervention is therefore welcome, though we do have concerns about their reliance on industry-led governance. We believe that industry-led governance arrangements have been sub-optimal for consumers[2] and we are cautious about Pay.UK's ability to do better here. If the PSR continues with Pay.UK as the operator of the MLA for Phase 1, then Pay.UK should establish a properly resourced reference group representing the interests of retail consumers as part of its governance.

Pricing

The PSR's selected approach to pricing must not distort commercial incentives (on any businesses, including billers) to adopt VRPs over other payment options. Nor must it artificially advantage VRPs over other payments using the faster payment system, or non-FPS alternatives, or lead

[2] We have raised concerns about industry-led governance to the Competition and Markets Authority in the context of the future governance of Open Banking and to the FCA in our response to their Credit Information Market Study interim report.

to under-investment in the FPS itself. By insisting on the full package of consumer protection measures discussed above, regulators can create a more level playing field with established payment options that include such features. The Panel is also mindful that the costs of payments (and banking services in general) is already highly opaque and includes multiple cross-subsidies and complex trade-offs. In principle, the Panel would prefer VRPs to start scaling on the basis of completely transparent and explicit payment and recovery of costs. Any inefficiencies and undue costs in such an approach can be removed later, once the true costs and incentives are understood. Full independent evaluation of Phase 1 on the basis of market data is particularly critical here. Given the sensitivity of the data likely to be required, we assume that regulators would need to conduct such an evaluation.

Conclusion

In conclusion, we welcome the development of new payment options to bring benefits for consumers and SMEs but the guardrails in place around Phase 1 are not sufficient to protect consumers. There is heightened risk of harm to consumers in the payments sector due to a poor behaviour by firms and a less comprehensive regulatory regime. We therefore do not agree with the PSR that Phase 1 is "low risk" and encourage them to strengthen their proposed controls accordingly.

Yours sincerely,

[redacted]
[redacted] Financial Services Consumer Panel

GoCardless

GoCardless

GoCardless Ltd.
Sutton Yard
65 Goswell Road
London
EC1V 7EN

Response to PSR CP23-12 - Expanding Variable Recurring Payments – Call for views

GoCardless is a global bank payment company. We help more than 85,000 businesses, from start-ups to household names, collect both recurring and one-off payments, without the chasing, stress or expensive fees. Each year, GoCardless processes more than US$35 billion of payments across 30+ countries. Our acquisition of Nordigen means we're also helping businesses make faster and more informed decisions through easy access to bank account data. We are headquartered in the UK, with additional offices in Australia, France, Latvia and the United States. For more information, please visit www.gocardless.com.

GoCardless welcomes the opportunity to respond to this call for views. We have been a strong supporter of the work undertaken by the Joint Regulatory Oversight Committee (JROC) and invested significant energy in participating in working groups over the past 18 months. Throughout that time, rolling out variable recurring payments (VRPs) to non-sweeping use cases (cVRPs) has been a key goal for us.

We would summarise our views on the PSR's proposals as follows:

1. **Bank coverage** - We support the PSR's intention to make ASPSP participation in Phase 1 mandatory. For cVRPs to take off, current account coverage that provides a baseline to build and iterate from will be vital. If Phase 1 is optional, many large banks will remain in "discovery" mode, effectively leaving merchants, consumers and PISPs in limbo and delaying the launch and market adoption of cVRPs indefinitely.

   We believe the appropriate mechanism for this would be to mandate the largest UK current account providers. Our view is that 90% coverage of current accounts would be required to achieve appropriate 'network effects'. A dynamic construct for defining which ASPSPs should be mandated would be more appropriate than the CMA9 though.

2. **Pricing** - We do not support the PSR's pricing proposal. We believe Phase 1 is an opportunity to kickstart a long-term competitor to card payments. All participants must be incentivised to invest, innovate and deliver a strong payer and payee proposition from the outset. A market price that is substantively lower than

interchange fees to create competition to cards, but more than zero to incentivise banks, will be needed to create this balanced, sustainable ecosystem and allow the UK to keep pace with other jurisdictions already exploring commercial models.[1]

Introducing a pricing model whereby the banks are not compensated for their services would mean a cheaper end product to paying merchants. It could even drive relatively large volumes of VRPs if e.g. a large utility provider were to adopt them. However, we think the problems it would create outweigh the benefits:

- Poor quality bank APIs, which have stunted open banking's growth to date because banks have treated them as a compliance obligation imposed by the regulators. Banks should be able to charge in return for ensuring the service received by TPPs is of a standard that means open banking and VRPs can genuinely compete with cards in terms of payer experience and conversion. The ongoing investment and innovation required to achieve this is what JROC's Principle 2 in the "*Principles for commercial frameworks for premium APIs*" paper highlights;
- Poor conversion rates during Phase 1 will damage merchant and payer confidence in cVRPs long term. These should be 'hero' use cases that drive payer and merchant adoption of VRPs, but if the banks do the bare minimum and payment conversion rates are poor (as they have been with open banking to date) we will not see later adoption where conversion rates really matter, such as in e-commerce;
- Non-mandated banks will be reluctant to provide cVRPs if they cannot charge. Some of these firms now have sizable customer bases that are arguably more inclined to try new payment innovations like VRPs than the average bank customer;
- Setting merchant pricing at an artificially low level will create false use-case pricing expectations for Phase 2 and beyond; and
- Learnings for how a truly commercial product should develop will be limited unless it's a genuine test environment.

We also have concerns about the impact of a distorted pricing model on the market for direct debit. JROC, the PSR and Joe Garner's Future of Payments Review have all focused on open banking offering genuine competition to cards. The low-risk use cases within Phase 1's scope will predominantly mean that artificially low-priced competition with direct debit is created though, which no one has suggested is too expensive or delivering a poor experience to customers.

It seems counterintuitive to have regulatory action negatively impacting a payment product where the regulators have not identified a market failure; in fact, "unlocking account-to-account payments" - in which direct debit plays an important role - is a

[1] Notably the SEPA Payment Account Access (SPAA) initiative in Europe.

priority objective of the PSR according to its own strategy. Meanwhile, Phase 1 will have a limited effect on cards, which are the subject of multiple PSR market reviews.

Further, we would be concerned about some merchants replacing direct debit functionality with cVRPs. If merchants and payers find their cVRP experience sub-optimal it will not be easy for them to exit it. There are no plans for a cVRP switching service (ie to another cVRP provider), nor could a merchant bulk transfer payer mandates (back) to direct debit.

In other words, there is a risk that some businesses find themselves 'locked in' to an arrangement that delivers a poor experience as a result of artificially cheap pricing, banks not being incentivised and mis-leading confidence in cVRPs given to customers by the open banking industry and regulators. Cashflow is often cited as critical to the viability of firms, particularly small businesses, and this could be negatively impacted by an inferior performing product. For consumers (payers), there may be financial inclusion and budgeting consequences.

We believe that cVRPs offer significant potential for improving merchant and consumer outcomes, but the roll-out must be done 'right' and that means alignment of incentives that encourage all ecosystem participants to pull in the same direction. We believe this can be achieved whilst observing all the principles issued in JROC's *"Principles for commercial frameworks for premium APIs"* document as well as the nature of 'future of open banking' discussions with JROC throughout 2023. However, based on the PSR's current proposals, more research and analysis of what would be a realistic starting price point is required.

3. **Provisional MLA** - We support the PSR's proposed creation of a provisional cVRP multilateral agreement (MLA) setting out required functionality, arrangements for pricing, dispute resolution, and liability. Bilateral contracts will result in an inconsistent user experience and also act as a barrier to entry for new TPPs.

   The industry-led "model clauses" initiative, co-ordinated by UK Finance, could contribute to the MLA. It would also help build towards a 'premium asset' MLA in Q3 2025 as targeted in JROC's roadmap.

   Our ideal scenario would be for Open Banking Limited (OBL) to transition to the Future Entity (FE) quickly and lead the MLA work. We note Open Banking Limited's experience of drawing up industry standards as well as the strong relationships they have developed on both the supply and demand side of the open banking equation. Whilst all parties are keen to move on from the CMA Order, we believe non-Order work could be supported ahead of the Long Term Regulatory Framework (LTRF) being in place if led by the Future Entity[2].

We understand the PSR's rationale for suggesting Pay.UK should lead the co-ordination and delivery of the MLA. However, we are concerned about Pay.UK's ability to deliver in time for a Q3 launch. There is a lot of work to be done, Pay.UK has a number of competing priorities and arguably does not have equivalent experience to OBL or a governance structure that would support such an undertaking. If Pay.UK were to take this activity forward we would urge them to set out a detailed project implementation plan that provides confidence to the market in their ability to execute as early as possible.

4. **Clarity on Phase 1 and beyond** - We are unclear whether Phase 1 is determined purely by the use-cases and will continue indefinitely, or whether time is also a factor under consideration by the PSR.

   Industry investment thrives on certainty so knowing if, how and when Phase 1 is expected to end, including what conditions would need to be met and how a transition to a future commercial model for the low-risk use cases could be achieved, is critical - particularly given the breadth of the Phase 1 use cases.

   If Phase 1 has no end then we are sceptical that non-mandated banks will ever participate. Its success will rely on incumbent banks maintaining their market shares in future.

   We would also like to better understand what Phase 2 of cVRPs would look like (although we welcome the PSR's acknowledgment that higher risk and more complex use cases may need different commercial models). This will help ecosystem participants to allocate resources accordingly. PISPs will also be better placed to provide guidance to merchants from the outset, which will allow for a more sustainable trajectory into the market for cVRPs.

Responses to the consultation questions

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.

Yes, we support the pricing principles. They are aligned with the finding from the Future of Payments Review's recommendations to move beyond foundational mandates and to arrive at

[2] *There is precedent for this: OBL was set up and undertook work in advance of PSD2 coming into force in January 2018.*

a commercial model that provides an incentive for all parties. This is crucial for encouraging investment and innovation in VRPs and open banking generally.

However, we question whether the proposal in the PSR's consultation aligns with Principle 2:

> *The level of charges for premium APIs should enable the ASPSP to earn a return over the long run that compensates them for the risk associated with any investment and innovation, and reward them for innovations and associated investment that bring benefits to end users. This will help ensure that open banking is sustainable and continues to expand its range of services and the number of users.*

By restricting banks from charging PISPs indefinitely, banks will do the bare minimum to meet the obligation imposed by the PSR.

Alternatively, the price will have to be revised upwards at some future point in time, but this will discourage merchant uptake as they will not have long term certainty. Neither option prioritises the payer as they are either unable to take advantage of VRPs or receive a sub-optimal experience, damaging trust in VRPs long term.

We believe that cVRPs offer significant potential for improving merchant and consumer outcomes, but that means alignment of incentives that encourage all participants to invest and innovate for a commercially sustainable ecosystem. We believe this can be achieved whilst observing all the principles but, based on the PSR's current proposals, more research and analysis of what would be a realistic starting price point is required.

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.

GoCardless supports the proposal for cross-industry coordination and a provisional MLA that can be built upon. We believe a framework that aligns industry will create the necessary baseline to coordinate the market and create a consistent, high quality experience for customers. Bilateral agreements as an alternative would lead to increased overheads, inconsistent outcomes across the value chain and act as a barrier to entry for new firms.

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 have concerns on the impact Pay.UK adopting the role of operator of the Phase 1 MLA will have on the wider payments ecosystem with the proposed implementation timescale given parallel initiatives such as NPA & APP Fraud Reimbursement.

Further, Pay.UK's current governance and operating structure mean that many PSPs (acting as ASPSPs and PISPs) may have limited influence on the design and development of the multilateral framework as they currently have little direct relationship with Pay.UK. Many PSPs may not be able to participate in Pay.UK's ultimate internal governance for finalising the MLA, and might only start to be able to influence the arrangements after the MLA is in place (i.e. by becoming participants).

Our ideal scenario would be for Open Banking Limited (OBL) to transition to the Future Entity (FE) quickly and lead the MLA work. We note Open Banking Limited's experience of drawing up industry standards as well as the strong relationships they have developed on both the supply and demand side of the open banking equation. Whilst all parties are keen to move on from the CMA Order, we believe non-Order work could be supported ahead of the Long Term Regulatory Framework (LTRF) being in place if led by the Future Entity[3].

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 agree with the current view of the market structure but we do not support the proposed pricing model, which does not offer incentives to all participants.

We believe phase 1 is an opportunity to build a worthy competitor to card payments. As such, we believe that all ecosystem participants should be incentivised to grow Open Banking and Premium by-products such as VRPs. If all participants in the value chain are incentivised then there is a better chance of the outcomes at each level seeing ongoing investment and innovation, such as an improved user experience, the ongoing quality of the APIs, the support turnaround times, amongst others.

In light of this we are not adverse to banks charging a small amount for cVRP APIs, but bank costs will be substantively lower than for cards and the end price to customers must similarly be substantively lower if cVRP adoption is to happen.

Question 5
Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.
No comments.

Question 6

[3] *There is precedent for this: OBL was set up and undertook work in advance of PSD2 coming into force in January 2018.*

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.
No comments.

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?
No comments.

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

Question 9
What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?
We consider that Phase 1 and beyond will have a better chance of success if a sustainable pricing model that commands market support from the outset is in place. It should not be fixed permanently, but at least give a realistic starting point. This is the approach being taken in Europe through the SEPA Payment Account Access (SPAA) process.

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.
Ignoring issues around the proposed pricing model for Phase 1 and focusing purely on account coverage, we agree that this is crucial for driving cVRP adoption and will act as an incentive to PISPs and/or billers. Our merchant research has identified this as a key driver alongside the user experience, price and finding a 'hero' use case that makes cVRPs highly visible.

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 our discussions with billers, coverage is non-negotiable. Coverage of current accounts would likely need to be at least 90% to achieve network effects.

So, we support the view to mandate but perhaps the 6 largest UK banks would create the necessary coverage to incentivise investment. And, is it worth considering the total addressable market given the role the large neo-banks now play instead of the likes of Danske, AIB and Bank of Ireland?

Question 12

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

Making Phase 1 optional will inevitably lead to an uneven response from the market and we will be left with significant unknowns.

We have been talking to banks for years about cVRPs, yet we are still in a market where only one is genuinely committed to seeing a cVRP market take off. This has unquestionably delayed customers from benefiting from cVRPs.

We would also be concerned about a lack of uniformity of implementation if banks offer cVRPs on an entirely voluntary basis, creating an uneven 'minimum viable product' (MVP) which will in turn impact adoption. Coupled with there being no commercial incentive for banks we would expect the user experience to be of a poor quality as well as uneven.

Our view is that the largest UK current account providers must be obliged to provide cVRPs whilst also being able to charge a small amount for their service. Our view is that 90% coverage of current accounts would be required to achieve appropriate 'network effects'. A dynamic construct for defining which ASPSPs should be mandated would be more appropriate than the CMA9 though given this group of banks was defined by market shares nearly a decade ago.

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?

Our view is that even if the commercial model offered incentives above debit interchange (which we do not support - we believe it should be substantively below the rate of debit interchange), most banks would still not invest in cVRPs in 2024 as it would require prioritising them over competing change and investment projects that they have already committed to delivering. Making the roll-out of cVRPs mandatory is required in order for this work to be prioritised above other projects.

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?

Phase 1 becomes a compliance exercise for banks and we repeat the mistakes of the original CMA Open Banking Order.

The commercial model must provide an incentive to all ecosystem participants, including banks, to ensure innovation and ongoing investment. The banks need to see the longer-term potential otherwise we risk creating a poor user experience and market distortions impacting account-to-account payments more broadly (i.e. direct debit). It could potentially even bolster the market position that cards enjoy, achieving the precise opposite of the PSR's strategic objective.

We would encourage the PSR to create an environment where participation is necessary but commercial incentives are still on offer.

Question 15
Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.
We are aware that the PSR is consulting with the European Payments Council (EPC) on the "black box" approach taken to arrive at the commercial model for the SPAA scheme. The process has not been without its challenges but the SPAA MSG's equally weighted membership managed to come to an agreement for a first version of premium API pricing. Perhaps there is an opportunity to take a similar approach (and hopefully learn and improve on the challenges faced with SPAA) whereby economists are instructed by the regulators to conduct a detailed analysis of what a sustainable pricing structure could look like.

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?
From our perspective as an account-to-account (A2A) payments provider, we would like to stress the risk that the current proposals achieve the opposite of what the PSR intends.

The low-risk use cases identified for Phase 1 are primarily (but not exclusively) served by direct debit today. We have concerns about the impact of an artificially low priced competitor product and have not seen any analysis of how the PSR anticipates their proposals will impact the market for direct debit though. JROC, the PSR (notably through live market reviews) and Joe Garner's Future of Payments Review have all focused on open banking offering genuine competition to cards, so it is surprising that the PSR would promote an approach that targets and undercuts A2A - particularly seeing as promoting A2A is a strategic objective for the PSR.

The lack of incentive for banks means that we see a significant risk that the Phase 1 product does not provide a strong user experience. However, some merchants may replace their DD payments with cVRPs and then find themselves 'locked in': VRP does not provide account switching functionality nor can VRP mandates be easily moved back to DD. We believe this issue should be explored further as a priority.

We also see a risk that card payments are actively given a boost if merchants receive a poor user experience with cVRPs.

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.

It was noted in a PSR-hosted webinar that Telecommunications use cases are in scope for Phase 1 despite Ofcom-regulated firms not being referenced in the consultation paper. Could the PSR confirm whether this is the case?

In addition, the Government use cases - HM Revenue and Customs (HMRC) and Gov.UK Pay - are limiting in the sense that this only affords an opportunity to compete for two contracts. We are unclear on the rationale for this and why it could not be extended to e.g. all Central Government.

Question 18

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

We would agree with a 10 year time horizon. The NPA is not likely to move forward until the National Payments Vision work completes later this year and we have not seen any plans pointing to significant improvements for Bacs functionality in the next 10 years or more.

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?

	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 success 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?

The PSR is better positioned to assess the key costs across the value chain. We broadly agree with the key costs outlined in this consultation but would once again encourage a deeper economic analysis to be conducted of the key costs for each of the different components.

Question 21

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

No comment.

Question 22

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

We do not think the current Phase 1 proposals will support a trajectory that delivers cVRP successfully into the market. An excellent customer experience is key to this as well as current account coverage and a price that is substantively lower than cards.

Also, we are unclear whether Phase 1 is determined purely by the use-cases and will continue indefinitely, or whether time is also a factor under consideration by the PSR. Industry investment thrives on certainty so knowing if, how and when Phase 1 is expected to end, including what conditions would need to be met and how a transition to a future commercial model for the low-risk use cases could be achieved, is critical - particularly given the breadth of the Phase 1 use cases.

If Phase 1 has no end then we are sceptical that non-mandated banks will ever participate. Its success will rely on incumbent banks maintaining their market shares in future.

We would also like to better understand what Phase 2 of cVRPs would look like (although we welcome the PSR's acknowledgment that higher risk and more complex use cases may need different commercial models). This will help ecosystem participants to allocate resources accordingly. PISPs will also be better placed to to provide guidance to merchants from the outset, which will allow for a more sustainable trajectory into the market for cVRPs.

Government Banking

Expanding variable recurring payments - Call for views

Consultation Questions

The following response has been collated by Government Banking with input from our customers including HM Revenue & Customs (HMRC), Department for Work and Pensions (DWP), National Savings & Investments (NS&I) and Driver & Vehicle Licensing Agency (DVLA) and reflects our views as end users of the UK Retail payment schemes.

Initial views suggest that the majority of Central Government do not expect to take up VRPs as part of the pilot. Of those that do, it will be a small proportion of their overall transactions. This is mainly due to cost but is also because flexibility on timing of payments would not be appropriate for many payments to government.

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 consider the pricing principles as presented *could* support delivery of a sustainable commercial model however we have concerns that if the sending banks are not to be financially reimbursed there will be no incentive for banks to create a good user-experience and take up by banks other than those mandated will be minimal.

VRP must be undertaken at a cost that is affordable to the public purse and is dependent on both competitive and low pricing models. Pricing must also be comparative to Direct Debit to ensure it is an attractive alternative payment method. To ensure sustainability consideration should be given to aspects such as negotiable pricing structure models and price caps that do not disincentivise the market or shut down access from a FinTech perspective.

Overall, the issue regarding pricing is that each part of the payment chain will need to recover costs. If the incentives move costs away from the sending banks and the third-party providers there is a risk that the billers and their suppliers will be required to pay more. That will increase the cost of collections and reduce any benefits that could have been achieved.

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.

Cross-industry coordination is essential to ensure consistency and fairness. It will be important for PSR to undertake ongoing analysis to ensure any concerns or issues raised will be addressed during Phase 1. We agree that an MLA is appropriate as it provides a platform for cooperation and access by the market, however this should include minimum standards of quality. Our understanding is that the MLA will also set out functionality, arrangements for pricing, dispute resolution and liability.

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.

Yes, as operators and the standards body of the Faster Payments Scheme; the UK's retail inter-bank payment system, Pay.UK are best placed to operate the MLA for Phase 1. Open Banking Limited may also need to have input to the technical aspects such as setting API standards.

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 agree with the view on the market structure and the concerns raised in the paper that the sending firms could have a 'bottleneck monopoly' as they control the access to their customers' accounts. The suggestion that safeguarding measures including regulatory intervention is likely to be necessary to prevent this both in terms of accessing data and payment initiation seems reasonable.

It will be important that all parts of the VRP chain including sending firms provide transparent and detailed pricing. If any organisation looks to recoup costs too soon or tries to recover revenues lost from other payment methods VRPs will not be cost effective for billers. There is also a risk that only the larger banks/fintechs that might be able to absorb some of the costs are able to compete, as the total cost of ownership could be too great for smaller third-party providers.

Question 5

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

We do not have any knowledge of what the sending firm related costs would be, so are unable to respond to this question.

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.

As end users, we are keen to achieve value for money and would support initiatives to minimise costs. Based on the detail in the consultation paper, we consider removing costs would be a better approach for the sender as it will encourage them to work with third-party providers on VRP and not promote the use of other payment options. However, moving those costs to the receiving firm will not benefit billers as they will still pay the costs, just to their own bank rather than their third-party provider.

In charging, commercial entities will need to consider the impact of VRP pricing versus existing options, whilst respecting that it is reasonable for commercial entities to charge for services. Commercially, transparent end to end pricing is crucial from an opportunity perspective, as unclear costs/pricing provides a barrier to success in providing value for money propositions.

Government would like to understand more about potential fees/additional charges so we can factor this into our plans and any funding requirements if we are to utilise VRPs.

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?

As above, moving the FPS 'price per click' charges from the sending firm to the receiving firm will not actively encourage billers to use VRPs as they will still be paying the costs, just to their own bank rather than their third-party provider who would be recovering charges levied by the sending bank. They would, however, be able to control the volumes of payments and budget for the costs.

We have limited information about what recovery through wider Pay.UK charging could look like but assume that there would be no change for consumers. If other FPS transactions were to become more expensive to cover the cost of the VRP FPS payments, organisations who do not use VRPs or those who receive high volumes of standard FPS payments will find their overall costs increase as they will be subsidising other organisations VRP FPS transactions.

Whatever charging mechanism is decided on, it needs to be transparent, so all parties understand what they are paying for. There needs to be very clear accountability on charging, otherwise 'price per click' could create friction and increase fees without stakeholders being able to challenge the value of the changes or the cost effectiveness of the product. Could consideration be given to reflecting both volume and value of usage within the costing mechanism, so larger users would benefit from economies of scale?

Question 8

Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence. December 2023 Payment Systems Regulator 24 Expanding variable recurring payments CP23/12

We have no knowledge of the OBL related costs and so are unable to answer this question.

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 that the proposal outlined in the consultation is a pragmatic approach but are unable to provide suggestions about other commercial models.

We have concerns around how the charging fee compliance would be managed to ensure that ASPSPs do not dominate the market. Enforcement and a policing mechanism will need to be put in place to protect third-party providers, consumers, and customers.

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 view is that if many customers have accounts that support VRPs, it could be sufficient to incentivise PISPS and/or billers, however that is unlikely to be enough if the costs involved in making the infrastructure changes required to implement VRPs or the ongoing costs are too high.

From a biller's perspective, incentivising would mean ensuring that solutions are robust, and that their customers understand that VRPs use FPS which is a trusted payment method. The solutions will also need to be more cost effective and offer additional benefits e.g., increased straight through processing for billers than the alternatives. From a consumer's perspective, providers will need to ensure the payment method is secure and seen as a trusted payment method.

HMRC believes there is potential for customers currently using Direct Debit for payment instalments to transfer to VRP. They consider take-up could be relatively high, depending on the affordability of the service. Others across government report that they do not consider that there is a business case to move customers from Direct Debit as it provides value for money, and they prefer being in control of the payments process particularly where timing of receipts is critical. They can, however, see the benefits of adding VRPs as an additional payment method for those struggling with Direct Debit or who are currently initiating their own electronic or paper-based payments.

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.

We do not have sufficient information to answer this question but consider that analysis of the data from the introduction of Payment Initiation may provide some insight.

Question 12

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

Yes. Without participation from the CMA9 banks it will be hard to drive participation and make an expanded version of VRP a viable product.

Mandating CMA9 banks will give greater numbers of consumers the opportunity to use VRPs and help drive competition (potentially lowering costs). With the relevant data and research this could feed back into the VRP process and allow for additional developments and innovation within the space.

HMRC have advised that their payment strategy is based on making available one consistent set of payment methods to all their customers across all tax regimes. They believe that mandating would be preferable as it creates consistency and would not confuse customers or penalise those who do not hold accounts with participating banks. It could also provide a more competitive costing model.

We suggest looking at other initiatives including the roll-out of Confirmation of Payee and Payment Initiation for insight into how mandating the CMA9 has been effective.

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?

Without mandating the CMA9 banks, getting coverage for Phase 1 will be very difficult as there is no real data or evidence of the benefits that could be realised. Running the pilot should help identify solutions to encourage 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?

We consider that the main risks and costs for the mandated banks would arise from the infrastructure needed and the timescale required to implement the service. Concerns were raised on the possibility of CMA9 banks/other providers exploiting mandating by artificially inflating prices. Risks and costs could be mitigated with a regulated and transparent cost structure, particularly one that is reviewed and adapted based on the ongoing developments and outcomes of Phase 1.

Secondly, low customer uptake is a risk as this could put service providers at a disadvantage and unable to recoup costs. Low uptake could be because customers themselves would face significant costs and issues to make the necessary changes to their internal systems to accommodate the changes.

NS&I, as an agency bank, have identified that if they were to be mandated as a “sending bank” they would face significant risks and costs as their terms and conditions state that payments must be made to a personal UK bank account or building society account in the customer’s name, so this would prevent its customers requesting payments to billers.

Question 15

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

We do not have sufficient knowledge of alternative models to answer this question.

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?

We have not identified any additional risks associated with the proposed commercial model but consider that there will be a risk to take up of VRPs if consumers are not sufficiently educated about the product. Most will not know anything about VRPs or the benefits they could get versus their existing payment methods such as Direct Debits.

There is also an underlying risk and potential costs associated with the need to provide consumer protection. It is likely that consumers, especially those who would consider moving to VRPs from Direct Debits, will require protection equivalent to the Direct Debit Guarantee. This is not currently inherent in faster payments, although the activities in respect of APP fraud may help in this area and provide an opportunity to encourage the use of VRPs.

As noted previously enforcement and policing are vital to ensure that risks associated with charging are mitigated.

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 the entities on the PSR's proposed list are in scope, but the full scope for Central Government is broader than just HMRC i.e. it includes other departments, non-departmental public bodies etc. The payment channels should also include more than just Gov.UK pay.

However, whilst government bodies may be eligible to engage in the pilot, it will be for each organisation to determine whether to utilise VRPs, based on a cost-benefit analysis of the service, which will include the cost of VRPs in comparison to all payment channels including Direct Debit.

The list also no-longer includes local government, which was originally identified in the VRP pilot, but this is out of scope for Government banking to comment on whether they would take-up the service.

Question 18

Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response. December 2023 Payment Systems Regulator 25 Expanding variable recurring payments CP23/12

Yes. We agree with the initial assumptions for the cost benefit analysis because it ensures open banking is not negatively impacted.

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?

We believe the benefits of VRPs are:

Consumers
- Control over their payments
- Greater flexibility in managing their finances
- Real-time settlements
- Improved choices

- Ease and simplicity of use, especially if the consumer is transitioning from an alternative service.

Merchants
- Instant payments (via FPS rather than Bacs)
- Increased likelihood of payments being made as the consumer can make the payment when they know funds will be available.
- Less risk of misallocation of payment as the PISP will populate the instruction with the details required by the biller.

PSO
- Innovation and development of Account-to-Account payments.

PISPs, & Sending Firms
- Increased efficiencies.
- Improved customer service.
- Increased revenue.

Many of the benefits will be difficult to measure and will require feedback from across the value chain.

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?

Consumers
- Minimal as consumers are not generally charged for their transactions and we do not expect this to change.

Merchants
- Increases in cost when compared to the existing payment methods. For example, when comparing VRPs to direct debits the merchant will incur costs from their PISP and pay more to receive Faster Payments than Bacs payments.
- Infrastructure costs and other costs to set up the service, including training and administration work.

PISPs
- API design and implementation.
- Upfront costs from adopting or switching to VRPs.

PSO
- Service standards and management.

Sending Firms
- potential loss of revenue from product displacement

To measure the differences, data will need to be collected from each of the groups.

Question 21

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

The proposals are predicated on the use of digital technologies but not all people with protected characteristics are able to use these services. We believe that unless the interests of people with protected characteristics are considered when the service is designed, they could be disadvantaged. Accessibility must be at the core of the design process. Providing choices and alternatives to those with protected characteristics will be important for the providers of VRP services if they are to maximise take up by consumers.

Government organisations including HMRC, DWP and NS&I have specific policies for those with protected characteristics, so it will be important to ensure these are aligned. Completing an Equalities Impact Assessment may identify additional requirements for this group of consumers.

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.

We accept that the current policy proposals have a focus on providing value for money and keeping costs down, but cost is potentially the biggest risk to scalability of VRPs. Until the end-to-end cost of VRPs can compete with the overall cost of Direct Debits, billers will not have the business case needed to warrant moving those payers to VRPs. This means that the take up of VRPs would be limited to non-scheduled/ad hoc payments which is only a small percentage of the overall payments made particularly for government.

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HSBC Bank

HSBC UK BANK PLC / HSBC BANK PLC

EXPANDING VARIABLE RECURRING PAYMENTS

CALL FOR VIEWS

CONSULTATION PAPER CP23/12

RESPONSE TO PSR CONSULTATION DATED DECEMBER 2023

2 FEBRUARY 2024

COVER SUBMISSION

HSBC UK Bank plc (‘**HSBC UK**’) and HSBC Bank plc (**‘HSBC’**) welcome the opportunity to respond to the Payment Systems Regulator’s (‘**PSR’**) Consultation Paper on *Expanding Variable Recurring Payments* (‘**VRP**’). We have answered the questions in the consultation below. Our key points are summarised in this cover submission.

Summary

HSBC UK and HSBC are supportive of increasing customer payment options and increased competition with card schemes; however, we believe that regulatory intervention is premature and will not deliver the intended outcomes and will detract from the wider PSR objective of enabling account to account payments for consumers. Within HSBC UK we currently offer our customers the option of making sweeping payments (me to me) from personal and business current accounts using VRPs and are active participants in the industry-led work to develop a common contractual framework and rulebook. Done correctly, we continue to believe that VRPs can be a useful addition to the UK payments market, offering both payers and payees the benefit of a flexible payment mandate that does not entail credit or operational risks that restrict availability. We also believe that VRPs offer the UK open banking ecosystem a route to moving beyond regulation and towards a sustainable economic model as endorsed in the Chancellor’s Autumn Statement and described in the Future of Payments Review. We are disappointed therefore that the PSR’s proposals do not align to these strategic outcomes and differ markedly from the expectations set in the April 2023 Joint Regulatory Oversight Committee (‘JROC’) market update. Specific areas of concern that we would highlight for PSR consideration:

1. **Open Banking Payment commerciality**. We support Conclusion 7 in the Future of Payments review. *“… the lack of a vision for sustainable commercials on OB needs to be addressed and delivered as a priority*”. This aligns with our view that open banking and open finance should be developed based on fair value distribution, not free to use as required under the current Payment Services Directive 2 (‘PSD2’) / Competition and Markets Authority (‘CMA’) open banking requirements in force. We note that JROC in

April 2023 also made promotion of Premium Application Programming Interfaces ('APIs') a key priority for the next phase of open banking in the UK. We therefore disagree with the proposed approach as inconsistent with both JROC's own stated intentions and the broader strategic direction endorsed in the Autumn Statement. Specifically:

- Price setting by the PSR for Phase 1 is not developing a sustainable commercial framework to support investment in VRP and could distort competition;
- Continuing to rely on Open Banking Limited's ('OBL') current economic model which is substantially subsidised by CMA Order activities is not developing a sustainable industry infrastructure to support collective investment in open banking;
- Commercial VRPs have become totemic in the open banking ecosystem – should these face uncertainty, industry willingness to commit to other Premium APIs will also inevitably be impaired.

2. **Phase 1 success**. We think the proposed approach to Phase 1 will discourage adoption of VRPs for a number of reasons:
   - Regulatory intervention from the PSR is premature and whilst well intended, will not deliver the desired outcome of account-to-account payments competing with card-based payments. A compelling merchant and end user proposition is necessary to enable competition with card transactions.
   - We cannot fully comment on the proposals as the PSR's use of legal instruments is currently unclear, however, there is a risk that the new payment options could be determined to be outside of the current legal framework for Payment Initiation Service Provider ('PISP') transactions, and this uncertainty creates a barrier for investment.
   - Billers will lack pricing certainty beyond Phase 1 because as proposed it relies on cross-subsidy from payer Account Servicing Payment Service Providers ('ASPSPs') to PISPs for a specific period. This uncertainty will make it difficult for billers to justify investing in technical changes to enable VRPs and marketing to customers to stimulate adoption.

- Billers will lack confidence that non-mandated firms will launch services given the lack of incentive at the proposed price cap, or if they do launch VRP services the cost to billers may be substantially larger as these firms can be expected to seek to recover costs incurred and PISPs will pass these costs on to billers.
- Payment Initiation Service Providers (‘PISPs’) and Account Information Service Providers (‘AISP’) will lack confidence in industry’s ability to define prices for VRPs beyond Phase 1 and will therefore be unwilling to commit resources in development. Innovation business cases are infeasible if there is a risk of price regulation in the near term.
- Phase 1, as proposed, cannot be seen as a pilot for expansion of VRP unless the pricing structure were to be replicated in future phases. A better plan would be to allow for a commercial incentive to PISPs and ASPSPs from the launch of Phase 1.

3. **Sustainable development**. Phase 1 should avoid throw-away development spend to enable subsequent scale-up as per the JROC vision without time-consuming and expensive re-work. The proposed removal of Faster Payments scheme charges relies on a temporary technical solution – this would require short-term, throw away implementation by sending banks. Other technical changes to the open banking standard should be designed to support future phases of delivery (whether regulatory or commercial). We disagree with the role proposed for Pay.UK and based on previous interactions with Pay.UK, do not agree that they are the right choice.

4. **Mandating participation**. We do not support any institution being mandated to participate in Phase 1. For Phase 1 to realise its full potential it needs to have adequate coverage of customer accounts and broad biller engagement based on value proposition and confidence in the longer-term economic viability of the VRP proposition. For these things to be true, all stakeholders require confidence that the product is both commercially viable and fit for purpose for end users. This necessitates there to be a positive business case for payer banks as well as for PISPs and billers. Mandating participation by any institution will signal to the market that

there is not a compelling business case for certain types of participants, which will undermine confidence in the longevity and ongoing willingness to invest in the wider structure. The PSR must be transparent about the legal powers it intends to use to mandate CMA9 participation in the MLA and to intervene in the market to set a central price.

Our response below sets out our responses to the PSR's questions and restates the elements that we believe are crucial in providing a sustainable, commercial method of promoting expansion.

RESPONSE TO QUESTIONS

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.

1.1 HSBC UK and HSBC are not clear on the status of the pricing principles published in June 2023. The document was not subject to consultation and contains principles that conflict, as noted at the time of issuance, terminology that is not based on the diverse open banking market, does not provide a basis for commercial sustainability and would require either cross subsidisation of losses. Moreover, we are unclear why specific principles for Premium APIs are required – ASPSP obligations under Consumer Duty provide sufficient underpinning for this market to operate in the interests of end users on a sustainable commercial basis in our view.

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.

2.1 Yes, we consider cross-industry coordination to be necessary for Phase 1 success; PISPs require a well-defined and consistent product to offer to potential billers.

2.2 However, we disagree with the approach of an MLA with scope as proposed, and we consider it an unhelpful precedent if the first meaningful extension to PSD2/CMA APIs includes price setting by a regulator instead of a commercially sustainable proposition being developed which is compelling for all participants and consumers.

2.3 We recommend the PSR consider a multi-party contract framework that includes coverage of necessary items to ensure a standardised product without stepping into economic regulation. This should include required functionality, user messaging (to both payer and payee), simple customer dispute resolution processes, (appropriate to the proposed lower risk use cases), and billing methodology (frequency, settlement terms, pricing structures, commercial disputes resolution processes).

2.4 The contract framework should stop short of setting actual prices at unit or *ad valorum* levels. It could be helpful for the industry to align on a common approach to charging, enabling PISPs to create a simple offer to billers, therefore the multi-party contract could standardise this methodology. Actual prices should be determined by participating payer ASPSPs in Phase 1 based on their firm-specific cost drivers. Consumer Duty includes provision for fair value by manufacturers and distributors, and we propose these guidelines are sufficient to provide pricing guidance to payer ASPSPs ("manufacturers") without additional intervention.

2.5 We cannot see that factors around the adoption by the merchant have been considered, including the material cost of adoption or how slow merchants are to implement payment technology change including digital wallets and SCA changes.

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.

3.1 As noted in Q2, HSBC UK does not support the proposed scope of MLA for Phase 1, however, we do support a multilateral contractual framework with a more restrictive scope.

3.2 We do not support Pay.UK taking on this activity for Phase 1. It is our view that Pay.UK is not best placed to take on this activity for Phase 1 nor on an ongoing basis. Pay.UK is already committed to delivering a congested runway of strategic change and its own reporting to participants evidences material risk therein. [redacted text]

3.3 In place of assigning Pay.UK to this role, we propose assigning this to the Open Banking Future Entity, with OBIE carrying out the activity in the interim subject to appropriate governance being followed and funding made available. This will ensure that any artifacts, processes and insight developed through this work can also be applied to non-payment extensions to open banking. We expect this will align to the proposed Long Term Regulatory Framework expected to follow the National Payments Vision strategy work currently in flight. [redacted text]

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?

4.1 HSBC UK disagrees with the core assumptions set out in CP23/12 and notes a fundamental shift from the position in the JROC Recommendations of April 2023 in which JROC stated:

> *2.15 One of our ambitions is to enable open banking payments to support retail transactions as an alternative to card payments. To do this, a commercially sustainable model … must be in place.*

4.2 Paragraph 4.8 suggests that VRP adoption to date has been slow due to payer firm charging structures. We strongly disagree. Instead, we believe that VRP adoption has been slow because of the ongoing consultation activity regarding the future direction of open banking and parallel changes to the wider payment liability framework in response to APP scams. New payment products require substantial operational and marketing support. In the absence of legal certainty on the future regulatory framework and economic certainty on future liability exposures it is unrealistic to expect market participants to make material commitments regarding new products. We consider it likely that the proposed approach will create further uncertainty and hamper development of VRP more widely because it creates ongoing uncertainty as to future economic structures.

4.3 Industry engagement during the Strategic Working Group ('SWG') stage and subsequent JROC work has demonstrated broad support from payer ASPSPs for extending application of VRPs beyond sweeping use cases and account to account payments more broadly. The parallel embedding of Consumer Duty into regulated financial institutions ensures the risks described in paragraphs 4.9 and 4.10 are mitigated. Specifically, payer banks have a duty to ensure any pricing applied to commercial VRPs represent fair value for end customers, irrespective of the impact on other revenue streams such as card issuing.

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

5.1 In Paragraph 4.14 the PSR asserts that investment costs for enabling VRPs are relatively small. It would be helpful to understand the basis for this statement. HSBC UK's own assessment is that investment costs would be [redacted] for us to support Phase 1, with exact cost dependent on the final specifications and scope of accounts which needs to be established during the coming months.

5.2 The PSR has correctly identified the key costs associated with processing VRPs, however it suggests that most of these costs are likely to be negligible during Phase 1. It would be helpful to understand the basis for this view, grounded in volume forecasts for Phase 1.

5.3 In our experience open banking fraud exposure frequently arises from payments to other regulated financial institutions which fall within the scope of Phase 1. Specifically, APP scams lead to customers making payments to accounts understood to be genuine parties but in fact controlled by fraudsters. Therefore, as a minimum we would expect 1) PISPs to be fully liable for verifying that beneficiary accounts are *bona fide* biller accounts (for example for settling credit card outstandings or depositing into investment accounts), and 2) a contractual mechanism for payer banks to recover such fraud costs (which are likely to be new, incremental, and non-negligible) through up-front payment costs or in-arrears from PISPs on an as-incurred basis through the life of Phase 1. Any fraud exposure is substantially new because VRP is intended to grow usage of A2A payments by substituting from other payment products where these exposures do not sit with the payer bank. The PSR should be aware that APP scam protections such as Confirmation of Payee checks and Effective Customer Warnings are not currently available in the Open Banking channel. If the PSR intends to proceed to direct HSBC UK and other payer banks as proposed, we suggest as a pragmatic approach the creation of a recovery fund for fraud losses funded by those PISPs who launch services to billers. This will enable Phase 1 to proceed at pace, will encourage effective financial crime controls by those participants that can operate them, ensure market pricing to billers is reflective of longer-term economics, and will provide all participants and the PSR itself with a transparent process through which to understand financial crime risks ahead of proceeding to more complex use cases for VRP. We would welcome further engagement with the PSR to discuss the way forward.

4.4 We note that Pay.UK appears to have committed extensive resource during 2023 to supporting Phase 1, without prior engagement with participants. We would be interested to understand whether the PSR has taken account of these costs in its assessment. All Pay.UK costs are recovered from participants and should be included in any cost-benefit analysis.

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.

6.1 We consider that sending firms should be charged and able to recover FPS related costs. It is difficult to see how FPS costs can be waived without these being recovered elsewhere. Removing the costs as proposed is very likely to create a cross-subsidy, with the cost of waived FPS costs being recovered across all FPS users. In the longer term it further exacerbates the current problem of OB Payments lacking a sustainable commercial model, storing up market disruption for the future as the various cross-subsidies are unwound.

6.2 From a biller perspective, the proposed approach is likely to deter participation because billers will be cognisant that the economic model proposed is time limited. This does not create the medium-term stability required to support the technical and customer-operational investments needed to deploy a new billing method.

6.3 In order to ensure effective positioning with billers and its longer-term success, the VRP product should be priced based on its economic fundamentals from the outset. VRP is inherently more expensive than direct debit due to the underlying scheme cost structures of Faster Payments and BACS. For this reason, VRP should be presented as a complement to direct debit - it offers a number of payer and biller benefits due to the flexibility it offers and the ease of management through digital interfaces. This is relevant for some payers who currently use manual or one-time payments and will generate operational efficiencies for billers. However, it is unlikely that VRP will be a substitute for existing direct debit mandates where these work well for both payers and billers. Sustainable pricing at the outset will ensure the long-term viability of the VRP product.

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?

7.1 Please see our response to question 6.

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

8.1 At present OBL has no funding for non-Order activity relating to VRPs in 2024. This can be evidenced through referral to OBL November FARC papers and December TMDG at which the PSR was present.

8.2 Therefore any OBL costs are, as yet, unconsidered and would need recovery from non-Order sources. This might include standards development (technical design, user experience), participant support in mobilising the Phase 1 activity, and/or ongoing MI collection and outcomes testing.

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

9.1 As noted in our response to question 3, the PSO, who we propose should be Open Banking Future Entity with OBIE carrying out the activity in the interim, should calculate a pricing methodology and framework. Our reasoning is that the price itself will need to vary as infrastructure costs and price changes, OBL pricing changes or is moved to different vendors. Therefore, it would be more sustainable for the PSO to manage the pricing model; this way a framework can be agreed and implemented with regular reviews (quarterly, bi-annually, annually etc.). Having the PSR set a non-sustainable price means that the VRP commercial model is baselined in a manner in which it cannot achieve sustainable growth. It will set up an uneconomic model from the outset which will cause unintended consequences.

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.

10.1 We cannot fully comment on the proposals as the PSR's use of legal instruments is currently unclear, however, we do not agree that having a large number of consumers with accounts that support VRPs will in and of itself sufficiently incentivise PISPs and/or billers to invest in offering VRPs. Following implementation of PSD2/CMA there are a large number of consumers with accounts that support international payments via open banking, yet there is little to no international payment traffic in the ecosystem. Similarly, there are large numbers of business accounts accessible that support bulk and batch payments, yet there is little to no payment traffic of this sort in the ecosystem.

10.2 In addition to scale, it is necessary that VRPs can demonstrate a sustainable value proposition that justifies investment by billers and PISPs. The tactical design of Phase 1 with temporary pricing controls and supporting solution design will not in our view evidence a sustainable product. We consider there to be a material risk that billers will find it an unattractive proposition because of the lack of long-term certainty. In our view a market-driven process which offers greater certainty because it is grounded in sustainable economics is more likely to achieve the PSRs target outcome of a successful launch of VRP.

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.

11.1 Please refer to Question 10 response.

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

12.1 We do not support any firms being mandated to participate in Phase 1, including the 'CMA9' banks as defined by the CMA. We consider it inappropriate to apply the CMA9 concept to outcomes that are substantially outside the CMA's market analysis done in 2016.

12.2 As noted above, for Phase 1 to realise its full potential it needs to have adequate coverage of customer accounts and broad biller engagement based on value proposition and confidence in the longer-term economic viability of the VRP proposition. For these things to be true, all stakeholders require confidence that the product is both commercially viable and fit for purpose for end users. This necessitates there to be a positive business case for payer banks as well as for PISPs and billers. Mandating participation by any institution will signal to the market that there is not a compelling business case for certain types of participant, this will undermine confidence in the longevity and ongoing willingness to invest in the wider structure.

12.3 If the PSR chooses to mandate institutions it should do so supported by a clear market analysis which is specific, current and relevant to the scope of Phase 1. The outputs of this analysis would define which firms to mandate, the scope in terms of customer/payer types, account types, and any other relevant parameters.

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?

13.1 We do not support any institution being mandated to participate in Phase 1. We believe that this would detract focus and resource away from developing a wider VRP commercial proposition.

13.2 We propose that payer banks (not just the CMA9 firms) are asked to participate on a voluntary and commercial basis. Pricing might be standardised on either a per-payment or *ad valorum* basis for Phase 1, determined by payer banks, with each bank charging all connected PISPs a constant price for the duration of Phase 1. This approach would make billing straightforward and quick to implement, whilst retaining firms' ability to derive some commercial benefit to offset investment costs. Following Phase 1, the market can then develop pricing organically in a manner that continues to incentivise investment by all parties.

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?

14.1 We do not support any institution being mandated to participate in Phase 1.

14.2 Any firms mandated to participate in Phase 1 will incur one-off technical change implementation costs. As noted above, we estimate these at [redacted] for HSBC UK, which is not negligible.

14.3 In addition, there is substantial financial risk exposure from fraudulent payments and customer disputes that cannot be directly resolved with the biller that will crystalise through Phase 1. These costs should in our view be recoverable through a commercial VRP pilot as proposed by JROC in April 2023 rather than through a mandated free-to-use VRP pilot as now proposed.

14.4 A broader market-wide risk arises from mandating participation. Commercial VRPs have become totemic in the UK open banking ecosystem as evidence that we can progress from regulatory open banking to a commercially viable ecosystem which can innovate across the payments value chain. If VRP is delivered into the market through compulsion it may signal that open banking extensions are only viable through continual regulatory intervention, and product innovation driven by industry is not feasible. That perception may lead to lasting, negative consequences in progressing other open banking and open finance outcomes. This does not seem consistent with JROC's vision for the future of open banking or wider Government policy.

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

15.1 HSBC UK advocates an alternative model aligned to JROC's prior vision of commercially sustainable extensions to existing open banking services. As described in our response to Question 13, we advocate a voluntary model with commercial incentives as more likely to deliver the outcomes JROC desires. Our rationale is set out in our response to Question 14.

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?**

16.1 The PSR has not outlined which powers it is proposing to use so we cannot fully comment. As previously noted, we believe that the PSR market intervention is premature and will not achieve the PSR intended strategy to increase competition with card schemes but may create risks for consumers and merchants and cut across Consumer Duty required outcomes. Given the uncertainty regarding the PSR use of legal instruments, we would also highlight that the regulatory classification of the proposed commercial VRP use cases is unclear and could be considered to be outside the scope of PISP FCA authorised activities and the existing right to access customer accounts to initiate payments, which is relied upon by PISPs.

16.2 The PSR use cases will primarily compete with direct debits and are similar in nature, these are payee-initiated transactions so this uncertainty could be a barrier to investment. The Payment Service Regulations (PSRs 2017) allow access to accounts to initiate payments on behalf of payers.

16.3 Prior to PSR regulatory intervention to mandate an extension to the use cases for VRP, it should also be considered that existing PISP services are provided under the PSRs 2017 on a PISP to end user customer basis. They do not envisage the provision of a regulated service to merchants. The PSR proposal is not explicit as to whether only authorised PISPs will be permitted to become VRP initiating firms in Phase 1, we assume this is the intent. We think it likely that VRPs will give rise to different characteristics to single immediate domestic payments as the dominant initiated payment envisaged in the PSRs 2017 - for example cumulative value of payments is likely to be much greater, concentration of payment value by payee is likely to be greater. The adequacy of the PISP authorisation and prudential capital framework should therefore be assessed prior to commencing Phase 1. In addition, ASPSPs should be provided with legal clarity as to whether they can rely on PISP authorisation carried out by the FCA as a sufficient basis for providing access to accounts for VRP mandates.

16.4 As we have previously indicated, wider focus is needed on account-to-account payments to ensure that a compelling proposition is developed which can compete with existing payment solutions to increase options for customers. This must also be achieved with a sustainable commercial model and the right consumer protections.

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

17.1 HSBC UK and HSBC agree with the proposed list of use cases – these are consistent with the industry discussions in the JROC sponsored VRP Working Group.

17.2 As noted in our response to question 5, some existing open banking fraud arises from payments supposedly to collection accounts with other regulated financial institutions. Therefore, the third use case proposed has quantitively different economic drivers to utility and government billers. We would be happy to share our current experience if helpful to the PSR's analysis.

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

We disagree with PSR's base assumption as follows:

18.1 Absent regulatory intervention, we expect the current provision of VRPs by sending firms will change. The industry-led activity to develop model clauses being coordinated by UK Finance has support from major retail institutions and PISPs. It includes direct funding, evidencing commitment to deploy VRP services. In our discussions with other industry participants, we note that the persistent risk of regulatory intervention has in fact stymied progress – lacking legal certainty, firms are challenged in making long term commitments to new products. We propose the PSR adjusts its assumption to be that "given appropriate clarity that there is not going to be a regulatory intervention, the current provision of VRPs will change with potential additional benefits and costs materialising."

18.2 In addition, we propose an assumption that "Commercially led development of VRPs by sending firms is likely to lead to greater innovation and end user benefit than development of VRPs through regulatory intervention and price setting". In our assessment, described above, commercially led development will lead to ongoing product innovation and investment, thereby unlocking many more use cases with end user benefits. By contrast, we consider it likely that regulatory intervention will lead to a lack of ongoing investment because payer banks will lack proper incentive to innovate.

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?

Specifically for Phase 1 as proposed:

19.1 We disagree with the assumed benefit to end users due to reduced use of credit. The proposed billers within scope of Phase 1 do not typically accept payment by credit card.

19.2 We disagree with the assumption of a meaningful reduction in cost to payees through late or misdirected payments. Direct debit payments seldom result in these outcomes, and debit card on file enables substantially the same outcomes as VRPs for the vast majority of payments. We consider it unlikely that customers currently making one-time payments following receipt of a bill (for example in person via credit slips, or via online/mobile banking) will be early adopters of VRPs during Phase 1.

19.3 We disagree that there will be meaningful benefits for payers currently using direct debit in having greater control over payment schedules. Whilst this benefit conceptually exists, we think it likely this will be small in practice because billers will not seek to migrate payers from low-cost direct debit to higher-cost VRPs. In any case, payers who are migrated will lose the benefits of the direct debit guarantee which should be considered as part of any cost/benefit analysis as well as whether the four Consumer Duty outcomes would be met.

More broadly, the only clear beneficiaries of Phase 1 as proposed are:

19.4 Billers, who will benefit from a service that is subsidised through regulatory intervention for the duration of this intervention. This is then offset by disruption from any repricing that occurs at the end of this period.

19.5 PISPs, who are able to generate 100% of the service fees for the provision of a service for which they need make only a small part of the initial investment and bear a small part of the ongoing operating costs.

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?

At a high level, across the value chain:

20.1 Consumers – limited direct costs within the scope of Phase 1 as proposed. Payers who switch payment method from direct debit to VRPs will suffer from a reduced level of customer protection (namely the direct debit guarantee) which may result in some costs for the consumer. Subsequent extensions to other use cases will expose consumers/payers to greater direct costs as a result of the loss of customer protection that is offered through the primary alternative payment method of debit cards. This includes benefit of chargebacks whilst claims are assessed, and the protection offered by card acquirers against default or fraud by a merchant they act for.

20.2 Billers or merchants – implementation costs from switching to VRPs; these could include front end digital channel changes, changes to T&Cs, IT based costs for API integration, developing and publishing consumer information where there is a clear understanding of the VRP payment type to enable the consumer to determine if it is the right option and any additional operational costs for creating a new payment acceptance method for ongoing management and reconciliation such as informing the consumers that the direct debit guarantee will not apply.

20.3 The PSO - will have initial costs for developing contractual terms, rule book, supporting structures. We noted earlier that the PSO should be OB Future Entity with OBIE acting in the interim, this entity will not have any non-order funding available and a funding structure will need to be established prior to commencing Phase 1. Ongoing costs may arise from any verification or assurance activities that arise over time, commercial and/or customer disputes resolution, customer marketing and communications, standards management, and MI collation to monitor ecosystem health. We would expect these costs to be recovered from PISPs on an equitable basis, recognising they are the only material beneficiaries of Phase 1. The PSO costs could also be throw-away costs as the PSR Phase 1 proposals are not intended to provide a viable commercial framework for VRP and will not address the need for enhanced consumer protection. PSO activities will also need to change to accommodate different merchant types.

20.4 PISPs – initial technology and operational implementation costs, marketing and customer (merchant) acquisition costs, and ongoing operating costs.

20.5 Payer ASPSPs – significant costs for set-up including technology enablement and operational enablement (training to customer facing colleagues, fraud operational changes, etc). HSBC UK estimate these costs at [redacted] for HSBC UK for the scope of Phase 1. In addition, there are ongoing operational costs incremental to the existing cost of regulatory PSD2/CMA open banking services along with the cost of customer education and public website changes and all other costs associated with developing a new payment option for third party payments.

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

We have not identified any relevant adverse implications of the Phase 1 proposals for people with protected characteristics.

22. Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.

22.1 As noted in response to question 14, commercial VRPs have become totemic in the UK open banking ecosystem as evidence that we can progress from regulatory open banking to a commercially viable ecosystem which can innovate across the payments value chain.

22.2 If VRP is delivered into the market through compulsion it may signal that open banking extensions are only viable through continual regulatory intervention, including price setting and cross subsidisation, and product innovation driven by industry is not feasible. That perception may lead to lasting, negative consequences in progressing other open banking and open finance outcomes. This does not seem consistent with JROC's vision for the future of open banking or wider Government policy.

Independent Open Finance subject matter expert

Consultation paper - Expanding variable recurring payments (CP23/12)

Response to Call for views

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.

Extensive experience of PSR in managing MLAs makes them a great candidate for operating the MLA for Phase 1. However, inputs, insights and agreement of OBL and FCA of the final models and MLA structure put forward are very important because OBL understand the TPP dynamics and challenges, and FCA understand how to maximize acceptance across the industry.

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?

Sending firms have the data advantage.

A framework that keeps sending firms from putting other players at a disadvantage is good to have.

Question 5

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

Sending firms incur expenses for design-build of VRP, hosting infrastructure, setup & contracts with TPPs for VRP.

Question 8

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

The OBL is yet to publish details of how the commercial and liability framework will be implemented and therefore some new costs that sending firms and other participants will incur are still unknown.

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.

For end consumers, the factors that influence adoption remain by and large the same – confidence that the PISP will be responsible with their data, privacy, ease of use and value-delivered towards their financial goals. If these are delivered by PISP and there is wide-spread awareness created on the benefits of this model of payment, they will join up.

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.

For end consumers, value proposition from PISP needs to be compelling for them to take up. For PISPs (some fintechs, some bigger banks) will compete for the market share of a use case, 60%-70% consumer adoption may give them all a chance to thrive.

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?

The large banks in CMA9 can play a key role in making VRP good for the target customers to use. They are best placed to tell what will incentivise them. This is only "setting up" for use. The real potential will be realised if value providing and/or innovative usage of VRP solutions become available from TPPs or Innovator tuned Sending firms. TPPs can be incentivised to put some very good ideas to work to reach 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?

A view on Fraud prevention and liabilities is important. Confirmation of Payee check, Acceptance of risks by end-customer and clear guidance on how to deal with disputes & frauds by OBL-FCA-PSR will lower the risk of failed Phase 1 deadlines when mandating participation. And if the guidance is pragmatic, then costs can be under control.

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?

1. By and large the commercial model proposed is in the right direction.
2. Incentivisation should be for all parties Sending firms, PISPs, Merchants and End customer.
3. Creating a model with multiple options, gives participants a chance to recalibrate at regular intervals.

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.

Yes. Utilities, Fees & Taxes are likely to be the most used VRP use cases. Telco & Council tax payments, regulated charities are also good candidates for VRP use and very close to the current use case list in terms of characteristics.

Question 22

Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why

Current proposal is aimed at creating an environment where third parties can deliver innovative and valuable propositions. Care must be taken to make it a win-win situation for all stakeholders i.e., data providers and consumers.

Innovate Finance

INNOVATE | FINANCE

Consultation paper (PSR, JROC)
Expanding variable recurring payments
Innovate Finance Response

About Innovate Finance

Innovate Finance is the independent industry body that represents and advances the global FinTech community in the UK. Innovate Finance's mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators to create a more inclusive, more democratic, and more effective financial services sector that works better for everyone.

The UK FinTech sector encompasses businesses from seed-stage start-ups to global financial institutions, illustrating the change that is occurring across the financial services industry. Since its inception in the era following the Global Financial Crisis of 2008, FinTech has been synonymous with delivering transparency, innovation and inclusivity to financial services. As well as creating new businesses and new jobs, it has fundamentally changed how consumers and businesses access finance.

Summary

Innovate Finance welcomes the aims and pace of the PSR's ambitions to develop the relevant rules and infrastructure for the adoption of commercial Variable Recurring Payments (cVRPs) considering the importance of enabling innovative market entries, protection of consumers, and systemic resilience across payments.

Throughout the process of achieving this, there are likely to be distinctions between an appropriate approach for an initial pilot phase, and the longer-term approach for cVRPs. We have strived to make this clear in our response where this applies.

Mandated participation in the VRP Pilot builds on the successful work of Open Banking implementation to date, ensuring consistency throughout the industry and widespread availability for consumers, and providing a basis for the pilot to serve as an alternative to Direct Debit payments. Given developments in the market since the CMA9 investigation, it may be most appropriate to determine pilot participants based on Faster Payment market share: share by bank. Six UK banks in the CMA9 give ~90% market coverage, providing a solid starting point[1].

Phase 1 should be enabled through the same framework as sweeping has today - involving open APIs with no contracts. OBL could be given responsibility for managing Phase 1, adopting the same approach as the sweeping VRP-managed rollout they have already undertaken, however - for a broader set of use cases.

We do not believe Phase 1 should be dependent on the development of a multilateral agreement (MLA), as lower-risk use cases are less likely to need dispute resolutions (which could be mitigated through a code of conduct), contracts are not required if the price is set to

[1] OBL: Finally, a new era in payments Sweeps in.

zero, or indicated for the pilot by the PSR, of which a shared rulebook would take months to agree and finalise.

For Phase 2 an MLA is more likely to be required to coordinate and clarify the necessary elements for higher-risk use-cases (including e-commerce). This should be developed throughout the rollout of Phase 1, including input from industry and the PSR. Given its nature as a pilot, JROC and industry participants should be prepared to take learnings from Phase 1 and accommodate changes where necessary in the future to enable mainstream usage of cVRPs to be accomplished.

For the pilot, we welcome PSR's willingness to take bold steps to remove FPS costs in order to proceed in the swiftest and most frictionless manner. However, given the likely changes necessary in pricing following the pilot and given the expanded API reliability necessary within higher-risk use-cases, it may be necessary for greater commercial viability to be considered from the outset, with a view to encouraging and maintaining ongoing investment and upkeep, whilst still ensuring new TPP innovation is not unduly restricted by cost.

The metrics for the success of Phase 1 need to be set appropriately. The initial use-cases identified broadly represent those where the introduction of cVRP is likely to be more straightforward. They do not necessarily, however, represent the instances where switching to cVRP may offer the largest potential benefits over existing payment methods. The pilot will ensure the fundamental infrastructure is up and running, introduce consumers to this new mechanism, and provide significant learnings for the wider rollout beyond Phase 1. It should be noted at the outset that the pilot's success may be less linked to levels of adoption in this early period, as the market's ability to develop a realistic alternative to card payments will arrive later.

Alongside these advancements, we also encourage JROC, OBL, and Pay.UK to continue to consider existing industry challenges - such as the inability of a PISP to check whether payments have been made under an active Domestic Standing Order (making it difficult to monitor e.g. recurring charity donation payments) and IES checks.

In summary, this initiative brings huge potential to drive further competition and innovation in the payments market, to the benefit of both merchants and consumers with secure customer authentication (SCA) built-in and immediate settlement, and as a key component of the UK's future National Payments Strategy. However, it should be noted, that we feel the consultation period (between 18 Dec 2023-2nd February 2024) did not supply industry sufficient time for full and proper consideration, specifically on the commercial viability of the proposals. We recommend the PSR issue a revised approach at pace, based on the feedback, facilitating further time for fuller consideration and response by industry.

We have responded to this consultation thematically:

- *Pricing and Commercial Model*
- *Multilateral Agreements and Governance*
- *Mandated Participation*
- *Cost-Benefit Analysis*
- *Beyond Phase 1*

Pricing and Commercial Model

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.
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?
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?
Question 8: Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.
Question 9: What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?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?

Innovate Finance welcomes the pace, future-looking and ambition within the PSR's approach to advancing cVRPs, of which Phase 1 and its pilot will bring considerable innovation and subsequent investment into the UK's Open Banking payments landscape, whilst enabling greater capability for consumers' payment habits.

We have supported the PSR's pricing principles since their publication, these are;

1. *Prices should broadly reflect relevant long-run costs*: Charges for VRPs should broadly recover directly attributable and efficiently incurred economic costs, ensuring fair value for TPPs. Pricing should reflect relevant internal costs and exclude those unrelated to providing VRPs.
2. *Prices should incentivise investment and innovation*: Charges should support a sustainable, long-term return for sending firms, compensating for risks, and rewarding innovation.
3. *Prices should promote adoption and encourage network effects*: Pricing is crucial to achieving these important goals.
4. *Fair treatment of TPPs*: Charges should avoid unfair competitive advantages and foster healthy competition. Pricing should not hinder TPP entry, growth, or investment in open banking. Transparency and potential standardisation of prices may contribute to equitable treatment.
5. *Transparent fees*: Pricing should be transparent and straightforward to create a level playing field and to facilitate the uptake of VRPs. Clear pricing helps TPPs make informed decisions and encourages competition.

We agree with the PSR's principles that pricing should ensure fair value for Third Party

Providers (TPPs), and not hinder TPP entry, growth or investment in Open Banking. The principles' central challenge exists between ensuring pricing is fairly distributed between PSPs, PISPs, TPPs and ASPSPs - whilst considering some FinTech firms sit between payments and banking. Ultimately, the split needs to be assessed and demonstrated to ensure innovation is not unduly restricted by cost, whilst commercial incentives are sufficient for ASPSPs to invest in ensuring a reliable and accurate customer experience.

For the pilot, we welcome PSR's willingness to take bold steps to remove FPS costs in order to proceed in the swiftest and most frictionless manner. However, given the likely changes necessary in pricing following the pilot and given the expanded API reliability necessary within higher-risk use-cases, it may be necessary for greater commercial viability to be considered from the outset, with a view to encouraging and maintaining ongoing investment and upkeep, whilst still ensuring new TPP innovation is not unduly restricted by cost. It may be appropriate for the PSR to consider capping the price sending firms can charge for VRPs below the card interchange rate, and capping the charges to end-users upon receiving faster payments when using cVRPs.

We would caution against planning for cost recovery at the receiving end, as passing costs to receiving banks is likely to increase the cost of acceptance. This is the price merchants and end-users have to pay for payment services. We believe the overriding principle for the development of cVRP pricing longer-term should be to enable a cost of acceptance to merchants and billers that is significantly cheaper than cards, while still incentivising sending banks to develop a compelling consumer experience.

Multilateral Agreements and Governance

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

We believe Phase 1 should be enabled through the same framework as sweeping has today - involving open APIs with no contracts. OBL could be given responsibility for managing Phase 1 - essentially a repeat of the sweeping VRP-managed rollout which they have already undertaken, but for a broader set of use cases.

We do not believe it is necessary for the pilot to be dependent on the development of an MLA because:

- An MLA was intended to manage issues such as disputes - however, as the PSR notes in its consultation, Phase 1 use-cases are low-risk of which disputes are unlikely. These could be mitigated through a commitment to a code of conduct or similar softer mechanisms by participants.
- Price is set to zero, or indicated for the pilot by the PSR.
- Developing a full MLA by Q3 2024 is highly ambitious, and there is a real risk of

delay.

- The shared rulebook within the MLA will take months to agree on and finalise, discussions facilitated by UK Finance to develop model clauses have already shown this to be a complex task, which is already delayed.
- Systems will need to be updated to differentiate between commercial and free PSD2 API calls/faster payments as this is not currently the case.
- Billing mechanisms will also need to be built individually by each bank participant, and integrated for each TPP.

This approach would allow industry to focus more time over the coming months on developing the MLA for Phase 2. During this time, the PSR should work with industry on the development of an MLA and its pricing approach for Phase 2 and beyond. An MLA presents a reasonable approach to coordinating and clarifying the necessary elements in the long-term development of Phase 2 use-cases, including e-commerce.

An MLA may build on the UK Finance work currently underway on model clauses. Were Pay.UK to lead on taking this further, consideration must be given to the institution's capacity, and TPP's outlook and experiences to how they develop and manage the technical framework. Were OBL to take responsibility for the MLA, its mandate would need to be broadened enabling it to do so as part of the transition to a Future Entity. In either scenario, both organisations will need to work together closely to ensure the ultimate success of cVRPs.

Mandated Participation

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.

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?

Mandated participation of the CMA9 builds on the successful experiences of Open Banking implementation to date, ensuring consistency throughout the industry and widespread availability for consumers - providing a basis for the pilot to serve as an alternative to Direct Debit payments.

The initial use cases identified for Phase 1 mostly represent those where the introduction of cVRP is likely to be more straightforward in implementation. They do not necessarily represent the instances where switching to cVRP may offer the largest potential benefits over existing payment methods. The metrics for the success of Phase 1 need to be set appropriately - the pilot will further the fundamental infrastructure, introduce consumers to this new mechanism, and provide significant essential learnings for wider rollout across e.g. e-commerce. Its success may be less linked to ultimate levels of adoption in this early period.

Cost-Benefit Analysis

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

The PSR must continue to assess this proposed list, whilst showcasing the cost-benefit analysis between other payment initiatives developed in the future, to ensure use-cases continue to work for both investment and consumer uptake.

As set out within Innovate Finance's 2023 JROC Position Paper, the PSR must look to ensure use-cases remain interoperable with other internationally-leading regimes, including the European Union's (EU) Payment Services Directive 2 (PSD2) SEPA and SPAA regimes.

[ENDS]

Interbacs

Interbacs does not support the Payment Systems Regulator's pricing proposal for extending Variable Recurring Payments (VRPs).

We have concerns about the impact of a distorted pricing model on the market for direct debit. The Joint Regulatory Oversight Committee (JROC), the PSR and Future of Payments Review have all focused on open banking offering genuine competition to cards. The low-risk use cases within scope of the PSR's Phase 1 proposals will predominantly mean that artificially low-priced competition with direct debit is created though, which no one has suggested is too expensive or delivering a poor experience to customers.

It seems counterintuitive to have regulatory action negatively impacting a payment product where the regulators have not identified a market failure; in fact, "unlocking account-to-account payments" - in which direct debit plays an important role - is a priority objective of the PSR according to its own strategy.

In addition to this, we are concerned about some merchants replacing direct debit functionality with cVRPs given it will not be easy for them to return to the status quo ante should the experience be sub-optimal. There will be no way for merchants to 'bulk switch' VRP back to Bacs, or even to another VRP provider.

We would urge the PSR to conduct deeper analysis of what would be an appropriate price for banks to charge PISPs for commercial VRPs, but this should not be zero.

Lloyds Banking Group

LLOYDS BANKING GROUP PLC

EXPANDING VARIABLE RECURRING PAYMENTS (VRP) – CONSULTATION RESPONSE

Submission Date: 02 February 2024

[redacted]

PART 1: EXPANDING VRP – EXECUTIVE SUMMARY

Lloyds Banking Group (LBG) provides financial services to 26 million customers in the UK. As a leading UK financial services provider, we help millions of customers – individuals, families, and businesses – to spend, save, borrow and invest and help Britain prosper. Every day, LBG processes around 35 million payments (over 11.5 billion annually) across 10 different payment methods. We provide a wide range of Open Banking services to our personal customers, offer propositions to our commercial clients, and we consume Open Banking services as a business.

