Payment Systems Regulator

Expanding variable recurring payments

Response to the call for views (CP23/12)

August 2024

RP24/1

Contents

1 Executive summary

1.1 Variable recurring payments (VRPs) enable customers to safely connect authorised payment providers to their payment account using open banking so that they can initiate recurring payments. These payments only occur with express customer consent, can be made at flexible intervals and can vary in amount within pre-agreed limits. We want to extend VRPs to enable payments between accounts in different names (non-sweeping VRPs). In this document we refer to this new payment functionality simply as VRPs.

1.2 In December 2023, we published a call for views (CP23/12) that set out our initial proposals on how to expand VRPs into new use cases, through a Phase 1 roll-out.[1] We received 39 responses from across the open banking ecosystem.

1.3 We are now publishing our response to the call for views and making public all the non-confidential responses we received.

Initial proposals and responses

1.4 We can summarise our initial proposals, the feedback we received from stakeholders and how we plan to develop our proposals further as follows:

Coordinating expansion through a multilateral agreement

1.5 There was support for our assessment that greater coordination is needed to expand VRPs. Concerns were raised around the need for a multilateral agreement (MLA) to facilitate that coordination, the extent to which the MLA should include a central price and Pay.UK's capacity to deliver the MLA on time. We continue to think that an MLA could be an efficient way of managing relationships between sending firms and payment initiation service providers (PISPs). However, we acknowledge the concerns with our proposal on who could operate the MLA. We will therefore work closely with participants of the VRP implementation group to look at what specific rules and provisions an MLA should include and who might be best placed to operate it.

1 We propose to initially enable VRPs for payments to regulated financial services, regulated utilities sectors and local and central government. We call this initial roll-out 'Phase 1'.

Mandated participation

1.6 Respondents mostly supported some level of mandated participation, but some said we should not rely on the concept or terminology of the 'CMA9' (a term adopted by the CMA Order to denote the nine banks and building societies identified at the time of the implementation of and subject to the CMA Order in 2017 as the largest) when considering who should be mandated. We agree with the feedback that we should not use the concept of the CMA9 beyond the purpose of the CMA Order. We still think a sufficiently large number of payment accounts supporting VRPs is crucial to Phase 1's success. We remain concerned that offering sufficiently strong financial incentives to motivate enough sending firms to offer access to VRP Application Programming Interfaces (APIs) could hinder or discourage wider adoption. We will continue to develop our thinking on whether mandated participation is necessary and how to identify firms we might mandate and will set out updated proposals in the autumn.

The pricing principles and a possible price intervention

1.7 While more respondents than not suggested some form of central price, there was a wide diversity of views on how best to price API access for VRPs in Phase 1 and no single approach garnered wide support. Respondents highlighted that determining a price based on a cost recovery approach may be challenging, as there may be relevant but as yet unknown costs beyond the Faster Payments charge to sending firms. We will evaluate the suitability of alternative access prices or approaches, including those alternatives suggested by respondents. This includes price setting based on pricing models in other payment systems, pricing based on a cost-recovery approach, including an economic return for sending firms, a 'black box' approach and some form of arbitrated price. We will also consider the potential effectiveness of interventions that do not establish a VRP API access price, such as price transparency or reporting requirements. We will update stakeholders on our analysis when we publish our updated proposals for consultation in autumn.

Further developing our proposals

1.8 When we set out updated proposals, they will include:

- the specific rules and provisions an MLA should include - if we continue to believe that one is required
- the organisation we think may be best placed to operate any such MLA
- our view on whether mandated participation may be required and whom we may mandate to participate in Phase 1
- our plans for determining a VRP API access price - if we decide this would be required
- the costs and benefits we expect from any proposed intervention – if we decide that this would be required

1.9 We welcome and will seek further dialogue with interested stakeholders in the coming months. Interested stakeholders who would like to get in touch with us ahead of our publication in the autumn can email us at a2a@psr.org.uk

2 Introduction

As part of our wider effort to enhance competition and promote innovation within the UK's payment systems, we want to expand the use of VRPs to a wider set of use cases.

We launched a call for views (CP23/12) on our initial ideas about how we might support the expansion of VRPs. We are now publishing the industry's feedback on our key proposals and how we intend to progress in light of those views.

2.1 In line with the JROC vision for open banking, we believe that open banking can enhance competition and innovation within the UK's payment systems. We think that account-to-account transactions can significantly benefit consumers and businesses, for example, by providing lower prices for payments, greater flexibility and control over finances.

