

Speech

Paul Smith at the Payments Innovation Conference in South Africa

Speech by Paul Smith, Head of Regulatory Strategy and Policy at the PSR, at the Payments Innovation Conference in Johannesburg on 6 October 2017.

“

It's a huge pleasure to be invited to speak today at this conference about the South African payments sector. I want to particularly thank the Reserve Bank for inviting the UK Payment Systems Regulator (PSR). I've really enjoyed the conference so far. It's been great to hear about the exciting developments and challenges you face in South Africa for payments. It's also great to share our experiences in the UK.



Paul Smith

It is so often the case at these types of events that we can learn a lot from each other, even if our countries have apparently quite different payment experiences. Although we must acknowledge that some of your challenges are not our challenges, and vice versa.

The PSR's role

The PSR is, I think, unique. There is no institution in the world with quite the same role and powers. Particularly a regulator separate from, but working closely with, our central bank. And a regulator that is independent of the industry. However, what are trying to achieve is not necessarily unique. I visited Australia earlier this year, and their Reserve Bank has a Payments division that has policy priorities that are similar in a number of respects to ours. I think we can say the same for South Africa, especially having heard the Deputy Governor and Tim Masela speak at this conference.

The PSR has existed for about three and a half years, with our full legal powers existing for about two and a half years. We are an economic regulator. We monitor and enforce various EU directives. We are also a concurrent competition authority, which means we can apply competition law within the activities we regulate.

We have three statutory objectives, which are to promote competition, promote innovation, and to act in the interests of service-users. We must also have regard to financial stability. We consider that these duties work well together, leading to a policy agenda that places the interests of those who use payment systems at the heart of our decisions, and seeks to create a dynamic and vibrant payments sector in the UK. By users of payment systems we mean not just banks, building societies and money transfer companies, but also you and me as retail users of payments, and corporate users, such as shops, large and small.

We directly regulate eight UK payment systems. You'll see that these are a mix of our domestic interbank schemes and the international card schemes. We also have regulatory powers for the payment service providers (PSPs) and infrastructure providers for these systems.

The UK payments sector

We enjoy a very reliable payments sector in the UK, almost to the point where this is taken for granted. Any disruption to the customer experience would be significant news. We also benefit from having had one of the earliest same-day interbank payment systems: Faster Payments started in the UK in 2008.

We are experiencing some changing trends in payments. Contactless payments have already reached around a third of UK card payments according to the UK Cards Association, although their average value remains low. £30 – about 500 rand - is the maximum value for a contactless payment. The number of transactions using cash is steadily declining. In 2016 cards accounted for more than half of all purchases, according to the British Retail Confederation. There are an increasing range of devices that can be used for payments, although phones are the strongest growth area. The ability to accept card payments is becoming increasingly ubiquitous across smaller merchants.

For all the positive aspects of our payment systems, there are frustrations that are driving the need for change. The PSR was created to help address some of these frustrations – in particular, the speed of change and the lack of focus on what users want. In this speech I'm going to talk about three particular areas of change in the UK payments sector, which hopefully will be interesting and relevant to South Africa. These are:

- improving access choice and quality for interbank payment systems
- collaborative innovation to improve the UK interbank payment systems
- Open Banking and PSD2

Access

When the PSR was set up, one of the key concerns of stakeholders was getting access to UK interbank payment systems. There had not been much interest in getting access for many years. But following the financial crisis there was a much greater focus on promoting challenger banks. There was also a recognition that the traditional agency bank access model may not be the best option for all access seekers: I don't want to have to use my competitor for access. Overall, there were concerns that onboarding took too long, access cost too much, and quality was variable. Our open access programme has been a cornerstone of our work and it is now delivering meaningful results for service-users. It can also facilitate more competition in retail banking, and payment service provision more widely.

In the last year or so we have seen real improvements, including:

- **Choice:** There's been a significant improvement in the choice of access options available to PSPs. The payment system operators have been working to make it easier for PSPs to become direct participants in payment systems. Direct participation in the interbank payment systems increased in 2016 and looks set to increase considerably throughout 2017. We have also seen three new entrants into the market for providing indirect access to payment systems – ClearBank, BFC Bank and Raphaels Bank. This gives PSPs that choose indirect access a greater choice of indirect access provider (IAP).
- **Time:** The operators have improved their processes for new PSPs joining as direct participants, reducing the time and complexity of joining. For example, recent joiners, such as Metro Bank, have reported very positive experiences of the process for joining Faster Payments. Another bank joined Faster Payments in seven months.
- **Value:** The cost of getting direct access appears to be reducing. We've been told it's gone from between £2.5 million and £4 million in December 2015 to around £1.2 million to £2.5 million for recent joiners. We also expect the new IAPs to increase competition in the provision of indirect access, which could lead to lower prices.
- **Quality:** For PSPs who choose indirect access, there have been improvements in the quality and availability of technical access to Faster Payments. For example, two IAPs – Barclays and HSBC – are now offering 'direct agency' access to Faster Payments. This allows PSPs to connect to the Faster Payments central infrastructure directly, giving their customers the same quality and availability of access as direct participants.
- **Engagement:** The operators and IAPs have taken steps to increase transparency of information and to engage with service-users. For example, the operators have produced a joint guide intended to help organisations consider their access options for the interbank payment systems.

A particularly exciting initiative for the next year is the opening up of direct access to Bank of England settlement accounts to non-banks. This could include money transfer companies and e-money licence holders. This will allow these businesses to get direct access rather than using agency providers. They will, of course, be required to meet regulatory standards set by our Financial Conduct Authority.