We recognise that the UK needs to harness emerging and developing technologies for economic growth and competitiveness, to remain at the forefront of innovation in money, payments, and financial services. We further recognise the Future of Payments Review recommendation to expand Open Banking and strongly agree that to be successful all Open Banking needs a sustainable commercial model, with legal certainty. We look forward to engaging with the Implementation Groups on functional capabilities and dispute resolution, as well as the further formal consultation on the commercial model.

The PSR is right to acknowledge the need for an 'all-encompassing' multi-lateral agreement (MLA) that establishes the required functionality, pricing arrangements and dispute resolution, and the distribution of liability. In this paper we also reiterate our support for the PSR's pricing principles, and in particular the principle that a cost recovery model that includes a reasonable return is necessary to establish a sustainable price for VRPs.

It is vital that the PSR establishes the right approach at this stage to ensure that VRP can be scaled up to a wider set of use cases, and to enable the expansion of A2A payments more widely (including making single instant access payments for e-commerce a sustainable and safe proposition).

However, there are seven key issues present in the PSR's proposals that prevent this. These are:

- **Issue #1:** the PSR should consider the broad nature of competition faced by ASPSPs and therefore review its idea of 'bottleneck monopolies', which risks developing the MLA on false assumptions.
- **Issue #2:** the PSR's approach to pilot pricing incorrectly assumes that the costs of sending firms are negligible, a view that has been reached without evidence.
- **Issue #3:** the proposal does not correctly apply the PSR's pricing principles, instead setting a flawed new test that focuses on costs that are 'incremental' to other payment options.
- **Issue #4:** the PSR does not provide sending firms with a commercial return. This will be fatal to the wider aim of establishing VRP as a viable alternative to existing payments and is in strong contrast to the Future of Payments Review's call for a sustainable commercial model.
- **Issue #5:** waiving or removing the FPS charge for sending ASPSPs will be distortionary.
- **Issue #6:** the proposal does not set out how Pay.UK's costs specific to the MLA will be recovered, including for the necessary work to enable Faster Payments to support VRP.
- **Issue #7:** mandating participation only for the CMA9 perpetuates the imbalance from the CMA Order, denying key ASPSPs the choice of whether to participate and therefore take on material liabilities and is not necessary if the MLA and pricing were well designed.

Our concerns relating to these seven issues are set out below and then in further detail in response to the PSR's specific questions. We also set out our proposed changes, including a pragmatic approach to estimating costs and establishing a sustainable commercial model through a formal cost study, underpinned by legal certainty to ensure confidence from participants.

Issue #1: the PSR should consider the broad nature of competition faced by ASPSPs and therefore review its idea of 'bottleneck monopolies', which risks developing the MLA on false assumptions.

The PSR's reference to a 'bottleneck monopoly', which implies ASPSPs have substantial market power and can withhold functionality (or otherwise charge prohibitively high prices for it) is not evidenced, it is a misdiagnosis of the nature of competition and the reasoning for intervention, and inflammatory.

ASPSPs compete with each other for customers. Competition in retail banking has been increasing with the advent of new digital challenger banks and technological advancements that have made multi-banking easier. The FCA has endorsed a view of increasing competition in recent publications.[1] Many Personal Current Account (PCA) customers now have more than one bank account, enabling them to try out the growing range of different ASPSPs without having to switch accounts, and to optimise their behaviour across multiple providers' features. As an indication of this trend, the FCA reports that over the four years from 2018-2021, the number of PCAs increased by 15%, from 87 million to over 100 million.[2] This means that, on average, each adult in the UK had approximately 1.9 current accounts in 2021, and this number is likely even greater today. These competitive dynamics mean that ASPSPs do not have a "bottleneck" on the provision of payment services, but have strong incentives to provide a range of valued services to attract and retain their customers.

There are further competitive pressures faced by ASPSPs with low barriers to entry into the UK (and global) payments markets. PayPal, which allows customers to fund their wallets by FPS and cards, is one of the largest merchant acquirers globally and has achieved significant merchant uptake. There is a similar story around buy-now-pay-later. These two material UK (and global) payment developments clearly demonstrate payments is an open market which enables non-ASPSPs to very successfully particate to support both retailers and consumers. These developments, alongside other competing payment options such as cards, serve as a competitive pressure and constraint on the prices that ASPSPs would be able to charge for VRP.

While some ASPSPs have created bilateral VRP agreements, it does not address the core challenge that a sufficiently scaled network is required to create utility for consumers and retailers. Bilateral agreements cannot achieve this, and also risk a fragmented ecosystem with consumers and merchants facing different terms depending on the ASPSP and TPP involved, and potentially an uneven playing field for smaller ASPSPs and TPPs. To bring consistency, fairness and build trust, we recommend that a comprehensive and voluntary MLA is the most efficient and sustainable route to overcome the inefficiencies and inconsistencies that may arise from a web of bilateral arrangements, enabling VRP to compete with alternative payment options.

Issue #2: the PSR's approach to pilot pricing assumes that the costs of sending firms are negligible.

The PSR argues that there will be 'negligible' investment and running costs for the low risk use cases included in Phase 1, but has not shared any evidence that supports this assumption. The direct cost analysis we have provided to the PSR in fact suggests the costs are not negligible. It is incorrect to assume ASPSPs already have the infrastructure in place to service these types of payments and that this infrastructure can be repurposed towards VRP with no additional cost.

The PSR has not yet considered the material investment costs that will be required for VRP functionality to be used for the Phase 1 use cases, and to develop additional capacity to support an increase in API

1 See for example the Strategic Review of Retail Banking Business Models, Final Report. FCA, 2022

2 Strategic Review of Retail Banking Business Models, Final Report. FCA, 2022.

calls due to VRP. The need for investment in functionality reflects that ASPSPs must implement additional controls and features to allow VRP to be used in use cases beyond sweeping, even for the use cases involved in Phase 1. These include changes to Open Banking journeys and consents for the new use cases, analytics to interpret transaction data performance and implementing and updating fraud controls and greater use of transactional information.

Material costs have already been incurred to uplift and augment existing systems and processes to service these new payment types, and further costs will be incurred in the future. We estimate that a minimum initial investment is involved to provide VRPs for Phase 1,[3] over and above our initial investment in sweeping of which a proportionate share must also be recovered. Additional costs will be incurred in response to changes to the FPS infrastructure and the design of the disputes process, which has not yet been agreed, while further investment will also be required as volumes scale in the future; these costs are not yet known but are expected to be significant.

ASPSPs will also incur operating and running costs in relation to VRP for Phase 1, most notably to ensure that customers are properly protected and serviced. There are significant volumes of disputes and fraud incidents on other payment options, including Direct Debits, and we expect the same will be true for VRP even at Phase 1. While the precise running costs are uncertain at this stage, these must be accounted for in the commercial model to ensure the sustainability of VRP.

We set out our expectations of the costs that will be incurred by ASPSPs in our response to Question 5.

Issue #3: the proposal does not correctly apply the PSR's pricing principles, instead setting a new test that focuses on costs that are 'incremental' to other payment options.

The PSR has asserted only costs that are 'incremental' or 'additional' to other payment options are relevant, and considers that there are no incremental costs to VRP. We understand the PSR to mean that only to the extent that VRP increases overall costs for the provision of *all* payment services should costs be recovered through a commercial model for the initial use cases. The result of such an approach is that the significant costs noted in this response in relation to factors such as processing, disputes and fraud would not be recovered through the VRP commercial model for Phase 1 as the PSR assumes they are presently incurred elsewhere in ASPSPs' businesses and would simply substitute to VRP.

This approach mischaracterises how costs will change as payments substitute from e.g. Direct Debits to VRP. Each payment rail has a range of fixed costs including processes, systems and people. Fixed costs will be incurred on both payment rails until such time as there is a significant or total substitution of volume.

More broadly, the PSR's proposed approach will not create the right conditions to incentivise provision and investment in VRP. If we apply the PSR's test that only costs that increase the total cost of providing payments are considered, then providers will be disincentivised from encouraging any switching from existing payment options as to do so will incur additional investment costs and lead to variable costs (such as fraud and complaints) substituting (or possibly increasing), but without a corresponding commercial model to fully recover them.

We understand that the PSR may have in mind that it is applying a "long-run incremental cost" (LRIC) approach. Such an approach typically consists of a forward-looking assessment of costs and volumes

[3] This investment includes investment in API infrastructure and capacity uplifts and strategic services such as contract management and supervision.

over the long-term, which means that all costs (including fixed costs) are considered to be variable. LRICs are all those that can be avoided by not providing the service. LRIC is generally used in markets such as telecoms where there are large incumbent fixed costs and there is monopoly provision (e.g. BT providing the network infrastructure) and is generally applied to existing and well-established services. It is clearly not the case that this market demonstrates the characteristics that typically lead to pricing interventions using LRIC approaches.

LRIC is unlikely to be the most appropriate methodology for VRP, but even if it were, the PSR's interpretation of the methodology requires further consideration. The incremental costs are those that the sending ASPSP would be able to avoid by not providing the VRP service, holding the provision of other services constant. If the PSR assumes that a substitute service is provided in the absence of VRP, then those costs need to be accounted for in a separate commercial model for that substitute service (which may be set by the sending ASPSP). The appropriate application of LRIC means that the different costs for each service are appropriately allocated and accounted for when considering the competitive price(s), and ensures that there is a viable commercial model across the whole set of payment services (i.e. the cost base for providing payment services can be recovered no matter what payment option is used). Our response to Question 5 provides a fuller overview of regulated price setting in other industries – none of which take the approach articulated by the PSR or result in a zero price.

While the PSR states that the current proposals only apply to Phase 1 use cases, the application of this reasoning to other higher risk use cases could lead to a zero price, and will certainly lead to less than full cost recovery. It could set a concerning precedent for future use cases and risks disincentivising investment and innovation in payments in the UK. It is important that the PSR does not use the 'incremental' test it has created as the basis for determining pricing in the commercial model. Instead it should follow its first pricing principle which is to "*broadly reflect relevant long-run costs of providing premium APIs*". We set out further detail on what this entails below.

Issue #4: the PSR does not provide sending firms with a commercial return.

The proposal also omits a reasonable return on investment. This is contrary to the pricing principles, and may result in ASPSPs choosing not to invest in and promote VRPs as an alternative payment option and further disincentivise entry from non-CMA9 ASPSPs.

The PSR partially justifies this approach by stating that its proposal '*does not limit sending firms' ability to innovate elsewhere in their business to commercialise VRPs further*'. The potential for commercialisation of VRP for other use cases is not a substitute for providing an appropriate commercial model for Phase 1 use cases and effectively builds in a reliance on cross-subsidisation from higher risk use cases.

Issue #5: waiving or removing the FPS charge for sending ASPSPs is distortionary.

We welcome the PSR's recognition that the FPS charge is a relevant cost that should be accounted for in the VRP commercial model. While we recognise that waiving the FPS charge could offset some of a sending ASPSP's costs which would otherwise not be recovered under the PSR's current proposal, this approach does not satisfy the JROC pricing principle and Future of Payments call for a sustainable commercial model and will lead to market distortions.

The PSR has recognised waiving the FPS charge will require either a cross-subsidy from all chargeable FPS transactions, or for the charge to be incurred by the receiving ASPSP. In the former, this increases the costs of other FPS transactions, and breaks the link between transaction volumes and marginal costs. This increases the costs of transactions outside the MLA, and so risks harming the broader FPS ecosystem and creating barriers to entry for new providers. We see no rationale for the PSR to create a new cross-subsidy.

In the latter case, applying the charge to receiving ASPSPs does not reduce the cost of the transaction, and instead shifts the cost to a party that sits outside the MLA. The PSR may expect that receiving ASPSPs can adapt their commercial model to account for the FPS charge. This may be possible, but it will be costly for receiving ASPSPs to implement and there is no rationale to do so other than to address issues created by the PSR's proposed imposition of a zero price between sending ASPSPs and TPPs. It is more efficient to use this initial phase to establish and test a working TPP to sending-ASPSP charging structure. It also asks one provider (receiving ASPSP) chosen by a merchant to pay for the value extracted by another provider (TPP): again, creating a new cross-subsidy.

We are also concerned that the PSR is considering extending this approach with recent comment noting the possibility that "*…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 – there is the prospect that competition in this part of the market can set prices. Avoiding the need for extensive price regulation.*"[4]

This approach could distort competition and risks failing to deliver a sustainable commercial model for the provision of VRP services or for wider Open Banking in the future. Sending and receiving ASPSPs are operating distinct business models in separate markets. ASPSPs operating in both markets could attempt to recover their costs through their receiving business, but doing so would create a number of issues, not least a competitive disadvantage to receiving ASPSPs that do not need to do so. ASPSPs will also participate in each market (consumer and merchant/business accounts) to different degrees. ASPSPs that are proportionately larger in the receiving market would benefit from such an approach, while ASPSPs that are proportionately larger in sending (i.e. actually providing the VRP service) would lose out. ASPSPs that do not operate in the receiving market (including many new payments entrants) would have no commercial model, creating a major barrier to entry and undermining UK international competitiveness.

Issue #6: the proposal does not set out how Pay.UK's costs specific to the MLA will be recovered, including for the necessary work to enable Faster Payments to support VRP.

The current proposal does not include suggestions as to how the costs incurred by Pay.UK that are specific to VRP will be recovered from participants in the MLA. This is at odds with the accepted principle for the Future Entity that funding should come from a broad and equitable base of participants.

The PSR has suggested that Pay.UK should take on the role of operating the MLA, at least for Phase 1. Pay.UK has also recognised that it is likely further work will be needed to adjust Faster Payments to support VRP. This reflects that Faster Payments was not designed to support the use cases that will be served by VRP, even at Phase 1. For example:

- Changes to transactional flags are required to identify VRP transactions. This will be necessary to support fraud detection and protection and enable the application of customer protections and the commercial model.

[4] Chris Hemsley speech at The Payments Regulation and Innovation Summit 2024

- FPS data standards have not yet migrated to ISO20022, limiting the exchange of information between the sending and receiving firm.
- Further capacity may be required to prevent the queuing of payments across all use cases and to ensure system resilience. We are concerned that the additional burden of new payment types could increase the frequency of incidents and maintenance events. This is a particular concern given the pausing of the work on the New Payments Architecture.

Further adjustments may also be identified as the Implementation Group progresses this year and must be completed before Phase 1 begins.

The result of this is that Pay.UK will face costs specific to the development and operation of the MLA and supporting FPS infrastructure that must be recovered from all participants, in line with the generally agreed principles of the Future Entity. In the absence of a proposal to recover these costs, there is a danger that the funding requirements are presumed to fall into the broader contributions of providers to Pay.UK, or increase the FPS charge on all payments. Neither outcome would be appropriate and would further the issue of cross-subsidy, with the largest ASPSPs incurring the costs of developing VRP with no compensation or commercial return.

These costs must therefore be accounted for in the VRP commercial model to ensure all participants contribute to the development and operation of the MLA. Costs incurred by ASPSPs in supporting this must also be included in the TPP-ASPSP charge, alongside the standard FPS charge as set out above.

Issue #7: mandating participation only for the CMA9 perpetuates the imbalance from the CMA Order, denying key ASPSPs the choice of whether to participate and therefore take on material liabilities.

The obligations imposed on the CMA9 under the CMA's Retail Banking Market Investigation Order followed an in-depth investigation over several years. Since then, the scope of these obligations has been expanded to such an extent that the initial cost outlay estimate from the CMA has been exceeded multiple times.

It is important to note that notwithstanding the scope expansion over the years, even the CMA recognises there are limits on what intervention can be justified by the competition findings it made. In March 2022, the CMA acknowledged in a letter to the Implementation Trustee that '*the CMA can only mandate sweeping access which address the AECs and associated consumer detriment and therefore sweeping access cannot be mandated on a 'use agnostic' basis. Although the CMA recognises the potential benefits of having a wider application of VRPs and sweeping services more generally, to mandate sweeping in such a manner would be outside the scope of the CMA's legal powers.*' If the CMA wanted to vary its Order in such a manner, it would therefore need to carry out a fresh market investigation and find feature(s) of the market that are having an adverse effect on competition to which such intervention would be a proportionate remedy.

It is inappropriate for the PSR to seek to impose financial and legal obligations on the CMA9 which go beyond anything the CMA accepts it could or should do itself, without such a robust competition assessment to confirm that such a market distortion can be justified. The proposal does not explain how imposing a commercial model that results in barriers to entry for other ASPSPs can be beneficial to the competition it appears to be asserting (without evidence) is lacking.

It is not clear to us which powers could be used by the PSR to implement the proposals set out in the call for views and we hope this will be made clear in any future consultation should the PSR continue to pursue these options. As a fundamental position, non-Order activity should be market-driven rather than mandated. Mandating participation also removes an important mechanism for ensuring the commercial model, and indeed the MLA as a whole, is effectively incentivising participation. Voluntary participation provides a powerful feedback mechanism for the MLA owner to ensure that all interests are appropriately balanced – ASPSPs, TPPs, customers, and merchants.

Mandating participation allows for imbalanced and distortionary terms to be applied (per the current proposals) which may superficially achieve the PSR's aims of achieving a sufficient network. But mandated participation is likely to lead to unintended consequences, such as sub-par investment and promotion that are likely to undermine the competitiveness of VRP over the longer-term.

These issues lead the PSR to a zero price for the use of VRP, creating risks for the rollout of the low risk and future use cases

The PSR has put forward a zero price for ASPSPs' commercial model and FPS charges. The immediate consequence is that the PSR will not meet its stated objective of delivering a sustainable commercial model. This is also in strong contrast to the Future of Payments Review's call for a sustainable commercial model, which would provide cost recovery, a return and incentive to participate, innovate and invest.

Wider consequences of that outcome include:

- **no incentive for ASPSPs to actively support** VRP by promoting its use and investing in new functionality;
- **introducing a reliance on cross-subsidy** from other payment options or ASPSPs' wider business models to account for the zero price;
- **creating a barrier to entry for ASPSPs** who may want to enable their consumers to use VRP services (but are not mandated to do so), but will be deterred because they cannot recover their own costs due to the zero price nor rely on cross-subsidy;
- **introducing unnecessary distortions in the FPS charging model** by requiring other payments using Faster Payments rails to subsidise the cost of VRP or for receiving ASPSPs to cover the cost;
- **eliminating the main feedback mechanism to ensure that an MLA delivers sustainable commercial models** – as exemplified by the current proposals – by mandating participation;
- **risking a precedent that no price could be charged for any VRP use case** or that key categories of ASPSP costs cannot be recovered (particularly based on the requirement for costs to be "incremental"), with no money to promote innovation or develop customer protections for higher risk use cases; and
- **hindering the broader commercialisation of VRP** through that precedent by setting an expectation for both TPPs and merchants of a zero price.

We understand that the PSR hopes that by setting prices at zero the adoption of VRP will be maximised. The PSR risks its aim of expediency undermining the long-term viability of VRP. The absence of a commercial model for ASPSPs today and potentially in the future is likely to create uncertainty, a lack of investment and innovation and wider support for VRP, undermining the capacity to compete with other payment options. It also omits the significant benefits of VRP to merchants beyond the cost element potentially driven by TPP-ASPSPs prices: there are a number of examples (e.g. BNPL, PayPal) where merchants are willing to pay higher prices where they believe there are benefits.

The PSR should set a price that reflects the economics of the provision of VRP and avoids unnecessary and damaging cross-subsidy

We strongly urge the PSR to reconsider its proposed approach, and would welcome further dialogue on this. At a minimum, we hope the PSR will:

- **Acknowledge the correct and clearly evidenced rationale for the MLA**, which is to resolve the inefficiencies of bilateral negotiations between large numbers of ASPSPs and TPPs, as opposed to any supposed "bottleneck monopoly". This is a necessary and sufficient cause to create an MLA.
- **Apply its pricing principles correctly** to account for the costs of providing VRP (not only those that are 'incremental' to substitutable payments) and provide a reasonable return. This will result in a non-zero price that is sustainable, cost-reflective and provides the right incentives to drive participation, investment and innovation from ASPSPs.
- **Include FPS costs within the VRP commercial model** to avoid distortionary effects on other FPS payments or charging parties that are not within the scope of the MLA.
- **Ensure the MLA is voluntary for all participants**, given it concerns non-Order activity. This will provide the appropriate feedback mechanism to allow the MLA's owner to fairly balance the interests of all participants.

The revised application of the PSR's pricing principles will require evidence around the costs that ASPSPs will incur to provide VRPs and the rate of return required. We are currently gathering that evidence and we recommend that the PSR engage with other ASPSPs to collect as much evidence as possible to set a reasonable initial price. Further detailed cost study work should be carried out in due course to support the continued setting of prices for Phase 1 use cases, and prices for any expansion of VRP to future use cases.

Calculating the relevant average costs incurred by an ASPSP in offering VRP payments will best meet the PSR's own principle of ensuring prices "*broadly reflect relevant long-run costs of providing premium APIs*" and the Future of Payments Review's call for a sustainable commercial model. It is a well-established, cost reflective approach that will provide both sides of the market with the right incentives to put VRP (and in future A2A payments more generally) on a strong footing to become a viable competitor to competing payment mechanisms, including Direct Debit and card payments. By enabling a reasonable share of fixed and common costs to be recovered, based on those that would be incurred by a standalone provider, providers have the correct incentives to make the necessary investments to generate optimal consumer and merchant take-up.

We provide further details of how such an approach might be designed in our response to Question 9, drawing on international precedent.

We encourage the PSR to engage further with these suggestions and we are keen to work across the industry with the PSR to find a solution to this and stand ready to support to identify a solution that is in the long-term interests of consumers.

PART 2: EXPANDING VRP – CONSULTATION RESPONSE

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 broadly agree with the pricing principles. In particular, we agree that prices should be set on the basis of the relevant long-run costs incurred by ASPSPs to provide VRP, and should provide sufficient return to encourage participation, investment and innovation.

However, we disagree that the PSR has properly applied the principles in stating that the only costs that are relevant when setting the price for VRP are costs '*directly*' incurred in the provision of VRP, or those that are '*specific to premium APIs*'. The approach to pricing should reflect *all* relevant costs that are incurred by an ASPSP when providing VRP, and therefore should include a fair proportion of relevant costs including those that are common to providing payments on FPS rails. This may include processing costs, fraud and fraud prevention costs, authorisation costs, and customer service costs, both directly relating to VRP, and shared infrastructure with other payment options offered on the FPS rails.

Excluding these 'indirect' costs requires that VRP is cross-subsidised by other business lines, favouring more diverse ASPSP business models and distorting competition. In particular, such an approach would inhibit the entry of new ASPSPs that are not able to cross-subsidise those costs from other sources of revenue.

The proposal has not correctly applied the pricing principles to the Phase 1 use cases. The proposal risks introducing a new and narrow focus on 'incremental' costs and its particular application leads to the failure to provide any commercial return to ASPSPs. This has resulted in a zero price despite material investment and running costs, and therefore a commercial model that will inhibit investment in and promotion of VRP by ASPSPs.

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 and an MLA is the best approach to develop the network required for VRP to succeed.

However, as explored further in our response to Question 4 below, this is not because of the position of sending ASPSPs within the market. Instead, this reflects that the network necessary for the success of VRP is unlikely to develop through bilateral arrangements, which are inefficient (given the number of ASPSPs and TPPs) and risk a fragmented ecosystem with barriers to entry for new providers.

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 accept that Pay.UK is a potential option for Phase 1. This accounts for the limited time within the JROC's roadmap. However, we remain concerned about Pay.UK's capacity to deliver VRP alongside its other important initiatives.

We also note that this will result in an increase in Pay.UK's costs, which underscores the importance of understanding how Pay.UK is recovering these costs once the FPS charge is removed for sending banks.

An alternative to Pay.UK might be to expedite the creation of the Future Entity to take on this role in the short term. This would allow for the development of the required capacity without the conflicting priorities faced by Pay.UK. Indeed, in the long-run we expect that a new independent body, separate from both Pay.UK and the Future Entity, is likely to be best placed to run a successful MLA and to compete effectively with other payment options.

We would also note that the successful scaling of VRP will require effective scaling of the FPS infrastructure. FPS was not designed for the payment of goods and services (as evidenced by the need for Pay.UK to make mandated changes to identify VRP payments) and will require further reform. Data standards are not yet ISO20022 which limits the exchange of information between firms. The governance and management of Pay.UK was not designed with consideration of using FPS for these types of payments and may need to reform. And it is likely that resilience and capacity issues will emerge as VRP is scaled up unless capacity is increased – a challenging task. All of these issues need to be addressed alongside who operates the MLA.

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 strongly disagree with the characterisation of sending firm ASPSPs as 'bottleneck monopolies'. The characterisation of "bottlenecks" is typically used in markets such as telecoms where operators are the sole gateway for a customers' call. This does not hold at all in the market for payments.

The PSR's references a 'bottleneck monopoly', which implies ASPSPs have substantial market power to behave to an appreciable extent independently of its competitors, customers and consumers, and have the ability and incentive to withhold functionality (or otherwise charge prohibitively high prices for it), is not evidenced. It is a misdiagnosis of the nature of competition and the reasoning for intervention, and inflammatory. In our view, it should be withdrawn.

ASPSPs compete with each other for customers. Competition in retail banking has been increasing with the advent of new digital challenger banks and technological advancements that have made multi-banking easier. The FCA has endorsed a view of increasing competition in recent publications.[5] One important facet of competition is that many more PCA customers now have more than one bank account, enabling them to try out different ASPSPs without having to switch accounts and to optimise their behaviour across multiple providers' features. As an indication of this trend, the FCA reports that over the four years from 2018-2021, the number of PCAs increased by 15%, from 87 million to over 100 million.[6] This means that, on average, each adult in the UK had approximately 1.9 current accounts in 2021, and this number is likely even greater today. This is a positive development for competition as it allows consumers to try out different products and build trust in other brands, and ultimately makes switching between ASPSPs even easier. These competitive dynamics mean that ASPSPs do not have a "bottleneck" on the provision of payment services and have strong incentives to provide a range of valued services to attract and retain their customers.

This is reinforced by the Consumer Duty, which is designed to increase focus on consumer outcomes and encourage firms to ensure that their products and services respond to customer needs, are fair value, and enable customers to pursue their financial objectives. ASPSPs are therefore compelled to act

5 See for example the Strategic Review of Retail Banking Business Models, Final Report. FCA, 2022

6 Strategic Review of Retail Banking Business Models, Final Report. FCA, 2022.

in the interests of their customers, which is at odds with the PSR's justification for imposing mandatory participation without a sustainable commercial model.

The PSR is also concerned that sending firms' position would allow them to set prohibitively high prices for VRP. This is a strong conclusion drawn without evidence. The competitive dynamics set out limit any potential market power of ASPSPs. Other competitive constraints are also in play. Merchants will typically offer alternative payment options, which have their own commercial arrangements. The ability of an ASPSP to set excessive prices is therefore also constrained by the prices charged for other payment options; if the price for VRP were materially higher than for other payment options, then merchants may choose not to accept VRP, knowing they can still receive payments through the alternative options available.

Given these competitive dynamics we see no evidential basis for concluding that ASPSPs have a bottleneck monopoly, nor that this is a barrier to the adoption of VRP.

And contrary to the PSR's assumptions in its cost benefit analysis, there have been bilateral agreements struck between ASPSPs and TPPs. LBG had also been exploring potential bilateral arrangements as an interim solution, and UK Finance has similarly started work on model clauses to reduce the burden on parties to develop agreements from scratch. This demonstrates that ASPSPs have not sought to withhold access to VRP or charge prohibitively high prices.

The market feature that justifies regulatory intervention is the coordination problem of establishing a network and the cost and inefficiencies of doing so bilaterally.

Successful payment methods have a set of consistent terms, including customer protections, technical requirements and liability models. This is essential to building confidence in the payment method amongst users. Creating this consistency is extremely difficult (and potentially impossible) in a market without substantial market power or a monopoly. In such cases, as with the market for payments, there are too many participants who would need to bilaterally agree to the same terms. To establish a network would require each ASPSP and TPP pairing to agree a consistent set of terms and to negotiate individual terms such as the commercial model. Given the number of ASPSPs and TPPs this could run to many thousands of agreements. That means that even if coordination could occur it would be highly costly and inefficient, thus necessitating an 'all-encompassing' MLA.

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

The PSR's consideration of the relevant costs faced by ASPSPs does not consider a number of important categories of cost, and otherwise dismisses large costs as either '*negligible*' or not '*incremental*'. Below we explain why:

- We do not agree that the remaining investment costs for ASPSPs to deliver Phase 1 are '*relatively small*'. Instead there remain large investments required to deliver VRP for these use cases.
- We also do not agree that costs can be ignored on the basis of not being '*incremental*' or '*additional*' to what is needed for other payment options. We believe that this test is misapplied and leads to the omission of large relevant costs. We will incur significant operating expenditure to service these payments on an ongoing basis, including costs associated with:
    - Processing and authorisations of transactions and management of mandates
    - Costs of dealing with payments disputes and enquiries

- Management of fraud systems and processes and the cost of reimbursing customers who have been victims of fraud

Each of these issues mean that the PSR's proposed commercial model fails to recover the costs of VRP for Phase 1, and therefore is not sustainable in the long-run. This will disincentivise adoption and investment by ASPSPs, and will impose barriers to entry for smaller providers outside the CMA9 that will not be able to recover any of the costs associated with VRP.

We take each in turn below.

The PSR's view that ASPSPs' remaining investment costs are 'relatively small' is not correct

The PSR has assumed that ASPSPs do not face large investment costs to deliver VRP for Phase 1. This is on the basis that the delivery of VRP for Phase 1 '*builds largely on existing open banking functionality*'.

This assumption is not correct. There is a significant difference between the existing Open Banking functionality (and in particular sweeping), and the VRP technology that will be required to serve the commercial use cases that make up Phase 1. In particular:

- An investment has already been incurred to **uplift the API infrastructure to accommodate live MVP testing of commercial VRPs** (e.g. proof of concept technical build, and further fraud integration), and ensure that it can service testing levels of capacity for low-risk use cases only. While volumes are expected to be low in the testing phase, there will be significant additional costs in due course when volumes increase. There is a high degree of volume uncertainty in the long run and volume forecasts will need to be revisited on a regular basis to assess the need for further capacity uplifts for the API alone. It is critical that the industry has the right positive commercial incentives to invest in and maintain infrastructure.
- We anticipate a minimum further investment will be incurred between now and when VRPs are expected to go live for Phase 1. This is to enable the **strategic services required in addition to the API such as contract management or supervision**. These costs are highly uncertain given that key processes around management of disputes and fraud are yet to be determined.
- The total cost to achieve VRP should also account for the foundational investment which **enabled 'sweeping' use cases**. These developments were to a shared service platform without which 'non-sweeping' use cases could not otherwise be achieved. While this was mandated on LBG, a fair proportion of this should be considered as relevant investment and recovered through the commercial model.
- Further investment will be required to **update internal processes to account for the potential risks of VRP transactions**. It is not the case that processes used for Direct Debits or other forms of payment can be copied or extended for VRPs. Systems for Direct Debit are highly integrated and automated, and are unlikely to be suitable as they stand for the new and unknown risks on VRP. Neither is it the case that we can easily repurpose colleagues from other parts of the Bank since this is an additive service and is not replacing any other type of payment service (which means existing processes on other payment types will need to be maintained). For example, we will need additional resources to design and operate:
    - New fraud processes designed to deal with this payment type.
    - New systems and processes for dealing with customer enquiries and disputes.
    - New or updated dashboards to store and display mandates to customers.
- Further investment will be required for ASPSP systems in response to **changes to the FPS system** mandated by Pay.UK, such as additional flags to enable merchants to identify VRPs (these are

explored further below). Given the design of the FPS system, the cost of such changes are not negligible.

- Substantial work will be required to **develop and implement a disputes process**, for which the costs remain uncertain until the Implementation Group has concluded its work to design the process.

Given this, we do not believe that it is fair to assume that the remaining investment costs faced by ASPSPs that have already developed VRP are '*relatively small*'.

The PSR should not dismiss costs that are incurred on other payment options on the basis of not being 'incremental' or 'additional'

The PSR's proposals introduce a new test that misinterprets its pricing principles by stating that ASPSPs should only be compensated for costs that are '*incremental*' or '*additional*' to other payment options. Through this test, the PSR argues that because payment volumes are likely to substitute from other payment methods, they '*do not impact sending firms' cost base*' and so should not be considered in the commercial model.

The PSR's approach risks failing to create the right conditions to incentivise provision and investment in VRP, and is not a good precedent for future premium APIs or for Open Banking generally. If we apply the PSR's test that only costs that increase the total cost of providing payments are considered, then providers will be disincentivised from encouraging any switching from existing payment options as to do so will incur additional investment costs and lead to variable costs (such as fraud and complaints) substituting, but without a corresponding commercial model to fully recover them.

Such an approach is misapplied on three grounds and fails to satisfy the PSR's principles, which state that the model for premium APIs should enable firms to recover attributable costs, including processing costs, in the long run.

First, the use of the Long-Run Incremental Cost (LRIC) approach, which we understand underlies the PSR's logic, does not align with the intent stated. The LRIC approach is designed for markets in which there is a dominant firm, and provides an estimate of a price "floor" to reflect that a profit-maximising firm would not set price below LRIC in the long-run. For example, a version of the LRIC approach has been used by Ofcom when assessing the appropriate charges for BT Openreach to set for its monopoly network. As set out in response to Question 4, ASPSPs do not enjoy substantial market power and instead face significant competitive constraints. As such, it is not the case that the market demonstrates the characteristics that typically lead to pricing interventions using LRIC approaches.

Second, the PSR then misapplies the LRIC approach. LRIC pricing models focus on changes in firms' costs in response to changes in volume within a certain increment of their business (which here can be assumed to be VRP). For example, it might consider the costs a firm may be able to avoid if it were to completely cease offering that service. Importantly, the standard LRIC approach assumes that volumes of all other products and services within that firm, and therefore the costs associated with those products and services, stay the same.

The proposal has stated that '*any incremental costs incurred by sending firms in Phase 1 are unlikely to be additional, as they substitute volumes from one payment method to another*'. This means that the model for Phase 1 does not allow the recovery of costs that would be incurred on transactions via VRP if they would also have been faced on an equivalent transaction on another payment rail. This is a misapplication of the LRIC approach and imposes an overly strict rule that denies recovery of any cost already incurred by ASPSPs elsewhere in their business model. As noted elsewhere in this response, the application of such a rule across all payments would lead to ASPSPs failing to recover the vast majority of the costs incurred, which is likely to have negative impacts on competition.

Third, the proposal is based on a misunderstanding that costs perfectly substitute rather than grow as payment volumes shift between rails. For many of the costs faced by ASPSPs, there are costs that apply to each payment method. As such, rather than costs substituting across rails with the payment, instead there is a duplication of costs. This is particularly likely in early phases of the VRP rollout, where fraud and disputes controls are not fully established and there are higher risks of bad outcomes.

As set out in Table 1 below, the application of LRIC (or related pricing approaches) in other regulated industries is fundamentally different to the PSR's approach.

Table 1: overview of approaches to regulated price setting in other industries

Sector	Price that is being set	Economic approach / methodology	Does the methodology only consider incremental costs vs substitutable services?	Is the price zero?
Retail Energy	Price cap	▪ Standalone provider that is efficient and at scale. ▪ Capital light services. ▪ Price cap accounts for the long-run costs, including cost of energy and customer services. ▪ The price includes a return on capital employed, including fixed assets, working capital and risk capital.	No	No
Aviation	Airport charges for airlines	▪ Airports can set prices up to a cap set by the regulator based on the operating costs, capital plan, depreciation etc of the airport. ▪ Total costs are divided by expected passenger numbers to set a maximum £ cap per passenger. ▪ Airports then usually set a landing charge (often broken down by short-haul and long-haul) and passenger charge (often broken down by domestic, short- and long-haul). ▪ The regulator provides high level guidance but is not prescriptive, recognising challenges in accurately allocating costs.	No	No
Electricity energy transmission	Price for usage of the network	▪ Capital intensive, so prices set to recover the sunk costs of the network ('residual charges') ▪ Additional pricing set to incentivise efficient use of the network ('cost reflective charges').	No	No

Telecoms	Wholesale prices for access to the network	▪ Priced based on a LRIC+ basis with a fair share of fixed and common costs and a reasonable return.	No	No
	Price charged by an operator terminating a call to an operator originating the call	▪ The operator terminating the call has a bottleneck position as it is the only operator who can terminate the specific call. ▪ LRIC is applied to establish a floor price, on the basis that wider cost recovery and returns can be achieved through the prices set by all operators acting as a call originator. ▪ This approach works because there is symmetry: originators and terminators are all operating in the same market.	No	No

The result of this is that the PSR is not recognising large costs that are incurred by ASPSPs in providing VRP on the basis that they are not '*incremental*'. The effect is to require an economically inefficient cross-subsidy from elsewhere in ASPSPs' business models, which may result in barriers to entry for smaller ASPSPs or new entrants.

A better aligned application of the LRIC approach (or any other reasonable approach to estimating relevant costs) would demonstrate that there are large costs that are relevant for the VRP commercial model and on which ASPSPs should earn a fair and reasonable return. These are the same cost categories that would be faced by a standalone provider, and include FPS and Open Banking investment and operating costs such as:

- Processing, reconciliation, and authorisation costs
- Fraud costs
- Customer service costs
- Disputes process costs

We expect that there will be substantial costs in each of these categories. For example, a significant number of disputes occur in relation to all forms of payments, including Direct Debits (such as in relation to incorrect payment amounts or dates). These take time and resources to resolve.

In the initial phases the costs in each of these categories are likely to be relatively higher due to the 'learning by doing' effect and the lack of established systems and processes, and the need to increase headcount managing this new workflow.

It is therefore critical that the PSR undertakes further work to properly assess the extent of the costs faced by ASPSPs in the provision of VRP, and adjusts its approach to remove this concerning focus on '*incremental*' or '*additional*' costs.

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.

Allowing sending firms / ASPSPs to charge, alongside a reasonable rate of return, is the better approach. This ensures that the costs faced by Pay.UK are taken into account in the commercial model of all participants for the payment, and therefore promotes efficient incentives.

Conversely, removing the costs is likely to have a distortionary effect. As discussed further in response to Question 7 below, this is because either option for removing the costs will result in an increase in the costs of FPS transactions outside the MLA. This does not promote efficient incentives, and instead will distort the wider FPS market.

Removing the FPS charge for sending firms also poses operational issues. Relevant transactions will have to be identified, flagged at an industry level and removed from the set of transactions on which sending firms are charged. In the event the charge is instead passed to the receiving firm, this must also be identified and the additional cost added to the receiving firm's invoice. Waiving the FPS charge for sending firms therefore introduces operational complexity.

Given this, we see no economic justification to remove the FPS charge for sending firms, instead of these costs being recovered through the commercial model between ASPSPs and TPPs.

It is also important to note that the introduction and growth of VRP is likely to result in an increase in the costs incurred by Pay.UK. This is due to the growth in transaction volumes facilitated by Pay.UK (for which there is potential for material growth if VRP succeeds), and also due to additional costs associated with operating the MLA and with building the additional functionality required for Faster Payments to support VRP (such as adding new transaction flags). These costs should be passed on to participants and reflected in the commercial arrangements for VRP, including the price paid by TPPs to ASPSPs.

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?

Neither approach is suitable.

If the charge is switched to the receiving side, this will have the effect of increasing the costs of the receiving firm that sits outside of the MLA. The receiving firm will face higher costs for VRP transactions than it does for other bank transfers. This may impact the receiving firm's incentives when negotiating commercial arrangements with the merchant. For example, the receiving firm may seek to pass these costs on (resulting in no gain for the merchant versus if the charge had been included in the VRP commercial model, while requiring the receiving firm to invest in updating its own systems to facilitate such an approach), and/or it may look to steer the merchant towards payment options that incur lower costs. After all, it is important to remember that the transfer of value in respect of VRPs is to a TPP (which is a party to the MLA), and not to a receiving firm.

If the charge is instead recovered through wider Pay.UK charging, this will have the effect of increasing the cost of all other FPS transactions. Many of these transactions will fall into categories such as P2P payments, for which there is no commercial model. This will mean the costs of parties facilitating those transactions will increase without any ability to recover those costs in a free-if-in-credit banking environment. Others will fall into categories where there is a commercial model, and may see resulting increases in charges to senders or merchants.

In either case, the result is that the costs of parties and potentially end users not included in the MLA will increase. This may harm the incentives to invest and innovate of sending or receiving firms for such payments, and may also impose barriers to entry for smaller firms. The approach necessitates cross-subsidies which would otherwise be avoided.

As discussed in response to Question 6, it is important that the sending firm's FPS charge is recovered directly from TPPs through the VRP commercial model rather than simply waived. This would be aligned with the principle of cost causality, which states that in general costs should be recovered from the service that causes the cost to be incurred.

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

In the event that Pay.UK is selected to manage the MLA in Phase 1, we do not expect there should be large additional costs incurred by OBL.

However, any costs incurred by OBL to support the expansion of VRP in Phase 1, including costs incurred by OBL to date, should be borne by a broad base of industry participants. It is not appropriate that the funding for non-Order activities is drawn from the CMA9 and the PSR should act to stop this practice.

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 that a commercial model based on ASPSP costs, set centrally as part of an MLA (with legal certainty) and with proper consideration of the costs incurred and returns required by providers is likely to be the best approach to develop a scalable pro-competitive design for VRPs in all phases.

As noted in response to the previous questions, we disagree with the PSR's approach to a commercial model for Phase 1, which does not deliver a sustainable commercial model and is likely to hinder the success of VRP by providing ASPSPs no incentive to participate or invest.

A more appropriate commercial model would be based on the results of a cost study that estimates the average efficient costs of ASPSPs providing VRP. In this approach, the relevant costs of providing a payment service are the costs associated with the provision of merchant benefits that would be incurred by a standalone provider of VRP.

There are international examples of payment commercial models being set on the basis of providers' costs. For example, the Australian card interchange model[7] allows for the recovery of a defined and narrow set of costs associated with the provision of services to merchants, as distinct from services of primary benefit to card-holders. Under the Australian regulation, a cost-based measure is calculated every 3 years based on total eligible costs for the previous year divided by total transaction value. The cost-based measure is set by an independent expert based on data from the card issuers and is approved by the regulator (the RBA). The allowable costs include:

(i) issuers' costs incurred principally in processing transactions, including the costs of receiving, verifying, reconciling and settling transactions;

(ii) issuers' costs incurred principally in respect of fraud and fraud prevention;

(iii) issuers' costs incurred principally in providing authorisation of transactions.

Importantly the costs include both direct costs and a reasonable share of shared costs such as those of fraud prevention, processing systems, call centres, and branch costs associated with customer enquiries and other customer service-related costs incurred in responding to authorisation or retrieval requests, chargebacks, lost/stolen card reports and customer enquiries on suspect transactions.

[7] Common Benchmark for the Setting of Credit Card Interchange Fees (rba.gov.au).

We recommend that the PSR explores a similar approach for VRP (and in future A2ART more generally), based on the relevant costs that would be incurred by a standalone ASPSP providing of VRP. This will include categories such as processing and authorisation costs, fraud costs, customer service costs and disputes process costs associated with VRP and the underlying FPS and Open Banking functionality maintained by ASPSPs. We expect that the pricing that results from such an approach will best take the form of a single uniform price for all ASPSPs ensures that participants have appropriate incentives (including ASPSPs to reduce costs) and allows for simple, transparent, and consistent pricing for TPPs and merchants. This single price could rise and fall with the value of the transaction ("ad valorem") or be fixed per transaction, each comes with trade-offs.

Such a model would appropriately incentivise take-up on all sides of the market, provide ASPSPs, TPPs and merchants with confidence in VRP for all phases and would enable effective and sustainable long-term competition with other payment options. This would best allow VRP to succeed in meeting the PSR's objectives.

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 merchants to invest in offering VRPs? If not, please explain why.

While we agree that coverage is important, it alone is not sufficient to incentivise PISPs and/or merchants to invest in offering VRPs.

Merchants value a range of pricing and non-pricing factors such as:

- high basket conversion/completion rates, which depends in part on the attractiveness of the payment option to consumers for the particular use case. This is often an area in which ASPSPs will invest further where the right incentives exist, such as through customer journey testing and monitoring and the development of improved payment journeys;
- pricing certainty;
- the ease of communication with customers around payment queries and disputes, and being able to direct customers towards their payment issuer to resolve any queries and disputes;
- cashflow benefits;
- the ease of reconciliation, such as with controlled referencing to match transactions to the relevant invoice or bill;
- ease of integration and operation – in addition to ease of reconciliation, ease of integration with billing engines will also be key. Merchants will need to embed VRP into their current processes for a) client onboarding; b) billing; c) reconciliation. Merchants will need to work with their software providers in order to develop either output files or API calls to generate payments, consider how they integrate a funds/permissions check and how they handle the responses; and
- the total cost to serve. This includes the price for each transaction, and other factors such as backend reconciliation costs and gains from cashflow improvements. Importantly, merchants will often face high administrative costs for payments that go wrong, for example where a customer fails to pay or where a dispute is raised.

To achieve the broad set of factors valued by merchants, we think it is important that ASPSPs are incentivised to actively promote and invest in VRPs. We also think it is important that the MLA is designed to offer attractive terms for consumers (including robust customer protections), such that merchants are confident that consumers will seek to use it as a payment option. The current proposal does not provide confidence that sufficient consumers will use it or incentivise maximum merchant adoption. It is the wrong approach to assume merchant adoption needs to flow from offering services for free; that simply suggests the PSR believes merchants do not want the service. As BNPL shows, merchants judge value and are willing to support non-zero-price commercial models (in some cases with prices higher than on card transactions).

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 merchant investment to realise network effects? Please explain your rationale.

There is no specific share that is likely to incentivise investment by PISPs or merchants. Payment options today have successfully grown from small starting points where the functionality, security and commercial benefits offered are attractive to customers and/or merchants.

It is critical that there is certainty about the sustainability of VRP and the benefits available to customers and merchants. This will provide the most likely conditions to drive uptake and build the required network in the long-run.

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

Mandating the CMA9, and no other ASPSPs or TPPs, is in effect an extension of the CMA Order into non-Order activity that results from design challenges in the PSR's proposal and/or an implicit belief in a lack of customer appetite. It is wholly inappropriate: as the CMA itself has recognised, there is no justification for it from the CMA's market investigation into the state of retail banking which resulted in the 2017 Order. Engagement with non-Order activity should be decided by individual firms on the basis of their commercial incentives. Given the zero-price put forward by the PSR, this in effect imposes on the CMA9 significant additional costs without any compensation, nor commercial return. It also creates a regulatory-driven barrier to entry / expansion: a new entrant will not wish to offer VRP for free given the considerable costs involved, and yet is highly unlikely to be able to charge if the CMA9 do not, given the strength of competition between ASPSPs for consumers.

As discussed in our previous engagement with the PSR, a further negative consequence of mandates is that it removes an important feedback mechanism. A voluntary MLA allows ASPSPs to choose whether to participate on the basis of the commercial terms – if they are not adequate, ASPSPs will not participate (or will cease participating). This is an important indicator that the commercial terms of the MLA require changing, and mirrors the ability of TPPs to withdraw if commercial terms are not appropriate. By removing this mechanism only for the CMA9, the MLA is at risk of providing commercial terms that do not incentivise their participation, and so risks the CMA9 having no incentive to actively promote or invest in VRP beyond the minimum required (as would be the case under a zero-price).

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?

This must be achieved by establishing a commercial model that is sustainable and incentivises participation by a wide range of ASPSPs and TPPs. If customers demand the functionality, and there is a commercial model that allows participation from all ASPSPs (including smaller entrants), then this will best enable coverage of a large proportion of customer accounts. We have set out suggestions elsewhere in this paper as to how such a model might be designed.

Mandating participation, particularly without a commercial model that incentivises participation, will only provide coverage in principle and will not enable the long-term success of VRP. It will also provide no incentive for ASPSPs beyond the CMA9 to engage with VRP, as they will not be able to recover their costs. This therefore places a limit on the number of customer accounts that will have access to VRP, and jeopardises the long-run engagement of ASPSPs with the payment option.

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?

As discussed above, it removes a critical feedback mechanism to test the adequacy of the commercial model, and risks halting any active participation from the CMA9. This also seeks to extend the CMA Order in a manner the CMA itself has said cannot be justified by the work done to create the Order in the first place.

A further risk is the stifling of innovation and investment amongst non-CMA9 firms, which will have no incentive to join the MLA given the non-existent commercial model.

Mandating also takes no account of the extent of demand from merchants for VRP. As stated in this response, the likely outcome of the PSR's intervention is that the commercial model will stifle participation, innovation and investment, and will result in a service that is unappealing to many merchants. The risk of mandating is therefore that it forces ASPSPs to incur significant investment costs while simultaneously eroding demand.

It is a lost opportunity to engage the industry and create a proposition that will effectively compete with other payment mechanisms and to set the scene for future premium APIs to compete for other payments.

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

As discussed previously with the PSR, a voluntary model will best identify the commercial conditions required for the success of VRP.

If this is combined with a proper assessment of the relevant costs that should recovered, and the appropriate levels of commercial returns for ASPSPs to allow recovery of efficiently incurred costs and a fair return on investment, this will identify a price that incentivises participation without being prohibitive to merchant uptake. This creates the best conditions for long-term competition with other payment options on the true merits and efficiency of VRP, rather than through mandating ASPSPs to absorb costs with no returns.

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?

First, the PSR's misapplication of its pricing principles risks creating a precedent for future phases of VRP by failing to consider costs incurred on other payment options. In particular, the costs incurred on card payments used for e-commerce are significantly higher, owing in part to the higher rates of fraud and customer and merchant disputes. It is critical that the commercial model for these use cases enables ASPSPs to sustainably recover these costs and support the protections necessary to avoid widespread customer harm.

Second, it distorts competition as VRP is rolled out more widely, with other payment options competing with an artificially low (zero) price. It removes the prospect for competition on the genuine efficiency of payment options, and disincentivises innovation in new payment options due to the lack of available commercial return, enabling providers to invest in services and recover efficiently incurred costs including a reasonable return on investment.

Third, it risks entrenching barriers to entry across payments by establishing that cross-subsidy is required to fund the associated costs. This will favour providers with diversified business models that are better able to support such cross-subsidy, and may result in an overall reduction in innovation in payments as innovative new entrants are excluded.

Fourth, for the reasons set out above, it risks harming the UK's international competitiveness and ultimately growth.

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 understand and agree with the focus of the CBA on the initial use cases; although as explained we do not consider the PSR has given full consideration to the likely costs and benefits.

It is also critical that a fresh CBA is carried out for later use cases where the risks, and therefore costs faced by ASPSPs, will be much higher.

The use cases for Phase 1 are not clearly defined. We understand that the three broad sectors of the economy have been chosen based on a poll to the VRP working group and the loose principle that these are regulated sectors, therefore customers have further options for recourse for merchant failure. Further work is needed to properly define and assess the sectors that should be included in Phase 1, as well as the types of products and services to be purchased. We would encourage the PSR to consult formally on the use cases that should be trialled in Phase 1 to allow industry to carry out robust risk assessment and develop mitigations to prevent consumer harm. We strongly encourage the PSR to consult further on the use cases that have been selected for Phase 1.

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

No evidence is given for the assumptions, which are unqualified and intangible. The approach to the CBA also fails to meet the standard required in setting out potential counterfactuals. The Treasury's Green Book highlights that a CBA should disaggregate a policy intervention into its component parts and assess each separately. In the context of the PSR's proposals, this means the CBA should separately assess the choice to introduce an MLA, the choice of a zero price and the choice to mandate the CMA9. This would therefore also require the assessment of reasonable alternatives at each stage, such as different options for pricing and different approaches to mandating.

We also believe the PSR is incorrect to assume current provision of VRPs would not change without intervention. In the absence of the regulatory-driven approach by the PSR, there was already material growth in A2A transactions and we understand a growing number of bilateral engagements between parties. Industry was also undertaking work to explore model clauses While an MLA will deliver a much broader network more efficiently, it is not correct for the CBA to assume the status-quo would otherwise have persisted in the absence of action from the PSR.

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?

We briefly set out the benefits to consumers, merchants, PISPs and sending firms from a successful and well-designed VRP ecosystem below:

- **Consumers** will benefit from an additional payment option and enhanced functionality such as greater control through flexible mandates and ease of cancelling via a mobile banking app, as well as easier payment journeys with parameters pre-filled by merchants.
- **Merchants** will benefit from VRP if it is able to deliver improvements (relative to existing payment options) on the factors set out in our response to Question 10. Merchants are a key beneficiary of payment mechanisms that enable them to take payments conveniently and quickly, and with minimal risk of fraud or other harm. We would expect that VRP is able to deliver improvements, including the ability to check funds prior to claiming a payment and reduced fraud due to certainty over account ownership.
- **PISPs** will benefit from the ability to provide payment initiation services to merchants and charge for that service.
- **Sending firms** will benefit from the ability to offer their customers an additional way to pay, and therefore an improved ability to compete with other ASPSPs for those customers.

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 are not in a position to comment on the costs incurred by Pay.UK or PISPs in relation to VRP. We have discussed the costs faced by merchants in response to Question 10.

The costs these parties incur are also not relevant for the assessment of an appropriate commercial model between sending ASPSPs and TPPs, which should be based on the costs incurred by ASPSPs in providing access to VRP for their customers. We have discussed these costs elsewhere in this submission already, in particular in our response to Question 5.

We would strongly encourage further consultation to ensure that the PSR understand the full range of costs incurred by ASPSPs associated with the provision of services to merchants and the importance of a commercial model that enables a fair and reasonable recovery of these legitimate costs.

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

To the extent that these customers may be regarded as vulnerable, they may be more at risk of fraud and/or may be less digitally enabled. As such investment in fraud prevention, seamless and easy-to-navigate customer interfaces, and high-quality customer service through a range of channels maybe particularly important for them.

The interests of vulnerable customers will be best promoted if ASPSPs are also incentivised to invest in customer experience and are able to recover the efficiently incurred costs of protecting customers from fraud, reimbursing customers who have fallen victim to fraud, and dealing with customer inquiries and disputes.

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.

As stated elsewhere in this response, the current proposals risk setting a precedent that categories of cost that are not '*incremental*' or '*additional*' to other payment options cannot be recovered by ASPSPs. Such a precedent would result in little or no cost recovery by ASPSPs, and would pose a direct risk to the sustainability of VRP and more generally undermine the expansion of other Open Banking use cases. It would also disincentivise investment and innovation, and result in barriers to entry for providers that cannot cross-subsidise elsewhere in their business.

We also note that the proposal has not yet stated how the commercial model will be decided after Phase 1, and whether this will result in a change in price for Phase 1 use cases in addition to setting the price for other use cases. Regardless of the approach taken, we expect that the zero-price set by the PSR for Phase 1 will pose risks to the scalability of VRP and Open Banking at later phases. This is because:

- In the event that the price for Phase 1 use cases remains zero, this may result in a significant difference in price between Phase 1 use cases and higher risk use cases such as e-commerce. Such a difference in price would reflect differences in the quality of protections offered to customers, and so the PSR's approach may open up customers on the supposedly lower risk use cases to greater harm (particularly where customers assume the protections offered on e-commerce apply to all use cases). It would likely also result in lower investment and innovation for these Phase 1 use cases.
- In the event that the price for Phase 1 use cases is subsequently revised, this would impact the cost faced by merchants to access VRP. Significantly, any merchants that have invested in using VRP on the basis of the zero price could be harmed. The uncertainty created by the PSR's 'pragmatic' approach is likely to hinder the willingness of merchants to adopt and invest in VRP.

Mastercard

Mastercard Response: CP23/12 Expanding variable recurring payments

Mastercard welcomes the opportunity to respond to the PSR's call for views (CP23/12) on expanding variable recurring payments (VRPs).

Open Banking has grown in the UK but is yet to realise its full potential. For Open Banking to achieve its potential it is important to secure the foundations for an appropriate commercial model. Such a model should incentivise investment and innovation; support a sustainable, longer-term return for participants; and compensate for risks whilst rewarding those who seek to innovate.

It is clear from CP23/12 that the PSR agrees these are the ingredients for a successful and sustainable market.

It is also clear that the PSR seeks a swift and practical approach to the scaling of VRPs and believes any model should avoid unfair competitive advantage and foster healthy competition. Mastercard shares these views.

Mastercard does not however believe that the way in which the June 2023 pricing principles have been applied in the PSR's proposed approach to Phase 1 would deliver these well-considered objectives.

Indeed, if the PSR proceeds with their proposed commercial model – severely limiting incentives for sending banks – the market is likely to find this actually weakens incentives for anything other than minimal adherence.

A commercial model that fails to incentivise will lead to a lack of investment, resulting in reduced innovation and a poor customer experience.

The Garner Review echoes this view, highlighting that it is the lack of vision for a sustainable commercial model which needs to be addressed and delivered, in order for the market to thrive.

In the longer term, a failure to facilitate such an approach would not only foster a poor commercial environment for Phase 1, but also set a precedent for future phases to offer limited financial rewards to participants. This would go directly against the PSR's desire to seek a practical approach to the scaling of VRPs.

Mastercard also believes the proposed approach would make it very difficult for the commercial market to develop alternative approaches, which are essential to ensure competition within this space is encouraged, in order to maximise innovation.

Ultimately, the subsidising of VRPs would lead to a competitive disadvantage being created for other payment types, such as Bacs. It is exactly this competitive disadvantage which the PSR says it is seeking to avoid. Mastercard believes the PSR's proposed approach in CP13/12 needs to be reassessed if a sustainable, long-term model is the outcome sought. Failure to do so will only entrench the problems highlighted above in the longer term, as those who seek to innovate will struggle to justify their role in the market, which will lead to a steady erosion of the consumer experience.

Q1. 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.

Mastercard does not believe that the way in which the June 2023 pricing principles have been applied in the PSR's proposed approach to Phase 1 would deliver a sustainable commercial model. Sustainable commercial models need to be in place for all industry participants and require an ability for returns to be generated in order to attract, secure and maintain investment. A lack of such incentives will starve the model of the investment required to become viable. The Garner Review explicitly noted the lack of vision for a sustainable commercial model which *'needs to be addressed and delivered as a priority'*. Indeed *'without a sustainable commercial model there is no ability to fund infrastructure investment.'*

Q2. 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.

Mastercard believes cross-industry co-ordination is required for Phase 1. Such co-ordination was demonstrated in the VRP SWG and sub-working groups which clearly delivered on the objectives set out by each working group. UK Finance also coordinates a cross-industry working group delivering standardised contractual terms which is in-flight.

For MLAs to work requires either ownership by industry or industry input and consultation towards a process which is owned elsewhere. Mastercard questions whether the approach being proposed here is appropriate to achieve that aim.

Commercial payment schemes have demonstrated the ability to develop and implement MLAs without regulatory intervention (e.g. the SEPA Payment Account (SPAA) scheme rulebook). Mastercard believes it is possible for the industry to generate alternative approaches.

Q3. 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.

Mastercard believes there are multiple potential options for MLAs to be driven by the market to ensure that competition within this space remains and is encouraged. This would be strongly in the interests of maximising the potential for innovation, enhanced end-user experiences, and thus adoption.

Q4. 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?

It is inevitable in such a market that unforeseen risks will continue to emerge. Mastercard believes that competing options and choice are the best way in which to resolve potential risks, align incentives and thus maximise competition and foster innovation. Mastercard is, however, concerned that the current approach risks the creation of misaligned incentives. For example, *price*, whilst important, is not the sole basis for the success of VRPs. Mastercard believes the PSR should give due consideration to all elements which may provide value to end users and industry.

Q5. Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.

The PSR have considered three cost sources for one party in the transaction (the ASPSP): sending banks' own costs (set-up and running); FPS related costs; and OBL costs, thus omitting all other participants in the ecosystem.

Other costs which may need to be considered include the building and operating of dispute resolution and fraud prevention, which is not an insignificant task. Similarly, the costs related to call-handling and customer support require operational capacity investment as well as increased overheads. These costs may be further magnified under the new Consumer Duty requirements around customer support. Running said systems at increased load (vs what impacted entities are accustomed to today) will also add to running costs.

Q6. 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 approach taken by the PSR suggests the only *relevant* costs for sending firms are FPS fees. Mastercard believes focussing on FPS cost alone does not meet the objective of developing a sustainable ecosystem. Forming a methodological position on this point requires the Implementation Groups to have completed their work before costs may be fully considered. Mastercard believes the focus should be on ensuring such costs are covered in the most fair and balanced way possible between the parties involved, considering not only the running costs, but also risk/liabilities, and as appropriate a profit-margin or value-based element to incentivise participation and usage. This cannot and should not be considered independently from other costs/fees in the broader ecosystem.

The importance of parity, both from a fairness and practical level, in respect of the PSR proposal that the FPS fee on sending banks should be removed for VRPs is something Mastercard also believes should be considered. For example, there are live VRP (cVRP and sweeping) solutions in market today (enabled by bilateral agreements direct between banks and TPPs) and there may be other MLAs in place in the future. Sending banks will be sending payments via FPS (upon receipt of a PIS instruction) in each of those examples, raising the question would these similarly be exempt from fees? If this is not clarified, it runs the risk of impacting the appetite for parties to interact outside of the proposed MLA structure. At a practical level there would need to be different FPS VRP markers and/or rules about when/where the marker can/cannot be applied to a VRP related payment, which may add complexity for all parties.

Q7. 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?

Mastercard believes focussing on FPS costs alone fails to meet the objective of developing a sustainable commercial ecosystem. We consequently believe it is not appropriate to remove FPS charges from either sender or recipient. This question requires the Implementation Groups to have completed their work before costs can be adequately assessed.

Q8. Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.

Yes, OBL's costs for quality, performance, reporting and standards with respect to commercial VRP (cVRP) are omitted from consideration and funding. The Strategic Working Group was clear that for the scaling of cVRP to be successful, additional functionality would be required. In order for these costs to be fully and properly considered, the Implementation Groups must be able to complete their work.

Q9. What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

Mastercard believes alternative commercial models must be encouraged to be developed, with a view to supporting competition and innovation.

It is important for policymaking within payments to have support and collaboration across the UK's payment systems. Mastercard believes the competitive market is best placed to deliver on the approach (with HM Government articulating the outcomes it wishes to see).

Q10. 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.

It is important that such a view is not based on an assumption, but data and research. Whilst Mastercard fully agrees that consumer account coverage is an important factor in encouraging PISPs and/or billers to invest, equally critical is the establishment of genuine value to the end consumer.

Q11. 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.

Q12. Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.

No response.

Q13. 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?

No response.

Q14. 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?

Mandating participation may risk the consumer experience not attracting sufficient investment to encourage adequate consumer adoption. Mastercard suggests that even if a mandated approach were proposed, this should not preclude other entrants from the commercial market being able to bring forward alternative solutions.

Q15. Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.

Mastercard believes alternative commercial models must be encouraged to be developed, with a view to supporting competition and innovation.

The SEPA Payment Account (SPAA) Scheme has developed standards and a pricing model (via use of economic consultants) which demonstrates that industry-led approaches are both attainable and valuable.

Q16. 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?

If there were to be limited financial rewards for senders, the market may find this weakens incentives for anything other than minimal adherence. Failure to incentivise will lead to a lack of investment. This may in turn present risks for the consumer experience, thus having a deleterious effect on adoption. Were this situation to manifest it would not only foster a poor commercial environment but also set precedent for future phases to offer limited financial reward to participants, thus leading to a continued lack of investment. There is also a risk that by setting a precedent for subsidising Open Banking VRPs, a competitive disadvantage is created for other payment types.

Given that Pay.UK operates both the FPS scheme and the Bacs scheme, the PSR needs to be clear how it expects Pay.UK to manage the competitive tensions between VRPs and direct debits, so as to promote competition, innovation and efficiency in the broader payments market and avoid placing Bacs (or other payment mechanisms with proven consumer adoption and strong consumer protection) at an unfair disadvantage.

Q17. Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis? Please provide reasons for your response

Mastercard supports the limitation to the low-risk use cases for Phase 1. However, it does not follow that limiting the cost/benefit analysis to such use cases is advisable beyond Phase 1 (for differing use cases) without further careful consideration.

However, low-risk does not mean no-risk. Even in Phase 1, it is important for the PSR to describe the risks, be clear on who in the payments chain bears the risks, and thus who in the payment chain should be rewarded for bearing such risks. This will help future-proof the commercial model when higher risk use cases are added in later phases. It will also incentivise the risk bearing parties to manage and reduce risks in an efficient manner.

Q18. Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response.

Mastercard disagrees with the assumption that in the absence of regulatory intervention, sending firms will remain unchallenged. A sustainable economic model at the heart of an ecosystem will encourage innovation and competition, whilst negating the need for regulatory intervention. Mastercard does not agree with the assumption that payment methods (alternative to VRP) will not significantly change and/or improve during this period. Such assumptions should be based on clear evidence. Conversely, there is a strong body of evidence to support the ongoing innovation which is happening in the market.

Q19. 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?

Mastercard believes any benefits will be negligible in the absence of a sustainable commercial model, which sits at the heart of an ecosystem and attracts investment, encourages participation/adoption and fosters innovation/competition.

Q20. 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?

No response.

Q21. How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?

Mastercard believes there would be merit in the PSR re-engaging their specialist stakeholders as part of this process.

Q22. Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.

If the PSR proceeds with their proposed commercial model (severely limiting financial rewards for sending banks) the market may find this weakens incentives for anything other than minimal adherence. A commercial model that fails to incentivize will lead to a lack of investment, resulting in minimized innovation and a poor customer experience.

The proposed regulatory-driven approach would make it difficult for the commercial market to develop alternative approaches, which are essential to ensure competition within this space is encouraged, in order to maximise innovation.

Not only do current proposals set a precedent for ASPSPs to receive no remuneration, they also set a precedent for subsidising Open Banking VRPs, thus creating a competitive disadvantage for other payment types. In the longer run, the proposals for Phase 1 are likely to hinder success in later phases (by embedding the business models of the subsidy proposed in Phase 1) which may prevent moving to a sustainable commercial model.

Modulr

Modulr

Subject: Draft EMA response to PSR CP23-12 – Expanding Variable Recurring Payments – Call for views

02 February 2024

Questions and Modulr 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 are confident that the pricing principles support delivery of a sustainable commercial framework for Phase 1. The principles are thorough and consider the essential factors relevant to Account Servicing Payment Service Providers (ASPSPs), Third Party Providers (TPPs), and customers, thereby endorsing the broader acceptance of VRP.

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 assert the necessity for cross-industry collaboration. We agree with the recommended approach for cross-industry coordination in Phase 1 and advocate for the adoption of an MLA to guarantee consistency among all participating entities. The employment of bilateral agreements, which are often expensive, intricate, and demand considerable time to negotiate, would disproportionately impact smaller enterprises by imposing undue burdens.

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 believe Pay.UK is well-positioned to operate the MLA for Phase 1. Their expertise in performing this function for other clearing systems positions them as a practical choice, one that is likely to facilitate the timely delivery of Phase 1. However, it is imperative to ensure equal involvement from both ASPSPs and TPPs as Phase 1 progresses. Furthermore, we recognise that a centralised MLA encompassing commercial agreements between participants necessitates the management of billing procedures for all involved parties. Given the complexities associated with this, we would be keen to understand the consideration that's been given to this.

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 believe the current view of the market structure and sending firms' position is broadly accurate and would echo the concerns that have been outlined in the proposal.

The costs incurred by sending firms includes their own costs, FPS (Faster Payments) costs and OBL (Open Banking Limited) costs. Own costs in this instance includes the investment required by sending firms to build VRP. As Phase 1 sweeping functionality builds upon existing Open Banking infrastructure then we would expect these initial investment costs to be low for Phase 1. Furthermore, we do not anticipate a material change in overall transaction costs – if customers switch from direct debit to FPS (as intended), cost savings resulting from the decline in direct debit transactions would likely be offset by costs increases driven by higher FPS volumes.

With over 90% of consumer and small business bank accounts provided by the CMA9, we understand the logic of removing the sending fee to stimulate competition and innovation among TPPs.

We note this analysis does not extend to costs for receiving PSPs. We would be keen to understand any consideration that has been given to this and any analysis of the potential impact on market dynamics.

Question 5

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

We believe the costs outlined cover the main sending firm related costs.

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.

We see the logic of removing the FPS charge to encourage take-up and in the spirit of simplicity and pragmatism we broadly agree with this approach for Phase 1.

We would, however, highlight the distinction between B2C and B2B transactions in relation to the impacts of the FPS charge. In the context of business payments, if the FPS sending cost is removed for ASPSPs and they continue to charge business customers at FPS rates for completing VRP transactions this will generate a 100% gross margin contribution from the transaction. Conversely, as most consumers do not currently pay transaction fees for direct debit or bank transfer then we would expect minimal impact from removing the FPS charge.

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?

We advocate for costs being recovered through wider Pay.UK charging, on the assumption this is referencing costs rather than prices charged to PSUs.

Switching costs to the receiving side may create unintended consequences or disincentives which could negatively impact VRP take-up. By recovering costs through wider Pay.UK charging we would anticipate a more equitable distribution of costs across participants which should minimise disincentives for any one party.

Question 8

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

We agree that the proposal covers the main OBL related costs.

Question 9

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

Whilst we have some reservations with direct price regulation, the rationale is clear, and we can confirm we support a zero fee for Phase 1. We recognise that a more enduring and scalable commercial framework will be required as we progress beyond Phase 1 and consider broader use cases, however at present we see no alternative model that could practicably support a Phase 1 go-live in Q3. A commercial roadmap would be useful to understand how the commercial model is expected to evolve over time.

One critical element of this will be the ability to distinguish types of FPS payments (sub-type codes) to enable FPS charges to be removed. This will require a technical solution and we're keen to work with Pay.UK on developments in this area.

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.

We believe that having a large number of consumer accounts that support VRP is crucial to its success. If this isn't in place as part of Phase 1, we strongly believe this will lead to loss of momentum in the market for VRP and potential incorrect conclusions being drawn with regards to VRPs place in the market and long-term application.

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.