2.2 One way to deliver account-to-account payments is through open banking. It allows consumers and businesses to grant third-party providers (TPPs) secure access to their payment accounts. This lets customers make payments without using cards, standing order, or direct debits. Open banking could foster the creation of new user-friendly fintech products, from budgeting apps to new payment acceptance products for businesses.

2.3 We see real potential for open banking-enabled account-to-account payments to provide an alternative to card payments, both online and in person. As a first step towards this long-term goal, we have been working closely with the open banking sector to expand and improve variable recurring payments (VRPs), which we believe can provide some of the functionality needed.

2.4 VRPs are enabled through open banking. They are payment instructions that allow customers to safely connect authorised payment providers to their payment account to make recurring payments. These payments only occur with express customer consent, can be made at flexible intervals and can vary in amount within pre-agreed parameters.

2.5 Implemented well, VRPs offer consumers and businesses a range of benefits, as illustrated in Figure 1. They can offer dashboards that provide more visibility and control, they can be configured to only initiate payments if sufficient funds are available; and they can reduce the risk of errors given the pre-populated payment details. VRPs can also reduce costs for billers as payment schedules can be aligned more flexibly to customer incomes and provide real-time settlements. Meanwhile, increased competition with existing payment methods could result in better services for consumers and merchants, and lower prices for payments.

Figure 1: The benefits of VRPs to consumers and businesses

Potential benefits of VRPs

Supporting all customers

For example, vulnerable customers who are on irregular incomes will be able to pay more for goods and services through VRPs. VRPs can likewise be configured to only make payments if the customer has sufficient funds.

Fewer misdirected payments

VRPs offer improved payment matching through the use of open banking technology. This will avoid payments being misdirected and provides added assurance to both the payer and payee when a payment is made.

Smarter billing

The increased flexibility can better align payment schedules with variable customer incomes. VRPs can be configured to only make the payment if the customer has sufficient funds in their account – reducing the risk of failed or bounced payments and associated costs for firms, and anxiety for customers.

Immediate settlement

Payments are made in real time so customers can immediately understand what they have paid and how it impacts their finances.

Furthermore, as payments made by consumers will be received by the merchant immediately, this will enhance cashflow.

Backend efficiency

As VRPs are ultimately a recurring payment method, they can offer reduced costs to serve – as Direct Debit does – compared with irregular payments, which can save backend administration costs.

2.6 In January 2024, Open Banking Limited (OBL) recorded 14.5 million open banking-enabled payments, with 8% of these being VRPs. At present, however, the majority of these VRPs are between accounts belonging to the same person. This is partly due to an obligation on the nine largest consumer banks to enable these 'sweeping' VRPs.[2] We want to support the expansion of VRPs to payments between accounts in different names. This will extend the benefits of VRPs to more consumers and businesses.

2.7 There is industry support for expanding VRPs. In February 2023, the Strategic Working Group (SWG) published a report that captured strong industry appetite to expand VRPs for use cases where payments are made between accounts in different names. While there is currently no obligation on firms to enable VRPs for payments between accounts in different names, the SWG suggested the introduction of such VRPs in low-risk use cases.

2.8 In April 2023, as part of the JROC, we published our recommendations for the future of open banking in the UK. One of the key priorities we identified in the report was to promote additional services and to unlock open banking's full potential for payments. We see the expansion of VRPs as crucial to fostering continued innovation in open banking and ultimately as a step towards account-to-account-based retail transactions.

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2 CMA Order

2.9 To support these goals, we chaired the VRP working group (VRPWG), comprised of industry participants, businesses and a consumer representative, and tasked with developing a blueprint for expanding VRPs. The VRPWG achieved significant progress in identifying the necessary next steps to expand VRPs and, in line with the findings from the SWG report, it suggested the expansion of VRPs to three additional low-risk use cases initially. We call enabling VRPs for these purposes Phase 1.

2.10 For Phase 1, the blueprint nevertheless suggested some enhancements to maximise functionality and improve the overall user experience. It also recommended the creation of a dispute mechanism process to manage communication between parties when something goes wrong with a payment. Finally, the blueprint emphasised the need for a viable and economically sustainable commercial model, while recognising views differed on how best to achieve this. To accelerate the delivery of a viable model, the VRPWG recommended the regulators consider a number of different options, ranging from a regulatory set price to a fully market-led approach.[3]

2.11 In our response to the VRPWG's blueprint, we called on Pay.UK and OBL to chair implementation groups tasked with making the proposed changes to functional capabilities and dispute resolution processes.[4] We also outlined our view that the implementation groups should consider additional technical challenges including how VRPs may be practically limited to the specific use cases of Phase 1.