Compared to when the PSR was set up, many stakeholders feel we have made real progress to improve access to interbank payment systems. There is always more we can do, and the operators continue to work actively on this issue – but the presence of so many challenger banks and new business models, with access options that work for them, is a strong indicator of the progress we've already made.

Collaborative innovation

I was particularly pleased to receive and accept the invitation to speak at this conference because it was an opportunity to talk about innovation. And specifically the exciting work that the PSR is doing, with support from so many in the UK payments sector, to allow exciting innovations to develop. Payments are ubiquitous in so much of our lives. They are the means by which we can purchase the necessities of life, but also enjoy our leisure time. So we will always need reliable and secure payments. But the PSR was created because there was believed to be an opportunity to increase the pace of innovation, while maintaining the reliability and security of payments.

The payments sector is characterised by lots of what I would describe as private innovation. This includes more payment options on mobile phones; making it easier for smaller merchants to accept a greater range of payments; more functionality at ATMs, etc. But a key issue identified when the PSR was set up was innovation that required collaboration within the industry. Historically this was seen as too slow, not inclusive, not user-focused, and only delivering when the government stepped in. I want to highlight in particular the work of the Payments Strategy Forum in promoting more inclusive collaborative innovation.

The Forum is a multi-stakeholder body that the PSR created. The Forum included a number of the largest banks, but also challenger banks, customer representatives, corporate users of payments, government and fintechs. We knew that this could create challenges in terms of reaching agreement. But we expected that the process of debate and challenge amongst the stakeholders would help to develop high quality outcomes. To help facilitate this process of debate, we appointed an independent Chair, Ruth Evans. Ruth has played a key role, particularly in facilitating the discussion between stakeholders and forging agreement.

When we set up the Forum, there were sceptics as to whether this approach would deliver. But as a regulator we understood that the industry, in its broadest sense, contained a huge amount of knowledge. But unlike what had happened previously, we recognised the vital importance of an inclusive approach. This was intended to help generate broader support for any proposals the Forum developed – but also to make sure that all of the relevant voices were involved in the discussions and the development.

We are now at a key, but also very exciting, stage of the Forum's work. The Forum published its strategy last year and, in July, a more detailed blueprint, which could transform the UK interbank payment systems. The blueprint aims to deliver new and better services to users of payments systems.

These services focus on:

- Giving users more control – such as request to pay. As a user I have more control than with direct debit about the timing and amount of my payment. As a business I reduce the risk of payments not being made.
- Making use of extra message capacity through ISO20022 – such as enhanced data. As a business I can attach invoices to my payments and integrate payments in to my accounting package.
- Helping to fight fraud – such as confirmation of payee. As a customer I can make a payment to a new payee with more confidence that I am paying the person I intend to.

The Forum has estimated benefits of £11 billion to £14 billion over ten years from the introduction of these services.

But this is just what we know about, can anticipate, and what the Forum can quantify. What the Forum is proposing creates the potential for new services, including ones nobody has yet thought of.

The Forum's blueprint is for a layered and much more agile system than the current Faster Payments, Bacs and cheque systems. This should allow new services to be introduced more quickly and more cheaply. And with the concept of overlay services, it should allow those services to be introduced within a competitive market.

I visited Australia earlier in the year to see the development of their faster payments system. It was exciting to see the ideas developing in that market for new and innovative overlay services. With more players and a bigger market, the UK should have the capacity to do even more.

For the PSR a key issue in the final stages of the Forum's work is implementation, and managing the risks associated with this. It is a large change programme for industry. We are aiming to start the migration to the new architecture from 2020. Our existing systems will initially run in parallel with the new architecture. While this is a challenging timetable, it is an exciting opportunity to develop the UK interbank architecture to be fit for purpose for the future, and deliver greater benefits to users.

PSD2 and Open Banking

One of the most exciting potential aspects of the new architecture is how it can help realise some of the benefits of PSD2 and Open Banking. At the heart of both of these changes is unleashing innovation in retail banking and payments through supporting access for new businesses, and principally fintechs.

PSD2 is a European Directive that comes in to force on 13 January 2018. It mandates that banks should open up access to customers' account information to third parties, where the customer has consented. This creates the opportunity for approved third parties to offer innovative services. This could include moving money around to get better interest rates.

In the UK, the provisions of PSD2 are further facilitated by the APIs created through Open Banking. This is work that our largest banks have been required to do by the Competition and Markets Authority, our overall anti-trust authority. APIs are a potentially more standardised way for third parties to access customer account information.

We think it is fair to say that the UK is ahead of many other countries in thinking about Open Banking. I would encourage you to look at what is happening in the UK and the EU to see what you might take from it to improve competition and consumer outcomes.

Conclusion

It's often a challenge when you give a speech at a conference in another country, to a largely domestic audience, to pitch your speech appropriately. I hope in the relatively short time I've spoken for I've given you a sense of the exciting and significant change in the UK payment sector. I also hope I've given you a sense of how the PSR, as a dedicated regulator, is trying to address the issues that led to our creation, and promoting positive change.

You will understand your local circumstances and challenges far better than me. Therefore, I will resist any sense of telling you what to do. But I would encourage you to continue to have the interests of users of payment systems and services front and centre in your thoughts. And to have a broad view of what a user is when you think about their interests.

We know as the PSR that there is much we can learn from the experiences of other countries. I hope today can be the start of a regular and fruitful dialogue between the PSR and the South African payments sector.

”