Market analysis indicates that to achieve network effects amidst a landscape of numerous payment alternatives, account coverage ranging between 40% to 60% is generally required. Our stance is inclined towards a more robust coverage, aligning more closely with the 70% figure referenced by some stakeholders in Section 2.15 of the consultation. Nonetheless, as elaborated in our response to Question 12, we believe striving for c.90% market coverage, as would be realised through a CMA9 mandate, is a desirable outcome.

Question 12

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

We believe the best way to achieve sufficient market coverage is to require the largest market players to offer Phase 1 VRPs. Considering the CMA9's current facilitation of VRP for sweeping purposes, expansion upon this established infrastructure is the most pragmatic approach. Similarly, the assurance that the vast majority (c.90%) of accounts will be covered is a crucial factor in motivating TPPs to deliver innovate solutions for billers.

We concur that the likelihood of an insufficient number of banks voluntarily participating - thereby failing to deliver the required network effects - is considerable. Therefore, we advocate for the compulsory inclusion of the CMA9 banks to increase the chances of success in Phase 1.

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?

We do not see a viable alternative that could deliver the same coverage for Phase 1, particularly given the CMA9 banks already support sweeping VRP.

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?

We feel the main risk of mandating participation is the potential for it to drive a compliance-centric approach to implementation which could impact longer-term functionality and performance. Although these risks exist for Phase 1, we feel they are outweighed by the benefits that we've outlined in Question 12. We advocate for the adoption of this approach in Phase 1 and propose a checkpoint at defined point to evaluate the effectiveness and any obstacles encountered with this strategy.

Question 15

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

Whilst each of the alternative models has its own set of advantages and disadvantages, overall, we believe the proposed approach provides the greater chance of delivering the desired outcomes for Phase 1. Alternative strategies, particularly those reliant on bilateral negotiations mandated by regulation, would likely introduce significant complexity and protracted timelines, which may disproportionately burden smaller firms and be challenging to deliver within the target timeline.

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?

We believe the risks of the proposed commercial framework are limited for Phase 1 and outweighed by the benefits of this approach. As noted in Question 9, whilst we have some reservations with regards direct price regulation, the rationale is clear, and we can confirm we support a zero fee for Phase 1. We recognise that a more enduring and scalable commercial framework will be required as we progress beyond Phase 1 and consider broader use cases, however at present we see no alternative commercial model that could practicably support a Phase 1 go-live in Q3. A commercial roadmap would be useful to understand how the commercial model is expected to evolve over time.

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.

In light of the ambitious timelines for launching Phase 1, we agree with the rationale behind prioritising the so-called 'low-risk' sectors. The established regulatory infrastructures, together with the existing provisions for consumer protection, liabilities, and dispute resolution mechanisms, enhance the likelihood of a successful launch in comparison to sectors lacking such established frameworks.

As the Phase 1 proposal develops, we would appreciate further clarification on the definition of regulated financial services and the scope of services covered, as we believe this is important for the cost benefit analysis and the application of Phase 1 VRPs.

There are a number of use cases we would like to be considered beyond Phase 1 which we believe can be a key driver in the wider adoption of VRP:

- Ability for consumers to pay for on-demand services when amount varies based on usage e.g. Uber being able to collect trip fees directly, safely and securely from a customer’s account.
- Ability for businesses to set-up recurring payments to suppliers in the digital economy e.g. businesses paying marketing agencies based on website traffic.
- Transport companies being able to charge directly from an account based on real-time service usage e.g. TfL being able to charge for journeys linked to an app.
- Travel companies offering savings pots to consumers/businesses which automate sweeping (within agreed parameters) to be used towards a travel goal.
- Loyalty apps connected to an account that offer rewards based on travel expenses e.g. travel loyalty apps collecting for airline tickets.

Question 18

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

We agree that the assumptions look reasonable. With regards the New Payments Architecture (NPA), we would request further analysis on VRPs role within the NPA and potential commercial implications to assess whether these costs can be disregarded.

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?

We believe the key benefits for consumers are:

- Increased flexibility, control and transparency around their money
- Greater choice of payment methods
- Easier, more convenient recurring payments, including ability to amend or cancel payments
- Improved cashflow management, including a potential reduction in overdraft usage
- Efficient subscription and membership management
- Easier account switching
- Enhanced security
- Direct relationships with merchants (including potentially better customer service and dispute resolution)
- Cost effective (in instances where a consumer is paying a fee for direct debits or bank transfers that the VRP is replacing)

We believe the key benefits for merchants are:

- Reduced payment friction
- Lower cost of payment acceptance
- Speed of settlement
- Easier to set up and monitor recurring payments
- Customer retention through wider payment choice and improved customer experience
- Improved cash flow and streamlined reconciliation
- Enhanced security
- Reduced dependency on other payment methods

We believe the key benefits for PISPs are:

- Innovation opportunities leading to new Open Banking propositions and revenue streams
- Enhanced customer experience and retention, and access to a wider customer base
- Increased transaction volumes and reduced payment failures
- Enhanced security to combat FPS fraud risks
- Additional data insights

We believe the key benefits for sending firms are:

- Reduction in payment set up costs, including cost of accepting third-party payments
- Enhanced security to combat FPS fraud risks
- Build upon existing VRP infrastructure / investment
- Enhanced customer service and retention
- Easier visibility and management of recurring payments
- Reduced payment failures
- Additional data insights

We believe the key measure of success will be take-up of VRP, particularly as compared against corresponding changes in direct debit usage / bank transfers in the Phase 1 industries. In addition, fraud statistics and payment failure data for VRP payments will be an important metric for measuring whether security benefits are being realised.

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 agree with the cost categories outlined in the proposal.

Question 21

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

As with any major payment initiative there are both positives and potential drawbacks to be considered.

We see the main benefits for people with protected characteristics as:

- Additional control and flexibility around how they manage their money
- Easier visibility and management of regular payments
- Improved accessibility via online and mobile apps (subject to having the required digital skills)
- Customisation options (such as setting lower transaction limits)
- Cost savings (e.g. through avoidance of overdraft fees)
- Reduced chance of incorrect charging and/or overpayment
- Potentially reduced reliance on caregivers with regards financial management/support due to greater direct control

We see the potential drawbacks for people with protected characteristics as:

- Digital exclusion (people who are not digitally literate or do not have regular internet access may find it difficult to manage VRPs effectively)
- Financial vulnerability (those on low incomes or with precarious financial situations might be at greater risk of financial hardship if VRPs cause unexpected account shortfalls or going into overdraft)
- Budgeting challenges (people with disabilities or cognitive impairments might find it more challenging to track and manage VRPs as they would need to ensure sufficient funds are available in the right account at the right time)
- Complexity of setting VRP parameters and managing consent periods (those with cognitive impairments may find it more challenging to set and amend VRP parameters and consent periods)
- Potential challenges understanding the differences between VRP and direct debit (this will require education from Open Banking participants)
- With the onus being on the individual to manager VRP parameters, we need to ensure customers have a clear understanding of how VRPs work, including the potential risks if parameters are not managed correctly.

We’re keen to ensure there’s alignment across the industry with regards protected characteristics, for example we would suggest all participants use the vulnerable customer guidance set out in the Consumer Duty. VRP vulnerable customer rules should not differ from existing industry standards.

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.

The current policy proposal, as it stands, is not perceived as a considerable threat to the scalability of VRPs and Open Banking beyond Phase 1. We recommend a checkpoint after Phase 1 has been live for a period to evaluate and ascertain the extent to which pricing regulations have influenced adoption rates. We acknowledge that quantifying this impact poses certain challenges, which will necessitate a collaborative effort to resolve effectively.

Moneybox

[redacted]

moneybox

Digital Moneybox Limited
1-2 Hatfields
London
SE1 9PG

26th January 2024

Delivery via email: a2a@psr.org.uk

Dear Sirs,

Response to: CP23-12 Expanding Variable Recurring Payments

Moneybox welcomes the opportunity to respond to the above open consultation.

By way of introduction, Moneybox is an award-winning consumer digital wealth manager, which supports over 1 million customers to build wealth with confidence, whatever their starting point, whether saving for a rainy day, growing their money through investing, buying a house, or planning a retirement they can look forward to. Moneybox helps people manage and achieve their short, mid, and longer-term financial goals all within one easy-to-use and engaging app supported by award-winning technology and customer support, as well as helpful tools and educational content. Moneybox was authorised by the FCA in mid-2016 and currently offers the following products: Cash ISA, Stocks & Shares ISA, Lifetime ISA, Junior ISA, general investment account, Personal Pension, and instant access and notice saving accounts.

Our current primary payment mechanism is a weekly direct debit. This is used to facilitate regular and one off payments as well as ‘roundups’ (the spare pennies from each purchase made in the investors bank account that week).

We also allow single payments of over £100 to be paid via open banking transfer (which we call ‘instant bank transfers’).

Currently we could only offer VRP to our customers who save into cash products due to the sweeping definition that prohibits payment into pension and investing products. We have not yet introduced a VRP mechanism as it will create differing experiences for customers depending on the products they hold and this could lead to customer confusion and dissatisfaction.

We believe the speed, security and customer control associated with VRP’s mean they could revolutionise our customers' saving and investing experience; as long as VRP’s are easy to access and administer, provide significant market coverage and operate with a viable commercial model. We are therefore very strongly supportive of the measures outlined in this consultation.

We have responded to the questions applicable to our customers.

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 necessary and the MLA is the best way to achieve this. We are keen to use VRP for all of our products, however we would be wary of non sweeping VRP's being introduced in a manner whereby the conditions (commercial, contractual and operating) could differ by PISP and/or sending bank. As our customers use a wide range of banks it would not be viable for us to administer arrangements on differing terms on a bank by bank basis. We believe an MLA is the best way forward.

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 agree with your view of the market structure and agree that regulatory intervention in price is needed. Our early discussions around commercial VRP's have indicated that banks were intending to price this comparably to card interchange fees, which are significantly more expensive than direct debits. As such commercial VRP would not be viable for us. We would also be unable to operate in a model where different sending banks charge different levels of fees for access to payments from their customer accounts.

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

Yes, launching a service of this kind is a large undertaking for our company. We would be unable to justify this investment with no guarantees of the market coverage it would provide.

It is also difficult for customers to understand and trust new features such as this when industry participation is low.

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?

Commercially viable VRP's with strong market coverage would be incredibly valuable for our customers.

Customers struggle to understand the direct debit cycle and why it takes time for the money they instructed us to collect to become invested. The immediate nature of VRPs is much simpler for customers to understand, and matches their experience for many other payments and purchases in their lives.

Finally we do see cases of direct debit fraud which would be eradicated by the strong customer authentication required to enable VRPs.

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?

The key costs for Moneybox are how much sending banks charge for initiating a payment from our mutual customer and how much PISPs charge merchants (such as Moneybox) for the facilitation of a payment.

Moneybox does not sell a good or service with a profit margin that can be eaten into when taking payment from a customer. The customers' money is our business. Therefore if a customer sends us £100, their account must receive £100. The costs associated with making that payment all eat into the profit we derive from the small percentage fee we deduct from the total assets we hold for a customer. As Moneybox encourages mass market micro saving and investing, in many cases customers are saving relatively small amounts through regular contributions. Regular contributions are an important aspect of our service as this allows customers to benefit from cost averaging in their investment purchases. Therefore as we take 52 payments a year, high transaction costs inflicted on us by sending banks or PISPs would make VRPs prohibitive.

We strongly agree with the suggestion of capping the charge sending banks can make as zero. We would also like attention to focus on monitoring that ensures the PISP market operates in a competitive way so merchant (and therefore customer) access is as wide as possible.

Monzo Bank

monzo

CP23/12: Expanding Variable Recurring Payments

Monzo response

7th February 2024

About Monzo

Monzo is a digital only bank that lives on your phone. Founded in 2015, we're the UK's largest digital bank and growing at pace. We have over 8.5m customers and an ambition to serve many more millions globally in future.

With a mission to make money work for everyone, we're transforming traditional money management with tech and co-creating with customers to deliver products and tools that put them in control of their finances. Examples of this include Monzo's:

- **Help for customers to start saving and investing,** for example pots to help budgeting- over 400,000 are created every month.
- **Open Banking interface**, which is used by over 3.5 million customers, helping businesses to get paid faster, and consumers to understand their spending and budget across all their accounts.
- **'Share with Us'** feature, which allows consumers in vulnerable circumstances to report situations like economic abuse in confidence,
- **Gambling block** which has helped roughly 600,000 customers tackle problem gambling.

Summary remarks

We welcome the opportunity to comment on the scope of the pilot, despite being out of scope of the initial Phase 1 implementation. Monzo has participated in the Joint Regulatory Oversight Committee (JROC)'s sub-working groups covering both the commercial model and consumer protection, and we are engaging with UK Finance regarding their role in the development of draft model clauses. We believe that the underlying Multilateral Agreement (MLA) for Commercial Variable Recurring Payments (CVRPs), including proposals on consumer protection and technical enhancements, will be vital not only to the success of the payment instrument, but also to the continued health of the payment account market in the UK.

We are concerned that these proposals are inconsistent with the ambition of JROC, and the recommendations in the Future of Payments Review, which highlights that *"without a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure investment"*[1]

We understand and support the PSR's ambition to develop a new payment method, and the regulator has sensibly outlined low risk use cases for a modest pilot proposal. While we do not agree that this is an optimal way forward, we wish to be pragmatic. As such, assuming the proposals proceed as outlined by the regulator, we have outlined below our main concerns, and questions:

1. **Alignment with existing industry initiatives:**

    a. We are uncertain whether the proposed MLA from Pay.UK will be mindful of the existing work draft model clauses developed by UK Finance and the industry. We would appreciate hearing from the regulator about whether or not they intend to take the model provisions into account in Phase 2, with an independent structure for Phase 1.

    b. We are curious as to how these proposals will align to the National Payments Vision, the consultation on the long-term regulatory framework for open banking and the development of the Future Entity.

Scope:

c. We delve deeper into what a proportionate scope for mandating participation might look like, as the market has evolved since the CMA9, with new considerations such as the distinction between primary and secondary payment accounts, as well as the size and scale of

[1]Future of Payments Review (p71), https://assets.publishing.service.gov.uk/media/6557a1eb046ed400148b9b50/Future_of_Payments_Review_report.pdf

participants, as highlighted in the FCA's Strategic Review of the Retail Banking Market.

d. We are also concerned that the use cases presented, particularly with regard to utilities, may not be attractive to merchants in those sectors. We would welcome clarity from the PSR that these merchants have indicated a willingness to trial the new payment method.

2. **Wind down plan:**

   a. If the proposals are carried forward as it is, we would welcome information on a wind-down plan for the industry, to give a clear end-date.

More detail on these areas, and responses to specific questions are outlined below. We would be happy to discuss our response with you. For more information, please contact:

Full response

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 PSR themselves have suggested three potential pricing models within this consultation, all presumably in keeping with the high level principles: a cost recovery model, vs introducing regulatory guardrails on bilateral price negotiations and setting a fee that replicates the revenue sending firms earn on the payment methods replaced by VRPs (for example, setting the fee at 0.2% based on the debit card interchange fee).

Any pricing model must lay the basis for a competitive approach to CVRP, and align incentives between ASPSPs and merchants, without requiring loss-making and/or cross-subsidisation, the possibilities of which are difficult to objectively identify at this stage without an MLA, evidence and industry buy-in.

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 support the development of an MLA to govern the terms of CVRP in the UK.

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.

No opinion.

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 believe the PSR has overlooked crucial elements. Monzo does not dictate to our consumers which payment options to use; instead, we offer what we need to be competitive. For example, we followed the CMA9 in implementing sweeping, not because we were compelled but because we believed this would become standard functionality for consumers.

If the CVRP vision is successful, the next payment account market entrants will likely have to offer such a service as table stakes.

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

Unsure - we have not seen any information on the costs associated with developing CVRP.

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.

We are not sure. We co-design our products and features with our customers, built on extensive user research. We have not seen or conducted any research to indicate the key gaps this new product could fill from a merchant perspective.

Our primary question is with regard to biller appetite, particularly in the utilities sector - we understand that some firms offer discounts for direct debit payments, and the initial investment to accept direct debit can be high.

Others in the market may already have evidence of an utility provider willing to accept CVRPs. If this does not come through in the consultation responses, in order to manage the risk of apathy from these large merchants, we believe the PSR should consider using their convening power to try and identify one energy provider willing to voluntarily 'switch on' CVRPs. This isn't an appetite the financial services industry can necessarily create for a free pilot with uncertain long term economics - it may not be worth the risk or build from the billers side. We'd welcome further involvement from the PSR to bring onboard significant billers to the table, as creating this appetite will be crucial beyond the initial pilot.

There is another issue, as the PSR will be aware, that utilities companies often offer discounts for direct debit usage. This will entrench the use of direct debit for consumers who can afford it. However, if the PSR were to work with these large billers to establish an appetite, the issue of variable pricing could perhaps be worked through, at least for the pilot. We understand that Fair By Design has long been concerned about the fact that consumers who cannot necessarily afford direct debit, pay more. It would be a huge win for underserved customers if the pilot could offer access to the preferential rates typically reserved for direct debit payers.

Generally, big utilities companies may not be well incentivised, in the same way that smaller merchants are. Our qualitative consumer research revealed that for our small business owners, trust, familiarity and legitimacy of a payment method all ranked highly. There's a question about user appetite in general, however we are not necessarily best placed to identify this. There's a possibility that further work would need to be done with regards to consumer journeys and education to drive adoption of the new payment rail. In theory, we are supportive of the greater control and flexibility offered by CVRPs vs direct debit for these use cases.

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.

Access is one barrier to successful CVRP adoption, and we have outlined our general support for the PSR's mandate in response to question 12.

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

Generally, we support a market led approach where firms can enter the market and experiment with different use cases/models - from which a commercial model may be developed.

We feel compelled to note at this stage that there is little link between transactional account provision and direct debit usage. Looking solely at transactional account numbers will likely result in the regulator mandating some participants unnecessarily, and likely cause a skew in the consumer uptake figures (we assume that the PSR will be monitoring consumer uptake as part of their metrics to determine whether the pilot has been successful). This is because UK consumers hold different current accounts/payment accounts to meet different needs.

There are additional factors that the regulator could consider, for example geographic coverage (should a provider have huge concentration in particular reason), size of the bank (the PRA identifies major banks as those holding more than £20bn in assets) or the number of customer deposits held. However, given the modest aims of the pilot we don't think sophisticated analysis is really necessary to identify participants.

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?

We generally support a market led approach. However if this is not favoured, the FCA has highlighted that the Big 4 banks in the UK cover 65% of the market, and that large banks offer the majority of primary personal current accounts. We think this would be a logical place to start, if the pilot is to reach the customer accounts that have direct debits set up.

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 further comment.

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

We have been reviewing UK Finance's alternative approach, and generally support the high level thinking.

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?

No further comment.

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.

Only one use case has given us pause: payments to other regulated financial services institutions.

Firstly, we assume that this covers payments to financial institutions accounts, not to financial institution's customers payment accounts (i.e. P2P payments).

We generally agree that these use cases are low risk, but we are concerned that this may effectively expand VRPs to EMIs with point of sale integrations with high risk merchants. Unlike those that serve as de facto current accounts, these integrations are especially frequent on gambling websites, where a customer can top up a niche EMI account only for the purpose of gambling.

Similarly, other EMIs may be fiat currency accounts closely linked to crypto exchanges -for example, where a customer makes a payment to an EMI in fiat currency, with the purpose of that deposit being converted to crypto by that provider. Ultimately, consumers can be supported to regularly top up their EMI accounts, but there are some sub-categories of firms that warrant a closer review in the category of 'low risk', when they are known to partner with, or operate in, high risk industries.

We'd be happy to support further analysis here, to ensure we've highlighted these risks - APP fraud liability is coming in for the industry, and we can envision some niche scenarios potentially captured in the use case descriptors where these payments could drive increased disputes/there may be more significant consumer protection gaps.

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

No further comment - it is difficult to identify all relevant costs without an MLA in place.

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 further comment.

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?

No further comment.

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

No further comment.

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

No further comment.

Nationwide Building Society

Nationwide response to PSR Consultation Paper 23/12 – Expanding Variable Recurring Payments Call for Views.

Version: 1.0
Date: 2 February 2024

Sent to: a2a@psr.org.uk

If you have any questions relating to this consultation, please contact: [redacted]

Executive Summary

Thank you for the opportunity to respond to this Call for Views.

Nationwide Building Society is owned by, and run on behalf of, our 16 million members. As a mutual building society, it is key that we look after our members and their money, providing customer-focused, sustainable, and reliable payment services. As Nationwide does not provide a business banking service or have a card acquiring arm, our response is focused on the consumer – our members. For this reason, we will always be supportive of initiatives that drive innovation in payments to create better experiences for consumers and increase competition on a commercial basis.

In our response, however, we set out several reasons why we do not agree with the PSR's proposal because we don't believe the initiative will achieve the above aims:

1. **Zero-fee model for VRP senders** – this model is unfair to sending firms and sets the wrong precedent. The proposed zero fee model should not be taken forward as it does not reflect the full setup, ongoing investment, and operating costs of sending firms and does not create a sustainable commercial model incentivising innovation and ensuring consumer protections. FPS scheme costs can never be the only cost for a solution that requires both Open Banking and Faster Payment messaging to operate.
2. **FPS scheme charges** – we disagree with the proposal to remove or re-allocate these. All sending costs should be covered by PISPs directly.
3. **Flawed Direct Debit comparator –** the proposal creates additional costs for sending firms, rather than substituting Direct Debit costs. It perpetuates the flawed Direct Debit model where senders bear costs but firms banking large utilities, government, or other recipient firms can cross-subsidise through charges to the end merchant.
4. **Legislative basis for the proposal** – the PSR has not stipulated the powers it intends to use to mandate CMA9 participation in the MLA or to intervene in the market to set a central price. These must be clarified as it is not clear to us that such a direction would fall within the scope of the PSR's existing powers under FSBRA 2013 and the PSRs 2017.
5. **Unbounded Phase 1 means MLA should not be mandated** – The PSR must clearly define Phase 1 ensuring that there is no onward expansion into more complex or high-risk use cases. The undefined timeframe and controls on scope for Phase 1 creates financial and customer risks for sending firms mandated to sign an MLA. Instead, the market should be allowed time to create an MLA on a voluntary basis.
6. **Economic model** - The PSR must enable independent economic analysis of the costs for both Phase 1 and the stretch e-commerce use cases. This will allow Commercial VRPs (CVRPs) to launch with clear customer protections and the commercial, liability, and governance models on which merchants, consumers, and providers can have the confidence to adopt.

Exploring the principal reasons we do not agree with the proposal in more detail:

1. **We do not agree with the PSR's proposal that sending firms should offer data access and initiate payments for a zero fee in Phase 1 as:**
    a. It is not true that the only relevant costs in Phase 1 would be the FPS scheme fees.
    b. This proposal should consider the financial investment, operating and central costs to sending firms required to offer these services. It is possible to see in the 65 actions in the JROC Commercial VRP Blueprint the extent of other developments which could be necessary to enable CVRPs. In addition, it appears likely that some form of per call charge will be used to fund standards development and operation of the Open Banking Directory in the future. The cost of both FPS and Open Banking calls would therefore also need to be included in the pricing model as they are integral to making a CVRP payment.
2. **The PSR appears to base its proposal for price intervention on a high-level assertion that sending firms "may have a bottleneck monopoly in relation to VRPs."**
    a. We have concerns firstly that this assertion is inadequately substantiated or reasoned; and secondly that it is a convenient characterisation which does not reflect the economic reality. Bottleneck monopoly theory forms part of the essential facilities doctrine, which regulates upstream market power where there is a risk to downstream competition. In the case of CVRPs, downstream competition takes place for merchants. PISPs compete with Direct Debit, continuous payment authority and other solutions for those merchants, as the PSR itself acknowledges.
    b. The PSR has not made clear how the imposition of a fair and reasonable charge on the PISP could have an impact on downstream competition for merchants between those payment methodologies, nor how such thinking meets the policy, legal or economic test for price intervention.
3. **FPS Scheme Charges should be covered by PISPs fees not removed or re-directed.**
    a. It is not clear how FPS fees cannot be charged for VRP without the sending PSP incurring these elsewhere through Pay.UK scheme fees.
    b. We therefore would not agree with the FPS charge being removed from the sending side without it being re-allocated to the receiving side at a minimum. However, we do not see this as sustainable and would argue strongly that the PISP cover this alongside other costs as part of a fee paid to the sending firm, since this sets a far better precedent for future price transparency.
4. **Direct Debit Model Comparator - why using Bacs Direct Debits as the comparator for cost and price considerations is incorrect.**
    a. The investments made to create Bacs Direct Debit were undertaken to offset the high cost (for both merchants and banks) of managing cash and cheque payments. The economics reflect both this, and the limited changes made to the Direct Debit system since inception. There are no such cost reduction benefits to be generated for sending ASPSPs by implementing another automated payment method for bill payments with just [CONFIDENTIAL information removed] of bill payments made through a Nationwide branch in December 2023. Investment will continue to be needed to maintain a resilient and fit for purpose UK Bacs infrastructure which is relied on by millions of end users for over 4.7bn Direct Debit payments annually (2022). [1] Therefore, developing, and operating CVRPs will incur incremental not substituted costs to sending firms.
    b. We further challenge the principle that Phase 1 VRP pricing should be based on the Bacs Direct Debit model, which appears to underpin some of the PSR's thinking. Nationwide believes that the current Bacs Direct Debit model, which also has a zero-fee pricing model, is inherently unfair. This is because Nationwide, like other retail-only banking providers, are not able to cross-subsidise free Direct Debit payments for our retail customers with charges levied on business account recipients of these payments. Replicating this model perpetuates pricing distortions that ultimately prevent markets from operating efficiently and provides an in-built advantage to firms banking large utilities, government, or other recipient firms.

[1] UK Finance Payments Markets Report 2023.

5. **Consultation Process and PSR powers – Nationwide seeks to understand more about the legislative powers the PSR is exercising to implement their proposal, since this is important for there to be clarity on due process being followed.**
    a. We note that the PSR has not set out in the consultation the legislative powers under which it is seeking to implement these changes, specifically the mandating of participation by the CMA9 firms in the MLA and intervening in the market to set a central price. We ask that you clarify the powers under which you would seek to implement these changes, as it is not clear to us that such a direction would fall within the scope of the PSR's existing powers under FSBRA 2013 and the PSRs 2017. For example, if the PSR was intending to rely on s57 of FSBRA 2013, we would query whether the zero fee under an MLA is properly the subject matter of s57 powers. Further, only fees or charges payable "under the agreement" are in scope of the power in s.57(2)(a). The only "agreement" to which this could relates is the one in s.57(1)(a), which does not include the PISP. We also note that s57 requires an application by a party to the agreement to be made.
    b. We would posit that any proposed use of the PSRs powers should not subject some firms to obligations and costs but not others who are in fundamentally the same position. We would like to understand how the mandating of participation will be expanded to a wider pool of ASPSPs as to not do so would surely create an uneven playing field and be anti-competitive, which may be inconsistent with the PSRs objective relating to competition under s49 FSBRA 2013, and contrary to use of the PSR's powers in line with its duties under public law.
    c. As a minimum, we would request that Phase 1 use case pricing must be expressly without prejudice to a fuller examination of the economic costs before CVRPs are rolled out to additional use cases.
    d. Lastly in respect of process, we would note that Nationwide is not clear whether it can meet a Q3 2024 timescale following a specific direction that may not arrive until Q2 2024. A longer timetable would create the necessary window in which a more thorough commercial model could be created to enable clarity from the outset on broader use cases.
6. **Unbound Phase 1 creates customer and financial risk for sending firms and should not be mandated.**
    a. We observe a lack of a clear proposal as to the aim of this initial Phase; with no stated success criteria, timescales, or a view on how Phase 1 will be used to inform subsequent phases or create a sustainable commercial model. The exact scope of the service offering, and the precise consumer protection proposition is also unclear. We believe Phase 1 should be used to test technical, commercial, and operational models across the ecosystem to help inform and establish a viable new payments service for the UK market.
    b. The MLA is clearly intended to be a vehicle for higher risk and more complex use cases creating risks for mandated firms that Phase 1 MLA and pricing could morph to include other use cases e.g. subscriptions, e-commerce use-cases etc. which have inherently more risks and operational complexity. Given the consultation does not indicate the process for expanding beyond Phase 1, we would want to understand how the PSR plans to manage the use of the Phase 1 pricing protocols and how expansion will be controlled to avoid them setting a de facto benchmark which is then inappropriately adopted for use cases with different underlying cost, investment, and consumer protection requirements.
    c. The sentiment that ASPSPs will not participate in CVRPs solely because there is an income risk also needs to be challenged, given that for Direct Debits and cards, sending firms participate in schemes under which payees have sponsor banks or acquirers to assess their suitability to receive that payment type and all parties commit to certain protections, liabilities etc. Today, this does not exist for CVRPs.
    d. The proposal requires sending firms to promote on an open-ended basis a new payment method where it is not clear that there are material benefits for end users or equivalence of protections compared to existing payments, while creating a material ongoing investment requirement. This creates customer outcome and financial risks that sending firms would wish to manage. As a mutual we must ensure that we are focused on how we spend our members' money to support their needs and interests.
    e. Therefore, we call on the PSR to reconsider mandating the signing of the MLA and instead allow the market time to agree a voluntary MLA covering a wider set of use cases so that firms have

certainty on financial and customer risks. As detailed above, we would also like clarity on the legal powers the PSR will be using to mandate signing of the MLA and the process it will follow. At this point, it is unclear who would be responsible for drafting the MLA or the process that it would be required to follow. Further, we do not see that that PSR has the power under s57 FSBRA 2013 or the PSRs 2017 to intervene in the market and set a central price.

7. **Potential long-run implications if VRP expands into other use cases such as e-commerce and the need for an independent economic model.**
    a. Both the April 2023 JROC vision and the Garner Report on the Future of Payments (2023) made clear that Open Banking APIs needed to be backed by broad-based commercial models that were reflective of the costs of provision but also, crucially, provided incentive to invest in further innovation. Throughout 2023, Nationwide had understood this to mean that commercial use cases for VRP would allow for recovery of the wide-ranging costs involved and provide a small profit margin to incentivise investment. It is therefore very disappointing to see that the PSR propose a zero-fee model for VRP Phase 1 and mandate the CMA9 to participate, thereby perpetuating a construct that has created an uneven playing field across the UK industry. This comes despite much of the work to progress VRPs to date having been voluntarily resourced and funded by several UK Finance Members, including Nationwide.
    b. Given the potential for any Phase 1 cost model to persist for an indeterminate length of time, we would recommend that an independent multi-party economic analysis (similar to that conducted to determine default fees for the SEPA (Single Euro Payments Area) Payment Account Access scheme) is conducted to determine all the potential costs (including those for innovation), relevant payback periods and anticipated volumes to determine a default price per transaction for both the Phase 1 and e-commerce use cases. Such an analysis would demonstrate proper due process and rigour in establishing the costs prior to a material price intervention. This fee should be chargeable by the sending ASPSP, setting an important principle that VRPs are not free and allowing the pricing set by the remaining market participants to organise around this through market forces. It is our belief that the long-term health of the VRP payment mechanism would be better served if a small profit margin were included within such a default price to provide incentive to innovate, particularly given the PSR's ambition that VRP will compete with Big Tech driven services such as Mobile Payment Wallets, as well as the card schemes.
    c. The cost model for e-commerce (and POS) transactions must take account of the need to create a commercial basis for comparable consumer protections to existing payment methods. As a sending ASPSP, this would need to recover the increased costs of dispute handling, write-offs and investment into disputes tooling and be accompanied by a clear liability model covering more complex disputes. Furthermore, the JROC Blueprint outlines a plethora of further enhancements that will require ongoing strategic investment by all participants that must be recovered through the commercial model over a timeframe commensurate with normal expectations of return on investment.
    d. The development of CVRPs is an opportunity to 'get the basics right' from the start and to design in governance, technology, liability, and commercial models prior to the service going live. By ensuring the building blocks are in place, such a model could encourage use of CVRPs payments for the purchase of goods and services for payers, suppliers, and PSPs. Parties would be aware of the protections and the commercial and governance model from the offset and, by being economically sustainable, a model would not act as a barrier to entry or a threat to free in credit banking or firms' general service and branch strategies.

Responses to Questions

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.

Although, with some development, we believe the pricing principles have the capacity to develop a sustainable commercial model for VRPs, we would not agree these are being used to support the delivery of a sustainable commercial model for Phase 1. Particularly, we are unable to see how the PSR's current proposal can align to principles such as "*Prices should incentivise investment and innovation: Charges should support a sustainable, long-term return for sending firms, compensating for risks, and rewarding innovation.*"

As discussed in our response to Question 5 below, the sending firm will incur additional, ongoing development, operating, central (standards and infrastructure development) and opportunity costs. And it is possible to see in the JROC CVRP Blueprint contractual, communication and functional enhancements being proposed to support these payments. The consultation is silent about the recovery of these costs and about how billers/merchants' contracts will develop to account for these. Furthermore, the PSR in its approach and principles is asking sending firms to take the risk of development costs in order to recoup investment.

Comments on the Principles and their Application:

- '*Principle 1: Broadly reflect relevant long-run costs of providing premium APIs.*' The PSR's Principles for Commercial Frameworks for Premium APIs (psr.org.uk) encourages ASPSP consideration given to low prices in the short to medium term to build demand and adoption. Initially discounted - or in this case free - and volume-based pricing models are reliant on successful adoption to increase, or in this case introduce, charges and recoup costs. This creates a risk for sending firms as it relies on increasing adoption of VRPs to be able to make a return. When it is factored in that the PSR expects returns have to be balanced over the longer term then this risks sending firms not being able to recoup their costs or not being able to do so for a long time. As above, it also creates a misconception of the true cost of these services to billers.
- Paragraph 3.17[2] – notes that '*ASPSPs may choose not to recover any relevant fixed costs through pricing initially (that is, to set premium API prices low initially) and to recover them instead over the medium or longer term as take-up of premium APIs increases and ASPSPs are able to make use of economies of scale*'. If all costs are not included in the calculation for initial pricing, then the PSR is pushing this principle rather than it being a choice. Any commercial business would require more certainty than provided in the PSR's proposal on when any 'freemium' pricing would revert to cost recovery.
- Principle 4: recognises the fair treatment of TPPs but should also clearly recognise fair treatment of ASPSPs. There is a risk here of distortion of competition in asking some sending firms to offer these services for zero costs and the principles should recognise different ASPSP business models. Investment costs incurred by firms who cannot charge for the service reduces the amount those firms have available to use elsewhere to innovate and compete.
- Principle 5: Transparent fees. There needs to be consideration here of how any commercially sensitive information could be shared.

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-party co-ordination is necessary for Phase 1 to help deliver good customer outcomes and that an MLA - which firms can choose to enter - could be an appropriate delivery vehicle to enable participation of TPPs and sending PSPs of different sizes. It is possible to see in the Direct Debit and card schemes, the value that a clear, common understanding – created through governance, rules, processes – can create for end users. Cross-industry coordination is already being demonstrated through the UK Finance led work on standard model clauses for CVRP bilateral agreements.

However, we would wish that any MLA would not preclude competitive bilateral pilots and would provide a set of standards on which competition can take place.

[2] PSR's Principles for Commercial Frameworks for Premium APIs (psr.org.uk)

As discussed in our response to Question 12, we do not agree that sending firms should be mandated to sign an MLA, however.

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.

Taking the example of Direct Debits and cards, we agree a central body such as a payment systems operator is the best place to operate an MLA. We would ask that a proper competition assessment is conducted to ensure there are no conflicts of interest for the body that is chosen.

It is important that any organisation given this task is set up for success. Meaning it is given realistic target dates, has sufficient bandwidth and capability. Given Pay.UK's existing portfolio of work, clarity is needed on how they will be suitably resourced, and how they or alternatively the OBL - will ensure the appropriate input, expertise, and perspectives from across the industry.

Although as the PSR says Pay.UK does operate FPS, Bacs, and ICS most of its work here is interbank rather than touching on the consumer retail payments. And neither the OBL nor Pay.UK operates disputes processes of the complexity of some of those which could occur under CVRPs or in developing associated commercial models.

Further, Nationwide has two concerns about the participation of Pay.UK:

(i) When Pay.UK was formed, through the merger of Bacs, FPS and C&CC, a CMA merger control review was required, to assess whether the transaction gave rise to a substantial lessening of competition. The theories of harm considered in that decision will be even more pertinent in the present case, given that CVRPs will compete directly with Direct Debit, which is operated by Pay.UK.

(ii) More generally, it is important that any funding for Pay.UK is made through its existing transaction payment tariff model, so as not to compromise its independence in any way.

Whichever choice is made, a close working relationship would be necessary between Pay.UK and OBL to manage the standards.

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 agree that pricing will be key to the successful development of CVRPs. However, the PSR's argument here is based on a concern that ASPSPs would seek to recover card revenues. We would advocate the management of this risk by development of a mechanism to determine what would be the appropriate commercial model for CVRPs, in their own right, to cover the cost, risk and service provided and across different use cases. Even competition law enforcement on bottleneck monopolies (the relevance of which we dispute, above) does not result in zero pricing, but rather typically some form of fair and reasonable charge.

If the PSR is concerned with the level of fees being charged by the small number of ASPSPs currently participating in CVRPs they should raise this with them directly rather than applying an approach that jeopardises market development by applying a zero-fee charge here.

The sentiment that ASPSPs do not want to participate in CVRPs simply because they are losing card revenues needs to be challenged. For Direct Debits and cards, sending firms participate in schemes under which payees have sponsor banks or acquirers to assess their suitability to receive that payment type and all parties commit to certain protections, liabilities etc. Today, this does not exist for CVRPs. Nationwide considers good customer outcomes to be a priority and currently there is a need to demonstrate how CVRPs can offer the consistency of service and consumer protections that other payment types do. The proposal requires sending firms to provide on an open-ended basis a new payment method where it is not clear that there are material benefits for end users or equivalence of protections compared to existing payments, while creating a material ongoing investment requirement. This creates customer outcome and financial risks that organisations would wish to manage. As a mutual we must ensure that we are focused on how we spend our members' money to support their needs and interests.

There is no evidence in this consultation of how the PSR would seek to ensure confinement of Phase 1 transactions to lower risk (not no risk) transactions to protect end users or establish/promote a sustainable commercial/liability model for protections etc, for Phase 1 type or other transactions.

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

Below, we set out both the costs that we believe will be incurred to participate in a Phase 1 of indeterminate duration but also those that we expect to be incurred on an enduring basis as the system scales beyond the Phase 1 use cases. We would re-iterate our earlier point that bounding costs for Phase 1 is incorrect since the precedent and expectations set by the Phase 1 pricing and underlying commercial model will persist into other use cases.

The PSR does not define the length of time of Phase 1; the developments needed, how use cases would be confined to lower risk transactions and how the sending firms would see sustainable returns in the long run from the provision of services to third parties for enabling Phase 1 type transactions. This makes it difficult for the PSR to know the extent of costs to sending firms.

The investments made to create Bacs Direct Debit were undertaken to offset the high cost (for both merchants and banks) of managing cash and cheque payments. There are no such cost reduction benefits to be generated for sending ASPSPs by implementing another automated payment method for recurring bill payments. Investment will continue to be needed to maintain a resilient and fit for purpose UK Bacs infrastructure which is relied on by millions of end users for over 4.7bn Direct Debit payments annually (2022).[3] Therefore, as set out above, all investment and operating costs to create VRPs will incur incremental not substituted costs to sending firms. In addition, as also set out above, Nationwide as a retail only provider cannot cross-subsidise these costs against income received from charges levied on business account recipients of these payments. Therefore, the PSR's assertion that the lack of income generated by Direct Debits validates a 'zero fee' proposition fails to consider the other costs required to setup and maintain a new payment service, outside of the direct FPS transaction fees. These new services need to be built to endure based on the PSR's assertion that Phase 1 will endure.

From our initial assessment, we believe the costs to join and maintain the services in Phase 1 broadly fall into the following areas.

- **Initial investment costs** for Phase 1:
    1) **Further API and digital screen development and testing** This is required on top of the existing VRP sweeping service, to allow differentiation between sweeping and non-sweeping VRPs, alongside work on our Faster Payments system to differentiate VRPs in line with Pay.UK proposals. There may also be a need to make technical changes to control the scope of Phase 1.
    2) **Procurement, legal and business SME expenses** Development of the MLA and associated contracts will require significant time and resources from across expert legal, procurement and business representatives.
    3) **Staff training and customer communications** This is required to ensure customer enquires can be correctly identified as a VRP payment and disputes appropriately handled in line with the terms of any MLA. Customers will also need to understand payments options, have education to support this and ensure colleagues provide the correct guidance to customers when they ask which payment method they should choose. Customer facing documentation (both print and digital) will need updating wherever it includes Direct Debit mandate wording.
    4) **New back-office development for dispute management** Current dispute management tools and services for Direct Debit indemnity claims will need an equivalent service built for Phase 1 use-cases. Our early-stage estimate is based on a simplistic disputes system with significant manual processing which will need to be improved over time with further material investment.
- **Ongoing technical and operational investment costs** – although Day 1 of Phase 1 may begin with similar functionality, it is obvious from the JROC VRP Blueprint that additional functionality is envisaged involving ongoing investment costs. These would include functional 'gaps' relating to consumer understanding and control (e.g. notifications, dashboards and account switching), and functional 'gaps' (e.g. new statement references for VRPs, enabling consent amendments and ensuring merchants can be accurately identified by consumers, TRIs, and other fraud prevention measures). As the service scales, there will need to be further

[3] UK Finance Payments Markets Report 2023.

investment into IT infrastructure and application build costs to drive improvements in availability and resilience to compete with cards as a benchmark rather than electronic payments via digital customer channels. In addition, we would expect to need to make material ongoing investment in our anti-fraud systems and processes if VRPs expand into e-commerce to provide equivalent sophistication to card.

- The PSR should also consider that the investment cost for other ASPSPs not currently offering VRP sweeping, or considering entering the current account market who would need to build the capability in the first instance, the investment costs are likely to be considerable. The 'zero fee' charging model does not provide an opportunity to re-coup these costs and could be prohibitive, whilst feeling like a potential barrier to ASPSP competition which we suspect would not be intended.
- **Operating costs** – include IT systems and software maintenance and infrastructure capacity, customer queries and disputes handling (through contact centres, branch, and operational staff), financial crime losses and write offs, financial crime prevention etc
- **Central costs to OBL, Pay.UK and the PSR**. These costs could include a per click fee to the OBL under the future commercial model and higher Bacs costs over time. But otherwise, would cover infrastructure and standards development, operation, and maintenance; related developments on fraud prevention (e.g. TRIs) etc; development and ongoing operation of the MLA, disputes process etc. We do not think it would be sustainable for Pay.UK to not charge for relevant FPS transactions since these costs will simply be borne elsewhere. It would also be inconsistent with the three-year commitment they gave in 2022 to cost recovery via a transaction payment tariff.

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 proposed zero fee model should not be taken forward as it does not reflect the full setup, ongoing investment, and operating costs of sending firms and does not create a sustainable commercial model incentivising innovation and ensuring consumer protections.

We believe that sending firms should be able to charge for the provision of services to enable CVRP reflecting the service, cost, and risk they provide and encouraging innovation and investment through the reward of sustainable returns.

We believe that a zero-fee model also sets the wrong precedent for PISPs, and risks costs being picked up by other market participants who are not participating in VRP. Allowing for PISPs to pay a fee to sending ASPSPs to cover the cost of FPS fees and any other ancillary costs (as detailed in our response to question 5) would appear to be both straightforward and transparent.

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?

FPS scheme costs can never be the only cost for a solution that requires both Open Banking and Faster Payment messaging to operate.

Sending charges should neither be switched to the receiving side nor recovered through wider Pay.UK charging. We believe that it is far cleaner, transparent, and logical that there is a fee charged by sending firms to PISPs to recover the cost of FPS charges and ancillary sending firm related costs. This fee would then be recovered through the onward value chain under competitive forces if this is a genuinely competitive and commercial payment type.

It should also be noted that, if Bacs transactions do migrate to CVRPs on which ASPSPs are charged no fees then unit costs of the Bacs infrastructure could increase – for all participants – using CVRPs or not. Similarly, it could undermine the commercial model for any central FPS model in the future.

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

Without clarity on the OBL's remit and role, it is difficult to say what the relevant OB related costs would be. However, any work that is outside of the Order will need to be funded by the ecosystem and is not incumbent on the CMA9 to solely fund. We would note at this stage that, in the absence of a wider legislative or funding framework for OBL/Future Entity, any requests for OBL funding in relation to CVRPs should be made bilaterally to Nationwide and not via the CMA9 to avoid competition concerns arising.

However, each VRP transaction requires Open Banking data calls as well as executing the Faster Payments message. Today they are borne by the CMA9 but under the future funding model may be based on a per call fee. The cost of these calls will be directly relevant to CVRPs cost calculations.

In addition to OBL costs, under the PSR's proposition there would be costs to be incurred by the party developing and operating any MLA and - we have commented more on centralised costs in our response to Question 5.

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

We suggest the PSR consider the approach taken by the European Payments Council in setting out its approach on fees for the SEPA (Single Euro Payments Area) Payment Account Access scheme. The Scheme requires fees for access to the API to be paid. Default Fees are paid by 'asset brokers' to 'asset holders' for premium services that sit over and above the 'free' data sharing and payment initiation services prescribed for payment accounts under PSD2. The process the EPC followed for creation of the scheme fees was intended to allow the EPC to reach a fair, objective and transparent cost, in line with applicable principles of competition law. The Scheme also builds in some flexibility, with asset brokers and asset holders able to reach agreement on a lower fee to the Default Fee, if they choose to do so (respecting the competition law considerations in allowing for such bilateral discussions).

To determine the precise charging model requires a full cost benefit analysis that is reviewed periodically as material costs shift in the ecosystem. It should ensure the ecosystem remains commercially viable and able to offer the required levels of service and protection to customers with appropriate incentives to all parties.

We would challenge the principle that Phase 1 VRP pricing should be based on the Bacs Direct Debit model, which appears to underpin some of the PSR's thinking. Nationwide, like other retail-only banking providers, are not able to cross-subsidise free Direct Debit payments for our retail customers with charges levied on business account recipients of these payments. Replicating this model perpetuates pricing distortions that ultimately prevent markets from operating efficiently and provides an in-built advantage to firms banking large utilities, government, or other recipient firms. Further cross-subsidisation would, also as noted in the Future of Payments Report, replicate the issues of the 'free if in credit' banking model. Therefore, compensation should be provided to the "account holding / issuing" side.

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.

Consumers need to see a reason to use VRPs. Billers' adoption will not only be influenced by cost or the number of people who can pay that way but also the number of people who choose to pay that way, innovation and the associated investment required, operational efficiency, the likelihood of being paid – including in conversion rates.

Providing a sustainable commercial model from the outset will give billers the confidence and certainty they require in the costs associated, to consider participating. If it is progressed on a 'zero fee' basis for an undisclosed and unknown period, billers will be reticent to sign-up when the true longer-term costs are unknown.

We would also observe that while there are others in the ecosystem who are better placed to comment on the appeal of use cases to merchants, it is our belief that the focus on Phase 1 use cases for rollout will negatively impact the eventual success of VRP since Phase 1 will delay investment in e-commerce use cases for which there is far greater interest. Phase 1 has moved from a lightweight pilot to a bigger first stage rollout that is targeting payment types for which there may well be little interest from billers in taking up. Rushing to push out the Phase 1 use cases without clear technical, commercial, and operational objectives to test and a commercial model to progress into e-commerce will inhibit the long-run development of commercial VRPs (CVRPs).

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.

This is to an extent for billers to comment on, but biller adoption will not only be influenced by cost or number of people who could pay that way but also the number of people who choose to pay that way, investment required, operational efficiency, the likelihood of being paid. Clearly, there are network effects at play but there are also competitive forces at work. If 2-3 of the main UK sending ASPSPs were to participate and consumers are shown to find value in the new way to pay, then there will be competitive pressure for others to respond. It is not clear that the market has been given sufficient time to see this occur organically.

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

We do not believe that the PSR should mandate or sending firms to participate in Phase 1 of VRPs. The lack of consideration of investment, operating, central and opportunity costs by the PSR in its proposal; the undefined controls around Phase 1 scope, and to be finalised CVRP service means it is not possible for the PSR to really know what the cost will be to sending firms of supporting this service and opens up financial and customer risks for sending banks and their customers. As we have previously noted, we have concerns about mandating firms to sign up to an MLA. Instead, the market should be allowed time to create an MLA on a voluntary basis.

It is critical that an effective commercial, liability and governance model is developed under which all parties know their roles and responsibilities from launch. To support this a proper economic analysis of all costs should be developed within a multi-stakeholder approach to develop a remuneration model for premium APIs/assets.

Whilst noting that the CMA9 were singled out because they have already implemented VRP for sweeping, we would also suggest that the PSR refrains from using the term CMA9 in future given this was a group constructed purely for the purposes of delivering the CMA Order. As such we do not believe it should be perpetuated for activities and industry developments outside of that Order where it is no longer a relevant construct.

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?

By creating an environment in which it is possible to develop the potential of open banking.

1) The development of such a payment service presents an opportunity to ‘get the basics right’ from the start and to deliver a consumer protection framework and supporting governance, technology, liability, and economic model prior to Phase 1 going live, incentivised by a fully reasoned cost-recovery model.

2) By ensuring the building blocks are in place, such a model could encourage the growth of open banking between payers, payees, and PSPs. Parties would be aware of the protections, commercial and governance model from the offset and by being economically sustainable a model would not act as a barrier to entry or a threat to free in-credit banking or firms’ general service and branch strategies.

The PSR should draw confidence from the level of engagement and commitment by industry to develop VRP capability from the work being undertaken via UK Finance, in the creation of standard clauses for bilateral agreements. As per our response to Question 9, this could be extended to a SPAA-like economic model.

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?

We can see several risks stemming from the PSR's mandating participation in Phase 1 including:

- Distortion of competition:
  - In attempting to promote competition, there is a risk that the PSR is being anti-competitive, imposing costs on some firms, but not others.
- Risks surrounding the unspecified factors in Phase 1:
  - Time and scope: The consultation is silent on Phase 1 time frame and how its use cases and the PSR's proposed zero fee cost model would be controlled, or indeed extended, in time and scope.
  - Precise Service: The lack of clarity of the launch service and the ongoing developments to support (e.g. functional, governance, communication, and consumer protections) will lead to costs which are not considered in the PSR's proposal.
  - In mandating the participation in an MLA, the PSR would be effectively forcing some sending firms to participate in an as yet to be determined MLA, for a service which does not have a full description, with payees over whom they have limited control, in a Phase 1 which has no ending and where control of the breadth of use cases is not defined - for a zero fee. This creates customer and financial risks to sending firms and a risk to the overall cost base of UK payments and the future commercial model of open banking payments.
- That the industry commits a lot of time developing an MLA for only three use cases.
- A mitigation here would be a clearly defined Phase 1, with a commercial model and that there is no onward expansion into more complex or high-risk use cases – including those where cards are normally used – under the MLA. Phase 1 should have success criteria, timescales/milestones, and commercial model to test technical, commercial, and operational models across the ecosystem to help inform and establish a viable new payments service for the UK market.

The MLA is clearly intended to be a vehicle for higher risk and more complex use cases creating risks for mandated firms that Phase 1 MLA and pricing could morph to include other use cases e.g. subscriptions, e-commerce use-cases etc. which have inherently more risks and operational complexity. Given the consultation does not indicate the process for expanding beyond Phase 1, we would want to understand how the PSR plans to manage the use of the Phase 1 pricing protocols and how expansion will be controlled to avoid them being utilised for use cases with different underlying costs, investment, and consumer protection requirements. Other risks which we can see here are:

- That the development of the MLA, functional aspects etc. is not delivered efficiently for Q3 2024 – negating the PSR's rationale that time is not available to develop a commercial model here.
- That TPPs and merchants will not want to move / do not have the correct contract to move from a free model to a sustainable model.
- Unintended consequences on entrants into UK banking.
- Unintended consequences to free in credit banking model.
- Risk of low adoption despite mandated provision and non-commercial pricing.
- Divergence from the recommendation in The Future of Payments report and HMT's National Payments Vision and Strategy.

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

CVRPs need their own commercial model.

There is often an assumption that firms' open banking costs would be covered by commercial customer revenues. Not all firms have commercial customers and cannot cross-subsidise costs incurred on the consumer side. Therefore, compensation should be provided to the "account holding / issuing" side. The PSR should drive the development of a commercial model to enable sending firms to recoup their costs, cover the costs of protections and drive innovation and investment. A mechanism for the creation of this is needed now.

We've noted the approach taken by the EPC in SPAA, in our response to Question 9, above.

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?

We have already noted our concern about the powers the PSR proposes to use to introduce the commercial model. The proposed zero fee approach creates a significant risk to the commercial model of a mature service. At best, setting a zero-fee cost which must then be revised upwards will create false expectations for merchants and may undermine the learnings about merchant uptake from the pilot. At worst, the zero-fee model persists into a mature service which starves it of the resources required to drive innovation and protect consumers.

The PSRs proposals do not align to the recommendations in the Future of Payments Review to:

- Make the commercial model sustainable; and to
- Target reduced regulation to enable firms to progress innovation.

The Future of Payments Review discusses the risks of perpetuating free provision of Open Banking services while needing to safeguard Fintech stability and investment. Risks including:

- "That new payments approaches can only thrive when they have both a sustainable commercial model and adequate consumer protection.
- Without a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure or consumer experience investment.
- Open Banking's current economics create no incentive for their providers to drive, invest and support it, and no margin to invest in consumer protection.
- While some argue that the costs should be funded from profits made elsewhere, this creates cross subsidy and replicates the problems created by the 'free if in credit' banking model. "

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.

As outlined earlier in the response, limiting the cost benefit analysis to the Phase 1 use cases risks setting a precedent and expectations about the cost of VRP services that cover too narrow a range of costs (see answer to Question 5) for both Phase 1 and very much for any later phase involving higher risk use cases.

Turning to the use cases themselves. From the perspective of which use cases are most likely to be a sustainable commercial success, we would venture that PISPs, and billers/merchants are better placed to respond on the attractiveness of the proposition. However, given the lack of traction on similar initiatives targeting utilities e.g. Request to Pay, alongside our own conversations with market participants, we remain concerned that a significant amount of time will be spent on Phase 1 use cases where there is little real interest in these use cases and far more in e-commerce. We believe that time spent now getting the right commercial model and consumer protections in place to go after the stretch use case could be a better use of time.

From the perspective of risk, we agree that a rollout of CVRPs should start with lower risk transactions such as those to utilities (water, gas, and electricity industries); government payments to HM Revenue and Customs and payments made through Gov.UK Pay; and regulated financial services).

We purposefully say lower risk here as they aren't 'no risk' cases. All payment types carry a risk of the transaction being made by somebody else or being made by the customer who has been scammed into thinking it's going somewhere else, intended for something else or for a different value. Disputes are still likely to occur.

Properly developed, we can see potential advantages in the use of CVRPs from a financial crime perspective but risks we can see here include:

- VRPs have a set up that is authorised / authenticated but subsequent payments happen without any customer involvement. This is inherently more risky than traditional Faster Payments where each payment is individually initiated and authorised by the customer, making the management and communication of consent limits very important.
- It is not always possible to identify the beneficiary of the recipient account in Open Banking. However, for VRPs

in particular, if the payment is to pay the entire balance on a credit card, or mobile phone bill, the paying PSP will not know what the future payments are going to be. Therefore, if a criminal takes over the beneficiary end of the VRP they may be able to make payments which will constantly be topped up by the VRP mechanism. Similarly, if a customer sets up a VRP and is comfortable with a low initial payment they will not necessarily know if there is an account take over and this figure later varies.

In terms of the specific use cases: the Call for Evidence should not imply payment security simply by referring to Regulated Financial Services firms – as these are senders and receivers of fraud and scams. We would recommend a definition of regulated financial services within this scope should be reached.

It is important for the PSR to specify how the Phase 1 scope and pricing model will be controlled to avoid a wider roll-out to other more complex and high-risk use cases for which no cost/benefit analysis would have been done, protections developed or commercial/liability model. We would reiterate the importance of a clearly defined Phase 1 or benefit of progressing this work now so that the service begins with necessary features designed in.

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

UK Finance is currently taking forward work, with the industry, to form a set of standard clauses for bilateral agreements for CVRPs in order that market participants can establish initial services. It cannot therefore be assumed that the PSR's regulatory action is necessary to achieve the costs and benefits set out in this document.

The PSR says that the central costs for migration to the NPA is not relevant for a VRPs cost benefit analysis. However, the development of a central infrastructure would be direct costs to sending firms to develop CVRPs, their functionality and operation of these. For example, if additional volumes, new messaging requirements for retail payments (e.g. for fraud prevention or enabling other controls), the development of the MLA (which the PSR note in 4.6. that they consider that ownership of a payments MLA would require significant additional capability and capacity), these are direct costs and should be identified and considered as so by Pay.UK and the PSR, respectively. And much of the work on the NPA was incurred considering instant payments for A2ART.

Pay.UK is currently working on a Future Bacs Strategy so it is not possible to say there would not be an improvement in the Bacs offering in the next 10 years.

Additionally, we are aware there is significant interest in allowing recurring payments and e-commerce payments to be made via VRPs. We would also challenge that is not possible for the PSR to assume that card payments would not improve or take a different form in the next 10 years.

We would note that a 10-year time horizon to assess costs and benefits is a long time and that many commercial organisations would operate on 5 years or less to reduce risk.

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?

We welcome that the FCA and PSR, are conducting consumer research here. It will be useful to understand what consumers perceive the benefits to be and how they will understand and engage with CVRPs for example in terms of flexibility on payments.

We would recommend that biller research is also conducted to understand finance features, the degree of flexibility of payments they will allow and if this is likely to provide enough flexibility to avoid the taking of credit by payers. This will enable the PSR to quantify this benefit and to ensure this benefit will be realised.

We do believe there are customer benefits though in terms of non-expiry and not disclosing account details.

We do not perceive there to be benefits to sending firms in the proposal being put forward to provide access to data and initiation of payments for a zero fee or the mandating the UK's largest banks and building societies to sign an unspecified MLA, for an undefined service, for a set of use cases which do not have defined controls. As we have already described – there are no cost savings for sending firms in investing and operating an additional form of recurring payments functionality.

Or any particular benefits to the PSO of not charging FPS fees which would need to be recovered elsewhere.

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 would encourage the PSR to change the focus of their argument in this Call for Evidence away from card revenues to the development of a sustainable commercial model for CVRPs themselves – so that these are attractive in their own right. Considering the development of CVRPs is an opportunity to 'get the basics right' from the start and to design in governance, technology, liability, protections, and commercial model prior to the service going live and giving transparency to all stakeholders.

Key costs

- Consumers: do not pay for transactions today – making it all the more important that alternatives work well for them. It is also unproven that they would benefit from a reduction in wider merchant prices from the introduction of CVRPs.
- Sending firms: would incur investment, operating and central costs as described in our response to Question 5.
- Merchant costs would include – adaption of internal payments systems and processes, staff training, customer communications and update of payments channels.
- PSO costs include:
    - Development and ongoing operation of the MLA (which as the PSR notes in paragraph 4.6 of the consultation that the 'ownership of a payments MLA would require significant additional capability and capacity'),
    - Loss of associated FPS revenues.
    - Infrastructure development, operation, and innovation (including for connectivity, developments necessary for JROC CVRP Blueprint etc)
    - Standards development, operation, and maintenance.
    - Any fraud prevention (e.g. TRIs) development, operation and updating etc.
    - Any arbitration process relating to the disputes process etc.

To measure sending firm costs, we suggest the PSR consider the approach taken by the European Payments Council in setting out its approach on fees for the SEPA Payment Account Access scheme, as noted above.

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

We welcome the greater consumer input which the FCA and PSR are seeking.

There is a need to understand the multitude of drivers for customers who prefer to use cash today – and would all have access to cards, FPS etc - to swap directly to open banking. As a digital (ideally mobile based service), it is not clear that Open Banking VRPs would overcome current barriers to digital adoption for some consumers.

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.

Yes.

- This proposal introduces the risk that this pricing model becomes a de facto benchmark in the long-term for other use cases. It sets a false expectation of the true cost of these services and an unwarranted precedent.
- It could undermine the trust of biller if a service goes to market which later turns out to not fully costed or fully specified e.g. without a sustainable commercial model or protections that need to be continually updated.
- If there is scope creep from lower risk transactions to other high-risk transactions for which the infrastructure is not ready and which have unclear protections, disputes and liability models and no commercial model this risks undermining end user trust.
- It does not provide incentives for sending PSPs to innovate.
- It does not address the recommendations of the Future of Payments Review – for sustainable payments

models enabling recovery of costs and a small margin or to recognise the opportunity costs for sending firms and their customers - of tying up investment, tech, and human resources in CVRPs – rather than innovations that could serve end consumers better.

- It could have unintended consequences for those thinking about entering the UK current account market – which would in itself impact choice to end users.

As per our response to Question 17, there is a risk that the investment in the lower risk, but also lower value use cases set out for Phase 1 could critically delay progression into the use cases for e-commerce where most participants appear to see far greater commercial value.

NatWest Bank

Expanding Variable Recurring Payments: Call for Views

Executive Summary

NatWest welcomes the PSR's call for views on expanding Variable Recurring Payments (VRP). We agree with the PSR that the swift extension of VRP to new use cases will increase choice and competition in payments – helping the adoption of Account-to-Account payments.

Our principal concern with the current proposal is that it will severely limit the growth of this proposition. While we support industry exploration of VRP delivery for low risk use cases, our view is that the long-term scalability of VRPs will come about through the development of a sustainable commercial model that incentivises participation in a competitive alternative to card payments. This is unlikely to take place through a piecemeal migration of existing Direct Debits to VRPs, as is likely from the Phase 1 use cases identified.

We are also concerned that the proposed actions will inhibit, rather than support, the short and long-term scalability of VRPs. Actions to mandate provision and control cost this early in the development of the market are significant interventions and are likely to cause commercial paralysis in the market. There is not a clear endpoint for the proposed Phase 1, its requirements are likely to have longstanding repercussions for the market and reduce market incentive for commercial exploration. We discuss these risks throughout our consultation response.

A sustainable commercial model is needed to ensure VRP has a compelling customer experience and value proposition to overcome customers' use of other trusted and established payment methods:

- **Customer** – compelling user experience with clear consumer protection, trust and a nationally recognised payments mark.
- **Merchant** – frictionless user experience which is available and widely supported by payment institutions, an automated dispute process and an overall superior value proposition.
- **PISP** – frictionless and feature rich user experience which supports a wide variety of use cases within a commercial model that is competitive with alternative payment methods.
- **Bank** – compelling user experience with clear consumer protection and a nationally recognised payments mark, but also an automated dispute process and economic model that incentivises innovation and is sustainable.
- **Scheme** – ensures a consistent and performant experience, aligns commercial incentives, provide consumer protection, and ultimately build trust in the new payment method.
- **Eco-system enablers/gatekeepers** – careful consideration should be given to the role and appropriate control of Big Tech (e.g. Apple, Google, Meta), PSPs (e.g. Stripe, Adyen) and commerce platforms (e.g. Shopify) in the competitive provision. Whilst offering great user experiences and hugely engaged audiences, they exhibit significant commercial bias to cards and a serious concentration / market consolidation risk.

In contrast, the customer journey for VRP is not as frictionless and does not protect customers or support merchant conversion in the same way as other payment methods. Without improvements, we believe that VRP payments will fail to gain traction. Customer ease will only be delivered by collaborative investment and innovation of all parties to a VRP – banks, PISPs and merchants alike.

NatWest has long been a supporter of VRP. As a bank we have signed partnerships with seven PISPs to provide commercial VRP payments, we have invested in an improved customer journey, and Payit, our PISP

[redacted]

service, is live with a customer pilot. The UK Finance project to standardise model clauses for VRP, funded by six banks and six PISPs, demonstrates there is market appetite to launch VRP.

The current proposals threaten this commercial exploration and are unlikely to drive investment to improve journeys and create innovative propositions. Given the potential impact of the proposal, we are concerned about both procedural fairness and the vires of the PSR to take the actions it is proposing. These concerns are summarised below:

- **Cost-based approach to commercial models:** The argument that sending ASPSPs constitute a bottleneck monopoly for VRPs is a misrepresentation of the market; the approach to market structure is too narrow in focus.
- **Development of Pricing Principles:** there was no indication when they were published last summer that the pricing principles would form a basis for the imposition of price controls. It is unclear whether the PSR has the legal power to control pricing in the manner envisaged.
- **Threat to commercial development:** NatWest believes that the most effective way to ensure the short and long-term scalability of VRPs is through the development of a sustainable commercial model. The lack of detail on a future 'Phase 2' for VRPs and the longstanding implications of the proposed interventions make it commercially difficult for ASPSPs to explore VRP propositions. Nor does it incentivise TPPs to sign commercial contracts while pricing intervention is being considered.

The incentives already exist to create innovative VRP propositions (e.g. eCommerce) and a compelling user experience. What's missing is improved industry co-ordination around implementation. NatWest has heard from PISPs and ASPSPs that the proposed approach has already impacted commercial discussions that were taking place and in effect precludes any bilateral path for VRP.

We agree with the PSR that driving the short and long-term scalability of VRPs is an important issue for the industry to consider within the wider context of driving choice and competition. We see an important role for the PSR in fostering this market development. We believe there may be grounds for a broad mandate that banks deliver VRP, but only alongside market-driven economic models that enable investment and innovation in the user experience. This is in line with the Future of Payments Report call for a sustainable commercial model for Account-to-Account payments.

A requirement for transparency around ASPSP charges can help ensure that prices converge without the need for any coordination between ASPSPs. It would provide industry participants with insights into the pricing practices of other firms in the market. This transparency together with natural competition may lead to a gradual alignment on pricing in the market over time. Once the market has settled on specific price points, this would be a suitable juncture for the regulator to review whether the pricing offered in the market was reasonable and competitive.

The application to ASPSPs of access principles similar to the proportionate, objective and non-discriminatory conditions that apply for access to payment systems may also help the market develop. These approaches are far less interventionist, and more appropriate, given the powers of the PSR in this regard. .

In short, we believe the market should be left to develop pricing without any intervention from the regulator. The market needs to be able to explore commercial opportunities to develop VRP services outside of a regulatory mandate. We welcome the PSR's consideration on how it can support the market through the provision of greater regulatory certainty.

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 agree with JROC that Premium APIs "should be underpinned by a sustainable, safe, commercial model that results in prices that are fair value, transparent and promote competition."[1] Adoption of VRP requires a sustainable commercial model for all participants that drives continued innovation and improvements in the proposition to persuade customers and merchants to switch from other payment methods.

The PSR helpfully published high level pricing principles in June 2023. However, we are surprised at the proposal to impose price caps on ASPSPs.

We have several concerns with the way the principles have been developed, and their proposed application. We set out our concerns in detail in the first annex. In summary:

- By focusing only on the prices charged by ASPSPs, no heed has been taken of the lessons from card values chains: when sending firm prices were capped, this did not lead to better outcomes for large numbers of merchants, as other participants in the value chain increased their own margins.
- This narrow approach has driven the finding that sending firms are bottleneck monopolies. No market definition exercise has been undertaken, which would demonstrate that merchants and consumers have a range of alternative payment options available and are able to switch accounts if they want to use different payment options. It is inappropriate to adopt a cost-plus model for a nascent product that has established alternatives available.
- A comparison with genuine bottleneck monopolies such as telecoms reveals that a cost-orientated approach to pricing would disincentivise any investment by sending firms beyond the regulatory minimum requirement, given the potential for significant stranded sunk costs, and no potential for any revenue upside: as such the first pricing principle undermines the second and third principles.
- It is inappropriate to treat TPPs as having rights equivalent to those for consumers under the Consumer Duty. They are also not bottleneck monopoly access seekers.

We would like the PSR to clarify the powers that it intends to exercise to impose price controls. We present a brief legal analysis of this in the second annex.

The fifth pricing principle notes that transparency of fees is a tool that can be used to help ensure that the VRP market develops successfully. At this stage in market development, we believe that transparency is a considerably more proportionate intervention than price controls. NatWest supports a requirement for firms to publish the fees they charge for the provision of VRP services. The PSR should consider waiting to see how the market develops before proposing more onerous interventions.

We share the PSR's aspiration that VRP payments will be competitively priced in comparison to card payments and Direct Debits. However, to support long-term scalability, our primary challenge will be to match existing payment types from a user experience perspective. This will require considerable innovation by all participants in the value chain. To justify this investment, we believe all participants need to expect to generate a return on investment. It would be very unusual, and counter-productive, to adopt a cost-plus pricing methodology in a nascent market with significant potential but also significant risk. We discuss this further in our responses to questions 6 and 9.

[1] https://www.fca.org.uk/publication/corporate/jroc-principles-commercial-frameworks-premium-apis.pdf

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.

NatWest agrees that cross industry agreement and coordination through an MLA will support wider adoption of a VRP product. An MLA should deliver standardisation and consistency between ASPSPs and TPPs. Natwest considers that industry is best placed to deliver an MLA that leads to the widespread adoption of VRP.