2.12 While we have been encouraged by the industry's appetite to expand VRPs, it was clear that in several areas stakeholders could not reach agreement. This was particularly the case for a commercial model for VRPs.

2.13 In December 2023, we called for views on our initial thinking about how we could support the initial rollout of VRPs for Phase 1 use cases. Our call for views (CP23/12) set out our thinking on the changes we felt might be needed.

2.14 We proposed:

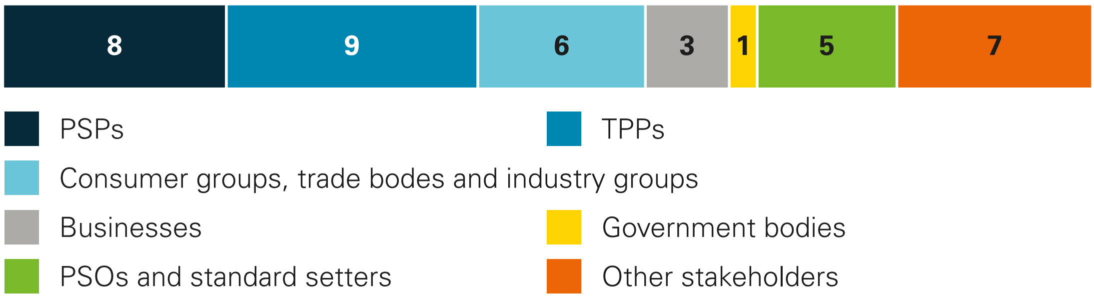
- a multilateral agreement (MLA) specifying the required functionality along with arrangements for pricing, dispute resolution and liability
- using our powers to set the parameters for a central price for VRPs based on a cost recovery model for the sending firm that applies our previously published pricing principles and enables sending firms to cover relevant marginal costs. We provisionally identified the Faster Payments charge as the only relevant cost for the initial rollout, which we proposed to remove for sending firms
- setting at zero the price sending firms can charge payment initiation service providers (PISPs) for access to customer accounts and payment initiation if we determine the Faster Payments charge to be the only relevant marginal cost for sending firms for the initial rollout, and if we subsequently take action to remove that charge for sending firms
- mandating the participation of the nine largest banks in the UK in the MLA

3 VRP Working Group - Blueprint

4 Response to the VRP Working Group's blueprint for non-sweeping VRPs

2.15 The call for views on these initial proposals ran from 18 December 2023 to 2 February 2024. In total, we received 39 responses from stakeholders across the sector (see Figure 2). These included payment system providers (PSPs), third-party providers (TPPs), consumer and trade groups, individual businesses, a government body, payment system operators (PSOs) and standard setters. The other stakeholders included submissions from individuals, consultancies, and Direct-Debit processors.

Figure 2 Breakdown of respondents to CP23/12 (by respondent type)



2.16 We are still analysing the suggestions from respondents, but at this stage, we still think that realising the full benefits of VRPs may require some level of regulatory action. In the next section, we summarise the feedback on our proposals. Where possible, we also set our current thinking, highlight the questions we will explore further and explain how we plan to reach decisions. We will continue to seek industry input and support throughout this process.

2.17 We aim to publish a set of updated proposals on expanding VRPs in the autumn, along with our draft cost benefit analysis. This will give all stakeholders another opportunity to comment.

3 Response to the call for views

Our call for views included a total of 22 questions that can be grouped into four themes:

- the need for a multilateral agreement and possible mandated participation
- pricing principles and a possible price intervention
- alternative ways of pricing VRP API access
- the costs, benefits and equalities impact of our proposals

Respondents broadly supported greater coordination, although they varied on explicit support for an MLA. Over half the respondents agreed that participation should be mandatory for some firms, while a quarter disagreed. We still believe an MLA could provide consistency across functionality and dispute mechanisms efficiently. We recognise the challenge to the use of the concept of the 'CMA9' but continue to consider that network effects are critical to VRPs. We continue to consider whether mandated participation may be necessary and who might be mandated. We will continue to explore what rules and provisions an MLA should include and who might operate it.

There was no clear majority either for or against our pricing principles, but respondents broadly agreed on the need to establish a sustainable commercial model. We will consider challenges regarding the pricing principles and how the principles may interact with the Consumer Duty. We will publish our updated thinking at our next consultation.

Similarly, views differed on the need for a central API access price and on our proposals for how it should be determined. While we agree with respondents who pointed out that there is competition in the provision of current account services, we remain concerned about sending firms' control over TPP access to sending firms' VRP APIs. We still consider that regulatory action to establish a central access price may be necessary. However, we will evaluate alternative approaches, including those suggested by respondents. These include prices based on pricing in other payment systems, pricing based on cost-recovery (including models that allow a return for sending firms), and an arbitrated price (including a 'black box' or regulator-led approach). We will update stakeholders on our analysis when we publish our updated proposals for consultation in autumn.

Our call for views on expanding VRPs

3.1 Our call for views set out our initial thinking on how we could support the expansion of VRPs beyond the existing use cases. At the time, we considered:

- a multilateral agreement (MLA) that specifies the required functionality and arrangements for pricing, dispute resolution and liability
- using our powers to set the parameters for a central price for VRPs based on a cost recovery model for the sending firm that applies our previously published pricing principles and enables sending firms to cover relevant marginal costs. We provisionally identified the Faster Payments charge as the only relevant cost for the initial rollout, which we proposed to remove for sending firms
- setting at zero the price sending firms can charge payment initiation service providers (PISPs) for access to customer accounts and payment initiation if we determine the Faster Payments charge to be the only relevant marginal cost for sending firms for the initial rollout and if we subsequently take action to remove that charge for sending firms
- mandating the participation of the nine banks subject to the CMA Order in the MLA
- the costs, benefits and equalities impacts of our proposals.

3.2 We asked a total of 22 questions that can be grouped into these themes.

The need for a multilateral agreement

Our proposals

3.3 We agreed with the VRPWG's view that a contractual framework is needed to manage the relationship between relevant parties in Phase 1. We proposed an MLA that sets out the required functionality, includes a mechanism for a specified and centrally determined price, establishes dispute resolution mechanisms, and clarifies liability.

3.4 We proposed that a multilateral agreement could overcome the inefficiencies associated with the number of sending firms and PISPs, and that it would help maximise participation. We pointed out that it would be costly and inefficient for parties to bilaterally agree on terms and conditions for Phase 1 and could limit PISPs' and smaller sending firms' ability to offer VRPs. We also observed that a bilateral approach would not be easily scalable.

3.5 We identified Pay.UK as a practical choice of owner of any MLA. As an existing PSO, it would be capable of delivering a Phase 1 MLA in the timescale required, as it already operates rulebooks, pricing, and dispute resolution processes for several national retail payment systems. We also considered OBL as a possible choice, noting its effective delivery of the open banking standards. However, we concluded that the operation of a Phase 1 VRP MLA would require significant additional capacities that would be difficult for OBL to procure in the time available. We also concluded it was impractical for a third party to develop an MLA for Phase 1 in time.

3.6 However, we emphasised that our proposal that Pay.UK should operate the MLA for Phase 1 was a practical choice and should not be seen as implying any future decision on who would operate other open banking MLAs.

Respondents' views on the need for a multilateral agreement

3.7 Just over half the respondents (22) supported greater cross-industry coordination. Eleven respondents were not supportive, while six responses did not express a view.

3.8 The ten respondents who supported our proposal noted that it would help address the inefficiencies associated with bilateral negotiations. They also thought it would help avoid market fragmentation while building consistency. Supportive responses also highlighted the potential positive impact of an MLA on VRPs' scalability and suggested it could ensure consistency in consumer outcomes. Some respondents supported greater coordination without endorsing our proposed MLA. They accepted the need for coordination but suggested that this coordination could be achieved through industry-led initiatives such as the model clauses developed by UK Finance.

3.9 Respondents who disagreed with our proposals mostly accepted that coordination was needed but argued that industry should lead the development of an MLA. They often particularly objected to an MLA that included a centrally-set price. As an alternative, they suggested undertaking bilateral negotiations under a multilateral framework, where functional requirements are initially standardised, pricing is left to negotiations and provisions under the framework can be changed based on bilateral agreement. Some respondents also suggested that no MLA was needed for Phase 1, because the proposed use cases already had consumer protections and liability frameworks in place through other means. Finally, some argued against an MLA that set a central price, in particular, because they felt this might discourage the commercial sustainability of VRPs. They argued that, in the absence of commercial discretion and/or a return on investment, sending firms would likely see Phase 1 as a compliance exercise, which could deter innovation deter sending firms from investing in scaling VRPs.