The development of a Phase 1 MLA should not prejudice the development of a Phase 2 MLA/commercial model or the parallel development by the market of alternative commercial models that deliver against a range of uses cases. The scope, specificity and lifespan of the proposed Phase 1 MLA cause concern:

- The proposal does not appear to have considered the value proposition that will drive the short and long-term scalability of VRPs. As we discuss in our response to question 10, the choice of use cases for Phase 1 appear to target Direct Debit payment journeys which is unlikely to drive significant VRP growth. A restriction of the market to these use cases reduces market flexibility and growth opportunities. Clarity is needed on how the market may be expected to deliver other payment services within a Phase 1 environment and we discuss the commercial implications of this in our response to question 9.
- There are significant differences in the value proposition between the delivery of Direct Debits and other payment journeys, such as card and online wallet journeys. Introduction of other payment types might drive better short and long-term scalability of VRPs; but this may need functional changes such as supporting guaranteed funds or enhanced reconciliation services for merchants.
- The pricing concerns appear to be focused on the competitive differences with card payments, which is not comparative to the use cases considered for Phase 1. This creates a risk that a Phase 1 MLA will not have a granular commercial framework and product requirements to support the migration of either model onto a VRP proposition.
- It is not clear whether firms will be permitted to offer commercial VRP services for use cases outside of those considered for Phase 1. Our responses to questions 9 and 10 articulate how we consider greater short and long-term scalability to be found in alternative use cases. We believe that the PSR's expectations may inhibit VRP adoption rather than encourage it.
- There is limited clarity on what is expected of any Phase 2 for VRP adoption and any changes that would be made to regulatory requirements, particularly price requirements. This creates commercial uncertainty for firms wanting to explore use cases beyond those identified in Phase 1 and limits the short and long-term scalability of VRPs. It also creates the expectation that the PSR would continue to set pricing requirements in Phase 2 and raises commercial risk for firms seeking to invest in VRP services, damaging the short and long-term scalability of VRPs. Making it more likely that the PSR will be continually obliged to direct and intervene in the market to increase adoption.
- The proposed pricing approach, particularly to making changes to FPS cost allocation, will likely have longstanding implications beyond any intended closure of Phase 1 delivery. It does not seem appropriate to make these changes to FPS pricing for the purposes of an interim MLA that is intended to kick start the market for VRP payments. Alternatively, if it is the intention to establish a longstanding change to FPS fees, the current consultation does not give sufficient analysis of any long-term impact of such a change to the market.
- Please also note our response to questions 3, 9, 10 and 22 which outline concerns relating to the proposal hampering the short and long-term scalability of VRPs, and Pay.UK's role as the proposed developer of any MLA.

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 recognise that Pay.UK may be considered as a long term 'home' for the legal agreements and standards for VRPs. In the immediate term, the developer of an MLA (or developers of MLAs) is less clear. While Pay.UK currently oversees rule books and pricing for other payment types, NatWest believes that the wider responsibilities of Pay.UK in the industry (e.g. New Payments Architecture) should be considered and their bandwidth to deliver more change.

Conversely, other firms are taking forward active development of MLAs and are responsible for some of the standards that VRPs are dependent upon. UK Finance is already leading work on VRP model clauses funded by 6 banks and 6 TPPs; encompassing most of the market share that the PSR proposes to mandate VRP services from. Open Banking Limited, while it is going through a transition to a future entity, is also directly responsible for the standards that would be required for the development of VRP solutions – a role that Pay.UK does not currently fulfil for the market. It is not clear why further collaboration between Pay.UK, UK Finance and Open Banking Limited in the short term to collectively drive adoption of necessary MLAs and standards, has been discounted.

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?

It is important that the structure of the market is considered, however we have concerns with the current view of the market structure and analysis of risks and incentives.

The proposed approach to market structure is too narrow in focus

We do not view VRP as a standalone product market. VRP is a potential alternative payment option for a range of pre-existing payment methods:

- Direct Debits, particularly for small merchants who face high charges from intermediaries;
- Card-based transactions, particularly card on file and continuous payment authority transactions.

As explained in the first annex, this is one of the reasons why we do not consider that sending firms are bottleneck monopolies.

We encourage the application of a much wider lens when analysing market structure. It should identify specifically which payment value chains could be most successfully targeted by VRP payments, and encourage market participants to target these, instead of mandating which areas the market should focus on first. We set out our views on the market opportunity in response to question 9.

NatWest's experience of the market is that there is real scope for ASPSPs and TPPs to work together to offer compelling alternative propositions to merchants, while making returns on investment.

The threat of regulatory intervention – particularly but not only on price – is distorting and misaligning incentives

Our experience to date is that - if market forces are left to prevail - the incentives of ASPSPs and TPPs have been sufficiently aligned, in that both can gain from championing VRP. If this were not the case, seven PISPs would not have signed commercial contracts with us to provide VRPs. However, the experience of our own

PISP, Payit, is that other ASPSPs are reluctant to commit to commercial VRP contracts that may be undermined by subsequent regulatory mandates.

Market participants are best placed to identify which categories of VRP are most likely to drive biller adoption. The focus on low-risk billers for Phase 1 is understandable but may not be the correct approach. As discussed in our response to question 9, there are several more compelling initial use cases for VRP that can be stress-tested through a process of market discovery. A mandate at this stage to develop VRP for less commercially attractive use cases would divert resources from where ASPSPs and TPPs see the most attractive opportunities, and lead to a distortion of competition.

A requirement for ASPSPs to develop commercial VRPs at cost-orientated capped prices will likely create a misalignment of incentives. TPPs looking for ways to create seamless customer journeys will have to rely in large part on the customer's engagement with the sending ASPSP. Sending ASPSPs mandated to deliver VRP with no capability to recover costs will focus on doing the minimum necessary to comply with any mandate and not on enhancing that customer journey. Merchants will have no interest in investing in an alternative payments solution that is unable to offer the same seamless experience as existing solutions, no matter how low the price.

There is a possibility that issues may arise around coordination between market participants, but these issues may be resolvable through industry collaboration, instead of regulatory mandate. UK Finance is playing an effective coordination role in the market to date, although the continuation of this will be contingent on the PSR's next steps.

To conclude, the most effective way to ensure that incentives remain aligned is to allow the market to develop on its own accord. A combination of light touch interventions (for example in relation to pricing transparency) and clear statements of intent regarding what it will and will not do (to ensure regulatory certainty) would be the most effective way for the PSR to promote competition and innovation in VRP.

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

NatWest supports the development of VRP services which provide frictionless, feature rich, user experiences with a commercial model that is cheaper than card payments. Notwithstanding the application of the principle that 'prices should incentivise investment and innovation', the proposal on cost plus pricing, as well as being inappropriate for an emerging market, is dismissive of significant categories of costs. Negating the ability for sending firms to recover the following costs will result in cross-subsidisation and mis-aligned incentives:

Cost	Description	Nature of cost	Impact[2]
Compelling VRP experience	Deliver a user experience to compete effectively with alternative payment products.	Fixed cost for build, but product change will need to support ongoing innovation.	[redacted]

[2] Note that all costs outlined below are indicative only and express the potential magnitude of costs to a sending ASPSP in the development, build and maintenance of a VRP service. They are not intended to indicate current or expected costs to NatWest specifically but illustrate potential costs to any firm providing VRP services to market.

Cost	Description	Nature of cost	Impact[2]
Payment mark and customer education	Agree a common name and deliver a payment mark for VRP.	Fixed industry cost for common name and payment mark.	<£500k total for industry.
	Running education campaigns for customers about VRP, including how to manage queries and disputes.	Variable cost for customer education campaign.	[redacted]
	Running a future mass media campaign at industry level to raise awareness.	Fixed industry cost per mass media campaign.	c. £10-15m per industry campaign[3].
Frontline staff education and training	Running education campaigns for frontline staff (e.g. branch network, telephony, fraud teams) and training on handling customer queries/disputes.	Fixed cost for education material. Variable cost for frontline staff training.	[redacted] [redacted]
Online help and query tools for customers	Delivery of online help (AI/chatbot) and query tools for customers.	Fixed cost for build.	[redacted]
Multi-Lateral Agreement (MLA) for VRP	Industry delivery of MLA for VRP.	Fixed cost for initial delivery, but MLA will need to support ongoing innovation.	c. £0.5-1m total industry cost for MLA (based on UK Finance Model Clauses work.
Update to VRP standards to deliver compelling experience and MLA	Delivery of updated VRP standards including technical specification, Customer Experience Guidelines, and operational Guidelines.	Fixed industry cost for Open Banking Limited delivery of updated VRP standard.	c. £300-500k total industry cost.
Implementation of updated VRP standards and MLA	Delivery of the recommended changes to functional capabilities and any other requirements from the Multi-Lateral Arrangement.	Fixed cost for build.	TBC per ASPSP depending on number and complexity of requirements.
Implementation of changes to FPS for VRP	Implementation of changes to VRP transaction codes and charging approach for FPS payments.	Fixed participant and CI cost for build and implementation.	TBC per participant; TBC CI cost.

[3] Please consider comparisons to Current Account Switch Service (CASS) marketing costs of c. £13m per annum.

Cost	Description	Nature of cost	Impact[2]
Dispute resolution mechanism	Delivery of a dispute resolution mechanism. Bill payments are not risk free and experience from Direct Debits indicates disputes will be raised, with this being more likely with a new payment method which is unknown to customers and merchants.	Fixed cost for build, but mechanism will need to be extensible to support future use cases. Variable operational cost of resolving queries and disputes.	[redacted] [redacted] [redacted]
Delivery of operational controls and reporting	Delivery of operational controls for non-Sweeping VRP and automated reporting.	Fixed cost for build, but solution will need to be extensible to support future use cases.	[redacted]
Fraud losses and making the customer good	Fraud losses and making the customer good with respect to fraud and disputes	Variable cost depending on transaction values	TBC per ASPSP depending on use cases and fraud mitigation measures in place.

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.

NatWest believes that sending firms should be free to charge prices that they consider are appropriate to enable them to continue to fund further investment in their VRP services.

Removing sending firm FPS costs runs the risk of obscuring the real costs to firms and their customers of VRPs. This is not sustainable, would incentivise cross-subsidisation of services and create mis-aligned incentives for firms. Displaced costs would be picked up elsewhere in a firms' business model and we explore this further in our response to question 7. Our response to question 8 considered other costs that may be cross-subsidised by sending firms under the current proposal for Phase 1.

We discuss further in our response to question 9 how sustainable commercial models are necessary to drive investment and ensure the short and long-term scalability of VRP payments.

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?

As we note in response to question 6, we believe that removing the ability for sending firms to charge PISPs for the provision of VRP services will create unnecessary distortions to competition.

We should not underestimate the magnitude of the economic changes to the FPS charging model that the current proposals would necessitate. Additional industry costs may be required to collectively audit the practice of Pay.UK customers to ensure that only payments genuinely initiated through VRP benefit from this change. In either of the proposed scenarios, covering these extra costs, plus the lost income from sending firm fee reductions, will lead to cross-subsidisation and mis-aligned incentives for the market. The changes are significant and create long-term lock-in to a Phase 1 model.

It is not clear what charges Pay.UK could increase to cover lost income. Any approach would result in cross-subsidisation of a single service through charges to Pay.UK's wider customer base. This approach could have an impact on the wider competitive incentive for Pay.UK or its customers to improve services and deliver better value to their customers, including end-users.

Moving charges to the receiving side will likely increase costs to merchants as ASPSPs or TPPs pass on the increased cost of receiving FPSs. While the PSR considers the provision of payment receiving services to be sufficiently competitive, increased receiving charges would have the same cost impact to PISPs and merchants of retaining sending firm charges for FPS services. The PSR note that they will continue to monitor the costs of payment receiving services. If the PSR controls this increase of cost to merchants from a receiving firm, this would ultimately result in firms being forced to adopt a 'cross-subsidisation' approach to cost recovery anyway.

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

OBL will need to update the VRP standards to deliver a compelling experience and incorporate MLA changes. Delivery of updated VRP standards would include technical specification, Customer Experience Guidelines, and Operational Guidelines. At this stage, it is difficult to predict all the OBL relevant costs. There is likely to be significant supporting activity (e.g. Managed Roll Out, service desk) necessary to ensure VRPs continue to function effectively.

Of most significance is the implementation of customer experience guidelines – deemed by many to be instrumental in the delivery of good customer journeys for Open Banking payments. Good customer experiences will be the most difficult part of a successful VRP proposition to get right and needs collaboration between PISPs and ASPSPs – particularly to compete effectively against alternative payment products in the market. This should also include a payment mark for VRP.

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

We encourage more faith in the ability of market forces to uncover the commercial model that is most effective at delivering the growth of VRP. We have not seen any compelling evidence that explains why market forces should not be left to operate.

At NatWest, we believe that we have demonstrated the ability for the market to develop commercially sustainable VRP propositions that enables TPP adoption at a competitive price point. We have signed bilateral [redacted] Our previous submission to the PSR of this approach demonstrates that the market is operating effectively, with firms starting to test different propositions and frameworks with billers. The main constraint the market faces is regulatory uncertainty. Informal discussions with the market already indicate that some firms have ceased commercial negotiations because of the this consultation.

A difficulty associated with the proposed approach is that it appears to assume that there should be a single commercial model to support VRP payments, or at least that only one commercial model is needed to support Phase 1. Our experience of working across multiple payment types and schemes is that there are often intricacies associated with individual payment types that necessitate different commercial models, based on the features and incentives for firms and customers to adopt the payment type in question. We recommend that market exploration of these models will be more effective at developing viable commercial models than a regulatory led approach.

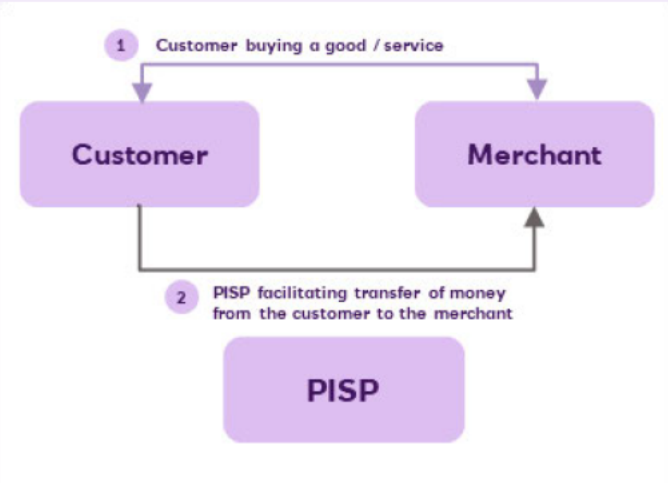
NatWest's current views on the development of the market

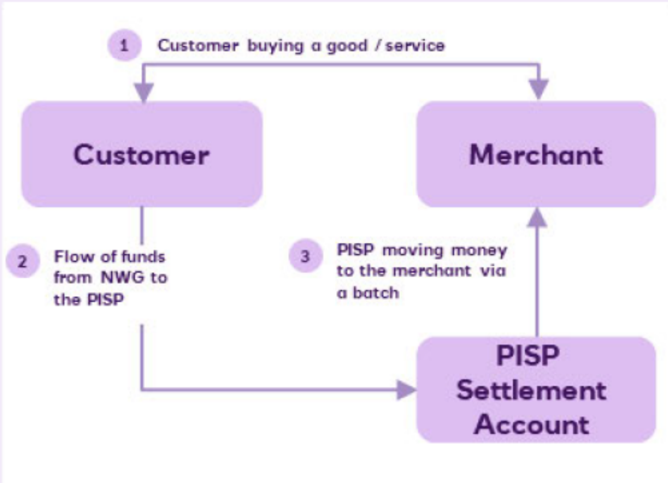
VRPs have the potential to deliver benefits to ASPSPs, merchants and PISPs. Compared to the price billers are paying for DDs and cards, VRP can be significantly cheaper for billers, while ASPSPs and PISPS are able to make returns that incentivise them to invest in the necessary infrastructure.

Our engagement with customers has identified two initial areas to develop effective commercial models.

- First, smaller billers are often reliant on intermediaries to manage the processing of direct debits. Charges from these intermediaries can vary between [redacted] and [redacted] per transaction. VRP would provide competition to these intermediaries and enable small billers to process equivalent transactions at a much lower cost. VRPs would also increase conversion rates and improve liquidity.
- Second, online card on file and digital wallet transactions can be very expensive for billers. One household name retailer told us that they pay [redacted] Through the agreements we have already signed with PISPs we are able to provide a better quality product to merchants at cost competitive price point.

We also continue to explore ways in which the market can work and how to identify different categories of customers who may require different levels of fees to reflect the different risk profiles they may have. In terms of market structure, we currently see two potential ways in which VRP payments can be processed:





On the left side, we see the potential for instant transfer of payments from the customer account direct to the merchant account, with the PISP acting purely as a payment facilitator. This has the advantage of ensuring near-instant funds transfer for the merchant. However, merchants may prefer to batch up payments so that they receive payments at set times during the day. This is represented by the diagram on the right hand side, where PISPs may act as an intermediary settlement account for a period of time. At this stage we are keen to test both types of payment flow.

There are other commercial peculiarities of VRP, such as the benefits of fixed fees vs. percentage based costs and commercial interchange vs. retail models. We believe that a process of test and learn, combined with the development of an MLA through the work being led by UK Finance, will be the most effective means by which to allow the market to determine the most effective commercial models for various use cases that could be supported by VRPs. This process could be accelerated if the ongoing regulatory uncertainty around the proposed approach was resolved. The current approach is likely to crowd out this private sector initiative, and slow down the development of the market.

We nonetheless see an important role for the PSR in fostering market development. We agree that requiring transparency around ASPSP charges could be a way to help ensure that prices converge without the need for any coordination between ASPSPs.

How would pricing develop in a market where market forces are allowed to operate?

We understand that the concern about how prices may be set in the market in the absence of regulatory intervention.

We believe the market should be left to develop pricing without any intervention from the regulator. A transparency requirement would provide industry participants with insights into the pricing practices of other firms in the market. This transparency may lead to a gradual alignment on pricing in the market as a result of natural market competition. Once the market has settled on specific price points, this would be a suitable juncture for the regulator to review whether the pricing offered in the market was reasonable and competitive.

We also encourage the support of industry efforts to manage competition law risks, rather than identifying a competition law risk and concluding that regulation is the only answer.

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.

A compelling customer experience delivering clear benefits is more likely to incentivise PISPs and billers to invest in VRP services. While the number of customer accounts is important, this will be less important than the customer and merchant experience in driving adoption. A good customer experience will drive better engagement from billers and their customers, incentivising wider ASPSP development of VRP propositions. Functional requirements, such as guaranteeing funds or enhancing reconciliation capabilities, will need to be developed to incentivise merchant adoption.

Phase 1 is targeting use cases with a high penetration of Direct Debit rather than Card on File or Continuous Payment Authority which are payment methods where we believe VRP has clear benefits. Direct Debit payments are widely regarded as a cheap, reliable and trusted form of regular payment. It is not clear that there will be much switching from Direct Debit as the VRP experience (including consumer protection) is not compelling enough for a biller or their customers. Our view is that the use cases identified in Phase 1 are unlikely to drive scalability of VRPs.

A better targeted solution would be to look at the functional benefits of VRPs over existing payment types, such as enhanced user control. Consumer trends indicate that early adopters of new services are likely to be advocates of enhanced user control. These customers are more prevalent in digital only banks. An approach that targets this early adopter market is more likely to succeed than one which simply targets volume of customers.

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

We refer to our answer to the previous question. While the proportion of customers that can adopt VRP payments is a relevant factor, an approach which ignores enabling early adopters to advocate for VRP is unlikely to see the sort of long-term scalability of VRP payments that is envisioned.

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

We believe that any mandate for ASPSPs to provide VRP services should be incumbent on the existence of sustainable economic models that drive investment and innovation in the user experience. This is in line with the Future of Payments Report call for a sustainable commercial model for Account-to-Account payments.

Once these economic models are in place, we recognise that the regulator may consider it necessary, to mandate banks to deliver VRP. We believe that mandating all ASPSPs to deliver VRP would be more effective as market shares can change rapidly and may leave certain customer segments (particularly digital first customers) without the ability to utilise VRPs.

There should be consideration of existing obligations for firms to provide access to payment services on proportionate, objective and non-discriminatory grounds. We believe that this model has been shown to be effective at ensuring that firms reliant upon ASPSPs to provide services for their customers are able to gain access to payment services while ensuring that an ASPSP can impose sufficient commercial requirements and controls over this service in order to fulfil its wider regulatory duties.[4]

This approach will also de-risk the regulator from having to continue to enforce access requirements on firms while enabling it to continue to have the regulatory ability to hold firms to account for failing to provide services and is a much more appropriate approach given the powers of the PSR in this regard.

The application of any mandate solely to the CMA9 is, however, unjustified given the market changes since the 2016 CMA Final Report and that the CMA has recognised the closure of the implementation phase required by the Retail Banking Market Investigation Order.[5] It is inappropriate for the PSR implicitly to link its proposed regulatory mandates to a market investigation that closed seven years ago, particularly given the PSR's objectives differ so greatly from those of the CMA Order. An independent approach which directs ASPSPs based on a de minimis number of accounts would be a more appropriate process to undertake.

[4] For further background please see Part 8 PSRs 2017, particularly regulations 103 and 104

[5] https://assets.publishing.service.gov.uk/media/63bed8958fa8f513b40f866c/BANKING_PROVIDERS_Roadmap_Completion_Decision_.pdf

[redacted]

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?

As we set out in our response to question 10, the key driver of adoption will be a compelling customer experience that billers and their customers want to use.

As we discuss in our response to question 9, market incentives to develop effective commercial models are already aligned between parties to a VRP. We believe that supporting existing market incentives is the best way to ensure that a sufficiently large number of accounts will support VRP services.

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?

We support – at some stage – a mandate that requires all ASPSPs to provide VRP services on proportionate, objective and non-discriminatory terms. We do not support any mandate that seeks to control the prices that any participant in the VRP value chain can charge. We have set out our views on the costs and risks of a price mandate in our response to questions 1, 4 and 9.

As we noted in response to question 12, we believe that any mandate for ASPSPs to provide VRP services should be contingent on the existence of sustainable economic models that drive investment and innovation in the user experience.

The proposed economic model for phase 1 (and the implications it has for subsequent phases) will result in many participants in the VRP ecosystem not regarding VRPs as commercially attractive. In the face of uncertain but heavy-handed regulatory intervention, firms will potentially adopt an approach of inaction until a mandate is imposed, and then do the minimum required to satisfy the mandate. This will result in a poor user experience, where customers and merchants have no incentive to switch from existing payment methods. It will harm the short and long-term scalability of VRP services; having the opposite impact that mandatory participation seeks to achieve.

These risks can be mitigated by the PSR setting out what it proposes in terms of immediate actions (such as a transparency requirement and a fair access requirement similar to that found for access to payment systems), what it might do in the medium term (such as mandate provision of VRP), and what it will not do for a set period of time (such as impose any form of price control). This would provide the regulatory certainty needed for the market to develop effectively. This has been an effective regulatory approach in other sectors such as telecoms.

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

In our response to question 9 we outline how an effective market led commercial model will incentivise adoption of VRP services by sending banks and enable a model that support cost recovery and justifies investment in services.

Our response to question 12 supports a requirement upon all ASPSPs to deliver VRP services.

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?

The additional risks are well covered in our responses to the previous questions, including questions 1, 4, 5, 7, 9 and 14.

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 outlined in question 10 our concern that the use cases identified in Phase 1 are unlikely to drive scalability of VRPs. We believe that giving the market freedom to explore alternative use cases will better support the scalability of VRPs. In our answer to question 9 we noted how the market is already exploring commercial opportunities to provide VRP services.

In short, it is not clear whether the proposed approach to a cost-benefit analysis is appropriate. The level of intervention that is proposed requires, in our view, a significant demonstration of benefit and it is our belief that a less drastic intervention to support a wider potential benefit will help the market to support the short and long-term scalability of VRPs.

This said, further clarity on the proposed use cases would be required to undertake a rigorous cost-benefit analysis. Clarity on which specific FCA regulated firms are in scope, which transaction types, which account types (e-money, investments, insurance etc.), for what products (provision of credit for mortgage transactions, car finance etc.), payment of store cards or other debts and specifics on local and national government remits all require clarity.

The pilot rules out the inclusion of multi-signatory account holders in the micro-enterprise and small charities space. There may be others who are small innovative businesses which would be keen to adopt VRP for the proposed payment types in the first phase of VRP rollout. Scaling should give consideration to the potential of commercial firms who would benefit from VRP over existing payment methods being part of the adoption strategy.

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

We do not agree with the initial assumptions for the cost benefit analysis; specifically:

- The assumption that, in the absence of regulatory intervention, the current provision of VRP by sending firms would not change, is factually incorrect. At NatWest we are actively engaged with a number of PISPs and merchants, and have launched a live trial since the publication of the consultation. UK Finance has discussed a new piece of work on the development of an MLA for VRP before the consultation was published (which was notified to the PSR). It is more correct to state that the regulatory uncertainty created by the consultation has had a chilling effect on the development of the market.
- The assumption that alternative payment methods to VRPs will not significantly improve in functionality during a ten-year period is untenable, particularly for cards. In the last 10 years, the user experience for card payments has improved dramatically, for example with the advent of Apple

[redacted]

Pay for both offline and online payments. There is scope for further improvements to user experience, both online and offline. In terms of commercial terms for merchants, the PSR's own interventions in the card acquiring market and with the card schemes are, according to the PSR, intended to improve the terms of trade for merchants in the coming years. Direct Debits have also improved over the last 10 years, through the advent of intermediaries who have enabled a more digital experience for merchants: we would expect competition in this market segment to increase in the coming years.

- The extent to which the assumption that any costs and benefits would be incurred by participants within a VRP service depends greatly upon the economic model that is utilised. See, in particular, our response to Questions 6, 7 and 8 that articulate the actual economic impact of changes in costs from OBL and Pay.UK that, if not limited to the explicit users of a VRP payment, will be distributed across the ecosystem in various cross-subsidisation efforts by all parties. Ultimately, this results in costs being borne by customers of ASPSPs that are not direct users of VRP payments. Additionally, see our response to question 5 which articulates a number of additional costs to firms that are not considered within the initial PSR analysis.
- The proposal has not outlined a likely timespan for a Phase 1 implementation of VRPs. Given our view that the commercial market needs to be given the freedom to innovate, it is concerning that Phase 1 activities should be judged against a 10 year time horizon. Our view is that a regulatory mandated VRP model should last for a maximum of two years and so we believe that the PSR should assess the benefits of intervention according to this time horizon.
- While the PSR is right to exclude migration costs specific to the New Payments Architecture, it is not clear whether sufficient transparency has been provided in the proposal as to the types of payment that it believes will migrate to VRPs; e.g. from Direct Debit payments, card payments or other payment types. These migrations will have tangible impacts on the internal costs of many ASPSPs and competitive implications for firms. We note in particular our analysis in Question 10 which may be helpful to consider in this regard.

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?

The UK is served from a wide variety of payment methods and customers already have compelling experience today in payments e.g. Apple Pay, contactless. Our research indicates that VRP could deliver a higher quality product in terms of:

- Increased conversion at checkout due to a more automated process and increased flexibility for customers;
- Reductions in fraud and disputes;
- Liquidity benefits to merchants through faster settlement;
- Reduction in internal reconciliation costs for merchants;
- It replaces non-recurring bill payment methods (e.g. customers who pay utility bills with single one off payments).

VRP will only be successful where it has clear benefits over existing experiences and therefore might not be applicable to all payment use cases.

Value chain component	Key benefits of VRPs	Key Costs of VRP
Consumer	• Greater consumer control over payment mandates. • Ease of making a payment to a biller/merchant. • Provide consumer buyer protection for goods and services. • Provide consumer protection against frauds and scams. • Clarity of who to raise disputes with, and efficacy of dispute process.	• Cost of effort to switch to VRP and overcome inertia. • Potentially less customer protection than other payment methods. Minimal investment to achieve behaviour change and gain confidence with new service.
Merchants/ billers	• Drives conversion of sales for a merchant/biller's goods/services. • Reduces back office costs to billers/merchants for reconciling payments. • Reduces cost to billers/merchants for receiving payments. • Reduces or makes more efficient the process of resolving customer disputes.	• Investment required to switch customers to VRP. • Potentially less customer protection than other payment methods, with risk of more queries/disputes. behaviour change. • Minimal investment to achieve necessary technical change.
PSO	• Competitive benefit of volume increase against other PSOs. • More income due to managing increased level of services.	• Loss of volume due to competition from other PSOs. • Investment required to provide infrastructure bandwidth. • Loss of income from migration of payments from other payment types.
PISPs	• Competitive benefit of new proposition against other payment types. • Provision of innovative products to merchants and consumers.	• Investment in infrastructure required to facilitate payments. • Investment in customer journeys to compete with payment alternatives. • Loss of income from migration of payments from other payment types.
Receiving Banks	• Greater volume of transactions routed through customer accounts and income opportunities.	• Investment required to receive payments; and ongoing cost of receiving payments. • Investment in infrastructure required to receive payments. • Loss of income from migration of payments from other payment types. • Cost of infrastructure change.
Sending Banks		• Investment required to send VRP payments and invest in customer journey. • Loss of income from migration of payments from other payment types. • Cost of infrastructure change.

We note that many of the potential benefits to parties within a VRP chain are based on volume and commercial, competitive benefits. It is not clear to NatWest whether the proposal should include benefits to one particular strata of firms as a benefit of VRP introduction. Indeed, this fact gives us no small amount of concern that the proposal is making such radical changes in the competitive market for payment services. Other elements of VRP benefits are much more intangible and we agree are difficult to measure without greater specificity on the scenario being considered for VRP adoption. We recommend that specific use cases be investigated individually to establish any suitable measure of economic benefit.

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?

Please see our response to question 19 which outlines elements of both cost and benefit to the parties within a VRP transaction.

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

We believe that all payment types should equally affect people with protected characteristics. At the current time we consider that VRPs may be designed to better protect people with protected characteristics; however, such functionality would require investment to build.

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

As we reference throughout this consultation response, we believe that the actions proposed present significant risks to both the short and long-term scalability of VRPs. Our response to this question builds further on our response to questions 2 and 14:

- Lock-in to Regulatory Timing – The proposed interventions run the risk of locking the industry into long-term dependence upon regulatory action. While the PSR is a very active regulator in the UK's payments market, we do not believe that it has the necessary bandwidth nor appropriate powers to respond to the commercial necessities of negotiating cost, access and functional requirements of a growing market.
- Lack of Phase 2 and beyond – There is no articulation in the proposal of how or when a Phase 2 of VRP implementation could commence. Beyond this lack of regulatory certainty, we are concerned that there has not been sufficient consideration of how long-term strategic support will facilitate the development of commercial frameworks to support the short and long-term scalability of VRPs
- Role of regulator – While NatWest recognises the temporary role that a regulator could adopt to galvanise the growth of a market, we believe that a regulator functions best when taking supervisory and monitoring activities rather than having a specific operational role within the industry. It is not

clear to NatWest whether it is appropriate for an economic regulator to adopt the role of de-facto scheme manager, setting access and pricing requirements for industry – even if this is achieved through directing a third party. We don't believe that the PSR has sufficient commercial expertise, nor appropriate governance to fulfil such a role and the creation of such a role (or direct authority over a third party) presents a long-standing undertaking that could compromise the PSR's independence in how it regulates the market.

- **Risk of misjudging the market** – Incorrectly setting prices and products in scope in regulatory requirements risks creating the wrong incentives for the market to act, resulting in poor performance, a lack of investment and threatening the short and long-term scalability of VRPs. This would be slow to change to under regulator timelines compared to an iterative approach that is possible through a commercial approach.
- **Inability to innovate** – Creating strict regulatory requirements for participation in an MLA targeting specific use cases runs the risk of locking the market into a single conception of a VRP payment, reducing the likelihood of market innovation, competitiveness with existing payment types, development of new user journeys and ultimately limiting the potential short and long-term scalability of VRPs.
- **Lock in to regulatory scope** – The specification of three use cases for consideration in Phase 1 may limit the perception of firms as to their capability of offering VRP services for customer journeys outside of the scope of Phase 1 use cases.

Annex 1 – Pricing Principles

This annex expands on the points highlighted in our response to question one. The second annex provides a commentary on the PSR's legal powers.

As the publication of Pricing Principles for commercial frameworks for premium APIs did not give firms the opportunity to comment on their drafting, we offer comment on their original publication[6] in this annex. We have concerns about both procedural fairness and the vires of the PSR to take the actions it is proposing.

The scope of the pricing principles is too narrow, and mis-applies the concept of "fair value"

The principles state (in section 2) that they are focused only on the prices that ASPSPs may charge to TPPs, and that they do not cover pricing that may be charged for other services in the Open Banking value chain, including prices that TPPs charge their customers. This fails to consider the price that the end customer – the merchant – will pay. In cards markets, the capping of interchange rates did not lead to a reduction in the prices paid by large numbers of medium and small sized merchants, as the margins of card acquiring providers increased to replace the reduced interchange margins. A narrow focus on the charges of ASPSPs may lead to an equivalent situation in VRP, whereby TPPs increase their own margins to substitute for the constrained margins of ASPSPs.

The principles deploy the concept of fair value and transparent pricing from the FCA's Consumer Duty. We agree that these principles are important. However, it is merchants, not TPPs, who are the "consumers" for the purposes of assessing consumer duty obligations. We address this in our comments on principle 4 below.

Sending firms are not bottleneck monopolies

The application of the narrow pricing principles leads to the mis-characterisation of ASPSPs as bottleneck monopolies, based on the incorrect premise that VRP forms a standalone product market (see para 2.3). This misguided premise arises from an undue focus on the position of TPP intermediaries, to whom ASPSPs may appear to be an unavoidable trading partner, given that TPPs must have access to the individual customer's bank account to process a VRP transaction. However, any assessment of market power needs to be undertaken from the perspective of the end customer, in this case the merchant.

The relevant market for the assessment of market power is the range of options that are available to merchants to process a payment from a customer, not the options available to a TPP to process a VRP as a specific type of payment option. The application of principles derived from the SSNIP market definition test indicates that banks are not in a position of significant market power. If banks charge a monopoly price for access to their bank accounts for the processing of VRP, then merchants will continue to use the alternative methods of payment that are already available to them – in particular, direct debit and card payments, as well as single use A2A payments.

VRP is clearly not a "must have" payment method for merchants – indeed today it barely exists as a payment method. Our view is that the focus has been on irrelevant considerations (the position of TPPs), at the expense of relevant considerations (the position of merchants) to reach the conclusion that a service that doesn't exist yet is a bottleneck monopoly.

Further, consumers also have a range of payment options available to them. Consumer preference can drive ASPSP behaviour. Apple was able to bring all card issuers onto its Apple Pay platform [redacted] as issuers were concerned that if they did not offer Apple Pay, their customers

[6] https://www.fca.org.uk/publication/corporate/jroc-principles-commercial-frameworks-premium-apis.pdf

would switch bank account. An equivalent scenario has the potential to develop in VRP, where customers select their bank account provider on the basis of their VRP proposition. Such switching behaviour is relatively seamless given the widespread use of the Current Account Switch Service (CASS).

The focus on ASPSP costs fails to consider relevant precedents

Principle 1 suggests that the pricing for premium APIs should reflect long run costs. This is based on the mistaken premise that there is a standalone market for VRP in which ASPSPs operate as bottleneck monopolies. A core feature of a bottleneck monopoly is that the monopolist benefits from a guaranteed revenue stream through charging for access. In such a scenario, the imposition of cost-based price control – to cap the upside available to the monopolist – may be justified, as there is very little downside revenue risk to the monopolist's guaranteed revenue stream.

In contrast, there is no justification for the imposition of cost-based price controls in respect of a product that has not yet been developed. The fact that the stated rationale for VRP is the creation of a viable alternative to card payments and direct debits indicates that there is no certainty over the revenue stream that ASPSPs may be able to generate.

Comparison with other cost-plus regulatory pricing regimes

A comparison with existing precedents from the telecoms sector for the imposition of cost-based price control helps to illustrate how principle 1 is misguided. In telecoms, price controls for wholesale call termination rates are based on analysis of long run average incremental cost (LRAIC), which takes fixed costs into account. Ofcom applied well-defined statutory powers to assess whether networks possessed market power (through the three criteria test), and then applied sophisticated analysis to determine LRAIC.

When Ofcom started to price regulate call termination charges, it was already well established that the only means by which one network could contact a customer on a rival network was by terminating a call on the rival network. There was therefore very little uncertainty over whether operators would be able to recover their call termination infrastructure investment costs. Ofcom assessed each operator's LRAIC cost base individually, and took into account that smaller operators would have similar fixed deployment costs to the larger operators. Ofcom set the price caps for smaller operators at higher levels than for large operators, to ensure that all operators recovered their costs over a reasonable and equivalent time horizon. There was no concern that setting a higher access price would somehow dampen demand or prevent calls to that network from taking off – because call termination was a genuine bottleneck monopoly, in which call originators had no choice but to pay the terminating network's access charge. It was possible to make reasonably accurate predictions about the time horizon over which the networks would recover their network investment costs.

In contrast, VRP is not an established payment method, and there is no guarantee that it will take off as an alternative to existing card or direct debit payment methods. As the principles acknowledge, the provision of premium APIs "may involve incurring substantial fixed costs upfront" (see paras 3.11 and 3.17 of the principles). However, the principles suggest that ASPSPs should charge nothing or very low prices at the outset, to maximise the prospects of VRP succeeding, and the possibility that ASPSPs may eventually recover their fixed cost investments. The fact that VRP may not succeed strongly indicates that there is no bottleneck monopoly. The suggestion appears to be that ASPSPs should invest heavily in infrastructure that may become a stranded asset, but that they should not be entitled to recover any more than their costs of building the infrastructure, over an uncertain time horizon, with a significant risk that they never recover their costs. The best-case scenario would be that that they recover their costs.

It is therefore difficult to see how proposals for cost-based price controls align with the PSR's competition and innovation objectives. Such proposals represent a significant interference in both property rights and the effective functioning of the market. The initial set up of Open Banking (where ASPSPs had to make significant investments to provide services for free), was a response to a lengthy market investigation into competition into retail financial services conducted by the CMA, which found that competition was ineffective. Even then, the CMA's cost-benefit analysis significantly underestimated the costs that would be imposed on financial institutions by the imposition of Open Banking. A proposal to impose a requirement to provide more services free of charge, on the basis of cost-orientated pricing analysis, should not be undertaken without findings that competition in a relevant market is not working well. No such analysis has been undertaken by the PSR.

Alternatives to cost-based pricing

At Natwest we do not consider that any form of price control is justified for a nascent product. Notwithstanding this, we also do not understand why the pricing principles have not considered other benchmarks for pricing – in particular, the prices charged to merchants for alternative payment options.

In payments, regulated issuer interchange fee caps are not set by reference to individual issuers' costs, but by reference to the merchant indifference test (MIT). The PSR has indicated that it will conduct its own MIT in relation to cross border interchange fees. In this case the PSR will consider the alternative options that merchants have to a card payment, including payment via three party schemes such as American Express, digital wallets such as PayPal, and potentially account to account transfers (see section 9 of the PSR interim report on UK-EEA cross border interchange fees).

If regulators considered that pricing principles were necessary at all, it would have been more appropriate to have suggested that the overall cost of VRP payments for merchants would need to be benchmarked against the alternative payment options available. This would be in line with existing practice on interchange. It would be considerably less prescriptive, and more in line with the PSR's statutory objectives. Any decision to impose price caps based on the MIT should only be taken after extensive work. By way of comparison, when the European Commission considered the appropriate level for interchange fees in the Interchange Fee Regulation, it carried out an extensive MIT assessment.

The pricing principles rightly identify that there is a range of pricing structures

The pricing principles consider a range of different pricing structures to achieve optimal outcomes for participants. These include setting prices at one level for a period of time and then changing them for a different period of time. They also include the prospect of volume-based discounts to create a pricing model that encourages increased adoption. We agree that a range of approaches is required, and indeed we have been following this approach with our first commercial trial that has recently launched.

There is insufficient consideration of the need to incentivise all participants to focus on the end user experience

Principle 2 acknowledges the need to ensure that all industry participants are rewarded for innovations that bring benefits to end users. Principle 3 states that it is necessary to incentivise the take up of open banking. We agree with these high-level statements. We believe there need to be commercial incentives for all parties to support the wider uptake of VRP payments, through constant iterative enhancements to the end user experience that enable VRP to offer a better experience for end users and merchants, when compared to existing payment methods. A model driven purely by lowest cost possible will not result in such benefits.

However, we are concerned that the principles have not given consideration to the importance of the end user experience in incentivising take-up. An attractive price and wide availability across ASPSPs is not enough to drive VRP service acceptance. Merchants are willing to pay a higher fee for services that drive customer engagement and/or ease of use. We provide two examples:

1. A number of merchants have adopted a Buy-Now-Pay-Later (BNPL) option at online checkouts, as a means of increasing conversion rates. Merchants are willing to pay companies such as Klarna higher fees for a product that drives increased revenues.

[redacted]

Innovation occurs when each participant in the value chain perceives an opportunity to make a return on investment. ASPSPs exercise a significant amount of control over the end user experience, but they will have very little incentive to go beyond the regulatory minimum requirements to make VRP attractive if there is no prospect of making a strong return from doing so. As a result Principle 1 therefore undermines Principle 2.

TPPs are not consumers and are not bottleneck monopoly access seekers

Principle 4 uses the language of the Consumer Duty to assert the rights of TPPs as intermediaries in a payments value chain. As outlined above, the consumer duty, to the extent it applies at all, should apply to the value that merchants receive. TPPs are analogous to product distributors, while ASPSPs are product manufacturers. As product distributors, TPPs may have obligations, not rights, to provide their customers with fair value for services rendered under the Consumer Duty.

The application of Consumer Duty principles appears to arise in a context in which independent TPPs are concerned that they will be at a competitive disadvantage to TPPs who are vertically integrated with an ASPSP, and that the solution is for ASPSPs to ensure that their own TPPs are charged the same price as independent TPPs (see for example para 3.21 of the principles). This is unrealistic and unnecessary.

A bank will likely operate an ASPSP and a TPP as a single economic entity. It makes no sense for such an entity to charge itself for the provision of a service. This does not mean that independent downstream TPPs are at a competitive disadvantage to the fully integrated ASPSP. Any one ASPSPs will only account for a relatively small proportion of the overall market; if there is any advantage to be gained from vertical integration, it will only apply in respect of that proportion of the market. The ASPSP's own TPP will still pay the same access charges as independent TPPs in respect of the rest of the market.

This concern for TPPs likely arises from the mistaken premise that ASPSPs are bottleneck monopolies. The implication is that TPPs should somehow be structurally separated from ASPSPs, as is the case for genuine bottleneck monopolies such as [redacted] However, APSPSs are not bottleneck monopolies, so there is no justification for any requirement that ASPSPs treat their own TPPs on an arm's length basis. A vertically integrated ASPSP/TPP may be able to eliminate double marginalisation for payments that originate from its own customer base, which may in turn lead to greater efficiencies and enhanced consumer outcomes. A suggestion that ASPSPs should seek to raise the costs of their own TPPs makes no sense where the is no bottleneck monopoly. Further, on a practical note, it would be very odd for small TPPs such as Payit to be required to segregate themselves from their parent bank.

Annex 2 – PSR Powers

The PSR does not set out the legal basis on which it is able to exercise a power to impose price control, and we invite it to do so. We set out below our provisional views on this subject.

We are concerned that the PSR does not have the vires to impose cost-oriented price controls in the manner anticipated. Price controls are a particularly intrusive form of market intervention, and require a clear legal basis for their application, as well as effective right of appeal, typically based on full merits (for example in telecoms, aviation, and water). Any market-wide price control is typically only justified following an extensive multi-year market investigation into the functioning of competition.

We cannot see any provision in the FSBRA that provides this clarity. Section 54(2) of FSBRA provides the PSR with a power to direct a participant in a payment system to take a “specified action in relation to the system”. However, we do not believe that this extends to directing the price that can be charged, particularly when taking into account the PSR’s regulatory duties set out in sections 49-53. Appeals over the application of section 54 are based on judicial review only.

Section 57 of FSBRA makes explicit reference to the regulator’s power to specify a maximum fee or charge in relation to any agreement between a payment system operator and a payment service provider (section 57(1)(a)). Section (57(1)(b) applies to any agreement made between a payment service provider with direct access to a regulated payment system and another person. Section 57(1)(c) applies to any agreement concerning fees or charges payable in connection with participation in a regulated payment system, or the use of services provided by a regulated payment system. This does not appear to cover the charges that may be applied by individual ASPSPs to TPPs. The section 57 powers are better read as applying to the charges that may be incurred by a participant seeking access to a payment system, either directly or indirectly. The fact that decisions under section 57 are subject to full merits appeals indicates that parliament did not intend section 54 to be used for the imposition of price controls.

In any event, even if section 57 did apply to agreements between ASPSPs and TPPs, the power under this section could only be triggered on the application of a party to an agreement to vary that agreement (necessitating the existence of the MLA before any application to control what can be charged thereunder could be made).

There is also ambiguity over whether the PSR would have jurisdiction under section 57 to respond to such an application or whether section 108 might preclude it from dealing with an application under its access powers in section 57 (see NoteMachine v Payment Systems Regulator [2023] EWHC 2522 (Admin)).

When considering its powers in relation to access to payment systems under regulation 103 of the Payment Services Regulations 2017 (PSR2017), the PSR’s power of directions under section 125 of PSR2017 face similar challenges to those that exist under section 54 FSBRA – namely, there is no explicit reference made to the setting of a maximum price and the rights of appeal conferred to parties by regulation 131 are restricted to judicial review.

New City Agenda

VRP Consultation Response – CP23/12 – Expanding Variable Recurring Payments

I am an independent consumer representative and was a member of the VRP Working Group. The clear objective of the introduction of VRPs must be to deliver benefits for consumers, including those with characteristics of vulnerability. Developing these services so that they offer good outcomes for consumers will require appropriate standards to be implemented and also for incentives on merchants, banks and PISPs to develop and offer these services to consumers, including designing services for vulnerable consumers. There will also need to be high standards of consumer protection and actions from regulators to monitor and mitigate any emerging risks for consumers. The misaligned incentives of those in the market means that high standards of consumer protection are unlikely to develop unless they are mandated by regulators.

It is vital that the organisation tasked with developing a framework for VRPs and setting standards has a clear duty and powers to act in the best interests of consumers and involves sufficient end user representation. The gaps in consumer representation and the unclear responsibilities and lack of action with regard to consumer protection for Open Banking enabled services has already led to significant consumer detriment following the mistreatment of customers by Safety Net Credit and then its failure.

As a minimum, I recommend that consumer protection / conduct standards for VRPs should include:

- A standardised name and terminology to describe VRPs and in the longer term, the development of a brand and logo to help consumers identify VRPs.
- Standardised communication documents which are understandable by consumers during the consent journey and communicate the features, protections and cancellation methods of VRPs
- Rules around the default parameters for VRPs and the extent of consumer/biller control over these parameters
- Consistent implementation of consent and management dashboards enabling consumers to understand, control, amend and cancel VRPs
- Information and technical standards which ensure that consumers can identify VRP transactions and billers on statements, banking apps and consent dashboards.
- Standards for notifying consumers of upcoming payments and giving them the opportunity to amend or cancel them.
- Processes which ensure that VRPs are reliable given the significant potential penalties for non-payment inherent in the use cases for the pilot.
- Inclusion of VRPs in the Current Account Switching Service.
- Dispute resolution processes which are clear for consumers and allow multiple points of entry into the system and for all participants
- Liability arrangements which provide clear redress for consumers in the event of payments failing and APP fraud and the introduction of purchase protection/biller insolvency equivalent to alternative payment types.
- Clear and documented arrangements between regulators for monitoring and mitigating risks to consumers during the pilot including the establishment of an End User Risk Committee and requirements on pilot participants to submit data and allow research.

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?

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.

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

I agree that coordination is necessary for Phase 1 and that an MLA is the appropriate vehicle to achieve this goal only if it ensures the introduction of appropriate and enforceable consumer protection standards for VRPs.

OBL and Pay.UK need to ensure that there is sufficient involvement of consumer representatives in the implementation groups covering functional capabilities and dispute resolution processes. At the moment, OBL are failing to ensure that there a diverse range of consumer representatives involved in their work and have chosen to scrap the End User and Participant Forum and the End User Risk Committee. I would recommend that these implementation groups should have at least one third consumer representatives. They should be recruited through an open call for expressions of interest and resources should be provided to enable a diverse range of consumer representatives to input into this important work. Without strong consumer and end user representation there is a risk that this could be an industry dominated process, which would not result in standards being set in the best interests of consumers.

The introduction of VRPs could bring convenience and flexibility for consumers if the functionality and consumer protection requirements are designed in the best interests of consumers. They could play a role in tackling the poverty premium by enabling consumers to budget and pay what they can afford. By applying variable and controllable payments to pensions they could help people, including the self-employed make better provision for retirement.

But it is clear that without stronger direction to the market on the consumer protection standards there is a risk that PISPs and banks develop standards which are in the best interests of billers. PISPs will have strong incentives to design products which meet the needs of billers for more flexibility alongside their desire for less stringent liability frameworks than under procedures such as the Direct Debit guarantee. At the moment, it is clear that there are misaligned incentives in the market which could work against the development of VRPs which meet the needs of consumers and offer a high standard of consumer protection.

As we proceed with the pilot and roll-out of VRPs, regulators will need to be strong and proactive to set conduct standards for VRPs and ensure that they work for consumers.

The Consumer Protection Sub Group of the VRP Working Group which I Co-Chaired developed the following objectives:

1. Consumers should understand that they are signing up to a recurring payment, the key terms and protections and be given the information and tools they need to understand, manage and cancel their payments.

2. Dispute resolution processes should be clear, efficient and easy for consumers to access, and where appropriate, consumers should be refunded in a timely manner.

3. Liability arrangements between participants including billers should be clear and provide strong incentives to prevent problems from occurring and to prioritise consumer redress.

4. Consumers are protected when using cVRPs with pilot participants including billers implementing all relevant regulations and guidelines for consumer protection, including the Payment Services Regulations, the Consumer Duty and relevant vulnerability guidance and regulators monitoring and mitigating risks to consumers. Billers will need to abide by their relevant consumer protection requirements.

As we move forward, I encourage the PSR to consider the following issues:

- Which organisation is going to be in charge of setting the pilot entry criteria and the consumer protection standards for VRPs?
- Are the responsibilities and powers across the various organisations sufficient to set and implement standards and protect consumers?
- What processes need to be established to help develop the consumer protection standards and ensure that they are ready for the roll-out?
- What research needs to be done and data needs to be gathered as part of the pilot to help develop the consumer protection standards?
- How can Consumer Representation be incorporated in the standards setting process – both drafting and monitoring/implementation?
- How can we avoid a race to the bottom on consumer protection and liability?
- How are the Consumer Protection standards going to be evaluated as part of the pilot and any necessary research conducted?
- What lessons can be learned from the failure/lack of traction of Request-To-Pay?

As a minimum, I recommend that the consumer protection / conduct standards for VRPs should include:

- A standardised name and terminology to describe VRPs and in the longer term, the development of a brand and logo to help consumers identify VRPs.
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- Dispute resolution processes which are clear for consumers and allow multiple points of entry into the system and for all participants

- Liability arrangements which provide clear redress for consumers in the event of payments failing and APP fraud and the introduction of purchase protection/biller insolvency equivalent to alternative payment types.
- Clear and documented arrangements between regulators for monitoring and mitigating risks to consumers during the pilot including the establishment of an End User Risk Committee and requirements on pilot participants to submit data and allow research.

Some of these consumer protection standards may be developed by market incentives. For example, communication documents sent to consumers after they have established a VRP will be required under existing regulations such as the Consumer Duty. But, given the lack of alignment of incentives, many of these consumer protection standards will not arise unless mandated by regulators. There is unlikely to be cooperation or agreement between the industry to develop a standardised name and communication document for VRPs. Liability and dispute resolution mechanisms will also need to be mandated by regulators given the different incentives and the lack of agreement over the standards which should apply to Open Banking payments. Changes which require significant investment such as the inclusion of VRPs in the Current Account Switching Service are also not going to happen without the involvement of regulators.

Question 12

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

Yes, the PSR should mandate the CMA9 banks to participate in Phase 1 of VRPs. Without mandated participation it is unlikely that sufficient CMA9 banks will offer these products. If participation is not mandated then CMA9 banks would also have significant market power over the standards to be set for VRPs as they would be able to refuse to participate in Phase 1 unless the consumer protection and technical standards were set according to their own preferences and incentives.

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?

One additional risk is that by setting the price at zero banks will be able to argue for low standards of consumer protection for VRPs. The only way of mitigating this risk is for the PSR/FCA to require the list of consumer protection standards identified in the answer to questions 2,3 and 4 to be implemented.

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.

I disagree with the inclusion of the use of VRPs for debt repayment. The use of VRPs for debt repayment is very likely to lead to a serious and unacceptable risk of harm to consumers. As I said during the VRP Working Group: “The consumer representative felt that that using cVRPs for repayment of debts, (particularly when used in combination with AIS data accessed through Open Banking) posed a higher risk of consumer harm and cited an example where harm had occurred such as in provision of high-cost credit. This lender was not using VRPs, but CPA on a debit card as the payment mechanism. In the view of the consumer representative, there was clear evidence that a failure to monitor and mitigate risks associated with lending products using open banking data had caused significant harm to consumers. The consumer representative believed that there should be no use of VRPs for debt repayment until there was a clear understanding of why the harm had occurred and what changes were necessary to FCA rules and the practices around monitoring risks associated with products and services using open banking to prevent similar harm from occurring. The consumer representative suggested that one possible way forward would be for JROC to commission an independent review into events surrounding the failure of the provider using Open Banking to provide high-cost credit and other practices around the use of Open Banking in the lending market to determine what changes to rules might be necessary to prevent harm to consumers."

So far, despite the significant detriment caused to consumers by Safety Net Credit and the inaction of those within the FCA and Open Banking Limited, it does not appear that any independent evaluation has been commissioned into what went wrong or what changes need to be made to consumer protection standards to stop it from happening again.

I am also expressing my concern about the use of VRPs for debt repayment and that there are reports that a PISP has signed an agreement with a firm called Lendable[1]. It is not clear if this agreement is within the scope of the Phase 1 pilot or not. Lendable also seem to be engaging in a number of practices which I would regard as abusive including repeat lending and inadequate assessments of affordability.[2] I am very concerned that the use of VRPs by Lendable will allow harm to consumers. I hope that there will not be a repeat of the circumstances around Wonga, Amigo Loans and Safety Net Credit where firms cause significant detriment to consumers and then go into administration leaving consumers unable to receive redress.

I also support the exclusion of the use of VRPs for payments to regulated financial services firms where the end destination is an unregulated investment.

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?

For consumers, in addition to the benefits listed, I would highlight:

- Reductions in the poverty premium if VRPs are attractive enough to consumers who normally pay in receipt of the Bill and provide appropriate standards of consumer protection. This should be a key consideration when setting the standards for VRPs as stated by attendees at the PSR's consumer roundtable the existing offers of variable payments do not meet low-income consumers desire for control which they need to budget, particularly for those on a variable income.
- Enabling the self-employed to make more flexible pension contributions by changing the need to make a fixed Direct Debit payment and replacing it with a percentage of earnings.

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?

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[1] https://www.finextra.com/pressarticle/98959/lendable-implements-variable-recurring-payments-with-truelayer

[2] Decision Reference DRN-4172584 (financial-ombudsman.org.uk)

One potential cost to consumers which is not included is the potential cost to consumers if VRPs have lower levels of liability for firms than other alternative payment mechanisms such as Direct Debits or Card-On-File. These will only be an issue if there are lower levels of liability for VRPs than for competing payment mechanisms.

It is clear that concern was raised during the process of the Strategic Working Group (SWG) regarding the risks to consumers if Open Banking payments continued to have lower levels of liability for issues such as purchase protection than other similar payment types. There are also divergent views within industry and limited details about what the protection regime might look like. This means that the industry is unlikely to come to an agreement on the appropriate level of protection. For example, please see the extract below from the SWG Report:

> "Area of Discussion 2: Purchase Protection
>
> This was cited as vital for promotion of open banking payments and a common topic across a number of answers. This was supported by expert advisers, ASPSPs and TPPs and platforms. However, there were limited details around what a customer protection regime might look like. There was a common view that customers need to understand the regime but a range of views around the broad scope of a protection regime. Some respondents suggested a similar model to cards. However, other respondents warned that replicating cards' consumer protection regime would not be an optimal outcome, as this adds costs and leaves no room for differentiation between cards and open banking. Expert advisers and a bank warned against competing on purchase protection as it could result in a race to the bottom in which protections are given up in return for cheaper payments, ultimately harming consumers and undermining adoption. They believe that parity in protections between payment rails is best achieved via a centrally set standard minimum standard for all payment methods."[3]

[3] Page 54, SWG-Report-The-Future-Development-of-Open-Banking-in-the-UK-Feb-2023.pdf (openbanking.org.uk)

Open Banking Limited

OPEN BANKING

OBL Trustee Response to CP23/12 - Expanding Variable Recurring Payments

Call for views

January 2024

Introduction

This is a pivotal year for both open banking and Open Banking Limited (OBL). It will also be a year of change as we begin to move beyond the CMA Order to a sustainable commercial model and new long term regulatory framework that will unlock the full potential of open banking. I therefore welcome the Payment System Regulator's (PSR's) ambition to pilot the first ecosystem-wide expansion of additional functionality beyond the current regulatory baseline.

As referenced in Joe Garner's *Future of Payments Review*: "*The UK has the opportunity to create a world-leading payments environment long into the future. But to do this we need to cut through the complexity and work towards a new shared vision consistently over the long term.*"

The collaboration we have seen from the industry, in contributing their views to the Joint Regulatory Oversight Committee (JROC), has been exemplary. Maintaining the momentum is important as we progress the various activities set out by JROC to enable open banking to continue to develop ahead of the implementation of the long-term regulatory framework and achieve our shared goal of broadening out the open banking use cases and ultimately creating account-to-account retail transactions (A2ARTs).

The pilot to extend variable recurring payments (VRPs) into additional low-risk use cases is an essential first step to better understand and establish the tools and capabilities required for the long-term future of open banking payments, as well as a multitude of new products and services based on commercial arrangements. As we move towards new models that support the extension of open banking, this pilot will be essential in providing the learnings as a first step towards successfully expanding open banking-based products and services.

In my capacity as open banking Trustee, I have set out a detailed response to the call for views on the development of VRPs and the proposed pilot. I have consulted both with colleagues and stakeholders. I have considered the CMA Order in its wider context, and outlined how best to ensure benefits of open banking are sustained for the public good as we begin to transition to a sustainable commercial model and new long term regulatory framework.

Summary

I am highly supportive of the PSR's vision and ambition to accelerate the expansion of VRPs as a key enabler for A2ARTs that will deliver benefits to end-users through enhanced innovation, choice, and competition. However, this pilot is also an opportunity to assess and refine a commercial model for the broader expansion of open banking via a broader set of APIs. In effect, I believe there should be two objectives of this pilot: first, to achieve the PSR's vision of driving innovation in payments and moving towards the successful expansion of A2ARTs; second, to develop a commercial and operational model that can be used to unlock the full potential of open banking.

I support the PSR's proposal in principle. However, it should be refined to maximise the future success and sustainable development of open banking and achieving the PSR's long-term goals. In my view, the pilot as detailed in the Call for Views:

1. Is a missed opportunity to establish the pilot for the expansion of VRPs as a stepping stone to the wider development of additional use cases and ultimately as an enabler for A2ARTs. To achieve this, we need to progress towards a sustainable commercial model for the future development of open banking rather than to perpetuate a free-to-access model for third party providers (TPPs) which removes incentives for account servicing payment service providers (ASPSPs) to invest and innovate.

2. Does not provide the foundations and opportunities for learnings as a first step in delivering a pathway to successfully expanding open banking, growth of the ecosystem and the range of new products and services offered. The long-term future of open banking will be delivered through several multilateral agreements (MLAs), not just for payments functionality but for data as well.

3. Fails to take the opportunity to move beyond the CMA Order. Non-sweeping VRP's were specifically excluded from the Order. The proposal to effectively extend the CMA Order requirements on the CMA9 banks is unnecessarily narrow and a missed opportunity not to use the VRP pilot to seek broader participation.

4. Does not meet JROC's ambition to create the necessary skills, and capabilities for the future entity to develop MLAs, future standards and schemes.

Creating the framework for the expansion of open banking as an enabler for A2ARTs

The development of a sustainable commercial model is crucial to the future development of the open banking ecosystem and new propositions. Both JROC's previous report of 17 April 2023 and the Future of Payments Review Report published in November 2023 (the Garner Report) were clear on the need to establish commercial models which create the right incentives for all parties to achieve the PSR's long-term goals of developing and broadening open banking-based payment propositions.

The VRP pilot is the ideal stepping stone on the journey to achieving this. However, the PSR's pricing proposal, while it may be pragmatic in a low-volume, low-risk initial environment, does not deliver the long-term strategic, sustainable solution that is needed to move open banking forward. By granting free access to TPPs, it creates market expectations that will be difficult to reverse in subsequent phases of the VRP roll-out or in future A2ART payment development. Further, it is a missed opportunity for policymakers to learn and inform future pricing structures applicable to other payment use cases.

During 2023, the PSR set out its principles for the pricing of access beyond existing regulatory requirements and for future schemes. I welcome these as a sound basis for future development, but I am concerned that the PSR's subsequent proposals in the Call for Views do not fully take account of these principles.

In contrast to this approach, there seem to be lessons that the UK could take from the work that the European Payments Council (EPC) is progressing with the SEPA Payment Account Access (SPAA) scheme. This alternative cost-based framework sets out a well-considered long-term approach to the creation of a sustainable commercial model with incentives for all participants.

The pilot is an ideal opportunity to gather learnings and data to act as a stepping stone towards the PSR's long-term vision.

Provide the foundations for delivering a pathway to successfully expanding open banking

JROC has clearly articulated that the ultimate success of open banking will be attained by the development of new and innovative products and services beyond existing regulatory requirements through the introduction of premium APIs. While I am supportive of maintaining the status quo in respect of free access to the APIs mandated by the Payment Services Regulations (PSRs), I believe that only by allowing ASPSPs to commercialise APIs offering broader or superior access will we succeed in enabling the development of the innovative and market-led solutions that would drive widespread consumer adoption

The VRP pilot is only the first example of a Premium API development. It is a missed opportunity not to use the pilot as a testbed for the approaches needed to deliver sustainable and scalable open banking propositions beyond payments. In the case of Premium APIs that relate to access to data, cost recovery by removing the marginal costs of Faster Payment Systems (FPS) charges will not present a viable long- term approach.

While I understand that the approach may be tactically attractive, it misses the opportunity to test and learn from a pilot experience in a way that is extendible to a broad set of use cases that would be valuable for the attainment of a core objective of the Committee.

It is critical that the pilot supports the development of future use cases well beyond VRP and payments to deliver a model that is scalable for future data sharing propositions which is needed to fully unlock the potential of open banking.

Moving beyond the Order

For the purposes of the pilot, I support the PSR's approach of mandating sending bank participation in the VRP pilot if voluntary participation cannot be achieved. However, limiting mandatory participation to just the CMA9 is unnecessarily narrow and backward looking. This proposed approach is at odds with the objective of moving to broad-based participation under the long-term regulatory framework. It also fails to take account of the competitive changes in the current account market that have occurred since the CMA9 banks were defined by the CMA where certain other ASPSPs now have more current accounts than some CMA9 banks.

It would be a missed opportunity not to use the VRP pilot to seek to expand participation beyond these nine organisations across a wider pool of firms that expands the ecosystem in a way that better aligns to JROC's objectives

Creating the right foundations for the future entity

To date, JROC has been clear that it sees a critical role for the future entity in the next development phases of open banking. By electing not to put OBL at the centre of the VRP pilot development, I believe we are missing an opportunity to build on existing capabilities and ensure that these can evolve to respond to future needs to develop data and payment based propositions. In the process, valuable learnings may be lost.

Moreover, the proposed approach is likely to lead to duplication, inconsistencies, and increase the costs to participants. The two key areas this will impact are, firstly, the development of the underpinning MLA; and secondly, in the supporting disputes management functionality.

The first area of developing an MLA is crucial to future development of new open banking propositions and the VRP pilot provides an ideal opportunity to start that process. I see MLAs as a critical requirement underpinning an array of new future services brought to market. Given the critical importance of MLAs to the future of open banking and beyond, it is essential that OBL plays a key role in bringing the first MLA to market as it transitions to the future entity. This will ensure that the organisation captures the learnings and builds the capabilities to drive forward the development of a broad range of open banking-based solutions.

In relation to the development of the VRP MLA, I contend that OBL already has highly relevant experience for this work. OBL has effectively built the product proposition and written the standards for VRP. It also has a track record of delivery, for example, the managed roll out of the sweeping VRP functionality and well-established relationships with both TPPs and ASPSPs. The product proposition and requirements defined in the Standard (e.g., the Customer Experience Guidelines (CEGs)) will be inextricably linked to the MLA and dispute management and cannot easily be disaggregated. Attempting to do so would create the risk of divergence between the MLA, the Standard and Disputes management.

The second key area relates to the development of the disputes management process. The work already undertaken by OBL in relation to the JROC roadmap has demonstrated a broad ecosystem consensus for the need for a disputes management process for all open banking payments, as well as data propositions.

It is also clear that there is a need for a disputes management process which can evolve as open banking-based propositions become more sophisticated and that the future entity has a key role to play in developing this functionality. In this context, I believe that by asking Pay.UK to develop the disputes management process for VRPs, we do not create the right foundations for future success. It will give rise to potential duplications and inefficiencies which could lead to poor ecosystem and customer outcomes. Leveraging the existing OBL disputes management framework offers a faster route to launch, and would provide participants with a familiar and easy to use interface, which in turn is likely to increase adoption.

The PSR report suggests that OBL does not have the capability to take forward the development of the MLA or the creation of a disputes management function for the pilot. However, I contend that OBL already has the foundations of the functionality in its technical support and monitoring functions from which this work could be developed expediently and efficiently, potentially using Pay.UK experts as part of an integrated team.

In summary, I believe the VRP pilot provides the ideal opportunity to set out on the right foot to support the future development of open banking. To not take advantage of this opportunity risks sacrificing achieving the PSR's goals of open banking's long-term success for short-term expediency.

Responses to questions

Q1. Do you think the pricing principles as published in June 2023 support delivery of a sustainable commercial model for Phase 1?
I believe that the previously published pricing principles are well-considered and should apply to the development of a sustainable commercial model for Phase 1 of VRPs and beyond. Principles 1 and 2 suggest that pricing should reflect sending banks' long-term costs, while also providing an incentive for investment and innovation in APIs. Principle 3 focuses on the need to encourage take-up by consumers and businesses. These principles make good sense. We note that the PSR has elected to use mandated participation as a key measure to address network effects. However, the current proposal to set the payment processing price at zero, despite the associated measures that are intended to make this cost-neutral to ASPSPs, are not aligned to these principles. As a result, we miss an opportunity to create a "a sustainable, safe commercial model that results in prices that are fair value, transparent and promote competition."[1] I am acutely aware that without providing a sufficient degree of commercial incentive to ASPSPs, this first development of open banking will be seen merely as an extension of the CMA Order which is "all stick and no carrot". My experience to date is that this can, unfortunately, act as a drag on implementation and make some steps of the process unnecessarily confrontational, while favouring strict compliance over innovation, functionality and outcomes. In its vision, JROC has specifically noted the critical importance of the creation of sustainable economic models to encourage competition and innovation in a more sustainable manner than previous regulatory-driven approaches have allowed. This is predicated on new commercial arrangements between participants, in which both ASPSPs and TPPs can make a commercial return for access to premium APIs. In my view it is therefore a missed opportunity that, in the first opportunity to action the principles, the PSR has proposed not to promote a commercial model that enables ASPSPs to make any form of commercial return in Phase 1. Rather, the proposed approach is not significantly different from the existing approach that underpins sweeping VRPs. I am concerned that this approach does not build a coherent pathway towards the attainment of JROC's ambitions for the long-term evolution of smart data and payments. While the approach may be expedient from a tactical perspective, enabling the pilot to get underway in 2024, it does not meet the strategic objectives of establishing and testing a sustainable commercial model. Such a model should be designed to underpin the continued development of open banking, provide opportunities for a fair return to all participants, incentivise the entire ecosystem to invest in new functionalities, collaborate to form a well-functioning network and progress premium API development beyond payments. This jeopardises the potential attainment of key benefits to end-users. While the PSR, within the consultation, is very clear that the proposed approach is aimed at scaling VRPs swiftly, I am concerned that it sets an unhelpful precedent and market expectation from which it will be extremely difficult to deviate in the future. The pilot needs to provide a runway to the rollout of VRP across a more comprehensive set of use

[1] Principles for commercial frameworks for premium APIs, June 2023, Page 8.

cases, which are inherently more complex, as well as developing learnings for other data sharing commercial arrangements. There is a significant risk that pilot commercial structures are difficult to subsequently unwind and are therefore likely to stay for the long-term, or that the absence of a commercial incentive discourages the allocation of resource to development and results in an inferior end product that meets the bare minimum requirements.

Instead, I consider that it would be helpful to establish a methodology that is intended to apply from the outset to future phases of VRP rollout as well as to the development of a broader range of premium API services more generally.

This could be on the basis that the fee is intended to recover only relevant costs (potentially with the addition of a margin to incentivise ASPSP commitment to innovation, possibly including a cap). I agree that the Faster Payment System (FPS) may be the only relevant cost in Phase 1 given that the initial pilot is specifically designed to minimise costs of dispute resolution, fraud prevention and fraud reimbursement, and the use cases are largely predicated on substitution of Direct Debit and bank transfers.

However, it seems important to flag to the market from the outset that fees are expected to be revised on a periodic basis as operational costs are quantified and the market develops.

Q2. Do you think that cross-industry coordination is necessary for Phase 1 and that an MLA is the appropriate vehicle to achieve this?

As Trustee, I have always considered that the best way to expand beyond the CMA Order mandated implementation of open banking is via the development of a "*rulebook, scheme or multilateral agreement*."[2] VRPs are the first obvious area for development, but should be seen as the first of many expansions and enhancements that are needed to fully realise the value of open banking to the UK economy and society.

I therefore wholly endorse the use of an MLA as the most appropriate vehicle to achieve cross-industry coordination and it should be one of the core objectives of the pilot to build learnings and experience in how best to develop and structure effective MLAs to expand open banking functionality.

However, in Phase 1, which is limited to low-risk use cases, a very limited MLA is required. The work currently underway in UK Finance to develop an initial MLA could deliver against this. It is encouraging to see collaborative industry activity such as the UK Finance initiative and it would be beneficial for regulatory activity to support continuation of this.

Q3. Do you think Pay.UK is best placed to operate the MLA for Phase 1?

The primary reason set out in the consultation for the decision for Pay.UK to operate the MLA for Phase 1 is expediency and Pay.UK's existing experience in managing MLAs. I believe there are several other important considerations that need to be taken into account before this important decision is confirmed.

My view is that assigning this work to Pay.UK is a missed opportunity to drive the long-term development of open banking, both payments and data, which would be

[2] Trustee End of Implementation Roadmap Report, January 2023.

better served by keeping the MLA development together with the management of the Open Banking Standard. This is not to say that Pay.UK does not have a role to play, but that mandating Pay.UK alone would create unnecessary divergence and operational challenges for participants. I believe instead that OBL and Pay.UK could work together, harnessing the expertise of both organisations, to develop a model based on the existing Open Banking Standard and dispute management processes. This could generate greater industry and consumer benefits at pace.

My rationale for this position is as follows:

Long-term strategic development of open banking: it is clear to me that the long-term future of open banking will be delivered best through several MLAs, not just for payments functionality but for data as well. This is the clearest and simplest way in which new functionality can be rolled out beyond the regulatory requirement, while also creating appropriate liability models, commercial conditions for TPPs and ASPSPs and protection for consumers. The expertise in developing these MLAs should reside in the future entity.

JROC agrees with my position on this, as I note in the JROC Recommendations report that JROC *"expect the future entity to convene and promote ecosystem discussions with a wide range of stakeholders where appropriate, and act as a facilitator in circumstances where collaboration between open banking participants and key stakeholders (including consumers and businesses) is required. For example, this would include supporting the development of multilateral agreements for new services and premium APIs, such as VRP for non-sweeping use cases."*[3]

As clearly envisaged above, the assumption is that the future entity would assume responsibility for MLAs which add incremental functionality or expand the scope of open banking beyond the regulatory core. This is, therefore, a critical function and yet for the duration of the pilot it is planned that the MLA for the VRP pilot will be developed and operated by a separate entity. Rather than building the capability for this within OBL and the future entity, the learning and ownership is fragmented. Potentially, there is a view that this MLA will be transferred to OBL in the future, but this simply creates another complex dependency and complication to the transition process.

Given that the ability to develop MLAs is considered an important function of the future entity, allocating this work to Pay.UK alone is a clear lost opportunity to build the skills and experience needed in OBL and the future entity.

Stakeholder engagement: OBL has over seven years' experience of engaging with a broad range of stakeholders and balancing their needs. We have well-established relationships with all the large TPPs and banks, and have convened multiple large ecosystem working groups over several years as well as incorporating the views of consumer organisations and small business. We have worked hard to build consensus across these diverse communities (TPP, ASPSP and end-user) and are broadly acknowledged to have succeeded in this. Pay.UK's engagement is typically much narrower, and it has very limited relationships with TPPs.

Relevant experience: I acknowledge that Pay.UK has experience of managing payment schemes and rulebooks. However, its experience of open banking is much more limited. VRPs under the pilot will be made using the Open Banking Standard and framework. Many elements of the MLA can be found in the VRP Customer Experience Guidelines and additional guidance, which will need to be translated into legal requirements on participants as part of the MLA. This experience is highly relevant.

[3] Recommendations for the next phase of open banking, Para 3.5.

I would also point out that UK Finance's work on model clauses will provide clauses for the MLA to cover where there are gaps in regulation and will also provide explanatory notes on how dispute-handling can be managed so much of the legwork for a successful VRP MLA pilot will have already been done.

It would also be entirely possible for Pay.UK's experts in developing and managing MLAs to work with OBL, either as part of the broader team or to be seconded to OBL to transfer knowledge and help to build a vital centre of excellence for the future. It is worth highlighting the very successful collaboration on JROC Workstream 4 between OBL and Pay.UK, where Pay.UK technical experts made valuable contributions to OBL-led workstreams.

Divergence between the VRP Pilot and the Open Banking Standard: as Trustee, I have significant concerns that a divergence could emerge between the VRP pilot and the broader Open Banking Standard. We need to minimise divergence and the most effective way of doing this is by ensuring that a single body oversees both the Standard and the MLA. This would be best achieved if OBL manages the MLA for the VRP pilot, using Pay.UK experience where needed in technical areas.

There are broader divergence risks if OBL does not develop the MLA. The way in which VRP operates today, the experience, the proposition and the limitations, are set out in the CEGs, part of the Open Banking Standard. The MLA must logically be an extension of these guidelines and any divergence would cause confusion, undermine the validity of the Open Banking Standard and cause issues for entities using the Standard.

Disputes: the PSR has prioritised expediency for this pilot. One important functional requirement for the pilot is a simple, effective disputes system to ensure that consumers can obtain redress and liability can be effectively assigned between participants, cases forwarded to the appropriate party and disagreements on liability between participants can be resolved. Given that the volume of disputes in the pilot is likely to be low, OBL has an existing ticketing system and monitoring function which we believe can meet the dispute and arbitration requirements of the VRP pilot. Disputes and the MLA need to be seamlessly managed by the same organisation. In addition, the OBL-led JROC Workstream 3 on consumer protection identified as a gap the lack of a dispute management process across all of open banking (both payments and data). Given the overlap, it would make commercial and economic sense for OBL to develop the dispute process for the pilot which could then be built on to develop a wider dispute process for open banking payments and data.

Payment-agnostic: the Open Banking Standard is payment system-agnostic. This reflects PSR requirements which require that any payment instruction that can be initiated directly by a customer via online banking has to be available via open banking. This should include internal transfers, FPS, BACS, CHAPS, SEPA and SWIFT.

While the majority of VRPs will likely pass through FPS, that is not always the case. In particular, a significant minority of VRPs are expected to pass through banks' own internal systems (where the sending bank is the same as the receiving bank). Pay.UK, as the payment systems operator for just FPS and BACS, is not well placed to create an MLA which is payment system-agnostic. It could be problematic from, for example, a competition law perspective for Pay.UK to set rules for internal bank transfers or other competing payment systems.

Q4. 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?

I understand the PSR's view about the potential control and dominance that the sending firms would have in the market, given an ability to control access and charges to the payment initiation service providers (PISPs). I note the PSR's position that sending firms' position of relative strength could lead to sub-optimal outcomes in terms of the growth of VRPs, such as limiting PISP access. As the PSR suggests, this could limit innovation in the market and slow the adoption of VRPs by billers.

In the first phase, I understand the need for regulatory intervention to provide impetus for the rollout of VRPs. Without this it will be difficult to compete against existing, well-established payment methods. In this context, aligning the prices for sending firms with competing payment methods and mandating sending firm involvement is a useful way to overcome the concerns highlighted by the PSR. However, we question whether this provides a sustainable, longer-term approach to address the concerns.

In terms of the infrastructure around VRPs, it is critical that access is provided by ASPSPs on a non-discriminatory basis and charging is fair. We note that there is precedent in payments legislation for the creation of rules requiring access to infrastructure e.g., payment systems, to be made available to authorised participants on a proportionate, objective and non-discriminatory (POND) basis. The combination of imposing a similar requirement, along with strict controls on the cost of access, would in my view also overcome the concerns highlighted without distorting the market or creating perverse incentives to stifle or delay innovation.

Q5. Do you think there are relevant sending firm related costs we have not yet considered?

While I broadly agree that the relevant costs are likely to be those identified by the PSR, an explicit purpose of the pilot phase should be to quantify any other relevant costs that may be identified. While, by design, the pilot is intended to limit the incidence of consumer dispute by exclusively focusing on low-risk use cases, some dispute management will inevitably be required. Similarly, VRPs may result in an increased level of customer enquiries due to it being a new, unfamiliar payment mechanism.

The pilot approach should be used as an opportunity to identify sending firm related costs that can be identified and included within the baseline cost recovery mechanism in the future. Establishing a price-setting methodology that is capable of evolution as new costs are identified during the expansion of VRPs beyond initial limited use cases will be important. While consumer protection and dispute resolution costs are, by design, limited in the first phase of rollout, these will become more relevant on the path to expanding VRPs and facilitating full A2ARTs. The model currently proposed by the PSR does not appear to be capable of expansion in this way.

This limited tactical approach to the setting of the commercial model in the UK stands in stark contrast to the approach adopted by the EPC for the SPAA scheme.

The EPC has taken a multi-stakeholder approach, underpinned by independent economic evaluation, to develop a cost-calculation methodology using anonymised and aggregated data collection to establish default fees to be used where alternative bilaterally agreed fees do not apply. It appears that this approach has been embraced by market participants. Our view is that this more strategic approach to price setting which will evolve in line with the market is more sustainable in the long term.

The UK should consider adopting a similar approach to ensure the basis for expansion of VRPs as an enabler for A2ARTs and as the basis for the evolution of premium APIs beyond payments. This is a key next step in the continued innovation in open banking.

It should also be noted that the Garner Report recommendations make a compelling case for the inclusion of a margin that incentivises investment by ASPSPs and breaks the cycle that requires regulatory intervention to deliver expansion.

Q6. Do you think allowing sending firms to charge for FPS related costs or removing the costs where possible is a better approach?

I support the PSR proposal to remove FPS costs as an enabler for the pilot. However, it is not a sustainable model for the future and a focus on evolving the commercial model for the future is essential.

I consider that enabling firms to recover costs is the preferable long-term sustainable model. Costs cannot be removed, they will simply be displaced. While the proposed tactical approach ensures that sending firms do not bear the relevant cost, presumably some underlying cost of the transaction is ultimately carried by Pay.UK.

While this has no appreciable effect in the Phase 1 pilot, where the volumes are envisaged to be small, if open banking payments were to expand in line with the JROC ambition, limiting cost recovery from the relevant end beneficiaries of a transaction will be more problematic. The proposed approach introduces the prospect of cross-subsidisation, which does not appear to be a sustainable future-proofed approach.

I believe that, wherever possible, approaches established from the outset should be designed in a way that enables progressive evolution to meet envisaged future needs rather than a short-term tactical approach that will need to be significantly revised at a later date.

Q7. 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?

Sending bank costs are not the only relevant costs and the PSR needs to look holistically at costs across the chain, including the receiving bank costs.

We understand that ASPSP charges for FPS acceptance are an issue for many PISPs which operate settlement accounts or otherwise to billers themselves. In order for the PSR to achieve its long-term objective of creating a credible alternative to other payment mechanisms, including cards and Direct Debits, it is necessary that the VRP pricing is lower than that for competing payment mechanisms. This is the critical for the long-term future success of VRPs and the attainment of the PSR's long-term objective to promote wider choice.

Q8. Do you think there are relevant OBL related costs we have not yet considered?

Some initial work has been undertaken by OBL to quantify potential costs to facilitate the initial launch of a pilot as well as an outline of subsequent costs that might be required if more substantive developments are considered necessary in relation to the development of a disputes management system or some of the functional requirements outlined in the VRP Working Group blueprint.

It is envisaged that these initial estimates will be revisited in light of findings from the Pay.UK and OBL-chaired implementation groups. OBL costs are expected to be modest given the limited requirements for Phase 1.

OBL is always completely transparent about its costs and where they are incurred. The current non-CMA Order approval arrangements mean that costs are forecast and subsequently tracked.

However, relevant costs that extend beyond OBL should be captured and considered. Costs are not the primary driver for decisions around the allocation of responsibility for pilot deliverables and the entities best placed to progress certain activities. However, if they are to be considered within the mix it does not seem sensible or appropriate for cost assessment to be exclusively limited to OBL costs.

Q9. What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

I understand the PSR's rationale for an expedient commercial for the purposes of the phase 1 pilot. However, I do not consider this to be a sustainable model for the long-term development of VRPs or open banking more broadly. It is important from the outset for the PSR to signal the how pricing is likely to evolve in phase 2 and beyond in order that all parties can see the necessary incentives for their business.

By not adopting the longer-term commercial model for the phase 1 pilot we potentially miss the opportunity to test and learn.

The commercial model in the long-term need not be predicated exclusively on cost recovery as set out in the Garner Report, but acknowledge that cost recovery is an important component. The Strategic Working Group process identified that misalignment or lack of commercial incentives was likely to impede the attainment of the widespread extension of open banking payments to the full range of use-cases, especially A2ARTs. It seems important that any commercial model specifically aims to encourage ASPSPs to invest in open banking payments. A model needs to ensure that there are viable commercial incentives for all parties to achieve the promotion and extension of open banking payments I do not consider that an approach which merely seeks to make ASPSP participation cost neutral achieves this.

The European approach should be informative. While the UK was the first country to develop an Open Banking Standard, many other countries are developing their own models. They have often looked closely at the UK experience to inform their approaches. However, there is equal benefit in the UK looking to other markets to inform our blueprint for the development of consumer-controlled data access regimes.

The approach to commercial model development by the EPC for the SPAA scheme is useful. Its starting point is rather different in that they have identified value-added ('premium') services rather than VRP use cases as implementation objectives. However, it has adopted a pricing approach based on the ability of ASPSPs to recover costs, based on robust cost studies. This model is more likely, in my view, to drive the innovation that JROC desires.

I believe that open banking will become increasingly widely adopted as the functionality it enables increases. We have successfully delivered the plumbing for the system, and the next steps require consumer benefits to be available that make it worthwhile to use it.

Not all of these can be delivered by regulatory mandate. The commercial model needs to be able to cater for an array of future premium services if open banking is to achieve its full potential. Taking an exclusively tactical approach at this time, focused on delivering only VRPs and driven largely by timeline considerations, is a missed opportunity.

Q10. 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?

VRPs have attractive features and benefits that will incentivise use of the VRP-related propositions. I am highly supportive of the PSR's vison and ambition to accelerate the expansion of VRPs as a key enabler for A2ARTs that will deliver benefits to end users through enhanced innovation, choice, and competition.

There are different approaches to ensuring the expansion of VRPs, and this includes a sufficient level of mandated participation and consumer coverage – including beyond the CMA9 - in the pilot that will enable and incentivise use by PISPs and merchants. However, the real incentive to meet the long-term objective of increasing competition, consumer choice, and innovation is to move towards a sustainable commercial model and beyond mandating participation, which can be counter-productive in the long term.

Q11. 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?

I consider that the findings set out in the VRP Working Group Blueprint Report are compelling. This suggested that a 60%-70% coverage would be the absolute minimum requirement to enable billers to consider implementation of VRPs. For a pilot to proceed and fulfil its purpose of delivering learnings which inform future developments, adequate biller adoption is necessary.

Q12. Should we mandate the CMA9 banks to participate in Phase 1 of VRPs?

I strongly challenge the proposed approach of effectively extending CMA Order requirements on the CMA9 banks. The CMA9 is a concept of the CMA Order, and it would be a mistake not to use the VRP pilot to seek to expand participation beyond these nine organisations particularly given the potential of VRPs to promote competition.

Limiting mandatory participation to the CMA9 seems unnecessarily narrow, particularly given the competitive changes in the current account market that have occurred since the CMA9 banks were defined by the CMA e.g., other ASPSPs may now have more current accounts than some CMA9 banks. The Committee is already talking to a wider pool of banks regarding the funding of Workstream VRP related work to progress key activities set out in the Response to the Blueprint.

While we agree that mandatory direction may be required at first in order to achieve the coverage threshold set out in our response to Q11 above, I believe there is a better basis for that mandate. An alternative basis for the mandate could be directing any ASPSP that has the technical capability to support sweeping VRPs by Q3 2024 to participate in the pilot, subject to an adequate cost-benefit analysis.

A further alternative would be to mandate participation on the basis of market share. I agree that it would be challenging to require any ASPSP which doesn't have the capability to build it prior to the target date, but I see no reason why firms who currently have capability would not be reasonably expected to participate.

Q13. 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?

As set out in in our response to Q12 above, I support the concept of mandatory participation, but do not consider that this should be exclusively restricted to the CMA9.

Q14. 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?

I do not think there will be significant risks and costs for those banks already offering sweeping VRPs.

Q15. Do you see advantages in any alternative models?

For the purposes of the pilot, I support the PSR's approach of mandating sending bank participation in the VRP pilot if voluntary participation cannot be achieved. It is encouraging that twelve participants are working together to develop the MLAs under the UK Finance initiative which indicates willingness to participate on a voluntary basis, including beyond the CMA9. It is essential for the long-term development of open banking that we move away from mandated participation and towards a commercially incentivised model. It is absolutely critical to create incentives for participants to commit and invest in the development of VRPs. It is very important for regulatory intervention to be a catalyst for the development of a long-term sustainable model.

Not all the areas where we believe improvements are required should necessarily be mandatory for banks to provide free of charge to TPPs. For some additional services, it may be useful to have standards, set uniformly across the market, for which commercial fees are applicable. This will increase the incentives for banks to develop their offerings further.

In contrast to the regulatory APIs that open banking currently provides, which the CMA9 are required by law to provide free and without contract, premium APIs are intended to open up myriad new opportunities beyond regulatory compulsion to the mutual benefit of ASPSPs and TPPs. This will deliver future revenue opportunities to both.

Open banking has to date been focused on the mandatory provision of a relatively small number of standardised APIs linked to payment accounts.

Allowing banks to charge for premium APIs is a pragmatic move, to increase cooperation and bring about the changes needed more rapidly than if banks were required by law or regulation to do so. Much evidence suggests that this approach is mutually attractive to both TPPs, which could develop much richer product offerings, and could offer a significant potential revenue stream to banks that has so far been missing from open banking. This provides the real potential to support the roll-out of new services to customers that the core APIs do not allow for.

The Committee recognises that resolving a misalignment of incentives that underpins many of the barriers to the attainment of a well-functioning and expandable ecosystem is a key priority. For instance, in the Strategic Working Group (SWG) process, ASPSPs often claimed that there was limited incentive for them to invest further funds to deliver more than the regulatory minimum. However, many TPPs urgently require further improvements in performance to support wider adoption of open banking, new functionality and access to additional datasets.

For open banking to successfully develop we need to move beyond being a competition remedy and look to harness commercial incentives. It will be a missed opportunity for open banking if the first attempt to implement a premium API makes no attempt to align participation incentives. This will erode the value of a pilot and the application of learning from it to facilitate delivery of a broader set of premium APIs.

Q16. 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?

We have already covered our views in the responses to other questions

Q17. Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis?

I agree that the three proposed use cases are appropriate. However, I would highlight that the pilot use cases are very close to existing VRP sweeping use cases defined by the Open Banking Standard. There will be considerable overlap between these and there needs to be consistency in approach across all other types of open banking payments.

It is important to ensure that there is consistency between sweeping and non-sweeping VRPs. If this does not happen, there is the risk of divergence between sweeping and non-sweeping VRP functionality and customer experience. This needs to be effectively managed both from a participant and customer perspective. Failure to do this could lead to customer confusion and affect the uptake of both sweeping and non-sweeping VRPs.

Given how close sweeping and non-sweeping use cases are (for example, a secured loan is non-sweeping, an unsecured loan is sweeping), it is essential that there is no divergence in the customer experience or functionality between these two products.

Q18. Do you agree with these initial assumptions for the cost benefit analysis?

I have no comments in relation to this question.

Q19. 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?
We have already covered our views in the responses to other questions, but believe there should be greater focus on the definition of the pilot's objectives and success measurement.
Q20. 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?
The pilot approach can inform long-term strategic view on pricing and the relevant heads of costs, for example, should give us some indicative data on the extent of disputes etc.
Q21. How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?
I agree with the PSR's view with that the proposals do not disadvantage anyone with protected characteristics.
Q22. Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase1?
I am highly supportive of the Committee's ambition to accelerate the expansion of VRPs as a key enabler for A2ARTs, and as a first step in delivering the pathway to successfully expand open banking to move to a new, economically sustainable phase with new products and services. I also fully understand the desire to drive progress towards these objectives as quickly as possible. However, it is imperative that the approach is fully aligned to achieving the stated long-term objectives set out by the Committee. I have concerns that the proposed approach set out in the PSR's consultation fails to achieve this purpose and may actually impede the attainment of the ultimate ambitions for the evolution of smart data and payments. The Committee clearly articulated the importance of the development of a sustainable commercial model that will underpin the next phase of the evolution of open banking in a way that secures its future. Notably the Committee set out that: • ***"The development of premium API propositions that facilitate and incentivise ongoing innovation for the benefit of businesses and consumers is an important part of moving to an economically sustainable and scalable open banking ecosystem."*** [4] • ***"In order to encourage competition and innovation in a more sustainable manner, the ecosystem must encourage and facilitate new commercial agreements***

[4] Recommendations for the next phase of open banking, Para 4.50

to emerge between participants, in which data holders can charge for access to premium APIs."[5]

I fully endorse this premise.

The premise of VRP to date is that some categories of VRP justify regulatory underpinning. In July 2021, the CMA mandated the use of VRPs as the mechanism for implementing sweeping as envisaged by the Retail Banking Market Investigation Report.

It was broadly expected that VRP for use cases beyond the CMA Order would be subject to an alternative approach which gave ASPSPs a commercial return for providing access. Such an extension fully aligns with a key observation made in the JROC report which states that, "*While recognising that the regulatory driven approach to-date, underpinned by free access to data remains pivotal to democratising access to data as well as to supporting innovation and competition to take this to the next level we need commercial arrangements that are fair and proportionate for a multitude of new products and services…*" [6]

This is also entirely consistent with one of the key recommendations emerging from the Garner Report which states that: "*Open Banking now has the technical potential to: a) create a viable alternative to the card schemes and b) improve the bank transfer payment journey – but only if the current commercial arrangements are changed.*"[7]

In fact, the Garner Report argues that the approach articulated in the Committee's Report published in April 2023 does not go far enough. It recommends that a commercial model should be extended across all open banking-initiated payments rather than just commercial VRPs, and argues that a sustainable commercial model will be required to fund consumer protections and provide adequate consumer protection.

It was noted that without a sustainable commercial model there was little incentive for ASPSPs to invest and support it. The report was particularly critical of any approach that relies on costs being funded from profits generated elsewhere. Their view was "t*his creates cross-subsidy and replicates the problems created by the 'free if in credit' banking model.*"[8]

Set against these aspirations, the PSR's proposed approach for what is the first example of premium API development fails to deliver a substantively changed commercial model and essentially extends the obligations to provide access for non-sweeping use cases on the same terms and at no cost to TPPs. This misses the opportunity to test and learn from a pilot experience in a way that would be valuable for the attainment of one of the Committee's core objectives.

Moreover, the proposals disregard what the Committee set out as key capabilities needed of the future entity. Again, the Committee's report published in April 2023 clearly articulated a number of expected capabilities required of the future entity. Pivotal to this was the role of the future entity as a "*facilitator in circumstances where collaboration between open banking participants and key stakeholders (including consumers and businesses) is required. For example, this would include supporting the development of multilateral agreements for new services and premium APIs, such as VRP for non-sweeping use cases*".

There is no doubt that the future entity will need the tools and capabilities to manage MLAs.

We noted in our response to Q9 that the SPAA scheme is focused on the development of MLAs for several potential premium services. This includes what it refers to as dynamic recurring payments (the equivalent of VRP).

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[5] Recommendations for the next phase of open banking, Para 2.13
[6] Recommendations for the next phase of open banking, Para 2.6.
[7] Future Payments Review – Conclusion 7 pg. 71
[8] Future Payments Review – Conclusion 7 pg. 71

It is notable that in establishing SPAA, the EPC had consciously chosen to position the MLA as relating exclusively to the exchange of payment account-related data and to the facilitation of the initiation of payment transactions between PISP and the sending bank. The underlying payment is not part of the Scheme, and the Scheme is payment scheme and infrastructure agnostic.

Our view is that even in the case of payment initiation, the MLA can and should sit outside the payment scheme as it relates to just the initiation of the payment. As set out in the diagram below (which refers to FPS only), the MLA is between the TPP and the sending bank. It may refer to obligations on the merchant or customer, but these are dealt with in back-to-back contracts with the TPP. The MLA does not include the receiving bank.

The obligations that arise between sending and receiving bank are entirely governed by their existing arrangements via their participation in the PSO and the scheme rules that apply. We consider that these arrangements are entirely suitable to sustain any "payment overlay" services.

OBL has effectively built the product proposition for VRPs and has established VRP consent that restricts the way in which it can be used to initiate payments. A core part of the Standard CEGs that govern the interplay between the TPP and the ASPSP, providing customer control in a secure environment.

The guidelines prescribe the information that customers need to be given, the permissions they are providing, and the service they will receive. The product proposition and rules defined in the Standards CEGs will be inextricably linked to the MLA and dispute management and cannot be sensibly disaggregated. Attempting to do so would create the risk of divergence between the MLA, the Standard and disputes.

This suggests to us that OBL and the future entity are the obvious candidates to orchestrate MLAs across both payment and data schemes in future and, irrespective of any decision taken in relation to VRPs, will need the capability to do so.

It is disappointing that the PSR has come to an initial view that it would be difficult for OBL to stand up the capability to take ownership of an MLA and a disputes mechanism system in the time available.

I disagree with this analysis. As set out in our response to Q2, OBL has existing capabilities that are relevant and, importantly, has existing relationships across all parties to an MLA, a deep and comprehensive understanding of the VRP proposition and how it operates, experience from the successful delivery of the managed rollout of sweeping VRPs, and an existing system which could enable intra-party disputes to be raised and processed.

My view is that these current capabilities provide an excellent starting point for the initial VRP pilot requirements to be delivered quickly, efficiently, and economically. The alternative approach that the PSR suggests will add complexity and additional time involved in standing up the VRP pilot.

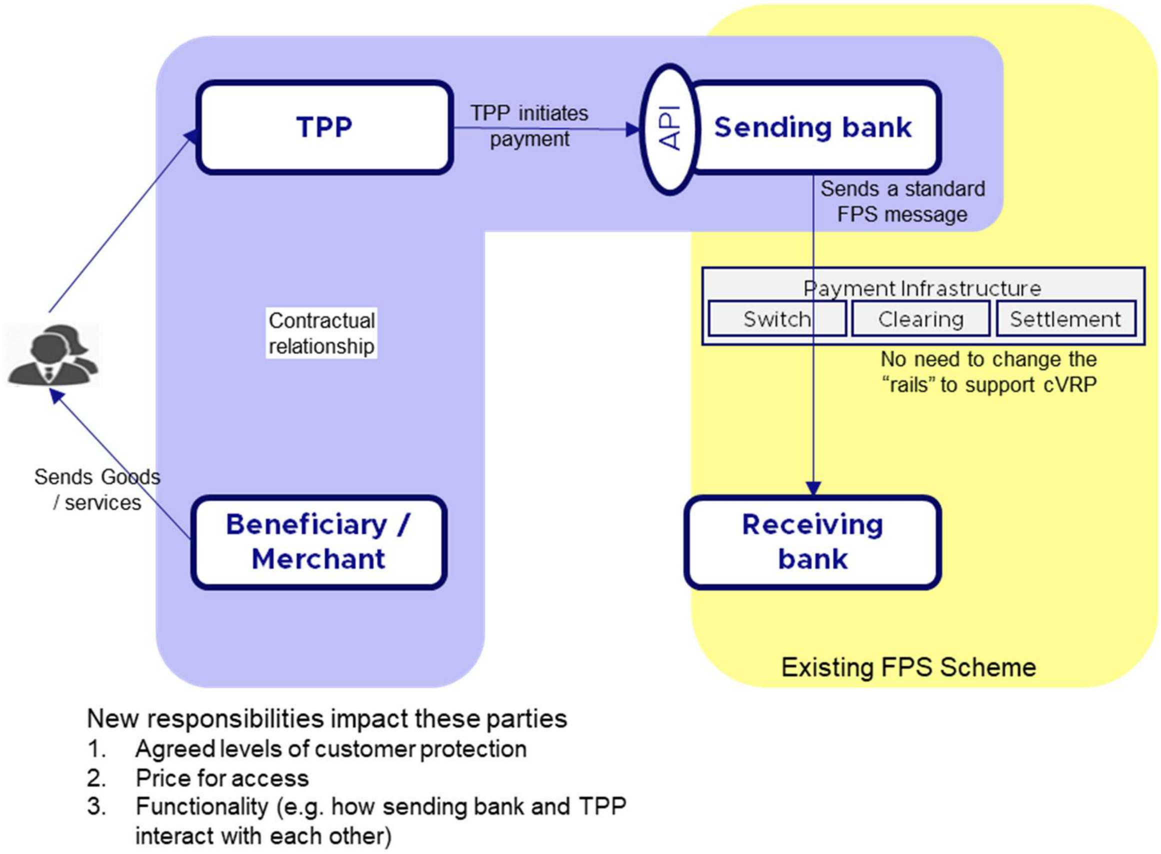
I also note that, in just six years, OBL has successfully created a world-leading open banking Standard and ecosystem, as required by the CMA Roadmap, demonstrating our ability to deliver on, and quickly adapt to, short-term and long-term objectives, in many cases under challenging circumstances. However, irrespective of whether the approach is tactically justified, the future entity most certainly needs MLA development and dispute management capabilities to achieve the expectation and purpose that has been set for it.

The development of improved or new open banking propositions is inextricably linked to the evolution of premium API services. This is recognised by the Committee. It makes little sense to take a short-term decision on this point, which could "*not be seen as* *determinative of any future decision on who would operate other open banking payment systems*".

Achieving that objective from the outset reduces the cost and complexity of downstream change as well as equipping the future entity with the essential capabilities that it needs. To do otherwise not only adds cumulatively to the expense and complexity of developing open banking, but risks introducing fragmentation, an inability to reuse key learnings from the pilot in other uses cases and sectors, resulting in duplication.

My concern is that cumulatively this may significantly impede the progress towards the outcomes that industry and regulators are striving to achieve.

The diagram below shows a VRP being sent on FPS rails:



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Open Banking payments subject matter expert

Page 2: General Comment

I wholeheartedly endorse the advancement of Variable Recurring Payments (VRPs) as a pivotal element within the UK's payments landscape. It is evident that VRPs possess the potential to diminish dependence on card-on-file solutions and, with the appropriate pricing structure, could also catalyse transformative changes within the Direct Debit sector.

Nevertheless, I view innovations such as Request to Pay as holding greater significance in bestowing consumers with control over their payments and serving as an indispensable tool in curbing Authorised Push Payment fraud. Consequently, I find myself perplexed by the Payment Systems Regulator's (PSR) omission of intervention to mandate the adoption of Request to Pay by banks, as suggested in this consultation document. A comprehensive PSR-provided overview of the payment landscape, along with identified priorities for intervention, would significantly enhance market comprehension, guiding the direction of development emphasis.

Furthermore, I express reservations about the involvement of Pay.UK in the critical delivery path of VRPs. I staunchly believe that payment overlay services should be independently owned and managed apart from Pay.UK. This approach ensures that Pay.UK remains dedicated to operating core payment systems without hindering innovation. Reflecting on Pay.UK's track record in innovation, from the introduction of PayM to Request to Pay and New Payments Architecture, underscores the effectiveness of this separation.

Naturally, in instances where updates to Faster Payment rules are necessitated, they should be included to facilitate execution of the requirements. However, I envisage this process occurring akin to the recent PSR instruction regarding new Authorised Push Payment rules, which was a consultation conducted externally but inclusive of Pay.UK and subsequently issued for their action.

Page 3: Response to questions

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.

To ensure the success of Variable Recurring Payments (VRPs), it is imperative to carefully deliberate on the ultimate cost or price range for the customer. Current evidence indicates that prevailing pricing structures result in merchants incurring significantly higher costs for conducting VRPs compared to payments made through Direct Debit. If the initial pricing in the first phase achieves similar outcomes, VRPs might be confined to relatively niche use cases.

Hence, I posit that while the outlined pricing principles serve as a reasonable starting point, a sustainable commercial model necessitates extrapolation and comparison with the prevailing market prices for existing regular payment methods. This assessment must encompass any charges imposed by the receiving bank on businesses for processing Faster Payment transactions.

It is important to acknowledge that this pricing model may exclude certain potential use cases, such as person-to-person money transfers, as charging consumers for a payment may not be viable. I believe this limitation is acceptable, provided alternatives such as the full implementation of trusted beneficiary lists, as stipulated under PSD2, are considered. This approach would enable the use of single immediate payments to attain the same objective.

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.

I believe that opting for a Multilateral Agreement (MLA) is far more advantageous than the completion of multiple bilateral agreements, considering the unfair competition and practical challenges elucidated in your document. However, given the substantial standardisation in pricing, liabilities, and common "guardrails," I seek clarification on the structure the MLA will assume.

My preference leans towards a single scheme manager overseeing contractual agreements that interface with Third-Party Providers (TPPs) on one side and Account Servicing Payment Service Providers (ASPSPs) on the other. Alternatively, a set of terms and conditions could be established, requiring TPPs to adhere to them, and once signed, necessitating no further ASPSP authorisation. To be explicit, I aim to avoid a singular agreement that mandates approval from each downstream ASPSP, as this could prove impractical.

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.

I hold the view that Pay.UK is not well-suited to be involved in the Multilateral Agreement (MLA) or bear responsibility for Variable Recurring Payments (VRPs). While their experience is valuable and they should have the opportunity to contribute to discussions, their role should be limited.

Pay.UK is currently undergoing an unprecedented upheaval, marked by a failure to deliver on several innovative projects, including PayM, Request to Pay, and New Payments Architecture. Industry-wide concerns also exist regarding potential disruptions to Confirmation of Payee due to Pay.UK's rejection of OBIE's directory without sourcing a viable alternative first. Imposing an additional burden on this organisation should be deemed a significant risk, especially considering the importance of VRPs as a key innovation in UK Payments.

Moreover, Pay.UK has not effectively utilised its Faster Payment rules to curb Authorised Push Payment Fraud. Given that APP fraud has been labelled by UK Finance as a "National security threat" and has surpassed card fraud, it is unwise to assign additional responsibilities to Pay.UK until it demonstrates the capability to control existing schemes. While I acknowledge recent APP rule changes, they were implemented as per the PSR's instructions. We require an entity that can consult and independently manage the service, and my recommendation would be that this is Open Banking Limited (OBL).

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?

I concur with this perspective, and it seems substantiated by the current VRP pilots in the market, which appear to be cost-prohibitive for widespread merchant adoption. However, in our assessment of pricing structures, it is crucial to consider end-to-end costs and identify any fees imposed by the receiving bank on businesses for processing Faster Payments transactions. This scrutiny is essential to avoid the possibility of a double charge scenario.

Hence, I agree that it is imperative to establish a pricing framework, taking into account the end-to-end costs incurred by the merchant. Such an approach would foster healthy competition while ensuring that the pricing model aligns with the overall cost structure of the VRP system.

Question 5.

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

No comment

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.

Your concern is valid, and it highlights a potential ripple effect in the form of increased charges passed on to businesses if all Faster Payments Service (FPS) related charges are shouldered by the receiving bank. This could, indeed, amplify the overall cost of Variable Recurring Payments (VRP) as merchants would then be compelled to cover both Third-Party Provider (TPP) related costs and additional bank charges.

To address this, a preferable option could involve the removal of charges altogether, mitigating the risk of an additional financial burden on merchants. By exploring ways to eliminate charges associated with VRPs, we can create a more conducive environment for widespread adoption and ensure that the benefits of VRPs are not overshadowed by increased costs for merchants. This approach aligns with the goal of fostering a competitive and cost-effective landscape for VRPs in the payments ecosystem.

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?

As above.

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

Should OBL actually become the scheme manager clearly more costs will be attributable to them and recovered directly.

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

I propose that, instead of commencing with cost considerations, our primary focus should be on defining a target pricing structure that facilitates healthy competition between Direct Debits and Variable Recurring Payments (VRPs). Achieving this benchmark is pivotal for ensuring the sustainability of VRPs, as insufficient volumes could impede their viability. Subsequently, we can adopt a reverse engineering approach, factoring in the costs incurred by each participant, to determine the percentage distribution of the benchmarked fee among all stakeholders involved.

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.

Absolutely, this is pivotal. The primary factor behind the failure of Request to Pay lies in the absence of constructing a self-sustaining network. The true value of any network lies in its reach, and early adopters often find themselves at a first-mover disadvantage, trapped in a 'chicken and egg' scenario with a limited audience. Preparing the market in advance by seeding it with a ready supply of consumer-activated accounts addresses one of the major concerns for billers. However, it's crucial to note that pricing and functionality cannot be disregarded in this process.

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.

It's evident that a higher percentage of reachable consumer accounts is advantageous. However, acknowledging the practicalities, achieving 100% coverage from day one is not realistic. To establish an acceptable target, we could consider using card conversion as a benchmark. Merchants typically find satisfaction when approximately 70% of their card transactions successfully conclude. Applying this principle to bank transactions, we recognise that at least 70% of bank consumers need to be available to ensure an equivalent conversion (first transaction), excepting any technical challenges. Considering potential dropouts during mandate signing and apprehensions about new or different processes, a reasonable target for consumer coverage might fall within the range of 80-90%

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

Absolutely. As emphasised in my introduction, Request to Pay offers heightened consumer control and enhanced protection against Authorised Push Payment (APP) fraud, a menace costing financial services hundreds of millions annually. Despite these advantages, the Payment Systems Regulator (PSR) has not mandated its adoption, resulting in not a single bank voluntarily embracing the scheme. The prevailing justification provided by the overwhelming majority of banks is their reluctance to join the service due to the absence of an established network.

Presently, banks also have the option to voluntarily provide Variable Recurring Payments (VRPs), but the majority have chosen not to participate, and those that have often lack competitive pricing. Given the substantial body of evidence, it becomes imperative that VRPs are mandated to ensure widespread adoption and to address the evident hesitations among financial institutions.

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?

An alternative approach could involve collaboration with major players such as Google, Apple, and PayPal to devise a solution that doesn't hinge on traditional bank accounts. Leveraging their extensive customer reach, these entities possess the potential to create a viable alternative.

It's advisable to steer clear of utilising SMS and email in any such solution. Considering the prevalent threat of Authorised Push Payment Fraud, introducing these insecure channels into any payment system should be actively discouraged.

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?

The primary risks associated with mandating participation mirror the challenges encountered during the initial implementation of Open Banking. When participation becomes mandatory, it often falls under the purview of regulatory teams within banks, who may perceive it as a checkbox exercise, ensuring compliance with the law without necessarily focusing on broader functionalities. The rollout of PSD2, for instance, prompted numerous clarifications from regulatory bodies to determine the scope of the mandate, addressing aspects like refunds which were initially unavailable.

While it may be challenging to entirely avert such scenarios, the associated risks can be mitigated by explicitly outlining the desired use cases and functionalities to be enabled upon completion of the exercise. Unlike Open Banking, which primarily focused on access and left room for ambiguity, this time, we have the opportunity to proactively address and avoid potential uncertainties.

Question 15.

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

No, I strongly support the model outlined

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?

I believe you should consider what TPP licensing should apply. I believe that VRPs as a new development distinct from previous Open Banking roll out requires a specific licence. I think this is warranted on the basis that the risk profile of a VRP payment is in my opinion less than that of a single immediate payment. It would also enable new entrants to apply for a relevant licence which is not possible today as only sweeping is today licensed as part of a PIS licence.

What was really helpful from OBL were the customer experience guidelines. These should be published alongside the mandate showing what good looks like and removing as much ambiguity from the process as possible.

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.

While the current list of use cases positions Direct Debit as the likely incumbent payment method, utilising it as a benchmark serves as a valuable test case to ensure the effective competitiveness of Variable Recurring Payments (VRPs).

Yet, the current examples may not adequately address scenarios involving card on file or the financially vulnerable. To thoroughly assess VRPs' potential as an alternative to card on file, it would be beneficial to include a major retailer that currently employs card on file as part of a subscription service. Examples such as Amazon, Netflix, and Spotify could provide valuable insights. Additionally, for evaluating the consumer benefits for the financially vulnerable, the inclusion of Housing Associations as key billers for this community would be pertinent. Housing Associations hold particular relevance, given that paying rent tends to be a high-value transaction where the fixed price of Open Banking transactions can play a pivotal role. It's worth noting that the financially vulnerable are also served by regulatory bodies such as Ofgem and Ofwat; however, they may already be using pre-paid meters, which VRPs may not necessarily replace.

One thing to be aware of is that there are likely to be many more TPPs wanting to participate than there are utility companies available. In which case how will TPPs and utility companies be paired with one another? Leaving it to the market could well see only the largest most well known TPPs serving the utility companies which would be to the detriment of this phase 1. Instead consideration should be given to ensure that as far as possible 1:1 relationships are established to provide many more opportunities to learn.

Question 18.

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

Noticeably absent from the list of assumptions is Request to Pay (RtP). I firmly believe that Request to Pay not only enhances consumer control but also serves as a valuable tool in combating Authorised Push Payment (APP) fraud. While both Variable Recurring Payments (VRP) and Request to Pay are integral components of the UK's payment landscape, I am curious about the prioritisation of VRP, especially considering that Request to Pay has already been technically delivered, albeit lacking a mandate. The tangible cost benefits associated with implementing Request to Pay are substantial and, in my view, outweigh the potential advantages of this new VRP development.

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?

Beyond the core advantages, additional benefits for payees include the avoidance of the open-ended Direct Debit Indemnity rules, which often pose challenges for billers and can result in fraudulent claims. Furthermore, substituting card-on-file methods could significantly alleviate the security burden on payees, sparing them from complex annual PCI-DSS checks and mitigating substantial reputational risks associated with any fraud occurring on their platforms.

Moreover, this innovation could empower payees to offer more flexible payment options, introducing the possibility of more frequent payment cycles, such as weekly or even daily. This increased flexibility benefits both payers and payees, especially for specific use cases.

From the consumer perspective, the primary advantage lies in the interoperability of Variable Recurring Payments (VRPs) with alternative payment methods. Unlike Direct Debits, which often remain static and disconnected from many other payment systems, VRPs offer the potential for a dynamic and interconnected payment landscape. Envisioning a future where VRPs can seamlessly integrate with single immediate payments and other services, based on the needs of both payee and payer, opens up exciting possibilities for a more versatile and user-friendly payment experience.

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?

No comment

Question 21.

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

No comment

Question 22.

Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.

The primary concern lies with Request to Pay, as the lack of initiatives to encourage its adoption, coupled with active interventions favouring Variable Recurring Payments, sends a clear market signal that Request to Pay is no longer actively supported.

Open Finance Association

Open Finance Association (OFA) response to Payment Systems Regulator (PSR) Expanding variable recurring payments: Call for views (CP23/12)

February 2024

Public version

The **Open Finance Association (OFA)** represents leading fintech companies focused on empowering consumers and businesses to access account data and make safe and secure payments through open APIs (application programming interfaces). We represent open finance providers and users of open finance. OFA members are responsible for the majority of all payment and data API calls initiated in the UK Open Banking ecosystem. We have brought multiple billions of pounds of investment to the UK and employ thousands of highly skilled staff.

Contents

Key points

- OFA strongly supports the PSR's ambition to expand the use of VRPs and to ultimately see their broad usage for account-to-account based retail transactions
- OFA fully supports the development of a commercial model and multilateral agreement that appropriately incentivises and binds all parties in the payments chain to delivering high-quality and competitively-priced end user propositions
- Key to the ultimate success of VRPs will be their enablement in retail use cases with costs that are lower than debit card interchange and scheme fees - the PSR should make these target outcomes explicit and prioritise their realisation in Phase 2 and beyond
- To address the need for sufficient market coverage to drive merchant adoption, OFA supports mandating large ASPSPs to support non-sweeping VRPs
- The PSR's work on Phase 1 should not risk delay or delivery of Phase 2 and beyond - work should proceed on both in parallel. To this end, we propose an adjusted pragmatic approach to Phase 1
- To support Phase 1 engagement and progression to Phase 2, PSR should set out its current thinking on Phase 2 commercial models at the next available opportunity (including with respect to use cases within scope of Phase 1)
- To facilitate and expedite delivery of Phase 2, we think the PSR should explore adoption of a collaborative approach with industry to developing the commercial model and MLA

Introduction

The OFA welcomes the PSR's call for views on the expanding VRPs. We fully support the PSR's ambition to expand the use of VRPs and to ultimately see their broad usage for account-to-account based retail transactions.

Before providing our views on the specifics of the PSR's proposals, we set out our views on the expansion of VRPs more broadly.

A path to realising material end user benefits through VRP expansion

OFA members are at the centre of driving innovation and competition in open banking payments. Our members are already leveraging open banking functionality to deliver faster, more secure, and better value payment services to end users.

However, variable recurring payments for use outside sweeping remains a critical missing piece of open banking functionality. Once broadly available, non-sweeping VRPs will play a key role in enabling open banking to functionally compete on a level playing field with existing incumbent retail payment methods across a broad set of use cases.

In particular, OFA views that the largest potential and opportunity for end user benefit from non-sweeping VRPs lies in their use in retail payment scenarios where debit cards are currently the main form of payment acceptance. It is therefore critical that the PSR clearly identify this as an ultimate goal and work towards enabling VRPs in these scenarios as quickly as possible.

OFA believes that to ultimately realise this outcome, non-sweeping VRPs will need to be underpinned by a commercial model and multilateral agreement that appropriately incentivises and binds all parties in the payments chain to delivering high-quality and competitively-priced end user propositions (on both the consumer and merchant ends of the payment).

The majority view of OFA members is that, in practice, this means any steady-state commercial model for VRP needs to facilitate a fee paid by PISPs to sending ASPSPs to incentivise the development and ongoing support of compelling VRP consumer user experiences.[1]

On the merchant side of the market, it is abundantly clear to OFA members that the overriding driver of interest from businesses in considering adoption of VRPs is reducing their cost of payments acceptance relative to that currently paid for cards. As a result, realising costs lower than debit card interchange and scheme fees should be adopted as a "north star" outcome that the PSR explicitly targets as its VRP work progresses.

There has now been a period of extended debate surrounding the potential expansion of VRPs outside sweeping. For both industry and regulators to maintain credibility and momentum behind VRPs, particularly in the merchant community, we think it is critical that real and tangible progress is realised in 2024. Seeing initial use cases of low risk non-sweeping VRP live before the end of year is therefore a key priority. Further, all members would welcome measurable progress towards development of an MLA and commercial model for a broad set of VRP use cases (including a target delivery date) - we view a collaborative approach between industry and regulator as being the best way of achieving this at pace.

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[1] One OFA member does not share this view and instead believes a flow of value to the receiving ASPSP (e.g. through the provision of business banking services) is a preferable approach to a steady state commercial model and instead believes an assessment of risk and liability be made and parties be appropriately compensated where greater risk/liability is apportioned, rather than additional fees levied on PISPs, which will need to be covered by merchants, ultimately giving ASPSPs an additional revenue line as a reward for opening up access.

Comments on the PSR's proposals to begin expansion of VRPs

The PSR has proposed a phased approach to support the expansion of VRPs into non-sweeping use cases, and set out a number of potential policy interventions to underpin this approach:

Phase 1 scope: Begin VRP expansion by enabling use in certain low-risk use sectors Utilities, Government and Financial Services			
Enabling intervention A: Mandate CMA9 participation	Enabling intervention B: Direct Pay.uk to develop an MLA	Enabling intervention C: Require zero price to be levied on TPPs by sending ASPSPs	Enabling intervention D: Remove central infrastructure charges for Sending ASPSPs for Faster Payments

We provide our comments against each element of the proposals below. Given the issues we outline regarding the current proposals, we then present a high-level proposal for a potential amended and pragmatic approach to Phase 1.

Phase 1 scope: Begin VRP expansion by enabling use in low-risk sectors - Utilities, Government and Financial Services

As a general observation, the primary existing method of payment acceptance in the identified low risk sectors is direct debit. While VRPs are able to function as an alternative to direct debit, our view is that the potential realisable end user benefit from migrating from direct debit to VRP is orders of magnitude lower than that possible for use cases where there is migration from card payments.

Given this, there is a universal desire from OFA members for any approach to Phase 1 to not distract or risk delay to the development of a Phase 2 commercial model/MLA. The potential for material end user benefits predominantly lies in use cases outside the Phase 1 scope.

For most of our members[2], in practice this means that as pragmatic approach as possible should be taken to accelerating delivery of Phase 1. For these members, Phase 1 still has an important role to play in demonstrating market progress on VRPs and to start demonstrating their real-world usage outside sweeping use cases. An outline proposal for a potential approach is presented below (see section titled "A proposal for an amended and pragmatic approach to Phase 1")

[2] One OFA member would prefer to see an alternative approach in which effort is solely focussed on upfront development of a fuller commercial model/MLA.

Enabling intervention A: Mandate CMA9 participation

We strongly agree that the PSR should mandate certain ASPSPs to participate in Phase 1. Given the current limited level of material proactive bank engagement in industry efforts to progress VRP, consideration of mandation for Phase 2 is also likely to be necessary.

There is a clear coordination failure in the market at present - With the exception of Natwest, banks have shown that they will not voluntarily develop the functionality of their open banking APIs voluntarily, even when offered commercial terms. Without mandating coverage, there will be gaps in provision, and VRP won't be able to compete with other payment methods that have ubiquitous provision across banks.

However, we don't believe the CMA9 grouping is the right approach - this is not about the CMA market investigation and the market has moved on significantly since that work. The PSR should instead look at Faster Payment market share data by bank (specifically, outbound Faster Payment share originating from consumer payment accounts).

We believe mandating at least the six largest UK ASPSPs (Barclays, HSBC, Lloyds, Nationwide, Natwest, Santander) would likely enable ~90% market coverage and should be the starting point for mandating coverage (for example, see current account market shares set out in Feb-23 HMT basic bank account report). This scale of coverage should support realisation of the appropriate 'network effects' and give comfort to merchants that a significant share of the market is covered.

Enabling intervention B: Direct Pay.uk to develop an MLA

OFA members have concerns over Pay.uk's capacity and ability to deliver a phase 1 MLA in a timely manner. Reasons include:

- Pay.uk already have a number of major in-flight initiatives to deliver which will take priority over VRP, such as:
    - Delivering the NPA (while currently on hold, work may resume in near future and delay is also likely to have knock-on resource requirements)
    - Delivering APP fraud reimbursement model and enhanced data sharing
    - Maintaining service for FPS, Bacs etc
    - Maintaining the CoP service
    - Maintaining the Current Account Switch Service
- Pay.UK does not have a track record of delivering things quickly or efficiently - the NPA for example, is years behind schedule.
- Pay.UK does not have an established track record of engaging with open banking stakeholders (bar some infrequent high level roundtables)

Members also have a general concern around the deliverability of an MLA that would see low risk use cases live in Q3, regardless of which entity is appointed to lead.

In our view, longer term, the OBL/the Future Entity are more suited to playing a central role in governing a steady-state VRP MLA and commercial model.

Under our proposal for an amended and pragmatic approach to Phase 1 (as set out below), there is no requirement for an MLA. A body would still be required to coordinate a managed roll out of limited low risk use cases - we think this role could be fulfilled by OBL(who completed the managed roll of out of sweeping VRPs) with not much more material/development/resource than they have today.

Enabling intervention C: Require zero price to be levied on TPPs by sending ASPSPs

There is agreement among OFA members that the extent of the proposed Phase 1 commercial model is not an appropriate steady-state model for VRPs. As set out in our introductory remarks, except for one member as footnoted above, OFA members generally see the need for any steady-state commercial model for VRP to facilitate a fee paid by PISPs to sending ASPSPs to incentivise the development and ongoing support of compelling VRP consumer user experiences.

In general, we think more thought is needed on approaches to pricing for a steady-state commercial model, including whether a regulator is best placed to lead on developing this.

We think it will be difficult to adopt a standard cost-based approach to price setting in this specific context. Banks providing current/payment accounts provide multiple services (ability to make/receive payments, overdrafts, savings, mortgages etc), and have multiple income streams (net interest income, fee revenue) and cost centres. There are complex issues around cost allocation and cross-subsidies that would need to be considered under such an approach. We believe a cost recovery model alone could lead to protracted arguments about what costs need to be recovered and levels of appropriate underlying assumptions (amortisation periods etc.).

There are a range of different possible approaches to price setting, in both regulatory and commercial contexts, and a fuller assessment of which approach(es) are most appropriate is still required.

We think it likely the most appropriate approach will employ a combination of approaches to deliver a range of credible potential prices, within which a final price can be triangulated. Potential approaches to complement a cost-based approach may include willingness-to-pay type approaches (a form of which - the merchant indifference test - was adopted in the Interchange Fee Regulation). We think an overriding consideration for the PSR should be ensuring any approach is supportive of delivering a costs lower than debit card interchange and scheme fees.

However, on the basis of pragmatically demonstrating timely market progress, to start demonstrating VRP as a proposition outside sweeping, and to avoid the need for an MLA for Phase 1, a majority of members support adoption of zero price for Phase 1 - as long as accompanied by a commitment for Phase 1 to be explicitly time bounded, and for upfront confirmation from PSR that the Phase 1 commercial model will not persist into perpetuity (this will be particularly important in managing expectations of merchants looking to participate in Phase 1).[3]

Enabling intervention D: Remove central infrastructure charges for Sending ASPSPs for Faster Payments

We do not think amendments to the central infrastructure charging arrangements for Faster Payments is appropriate to support Phase 1 for the following reasons:

- currently, a single set of per-item/click fees is consistently charged across all types of Faster Payments. Removing charges for a subset of Faster Payments will thus represent a further change requirement and is likely to have a number of material impacts on technical and operational processes at Pay.uk. As outlined above, Pay.uk has a number of other material items in their delivery pipeline. As a result we query the deliverability of these changes to support a Q3 go-live timeframe for Phase 1;
- the PSR's position is (rightly, in a majority of OFA member' views) that the Phase 1 commercial model is not the correct long-term position and so any changes at the infrastructure level may not be consistent with a steady-state model; and
- sending banks currently already pay outgoing fees to Pay.uk on faster payments sent from their consumer accounts without receipt of any direct inbound fees (consumers are typically not charged for sending - or receiving - faster payments). (Most OFA members view sending ASPSP compensation is best addressed in steady-state by a fee payment from PISPs)

However, we do think there a number of related strategic issues that the PSR should look into to support wider adoption of VRPs:

- The central infrastructure costs of sending and receiving Faster Payments remains expensive compared to international comparators. The total per-item/click infrastructure level fees for a Faster Payment (sending + receiving) are currently 1.9p[4]; by comparison, in Europe, infrastructure fees for an SEPA instant payment cleared via RT1 and settled via TIPs costs 0.5p[5] - so the infrastructure level costs of an instant payment in UK are over 3.6x in comparison. Driving these infrastructure level costs down will be an important part of facilitating broader use of VRPs for retail payments, particularly at lower transaction values.
- The costs levied by receiving banks on merchants to receive incoming Faster Payments into business bank accounts can be significant and also materially impact the economics of a merchant looking to accept VRPs. Given this, the PSR should look into receiving ASPSP's charging practices to businesses for inbound Faster Payments. Further, we (with the exception of one member) disagree with recent comments from Chris Hemsley that changes to costs at the receiving end through

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[3] One member views zero price for Phase 1 use cases as being the correct long-term approach. Another member supports upfront focus on development of a fuller commercial model.
[4] Pay.uk Faster Payments Service Principles
[5] See ECB What is TARGET Instant Payment Settlement (TIPS)? and EBA Clearing RT1 Pricing.

business bank accounts may be the right way to approach the longer term commercial model for VRP.

A proposal for an amended and pragmatic approach to Phase 1

A majority of OFA members recognise that the PSR's proposed 'phase 1' is an important and pragmatic starting point to begin expansion of VRP usage. These members are keen for it to be delivered without delay.

A multilateral agreement (MLA) is key to coordinating and clarifying the necessary elements in the long-term development of Phase 2 use cases (including e-commerce). However, we recommend delay of implementing an MLA until after Phase 1.

The majority of OFA members believe that phase 1 should be time limited, in respect of the pricing and MLA, and enabled through the same framework as sweeping has today - i.e. open APIs with no contracts. We don't believe phase 1 should be dependent on an the development of an MLA because:

- The key goal should be to have low risk non-sweeping VRP low risk cases live in 2024.
- Developing a full MLA by Q3 2024 is very ambitious and there is a real risk of delay:
  - The shared rulebook at the heart of the MLA will take months to agree and finalise, discussions facilitated by UK Finance to develop model clauses have already shown this to be a complex task, which is already delayed;
  - Systems will need to be updated to differentiate between commercial and free PSD2 API calls/ faster payments.
  - Billing mechanisms will also need to be built individually by each bank participant, and integrated by each TPP.
- The intention of an MLA was to manage issues such as disputes - but, as the PSR notes in its consultation - phase 1 use cases are low risk and disputes are unlikely. These could be mitigated through commitment to a code of conduct or similar softer mechanism by participants, drawing on the work being done on model VRP clauses by a UK Finance-convened group of banks and TPPs.
- If the price is set at zero, no contracts are practically required
- OBL could be given responsibility for managing, what is essentially a repeat of the sweeping VRP managed roll out they have already undertaken, but for broader set of use cases

This approach would allow industry to focus over the coming months on developing the MLA for phase 2. During this time, the PSR should work with industry on development of an MLA and approach to pricing for Phase 2 and beyond.

Approach to Phase 2 and beyond

To facilitate and expedite delivery of Phase 2, we think the PSR should explore adoption of a collaborative approach with industry to developing the commercial model and MLA. Under such an approach, we would propose:

- the PSR would set out the outcomes it expects the process to deliver (for example, realising costs lower than debit card interchange and scheme fees) and by when (e.g. Q4 2025 per December JROC publication), providing final decisions on contentious issues, supporting with management of competition law risks, and maintaining a credible threat of intervention should progress stall.
- Industry would be tasked to develop the specifics of the MLA and commercial model (likely involving engagement of independent third-party subject matter experts with close regulator oversight to ensure this is not unduly delayed or cost prohibitive)

Work on such an approach should begin immediately and run in parallel with Phase 1.

Optima Consulting

Response of Optima Consultancy.

Question 10

Customer payment behaviour is entrenched so the incentive to get customers to switch this behaviour is difficult for PISPs/billers. What existing payment behaviour are you expecting them to switch – if it's to change from DD then why is VRP better in the consumers' eyes? It's probably not for most. The incentive for billers is to probably to move people from cash/manual methods but this is a BIG jump to go to a 'new' unheard of method.

Question 11

Unless you have 'All' of the market supported then it's very fragmented and/or frustrating to communicate to end customers. It's not going to be practical to 'push' this message to all customers if half of them can't enable it?

Question 12

You should mandate more than juts the CMA9 to participate- market share has moved on so it needs to ensure wide coverage and needs to be consistently available at the point of launch.

Question 13

I don't think you can ensure sufficient coverage without a mandate.

Question 17

I believe the use-cases are the wrong ones to try and stimulate the market and get the learnings needed. By choosing use-cases with little dispute potential you won't get the understanding of how this needs to work and the likely level of disuptes.

I also think the use cases will not generate sufficient take-up to get statistical or robust analysis of the pilot. Suppose you get a couple of major utilities decide to take up the pilot. Let's say they have 10m customers. The majority are on a DD which I think is very difficult to persuade to switch behaviour. Suppose there are 1m non-DD customers, a very optimistic/generous 1% may read/respond to a communication. Say a huge 25% then decide to action, this would only generate 2,500 VRPs. If 1% had issues/disputes (very high) then this would only be 25 disputes. These sort of numbers in an optimistic scenario will not really help shape the future of VRP for retail type payments as competition for cards.

Question 19

10 years feels too long an assessment period for participants in the system such as billers/PISPs – 5 years more relevant. The change in the payments ecosystem will also make years 6-10 irrelevant/hard to forecast.

Question 22

You are not choosing uses-cases that are reflective of where you want VRP to compete as a competitor to cards. Cards dominate retail and this is where you should be testing the water in terms of user cases and get the learnings. A Netflix, Spotify etc would be much better to drive scale and learnings.

Ordo

PSR Call for Views CP23/12:

Expanding Variable Recurring Payments

Ordo response

Submission to: a2a@psr.org.uk by 5pm 2 February 2024

The following information is the property of The Smart Request Company Ltd, trading as Ordo ("Ordo") and is provided to you in response to the above Call for Views only.

The information is only to be used by you in connection with the consideration of your response expanding variable recurring payments, it is not to be used by you for any other purpose. The ***REDACTED*** *version only may be published in response to this consultation, without alteration.*

This is the REDACTED version of our response and may be published

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Introduction

What does Ordo do?

Ordo's fully hosted and customisable open banking-enabled payments managed services provide businesses – large and small – with low cost, highly secure, real-time and easy to use Request to Pay, e-commerce, Point of Sale/QR Code, invoice and contact centre payments direct from their customer's ASPSP accounts into their own ASPSP accounts for both single and variable recurring payments (VRP).

Businesses can access the Ordo managed service in a number of ways: though an Ordo Merchant Acquirer/PSP payments partner, such as Access Group's Pay360 platform, directly via Ordo's business level APIs, and for smaller businesses, through our integrations with QuickBooks, Sage, and Xero accounting software or via Ordo's web/app interfaces.

Ordo also uses open banking to enable refunds and secure customer pay outs as well as account validation services and has fully managed VRP enabled services live with several clients for sweeping, but which require no further build or development to be rolled out for variable recurring payments beyond sweeping. Our platform allows businesses to take advantage of the latest open banking technology with minimal development and integration effort.

Ordo's cloud-hosted managed service is fully white-labelled allowing business's own brand and look & feel to be incorporated into all customer interactions, giving a consistent customer experience but without the overhead of developing, ensuring regulatory compliance and keeping up to date their own open banking customer journey.

Who are Ordo?

Ordo was founded by the former management team of the UK's Faster Payment Scheme in 2018 to use Open Banking payments to provide businesses with a much-needed alternative to slow, high-cost card payments and insecure direct ASPSP payments. Ordo launched its VRP service for sweeping clients in 2023. Ordo is authorised by the Financial Conduct Authority as an Authorised Payments Institution to carry out Account Information Services and Payment Initiation Services (FRN 836070).

We are pleased to see the PSR consulting on a proposed model for a phased approach to expanding the use of variable recurring payments ("VRP"), beyond the single use case of sweeping, to drive real competition to cards in the UK market with more choice of lower cost, better functionality payment services. It evidences the PSR's commitment to unlocking the potential of open banking, and will enable open banking providers, new innovative entrants to the market, being FinTechs like Ordo, to deploy value-added services that compete more effectively and completely with cards (especially card on file/continuous payment authority), providing benefits to businesses and consumers. Enabling VRP to be rolled out to regulated sectors is a critical step that will enable businesses to collect repeated payments in real time, with less friction where the customer consents, at lower cost than with cards and greater functionality than with direct debits.

Ordo sees this as a breakthrough opportunity for payments competition in the UK and fully supports the PSR's proposals.

Q1 – Do you think the pricing principles as published in June 2023 support the delivery of a sustainable commercial model for Phase 1? Please explain the reason for your answer.

Yes.

Third Party Providers ("TPPs") are the open banking service providers in the payments ecosystem, and *business serving* TPPs (as opposed to TPPs that are also Technical Service Providers ("TSPs"), who sell services to banks to help banks support their Open Banking obligations) need to be able to create sustainable future profits from the investments they have made and continue to make. It is business serving TPPs that bring innovative value propositions to market, not banks or TSPs providing services to banks. Therefore, it is business serving TPPs that need an environment that encourages investment, allowing business serving TPPs to continue to be economically sustainable. Business serving TPPs need a cost base that enables them to deliver compellingly priced VRP services to their business customers, and ultimately make an economic return on their VRP service investments. Incumbent banks, given their conflicting position as suppliers into the VRP market, competitors with the VRP market, and monopoly providers of VRP APIs to TPPs, should only be able to recover their truly incremental costs and be appropriately compensated for incremental risk only when there is such risk (which is not Phase 1 given the careful selection of target sectors). This is reflected in the pricing principles.

Q2 – 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.

Yes.

An MLA should be helpful to ensure a competitive multi-PISP market with adequate bank coverage and equal treatment of all PISPs and ASPSPs is efficiently created. Only a market with multiple PISPs offering services and adequate bank coverage will be effective, and encourage adoption through the provision of a consistent, predictable and reliable service offering to the majority of PSUs in the UK.

Given the chosen, regulated, sectors for Phase 1 (Utilities, Financial Services and Government) <u>and the fact that sweeping is already live today</u>, this MLA should be limited to the minimum necessary additional elements for proper ecosystem coordination and therefore easier to come to agreement on content and wording.

However, given the banks conflicts of interest in this market, the regulator will need to oversee this process to ensure it does not become another way for banks to frustrate the expansion of VRP unnecessarily by slowing the process of MLA creation. [redacted]

In the event agreeing an MLA for Phase 1 within the timeline set out by the PSR becomes at risk, we envisage that the current structure for managing sweeping, i.e. no contracts, could be extended to VRP within the Phase 1 regulated sectors, effectively *sweeping+*. A long stop from the PSR of applying a simple extension of the sweeping operating model if the MLA is not agreed by planned launch at the start of Q3 2024 might incentivise all parties to quickly reach agreement on the minimum necessary terms.

In the early stages of MLA development, the PSR should review the proposed elements of the MLA and require the working group to justify why each element is either an essential requirement for a phase 1 MLA, or is of universal appeal to market participants that it can be included without any disagreement.

Q3 – 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 agree this is a pragmatic answer given timing of the Future Entity work and the fact that the PSR regulates Pay.UK. [redacted]

We suggest that, if Pay.UK is the body that progresses Phase 1 VRP, the PSR should play an active role in the oversight of this preparation and roll out [redacted]. The PSR should also require Pay.UK to exploit the resource, experience and capability within OBL that already exists, effectively outsource services to OBL, subject to it continuing to be available in OBL.

Q4 – 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 agree.

The Call for Views outlines the economic reality. Not acknowledging this reality (that each bank has a bottleneck monopoly in VRP API provision and a conflict of interest in making VRP successful as they will be the main and direct competitor to VRP via their existing debit card services) and hoping that somehow the market will suddenly produce a competitive solution risks open banking failing in the UK altogether. The result of this will be, as the UK becomes ever more cashless, Visa, Mastercard and the banks dangerously dominating.

TPP Views Will Vary

Not all TPPs may have the same economic drivers as Ordo, a pure play Open Banking service provider to merchants, and these differences in market position and attitudes to the VRP market need to be appreciated [redacted]. Some TPPs generate a significant part of their business acting as Technical Service Providers (TSPs) and often provide services to, and due to the immaturity of the market, are likely to generate much of their core revenue from, banks/ASPSPs – these players may be reluctant to publicly support a position that could be seen as negative by their main customers. [redacted] direct debit based services to small businesses and generates significant revenue from this segment which is poorly served directly by banks. They may also look at the expansion of VRP as a competitive threat to their current market position and therefore not support actions which will promote this competition. In this sense, not all TPPs are alike nor have aligned interests; in fact, bank serving TPPs are more aligned to bank interests, which is not conducive to promoting further competition between bank payment systems (Card and Direct Debit) and VRP.

The misaligned incentives of banks and pure play TPPs are a product of fundamental market structure and economics. Banks' reluctance to provide services (VRP APIs) that can compete with and cannibalise their existing revenues is natural, and an expectation that Banks will quickly behave differently is naïve and not supported by bank actions over the last 24 months. Additionally, the banks' position as individual monopoly suppliers of VRP APIs means that a market-based price discovery mechanism can't operate and therefore a proxy, such as LRIC (long run incremental cost) is the only credible price generating mechanism for VRP API access. This is the only 'sustainable' and 'fair' price that banks can be allowed to charge given their natural market position and role as an existing competitor to VRP.

Some TPPs suggest that banks must see a positive business case for supplying VRP APIs before they act, and that if mandated by regulation they will simply treat this as a compliance duty and somehow provide API access less effectively than is needed for VRP to take off. Looking at these points:

- Given banks' current position as the main competitor to VRP via their provision of debit card and direct debit services we cannot see a situation where there can be positive business case for banks providing VRP APIs (i.e. there is no net cannibalisation of their revenues) and the resulting pricing of VRP services means that businesses will adopt them as better value than cards or direct debit.
- Even if there was magically a positive business case for banks providing VRP APIs the need for the bulk of large banks to provide API access at the same time to enable a credible customer proposition and the long demonstrated 'collective action' problem across UK banks seen for many years suggests that it would take many years before all the banks were aligned to provide a VRP service.
- Although imperfect, compliance requirements have driven UK Open Banking for single payments and AIS to be reasonably effective. As we regularly hear from banks of all sizes, unless there is a regulatory requirement for a product investment it is very difficult for banks' product teams to get development and commercial resources allocated to speculative new service developments.

[redacted].

Beyond Phase 1

The accurate market structure and misaligned incentives outlined in the PSR's consultation will not change for use cases beyond Phase 1 VRP. Consequently, whilst we support the 'VRP light' approach to roll out *some* VRP use cases beyond sweeping, urgent thought and direction must be given to make progress beyond Phase 1, to avoid 'beyond Phase 1' becoming the new 'beyond sweeping' and subject to untenable delay. It is only once business serving, pure play TPPs can provide businesses and consumers with the benefits of open banking for *all* payment types, including unrestricted VRP, that TPPs are more likely to become economically sustainable i.e. revenue and ultimately profit generating. A further delay that risks this end game being reached should not be tolerated.

As the JROC VRP functional sub-group concluded there were no material functional changes need to move to Phase 1, the only uncertainties we can see for moving beyond Phase 1 are those of consumer protection, liability for higher risk eCommerce, and access to reliable APIs for beyond Phase 1 merchants from the banks. The first two are challenges that are capable of resolution by cross industry coordination and building on the Phase 1 MLA; account access and this not being allowed to be delayed unduly by a combined (well-funded and well resourced) bank and bank serving TPP contingent, will still require regulatory intervention because there is a permanent conflict of interest.

Beyond Phase 1 pricing model

The SEPA Payment Accounts Access scheme (SPAA) will no doubt be considered for determining a pricing model for beyond Phase 1 VRP. We would caution against adopting the same method. To date, no banks have joined, despite potentially acquiring a new revenue line from TPPs. TPPs consider the proposed 'cost based' pricing far too high and to be substantially above legitimate bank costs and even cost plus a reasonable margin. Not only did this third-party cost analysis process incur a delay and high cost to run which favours banks, the cost gathering process is immediately being re-run.

We suggest that, for beyond Phase 1 VRP pricing, what liability and risk is incurred must be considered, who should sensibly carry that risk in the ecosystem, and if/how that should be compensated in wider (beyond Phase 1) VRP scenarios, rather than starting from listing additional costs to be covered. eCommerce attracts increased purchase risk which may generate increased customer care costs; these are as a result of a potentially higher risk merchant signed up by a TPP being a bad actor. Extra Customer care due to higher risk merchant issues are legitimate incremental costs which, if incurred, the supplying bank should be compensated for. Where open banking payment initiation is used, the PISP is in the best position to assess and manage merchant risk – the merchant is their customer. Consequently, liability for KYC-ing the merchant and for any fraud perpetrated by the merchant (e.g. APP fraud) should be with the PISP, not with a sending bank that has no relationship with the merchant. In this structure, there is no incremental cost to the bank because the bank is not carrying additional liability/risk, so the bank should not be compensated for the increased risk transaction. The bank could be paid a separate flat fee to cover customer care costs per disputed payment.

The beyond Phase 1 pricing does need to consider what degree of *purchase* protection needs to be included in this payment option, and which player should provide that *purchase* protection – specifically for non-fraudulent issues such as supplier business failure or contractual disputes. This is a significant policy question and needs to balance the degree of consumer purchase protection required and the costs to all consumers of that protection. While cards provide a high degree of consumer protection, other current alternative payment options like Direct Debit, Bank Transfer, Cheque and cash payments have much less, if any, and are still widely used and provide significant utility.

Q5 – Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.

No.

For Phase 1, we do not consider there are any other costs that are not entirely insignificant. Beyond Phase 1 will need to address the increased risk in, for example, eCommerce transactions, but this is not the case for

Phase 1, and may not apply to a sending bank beyond phase 1 if the PISP takes full responsibility for the conduct, KYC-ing and liabilities of their merchant customers.

It has been suggested (and is covered in more detail in later questions on the cost/benefit analysis) that bank card revenues cannibalised by competition from VRP should be treated as a **cost to banks** that needs to be considered. While this is a legitimate approach for internal bank business case/investment decision-making, and is the reason why we cannot see bank's voluntarily supporting VRP beyond sweeping at a competitive price, this is not a legitimate cost for a sending firm to recover. This loss of revenue is due to increasing competition, it is not a bank cost that can or should be recovered from merchants via PISPs to 'compensate' banks for the increased competition from VRP that they have, to date, been able to block.

Q6 – 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.

See answer to Q7 below.

Q7 – 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?

Answer to Qs 6 & 7

The central Faster Payments system is essentially an annual fixed cost that is recovered equally over all the transactions that flow through the system in a year, currently on each half (sent or received) transaction – for equity, and to promote fair competition between all participating institutions there are no discounts for larger volume or premiums for low usage. Within quite significant limits the total cost of the system to its participants (via Pay.UK) is insensitive to the number of transactions processed. Adding traffic to the FP system is unlikely to increase cost (volumes would have to unrealistically increase to incur further increases in the cost base). Therefore, there is no incremental cost of increased transactions going through FP. Increased traffic, due to the introduction of a greater number of open banking transactions, will actually reduce the unit cost of each faster payment and the cost to a bank of sending or receiving each faster payment.

On average, FP participants individually send and receive equal volumes of payments, and consequently, moving the cost of an FP transaction from sending bank to a receiving bank will not materially change overall participation costs. In simple terms faster payments are sent by consumers and received by businesses. Banks with more consumer focussed customer bases will generally send a little more faster payments and generally don't charge their consumer customers per payment sent. Banks with more business focussed customer bases will tend to receive a little more faster payments, and generally do charge their business customers for the receipt.

The receiving bank (and their customer) benefits the most from FP transactions. Given this factor, and that per payment pricing to consumers of sending a faster payment has been driven to zero by competition, and seems to act in the consumer's interest, we can see a logic for Pay.UK not charging a bank to send a VRP initiated faster payment. Indeed, there is a reasonably compelling case for extending this to all faster payments. This would reduce the invisible but real cross subsidy paid by consumer focussed banks to business focussed banks inherent in the current Pay.UK cost recovery model.

Note that when the Faster Payment Scheme launched in 2008 the scheme transaction charge was paid by the sending bank only. The charge was only later split between sender and receiver to address a 'free-rider' problem when a business only bank joined the scheme and was mostly a receiver of payments.

Assuming that Pay.UK does not charge for sending VRP faster payments, then we suggest that the simplest way of recovering this uncharged amount is by applying the total faster payments costs across all other transactions in the scheme. This can be done simply: the sending banks just report their annual VRP sent faster payments and the Scheme can adjust its cost recovery. We don't believe that it is necessary to specifically apply those uncollected charges to received VRP faster payments. In general terms, given that any bank can be the receiver of VRP faster payments (they don't need to support sending VRP), received VRP faster payments will spread across UK banks broadly in line with their share of overall faster payments, which is how overall costs are charged.

Finally, it is worth reiterating that overall, even if millions of new faster payments are generated by the successful adoption of beyond sweeping VRPs, the total central system cost of delivering all faster payments will not rise, and therefore the incremental central cost of faster payments to all banks will be zero. Any additional charge to an average bank for extra VRP faster payments will be offset by a reduced unit cost for their total faster payment usage. If banks are permitted to charge their sending faster payment costs to PISPs, PISPs will have to recover these costs from their merchants. This will result in a straight financial transfer from merchants to banks. Without these charges, banks are no worse off in terms of their faster payments costs, and merchants benefit from lower PISP costs which they can share with their end customers through lower overall prices.

Q8 – Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.

We do not think any material OBL costs are driven by VRP.

Q9 – what alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

None.

The second option cited in the Call for Views, replicating lost card revenue for sending firms, is anti-competitive (in that it would represent price fixing that would prevent VRP being a cost competitor to card on file) and it is right this is not being progressed.

Regarding Pay.UK calculating a price for Phase 1 VRP: Pay.UK has no experience in calculating a price for third parties in a competitive market. Its only experience is in simple cost recovery of all its own centrally incurred costs across its participant institutions in a fair and equitable manner. We agree this should not be implemented.

[redacted] the SPAA model of an independent third-party assessing costs and setting a price: We cannot see how this is achieved in a way which is not price fixing and consequently anti-competitive. Even if this were achievable, the SPAA process was delayed and expensive and such delay, expense, and necessary resource, which cannot be matched by FinTechs, will only advantage banks. SPAA has also been summarised by many FinTechs as resulting in a price which is 'too low for banks to be happy with, and too high for TPPs to make a business from'. Furthermore, at the time of writing, whilst we understand 2 TPPs have now joined; no banks have joined: even being able to charge has not created a commercial model whereby banks voluntarily participate. Costs are also being re-assessed to adjust for more accurate volumes, with the hope of bringing costs down, which will further disincentivise banks to participate. The SPAA cost analysis also provides for full recovery (over quite a short time) of all the investments needed to build the SPAA services. In the UK with VRP, these investments have already been made in response to the CMA's competition remedy by the CMA9 and as is clear in the PSR's pricing principles, these costs should not be recovered in future pricing.

What does a sustainable commercial model mean?

Given that the extension of VRP is about enhancing competition in payments, 'sustainable' does not mean that every customer and every supplier in the VRP value chain can be financially better off from the extension of VRP. If this competition is to be successful, the following commercial priorities must be achieved:

- Priority 1. The price of VRP services to businesses must represent significant enhanced value compared to the alternatives (card on file and direct debit from banks) for them to risk integrating and adopting the service for their customers.
- Priority 2. In the medium to long term PISPs providing these services need to be able to operate with a sufficiently low cost base that they can achieve priority 1 and make a long-term economic return on their investment in VRP services to meet the risk adjusted return requirements of their investors. Unless there is a clear prospect of this return, investors will not fund PISPs to build and distribute these services.
- Priority 3. Banks can expect to have their long run incremental costs of supporting VRP APIs covered, but not much more. If provision of VRP APIs was competitive (and PISPs had a choice of supplier) this is what market forces would drive pricing too.
- Banks cannot expect to recover revenues lost from card issuing fees and direct debit services they supply that are competed away by VRP services. Banks have no right to protect or retain these revenues if new competition provides better solutions for their customers.

Q10 – 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 VPRs? If not, please explain why.

Yes.

Ordo has already invested in the development of a complete VRP service that supports sweeping and non-sweeping use cases. We have customers that are using our service for sweeping from the CMA6 (GB) banks, as this is enough coverage for them. We also have customers in utilities, finance and government that are ready to adopt as soon as VRP is opened up to their sectors. The CMA6 (GB) bank coverage is sufficient coverage for them to adopt VRP.

The CMA6 (GB) and soon CMA9 (UK) bank coverage is enough for VRP adoption. With 90 percent of banks providing VRP, over time, competitive pressure will bring non-CMA9 banks into the service as their customers realise that they cannot benefit from VRP unless they switch banks. Requiring the CMA9 to deliver VRP, bearing in mind this has already been required of the CMA9 for sweeping, is enough to reach critical mass.

To delay bringing to market the benefits of VRP Phase 1 for the sake of waiting for banks that collectively serve 10% of the current account market is not a fair, sensible or balanced way forward for society.

[redacted]. Accordingly, we do not think it plausible that a merchant/business would invest time and money in integrating and educating its customers on a new payment method which would reach around 15% of their customer base ([redacted] payers only). [redacted].

To be clear, none of our potential customers would have proceeded with a [redacted] payer only VRP offer on the grounds of end customer bank coverage, putting aside any other issues of cost [redacted].

Q11 – 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 rational.

Based upon our experience with live VRP sweeping customers and discussions with potential adopters of Phase 1 VRPs, CMA6 in England, Scotland and Wales, being 90%of the current account market.

The greater the number of accounts reached the better to build confidence in a still nascent market. If a payer attempts open banking and cannot find their bank, they will assume open banking and open banking providers (FinTechs) are at fault rather than their bank. And if fewer than the CMA6 were to be mandated, what would be the justification for leaving 1 or more of the CMA6 out? This would also weaken the VRP offering.

Some ecosystem participants may argue that, for example, TSB, Virgin Money and Starling ought to contribute to this ecosystem in terms of mandated access and cost, but as we demonstrate in answer to Q10 above and as has already been seen with open banking single payments, once the CMA6/9 are compelled to provide access to enable FinTechs to provide services, remaining banks are at a disadvantage if they do not follow; competitive forces will ensure they participate. To delay bringing to market the benefits of VRP Phase 1 for the sake of waiting for banks that collectively serve 10% of the current account market is not a fair, sensible or balanced way forward for society.

Current Account Switch Service (CASS)

Some ecosystem participants may argue that VRP not being reachable by CASS is a problem, particularly for beyond Phase 1. We would argue this functionality should be categorised as 'nice to have' rather than essential. Unfortunately, CASS is not widely used (around 1 million switches per year. For context, the population of London alone is nearly 8.8 million.) It is disproportionate to delay the benefits and cost savings to businesses and consumers, and competition to other payment schemes, to come to fruition because VRP cannot easily be included in another little used scheme. The alternative to VRP being automatically included in a current account switch can be managed, albeit not in an automated fashion. In reality, a bank will tell the PISP the customer has moved bank upon a VRP being attempted, the PISP will tell its customer, the merchant, and the merchant can contact its customer to rectify the payment mandate accurately from the beginning, negating the need for a lengthy correction period. The real time nature of VRP failure notification to merchants and the simple but secure mandate approval process for end customers means that the 'cost' of reapproving a new mandate is low, and the consumer benefit of checking that a mandate is still validly in place (which never happens with direct debits) probably fully offsets that 'cost'.

We would urge the PSR to investigate who may be raising this objection and consider their incentives, whether they are connected to the direct debit scheme, CASS, or the provision of direct debit supply chain services or similar.

Q12 – Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.

Yes. This is essential.

Please also see answer to Q11.

Q13 – 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?

We do not think sufficient network effects will be achieved if, as a minimum, the CMA6 are not mandated to provide access.

The CMA6 and in theory the CMA9 should have already built and operate VRP to be in compliance with the CMA Retail Banking Order. Given this we see no justification or rationale for allowing any of these banks to prevent access to their existing live service to Phase 1 use cases. At this point we don't need more than the CMA6/9 for VRP to be successful and there is no rational for less than the CMA6/9.

Please see attached our spreadsheet showing material lack of engagement and progress in trying to voluntarily, commercially and bilaterally agree access with the CMA6 so we could provide a viable service for VRP beyond sweeping to our clients.

Some ecosystem participants may argue that more time needs to be given for a market to emerge or that a step was missed in not following the SPAA process of an independent third party assessing a cost. However, our and other TPPs' experience, and the delay and lack of bank sign up to SPAA, prove even the possibility of a commercial carrot is not enough incentive for banks to forego their card revenue which is their conflicting interest in granting PISP VRP access.

Q14 – 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?

We see no risk or material costs, when coupled with zero pricing, for the CMA6 who have already built sweeping to be mandated to provide VRP. It is simply a case of already live payment capability being rolled out to additional regulated safe sectors.

Regarding a risk of mandating participation distorting a market, our view is that there is no, and for all the reasons we have laid out cannot be a, competitive market in VRP API access to distort. This is practically evidenced by our spreadsheet attached detailing progress to date of being given access by banks at open market commercial rates, and our conversations with other PISPs who have received the same responses. Please also see our answer to Q13.

Finally, there is a risk, due to the conflict of interest position of the banks and the fact that VRPs will replace (some of) their card on file revenue, that the banks will seek to challenge the PSR mandating they provide VRP for Phase 1, or at the very least, delay matters as long as possible. Whilst there is a delay, the banks continue to receive card revenue funded by businesses and consumers and PISPs are prevented from being able to supply competitive services to the market. The longer any delay from bank challenge goes on, the higher the likelihood that PISPs are unable to build their businesses, satisfy their investors and then be forced to leave the market.

Q15 – Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.

No.

We have been working on this issue for over two years and, given the fundamental economics of the situation can see no alternative model.

Unless the CMA6 are mandated to provide access to PISPs for VRP, open banking will fail in the UK. The last 5 years have proven that single and sweeping open banking payments are not useful and ubiquitous enough to compel businesses to wholesale change their payment methods. Broader VRP is key because it caters to what a business values most: recurring revenue, never more so than in a difficult economy and in a society where subscriptions are so prevalent. Once open banking closes the gap in the payment types it is capable of, namely broader VRP, businesses will be more interested in integrating open banking and risking converting their customer to a new payment method; it will be VRP that catalyses further open banking usage, with single open banking payments then following and finally becoming mainstream and a proper competitor to cards.

Some ecosystem participants may argue that, for example, TSB, Virgin Money and Starling ought to be contributing to this ecosystem in terms of access and cost, but as we demonstrate in answer to Q10 above and as has already been seen with open banking single payments, once the CMA6 are compelled to provide access to enable FinTechs to provide services, these remaining banks will be at a disadvantage if they do not follow and competitive forces will ensure they too participate. To delay bringing to market the benefits of VRP Phase 1 for the sake of waiting for banks that collectively serve around 10% of the current account market is not a fair, sensible or balanced way forward for society.

Q16 – 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?

Although not well documented in the Blueprint, this model was extensively discussed at SWG, during the JROC VRP working group process and in bilateral conversations, and no further risks regarding the model were identified.

However, as this is a substituting market with growing competition, there will be ecosystem participants that lose in this model, and potentially progressing beyond Phase 1, namely, the banks, card schemes, and other existing payment providers. Consequently, some of these parties are likely to vigorously resist this approach. These participants are extremely well-funded and well-resourced and, in objecting to a model in which they will lose, can cause and absorbing extensive delays; delay itself which favours them, the incumbents. Merchant serving TPPs are not so well funded nor resourced to absorb cross industry committee work or delays, and this is a significant risk to VRP and open banking generally being successful.

Throughout the consultation the PSR refers to Phase 1 being live *by* Q3'24. *By* Q3'24 means 1 July 2024. Other ecosystem participants are already quoting the live date as 1 October 2024 and that this is unrealistic. The PSR needs to be ready to ensure this date does not slip, especially as the JROC functional sub-group found there were no material functional deficits to go live with Phase 1 VRP, that consumer protection issues are likely to be minimal given the safe nature of the regulated sectors chosen, and there are no billing engines to build.

For clarity, no changes are required to the Ordo VRP service to support Phase 1. Ordo can go live now with Phase 1 customers, all that is required is that CMA6 banks are prevented from restricting access to our non-sweeping customers. While an MLA is helpful, it is not essential, simply agreeing to operate as we do for sweeping VRP should be enough for Phase 1.

Q17 – Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis? Please provide reasons for your response.

Not fully.

More use cases would be helpful for accuracy.

The utilities sector should include TelCo which has OFCOM as a regulator and customer care frameworks.

The government use case should include all central and local government where repeated payments are a model, including: TV licensing, DWP, DVLA and local councils – these departments and organisations all have well known repeated payment needs and problems which could be well served by VRP and should be included to give a fuller and more accurate picture of potential costs and benefits. Reducing costs to the public sector will allow more of their revenues to be used to provide services that benefit their citizens which, in a cost of living crisis, should be an imperative.

Q18 – Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response.

Not fully.

A crucial benefit is missing: VRP is a competitive and technologically advanced solution for collecting repeated payments. It is lower cost and quicker for businesses and should allow consumers to reap benefits of lower payment costs whilst being able to control their finances better. VRP is an all-round better way to collect repeated payment. It could therefore negate the need to incur the cost of replacing the central Bacs Direct Debit system in due course, and do so with multiple competitive solutions from different PISPs. Not only would it provide long term competition, but it would avoid the central and bank costs of DD system replacement.

Q19 – What do you think are the key benefits of VRPs for each of the components of the value chain: consumers, merchant, the PSO, PISPs and sending firms? How should or could these be measured?

Consumers: in terms of lower costs to cover - shorter business liquidity cycles and associated costs with potential savings, more agile personal liquidity cycles with lower associated costs and potential savings, lower/no costs in missed/bounced payments due to flexible and real-time VRP capability, lower indirect costs of calling customer service as consumers can be more flexible in managing finances which should lead to fewer customer call centre calls, covering lower compliance costs from no PCI-DSS adherence as the PISP as the regulated entity handles limited data and lower data and privacy costs as less data need be collected with open banking technology versus card, covering lower payment integration costs with API technology.

More generally - increased flexibility and control over finances, ability to dynamically and up to the second payment is made control payments, decreased risk of missed payments if consumer refuses DD or card on file payment, decreased risk of mistaken payment as consumer input of data negated at set up, decreased risk of fraud as PISP indelibly populates sending account title, decreased risk of fraud as repeated payments cannot be set up against someone else's account as for DD, set up within minutes meaning goods/services can be dispatched immediately rather than either a delay or additional payment being required, consumer friendly digital journey.

The mandate limits enabled by VRP also provide a significant consumer protection compared to Direct Debit. While the Direct Debit guarantee means that banks must refund DD payments to consumers taken in error, this process can take many weeks involving real pressure and time from consumers and leaving those consumers out of pocket for many weeks. At the time of writing, a BBC investigation has identified multiple cases where utility customers have been accidently billed for massive amounts of energy and caused significant distress to the payers and huge amounts of time and effort to resolve. These errors will be prevented by the mandate limits in VRP avoiding the need for guarantees and protecting consumers from even short term over payment, and the time and distress to rectify.

Merchant: in terms of lower costs to cover – lower cost of payment, shorter business liquidity cycles and associated costs with potential savings, lower indirect costs in reconciliation, lower costs in missed/bounced payments due to flexible and real-time VRP capability, lower indirect costs of customer service as consumers can be more flexible in managing finances which should lead to fewer customer call centre calls and cancelled payments, lower compliance costs from no PCI-DSS adherence as the PISP as the regulated entity handles limited data and lower data and privacy costs as less data need be collected with open banking technology versus card, and lower payment integration costs with API technology.

Generally - automatic correct reconciliation, immediate set up, increased liquidity, greater security, lower compliance burden, certainty of payment, better customer service from customer centric digital journeys, ability to respond dynamically to customer.

PSO: negates the need to replace Bacs Direct Debit system in due course.

PISPs: richer proposition covering the payment type merchants are most interested in: recurring revenue, more attractive investment proposition

Sending firms: none, hence an irreconcilable conflict of interest

Q20 – What do you think are the key costs of VRPs for each of the components of the value chain: consumers, merchant, the PSO, PISPs and sending firms? How should or could these be measured?

The first bullet point in the Call for Views (Banks lost revenues from card payments) is not a cost, it is a product of competition. To the extent that it is part of the business case for VRP extension, the lost bank revenues should be considered as a benefit to merchants (and the UK economy) from lower prices for VRP compared to cards, and under no circumstances should the 'cost' of lost revenues be considered as a cost in the overall VRP business case.

Consumers: None, beyond covering merchant costs outlined below.

Merchant: Bank payment receipt charges.

PSO: Potential increase in skills and resourcing need/outsourcing to OBL costs.

PISPs: run of VRP services, cost of running a business to provide VRP services, attracting investment, cost of obtaining/retaining VRP customers, cost of helping VRP customers educate their own customers, cost of development to update/innovate VRP services.

Sending firms: API calls, additional material incremental cost is zero, long run incremental cost is the FP charge if retained and if the overall fixed nature of FP system costs is ignored.

Q21 – How do you think our proposals might affect people with protected characteristics? what approach might better serve their interests?

Lower income people often have protected characteristics. The model proposed allows PISPs to offer VRP with the benefits outlined in answer to Q19 above. This would help people who often have protected characteristics.

Q22 – 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.

Unless enacted quickly, there will be no Phase 1, nor then a beyond Phase 1, as FinTechs do not have deep enough pockets nor degree of resourcing to absorb the length of delays, cross industry work and engagement of expensive external advisors banks will attempt.

Please also see our answer to Q14 above.

Pay.UK

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

Pay.UK response

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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.

Santander Bank

Santander

Non-Confidential Version
2 February 2024

Santander UK response to the PSR's Call for Views on expanding variable recurring payments (CP 23/12)

Executive Summary

1. Santander UK plc (**Santander**) welcomes the opportunity to respond to the PSR's Call for Inputs on expanding variable recurring payments (**VRP**), published on 18 December 2023 (the **CFI**). We are excited about the opportunities afforded by Open Banking and fully support the expansion of VRP to the three low risk use cases set out in the CFI. However, the CFI does raise a number of issues that in our view require reformulation if VRPs are to scale to their full potential and ensure a sustainable and resilient financial services sector that.

2. We have provided responses to each specific CFI question below. However we also draw out in this Executive Summary a number of important points that we believe are not fully captured by the questions in this CFI.

3. In particular:

   i) **Legal uncertainty around status of the Pricing Principles, which were not consulted upon**: The CFI relies upon the JROC's Principles for commercial frameworks for premium APIs as published on 26 June 2023 (the "**Pricing Principles**")[1] as the basis for considering the commercial framework. However the legal status and workability of the Pricing Principles is unclear. Whilst the PSR states in its CFI (at paragraph 3) that these principles are binding and that it expects firms to adhere to them, the previous PSR /FCA position in a face-to-face meeting with Santander UK on 17 October 2023[2] was that these pricing principles were non-legally binding and merely designed to stimulate discussion in the JROC VRP working group. This is consistent with the fact that the JROC Pricing Principles were published without notice, and without any prior industry consultation as required by regulatory best practice, particularly for a topic of such import. There are a number of issues with these initial principles that have not yet been addressed.

   Since the CFI explicitly relates only to the expansion of VRP within the limited Phase 1 context described in the CFI, this consultation process cannot therefore be used to verify the previous Pricing Principles, even where these appear incorporated by broader application.

   ii) **It is inappropriate to direct additional compliance obligations in respect of VRP on the CMA9**. The 'CMA9' as a construct was formulated for the purposes of the narrow Open Banking remedy stipulated in the CMA's Final Report after the Retail Banking Market Investigation in August 2016. This remedy reflected a thorough review of the competitive dynamics in the UK retail banking market between 2014-2016, and even then using historical market shares. Although a neat solution, it is inappropriate – and legally unclear if permissable – for the CMA9 construct to be retained for yet new obligations at this juncture. In the decade since the CMA's review, the banking sector has changed significantly. New entrants include significant players, such as the consolidated Virgin/Yorkshire Bank/ Clydesdale Group, Starling, Monzo, Chase UK, Marcus UK, Revolut, Tesco Bank, Tide and Atom. Some of these players are gaining more new business across personal and business accounts than the CMA9.

   Placing additional regulatory obligations (and associated compliance costs) on some firms

[1] https://www.psr.org.uk/media/4u1afjt2/cp23-12-vrp-expanding-variable-recurring-payments-december-2023.pdf
[2] [✂]

whilst not on others, on the basis of a market analysis done a decade ago, is inconsistent with the rules of competition. If the PSR considers that it needs to intervene to move VRP forward (which in our view is unnecessary, as shown by the various industry-led initiatives to move this forward, where we have sought the PSR's support), then it should consider imposing the obligations on a wider cohort of industry participants.

iii) **Likelihood of scope creep beyond low-risk VRP:** We are also concerned that, although the commercial model (pricing and liability/ disputes and form of contractual agreement) on which the CFI consults relates only to three low-risk use cases, in practice once this model is established it will be difficult to implement any different model in respect of higher risk uses cases for future developments, as well as for broader developments such as Open Finance and Smart Data.[3] The PSR needs to provide comfort and clear guidance to industry on the limited scope of any decisions taken in respect of Phase 1 of VRP. It is incumbent on the PSR to satisfy itself that this can be done before legislating for any rules for phase 1.

First, any higher risk uses cases are likely to entail far greater costs, including from reimbursement of fraud in the ecosystem. This will not only need to be reflected in pricing but in commercial framework and dispute and liability mechanisms developed. Second, the TPPs that are likely to use broader VRPs and Open APIs will include Big Tech platforms and phone providers. These companies are themselves likely to become gatekeepers of financial market places going forward, and already enjoy far more negotiating powers than ASPSPs in commercial negotiations.

iv) **Unintended consequences for banking**. The PSR's approach, as set out in the Pricing Principles, of only considering directly incurred costs and setting the cost to zero, is unusual for a commercial operation and has not been seen in any other industry to date. Commercially it is unsustainable in the long-term. Moreover, as we explain in our response to question 1, this is not consistent with the existing approach to retail banking pricing, which was reviewed by both the FCA in its Strategic Review of Retail Banking and the CMA in its review of competition in retail banking. The current "free-if-in-credit" retail banking business model, where customers get accounts and banking services for free, and banks provide a number of societal services such as branch provision (in a world where usage is declining), fraud prevention and reimbursement of scam losses relies on portfolio pricing across the portfolio of products. The PSR needs to be cognisant of the risks of undercutting this and consult with the Prudential Regulation Authority and the FCA before making any decisions on price regulation that could have far-reaching implications.

v) **The proposals run counter to the PSR's competitiveness objective:** While the Pricing Principles proposed that pricing should reflect ASPSP's long-term directly attributable costs, the CFI suggests that for Phase 1 of the commercial VRP roll-out the price that sending firms can charge PISPs should be zero. By contrast, we note that the PSR does not propose to regulate PISP charges to merchants, with these instead being left to market forces. This is inconsistent with a long term, successful ecosystem that incentivises investment in the UK. As

[3] The PSR recognises this challenge in the CFI: "*These include questions on how it may be practically possible to limit VRPs to the specific use cases of Phase 1.*"

such it contradicts JROC's view that any commercial model should incentivise investment and innovation in premium APIs (Principle 2).[4]

ASPSPs will also incur significant costs to support the commercial VRP model, as well as time and resource pressure to define, agree build and deploy necessary technical changes. In addition, they will need to maintain, report and support a new payment servicing model. If pricing does not cover these expenses, ASPSPs (and the CMA9 in particular) will not only be operating at a loss (or passing those fees to customers elsewhere) but cross-subsidising the rest of the ecosystem, including Big Tech and large fintech firms. The PSR would be mandating for TPPs to be able to operate at a profitable level, while at the same time mandating that ASPSPs have to operate at a loss. This runs counter to the PSR's competitiveness objective.

4. In our view the PSR should allow industry and market forces to develop an effective pricing mechanism for commercial VRPs.

5. We also wanted to highlight that much of the language in the CFI suggests that ASPSPs require regulation to act fairly. This is not only far from the truth – and at Santander our mission is to help our customers make our better happen and customers are at the heart of everything we do – but it risks exacerbating the commercial (and self-interested narrative) that some TPPs are pushing. We note that the FCA's Consumer Duty already contains overlapping requirements on fair value, and is already applicable to the pricing of APIs.

6. We hope that you find this response helpful. Should you wish to discuss, please do not hesitate to contact santanderregulatoryliaison@santander.co.uk in the first instance. Please note that we consider this response to be commercially sensitive and therefore do not consent to its publication, in whole or part, without our prior written consent.

[4] See paragraph 1.3: https://www.fca.org.uk/publication/corporate/jroc-principles-commercial-frameworks-premium-apis.pdf

Response to specific questions in the CFI

1 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.

1.1 Santander has previously provided comments to JROC on JROC's Principles for commercial frameworks for premium APIs as published on 26 June 2023 (the "**Pricing Principles**") via an email dated 8 August 2023. We also attended an in-person meeting with the PSR and FCA on 17 October 2023 to discuss the concerns articulated in that email.[5]

1.2 We restate those concerns here, alongside on comments on the additional details on these principles in the CFI, which appears to go further than the original pricing principles. Although the PSR gave comfort on the scope of the Pricing Principles in the bilateral meeting (i.e. stating that they had no regulatory force and were to prompt discussion by the VRP working group only), this CFI unfortunately bakes them into reality.

<u>a) Comments provided to JROC on the Pricing Principles on 8 August</u>

Proceedual issues

1.3 The Pricing Principles paper was published by JROC without any notice or prior consultation, which meant that there was no opportunity for industry to provide constructive challenge on or think through the principles. Given the import of this topic to firms' ability and incentive to conduct business in the open banking ecosystem, and the status that is attributed to regulatory publications, we flagged that we would have expected some form of consultation on the Pricing Principles prior to publication. We are unaware of any other material regulatory action or development where firms whose legitimate business interests are impacted are not given an opportunity to provide views.

1.4 We flagged this procedural issue in our meeting with the PSR and FCA on 17 October 2023. The PSR and FCA responded that the Pricing Principles paper was merely intended to stimulate discussion in the VRP working group and was not intended to be binding. When we noted that the paper read as final and would act as a point of reference for regulatory expectation for anyone considering this topic now and in future, the PSR noted that its limitations would be evident from its context. That position has now been reversed in the CFI, where paragraph 3 states that firms are expected to adhere to the Pricing Principles.

1.5 In terms of the intent that discussion of the Pricing Principles would happen at the VRP working group (which conversation we understand never occurred), we flagged that this conversation is relevant to firms' business models and portfolio pricing and that the conversation would more properly occur at organisational level (rather than payments working groups).

Unhelpful positioning and inaccuracy

[5] [✄].

1.6 We have also previously flagged that the framing of the Pricing Principles was likely to be counterproductive in formulating the constructive ASPSP-TPP dynamic that is critical for open banking to succeed. We urged JROC to reconsider some of the language in the paper both for accuracy and given the JROC's commercial principles could be applied in a variety of scenarios in the future as Open Banking expands (e.g. to include Open Finance). In particular:

i) The terms "gatekeeper", "monopoly" and "market power" have specific connotations in competition law, and none of them apply to ASPSPs. "Market power" refers to firms with a strong market position (typically with greater than 40% market share) that are able to act independently without being constrained by competitive pressure.

This is not the case in the retail banking market which is highly fragmented. No retail bank has this level of market share and there are over 40 licenced ASPSPs currently operating with scale. Several recent market reviews have concluded that competition in retail banking is working well. To the extent similar language was incorporated in the CMA's Final Report in the Retail Banking Market Investigation (although it was absolutely not its focus), that report reflected the CMA's competitive assessment a decade ago. It is inappropriate to consider this still fit for purpose without refresh, particularly when considering the imposition of new regulatory obligations. This requires a cost-benefit analysis.

ii) Equally, the term "gatekeeper" originates from the EU's Digital Markets Act (and is also reflected in the new UK digital markets regime within the "strategic market status" concept) and specifically refers to a few large tech companies that are: engaged in specified activities in digital markets; operate large scale platforms; and possesses the market power necessary to "tip" adjacent markets in their favour.

1.7 The frequent use of these terms in the paper not only implies that there are competition issues in the Open Banking ecosystem (by drawing analogy with the dominance of the Big Tech firms) but creates an assumption that ASPSPs will act anti-competitively if left unchecked (notwithstanding they are subject to a plurality of regulations on pricing, including the need to offer fair value in the Consumer Duty). The Pricing Principles – as baked in by language in the CFI – could encourage friction from parties unfamiliar with competition law and with a commercial position to advance. The Open Banking and broader financial services ecosystem relies on partnerships between ASPSPs and TPPs.

1.8 Moreover, TPPs are often extremely large companies (including BigTech firms) and are not always small firms. Big Tech firms such as Apple, Google and potentially future financial market places such as Amazon are likely to be significant users of Open Banking and VRP. These companies already have significantly more market and negotiating power than banks and are likely to become gatekeepers of wallets and financial marketplaces going forward. The PSR must be mindful of creating unintended consequences via the Pricing Principles, and baking in advantages for tech firms, which runs counter to the FCA's current work on assessing the competitive advantages of Big Tech.

Substantive concerns

1.9 In August 2023 we also articulated the following substantive concerns on the Pricing Principles. We restate those here, notwithstanding updates/expansion in the CFI, which we address after:

i) There is a conflict between Principle 1 which states that "*ASPSPs should not recover more than directly attributable and efficiently incurred costs*" and Principle 2 which states that the "*level of charges for premium APIs should enable the ASPSP to earn a return over the long run that compensates them for the risk associated with any investment and innovation*". It is not possible for ASPSPs to both earn a return that compensates them for risks while at the same time not being able to recover more than direct and efficiently incurred costs. Whilst JROC acknowledged there may be conflicts between the five principles (para 3.3), it did not consider how to resolve these.

ii) Principle 1 (that API pricing may only cover directly applicable and efficiently incurred costs) will be logistically challenging to implement. It is extremely challenging for firms to understand the direct costs associated with a specific API in light of common infrastructure, resource, reuse, customer journey, compliance and risk. Firms will apply differing cost methodologies. In a bilateral pricing model (recognising the competition challenges of a multi-lateral pricing model), the central body and TPPs will expect and negotiate for similar prices for APIs notwithstanding the different costs ASPSPs will incur in developing, rolling-out and implementing a given API.

(NB: while the Pricing Principles proposed that pricing should reflect ASPSP's long-term directly attributable costs (Principle 1), and that pricing should incentivise investment and innovation in premium APIs (Principle 2), the PSR's current position for Phase 1 of the commercial VRP roll-out ("**Phase 1**") is that the price that sending firms can charge PISPs should be set to zero. By contrast, we note that the PSR does not propose to regulate PISP charges to merchants, with these instead being left to market forces. We address that below).

iii) The suggestion in Principle 1 (reinforced by Principle 3) that ASPSPs may need to initially operate at a loss for an unspecified period of time until widespread adoption is achieved (which is not guaranteed) would severely impact ASPSP incentives to develop premium APIs beyond the minimum required, which contradicts principle 2.

iv) The expectation that ASPSPs can only recover direct and efficiently incurred costs, i.e. specifically excluding costs incurred in their wider business and costs incurred as part of the "free if in credit" banking model, is highly significant and requires further discussion before concluding. Whilst we understand the logic, the reality is that the current "free-if-in-credit" retail banking business model, where customers get accounts and banking services for free (including ongoing access to branches as mandated by the FSMA, financial support, fraud prevention and reimbursement of scam losses), relies on banks covering the cost of provision through their wider portfolio of products.

The free-if-in-credit model was considered both in the CMA review of retail banking and the FCA strategic review of retail banking and societal import recognised. As Open Banking/ Payments is likely to grow to a core component of firms' revenues in coming years, and as the volume of regulatory and technical change increases, this cannot automatically be separated from the free if in credit banking model.

1.10 In our view, the points above were inconsistent with Principle 2 (to incentivise investment and innovation in premium API) and with the desire to create a safe and sustainable ecosystem. By contrast, Principles 2 - 5 are consistent with ASPSP requirements under the Consumer Duty to provide a good customer outcome (including fair pricing) and with the FCA's secondary objective to facilitate economic growth and competitiveness."

1.11 In relation to liability, we also flagged that under the existing Open Banking framework implemented by the CMA, certain retail banks (but not new entrants since 2016) also face significant regulatory and compliance costs that are not incurred by other participants in the Open Banking ecosystem. On this, the increasing volume of APP scams means that investment in protecting customers needs to be consistently applied across the widest ecosystem (not predominantly ASPSPs) to ensure customers are protected. The liability framework needs to be addressed so as not to increase moral hazard, particularly as the ecosystem expands. See our comments at paragraph 3(iii) of the Executive Summary for the probability of scope creep and for issues of liability and dispute resolution to be developed at the outset.

<u>Additional concerns on the proposed pricing of VRP outlined in the CFI</u>

1.12 The CFI provides further detail on the application of the Pricing Principles for 3 low-risk VRP use cases. It specifies that the PSR is proposing to set: i) an encompassing MLA that sets a central and regulator-set price; and ii) setting at zero the price sending firms can charge PISPs (and removing the FPS fee sending firms would otherwise be charged).

1.13 Our specific concerns are as follows:

i) There will be significant costs incurred by ASPSP suppliers to support the commercial VRP model, as well as time and resource pressure to define, agree build and deploy necessary technical changes. In addition, ASPSPs will need to maintain, report and support a new payment servicing model. Pricing should, at the least, cover these expenses. Otherwise, ASPSPs (and the CMA9 in particular) will not only be operating at a loss (or passing those fees to customers elsewhere) but cross-subsidising the rest of the ecosystem, including Big Tech and large fintech firms. The PSR would be mandating for TPPs to be able to operate at a profitable level, while at the same time mandating that ASPSPs have to operate at a loss. This runs counter to the PSR's competitiveness objective.

ii) Although the zero-pricing proposal only relates to Phase 1, as described at paragraph 3(iii) of the Executive Summary, there is a significant risk that it becomes the market expectation, and that will later make it difficult to move to an equitable charging model.

iii) The PSR's approach will have a significant impact on incentives to develop the ecosystem further. There is widespread acceptance that the future regulatory framework must move away from the Order to an equitable footing which provides sufficient commercial incentives to all participants. This point was recognised and emphasised in the Joe Garner Future of Payments report.

iv) There are existing, alternative payment schemes available for the use cases proposed for Phase 1 of the commercial VRP roll-out. The alternatives have long established protection, liability, and pricing structures including the Direct Debit Guarantee scheme, Section 75, Debit purchase protections and PSD2 Liability obligations. The costs of providing these protections are partially offset by payment charges made to merchants, as well as to commercial entities when processing large scale payments. The PSR has not considered how equivalent protections will be funded in a zero-fee model.

v) The current zero fee model for sweeping has only seen limited TPP engagement to date. It seems contrary therefore to suggest pricing controls should be imposed on commercial VRPs when zero pricing has not helped sweeping payments to reach widespread adoption.

vi) Finally, we note that the pricing model for commercial VRPs will be impacted by decisions that are yet to be made on protection and liability – which currently have no universal agreement. It is therefore premature for the PSR to take a firm stance on pricing for Phase 1.

1.14 Overall, we believe that the pricing principles, and the PSR's proposed pricing approach for Phase 1, are fundamentally flawed. We urge the PSR to allow industry and market forces to develop an effective pricing mechanism for commercial VRPs.

2 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?

2.1 Santander agrees that cross-industry coordination is necessary for Phase 1. We note that UK Finance is currently chairing a series of workshops – voluntarily instigated and funded by industry - to agree a set of recommended model clauses, which participants can choose to utilise in future agreements as appropriate. Santander supports the flexibility offered by this approach.

2.2 However we do not believe that the "CMA9" as a construct is valid, or that this is the appropriate way to ensure industry participation. See further the response to question 12.

2.3 Santander does not believe that mandatory application of an MLA is the appropriate vehicle for Phase 1 pilots, since it would be too restrictive. There is also a practical question as to whether this can be agreed within the timeframes envisaged by the pilot in light of the significant numbers of firms involved and legal complexity (ensuring guarding against competition law risk akin to the interchange cases).

3 **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**.

3.1 As mentioned above, Santander does not agree that a MLA is the best vehicle for Phase 1, since in our view a more commercial approach (i.e. allowing bilateral negotiations between ASPSPs and PISPS) would be more appropriate.

3.2 That said, given there is no certainty that Open Banking Limited will continue to exist after the imminent creation of a Future Entity (and was set up as an Implementation Entity for the time-limited CMA Retail Banking Order), we do not at this stage consider it prudent to give additional responsibility to OBL, particularly where it has no regulatory mandate.

3.3 To the extent Pay.UK runs a scheme, the legal basis for setting any fee needs to be considered in light of competition law. That said, it must not have the unintended consequence of setting the fee to zero. Any competition law risk associated with setting a price – should that be the PSR's preferred outcome - could be mitigated if this were set by the PSR.

4 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?

4.1 See the responses to Questions 1 above and 12 below regarding our views about the PSR's current view of the market structure and sending firms' position in it.

i) The PSR's characterisation of the market is inappropriate. The terms "gatekeeper", "monopoly" and "market power" have specific connotations in competition law, and none of them apply to ASPSPs. "Market power" refers to firms with a strong market position (typically with greater than 40% market share) that are able to act independently without being constrained by competitive pressure.

This is not the case in the retail banking market, which is highly fragmented. No retail bank has this level of market share and there are over 40 licenced ASPSPs currently operating with scale. Several recent market reviews have concluded that competition in retail banking is working well. To the extent similar language was incorporated in the CMA's Final Report in the Retail Banking Market Investigation (although it was absolutely not its focus), that report reflected the CMA's competitive assessment a decade ago. The Order related to the specific adverse effects on competition identified by the CMA, and commercial VRPs are not in scope.

ii) The CMA9 as a construct was formulated in the CMA's Final Report after the Retail Banking Market Investigation in August 2016, which reflected a review of between 2014-2016, and even then using historical market shares. In the decade since that review, the banking sector has significantly changed. New entrants include very significant players, such as the consolidated Virgin/Yorkshire Bank/ Clydesdale Group, Starling, Monzo, Chase UK, Marcus UK, Revolut, Tesco Bank, Tide and Atom. Some of these players have larger market shares across personal and business accounts that the CMA9. It is anti-competitive to place regulatory obligations (and associated compliance costs) on some firms whilst not on others, on the basis of a market analysis done a decade ago.

It is inappropriate to consider this still fit for purpose without refresh, particularly when considering the imposition of new regulatory obligations. This requires a cost-benefit analysis.

iii) TPPs are often extremely large companies (including BigTech firms) and are not always small firms. For example, the Big Tech firms such as Apple that are likely to be significant users of Open Banking and VRP have significantly more market and negotiating power than banks and are likely to become gatekeepers of wallets and financial marketplaces going forward. The FCA is currently conducting work to assess the competitive advantages of Big Tech entering financial services. The PSR must be cognisant of the ongoing shifts in retail banking and mindful of creating unintended consequences via the Pricing Principles.

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

5.1 There are several additional costs to be considered, including:

- The technical build costs associated with the new model, including new data fields to be mandated on consent entry to capture the necessary additional information to determine and differentiate between different user cases; changes to the Customer User Interface; and Fraud decisioning engines to provide the appropriate risk assessment for each user case/consent presented for approval.
- Changes to the dashboard model currently operated: to show and make customers aware of the new consents and agreed common language to differentiate VRP's from current sweeping payment consents.
- Associated costs for the liability model: dependant on where the liability lies. The regulator and industry must ensure that consumer protection for VRPs is at an equivalent level to that offered in other existing protected payments (as set out above).
- Additional fraud refund requirements need to be determined and funded. These are currently partially funded from associated card or merchant fees levied on merchants/business customers rather than direct to Retail customers – so an element of equivalent cost coverage should be considered.

5.2 In addition, the UK operates a free-if-in-credit retail banking model, where customers do not pay for their deposit accounts. As the FCA considered in its strategic review of retail banking and the CMA considered in its review of competition in retail banking, banks tend to operate portfolio pricing across their products as services. Revenue streams from all products (including the various interchange revenues that are likely to diminish in future) cross-subsidise and affect the economics of a number of critical services that banks provide society, such as branch provision and the reimbursement of fraud losses, even where that is not a bank's fault.

5.3 The PSR should consult with the Prudential Regulation Authority and the FCA to ensure that it does not inadvertently create unintended consequences that might undermine long-standing and important policy objectives for UK retail banking by creating a commercial and liability model that will set the frame for the future of banking. This is plausible given the move towards Open Finance and a digital economy where platforms or big tech may become financial marketplaces. The costs of societal services need to be recovered by banks.

5.4 Finally, we note that the PSR's approach, as set out in the Pricing Principles, of only considering directly incurred costs, is an unusual for a commercial operation. This approach has not been seen in any other industry to date, and in the long-term it is unsustainable.

6 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.

6.1 See the responses to Questions 1 and 5 above for Santander's view on the PSR's proposed pricing model for commercial VRPs.

7 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?

7.1 See the responses to Questions 1 and 5 above for Santander's view on the PSR's proposed pricing model for commercial VRPs.

7.2 We note that Pay.UK themselves charge a cost per click equivalent charge for Confirmation of Payee checks.

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

8.1 OBL currently manage and operate the Open Banking certification scheme, allowing senders and receivers to confirm certification statuses to operate using Open Banking identification rails. Whilst the cost of this service which is currently borne by the CMA9, JROC is currently considering how this service will be provided and funded after transition to the long term regulatory framework.

8.2 In light of JROC's work on the creation of a Future Entity, where a number of options are under consideration and will likely be reassessed in light of the Joe Garner review and any new parliament, it is premature to place too much emphasis on OBL costs.

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

9.1 We believe that choice of use cases and pricing structures for Phase 1 should be left to market forces, with industry designing viable propositions on a voluntary basis. This should be underpinned by central guidance and core agreement on functionality, design, liability, data, user interface, and suggested model clauses to simplify the process where possible.

9.2 UKF has commenced work on model clauses in this regard, which would benefit from PSR support. UKF has also indicated support for an-industry led collaboration on a scheme.

10 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.

10.1 Santander does not believe that having a large number of consumers with accounts that support VRPs alone will sufficiently incentivise PISPs and/or billers to invest in offering VRPs. The Phase 1 use cases now proposed will likely see restricted interest from TPPs. It is likely that a few major players will be able to invest and participate at scale – while many others will not and will choose to not participate in the hope that future phases offer a more widespread service.

10.2 We note that sweeping proved popular as a method to top up accounts, however we think that it is unlikely that utilities and government payments would be able to reach the same level of take-up.

10.3 Santander believes that Phase 1 does not need to be limited to the three proposed use cases. Allowing ASPSPs and TPPs to explore a wider variety of use cases would allow the industry to discover what may be commercially viable. It will also allow wider TPPs participation, as TPPs would be able to work directly with ASPSPs to develop the use cases that have the most demand.

11 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

11.1 In our view it is more appropriate for PISPs to answer this question.

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

12.1 As mentioned in the response to question 9 above, Santander believes that participation in Phase 1 of VRPs should proceed on a voluntary basis.

12.2 The CMA9 as a construct was formulated in the CMA's Final Report after the Retail Banking Market Investigation in August 2016, which reflected a review of between 2014-2016, and even then using historical market shares. In the decade since that review, the banking sector has significantly changed. New entrants include very significant players, such as the consolidated Virgin/Yorkshire Bank/ Clydesdale Group, Starling, Monzo, Chase UK, Marcus UK, Revolut, Tesco Bank, Tide and Atom. Some of these players have larger market shares across personal and business accounts that the CMA9.

12.3 Placing regulatory obligations (and associated compliance costs) on some firms whilst not on others, on the basis of a market analysis done a decade ago and without any legitimate basis, appears to run counter to the PSR's competiveness objective.

12.4 If voluntary participation is discarded, a more appropriate direction could apply to the Confirmation of Payee banks, which reflects a fairer and more objective selection.

13 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?

13.1 As mentioned above, Santander believes that compelling use cases are what will ensure that a sufficiently large number of customer accounts will sign-up. Reducing compliance costs will allow firms to focus innovation on the use cases and services that really matter to customers and will in turn provide a competitive advantage.

14 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?

14.1 As previously mentioned, we disagree that there should be mandated participation. We suggest consultation with the OBL over their experience in managing the Sweeping delivery, where not all CMA9 participated equally or delivered to the same timelines. The OBIE should have a unique and relevant view on the VRP phase 1 and some of the broad assumptions being made.

14.2 As flagged, the proposal of mandating a zero cost model also emails significant risks not to the participation of ASPSP's in the Pilot, but also to the PSR's competitiveness objective (where it is required to "promote effective competition in the markets for payment systems and services - between operators, PSPs and infrastructure providers") and longer term to the provision of retail banking services as currently understood. See the Executive Summary and our response to question 1 above. Participating CMA9 ASPSP's would have to fund these developments at a cost loss basis, delaying the introduction of commercial models which also need to be trialled and tested just as much as user cases.

14.3 In addition, as ar January 2024 we have no agreement of the actual scope of the pilot, the common technical functionality required to support the new user cases, or a realistic build and delivery timescale to deploy new functionality to production. Open Banking to date has operated a 6 month deployment schedule to delivery of new functionality, once the specific requirements (both business and technical) have been fully agreed and defined. The timescales in the CFI appear optimistic. In light of the challenges as manifested in the VRP working group (without even review by legal and compliance teams), it is also unlikely that a sustainable liability and dispute model could be stood up in time for the pilot and any MLA for that pilot.

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

15.1 Santander's views on the appropriate model are set out in the responses above.

16 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?

16.1 Santander's views on the risks associated with the PSR's proposals are set out in the responses above.

17 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.

17.1 As mentioned above, Santander believes that the proposed use cases for Phase 1 are too narrow and will likely not see wide TPP participation as they will only be relevant to a small number of TPPs. The result will likely be a small pilot with limited learnings for future phases.

17.2 The restricted pilot does simplify some of the issues of fraud, protection, and liability but this merely delays the challenges that JROC faces in resolving these issues.

17.3 Of the three proposed use cases, we anticipate that VRPs to regulated financial services firms will be most popular, especially for those companies that already offer a variable top up contribution model to investment products (such as stocks and shares ISAs etc), which are currently utilising Direct Debit payments.

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

18.1 Santander are unsure how VRPs will ensure customers have less reliance on payments via credit. Use of credit implies lack of currently available funds, which would be unaltered by a VRP direct account payment.

18.2 Most payments currently in the three proposed use cases are currently made by way of Direct Deposit. Misdirected payments are covered by the Direct Debit Guarantee and late payments are largely due to lack of funds. By contrast, misdirected VRP payments disputes are currently unprotected, and lack of funds would halt a VRP in the same way as for Direct Debits.

18.3 We encourage the PSR to factor in the relative customer protections available in the cost benefit analysis.

19 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?

19.1 With the currently proposed zero-cost model, there are very few benefits for sending firms to incentivise their participation. They will face significant build costs, consumer confusion over new 'third parties' and issues over operational support. We set out our concerns more fully on this point in our responses above.

19.2 For PISPs the margins are likely to be thin, especially with the whole process being cost compared to a two-party model currently (despite the fact that VRPs now need to accommodate a third party).

19.3 Utilities and local government payments are often currently served by Direct debits – which have operated well and are established modes of payment – and set payment amounts have worked well to this point. It is unclear whether consumers or merchants will face significant benefits from moving to VRPs (as currently proposed).

20 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?

20.1 Consumers should see no difference in costs (as they face no costs from either payment type).

20.2 Merchants will be charged by TPPs, with pricing to be determined replacing banking fees levied currently. It is currently unclear how much of a cost saving this will represent for them.

20.3 PISP costs will depend on charges from sending banks plus their internal cost to develop the new functionality. They are unlikely to bear operational costs as TPPs do not tend to offer operational support to consumers. It is likely that this would remain with sending firms and merchants in these cases.

20.4 Sending firms will face significant costs (as set out in the responses above).

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

21.1 Open Banking services are all digital – requiring digital access, mobiles, and familiarity with the digital processes and functionality. This is likely to restrict participation from customers who face digital exclusion, especially where VRPs are competing with direct debit schemes and traditional payment banking. It could also impact the ability of vulnerable customers to participate.

21.2 **Question 22 Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.**

21.3 As mentioned above, there are a number of issues with the Pricing Principles, both as articulated in the JROC paper of 26 June 2023 and this CFI that pose risks to the scalability of VRPs and the evolution of a sustainable, innovative Open Banking ecosystem. In addition, Phase 1 will not resolve ongoing issues related to fraud, protection, and liability. Until these critical issues are resolved, scalability will remain limited.

Tesco Bank

Tesco Bank
EHQ
2 South Gyle Crescent
Edinburgh EH12 9FQ

T: +44 (0) 131 203 5000

2 February 2024

Tesco Bank response to PSR CP23/12

Dear Sir/Madam,

We are encouraged by the regulatory focus on this area and the stated aim to grow the adoption of VRP beyond its current use. The targeted date of Q3 2024 for Phase 1 is welcomed.

The ‘low risk’ use cases selected are sensible as a first step, and VRP seems well suited to the industries and organisations involved; however, a consideration of customer willingness to adopt VRP across these use cases has not been fully addressed within the consultation. We would therefore request a degree of customer research be performed, specifically focused on the customer benefits provided by VRP, to be viewed in contrast with customers' existing payment method, to determine if these benefits are enough to encourage a behaviour shift. Our own customer research has indicated that without incentivisation the benefits provided by VRP are not sufficient to see this shift in behaviour.

Ensuring selection of the correct use cases is vital; however, this additional customer research would also allow for the creation of customer experience guidelines, the standardisation of the payment journeys and the early identification of risks that could result in incoherent and inconsistent user experiences which would in turn stifle adoption.

We would urge caution to ensure that industry does not lose sight of use cases beyond Phase 1 and inadvertently build a solution (including pricing and muti-lateral agreements) which is not adaptable or scalable. As such, we would welcome regulator consideration of the re-introduction of the ‘stretch’ use case proposed in the e-commerce space. We would also welcome clear success criteria and the establishment of boundaries to ensure an understanding of when Phase 1 is complete, as well as further detail on the vision for Phase 2 and beyond. We believe understanding the entire roadmap will allow industry to effectively deliver Phase 1 with a clear vision of the objectives for the future development of VRP.

In keeping with the principles of the Open Banking Future Entity, we would welcome the eventual introduction of parity across all ASPSPs to achieve true ubiquity of both capability and availability/performance of service. The consultation lacked information on biller adoption which would need to be established in advance of Phase 1 to ensure technology and operational development can be appropriately planned to maintain the proposed timelines.

It is noted that further detail regarding the commercial model for VRP will be provided through Q2 2024. It has been our experience to date that commercial VRP is currently priced above that of debit card interchange fees, precluding retailer adoption. To create a viable alternative to card payments we welcome regulatory measures to consider centralised pricing. This must, however, allow all parties in the value chain to realise the financial benefits of premium APIs and not just focus on cost mitigation. We see benefit in the steps being proposed to reduce FPS related costs; however, we would question if moving the fees to the receiving bank will have a fundamental impact on the cost passed onto PISPs, and in turn end users.

The costs associated with providing consumer protection similar to cards have not been fully addressed within the consultation. This will become of increased importance when looking to move beyond Phase 1 into more complex use cases, such as retail transactions. The costs associated with providing refunds should also be further addressed.

In conclusion, we view the proposed activity within consultation CP23/12 as an encouraging first step in promoting the adoption of VRP. However, we would request that Phase 2 be more detailed e.g., with the inclusion of indicative timelines.

Teya

Expanding variable recurring payments

Teya's response to the PSR and JROC call for views on CP23/12

2 February 2024

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About Teya

Teya is bringing a one-stop solution to European businesses. Formerly known as SaltPay, Teya combines payment acceptance and business management tools in one ecosystem - including electronic-point-of-sale, merchant account services, a digital loyalty platform, and other software-as-a-service solutions. Teya is headquartered in London, has offices in 15 countries across EMEA, and has 300,000 merchants using its products globally.

Teya exists to ensure that every small, medium, and growing business in Europe has the opportunity to thrive. Our payments and business management technology is designed to help the people running businesses to take hassle-free payments, manage their business, and find and reward their customers - all on fair terms. We want to free business owners from the everyday complexities and headaches that stop them from being successful. With our commitment to care and innovation, they can feel confident in making the most of every opportunity and experience the joy of running a business.

Establishing a competitive A2A landscape

Before answering the PSR's consultation, Teya would like to explain its views on creating a world-leading A2A landscape that works well for small businesses. Our views below link to ensuring a sustainable long-term model for VRPs and open banking payments.

Teya believes that the goal of encouraging the use of digital payment methods is a consideration that no longer applies in the UK – a country with one of the highest penetration levels of digital payments in the world. As a result, we believe that there should be no inter-PSP fee in a future account-to-account payment system.

As issuing banks (or account servicing payment service providers – ASPSPs) stand to gain with fewer API implementations, Teya foresees them embracing the trend of market concentration among API aggregators. Moreover, the need to integrate with ASPSPs will mean that API aggregators could incentivise to ASPSPs to preferentially build better APIs for them rather than their competitors. This could occur outside of the JROC's multilateral agreement, as API aggregators could leverage their market power to sign partnerships with banks outside the regulatory forum, particularly considering ASPSPs' incentives to do so.

a. Alternatives to inter-PSP fees

On the other hand, if the multilateral agreement is delivered in a way that removes the possibility of a per-access inter-PSP fee while mandating banks, ASPSPs would have to find alternatives to create an economically sustainable A2A scheme. Teya believes that one such means would be for banks to be granted shareholder status over the future scheme. In this way, participants in the multilateral agreement could pay a per transaction fee to the scheme, which would then be shared by the shareholder banks on a reasonable profit margin basis. This would alleviate the anti-competitive structure of the inter-PSP fee and ensure that banks remain invested in a single, publicly accountable account-to-account scheme.

In Teya's view, this ownership and revenue should come from the interbank infrastructure (Faster Payments) layer rather than the API (open banking) layer

As will be elaborated further below, banks will attempt an inter-PSP fee based on APIs to recoup the fixed costs they have already undertaken to build open banking APIs.

Nevertheless, banks have provided real-time payment rails (FPS) for A2A as guarantors of Pay.UK, Teya considers the infrastructure layer as a more appropriate basis for compensation. Accordingly, Teya believes that this can be achieved by converting Pay.UK from a not-for-profit entity to a commercial entity under strict PSR regulation. Teya's approach to the same is described in detail below to Question 3 on the role of Pay.UK in expanding VRPs.

b. API architecture

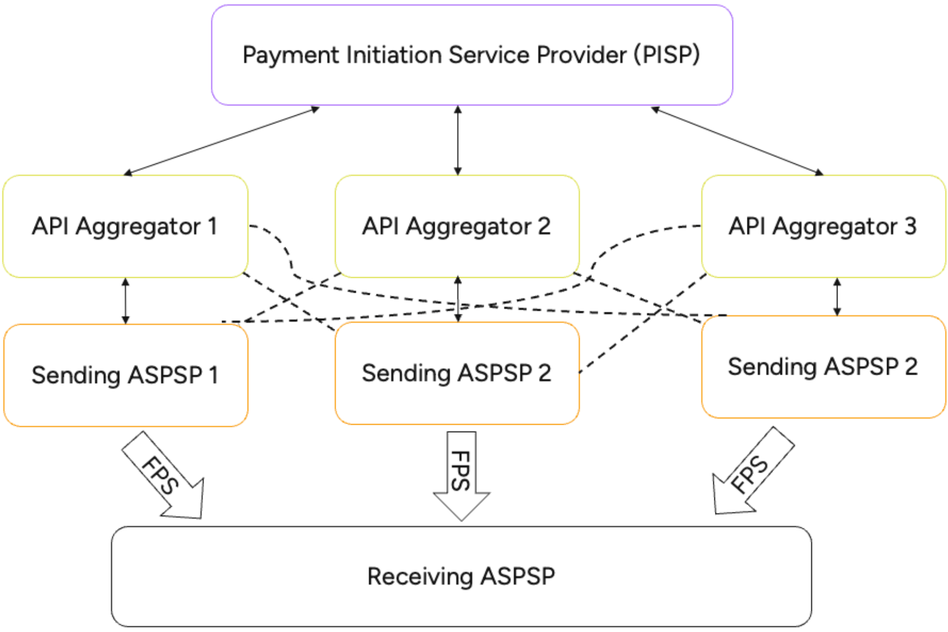
Despite multiple regulatory mandates and significant investment into Open Banking, market coordination has resulted in extremely slow progress. Accordingly, Teya believes that the UK should move away from a decentralised API infrastructure towards a centralised API interface managed by Pay.UK. A centralised API infrastructure would speed up the adoption of a more innovative and cost-efficient alternative payment method by overcoming the resistance of incumbents towards high-quality standardised APIs. Inspired by models adopted by India and Brazil, the central API could also be linked to a centralised database of aliases (proxy lookup) linked to bank accounts, therefore allowing the extension of the infrastructure beyond open banking and into open finance and smart data. Crucially, centralised infrastructure would enable a higher degree of interoperability.

The decentralised approach, which follows the 'single standard, multiple APIs' approach, has created a coordination problem. This is because each TPP must integrate directly with each ASPSP, which from the perspective of the latter creates additional costs. In other words, ASPSPs must not only carry out multiple integration processes, which involve certification of TPPs but also engage in ongoing monitoring to ensure that TPPs meet the appropriate standards described by Open Banking Limited (OBL). Additionally, the decentralised approach will in the future create barriers to the rolling out of consumer protection, anti-fraud, and liability management standards as a scheme manager (or individual banks) would have to ensure that each third-party API aggregator meets the standards. On the other hand, the management of a single API interface would mean that standards can be rolled out on a sector-wide basis, allowing a high-quality payment ecosystem. In Teya's view, this uniformity in user experience, security, and reliability is crucial to ensure the consumer trust required to achieve the critical threshold of network effects required.

To recap, this relates to API aggregators, following market concentration in the long run, charging increasing amounts to merchants to obtain high-quality bilateral APIs for themselves to outcompete other aggregators. Teya foresees a scenario where a handful of API aggregators each have preferential relationships with individual large banks, thereby becoming the provider of choice for those banks. A centralised API ensures a single high-quality API, and thus a level playing field, for PISPs to easily access accounts held with all ASPSPs with one integration. Then, PISPs will compete with each other based on the value they provide to their customers as opposed to the state of their relationship with individual ASPSPs. To elaborate further, with the current approach in the UK, it is unlikely that each PISP will create direct API connections with the banks. Rather, given banks' costs in carrying out new integrations, a small number of API aggregators would act as technical service providers for smaller PISPs, who would then become price takers. This would increase the number of intermediaries in the value chain, therefore placing further upward pressure on retail prices paid by merchants to accept open banking payments. There is also a risk that large API aggregators would offer their own PISP services directly to end-users, thereby raising self-preferencing competitive concerns.

Figure 3 illustrates the risks associated with the emergence of a handful of dominant API aggregators. The dotted lines represent default APIs (under a multilateral agreement), while the solid lines show each API aggregator's preferential API agreement with an ASPSP. In turn, this would trigger competition between such ASPSPs to win preferential treatment from respective ASPSPs. The PISP on the other hand is a mere price taker in this scenario as connections to banks are gatekept by the dominant API aggregators.

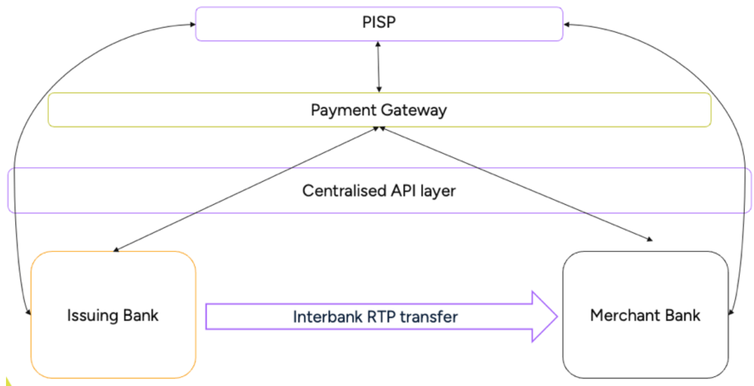
***Figure 3* – Illustrative example of an architecture with dominant API aggregators under a decentralised approach**



Source: Teya's illustration

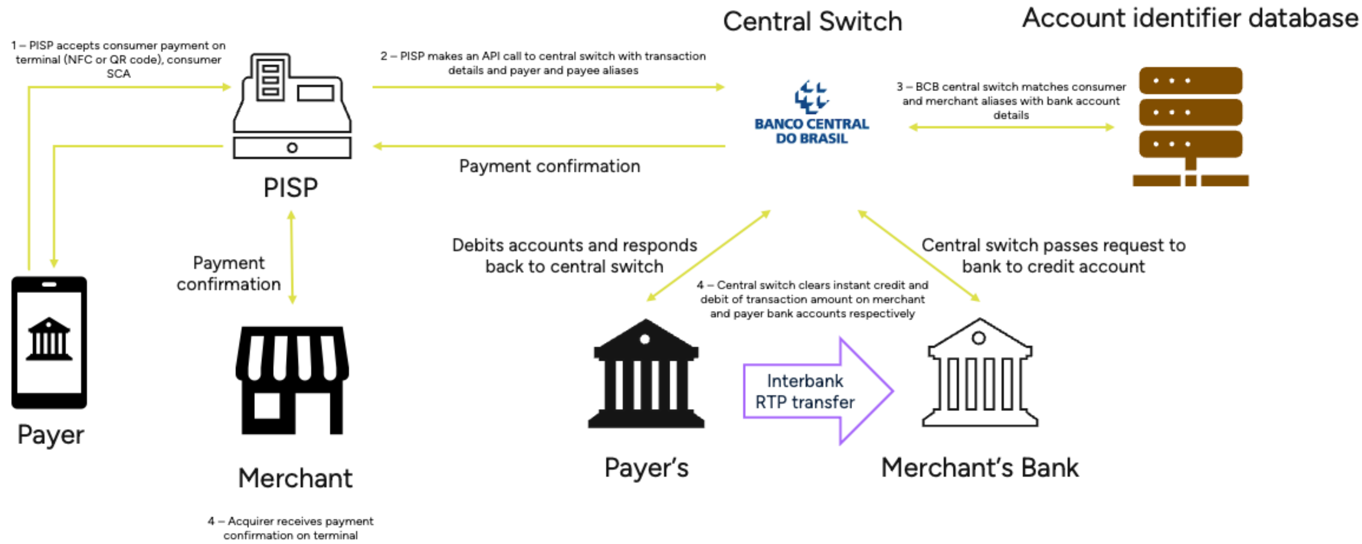
On the other hand, Figure 4 and Figure 5 respectively highlight the simplified architecture of a centralised API model and the transaction flow. Here, there are low barriers to entry for any PISP that wishes to provide Open Banking payments, as they could easily connect with the single API. Note that although under such an approach a payment gateway could exist to intermediate a connection with the single API layer, such a player would not become dominant due to the low technological barriers to entry for a PISP to connect directly. Moreover, Teya believes that in the future of payments, the barriers to entry should be low enough for merchants to integrate into the centralised API layer to provide payment initiation capabilities themselves.

***Figure 4* – Illustrative example of an architecture with a single API connection under a decentralised approach**



Source: Teya's illustration

Figure 5 **– Transaction flow under a single API model in Brazil (Pix)**



Source: Teya's illustration based on Banco Central do Brasil[1]

Google highlighted in its whitepaper to UK and EU policymakers that based on its experience as a PISP in the Unified Payments Interface (UPI) ecosystem in India, a single API interface is preferable to a decentralised one on several grounds.

The centralised approach is particularly useful for the UK considering the existence of the infrastructure to facilitate the same. In its response to the Future of Payments Review, Pay.UK discussed the challenges it faced in implementing the UK's account identifier database (i.e., alias database or proxy lookup service) in PayM. However, it spoke of its intention to consider learnings from the issues with PayM to implement a state-of-the-art proxy-based service on the New

[1] https://www.bcb.gov.br/en/financialstability/pixcentralbanksrole.

Payments Architecture (NPA).[2] However, Teya believes that considering Pay.UK's experience in this regard, such a feature should also be rolled out as part of Faster Payments to help support the implementation of A2A in the UK. Again, while ASPSPs might be hesitant as guarantors of Pay.UK to provide frictionless access to their customers' bank accounts through proxy lookup, providing them with an incentive to earn a reasonable profit from ownership of Pay.UK in the future would incentivise investment at the infrastructure level. Regardless, a proxy lookup add-on would be a 'nice-to-have' feature: an API interface can leverage the network of existing APIs to allow users to select their banks and send an API call directly to that bank to allow the completion of a payment.

In terms of the existing Open Banking ecosystem and the possible sunk costs of such providers, Teya believes that the majority of PISPs have been successful not by creating mere API connections between merchants and ASPSPs, but rather through the consumer-facing products that they have created. Therefore, it would be in the interest of competition to enable PISPs to compete on a level playing with each other, lowering barriers to entry, and preventing over-reliance on a small group of API aggregators. Existing API infrastructure would nevertheless be used to create the network of APIs, as Teya would recommend the PSR and Pay.UK to appoint API aggregators as technical service providers to build connections between different banks. Considering that these APIs have already been built, Teya believes that the work ahead would involve integrating APIs from several different providers into one centralised roof.

***Figure 6* – Comparison between centralised and decentralised API approaches**

	Centralized	Decentralized
Central Infrastructure	Required	None required
Policy enforcement	Handled centrally, full control	Handled by FSPs, audit only
Integrations for TPPs	1 per TPP	1 per FSP per TPP
Guaranteed consistency for all integrations	Yes, one implementation means no variation whatsoever for API clients	No, different implementations may have subtle differences in behavior (even with same API)
Leads to aggregators	No, central system is already an aggregator	Yes, aggregators have a viable business model which may create costs for TPPs
Allows competition on API specifications	Yes, new API methods can be routed through extensions in the central switch	Yes, FSPs can support additional API methods
Version fragmentation	No, single deployment means all bug fixes and new versions are fully controlled	Yes, changes rolled out across all FSPs on varying timeframes

[2] https://newseventsinsights.wearepay.uk/media/kzsejase/the-future-of-payments-review-payuk.pdf.

Source: Google Whitepaper[3]

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.

As mentioned above, Teya does not believe that a fee charged by ASPSPs to TPPs to provide basic payment services is appropriate. Teya recommends that the PSR convert Pay.UK into a for-profit entity such that ASPSPs can earn a reasonable profit margin through the fees paid by participants to send and receive funds through the Faster Payments (or NPA) scheme.

Merchants should have the freedom to decide the premium features that they use

Notwithstanding, Teya believes that certain premium features beyond basic payment services should be monetizable by ASPSPs, as long as it remains up to merchants and their PSPs to the premium features that they want to invoke. Consumer protection could be achieved by providing guidance in an MLA relating to the risk-scoring of a transaction, and accordingly applying different levels of premium features therein.

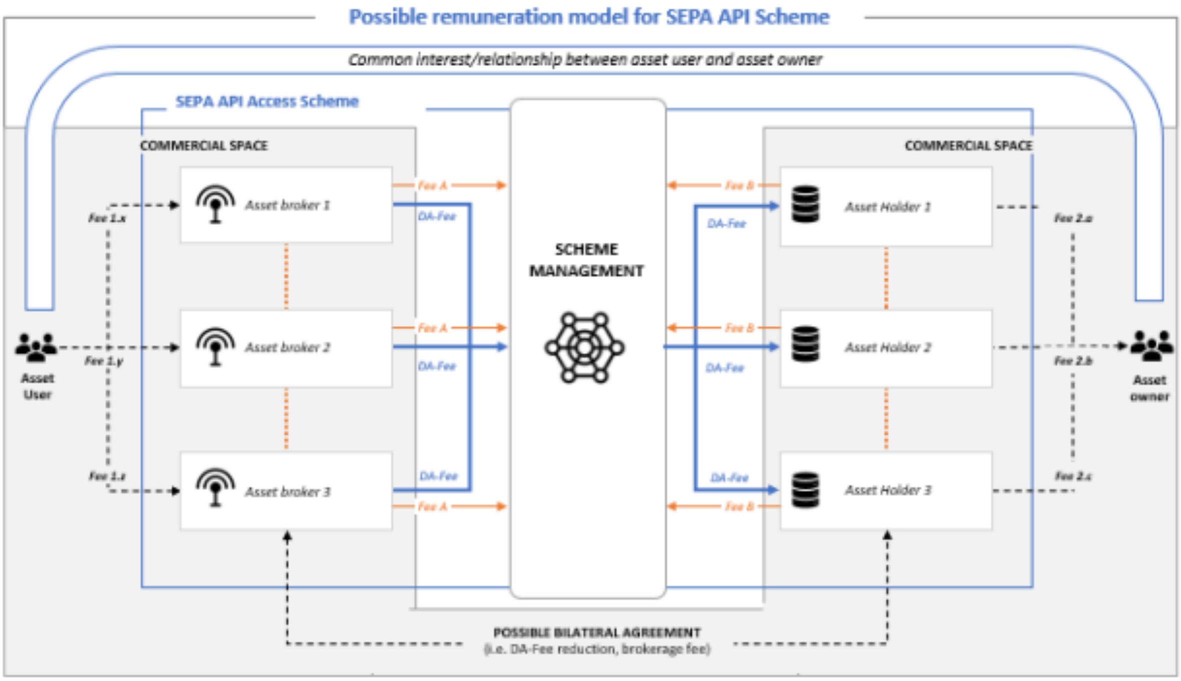
The SPAA scheme is an example of a poor commercial model

The EU's SEPA Payment Account Access (SPAA) scheme comprises a rulebook provided by the European Payments Council (EPC) for interactions between TPPs (AISPs and PISPs) with ASPSPs. It covers both open banking use-cases such as basic payment services and access to payment account information as well as premium use-cases. The SPAA scheme has stated its objective as being the alignment of ASPSP technologies and service levels with those of TPPs. Accordingly, the SPAA rulebook describes API standards for basic and premium APIs while also providing for multilateral API access (inter-PSP) fees. As a result, the SPAA scheme's scope can be considered to be equivalent to that of a future MLA in the UK to enable VRPs.

The basic foundation of the SPAA commercial model involves both a default API access fee that applies irrespective of the type of request by a TPP, as well as differing premium feature fees that can be applied based on the type of transaction. On top of this, there would be a scheme fee paid both by ASPSPs (asset holders) and TPPs (asset brokers) to the European Payments Council for its scheme management service (Fee A and Fee B in *Figure 7* below). *Figure 7* below shows how the SPAA scheme would look in terms of the different entities and fees involved.

Figure 7 **– Remuneration model for the SPAA scheme**

[3] https://static.googleusercontent.com/media/pay.google.com/en//about/business/static/data/gpay-open-banking-whitepaper.pdf.



Source: European Payments Council[4]

For instance, in the case of a VRP (referred to as a dynamic recurring payment in SPAA), there would be (at least): [5]

- a default API access fee;
- a premium API fee for dynamic recurring payments;
- a payment certainty mechanism request premium API fee;
- a request for supporting account information premium API fee;
- a SCA approach preference information premium API fee; and
- a premium API fee for a request to ensure that the payer is not charged transaction fees.

Other premium API fees could be applied based on the type of transaction, the preferences of the individual ASPSP, as well as the actions of the consumer or merchant. Teya notes, even before a discussion of how these fees were calculated and their levels, that the definition of 'premium' under the SPAA scheme is kept highly broad and the definition of basic highly narrow. In other words, the SPAA scheme involves a narrow interpretation of PSD2, thereby increasing the potential of higher fees to be charged per transaction. A good example of the same is the fact that a premium API feature must be invoked simply to ensure that the payer is not charged transaction fees. Moreover, it is telling that even the inclusion of such a fee as a premium feature, which Teya considers should

[4] https://www.europeanpaymentscouncil.eu/sites/default/files/kb/file/2022-03/EPC077-22%20v1.0%20Request%20for%20Proposal%20SPAA%20Economic%20Consultant_0.pdf. Fees A and B are scheme fees paid to the European Payments Council.
[5] https://www.europeanpaymentscouncil.eu/sites/default/files/kb/file/2023-06/EPC012-22%20v1.1%20SEPA%20Payment%20Account%20Access%20Scheme%20Rulebook.pdf.

be assumed as a basic feature, was the subject of major pushback from banks during the development of the SPAA rulebook.

In terms of setting the fees, the EPC made clear in its Request for a Proposal to hire an economic consultant to calculate the default and premium API access fees that ASPSPs would receive fees for cost recovery as well as a reasonable margin on top of it.

1. **Cost.** In terms of what the economic consultant could consider 'cost' in its collection of data from banks and the calculation of overall costs, the EPC stated the following:

   > *"The cost-calculation methodology and the data collection process should aim at estimating (per asset class, as well as about the fallback Fee):*
   >
   > - *asset classes (for which separate Fees shall be established and calculated)*
   > - *investment cost recovery (estimated investments based on an amortisation duration, testing activities and roll out, etc.)*
   > - *direct costs (technical, operational, etc.)*
   > - *indirect costs (HR, invoicing, overheads, etc.)*
   > - *risk-related costs (anti-fraud, Op-Risk, business contingency, etc.)*
   > - *estimation of number of API calls per year*
   > - *cost of capital"*

   As a result of this highly broad definition, the initial investment of legacy banks to build PSD2 APIs since 2016 could be accounted for – both the direct technical investment costs as well as indirect costs, for instance, a legacy bank hiring software developers for the first time following PSD2 to build APIs.

2. **Reasonable margin.** Despite the risk that 'reasonable' margin is an imprecise concept, there has been little attempt to provide narrow guardrails for the economic consultant in calculating such fees:

   > *"The calculation methodology for the reasonable margin, as described in the June 2021 ERPB Report, could be based on a 'cost to income' ratio that can be found e.g., in the 'consolidated financial statements' of companies as applicable to different asset classes, so it can be unequivocally defined as an average of its value for a significant sample of possible scheme participants.*
   > *The reasonable margin takes the value created into consideration and makes it attractive for actors of all sizes to join the scheme."*

   The benchmark for the cost-to-income ratio is therefore 'different asset classes' as defined under the SPAA rulebook. The SPAA rulebook considers payments (VRPs, one-offs, etc.) to be asset classes.

The decision to review the fees two months after their publication is a natural decision, as the economics of the fixed (cent, rather than percentage variable) fees are unsustainable for all merchants rather than those with the highest average transaction values.[6]

For example, a VRP transaction for a standard monthly Netflix subscription of €10.99 with the minimum required features to carry out such a transaction (described above) would entail an API access fee of 1.32% of the transaction for the merchant. Considering that this is the equivalent of an interchange fee in card payments (does not include EPC scheme fees which would be separate and are as yet undecided), the fee here would be 1.12% higher than a card transaction (i.e., 0.2% as per the IFR caps for debit card transactions). As a result, the only viable use cases could be those such as long-haul airline tickets.

Teya believes that such a fee is unreflective of any value created for end-users nor the costs of providing the premium features themselves. Rather, it serves as a fixed fee based on projected volume (number of transactions) to allow banks to recoup the costs of implementing a regulatory measure – open banking – that flowed from their failure to compete effectively and innovate. Resultantly, Teya the PSR not to adopt the SPAA rules around the VRP commercial model. In other words, the PSR should focus solely on the incremental costs of providing premium APIs for ASPSPs (in relation to the value they add to end-users) rather than set fixed fees with a view of allowing banks to recoup their initial investment in creating open banking APIs.

The recovery of fixed ASPSP costs should not form a part of the commercial model

In Teya's view, the potential benefits of any extension in VRPs for end-users would be eroded if a commercial model allows banks to recoup their fixed costs of investing in creating APIs. As highlighted above, banks should not be rewarded for their failure to compete effectively or innovate for the benefit of end-users.

In this vein, Teya appreciates the JROC's note under Principle 1 of its June 2023 publication: "premium API prices should not recover more than directly attributable and efficiently incurred costs, nor allow for higher-than-competitive returns." Moreover, Teya welcomes the JROC's recommendation that "ASPSPs should delay recovery of the bulk of relevant fixed costs, using techniques like amortisation where applicable, once open banking volumes grow to a sufficient scale and can be spread across a larger customer base".[7] However, Teya would recommend that the PSR and JROC go even further, for the avoidance of interpretative leeway, to state that the multilateral fees for premium APIs will be decided solely on the basis of incremental (or marginal) per transaction costs to the banks. With variable, per transaction percentage fees to reflect the differing costs of premium APIs based on the transaction, the PSR would allow the use of A2A payments, particularly VRPs, for high-impact (for SMEs) low transaction value use-cases.

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[6] https://www.europeanpaymentscouncil.eu/sites/default/files/kb/file/2023-11/EPC270-23%20SPAA%20Scheme%20Default%20Fees%20Version%201.0_2.pdf.
[7] https://www.psr.org.uk/media/w13hqtex/jroc-princples-for-commercial-frameworks-for-premium-apis-june-2023.pdf.

Additionally, these should not include *all* incremental costs, but rather those costs taken by ASPSPs that lead to the creation of value for the payers of the fees – merchants.

The existence of incremental variable costs for each premium API must not be assumed

The PSR is correct to shift the burden of proof of highlighting the relevant costs for each particular API functionality to the sending ASPSPs. In other words, any inter-PSP fee should be assumed to be zero given its fundamentally anti-competitive nature, with the need for any justified by the recipient. Accordingly, Teya agrees with the proposal in CP23/12 that the only identified relevant cost for Phase 1 use-cases for sending banks was the FPS charge, which could be waived to yield a zero inter-PSP fee.

To justify the need for any fee due to costs, ASPSPs must not be allowed to consider *any* incremental or variable cost that they face. Past issuer cost analyses such as the SPAA model have erroneously assumed that issuers should be compensated for their entire cost of providing the functionality linked with each premium API being called in the transaction. However, when considering what cost should be displaced to merchants via an inter-PSP fee such as a premium API fee, the correct question is what are the costs that are borne (and can only be borne) by issuers which create a benefit to the system which merchants exclusively benefit from. Only under that analysis could one conclude that there should be a remuneration from the payee to the payer side of the market to balance the system. In other words, the cost should be linked to the value delivered to the payer of the fee. This would be in line with the JROC's statement under Principle 1 in the June 2023 document that API prices should be linked to "efficiently incurred costs". A consideration of all ASPSP costs would disincentivise inefficient ASPSPs from improving their operations.

Accordingly, any variable per transaction fee for premium APIs must be linked to the value the underlying functionality provides to merchants. A good example of this would be the payment certainty mechanism: as it poses a risk (and thus a cost) for sending banks and value for merchants, it should be a variable percentage fee based on the type of transaction (e.g., online or physical, recurring or one-off), rather than as it is under SPAA – a fixed fee. Naturally, a payment certainty mechanism involves increasing risk with increasing value, and therefore an SPAA approach of setting a fixed fee for this premium API would make little sense.

The reasonable margin should not come from the API layer

Teya does not agree with Principle 2 of the JROC's June 2023 pricing principles because of the difficulty in measuring the level of premium API fees required to incentivise investment and innovation by ASPSPs. This can be attributed to the fact that considering incentives to invest and innovate will require a future-facing analysis when calculating the markup over costs that sending ASPSPs would be allowed to charge. To elaborate, banks would be receiving a mark-up in advance of innovating or investing to create better services that add value for end-users. This would allow considerable leeway for banks to seek rents, due to the difficulty in measuring the extent to which the additional mark-up over costs was reinvested towards innovating.

As a result, Teya believes that any margin that the banks should make over costs, even concerning premium APIs, should come from their ownership of Pay.UK – i.e., from the interbank infrastructure rather than the API layer. This would require, as described in further detail under Question 3, the commercialisation of Pay.UK under the close regulatory supervision of the PSR. Subsequently, Pay.UK could charge a scheme fee to participants and banks as shareholders could earn a limited margin as dividends.

Non-discrimination of TPPs is linked to preventing the reverse competition described above

Teya is supportive of the JROC's inclusion of Principle 4 to oblige ASPSPs to treat all TPPs equally. This is because, as highlighted above, there is a risk of API aggregators becoming dominant due to the preference for banks to deal with fewer integrations. This is leading increasingly to PISPs becoming reliant on API aggregators as technical service providers to access bank accounts. As stated above, Teya believes that this issue could be solved through the creation of a single API layer when the NPA is rolled out, ensuring that dominant technical service providers do not arise.

Regardless, in the near term, there are certain TPPs (who are dominant API aggregators) to acquire unfair competitive advantages due to their position as gatekeepers to bank APIs. This leads to several risks including self-preferencing (if the API aggregators are also themselves PISPs). Moreover, and arguably more concerningly, these dominant API aggregators could try to form bilateral, preferential partnerships with banks (as represented in *Figure 3* above). This could trigger competition among API aggregators, who raise fees on PISPs in order to earn preferential APIs (which could be superior in quality to the default) by compensating banks at a level greater than the multilateral premium API fees.

Accordingly, pricing should be uniform and bilateral, preferential partnerships should be enforced against (i.e., if they involve fees for TPPs and merchants in excess of the default). Therefore, Teya is supportive of the JROC's commitment to establish a commercial model whereby all TPPs, regardless of size are treated fairly.

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.

For reasons described above linked to preventing fragmentation and avoiding preferential treatment of certain TPPs by sending ASPSPs, Teya believes that an MLA will be required in all phases of rolling out VRPs. While Teya understands arguments from industry participants that an MLA for low-risk Phase 1 use-cases such as utility bill payments might not be required due to the pre-existing consumer protections in place there, there remains scope that certain TPPs would use their incumbent advantage and superior bilateral relationships with banks to gain a competitive advantage in Phase 1. Hence, considering that one of the goals of Phase 1 is to familiarise consumers with VRPs, preferential APIs by banks to certain TPPs could lead to them becoming dominant, in contravention of the JROC's goals to ensure a level playing field for all TPPs.

Given the choice provided by premium APIs however, a merchant could decide to transact without any fee for a basic transaction when a consumer is buying a coffee in-person, while deciding to apply strong protections when a consumer is purchasing a smartphone online. Therefore, there would be a stronger link between the value added to the merchant and the fee paid.

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.

Pay.UK is in Teya's opinion well-placed to operate the MLA for Phase 1. This is because of Pay.UK's experience with customer protection overlay services such as Confirmation of Payee, and its operation of the Bacs Payment System for direct debits – a leading means of payment for the use-cases covered under Phase 1 (e.g., utility bill payments).

Moreover, looking beyond Phase 1, the infrastructure layer is well-placed to create a sustainable retail payment system. Differently put, Pay.UK is the only entity in the open banking ecosystem that manages the infrastructure common to all transactions. The UK's decentralised API approach means that there is no other means to rollout system-wide measures other than through Pay.UK. Therefore, Teya recommends above that Pay.UK eventually manage a single API interface, perhaps following the rollout of the NPA, to facilitate seamless interbank payments by PISPs through low barriers to entry and innovation.

Regardless, there remain concerns regarding Pay.UK's funding, and its ability to manage innovative payment systems such as Open Banking. Teya agrees that Pay.UK's issues flow from its lack of funding, which is attributable to its status as a not-for-profit entity that only enables its guarantor banks to recover their costs. Currently, the entity generates no profit for issuing banks/ASPSPs. As such, merchants and consumers are unable to realise the benefits flowing from 24/7 instant payments. On the other hand, card payment rails provide Pay.UK guarantors with a substantially stronger revenue stream in the form of interchange fees. This underlines the importance of ensuring that a regular flow of funding can be allocated to improving A2A payments infrastructure in order to allow it to compete on even terms with other payment instruments.

If Pay.UK is converted into a for-profit recognised payment system operator ('RPSO') under strict PSR scrutiny, its guarantor financial institutions would have greater incentives to invest both in the infrastructure underlying account-to-account payments as well as the fraud detection systems required to reduce the rate of false positive and false negative red-flagging of Faster Payments transfers. As has been considered by the JROC before, the prevention of fraud is a key aspect of ensuring the uptake of open banking payments and in Teya's view Pay.UK's role is crucial in that regard. From the infrastructure perspective, of particular relevance is building an NPA that is suited to supporting high-frequency, low-value P2B payments. In other words, if Pay.UK guarantors are provided with a viable business case for A2A payments powered by open banking, then they will increasingly view the Faster Payments Scheme to be fit for retail use-cases as opposed to the current status quo, which effectively restricts it to wholesale payments.

Moreover, they could be incentivised to create the preferable single API interface and an accompanying high-quality proxy lookup service as part of the NPA, which would allow the UK to create a world-leading payment system on par with Brazil's Pix, India's UPI, and Australia's New Payments Platform.

Lastly, the reasonable margin that banks would earn in the form of dividends as owners of Pay.UK would be pro-competitive. As part of this reasonable margin, the PSR should impose a rule that equalises the scheme fee charged by Pay.UK on both the sending and receiving sides of the market.

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?

As mentioned above, Teya believes that sending ASPSPs' incentives are skewed against the promotion of open banking payments. As part of such an approach, banks would have to highlight in relation to each premium API their incremental costs per transaction that are linked to value delivered to the payers of the premium API fees i.e., merchants. This would be, in Teya's view, the only efficient way to mitigate risks and overcome misaligned incentives in order to find the balance of interests that maximises system-wide efficiency.

Additionally, in this regard, Teya reiterates that it would not be appropriate to allow banks to recoup their fixed costs of investment into building APIs.

In other words, TPPs who are also dominant API aggregators may tend to charge increasing amounts to merchants in order to gain bilateral contracts from ASPSPs (i.e., in exchange for higher quality APIs). In Teya's opinion, the way to resolve this in the long-run would be to create a single, centralised API infrastructure with a proxy lookup service built into the NPA, as opposed to the current decentralised approach that brings with it long-run competition risks due to concentration in the market for API aggregators.

Question 5

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

Teya believes the PSR has considered all relevant sending firm related costs in CP23/12 as part of Phase 1 use-cases. We agree with the PSR's finding that for Phase 1 use-cases the only relevant cost is the FPS charge. As stated above in our response to Question 1, looking beyond Phase 1, basic payment services APIs should remain free, with banks having the burden of proof to show that incremental costs incurred in providing each premium API functionality provides a value-add to merchants in order to be able to monetise it.

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.

Sending firms should not be able to charge consumers for FPS related costs. As discussed in the context of SPAA under Question 1, it must be a part of the basic MLA to ensure payers are not charged fees for the use of A2A as this would discourage adoption. As suggested by Teya, the most efficient way to operate the FPS would flow naturally as a result of commercialising Pay.UK and incentivising banks to invest in the currently not-for-profit entity. In turn, scheme fees could be levied on both sending and receiving ASPSPs, possibly passed down to TPPs, and banks could earn a reasonable profit margin regulated by the PSR as shareholders of Pay.UK.

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?

Both sending and receiving ASPSPs can pay Pay.UK a fee in the future, as highlighted above, resembling a scheme fee for participation. The fees paid by the sending and receiving side should mandated by the regulator to remain equal to prevent any distortion of competition towards the sending side. The banks can benefit from this fee as owners of Pay.UK if as per Teya's proposals the entity is commercialised and kept under strict PSR regulation.

Question 8

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

No, Teya believes all OBL related costs have been considered.

Question 9

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

Teya has highlighted the alternate commercial model to inter-PSP fees above, and in our response to Question 1 and Question 3. To recap, Teya's proposed commercial model is as follows:

- **There should be no fee for basic payment service APIs.** There should be no inter-PSP fees (due to their fundamentally anti-competitive nature) for basic payment services, defined broadly to include essential functionalities contrary to the SPAA approach to including seemingly basic services as premium APIs.

- **Premium APIs should be monetizable only to the extent that they add value to merchants.** Sending banks can charge for premium APIs, but only up to their incremental per transaction costs of providing the same. As premium APIs are services paid for by merchants, only costs that are directly linked to value-added for merchants should be included.

- **Reasonable profit margin should be earned at the infrastructure level.** Banks can be incentivised to support long-term investment into creating a world leading A2A infrastructure by virtue of their guarantorship of Pay.UK. Namely, if Pay.UK is transformed into a commercial entity under close PSR supervision, banks can recover a reasonable profit margin as dividend given their shareholder status. The dividends would be funded by scheme fees for participation in the FPS or NPA schemes, charged at an equal level to both sending and receiving ASPSPs to include costs and a reasonable profit margin.

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.

The main purpose of mandating VRPs for Phase 1 use-cases is to familiarise customers with A2A payments.

Billers or merchants outside of the Phase 1 use-cases, who are often large utility companies or financial institutions could invest in VRPs due to the zero-cost proposed in Phase 1. However, going forward, it would be difficult to incentivise merchants, particularly small businesses to invest in VRPs due to the unknown costs. In other words, VRPs being free for Phase 1 billers has no impact on other merchants as there is considerable uncertainty (among pressure from banks for higher fees) around the commercial model in retail use-cases beyond Phase 1. While a large number of consumers may become habituated with VRPs in Phase 1 use-cases, it is unlikely that merchants will invest in VRPs for the future despite not knowing the cost. This is different to other retail use-cases.

In Teya's opinion, the way to incentivise PISPs and billers to look to VRPs in use-cases beyond Phase 1 is to mandate sending banks to provide VRPs on a use-case agnostic basis. Moreover, there should be clarity on the pricing model, for instance by highlighting that: (a) the commercial model would not include fixed cost recovery for banks; (b) basic payment services APIs would remain free, and would be broadly defined to include essential payment features such as an obligation for ASPSPs not to charge payers; and (c) premium APIs would be priced at marginal variable cost for banks in the context of each transaction, with only costs that lead to value added for merchants considered.

Question 11

What number of 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.

As stated above, consumer uptake in Phase 1 is not adequate to spark the required network effects on either the payer or the payee side of the market to make VRPs a promising prospect beyond Phase 1. In particular, billers outside of those covered in Phase 1 are unlikely to embrace VRPs unless there is clarity provided on pricing. Teya's proposals for the PSR on the commercial model, if adopted, would provide a level of comfort for merchants. This is what could spark the two-sided network effects. Regardless, the level of network effects will not be achieved unless barriers to entry for PISPs are lowered considerably. This can be achieved through a single API infrastructure as highlighted above, complemented by a proxy lookup service, that allows PISPs (or even larger merchants) to integrate directly into the A2A infrastructure to provide meetings, bypassing the hesitancy of sending banks.

Question 12

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

As stated above, banks are disincentivised to support the creation of VRPs.

Question 13

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

Teya does not believe there is any alternative to mandating banks to support VRP to reach a sufficient number of customer accounts.

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?

There is no risk to end-users, who should be intended recipients of any benefits of regulatory measures such as those in the present scenario.

Question 15

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

There is no alternative to mandating participation of banks in Phase 1 and any subsequent phases. In the long-run, the most appropriate model would be to (a) create a single, centralised API infrastructure as proposed above, (b) commercialise Pay.UK under strict PSR scrutiny as an RPSO such that banks can earn dividends by virtue of their ownership of the entity, and (c) ensure that any scheme fees levied by Pay.UK as a result of its operation of FPS or the NPA in the future, or the Future Entity if it is the scheme operator for the API layer, are mandated to be equal on the payer and payee sides of the market.

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?

Teya believes that the risks listed above concerning the implementation of VRPs can be alleviated by implementing the commercial model guardrails proposed above in our response to Question 1. However, additional risks with the proposed commercial model's focus on variable sending ASPSP costs flow from the fact that the input to devise the actual level of premium API fees would come from the banks. This was a key obstacle for the SPAA scheme in the development of its commercial model. In turn, the economic consultant, given the black-box approach to set the fees, was unable to arrive at a competitive fee level.

The PSR should, in the development of the commercial model, require any economic consultant responsible for calculating the level of fees (if any) for premium APIs to pursue strict justification from the banks of the marginal costs they face in providing the service. Moreover, as stated in our response to Question 1, any costs that are included in calculating the variable per transaction premium API fees should be directly linked to the value the underlying functionality provides to merchants. After all, it is the merchants that pay the fee, and as such an efficient price would thus be linked to their demand.

However, additional risks with the proposed commercial model's focus on variable sending ASPSP costs flow from the fact that the input to devise the actual level of premium API fees would come from the banks.

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.

Teya believes that the PSR should be broader in its consideration of the benefits. The evolution of this workstream, including the pricing principle and the emergence of multilateral agreements, are all part of the necessary groundwork to bring Open Banking payments closer to becoming mainstream, which Teya strongly believes would be the most impactful development that could be introduced from the JROC.

In this regard, measures such as Teya's proposed pricing model that focus on free basic payment services, percentage variable premium API fees, and increased choice for merchants in the premium API features they invoke, would make it economically viable for open banking payments in the physical space, particularly for low average transaction value transactions.

Nevertheless, Teya recognises that the path towards creating an account-to-account payment method in the POS environment involves many steps which include opening up access to NFC in the UK and ensuring A2A payments are EMV compatible. We therefore argue that the decisions being made now by the PSR, such as the establishment of pricing principles, the rationale around inter-PSP fees, and the creation of a multilateral agreement are all necessary (but still insufficient) steps towards this goal, which in our view should be the ultimate priority for the PSR. The contribution of the ongoing work towards eventually establishing A2A in the physical POS environment should therefore be reflected in the benefits of this policy intervention. This approach is reflective of how the JROC roadmap strategized around achieving increasingly more complicated use-cases which require further coordination and intervention but are all linked as a series of progressive steps towards the establishment of a fully-fledged alternative payment method for retail payments.

Question 18

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

As discussed at length in our response to Question 1, it is important to differentiate between costs that sending banks have incurred as a result of regulatory obligations they have had to historically comply with, versus costs they would be incurring as a result of new developments. More specifically, the only costs that should be considered are ones which sending banks exclusively bear, but the corresponding benefit of which is received exclusively by receiving banks/merchants. A cost that sending banks incur as part of their normal cost for running the payment system, which they can (if they decide to commercially) recoup from their customers who use the respective features, should be excluded from the scope. Importantly, as stated in multiple instances above, it is the sending banks, as the gatekeepers to further development, which hold the burden of proof on whether any such costs exist.

Furthermore, the PSR should also consider the interest of Acquirers and wider merchant-facing PSPs in this context. A successful A2A scheme will heavily rely on these players, which currently own the vast majority of payment relationships with merchants, for distribution and ongoing development. These players also control key acceptance infrastructure (POS Terminals) which will have to be leveraged for successful distribution of Open Banking payments. The PSR should envision a future where acquirers will also want to offer their merchants OB as an alternative payment method with its benefits, provided that enough customers want to pay with it. The importance of Acquirers in the rollout of Open Banking payments is evidenced by the fact that leading TPPs have distributed their services through partnerships with acquirers.

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?

This potential benefit can only materialise if enough consumers can adopt the payment method such that it makes sense for merchants to offer it.

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 provider on the acceptance side of the market, there are two points that Teya would like to highlight. Firstly, it must be understood that any inter-PSP fee that flows from the acceptance side of the market to the sending side will be ultimately passed down to and paid for by merchants. It is, therefore, crucial to understand that this sort of remuneration is not ultimately one exchanged by two providers, but one paid by the end-user with the payment system. Additionally, one has to consider the operational burden on merchant-facing providers in having to understand how to best pass down this cost. As stated above in our response to Question 2, one way to mitigate this uncertainty would be to provide PSPs with the choice as to the premium APIs they call based on the type of transaction to best suit the needs of their merchants.

Question 21

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

N/A.

Question 22

Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.

The scalability of VRPs beyond Phase 1 will largely depend on the commercial model adopted. In this context, the pricing principles and current policy proposals made by the PSR are welcome. Nevertheless, as outlined further in the first section of this response, the long-term sustainability of the development of account-to-account payments at retail will depend on significantly lowering the barriers to entry and coordination costs that currently exist via the implementation of a single API infrastructure enabled by the New Payments Architecture.

Tink

[redacted]

Response to CP23/12: Expanding Variable Recurring Payments - Call for Views

2 February 2024

General comments

1. Tink Financial Services Ltd ("Tink") is pleased that the Payment Systems Regulator (PSR) is requesting views on its consultation paper regarding the expansion of variable recurring payments (VRP) beyond sweeping. As a regulated payment service provider (PSP) delivering account information services (AIS) and payment initiation services (PIS), we believe the United Kingdom (UK) has tremendous potential to expand beyond the scope of Payment Services Regulations of 2017 ("PSRs2017") and the Competition and Market Authority (CMA) Retail Banking Market Investigation's Final Order ("CMA Order") on the nine largest banks ("CMA9").

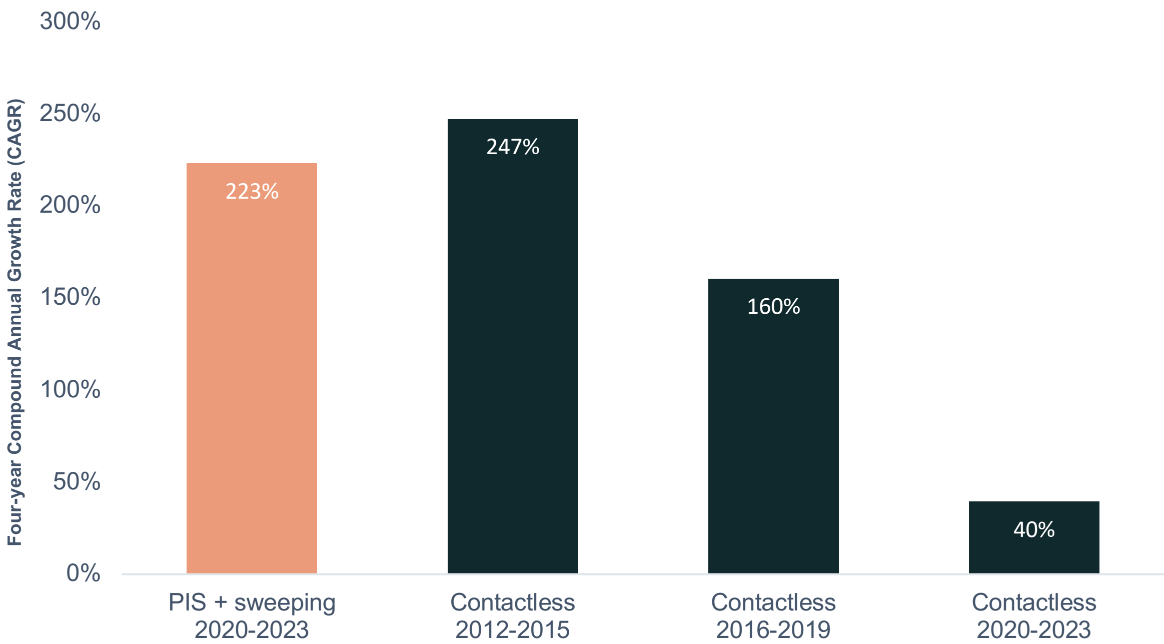
2. However, we believe that the ambition of the PSR to set out the requirement for the development and key terms of a multilateral agreement (MLA) for non-sweeping VRP use cases undermines the willingness of market participants to launch an industry-led solution and the opportunities introduced by the Financial Conduct Authority (FCA) with the authorisation of payment initiation service provider (PISPs) under the PSRs2017. Tink is fully committed to support and participate in a pilot for the identified low risk use cases in Phase 1, but we are concerned about process and the level of intervention that the PSR is proposing.

3. In the consultation paper, the PSR refers to the growth of so-called "open banking payments" that the UK has recorded since its launch in 2018 — citing that the number of monthly PIS transactions has reached 13 million by the end of 2023. The graph in Figure 1 shows PIS continues to stand at the foothill of tremendous growth and potential. Looking at the four-year compound annual growth rate (CAGR) from when the data was first available, PIS grew at a rate of 217% (2020-2023) — 223% including sweeping. By comparison, contactless card payments grew at a rate of 247% (2012-2015) and 40% since the pandemic (2020-2023).

[redacted]

Figure 1

Four-year CAGR for PIS compared to key periods in contactless card payments



Note: Contactless card payments data (credit and debit) is only available from 2012 onwards; 2012 was a key year for contactless card payments as it is when it started to be accepted on London buses. In 2014 contactless accepted on wider Transport for London Network; in 2021 contactless card payments experienced a surge in adoption following COVID 19. Source: UK Finance, Open Banking Limited, Tink analysis.

4. We therefore believe that the PSR's proposed intervention to accelerate the adoption of account-to-account (A2A) payment methods is premature. Moreover, it is not clear that the available evidence supports the level of intervention that is proposed. The current PSRs2017 provide plenty of opportunity for PISPs to launch solutions that can effectively compete with existing payment methods. We invite the PSR to consider our response to His Majesty's Treasury (HMT) 'Payment Services Regulations Review and Call for Evidence' where we make several recommendations how regulatory barriers can be removed from the PSRs2017 to enable PISPs to lower merchants' costs even further and improve authentication experiences beyond what account servicing payment service providers (ASPSPs) offer payment service users (PSUs) today.

5. The PSR may be operating under a misconception that VRP is a product of PIS. On the contrary, VRPs are not available to the PSU through their customer interface, and VRPs can only be initiated by a third-party service provider (TPP) after it has established a contract with the ASPSP. There is no legal requirement for a TPP to be regulated by the FCA for it to initiate non-sweeping VRPs because it is not a regulated service under the PSRs2017. This means that the PSR's support for VRPs and the potential admission of non-regulated TPPs through contractual arrangements with ASPSPs may eventually create a major 'blind spot' to the financial authorities and expose the payments ecosystem to unnecessary risk.

6. Moreover, in the scenario that the industry wishes to launch an alternative VRP scheme, the PSR's intervention would give its own MLA an unfair advantage by mandating a cost-recovery model for Faster Payments (FPS) that would be unobtainable in an industry-led approach.

7. Therefore, Tink does not support PSR's proposal to mandate participation in a payment solution with an unfair cost-recovery model that inherently competes with PIS, jeopardizes the investments and progress that PISPs have made over the last five years, and enjoys an unfair advantage over alternative VRP schemes.

8. Tink strongly recommends the PSR to let the market mature its PIS propositions and for industry-led solutions to be created organically. We believe that this will lead to plethora of payment services that meet the PSR's objectives for A2A payments. For Phase 1, Tink would like to see the PSR, working alongside their JROC colleagues, to encourage the industry to develop a multilateral framework, providing a minimal set of standards and guidelines, which can form the basis for future competitive multilateral agreements. The benefit of this approach is it could provide the foundation for both the Phase 1 pilot, but also support future expansion of VRP to Phase 2 and beyond, including for innovative and yet unknown use cases. This is because the market would be free to build upon this minimal framework to adapt and develop their own competitive multilateral agreements, which would specify the commercial terms on which services are provided (e.g., pricing), expanding the capabilities beyond the default and adapting it to meet the needs of the target use cases, including for example improved customer protections.

9. In preparation for a market developed MLF, the PSR/JROC could set out its minimum expectations of what such a framework, and any multilateral agreements, would need to support for Phase 1. For example, this may include how and what participants should communicate to payers regarding the key features of the VRP service and what to do when things go wrong.

10. In supporting the industry to develop and run a Phase 1 pilot for VRP based on a fair and sustainable commercial basis, the PSR would be able to obtain relevant data to objectively assess the outcome of a pilot, from which it can consider the lessons learned and make the necessary recommendation for its further development. Under its current interventionist proposals, it is simply creating a pilot based on an unstainable and manipulated pricing model, and forcing participation, which will derive very little learnings in terms of measuring impact.

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.

11. The PSR's five pricing principles are:

    i) Broadly reflect relevant long-run costs of providing premium APIs
    ii) Incentivise investment and innovation in premium APIs
    iii) Incentivise take-up of open banking by consumers and businesses and use of network effects.
    iv) Treat TPPs fairly
    v) Be transparent

12. Tink believes that regulators should stay away from dictating any restrictions or requirements when it comes to pricing as it many discourage innovation and have an adverse impact on fair competition. Markets do not function properly and competitively when pricing is restricted or manipulated. Not only can it dis-incentivise investment and innovation – which contradicts one of the PSR's five principles - but it can also distort competition elsewhere and negatively impact the investments made and commercial viability for other substitute products in the market, including PIS.

13. Tink prefers to let the market compete on pricing, especially for a payment service that has not yet been established. It is for that reason we are surprised at the level of intervention around pricing being proposed by the PSR in its consultation paper — including passing on the operating costs for FPS and restrictions on financial incentives for sending PSPs. Not only are these recommendations contrary to the PSR's own published pricing principles, but they are also contrary to JROC's overarching objective of *"creating an ecosystem that […] builds commercial arrangements that are fair and proportionate for a multitude of new products and services.*[1]

14. Moreover, in the consultation paper, the PSR acknowledges that the costs incurred on FPS is what may keep participants from creating a commercially sustainable model. Following PSR's pricing principles, the solution should not be to tamper with the cost-recovery model, but rather encouraging Pay.UK to find cost-efficiencies and economies-of-scale.

15. Tink therefore believes that the PSR's proposal could have a negative impact on the long-term development of non-sweeping VRP and the ability to launch alternative commercial arrangements.

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.

16. Successful payments systems rely on scale which requires a certain level of cross-industry coordination. Diverging interests and the need to reach consensus, means some form of coordination is inevitable. Coordination should help facilitate industry collaboration and discussion on setting some basic standards, but the aim should be to better foster open and fair competition.

17. Tink agrees with the PSR that resource requirements for negotiating individual bilateral agreements could potentially be a hinderance to participation from smaller TPPs and sending PSPs during Phase 1 and beyond. As such, we agree that the creation of an MLA provides a necessary starting point for any framework that intends to broker supply and demand.

18. Tink's preference, however, would be for the PSR to consider alternative options, such as supporting the industry to develop a multilateral framework (MLF) for VRP, which is defined in the Blueprint as *"a set of standards-based guidelines to be used for contractual*

[1] JROC, "Recommendations for the next phase of open banking in the UK", 17 April 2023

relationships between more than 2 parties."[2] An MLF can be established through industry collaboration which can be conditional to specific use cases and form the basis for multilateral/bilateral agreements. Driven by competition and customer expectations is then up to industry participants to consider if they would want to expand the capabilities beyond the default. We also think the PSR, working with JROC, could set out minimum expectations of what such a framework, and any multilateral agreements, should deliver.

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.

19. We are pleased with the PSR assertion that its recommendation for Pay.UK to operate an MLA for Phase 1 is not a determinant of any future decisions on who would operate other payment systems. As stated above, Tink supports the idea of an industry-developed MLF with a default and minimal set of standards, which could form the basis of competitive and commercial multilateral/bilateral agreements.

20. Enabling a competitive layer, backed by the certainty of baseline framework that users can rely on, ensures VRP can continue to evolve and innovate.

21. In terms of Pay.UK's role, our consideration would be to ask what would qualify an organisation to carry out the role of operating an MLA. A relevant body should have a commercial mindset, the ability to respond to fast changing needs, transparent in how it deals with stakeholders, and incentivise and support market innovations.

22. Our primary concern with Pay.UK is the potential conflict of interests because it operates the FPS. For example, one proposed option of the PSR would see VRP transaction costs diverted across FPS participants thus undermining its ability to fairly manage its obligation to the FPS scheme.

23. Furthermore, it is important to note that Pay.UK also operates the Bacs Direct Debit (BDD) scheme, which is currently the preferred payment service used to support the sectors and use cases identified for Phase 1. Pay.UK has an obligation to promote, innovate, and support the continued success of BDDs while also being asked to manage a competitor product.

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?

24. Tink disagrees with the PSR that ASPSPs enjoy a "bottleneck monopoly" on non-sweeping VRP. Non-sweeping VRP is currently non-existent; neither PSUs nor PISP have access to such payment functionalities. ASPSPs cannot exercise a bottleneck monopoly for a service that does not yet exist.

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[2] PSR, "[VRP Working Group – Blueprint]", December 2023

[redacted]

25. When it comes to customer choice it is still the PSU that decides where he or she opens a payment account. ASPSPs that provide poor customer experiences in relation to account access and payment services run the risk of losing customers to a competitor. Moreover, consumers are increasingly comfortable operating multiple payment accounts across ASPSPs. According to Pay.uk[3], 53% of UK consumers operate two or more current accounts — which is equivalent to over 28 million consumers. As such, we think there is healthy competition in the UK retail banking market, and it is being driven by customer experience.

26. It is also important to note that the incentive challenge highlighted in paragraph 14 is precisely what non-sweeping VRP is aiming to address. However, instead of tackling this issue, the PSR's proposal *"does not enable sending firms to make an explicit return for Phase 1"*. We believe this goes against the spirit of the VRP Working Group Blueprint and exposes the project to significant risks of failure.

27. Finally, we believe the PSR should not compare the interplay between ASPSPs and PISPs under the PSRs2017 with the challenges or opportunities associated with launching non-sweeping VRP solution. The discussions around non-sweeping VRP were originally driven by the market because there is no sound economic model for dedicated interfaces (i.e., regulated APIs) under the PSRs2017. ASPSPs have no revenue and/or cost incentives to invest in their dedicated interfaces beyond the compliance requirements in the RTS-SCA and CMA Order. This is one of the main reasons why Tink had high hopes for VRP: the opportunity to introduce a revenue incentive could help ASPSP justify investment in favour for consumers and merchants, beyond the regulatory requirements. Tink believes there are regulatory barriers in the PSRs2017 that keep PISPs from offering more competitive positions, but this should not be used as an argument for the proposed policies to bootstrap a new market in existence.

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

28. Yes, we believe the PSR may not have considered the potential costs associated with customer disputes due to the nature of the products and services sold by the covered industries in Phase 1.

29. During a 15 January 2024 webinar outlining its consultation, the PSR noted that regulated 'utilities' include the industries under supervision of Ofcom, and that people will be able to pay their phone bills during Phase 1.

30. In the consultation paper, the PSR also states that: "For Phase 1 we, however, consider that the costs of dispute resolution, fraud prevention and fraud reimbursement are likely to be negligible because the three initial use cases are limited to regulated industries with minimal risk of fraud costs to sending firms."

31. Many of the industries regulated by Ofcom embark in general ecommerce. For example, some telecom providers also operate storefronts that allow you to purchase a range of goods, including smartphones and wearables, video games consoles, printers,

[3] Pay.UK, "Exploring the Future of Switching", June, 2023

televisions, smart speakers, even baby monitors, as well as digital content. Many of these items are unlikely to be considered low risk purchases, based on scope for Phase 1 as outlined by the PSR in the consultation paper.

32. Although the ecommerce site operated by these regulated entities are often separated from the contracted services they offer, it is also not uncommon to sell additional relevant accessories during the checkout process when signing up to a regulated contract.

33. If the PSR attempts to specifically limit the use case to the regulated component of the consumer transaction it will mean that VRP is less attractive to the biller as additional sales are an important revenue stream. It could also create payments friction and basket abandonment if the consumer is required to make separate transactions using different payment methods. If these additional purchases are allowed, many of the assumptions outlined by the PSR around cost and risk may need to be reconsidered.

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.

34. Please see our response to question 7.

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?

35. Electronic payment services have delivered huge social and economic benefits in the UK since the first cards and interbank payment systems emerged in the 1950s and 1960s. During this time, we have seen enormous advances in technology, and through continued competition and innovation, the UK has evolved into one of the most developed payments markets in the world. These significant social and economic benefits have been realised because of financial incentives to develop and innovate these payment systems, as well as the ability to recover costs to run and maintain them.

36. Building a long-term commercial framework for non-sweeping VRP needs to be realistic and reflect costs associated with the payment. Tink therefore believes that costs associated with the payment must be able to be recovered from merchants. As such, we favour a solution where costs are factored into the price ASPSPs charge the TPPs, and what the TPPs charge the merchants.

37. Neither of the PSR alternative solutions change the basic economics of the transaction - they simply shift the burden and pass the cost on elsewhere.

38. One solution suggested by the PSR is to switch the cost of the FPS transaction from the sending PSP to the receiving PSP. Although this may encourage a lower overall cost that the merchant is charged by the TPP — as there are no costs charged by the sending PSP — the merchant is still likely to pay this charge indirectly as the receiving bank will want to recover these costs from the VRP beneficiary. This is simply creating hidden fees elsewhere and runs contrary to the PSR's pricing principle of creating transparent and straightforward fees.

[redacted]

39. The other option suggested by the PSR is to make FPS members pay for the cost. As the CMA9 are the primary users and funders of FPS, this is simply moving the cost from being direct to indirect. It also implies that FPS members that do not participate in the PSR's MLA for VRP may end up cross-subsidising potentially rival payment solutions. Again, this does not seem to hold up to the transparency principle and could unfairly distort competition by those wishing to develop alternative payment solutions.

40. The PSR says its approach does not allow sending PSPs to make an explicit return on investments based on Phase 1 use cases, instead insisting that this can be done with future use cases. This also runs contrary to its pricing principle to incentivise investment and innovation in premium APIs.

41. Tink's concern is that we seem to be back to square one: commercial VRP without the commercials. The lack of an economic model in PIS is one of the challenges that we set out to address. It is also something that was explicitly raised in the recent Future of Payments Review.[4]

42. In the consultation paper, the PSR says that *"In the case of substitutes from Direct Debit and bank transfers, we think that any incremental cost incurred by sending firms in Phase 1 are unlikely to be additional, as they substitute volumes from one payment method to another, and do not impact sending firms' cost base."*

43. It is unclear what the like-for-like impact of such a substitution on costs would be, as the substitution primarily uses a different payments infrastructure (i.e., from BACS to FPS). Moreover, one of the potential benefits of VRP is that it can support PSUs who do not currently access BDD or are unable to. BDD and Standing Orders account for around 80% of regular payments.[5] As a result, there is a significant incentive for merchants to adopt VRP to offer an alternative solution, thus improving customer relationships, driving efficiencies, and reducing the costs of chasing customer delinquencies. Therefore, VRPs may not simply be used as a BDD or a credit transfer substitution for the payment use cases identified in Phase 1.

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

44. As shown in the Future Entity Working Group report, Open Banking Limited (OBL) has lacked transparency to give the industry any indication of the costs incurred for the delivery and maintenance of the services directed at the CMA9, non-CMA9 and TPPs. Moreover, unless the role of OBL is explicitly defined and scoped in detail, it is impossible to assess or predict what the relevant costs would be.

45. We believe that the launch of non-sweeping VRPs is not dependent on OBL in any way. Although they have delivered on the CMA Order roadmap to create, deliver, and support the standards and rollout of sweeping VRP, there is no requirement for OBL to stay involved beyond the anti-trust remedy. There is no legal requirement for TPPs initiating non-sweeping VRPs to be licensed as PISPs. And there is no legal requirement for the

[4] Garner, J., "Future of Payments Review", November 2023, p. 25
[5] UK Consumer Payments 2023, UK Finance, December 2023

CMA9 to rely on OBL's trust, directory, or support services. Therefore, the relevant costs could be nil if designed that way.

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

46. As highlighted in paragraph 9, 18 and 19, Tink strongly supports the idea of an industry-led MLF as outlined in the PSR's VRP Working Group Blueprint. The advantages of this model is it creates all the necessary conditions to make VRP scalable: a default and minimal set of standards are established - which can be situational - forming the basic foundation for all potential participants big or small to create commercial agreements. These commercial agreements would then be free to go beyond the default, driven by competition and customer expectations, to deliver the best possible VRP experiences. Such an approach would better meet the criteria of the PSR's pricing principles because 1) it incentivises participation and enables a truly commercially sustainable model; 2) provides a common base-line user experience, while also promoting further investment and innovation; 3) is transparent; 4) and removes potential barriers to participation.

47. One of the issues with the PSR's approach to pricing is it effectively shuts out competing solutions. For example, it is unclear whether the arrangements being suggested for the Phase 1 MLA to remove the "price per click" are for the timeframe of a pilot or are expected to be ongoing. The proposal effectively shuts out competition for alternative MLAs, as only Phase 1 MLA would benefit from the mandated price subsidies. Any attempt to invest and deliver superior customer propositions would be hampered by the unnatural price sensitivity created by the PSR's proposed mandate.

48. Tink believes there is a significant opportunity for VRP and is invested in making it a success. However, we believe that the PSR's focus and proposed measures on directing VRP development could have several unintended consequences. Rather than support the market to organically develop this opportunity, it is proposing the creation of a distorted market, which could have significant long-term impact on competition. This not only impacts established market solutions, but also could have serious negative consequences on developing solutions, including regulated PIS.

49. To reiterate, non-sweeping VRP was envisaged as a means from which the industry could establish a commercial model for A2A payments through the use of Premium APIs. As such, there are clear incentives for the market to develop VRP and there are several industry initiatives currently at work that could support an industry-led approach, including UK Finance's Model Clauses workstream.

50. We feel the PSR's efforts could be better deployed to solve some of the ongoing issues and needed areas of improvement to existing PIS. In a previous response to a Call for Input as part of HMT's Payment Services Regulations, Tink highlighted current obstacles that if removed could help allow PISPs to deliver on their promise to transform the payments landscape, including lowering costs for merchants, reducing fraud, and improving payer experience using state-of-the-art authentication technologies. For example, Tink suggested revising the PSRs2017 to:

    a. **Ensure PISPs can access account information** prior to finalising a payment initiation service to improve the payer experience by presenting information (e.g.

account balance) and at the same time mitigating the risk of non- execution by identifying payment limits and available funds;

b. **Ensure PISPs can embed the access interface** to compete and innovate among each other by creating intuitive user experiences that are best suited for the channel or use cases requested from the PSU without requiring additional investments from the ASPSPs; and,

c. **Ensure PISPs are notified when the payment status changes** by requiring ASPSPs to inform the payer or party initiating a payment on behalf of the payer. Specifically, PISPs currently only receive information about the payment up until the initiation. If a transaction fails post-initiation, PISPs often find out through the merchant. To make PIS an even more competitive proposition, ASPSPs should be required to inform the PISP about the change before, during and after the payment is executed.

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.

51. Although having a significant addressable number of consumer accounts is important, we do not think it is necessary to have full reachability for a pilot project. Certain billers, for example, may have significant biases towards certain banks. To answer this question, it would first be important to understand the objectives and measures of success for Phase 1.

52. From a Tink perspective, we have already made investments in VRP and will continue to do so as we believe it represents significant opportunity to deliver additional value and experiences to both consumers and merchants. Ability to reach all payment accounts is ultimately where we want to get to, but it is also important to consider the wider long-term implications of how we get there.

53. The future success of VRP requires a commercial model in which all parties — including consumers, merchants, ASPSPs and TPPs — recognise clear benefits and opportunities over alternative payment services.

54. For merchants, account reachability is of course a significant factor to support adoption during Phase 1. But TPPs will also need to articulate to merchants the many other benefits of participation. This could include the ability to convert one-time payers into recurring payments, higher payer conversion rates, lower fraud rates, and potentially reduced costs from chasing delinquent customers.

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.

55. Given the high concentration of consumer accounts across the CMA9 (9 in 10 primary accounts), it may be possible that a small proportion of these ASPSP could satisfy requirements for a pilot if they voluntarily supported the VRP pilot/phase 1 (especially if one or two of the larger banks agreed to participate). According to Mintel[6], three-quarters of UK consumers have an account with one of the 'Big 4' banking groups (i.e., Barclays, Lloyds Banking Group, NatWest Group, HSBC). However, without a full understanding of what the success metrics are for Phase 1, it is difficult to provide a definitive answer to this question.

56. It is also noteworthy that the PSR is only considering VRP Phase 1 from a consumer point of view. There are a significant number of businesses, particularly small businesses, that would substantially benefit from the payment options offered by VRP. In some cases, there needs are in fact greater than that of consumers.

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

57. Tink would much rather have ASPSPs participating voluntarily on the basis that they can build a business case that enables them to realise a return on investment.

58. It is commonplace among UK consumers to operate multiple payment accounts, often switching between providers depending on purpose or scenario. For example, many UK consumers will have a secondary bank account (i.e., an account other than the primary account where their salary is paid into) for budgeting purposes or to make everyday payments. On the one hand, it seems too unfair to focus solely on the CMA9 — designated as such for specific competition remedy purposes — while also ignoring the substantial number of payment accounts that sit outside this grouping.

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?

59. Tink's experience of working with the industry to support the aims of JROC suggests strong interest and commitment from several ASPSPs and TPPs to develop VRP. We suggest surveying the industry to ascertain the level of support among participants and seeking their voluntary commitment to support Phrase 1.

60. The PSR's assertion that *"without financial incentives too few ASPSPs would voluntarily offer the required functionality"* could become a self-fulfilling prophecy when it is introducing a financial model that is unsustainable in the long-term — i.e., subsiding or hiding costs of FPS with no financial incentives for sending PSPs.

61. In effect, the PSR is essentially proposing regulatory mandate, which ignores the learnings from the FCA's PSRs2017 and the CMA Order.

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[6] Mintel, "Current Accounts Market 2023", 2023

62. Allowing the market to develop its own multilateral approach to address and develop sustainable commercial models for VRP is the most practical solution to participation. Not only will this allow the market to develop competitively, but it will also provide relevant incentives for ASPSP to participate and help ensure a sufficiently large number of payment account will be available for Phase 1 and later use cases for VRP.

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?

63. There are ample risks associated with the mandated participation in Phase 1:

   a. The PSRs2017 and CMA Order have proven that regulatory incentives for ASPSP to create high-quality APIs is difficult if not based on a sound business case — it needs to be driven by costs or revenue incentives.

   b. Despite the CMA Order Roadmap, sweeping VRP is currently not available across all the CMA9 banks. A mandate on the CMA9, may create unrealistic expectations regarding support for non-sweeping VRP use cases.

   c. The lack of incentives could also discourage CMA9 participation beyond Phase 1, and discourage non-CMA9 participation altogether, which could disrupt momentum.

   d. It could discourage the industry launching alternative MLAs for VRP — with different terms and conditions on for example, covered use cases, liabilities, pricing, protections — thus restricting competition and reducing the potential of market innovations.

   e. From a PISP perspective, we fear it could also jeopardize existing commitments for PIS among merchants in the utilities space and delay PIS adoption.

   f. And we are also afraid that it could draw from investment budgets that would otherwise go into improving PIS proposition as there are still many unresolved and outstanding issues regarding the dedicated interfaces.

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

64. In 2021, the CMA mandated the implementation of VRP as the mechanism for the CMA9 to allow for the sweeping funds between two accounts with the same account holder name. However, VRP as a mechanism has long been considered an exciting opportunity to develop new, innovative A2A payment solutions for merchant payments across the UK and the European Union (EU).

65. Specifically, Tink has been directly involved in the creation Single Euro Payments Area (SEPA) Payments Account Access (SPAA) scheme since its initial inception five years

ago.[7] We are extremely proud that the European Payments Council (EPC) has now published an updated SPAA Rulebook[8] as well as a remuneration model[9] that allow "Asset Holders" (i.e., ASPSPs) to generate a fair return on investment when enabling Asset Brokers (e.g., PISPs) to deliver competitive payment services.

66. The EPC SPAA Scheme is an industry-led initiative which has introduced rules, practices, and standards to support 'value-added' ('premium') API-based services such as VRP — otherwise known as dynamic recurring payments (DRP), as well as a remuneration model. As part of our support for SPAA, Tink has also recently announced that we are one of the first participants to join the new scheme.

67. We believe that the UK should consider a similar approach. In April 2023, JROC published its Recommendations for the next phase of open banking in the UK, outlining a desire to promote additional services*, "using non-sweeping variable recurring payments (VRP) as a pilot,"* while also noting the need for *"a sustainable pricing model needs to be in place to encourage ongoing development and innovation in a sustainable way."* To support potential multilateral/bilateral agreements for such a pilot, UK Finance is currently running industry working groups, which includes participation from both sending PSPs and TPPs, with the aim for creating model clauses to be used in such agreements.

68. Tink's view is there is both precedent for an industry-led approach and concrete action already taking place in the UK market that will make good JROC's nudge for a VRP pilot. As outlined elsewhere in our submission, it is both unnecessary and potentially harmful for the regulator to intervene in this way. Our advice is to let the industry take the lead in developing the commercial arrangements for VRP both in Phase 1 and beyond.

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?

69. Please see our answers to previous questions.

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.

70. In the consultation document the PSR says for the cost benefit analysis, utilities payments will encompass water, gas and electricity industries that are regulated by Ofgem and Ofwat. However, in the November 15 webinar organised by the PSR, it says that as part of phase 1, consumers will be able to pay their phone bills regulated by Ofcom. If regulated Ofcom entities are included in Phase 1 proposals, this will represent a significant proportion of regular payments in the UK. Based on UK Finance Consumer

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[7] ERPB, "Report of the ERPB Working Group on a SEPA API Access Scheme" June 2019
[8] EPC, "The SPAA Scheme Rulebook v1.1", November 2023
[9] EPC, "Version 1.0 of the SPAA Scheme Default Fees", 23 November 2023

Statistics 2023, these use cases alone could account for up to 4.8 billion payments. We think this is a significant addressable market for the pilot phase.

71. New payments solutions are successful when they identify and address pain points in existing payments services, whether that be customer experience, security, price, or functionality. Payments for the use cases identified for Phase 1 are currently overwhelmingly carried out by BDD. The PSR's proposals to artificially remove the cost of the FPS from sending banks as it, *"assume billers will only invest in adopting VRPs if they offer better value for money or other benefits than existing payment methods,"* indicates that price is not a major pain point with BDD. As such, the question becomes whether VRP offers significant benefits in terms of customer experience and functionality, over existing methods that supports the choice of use cases. As outlined in our answer to Question 19, we think there are important key benefits that VRP offers over BDD that could be attractive to both consumers and merchants.

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

72. Non-sweeping VRP represents a significant and attractive market opportunity that could lead to a profound change in the way consumers and businesses pay each other — not just for recurring payments outlined in Phase 1, but more broadly targeting ecommerce for Phase 2 and beyond. One of its benefits, is it provides commercial opportunities for all stakeholders, including merchants, TPPs and sending banks. As outlined in Q15 – we have noted considerable willingness within the industry to develop commercial options for VRP. As such, we think it is pessimistic for the PSR to believe that *"in the absence of the potential regulatory intervention, the current provision of VRP by sending firms would not change."*

73. Given the advancements in technology, improved authentication methods, as well as existing modernisation plans via the New Payments Architecture (NPA), we think it is unrealistic to suggest that payment methods that we deem to be alternatives to VRPs in Phase 1 will not significantly improve functionality or benefits to billers and/or sending PSPs during the ten-year period.

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?

74. Consumers

    a. VRP could give consumers real-time control and visibility of recurring payments versus open-ended BDD mandates, including ability to set limits. Helping consumers stay within budget while also avoiding 'set and forget' subscription traps.

    b. Flexible payment schedule within the pre-defined mandate limits, aligning to when funds are available.

c. Real-time payments allow consumers to better budget and ensure funds are available.

d. Notified of failed or cancelled payments in real-time, allowing an adequate window for any necessary follow up. Reducing late payment fees.

e. Improved user experience, with simple, fast, click-through payment journey with no manual input required to link your bank account.

75. Merchant

a. High conversation, and improved customer experience.

b. Notified of failed or cancelled payments in real-time, allowing an adequate window for any necessary follow up.

c. By processing payments when funds are available – in one go or via instalments – merchants can also reduce the number of failed payments, ensuring better customer retention.

d. Can be used as an alternative for customers missing direct debit payments, helping to reduce churn.

e. Recurring top-ups via a standing agreement without any extra setup, ideal for usage-based billing.

f. Can target customers unable or unwilling to use Direct Debits, thereby gaining additional benefit of automatic payments for recurring bills.

76. Payment system operator (PSO):

a. For PSO (i.e., Pay.UK), the benefit is increased volume across their service.

b. Economies of scale could also help reduce overall unit costs and create other similar benefits.

77. TPP (e.g., PISP)

a. Higher customer conversion, potential to significantly grow payment volumes through superior customer proposition.

b. Significant market opportunity to establish a competitive, alternative A2A payments solution.

c. Innovative solution with significant runway of opportunity – VRP could be adapted to support and improve user journeys across multiple different payments journeys.

d. Economies of scale, support improve financial standing and further investment in innovation.

e. VRP provides additional protections to consumer/merchant, improving customer retention and reducing risks.

78. ASPSP

a. Commercial opportunity to develop sustainable payment solutions. Many will see this as a benefit compared to existing PIS model.

[redacted]

b. Liquidity benefits.

c. Potentially less friendly fraud.

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?

79. Consumers

a. Without a truly sustainable commercial agreement, there is the risk that consumers could pay increased prices for their personal current account, either directly if they pay monthly subscription fees, or indirectly via other financial services or hidden bank fees.

80. Merchants

a. Costs of creating VRP Mandate and instructing payment via PISP.

b. Costs relative to other payment services (e.g. PIS, Cards, Bacs DD).

c. Depending on funding model, may find receiving PSP pass down VRP costs or increase service fees as FPS participation fee rise.

81. PSO

a. Increased volumes and maintenance of FPS standards.

b. Opportunity costs of launching a new system competing with existing Bacs DD.

c. Costs of reporting and billing FPS participants based on VRP usage.

82. TPP (e.g., PISP)

a. Cost of integration and updating front end interface.

b. Cost of ASPSP management.

c. Cost of customer acquisition.

d. Cost of dispute management and resolution.

83. ASPSP

a. Cost of technical deployment and provision of secure VRP API keys.

b. Cost of PISP/VRPSP management.

c. Cost of disputes and resolution.

d. Cost of funding VRP via FPS fee and/or as a receiving PSP.

e. Cannibalization of other revenues (e.g., BDD).

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

84. VRP could allow consumers who are currently unable to qualify for BDD due to financial standing — or choose not to use BDD because of its inflexibility — to access the benefits of low-cost automated recurring payments. Consumers unable to access BDD typically tend to be more vulnerable, particularly impacting those living in poverty. As many anti-poverty charities have noted, those who are unable to access BDD to pay their bills can find themselves within a 'poverty premium,' whereby low-income customers are charged more for the way they spend their money.[10] According to the charity Fair by Design, *"the more protected characteristics a person has, the more likely they are to be in poverty – and paying a poverty premium."*

85. VRP offers consumers greater flexibility and control over recurring payments when compared to Direct Debits. Although these additional benefits affect all consumers, they offer particular advantages for those in poverty, who are more likely to possess protected characteristics.

86. It is unclear the extent to which the PSR's proposed pricing model will extend beyond Phase 1, or, if not, when an evaluation of the commercial arrangements will occur. The absence of fully costed commercial model, and these potentially temporary measures, could cause uncertainty. For example, at some point will a fully costed commercial model need to be developed? If not, is this sustainable in the longer term?

87. The danger with its approach, and the absence of fully costed commercial model, there could at some point be a sudden jolt in the service of VRP, impacting participation. This could cause disruption to service and affect those consumers, particularly those with protected characteristics, who have come to rely on VRP. This further highlights the need for a long-term sustainable and commercially driven approach to VRP.

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

88. As a participant of the UK Finance Model Clauses working group, we are already discussing the feasibility of a Phase 2 rollout for non-sweeping VRP. Unfortunately, the PSR's proposal and consultation paper on expanding VRP is setting back the conversation to square one: because of the PSR's proposals participants argued there would be little competitive advantage and differentiation between service providers for the Phase 1 and no viable commercial model to support Phase 2. In other words, the PSR's policy proposals appear to have slowed down the momentum for an industry-led solution.

89. The PSR should acknowledge that its proposal stands entirely separate to the scope of the PSRs2017 and the role of PISPs. It must be acknowledged that there is no regulatory

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[10] https://tfl.ams3.cdn.digitaloceanspaces.com/media/documents/Fair-BY-Design-Payment-Systems-the-Poverty-Premium-May-2023.pdf

restriction keeping an MLAs from accepting TPPs that are not regulated by the FCA. The PSR may unintentionally open doors to a wave of new market entrants that are not exposed to any financial regulations, thus potentially creating a massive 'blind spot' for the financial authorities.

About Tink

Tink is a market-leading payment services and data enrichment platform. Through more than 6,000 connections to banks, Tink provides payments, banking, and lending solutions that power the new world of finance – whether that's making account-to-account payments, onboarding new users, making better risk decisions or creating engaging money management tools. A wholly owned subsidiary of Visa, Tink was founded in Stockholm in 2012 as a pioneer of open banking. Today, Tink is present in 19 markets with an enhanced fintech platform that goes beyond its open banking beginnings, to serve many of the world's largest financial institutions. Tink enables its partners to take processes that are filled with friction and replace them with data-driven experiences that helps eliminate complexity for millions of consumers across the globe. For more information visit tink.com.

Truelayer

TRUELAYER

TrueLayer response to CP23/12 VRP expanding variable recurring payments

2 February 2024

NON-CONFIDENTIAL

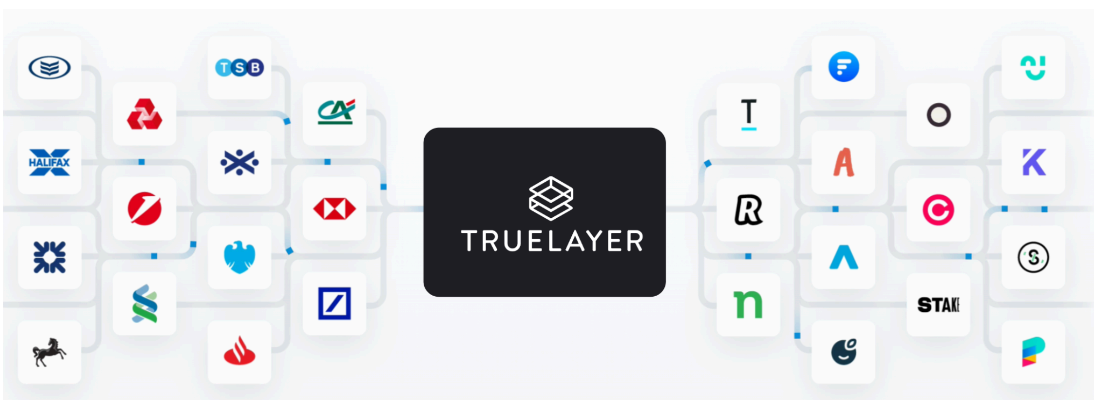
About TrueLayer

Founded in London in 2016, we are an open banking payments network, operating in the UK and across Europe. We are regulated by the FCA as an Electronic Money Institution, which enables us to build additional payment services on top of open banking. We are backed by leading venture capital including Tiger Global, Stripe, Tencent, Temasek, Northzone, Anthemis, and Connect Ventures.

Building an open banking Network

Groundbreaking open banking legislation in 2016 aimed to boost competition and innovation in financial services by opening up bank account data and payments functionality to third parties, using internet-era technology - APIs (application programming interfaces).

TrueLayer's founders were early to realise that a new network could be created, by connecting to all the banks' APIs - and providing a single connection to other fintechs and businesses, and providing additional services such as payments and enriched data. That's the network we've built:



We now offer access to our network of bank connections to hundreds of businesses, so they can harness open banking payments and data (Revolut, Nutmeg, Freetrade, Plum, Stripe, Chip and many more). We process millions of open banking payments per month, including over **1 million VRP payments.**

Executive summary

We welcome the PSR's call for views on the commercial model for VRP. TrueLayer is deeply involved in driving innovation and competition in payments. Recurring payments are a critical missing functionality that, if enabled, will significantly contribute to levelling the playing field for open banking to better compete in the retail payments market.

We believe that to ultimately realise this outcome, non-sweeping VRPs will need to be underpinned by a commercial model and multilateral agreement that appropriately incentivises and binds all parties in the payments chain to delivering high-quality and competitively-priced end user propositions (on both the consumer and merchant ends of the payment). In practice, this means any steady-state commercial model for VRP needs to facilitate a fee paid by PISPs to sending banks to incentivise the development and ongoing support of compelling VRP consumer user experiences.

We are supportive of the PSR's intention to ensure a swift expansion of the use cases for VRP beyond sweeping. However, the primary existing method of payment acceptance in the identified low risk sectors is direct debit. While VRPs are able to function as an alternative to direct debit, our view is that the potential realisable end user benefit from migrating from direct debit to VRP is orders of magnitude lower than that possible for use cases where there is migration from card payments.

Avoiding delay to unlock further VRP value

We are concerned that the proposed approach to phase 1 could delay progress towards a solution for all VRP use cases, including retail payments (which we are calling "phase 2"), risking progress against the PSR's own strategy.[1]

Phase 1 should lay solid foundations for phase 2, but if sending banks believe they won't be able to monitise VRP over the long term, they will treat phase 1 as a compliance exercise, denying it is necessary, delaying any implementation, and then making it difficult and costly to complete, while implementing the bare minimum, leading to a poor product. Sending banks followed this same pattern when PSD2 introduced requirements for APIs (free for TPPs to use) in 2018.

We call on the PSR to revise its approach so that industry can focus now on developing a commercial model for phase 2 that ensures fair value exchange, and incentivises sending banks to invest in VRP for the longer term.

This would mean:

[1] https://www.psr.org.uk/media/k1rb52zq/psr-strategy-summary-version-jan-2022.pdf

- **Further reducing the scope and risk of phase 1 use cases and allowing them to be delivered, by OBL, through an extension of sweeping, without an MLA**
- **Starting work with industry now on the development of a commercial framework for phase 2 and setting a realistic delivery deadline for this**

Cost of acceptance

We believe the overriding principle for development of pricing should be to enable a competitive **cost of acceptance** to merchants and billers.

Cost of acceptance is very different for direct debits and debit cards, both of which VRP has the potential to compete with. Direct debits tend to have a very low, flat fee, around —- per transaction (at high volumes). Debit cards have an ad valorem fee, this can be around —-- for high volume ecommerce merchants.

A major component of VRP cost of acceptance is the fee merchants pay to accept faster payments (FPS). If merchants receive VRP payments directly into their bank account, this is additional to the fee they pay the PISP for payment services.

Current prices in business banking for FPS acceptance indicate that there is not sufficient competition to drive FPS acceptance prices down.

As such, we disagree with comments from Chris Hemsley that competition at the receiving end through business bank accounts can be relied upon to drive down cost of acceptance.

We are concerned by the PSR's reference to 'passing the sending firm's share of the FPS charge to the receiving firm'. This would likely further increase what receiving banks charge billers for FPS acceptance.

The PSR should discount the idea of passing the sending bank's FPS charges through to the receiving bank as it will likely be passed on to billers, and reduce competitiveness of VRP.

Unlocking value for sending banks

We believe that beyond phase 1 use cases, where VRP is enabled to compete with debit card, there is a win-win for banks, PISPs and merchants. That is, we believe over a certain value threshold, and factoring in FPS acceptance costs and appropriate premium API fees for sending banks, VRP can compete well with debit cards. **This is a reason to be pragmatic in getting beyond phase 1 as quickly as possible.**

Mandating coverage for VRP phase 1 and phase 2

We agree that the PSR should mandate banks to participate in VRP. Mandating coverage is necessary because there is a clear coordination failure. Without mandating coverage, there will be gaps in provision, and VRP will not be able to compete with other payment methods that have ubiquitous provision across banks. However, we think the CMA9 grouping could be reconsidered. The market has moved on significantly since the CMA market investigation, in particular due to the growth of challenger banks etc.

We recommend that the PSR considers market share data by bank, which more closely reflects today's market dynamics and can better indicate the coverage that VRP would attain. For example, see current account market shares set out in Feb-23 HMT basic bank account report).

Pragmatic and proportionate approach to phase 1 pilot

A multilateral agreement (MLA) presents a reasonable approach to coordinating and clarifying the necessary elements in the *long-term* development of VRP use cases (including e-commerce). However, it risks unnecessary delay and frustrating the PSR's plan for a swift implementation. We don't believe phase 1 should be dependent on an the development of an MLA because:

- The key goal should be to have low risk non-sweeping VRP low risk cases live in 2024.
- Developing a full MLA by Q3 2024 is very ambitious and there is a real risk of delay.
    - The shared rulebook at the heart of the MLA will take months to agree and finalise, discussions facilitated by UK Finance to develop model clauses have already shown this to be a complex task, which is already delayed;
    - Systems will need to be updated to differentiate between commercial and free PSD2 API calls/ faster payments.
    - Billing mechanisms will also need to be built individually by each bank participant, and integrated by each TPP.
- The intention of an MLA was to manage issues such as disputes - but, as the PSR notes in its consultation - phase 1 use cases are low risk and disputes are unlikely. Any residual issues could be mitigated through commitment to a code of conduct or similar softer mechanism by participants, or by further limiting the use cases in the pilot.
- OBL could be given responsibility for managed Phase 1 - essentially a repeat of the sweeping VRP managed roll out they have already undertaken, but for broader set of use cases

We believe phase 1 should be enabled through the same framework as sweeping has today - i.e. open APIs with no contracts.

This approach would allow industry to focus over the coming months on developing the MLA for phase 2. During this time, the PSR should work with industry on development of an MLA and approach to pricing for Phase 2 and beyond.

<u>Pricing model</u>

More thought is needed on approach to pricing in any eventual commercial model. It is difficult to adopt standard cost-based regulatory approaches to price setting. Banks providing current/payment accounts also provide multiple services (ability to make/receive payments, overdrafts, savings, mortgages etc), and have multiple income streams and cost centres - there are complex cross-subsidies, and free-if-in-credit UK banking model etc to consider.

We believe a cost recovery model could lead to protracted arguments about what costs need to be recovered. Below we have set out arguments for adopting a substitute price model instead.

TSB Bank

Consultation Questions

Question Ref	Description	TSB Response
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	While we agree with the underlying principles, we do not support the pricing model outlined in CP23/12 Variable Recurring Payments (VRPs). We believe pricing decisions should be market driven. Additionally, we have concerns about the pricing principles allowing firms to charge Third Party Providers (TPPs) for accessing customer account data and initiating payments. This model creates costs between TPPs and ASPSPs (Account Servicing Payment Service Providers), which goes against Payment Services Directive 2 (PSD2) regulations. Instead, we propose that TPPs charge receiving firms for their VRP services, viewing it as an additional revenue opportunity.
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.	As a sending firm, we believe that a light-touch contract is formed during the consent process with our customers. Similarly, there is a light-touch contract between the TPPs and the customer when the customer grants consent for the TPP's request. We view this arrangement to be sufficient basis for a contract. Additionally, we recommend that the existing consent model incorporate a dispute resolution mechanism, managed by the TPPs.

Question Ref	Description	TSB Response
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.	While we believe that a regulatory body is necessary to set up the general terms of an MLA framework, we emphasize that this body should not manage operational aspects, and the MLA framework when established should serve as the foundation for a contract between a TPP and an ASPSP. [redacted]
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?	In Phase 1, we see minimal risk for PISPs/billers due to their use cases. However, we view the assumption that ASPSPs can recover costs from implementing VRP as a potential risk.

Question Ref	Description	TSB Response
		[redacted]
Question 5	Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.	We believe there are additional costs that have not been considered. Some examples include: • Refunds: The cost of refunding and ensuring customer protection can be significant. • Additional Fraud Costs: Addressing fraud incidents incurs extra expenses. • Liability and Shared Liability Models: Setting up liability frameworks involves costs. • Resolution in Unhappy Path Journeys: Handling issues when things go wrong requires resources. • Customer Education: Educating customers about processes and risks comes with associated costs. • Communication: Effective communication with stakeholders also has financial implications.
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.	[redacted] [redacted]
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	We believe that this charge should shift to the receiving side. While we acknowledge the possibility of some Third-Party Providers (TPPs) opting out of providing VRP, we view this approach as a driver for competition and innovation in the market. Additionally, it will encourage TPPs to develop fee-based solutions.

Question Ref	Description	TSB Response
	receiving side or recovered through wider Pay.UK charging, and why?	[redacted]
Question 8	Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence. We do not know what additional cost OBL will incur	We are unaware of any extra costs for OBL (Open Banking Limited).
Question 9	What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?	We believe that a commercial model that incentivises TPPs to offer VRP services that customers are willing to pay for would create a sustainable business model.
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.	We believe that the current number of consumers with accounts supporting open banking is insufficient to incentivize an adequate number of Payment Initiation Service Providers (PISPs) and billers. We recommend that the industry invest in educating customers about PISP and other open banking products. This education program should extend to potential receiving firms and billers beyond those named in phase 1. Our understanding is that open banking products, while growing, remain underutilized. A comprehensive awareness and education program are essential to drive consumer adoption.

Question Ref	Description	TSB Response
		Additionally, we propose a program to enhance customer confidence in Open Banking, which may require new legislation mandating ecosystem members to educate customers about open banking products.
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.	See above.
Question 12	Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.	We support regulations/mandate that affect the entire ecosystem, an example is the implementation of PSD2 regulations. Consistency and fairness benefit everyone involved and promote a healthy financial environment.
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?	We support regulations/mandate that affect the entire ecosystem, an example is the implementation of PSD2 regulations.

Question Ref	Description	TSB Response
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?	Aligning mandates with the National Payment Vision (NPV) is essential for managing risk and costs for participants. By taking NPV into account, we can make informed decisions that maximize long-term value and sustainability.
Question 15	Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.	Direct Debit (DD) is the main alternative to this model. To encourage the adoption of VRP, which gives consumers greater control over their payments, we recommend introducing an education and communication model that highlights the benefits of Variable Recurring Payments (VRP).
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?	See above.
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.	As a sending firm, we believe in the dynamic nature of the market. Over time, the evolving landscape may indeed prescribe additional use cases that sending firms will adapt to. Flexibility and responsiveness are key in navigating this ever-changing environment.

Question Ref	Description	TSB Response
Question 18	Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response	See above.
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?	See above.
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?	See above.
Question 21	How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?	Variable Recurring Payments (VRPs) offer significant benefits for vulnerable individuals. For example, managing finances during life events can be challenging for vulnerable customers, including those who are paid weekly, self-employed, or experiencing significant changes. And VRPs will provide flexibility and adaptability, helping them navigate financial challenges. When catering to vulnerable customers, it is essential to consider their mental well-being and financial understanding. Clear communication and education will play a crucial role. We recommend an approach that prioritizes their mental well-being and ensures they understand their financial options. Making VRP suitability obvious for their specific needs over other payment types is essential.

Question Ref	Description	TSB Response
Question 22	Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.	See above.

UK Finance

UK Finance response to the PSR consultation paper on Expanding VRPs

Key messages

UK Finance agrees with the PSR that it is important that the proposals for Phase 1 of commercial Variable Recurring Payments (VRP) lay the foundations for customers, billers and market participants to find VRP attractive. It should also provide a test case for a flourishing commercial market to develop in future payment overlays/arrangements and premium APIs.

The Phase 1 proposals will not however deliver commercially sustainable VRP and could indeed inhibit development of the most valuable use cases in e-commerce.

The PSR's proposals do not remove the need to identify a sustainable commercial framework for future phases that drives investment in VRP, great customer journeys and ultimately merchant/customer demand. A group of our members are offering to resource that work, reporting to the PSR and do so by Q3 2024. This work would provide an independent rigorous data-led analysis of the options for commercially sustainable framework(s) considering methodology, options, the approach to risk, liability and customer protection, and route to implementation (including use case applicability and legal certainty).

Our members have different views on the merits of each of the PSR's proposals (set out below) but they would all like to see industry and JROC work together in partnership to develop a commercially sustainable framework for VRP that offers customers protection.

They agree too that:

- The ability for VRP to compete with other payment types on price and customer experience requires more evidence than is currently available or likely to be surfaced by the current scope of the Phase 1;
- The PSR is proposing significant interventions – including price regulation – that do not appear to be justified by the evidence presented and could distort competition;
- The Phase 1 use cases will attract limited merchant interest and the future of VRP rests on a wider set of e-commerce use cases. The selected use cases target billers using Direct Debit rather than card on file raising questions about alignment to the PSR's own strategy [1];
- The commercial framework should provide for customer protection and incentives that drive investment in VRP for all parties;
- The timelines need to be realistic and take account of industry and merchant technical change programmes and the realities of commercial product development;

[1] https://www.psr.org.uk/media/k1rb52zq/psr-strategy-summary-version-jan-2022.pdf

- The approach to contractual structures, such as multi-lateral agreements, needs to be pro-competitive and align to HM Treasury's future vision for payments. Multi-lateral agreements (MLA) should be in the commercial sphere;

- Coverage and ubiquity are integral to successful payment types.

- There is also a need for the PSR to be transparent about the legal powers it intends to use to use to mandate CMA9 participation in the MLA or to intervene in the market to set a central price.

There are divergent views in the UK Finance membership:

- some TPP members do support the PSR's proposals for a cost recovery model for phase 1 but recognise that going forward there is a need for a commercially sustainable price consistent with the PSR's pricing principles. They also support broader mandating to ensure coverage. They believe these measures are critical for A2A to build momentum if it is to meet the PSRs ambition for account-to-account payments to deliver new options for retail payments and providing competition for card payments;

- other members, including ASPSPs and firms not caught by the proposed mandate contest it strongly. Nearly all our members challenge the relevance of the CMA9 Order (which the CMA announced as completed in January 2023) [2] and warn against further entrenching a two-tier open banking system;

- some of our members support the role proposed for Pay.UK on the Phase 1 multi-lateral agreement, others express a preference for Open Banking Limited (noting that the Future Entity/Open Banking Limited in the interim state needs a fair and equitable funding model), others a commercial joint venture;

- some of our TPP members supported an approach to Phase 1 by enabling a limited number of non-sweeping low-risk use cases without an MLA and for a limited trial period. These members argued this would provide for testing of initial real-world usage of VRP outside sweeping (in low-risk use cases) and allow resource and focus to remain on enabling a Phase 2 MLA underpinned by a commercial model. Other members opposed this proposal on the basis it had no commercial or customer protection model.

UK Finance places considerable weight on a sustainable commercial model.

We were sceptical that the PSR chaired VRP Working Group would deliver a commercial model – our members are understandably reluctant to discuss commerciality and pricing in industry forums.

On 23rd October David Postings wrote to Chris Hemsley and said "*On pricing, it is essential that the pricing model has legal certainty, and is conducive to promoting innovation, competition, and good customer outcomes. Given that there are divergent views from our members on this point, we should assess the different approaches to achieve that* ***with support of an independent body if necessary****.*"

[2] https://www.gov.uk/government/news/millions-of-customers-benefit-as-open-banking-reaches-milestone

The lack of agreement in the Working Group should not therefore be the justification for the PSR to impose proposals for Phase 1 that are inconsistent with:

- JROC's ambition to make open banking commercially sustainable;

- using VRP as a test case for premium APIs given that other MLAs, in particular those for data, are likely to governed outside Pay.UK;

- levelling up open banking since it entrenches a differential approach to sending banks;

- designing a Future Entity that can deliver or help incubate the next phase of open banking and premium APIs for both payments and data and voluntary commercial arrangements (as proposed in the Future Entity Working Group report[3]).

The Future of Payments Review[4] (which HM Treasury broadly supports) recommended a wider commercial approach to open banking. It says *without a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure investment[5].*

The PSR's specific proposals

On each of the specific proposals:

- multi-lateral agreements are required for VRP. Some members do not support Pay.UK as the body to govern a VRP MLA for either Phase 1 or beyond. Given that Pay.UK is responsible for Direct Debits, their governance of VRP is likely to give rise to competition concerns or a mindset that reads across from the Direct Debit model. The PSR should reassure the market that a competition assessment has been made. There are widespread industry concerns too about Pay.UK's track record[6] and engagement with the open banking payments ecosystem. Some of our members support Open Banking Limited as a better alternative but note that it does not have the mandate, funding or governance to develop commercial models;

- effective ways to determine fees charged between PISPs and sending ASPSPs for payment initiation may be needed for VRP but pricing models and their merits need to be analysed transparently and a sustainable and legally certain model/models developed that command widespread market support. The PSR proposal for a zero price between PISPs and ASPSPs fails to provide equitable commercial incentives, lacks for any evidence and removes any incentive for ASPSPs to invest in innovation. At best, setting a zero-fee cost which must then be revised upwards (with consequent impact on charges from PISPs to merchants) will create false expectations for merchants and may undermine the learnings about merchant uptake from the pilot. At worst, a zero-fee model persists into a mature service which could result in permanent

[3] the FE may need the capability to service industry stakeholders or coalitions of industry stakeholders who have set up and are running voluntary commercial arrangements (e.g. cVRP).

[4] https://www.gov.uk/government/publications/future-of-payments-review-2023

[5] Ibid

[6] Ibid

discounts (for example, in the energy market previously subject to competition investigation[7] rather than charities seen as key market for open banking payments[8]) and starves VRP of the resources required to drive innovation and protect customers and distorts the market in terms of competition and entry;

- mandating CMA9 participation understandably provokes mixed views. It is clear however that the CMA Order and the CMA9 construct is wholly irrelevant – and if the rationale is to ensure ASPSP coverage, the inclusion of AIB, Bank of Ireland and Danske Bank in such a mandate is fallacious;

- it is unclear how Phase 1 relates to a trajectory that delivers VRP successfully into market through an excellent customer experience. The proposal for Phase 1 does not define the specific objectives, the timelines for any assessment and progression to the next phase.

The way forward and our request of the PSR

A commercially sustainable VRP ecosystem which provides for a compelling customer journey needs to attract investment. This will not be driven by forcing a loss-making service on parts of the market.

The approach should be industry led (with the support of industry bodies and in partnership with the PSR to develop a contractual framework(s)), and consider commercial model(s) and common standards for customer protection. This could align to the National Payments Vision, the consultation on the long-term regulatory framework for open banking and the development of the Future Entity. All of our members agree this needs to be developed and we urge the PSR to give our offer above (and made previously last year) serious consideration[9]. At the time, we said: *an industry led approach could be faster, more agile in being able to adapt to consumer and merchant needs and have the flexibility to support a broader range of uses cases.*[10]

Industry has already begun to develop elements of a contractual framework for VRP, with a balanced group of twelve firms, with PISP and ASPSP co-chairs, expert legal support, industry body observers, end user review and a wider Engagement Forum (which met on 18th January and attracted over 70 participants). The PSR are welcome too to observe the model clause work.

This work will not fully develop the commercial and functional framework. Our attention is now focussed on closing that gap and the offer to work in partnership with the PSR to develop proposals for a sustainable commercial framework(s) for VRP by Q3 2024.

We are supportive of Open Banking Limited/Future Entity leading work on the technical capabilities/enhancements to the VRP API standards and other system requirements at the

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[7] https://www.gov.uk/cma-cases/energy-market-investigation

[8] https://www.openbanking.org.uk/insights/new-impact-report-sees-significant-growth-in-open-banking-payments-and-increased-business-use/

[9] UK Finance set out the approach to develop the commercial framework to the PSR on 24th November and met with the PSR on 27th November to discuss the proposals. The PSR has not responded to these proposals.

[10] E-mail to PSR dated 24th November.

appropriate point and subject to a broad-based funding arrangement that will allow it to undertake non-Order work (for which it is not currently set up to do).

Alongside the development of a commercially sustainable framework that commands widespread industry support, there is an opportunity for a period of experimentation in which firms can enter the market, test market-based pricing, apply model clauses to contractual agreements, experiment with use cases and test the utility of customer propositions.
Finally we would request that the PSR consult further on any revised proposals and the legal instruments it will use.

In particular, it should set out further detail of its intended outcomes for the Commercial Model for VRP for Phase 2 and beyond, including with respect to how the model currently proposed for Phase 1 use cases may evolve in future (and when). Clarity on PSR's intended future evolution of the commercial model upfront will be critical to driving any merchant interest in VRP adoption (including at Phase 1).

To discuss this submission please contact:

[redacted]

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 pricing principles published by the PSR in June 2023:

- have not been subject to public consultation – their status is unclear. The Consumer Duty[11] provides a legal requirement on firms to provide fair value and sets obligations on manufacturers and distributors;

- use terminology that is contentious and is not based on evidence relating to the heterogeneous open banking market (for which the characterisation of third parties and retail financial institution is at best a legislative construct, at worst an out-dated caricature);

- include principles that conflict with each other, for example principles 1 and 2, which suggest different pricing models one based on cost recovery, the other, including return for risk, innovation and investment;

- do not lay the basis for commercial sustainability and require loss-making and/or cross-subsidisation.

Since the end of the CMA roadmap, there appeared to be agreement from JROC that it was important to see Open Banking taken forward on a commercial basis with funding and support drawn from a broad base of providers. Indeed, JROC's April 2023 document 'Recommendations for the next phase of open banking in the UK'[12] notes that "*for open banking to successfully move to a new phase, in which more products and services that benefit consumers and businesses are offered, the ecosystem needs to become economically sustainable".*

In practice, this means creating an ecosystem that, through industry action and regulatory support, builds commercial arrangements that are fair and proportionate. This principle has underpinned the work on VRP to date, with much of the work to progress having been voluntarily resourced and funded by several UK Finance members.

The requirement to make future Open Banking arrangements commercially sustainable was identified as key by the recent Future of Payments Report, which recognised that '*without a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure investment'*, and in the Autumn Statement, HM Treasury said *The government's intention is for the new regulatory framework to require firms beyond the largest banks to participate in a sustainable and equitable commercial model through which the technology and necessary consumer protections will be developed."* [13]

However, the papers' suggestion that ASPSPs will not be able to charge for VRP is directly contrary to this direction of travel.

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[11] https://www.fca.org.uk/publication/policy/ps22-9.pdf

[12] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1150988/JROC_report_recommendations_and_actions_paper_April_2023.pdf

[13] https://assets.publishing.service.gov.uk/media/6568909c5936bb00133167cc/E02982473_Autumn_Statement_Nov_23_Accessible_Final.pdf

There are a number of potential negative consequences of this approach, including:

- While the costs and risks involved in an early-stage pilot may be lower than those for a mature service, the proposed approach creates a significant risk to the commercial model of a mature service. At best, setting a zero-fee cost which must then be revised upwards will create false expectations for merchants and may undermine the learnings about merchant uptake from the pilot. At worst, the zero-fee model persists into a mature service which starves it of the resources required to drive innovation and protect consumers;

- A free model would be harmful to competition, with a skewed market and cross-subsidisation of large players like Big Tech firms by larger ASPSPs will create a false economy and is not aligned to the overall objectives of JROC to create a long-term sustainable ecosystem;

- The pricing principles also state that there should be “fair treatment of TPPs”, however the suggestion is that for Phase1 use cases VRP payment initiation by ASPSPs should be free to requesting PISPs. By definition this could create significant advantages for those TPPs that already have those relationships for the low-risk use cases, and those that work in ecommerce or beyond could be significantly disadvantaged;

- Although the zero-pricing proposal only relates to Phase 1, there is a significant risk that it becomes the market expectation, and that will later make it difficult to move to an equitable charging model.

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.

Yes, cross-industry co-ordination is required to deliver a consistent customer experience.

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.

Our members do not have a shared view.

There is however an argument that the Open Banking Limited/Future Entity could be better positioned to operate an MLA for the following reasons:

- Resource constraints at Pay.UK due to competing priorities such as the delivery of Confirmation of Payee, Enhanced Fraud Data-sharing and APP Fraud Reimbursement Requirement;

    - .

- Diverse representation at the decision making level is essential to achieve the desired outcome of wider market uptake. OBL/FE Entity may be better positioned to engage TPPs, encourage greater buy-ins from a wider range of market participants and facilitate more comprehensive considerations for the initial design of an MLA;

- OBL/FE is closer to open banking developments and thus has a deeper understanding of the challenges, issues and needs, and are arguably better positioned to understand the aspects needed to establish a viable commercial models, including setting the foundation for future premium API innovations;

- There needs to be sufficient segregation of duty to prevent unintended conflict of interest and ensure neutrality. The design of an MLA should not be bias towards or limited by existing methodologies, approaches and systems. It should also be segregated from the scheme operation. Considering Pay.UK already defines the rule and runs the scheme operation, the responsibility of any MLA should therefore be segregated to a separate impartial body.

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 agree that sending firm coverage is needed for VRP to be successful. Most members agree this needs to be driven by commercial incentives and voluntary participation, although some support a mandate on larger ASPSPs.

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

- Sending firms are best placed to respond to this question. There are costs that would relate to::

- IT infrastructure (for example, changes to the dashboards) and application build costs (expense for delivery will go beyond a simple change in the API itself, there is front end UI work to complete which if not delivered as part of the build may create poor experience);

- operational costs include dispute handling, customer queries (including contact centre, branch, and operational staff and associated training costs);

- infrastructure and software maintenance and infrastructure capacity costs;

- liability and write off costs and central costs include development of infrastructure;

- requirements around fraud;

- standards development and implementation;

- connectivity.

Any changes to the FPS platform will impact all users, even if they are not relevant to VRP. Even if the PSR were correct in asserting that the sending bank costs identified in the consultation may be negligible on a per transaction basis these could be material on a cumulative basis. Additionally, future expansion and innovation will most likely require additional investments from the sending banks. Sending banks therefore need to be able to recover these costs to support the long-term viability of the service and to encourage further innovation. It is of course the TPP that is extracting value from the merchant relationship to initiate payments, which the sending bank is executing – the latter should not meet the costs of the former.

The undefined Phase 1 and undefined VRP service means it is not possible for the PSR to really know what the cost will be to sending firms of supporting this service, and its scope will be difficult to guarantee, meaning it could morph into different higher risk cases for end users. Some of our members argue that it is therefore fundamentally wrong to consider mandating larger ASPSPs to sign up to an MLA considering the financial and customer outcome risks.

It is dangerous to compare the costs/charges with interchange ahead of any MLA being developed. Existing payment methods have well established liability models, and frameworks to support all parties in the chain, including end users. Comparisons at this stage don't work. Sending firms take on much more liability as things stand, so the "cost" goes way beyond the interchange loss that's been stated.

It is also important to note there is no "one size fits all" approach. Firms' business models differ. There is often an assumption that firms' open banking costs would be covered by commercial customer revenues. Not all firms have commercial customers and cannot cross-subsidise merchant/submitter submission fees against costs on the consumer side. Bacs and FPS where income is accrued on the business side, but costs incurred on both sides, of the payment model is a bad comparator in this instance. Further cross-subsidisation would, as noted in the Future of Payments Report, replicate the issues of the 'free if in credit' banking model. Therefore, additional costs should therefore be applied to the "merchant" side of the business and compensation should be provided to the "account holding / issuing" side.

It is therefore absolutely not the case that existing functionality can be used to ensure "minimal costs".

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.

It is difficult to see how FPS fees cannot be charged for VRP transactions without these being incurred elsewhere - including for Bacs infrastructure if migration takes place.

There should also be recognition that certain ASPSPs submit far larger volumes through FPS than others. This means that if the FPS cost for sending firms is waived for VRP and the cost of this is recovered across FPS users, those firms which submit larger volumes of FPS will carry a large amount of the mutualised cost of VRP..

There are other costs for VRP that will need to be considered that are not part of the fees paid to the FPS scheme, for example, data storage. Direct Debit (DD) currently doesn't require user authentication for each payment. For VRP, individual payment authentication data will need to be stored and managed appropriately, in line with data localisation and data privacy requirements. Another potential cost, depending on the specific design of an MLA, is the need for some control mechanism to be built, for example, if no payments have been taken for an extensive period of time, then such VRP should be automatically cancelled or subject to periodic reauthentication.

The approach in the paper does not therefore reflect the full cost of implementation.

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?

Please see above – we do not support the pricing proposal.

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

Open Banking Limited have not set out their costs for supporting the development of VRP or how they would be met by a wide set of market participants or any synergies that could exist with their current activities, for example on ticketing. The PSR do not appear to have factored in development costs into the pricing model.

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

Phase 1 is not based on a sustainable commercial model, which is necessary both for the success of VRP and as a test case for premium APIs. Such model(s) require rigorous analysis, options analysis, supported by data and evidence and to be tested for legal certainty, applicability to use cases and competition impacts.

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.

Account coverage will be a key consideration for PISPs and billers but there will be other consideration, including for billers their own costs of change. Firms themselves are best placed to identify the market opportunities, the customer propositions that drive investment by APSPs, PISPs and billers.

Before our members launch a product in market, they subject the customer proposition and use cases to rigorous analysis and testing. We do not agree that the proposed use cases provide the basis for testing the market, for example, most utility payments are received through Direct Debit and payments to government is not a segment that is going to open up to a wide range of providers.

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.

The PSR should look beyond the supply side via cost/pricing. There are other incentives for billers, in particular the reduction of settlement risk for both the biller. VRP have a much shorter settlement time compared to Direct Debits. Additionally, unlike a Direct Debit which can be recalled, once a Faster Payment is authorised and processed, it is usually considered final and irrevocable thus providing greater certainty.

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

The CMA Roadmap closed with the completion of VRP for sweeping. Given VRPs fall outside the scope of the open banking roadmap, it is unclear what basis the CMA9 should be the mandated to provide VRPs.

Critically, the CMA order is not a vehicle to mandate the provision of this service, and the PSR therefore needs to clarify what regulatory power it would use to enforce a mandate.

In addition to these fundamental legal issues, we would query why they propose to mandate the CMA9 – given that construct was based on a market share assessment which was completed nearly a decade ago now. It would maintain the “two-tier system” already in place and contradicts the other “levelling up” activity that’s ongoing based on JROCs suggestions for non-CMA9 banks.

The banking landscape has changed significantly since the introduction of the market order in 2017 based on an investigation that reported in 2016[14] and opened in 2013. If the PSR is seeking to identify a group of institutions which have collective meaningful scale then it should conduct current analysis based on objective and relevant criteria and offer participants the opportunity to comment on this analysis.

Whilst we agree that there needs to be sufficient coverage mandating the CMA9 to do so is not the right approach and may not be legally acceptable in any case. There are however firms in UK Finance membership not covered by the proposed mandate that are supportive of the principle (but are in agreement that CMA9 is not the right construct) as a pragmatic way to provide coverage.

Northern Irish Banks

The paper states that the intention is to generate sufficient scale to encourage the take-up of VRP. While we understand this view, we note that the three Northern Irish banks are part of the mandate. However, they are certainly not part of the ‘9 largest banks in the UK’. Of the 3 Northern Ireland banks, 1 is still in the Managed Roll Out for VRP, with no fixed date for a market-wide launch, and another is not due to deliver VRP and enter the MRO until March at the earliest.

The proposed approach is not appropriate for smaller ASPSPs with limited market share. While much lower than if VRP was being delivered from scratch, it appears there will still be some initial delivery costs, and costs which aren’t on a per transaction basis disproportionately impacts smaller firms. In line with market share, there are much fewer PIS payments amongst smaller CMA9 banks. We are also aware of PISPs not ‘turning on’ their propositions with smaller ASPSPs due to their small market share. We have evidence which suggests that NI banks have a smaller share of PIS transactions amongst CMA9 compared to their current account market share. It is probable that it would be the same for VRP. The approach to pricing in the paper would therefore fail the pricing principle on recovering costs as any material implementation cost means that the proposed pricing will make it exceptionally difficult for smaller ASPSPs to recover costs in an appropriate timeframe

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?

The PSR should address the coverage questions to individual firms, both ASPSPs and PISPs. It is not clear that the proposed (Phase 1) use cases are commercially attractive and will result in biller uptake regardless of the approach the PSR takes.

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?

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[14] https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf

Mandating participation is not the route towards developing a commercially sustainable market in VRP. It is frankly unlikely to deliver the PSR's desired outcome and will reduce the resources available to banks to pursue potentially more commercially sustainable models.

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

We annex an industry-led approach originally sent to the PSR in December 2023 (separate file).

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?

The PSR has not set out the legal powers it would use to intervene.

The market intervention is premature and is not warranted by the evidence available, creates risk for customers and merchants and could cut across other regulatory requirements, including the FCA Consumer Duty.

The model is likely to be an "MVP" with consequently few protections for consumers thus with the potential to be exploited for fraud.

The pricing model is likely to have unspecified consequences affecting the development of other A2A-based payments models.

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 the widely held industry view is that they are restrictive, commercially unattractive and not representative of the potential of VRP.

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

This detail is best provided by the market actors themselves.

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?

This detail is best provided by the market actors themselves.

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?

This detail is best provided by the market actors themselves.

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

Please see above.

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 above.

They set a course for open banking and premium APIs to develop through regulatory mandate, with firms compelled to enter the market, enable products and services at a loss, with weak incentives to invest and expose their customers to detriment (for example, through payments that do not offer comparable protections).

We set out an approach in the annexed slide deck which tackles the challenges with expert advice and support, within an inclusive governance model and cross-industry working. We urge the PSR to review their proposals, support the approach and review later in the year.

Commercial VRP - the work blocks

There are five work blocks to create a sustainable the basis for Commercial VRP:

1. MLA governance including onboarding into/offboarding market participants out of the MLA
2. A commercial pricing model
3. Customer purchase protection
4. MLA development building on the model clause work
5. Technical capabilities/enhancements to the VRP API standards and other system requirements, which may require a regulatory mandate – delivered by the [Functional] Implementation Group chaired by Open Banking Limited

(Items 2 and 3: delivered as a ‘black box’ model by an independent economics consultancy)

7

Workblock 1: Governance model

Would involve an options analysis to define the role, requirements and economic model of governance

The role of governance could include:

- maintain, set rules and guardrails
- mandate API conformance, technology requirements and interfaces
- operate claims management, dispute systems and arbitration
- underwrite MLA risk, for example in relation to participant’s failing
- promote the brand

The options analysis would assess:

- the costs and capital requirements of the activities of governance
- the options where industry’s starting preference is:
  - New or existing bodies manage the commercial framework(s) and VRP rulebook(s)
  - Future entity continues to set standards for APIs (the instructing layer)
  - Pay.UK continues to set rules/standards for interbank layer

6

Work blocks 2 and 3: commercial pricing model and customer protection

UK FINANCE

Next steps would involve issuing an RFP to an economics consultancy

Issue an RFP for an economics consultancy to:

1. set out the pricing model principles
2. develop options for the pricing model and model components including customer protection, analyse their merits and route to implementation
3. populate the preferred model with anonymised and aggregated data
4. provide an independent view on fair and equitable prices (including fees to the operator) and process for future price review

Industry would work with PSR and industry bodies to develop a pricing methodology and that the price that results is transposed into a legal requirement, to ensure legal certainty to support participation, investment and innovation.

Notes: The model would need to consider phasing/scalability in relation to a) a Q3 cVRP pilot b) customer protection

Work block 4: building on the model clause approach for MLA

UK FINANCE

The governance model for developing model clauses could be expanded/adjusted and given a wider purpose

- For the MLA phase, the JROC should be closely engaged
- The governance model from the model clauses provides a solid foundation to build upon:
  - Co-chairs
  - A balanced group of market participants providing funding
  - Expert legal advisers including competition lawyers
  - An Engagement Forum for all stakeholders to be involved and consulted including end user input
  - Industry bodies taking part as observers - Open Banking Limited and Pay.UK (the PSR should join as observers too)
  - A secretariat – UK Finance
  - This model and terms of reference have been assessed for competition risk.

Visa

Visa's response to the Payment Systems Regulator's call for views on expanding Variable Recurring Payments

February 2024

Visa Europe (referred to as 'Visa' in this document) is pleased to respond to the Payment Systems Regulator's (PSR's) call for views on expanding Variable Recurring Payments (VRPs).[1]

Visa supports the work of the PSR, the Financial Conduct Authority (FCA) and HM Treasury to unlock the potential of account-to-account payments in the UK. The benefits could be significant. VRPs,[2] for example, can give people much more control, flexibility and transparency over household bills compared to Direct Debits and a better user experience when paying by bank transfer. They could also give customers more choice of ways to pay and be paid across a wide range of use cases.

We firmly believe that customers' interests and the UK economy are best served by encouraging competition and innovation. The history of UK payments over the past 25 years shows the benefits of stable, proportionate and balanced regulation that ensures a level playing field and gives market participants the confidence to invest and solve for customers' needs.

For this reason, we have a number of concerns about the PSR's call for views. The proposals involve significant interventions – including direct price regulation – that are unlikely to achieve the Joint Regulatory Oversight Committee's (JROC's) goals and do not seem consistent with the PSR's objectives to promote competition, innovation and the interests of service users. We highlight the following concerns:

- **The PSR's proposals are unlikely to deliver a sustainable commercial model.** The proposal to set to zero the price that Account Servicing Payment Service Providers (ASPSPs) receive from third-party providers (TPPs) would not encourage adoption, investment and innovation because ASPSPs receive no benefit from take up and use of VRPs. To be successful, VRPs must be backed by a sustainable commercial model that gives all ASPSPs and TPPs incentives to offer and promote VRPs, improve the user experience and protect customers from fraud.
- **It is unclear what evidence the PSR has used to support the level of intervention it is proposing.** The measures proposed by the PSR – not least, direct price regulation – are normally reserved for instances of substantial market failure. We do not believe that the PSR has established that such a market failure exists. The PSR's proposed cost-benefit analysis also makes assumptions that do not reflect the dynamism of UK payments – for example, that payment methods deemed as alternatives to VRPs in Phase 1 will not significantly improve over the next 10 years.
- **The PSR's proposals create risks to competition and risks of unintended consequences.** Rather than enabling multiple solutions to compete to offer VRPs, the PSR's proposals risk creating conditions in which only one solution – the PSR's – appears viable. Such an approach differs

[1] CP23/12. https://www.psr.org.uk/publications/consultations/cp23-12-expanding-variable-recurring-payments-call-for-views/

[2] In this response, we use the term VRP in the same way that the PSR does in CP23/12 – i.e., to refer to non-sweeping VRPs.

from interventions that the PSR has made in the past that rightly seek to open up account-to-account payments to competition and create a level playing field. There could also be unintended consequences, such as exposing customers to higher risk of fraud.

Given the above concerns, we encourage the PSR to consider other options that could achieve the JROC's goals, while avoiding the risks and unintended consequences created by the PSR's current proposals. We believe the PSR should be creating a level playing field that enables the competitive development of different VRP solutions and commercial models. One potential option would be for the PSR – together with the other JROC members – to set out the essential elements any multilateral agreement (MLA) must contain and the outcomes they expect to be delivered. To further support competition, the JROC could also sponsor piloting of VRP solutions.

In the remainder of this response, we elaborate on the above comments. Where relevant, we identify where our views are responsive to specific consultation questions. We are happy to discuss any aspect of this response with the PSR and would welcome further engagement on its proposals.

Customers' interests and the UK economy are best served by encouraging competition and innovation.

This section is responsive to the call for views generally.

Over the past 25 years, the UK payments sector has been at the forefront of innovation, fuelled by vigorous competition. Fast, secure, and convenient ways of paying – like contactless – launched earlier in the UK than elsewhere. Disruption remains rare, thanks to big investments by market participants in resilience and cyber-security. Choice for customers has never been greater and continues to grow.

The Government and regulators have helped create the right conditions for competition and innovation to thrive. The UK has a long-standing reputation for stable, proportionate, and balanced regulation. This gives market participants the confidence to make investments that enhance the customer experience and encourages them to bring new innovations to the UK first. It also attracts new entrants. Around 2,500 fintechs call the UK home and nearly a fifth specialise in payments,[3] helping create a vibrant and dynamic payments sector. Regulation that opens up markets to competition and creates a level playing field, while letting the industry solve for customer needs, has served the UK well.

In the call for views, the PSR proposes a much more interventionist approach to expanding VRPs. The PSR proposes to task Pay.UK with the creation of a new MLA and use its powers to regulate pricing by:

- permitting ASPSPs that join the MLA to recover only their incremental costs of the Phase 1 rollout of VRP; and
- setting the only incremental cost the PSR has identified – the FPS charge – to zero.

[3] Kalifa Review of UK Fintech. https://www.gov.uk/government/publications/the-kalifa-review-of-uk-fintech

As this pricing structure gives ASPSPs no incentive to join the MLA, the PSR also proposes to require the CMA9 to participate.

As we explain further below, the PSR's proposals are unlikely to deliver a sustainable commercial model that supports adoption and usage of VRPs. In addition, it is not clear what evidence the PSR has to support the level of intervention proposed or that the PSR has considered adequately the risks to competition and the risks of unintended consequences.

The PSR's proposals are also out of step with the approach taken in comparable jurisdictions. In the European Union, for example, the European Payments Council has developed the SEPA Payment Account Access scheme, which will facilitate the initiation of payment transactions – including VRPs – using 'premium' Application Programming Interfaces (APIs). This scheme includes a commercial model that recognises that asset holders (the equivalent of ASPSPs) need incentives to participate and deliver high-quality APIs. Importantly, regulators have supported this process and given the industry the space to come together to provide a solution. We note that there is a similar process underway in the UK, led by UK Finance. Another example is the U.S., where open banking has developed organically and – on many measures – is ahead of other countries. Nearly 90% of US consumers use open banking for a wide range of use cases[4] and the security and privacy standards developed by the industry exceed the regulatory requirements in the UK.

Some countries use a different approach to meeting customers' needs. For example, the Brazilian central bank has stepped in to create an instant payments platform, while in India the central bank, together with the Government, has steered and championed the Unified Payments Interface. Importantly, the context and the pressing issues that needed to be solved in these countries are different from those in the UK. For example, a key objective of government intervention in both Brazil and India was to improve financial inclusion, promote digitisation of payments and modernise legacy payments infrastructure. The UK does not face these challenges and unmet needs to the same degree. Just 1.3% of the UK's population is unbanked[5] and the UK is one of the highest users of digital payments.[6] The UK was also one of the first countries to offer near real-time payments when Faster Payments was launched in 2008. Government interventions have also brought unintended consequences, including higher fraud, in both Brazil[7] and India.[8]

[4] Visa, The U.S. Open Banking Movement. https://navigate.visa.com/$/v/5/na/m/x/u/23a556e7-8cb6-43fa-b62b-f8af7e6212be.pdf

[5] FCA Financial Lives Survey. https://www.fca.org.uk/publication/financial-lives/financial-lives-survey-2022-key-findings.pdf

[6] In 2021, 99% of the people aged 15+ in the UK had made or received a digital payment, the joint second highest globally. World Bank, The Global Findex Database 2021. https://www.worldbank.org/en/publication/globalfindex

[7] Reuters, 'Pix Gangs' cash in on Brazil's mobile payments boom. https://www.reuters.com/article/brazil-crime-payments/feature-pix-gangs-cash-in-on-brazils-mobile-payments-boom-idUKL8N37Z4E1/

[8] India Today, More than 95,000 UPI fraud cases reported in 2022, here is how you can stay safe. https://www.indiatoday.in/technology/news/story/more-than-95000-upi-fraud-cases-reported-in-2022-here-is-how-you-can-stay-safe-2386084-2023-05-29

The PSR's proposals are unlikely to deliver a sustainable commercial model.

This section is responsive to questions 7, 10, 21 and 22 in the call for views.

There is broad agreement that VRPs should be underpinned by a sustainable commercial model. This was recognised in JROC's roadmap, which said that the success of work to promote new products and services beyond existing regulatory requirements "will be measured through the development of a sustainable economic model for premium APIs, starting with the implementation of a pilot for non-sweeping VRPs".[9] Joe Garner's Future of Payments Review also emphasised that "[w]ithout a sustainable commercial model, there is no money to fund adequate consumer protection and infrastructure investment."[10]

A sustainable commercial model ensures that both sides of a transaction receive value and therefore have incentives to adopt VRPs and innovate. To realise the potential of VRPs requires investment in resilience, fraud prevention and mechanisms that support customers when things go wrong. Investment will also be needed to ensure a seamless and convenient user experience that gives customers more control and flexibility. Importantly, a sustainable commercial model ensures that VRPs keep step over time with rapidly evolving customer needs and expectations.

The PSR's proposals are unlikely to deliver a sustainable commercial model for VRP in Phase 1 or in future phases. We highlight the following concerns:

- The PSR proposes to set to zero the FPS charge for a transaction initiated via Pay.UK's MLA. In reality, though, there is a cost of clearing and settling a payment using FPS. Using regulation to allocate this cost to other users – for example by spreading them across all FPS users – is not consistent with creating a sustainable VRP solution. This approach also distorts competition, as outlined below, and introduces potentially harmful inefficiencies to the payments sector.
- The PSR's pricing proposal does not incentivise investment and innovation because ASPSPs receive no benefit from take up and use of VRPs. This could have material consequences for customers. For example, ASPSPs may not make investments to detect and prevent fraud. In addition, ASPSPs may not innovate to improve the customer experience, which could mean the UK does not realise the full potential benefits of VRP.
- The PSR's pricing proposal does not incentivise adoption on the payer side of the network for the same reason that it does not incentivise investment and innovation – because ASPSPs, even those required to join Pay.UK's MLA, receive no benefit from promoting take up of VRPs to their customers. This could, in turn, affect adoption on the payee side of the network – businesses may not choose to accept VRPs if they think few customers will use this payment option.

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[9] Joint Regulatory Oversight Committee, Recommendations for the next phase of open banking in the UK, pp. 37 and 38.
https://assets.publishing.service.gov.uk/media/643e608e22ef3b000c66f3bf/JROC_report_recommendations_and_actions_paper_April_2023.pdf
[10] J. Garner, Future of Payments Review, p.71. https://www.gov.uk/government/publications/future-of-payments-review-2023

Although the PSR's proposals relate to Phase 1 use cases only, the absence of a sustainable commercial model risks holding back the development and adoption of VRPs for these use cases and limiting what can be learned about demand for VRPs and how they can be scaled successfully in future phases. The consequences could be material for customers and might include higher fraud risk, a mediocre (or worse) customer experience and low adoption as described above. Of course, the PSR could adjust the commercial model for the Phase 1 uses cases over time or continue to add obligations on ASPSPs to make changes. But this is unlikely to be straightforward and could be time consuming, stalling innovation and leaving customer needs unmet.

It is unclear what evidence the PSR has used to support the level of intervention it is proposing.

This section is responsive to questions 4 and 18 in the call for views.

The PSR's proposals – not least, direct price regulation – are normally reserved for instances of substantial market failure and with good reason. Interfering in pricing stifles market development, distorts competition and reduces quality, investment and innovation.[11] It is especially challenging to regulate pricing in two-sided markets, given the role pricing plays in attracting both sides of a transaction to participate.[12] We also note that the Competition and Markets Authority (CMA) forced the CMA9 to let third parties access transaction data and initiate payments on customers' behalf for no charge only after an in-depth investigation of retail banking lasting 20 months. Price regulation of contestable products and services in other sectors has followed similarly detailed examinations of the effectiveness of competition.

The PSR's proposal to regulate pricing is linked to the view that ASPSPs have a 'bottleneck monopoly' in relation to VRPs because they control access to their customers' accounts. There are, though, reasons to suggest this is not the case. Customers can switch provider with fairly limited costs, helped by comparison websites and the Current Account Switch Service (CASS), and there are many current account providers to choose from. The number of customers who are switching is growing – Pay.UK reported that there was a 70% increase in switches in the first quarter of 2023 compared with the same period in 2022.[13] Customers can also multi-home by holding current accounts with different providers. The available evidence suggests this is common – a Pay.UK survey of 2,000 UK consumers in 2022 found that 53% have more than one current account.[14] The ability for customers to switch and multi-home makes it unlikely that one ASPSP can act as a bottleneck monopoly – if they do so, the ASPSP would risk losing customers to rivals that allow access to VRPs.

The PSR also refers to the challenges that the VRP Working Group (VRPWG) faced in agreeing a commercial model for Phase 1, but this was not an appropriate forum for discussing pricing - for

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[11] For example, M. Spence, 'Monopoly, quality and regulation' (1975) *Bell Journal of Economics*, gives a classic view on the risks to quality from price regulation.

[12] As seen for example in J.C. Rochet and J Tirole, 'Platform competition in two-sided markets' (2003) *Journal of the European Economic Association*, pricing in a two-sided market can take a variety of forms, depending on the specifics of the market. Limiting the ability to price on any one side of the market may impact the take-up and usage of the platform in question.

[13] Financial Times, Surge in UK current account switching. https://www.ft.com/content/d15021f5-aa70-4ced-82b3-e650c42acbec

[14] Pay.UK, Exploring the future of switching. https://newseventsinsights.wearepay.uk/media/tprokfwh/payuk_davieshickman_report1v142.pdf

example, because of competition law. The failure of the VRPWG to develop a commercial model is not a justification for the level of intervention the PSR proposes.

We note that the call for views invites comments on the pricing principles that the PSR intends to use to set the prices that ASPSPs can charge to TPPs. We consider this to be premature given the risks and potential unintended consequences of price regulation and our view that the PSR has not provided evidence of a substantial market failure that would warrant this level of intervention. For this reason, we do not consider it appropriate to comment on the PSR's proposed pricing principles at this time.

The PSR also proposes to make several assumptions when assessing the costs and benefits of its proposals, most noticeably that over the next 10 years:

- there will be no change in the current provision of VRPs, absent regulatory intervention; and
- payment methods deemed as alternatives to VRP in Phase 1 will not significantly improve in functionality or benefits.

The first of these assumptions overlooks that other comparable jurisdictions have introduced VRPs without the types of interventions the PSR is proposing. For example, as set out above, the European Payments Council has developed the SEPA Payment Account Access scheme, which will facilitate the initiation of payment transactions – including VRPs – using 'premium' APIs.

Both assumptions do not recognise that the UK payments sector is highly dynamic and fast-moving. Using these assumptions will not help the PSR reach an informed decision about the costs and benefits of intervention. As set out above, competition in payments is fierce, with new entrants and established providers constantly innovating to improve the customer experience and meet their needs. In less than a decade, the way we pay has changed dramatically – in 2014, nearly 50% of payments were made using cash, whereas in 2022 the large majority (around 85%) were made digitally.[15] Many market participants are investing in account-to-account payments, not least VRP, which is widely recognised as having significant potential. The UK pioneered open banking and is home to a thriving ecosystem – as of June 2023, there were 45 TPPs with live payment initiation offerings.[16] Customers are also increasingly embracing open banking. In the first six months of 2023, the number of open banking payments doubled compared to the same period the year before and a record 9.7 million such payments were made in June 2023.[17] These figures do not indicate a substantial market failure – indeed, they suggest vibrant competition. We encourage the PSR to take account of these competitive dynamics when considering how to expand use of VRPs and when making assumptions to inform its cost-benefit analysis.

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[15] Visa analysis of UK Finance, UK Payment Markets 2023. https://www.ukfinance.org.uk/policy-and-guidance/reports-and-publications/uk-payment-markets-2023

[16] OBL, The open banking impact report. https://openbanking.foleon.com/live-publications/the-open-banking-impact-report-october-2023/outputs-availability

[17] OBL, Open Banking Impact Report – October 2023. https://www.openbanking.org.uk/news/open-banking-impact-report-october-2023/#:~:text=Over%201%20in%209%20(11,for%2075%25%20of%20all%20propositions.

In addition, the PSR's cost-benefit analysis needs to consider fully the alternative options available. We set out below some alternatives that we believe will achieve JROC's goals without the risks and unintended consequences of the PSR's proposals.

We note that the call for views states that the PSR proposes to use its powers to mandate participation of the CMA9, set the parameters for a 'central price' for VRPs, as well as set to zero the FPS charge that ASPSPs incur. It is not clear what powers the PSR intends to use to achieve each of these objectives or how it would go about this. We would welcome further clarity from the PSR.

The PSR's proposals create risks to competition and risks of unintended consequences.

This section is responsive to questions 6, 14 and 16 in the call for views.

The PSR's proposals to regulate pricing and mandate that the CMA9 join Pay.UK's MLA create risks to competition in payments. Rather than enabling multiple solutions to compete to offer VRPs, we are concerned that the PSR would create conditions in which only one solution – the PSR's – appears viable. This approach risks depriving customers of the full potential benefits of VRP and is in marked contrast to the PSR's current approach to regulating account-to-account payments, which rightly seeks to promote competition – for example, by requiring competitive tendering of infrastructure services.[18]

One risk to competition from the PSR's proposals is that rival solutions seeking to address the Phase 1 use cases will not be competitive with Pay.UK's MLA for two reasons:

- First, it will be more difficult for rival solutions to design a commercial model that attracts both sides of a VRP transaction to participate. TPPs may be unlikely to use any solution that charges them to initiate VRPs, given Pay.UK's MLA enables them to initiate VRPs for free. Rival solutions, though, may not be able to offer a commercial model that charges TPPs nothing (or very little) while convincing ASPSPs to participate. Such an approach is not sustainable and is only possible for Pay.UK's MLA because (a) the PSR will require the CMA9 to participate and will prevent them from recovering any costs except the FPS charge and (b) the PSR would create a preferential and artificially low FPS charge for Pay.UK's MLA that no rival solution could access.
- Second, both TPPs and ASPSPs may be reluctant to participate in a rival solution that does not have regulatory backing.

We also ask if the PSR has considered the competition risks that arise from the uncertainty about what it intends for potential use cases not covered by Phase 1 and whether it will employ similar, highly interventionist measures to achieve its goals. Importantly, the PSR has not identified how it will measure the success of Phase 1 or on what basis it might decide to move to the next phase, whatever that may involve. It is also unclear if Phase 1 is a pilot – previous JROC publications indicated this was the intention but there is only one mention of this in the call for views. All this uncertainty will affect investment decisions, potentially stifling the development of VRPs and other forms of account-to-account payments.

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[18] See Specific Directions 2 and 3.

We believe VRPs have the potential to increase choice and create a better customer experience when settling bills and paying by bank transfer. Stifling competition risks depriving customers of these potential benefits by reducing the incentives on market participants to invest and innovate to meet customer needs. Customers with vulnerable characteristics could be among those that lose out. For example, people on irregular incomes, who may sometimes struggle to pay household bills when they fall due, could benefit significantly from the control and flexibility that VRPs could provide compared to Direct Debits.

In addition, the PSR's proposals create risks of unintended consequences. For example, while the PSR considers that the Phase 1 use cases carry a low risk of fraud, no use case is risk free and fraudsters are highly adaptable to new opportunities. In addition, it is also unclear how Pay.UK will police use of VRPs in Phase 1 to ensure that they are only used for the PSR's intended use cases and not for other, higher risk, use cases. Given that the PSR does not intend to introduce consumer protection measures during Phase 1, it is important that full consideration is given to the unintended consequence of potentially exposing customers to higher risk of fraud.

Another unintended consequence could be to create a two-tier retail banking market, with the CMA9 forced to support VRPs but other banks unable to do so because of the absence of adequate commercial incentives in Pay.UK's MLA.

Alternative approaches to extending VRPs.

This section is responsive to question 15 in the call for views.

Given the above concerns, we encourage the PSR to consider other options that could achieve the Joint Regulatory Oversight Committee's (JROC's) goals, while avoiding the risks and unintended consequences created by the PSR's current proposals. We believe the PSR should be creating a level playing field that enables the competitive development of different VRP solutions and commercial models. This would increase customer choice and encourage innovation and investment that delivers a high-quality user experience and ensures VRPs are secure.

One potential option would be for the PSR – together with the other JROC members – to set out the essential elements any MLA should have and the outcomes they expect to be delivered. For example, the JROC could specify that an MLA should ensure that the customer receives clear and adequate information about the VRP service they are signing up to and can obtain prompt and appropriate redress if things go wrong. Potentially, the JROC could also make clear that ASPSPs and TPPs should only join an MLA that meets the outcomes it sets. Such an approach would enable competition in VRPs by providing clarity on the JROC's expectations, while letting the industry work out how best to deliver them. For example, the JROC would not specify the pricing arrangements for VRP, which are best left for market forces to determine. This is most likely to deliver good customer outcomes – industry has the flexibility to innovate to meet customer needs and bring different solutions to market, within clear boundaries set by regulators.

To further support competition, the JROC could also sponsor piloting of VRP solutions. This could be delivered quickly and would allow industry to test and demonstrate different ways of meeting the JROC's minimum expectations. It would be important that different MLAs, not just one, be able participate in piloting to maximise the potential learnings and encourage innovation.

Xplor Technologies

[redacted]

From: [redacted]
Sent: 06 August 2024 15:51
To: [redacted]
Subject: Re: Response req: UK payments regulation: Publication of Non-confidential VRP consultation responses.

[redacted]

Hi there,

Here's a comment from Xplor Technologies. Thank you for the chance to contribute and for extending the deadline for us too.

Xplor Technologies have expressed concerns for the UK PSR's pricing proposal for extending Variable Recurring Payments (VRPs).

Our concerns are focused on the impact of a distorted pricing model on the direct debit market. The Joint Regulatory Oversight Committee (JROC), the PSR and [Future of Payments Review] have all focused on open banking offering genuine competition to cards. However the low-risk use cases within the scope of the PSR's Phase 1 proposals will create artificially low-priced competition with Direct Debit, when no one has suggested Direct Debit is too expensive or that it delivers a poor customer experience.

If merchants look to replace Direct Debit payments with commercial VRPs, there will be no way for merchants to 'bulk switch' from VRP back to BACS, or even to another VRP provider if their experience is sub-optimal. We believe it's important for merchants, payers and payees to have more choice when it comes to payment methods, without disadvantaging Direct Debit, the consumer protection it provides, and the industries that rely on its universal accessibility. Making commercial VRP's cheaper than Direct Debits could lead to negative outcomes for payers who are unaware of the lack of protection for online purchases. We would urge the PSR to conduct a deeper analysis of appropriate pricing for banks to charge PISPs for commercial VRPs, this should not be zero.

[redacted]

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xplor

[redacted]

xplortechnologies.com

[redacted]

[redacted]

Yapily

CP23/12 Expanding variable recurring payments: Call for views

Yapily consultation response

2 February 2024

Key points

- Yapily strongly supports the PSR's ambition to expand the use of VRPs and to ultimately see their broad usage for account-to-account based retail transactions
- Yapily fully supports the development of a commercial model and multilateral agreement that appropriately incentivises and binds all parties in the payments chain to delivering high-quality and competitively-priced end user propositions
- Key to the ultimate success of VRPs will be their enablement in retail use cases with costs that are lower than debit card interchange and scheme fees - the PSR should make these target outcomes explicit and prioritise their realisation in Phase 2 and beyond
- To address the need for sufficient market coverage to drive merchant adoption, Yapily supports mandating large ASPSPs to support non-sweeping VRPs
- The PSR's work on Phase 1 should not risk delay or delivery of Phase 2 and beyond - work should proceed on both in parallel. To this end, we propose an adjusted pragmatic approach to Phase 1
- To support Phase 1 engagement and progression to Phase 2, PSR should set out its current thinking on Phase 2 commercial models at the next available opportunity (including with respect to use cases within scope of Phase 1)

Yapily welcomes the PSR's call for views on the expanding VRPs. We fully support the PSR's ambition to expand the use of VRPs and to ultimately see their broad usage for account-to-account based retail transactions.

Instead of providing our views on the specifics of the PSR's proposals, we have set out our views on the expansion of VRPs more broadly.

Introductory remarks: A path to realising material end user benefits through VRP expansion

Yapily is at the centre of driving innovation and competition in open banking payments. We are already leveraging open banking functionality to deliver faster, more secure, and better value payment services to end users.

However, variable recurring payments for use outside sweeping remains a critical missing piece of open banking functionality. Once broadly available, non-sweeping VRPs will play a key role in enabling open banking to functionally compete on a level playing field with existing incumbent retail payment methods across a broad set of use cases.

In particular, Yapily views that the largest potential and opportunity for end user benefit from non-sweeping VRPs lies in their use in retail payment scenarios where debit cards are currently the main form of payment acceptance. It is therefore critical that the PSR clearly identify this as an ultimate goal and work towards enabling VRPs in these scenarios as quickly as possible.

Yapily believes that to ultimately realise this outcome, non-sweeping VRPs will need to be underpinned by a commercial model and multilateral agreement that appropriately incentivises and binds all parties in the payments chain to delivering high-quality and competitively-priced end user propositions (on both the consumer and merchant ends of the payment).

In practice, this means any steady-state commercial model for VRP needs to facilitate a fee paid by PISPs to sending ASPSPs to incentivise the development and ongoing support of compelling VRP consumer user experiences.

On the merchant side of the market, it is abundantly clear to us that the overriding driver of interest from businesses in considering adoption of VRPs is reducing their cost of payments acceptance relative to that currently paid for cards. As a result, we think this should be adopted as a “north star” outcome that the PSR explicitly targets as its VRP work progresses.

There has now been a period of extended debate surrounding the potential expansion of VRPs outside sweeping. For both industry and regulators to maintain credibility and momentum behind VRPs, particularly in the merchant community, we think it is critical that real and tangible progress is realised in 2024. Seeing initial use cases of low risk non-sweeping VRP live before the end of year is therefore a key priority. Further, we would welcome measurable progress towards development of an MLA and commercial model for a broad set of VRP use cases (including a target delivery date) - we view a collaborative approach between industry and regulator as being the best way of achieving this at pace.

Comments on the PSR’s proposals to begin expansion of VRPs

The PSR has proposed a phased approach to support the expansion of VRPs into non-sweeping use cases, and set out a number of potential policy interventions to underpin this approach:

<table>
<tr><td colspan="4">Phase 1 scope:
Begin VRP expansion by enabling use in certain low-risk use sectors
Utilities, Government and Financial Services</td></tr>
<tr><td>Enabling intervention A:</td><td>Enabling intervention B:</td><td>Enabling intervention C:</td><td>Enabling intervention D:</td></tr>
</table>

Mandate CMA9 participation	Direct Pay.uk to develop an MLA	Require zero price to be levied on TPPs by sending ASPSPs	Remove central infrastructure charges for Sending ASPSPs for Faster Payments

We provide our comments against each element of the proposals below. Given the issues we outline regarding the current proposals, we then present a high-level proposal for a potential amended and pragmatic approach to Phase 1.

Phase 1 scope: Begin VRP expansion by enabling use in low-risk sectors - Utilities, Government and Financial Services

As a general observation, the primary existing method of payment acceptance in the identified low risk sectors is direct debit. While VRPs are able to function as an alternative to direct debit, our view is that the potential realisable end user benefit from migrating from direct debit to VRP is orders of magnitude lower than that possible for use cases where there is migration from card payments.

Given this, the approach to Phase 1 should not distract or risk delay the development of a Phase 2 commercial model/MLA. The potential for material end user benefits overwhelmingly lies in use cases outside the Phase 1 scope, such as ecommerce.

In practice this means that as pragmatic an approach as possible should be taken to accelerating delivery of Phase 1. Phase 1 still has an important role to play in demonstrating market progress on VRPs and to start demonstrating real-world usage outside sweeping use cases. An outline proposal for a potential approach is presented below (see section titled “A proposal for an amended and pragmatic approach to Phase 1”)

Enabling intervention A: Mandate CMA9 participation

We strongly agree that the PSR should mandate certain ASPSPs to participate in Phase 1. Given the current limited level of material proactive bank engagement in industry efforts to progress VRP, consideration of mandation for Phase 2 is also likely to be necessary.

There is a clear coordination failure in the market at present - we have had conversations with the majority of the CMA9 about expansion into non-sweeping VRP and, with the exception of Natwest and two other banks, the majority have stated that they are not planning to develop non-sweeping VRP, even when offered commercial terms. Without mandating coverage, there will be gaps in provision, and VRP won’t be able to compete with other payment methods that have ubiquitous provision across banks.

However, we don’t believe the CMA9 grouping is the right approach - this is not about the CMA market investigation and the market has moved on significantly since that work. The PSR should instead look at Faster Payment market share data by bank (specifically, outbound Faster Payment share originating from consumer payment accounts).

We believe mandating at least the six largest UK ASPSPs (Barclays, HSBC, Lloyds, Nationwide, Natwest, Santander) would likely enable ~90% market coverage and should be the starting point for mandating coverage. This scale of coverage should support realisation of the appropriate 'network effects' and give comfort to merchants that a significant share of the market is covered.

Enabling intervention B: Direct Pay.uk to develop an MLA

Yapily has concerns over Pay.uk's capacity and ability to deliver a phase 1 MLA in a timely manner. Reasons include:

- Pay.uk already have a number of major in-flight initiatives to deliver which will take priority over VRP, such as:
    - Delivering the NPA (while currently on hold, work may resume or have knock-on resource requirements)
    - Delivering APP fraud reimbursement model and enhanced data sharing
    - Maintaining service for FPS, Bacs etc
    - Maintaining the CoP service
    - Maintaining the Current Account Switch Service
- Pay.UK does not have a track record of delivering things quickly or efficiently - the NPA for example, is years behind schedule.
- Pay.UK does not have an established track record of engaging with open banking stakeholders (bar some infrequent high level roundtables)

We also have a general concern around the deliverability of an MLA that would see low risk use cases live in Q3, regardless of which entity is appointed to lead.

In our view, longer term, the OBL/the Future Entity are more suited to playing a central role in governing a steady-state VRP MLA and commercial model.

Under our proposal for an amended and pragmatic approach to Phase 1 (as set out below), there is no requirement for an MLA. A body would still be required to coordinate a managed roll out of limited low risk use cases - we think this role could be fulfilled by OBL (who completed the managed roll out of sweeping VRPs) with not much more material/development/resource than they have today.

Enabling intervention C: Require zero price to be levied on TPPs by sending ASPSPs

The proposed Phase 1 commercial model is not an appropriate steady-state model for VRPs. As set out in the introduction, Yapily sees the need for any steady-state commercial model for VRP to facilitate a fee paid by PISPs to sending ASPSPs to incentivise the development and ongoing support of compelling VRP consumer user experiences.

In general, we think more thought is needed on approaches to pricing for a steady-state commercial model, including whether a regulator is best placed to lead on developing this.

We think it will be difficult to adopt a standard cost-based approach to price setting in this specific context. Banks providing current/payment accounts provide multiple services (ability to make/receive payments, overdrafts, savings, mortgages etc), and have multiple income streams (net interest income, fee revenue) and cost centres. There are complex issues around cost allocation and cross-subsidies that would need to be considered under such an approach. We believe a cost recovery model alone could lead to protracted arguments about what costs need to be recovered and levels of appropriate underlying assumptions (amortisation periods etc.).

There are a range of different possible approaches to price setting, in both regulatory and commercial contexts, and a fuller assessment of which approach(es) are most appropriate is still required.

We think it likely the most appropriate approach will employ a combination of approaches to deliver a range of credible potential prices, within which a final price can be triangulated. Potential approaches to complement a cost-based approach may include willingness-to-pay type approaches (a form of which - the merchant indifference test - was adopted in the Interchange Fee Regulation). We think an overriding consideration for the PSR should be ensuring any approach is supportive of delivering a cost of payments to merchants that is less than that for debit cards.

However, on the basis of pragmatically demonstrating timely market progress, to start demonstrating VRP as a proposition outside sweeping, and to avoid the need for an MLA for Phase 1, we support adoption of zero price for initial Phase 1 roll out - as long as it is accompanied by an upfront confirmation from PSR that the Phase 1 commercial model will not persist into perpetuity (this will be particularly important in managing expectations of merchants looking to participate in Phase 1).

Enabling intervention D: Remove central infrastructure charges for Sending ASPSPs for Faster Payments

We do not think amendments to the central infrastructure charging arrangements for Faster Payments is appropriate to support Phase 1 for the following reasons:

- *currently, a single set of per-item/click fees is consistently charged across all types of Faster Payments. Removing charges for a subset of Faster Payments will thus represent a change from current practice and is likely to have a number of material impacts on technical and operational processes at Pay.uk. As outlined above, Pay.uk has a number of other material items in their delivery pipeline. As a result we query the deliverability of these changes to support a Q3 go-live timeframe for Phase 1;*
- *the PSR's position is that the Phase 1 commercial model is not the correct long-term position and so any changes at the infrastructure level may not be consistent with a steady-state model; and*
- *sending banks currently already pay outgoing fees to Pay.uk on faster payments sent from their consumer accounts without receipt of any direct inbound fees (consumers are typically not charged for sending - or receiving - faster payments).*

However, we do think there a number of related strategic issues that the PSR should look into to support wider adoption of VRPs:

- The central infrastructure costs of sending and receiving Faster Payments remains expensive. Driving these infrastructure level costs down will be an important part of

facilitating broader use of VRPs for retail payments, particularly at lower transaction values.
- The costs levied by receiving banks on merchants to receive incoming Faster Payments into business bank accounts can be significant and also materially impact the economics of a merchant looking to accept VRPs. Given this, the PSR should look into receiving ASPSP's charging practices to businesses for inbound Faster Payments.

A proposal for an amended and pragmatic approach to Phase 1

Yapily recognises that the PSR's proposed 'Phase 1' is an important and pragmatic starting point to begin expansion of VRP usage. We are keen for it to be delivered without delay.

A multilateral agreement (MLA) is key to coordinating and clarifying the necessary elements in the long-term development of Phase 2 use cases (including e-commerce). However, we don't believe Phase 1 should be dependent on an the development of an MLA because:

- The key goal should be to have low risk non-sweeping VRP low risk cases live in 2024.
- Developing a full MLA by Q3 2024 is very ambitious and there is a real risk of delay.
    - The shared rulebook at the heart of the MLA will take months to agree and finalise, discussions facilitated by UK Finance to develop model clauses have already shown this to be a complex task, which is already delayed;
    - Systems will need to be updated to differentiate between commercial and free PSD2 API calls/ faster payments.
    - Billing mechanisms will also need to be built individually by each bank participant, and integrated by each TPP.
- The intention of an MLA is to manage issues such as disputes - but, as the PSR notes in its consultation - Phase 1 use cases are low risk and disputes are unlikely. These could be mitigated through commitment to a code of conduct or similar softer mechanism by participants, drawing on the work being done on model VRP clauses by a UK Finance-convened group of banks and TPPs.
- If the price is set at zero, no contracts are practically required
- OBL could be given responsibility for managing what is essentially a repeat of the sweeping VRP managed roll out they have already undertaken, but for broader set of use cases

This approach would allow industry to focus over the coming months on preparing for Phase 2. During this time, the PSR should work with industry on development of an MLA and approach to pricing for Phase 2 and beyond.

Approach to Phase 2 and beyond

To facilitate and expedite delivery of Phase 2, we think the PSR should explore adoption of a collaborative approach with industry to developing the commercial model and MLA. Under such an approach, we would propose:

- the PSR would set out the outcomes it expects the process to deliver (for example, realising a cost lower than debit card interchange and scheme fees) and by when (e.g. Q4 2025 per December JROC publication), providing final decisions on contentious issues, supporting with management of competition law risks, and maintaining a credible threat of intervention should progress stall.
- Industry would be tasked to develop the specifics of the MLA and commercial model (likely involving engagement of independent third-party subject matter experts with close regulator oversight to ensure this is not unduly delayed or cost prohibitive).

Work on such an approach should begin immediately and run in parallel with Phase 1.

PUB REF: CP23/12 Submissions

12 Endeavour Square
London E20 1JN
Telephone: 0300 456 3677
Website: www.psr.org.uk