3.10 Twelve respondents expressed concerns, but no direct objection, to our proposal to have Pay.UK operate a future MLA in Phase 1. Eight respondents voiced explicit opposition. Over a third of respondents (14) did not express a view and six respondents were in favour. A large number of PSPs who participate in systems currently operated by Pay.UK were either opposed or concerned.

3.11 Of those opposed to our proposal, most raised concerns around Pay.UK's capacity to deliver the MLA on time and referred to competing demands currently placed on Pay.UK. Some argued that our proposal would create a risk of divergence between the open banking standard and VRP APIs, which could create operational challenges for participants. As alternatives, respondents suggested that either OBL or the Future Entity should operate the MLA or argued that no MLA was necessary at all.[5]

3.12 Respondents who expressed concerns, but not explicit opposition, to Pay.UK's possible operation of the MLA focused largely on whether it could deliver the MLA in the proposed timelines, its ability to fund the work to develop and administer the MLA, and possible conflicts of interest as the operator of other payment systems. Finally, some were concerned about the lack of TPP and consumer representation within Pay.UK.

3.13 Those who expressed support for our proposal agreed that it would be a practical choice and that Pay.UK had the expertise required to be the operator of a proposed MLA.

5 JROC's proposals for the design of the Future Entity for UK open banking

Our response

3.14 We note the agreement in the responses with our assessment that greater coordination is needed to expand VRPs but also recognise that there are varying degrees of support for our proposal to include a central price in the MLA.

3.15 We continue to believe that an MLA could overcome inefficiencies associated with seeking to establish new services across many sending firms and PISPs. An MLA could be an effective way of setting consistent minimum levels of service and give clarity on responsibilities across all participants. Various kinds of MLA or MLA-type structures already exist in payments and are fundamental to the successful and consistent deployment of payment services to customers. For example, in the Direct Debit scheme the standard indemnity has the effect of binding all service users to standard terms, liabilities and obligations set out in the Direct Debit scheme rules and procedures. Meanwhile, other standardised or multilateral agreements bind paying firms, sponsoring firms and other parties to their relevant standard responsibilities and obligations.

3.16 Some respondents share this view. We note that others believe that no MLA is needed given the low-risk nature of Phase 1 use cases. We currently consider the proposed use cases for Phase 1 as lower risk to sending firms, but we want to further understand the existing sectoral regulation ahead of implementation. However, at present we believe an MLA may still be necessary. One factor is the inefficiencies of other approaches (see 3.4). Another is the benefit of increased consistency across functionality alongside the need for a dispute mechanism to efficiently resolve issues such as technical problems with VRP payments regardless of the risk factor involved. We intend to work closely with the VRP implementation group to develop recommendations for the specific rules and provisions an MLA should include.

3.17 We note the concerns expressed by some respondents about the possible impact of a central price being included in an MLA. We discuss these views in paragraphs 3.60 to 3.76.

3.18 Some respondents were concerned about Pay.UK's possible operation of an MLA for Phase 1. We will continue to develop our thinking on which organisation is best placed to operate an MLA over the coming months. We will monitor the implementation group's progress and seek Pay.UK's views on the concern raised.

3.19 A number of respondents suggested OBL could operate the MLA. We will also engage with OBL to gain a better understanding of its capabilities and capacity and to identify any potential hurdles to it assuming such a role. We will also seek the VRP implementation group's input on which roles and responsibilities Pay.UK and OBL could have for a Phase 1 MLA.

Mandated participation

Our proposals

3.20 We considered that for the expansion of VRPs to succeed, it was crucial that a sufficiently large number of customers have payment accounts that support them during Phase 1. This should enable the necessary network effects for VRP to compete effectively with other payment methods. A large pool of potential customers is necessary to incentivise PISPs and businesses to offer VRPs, maximising the benefits to all involved. We sought stakeholder views on what share of payment accounts was needed to support VRPs in Phase 1 to realise these network effects.

3.21 We proposed to mandate the participation of the nine banks identified in and subject to the CMA Order (the 'CMA9') in the MLA for Phase 1. We highlighted evidence which suggested that without strong financial incentives, too few sending firms would voluntarily offer the required functionality. We pointed out that only limited agreements to provide VRPs between sending firms and PISPs exist, despite the fact that there are no restrictions on firms' ability to implement VRP independently or agree a price bilaterally. We recognised that our proposed price intervention (see 3.60) was unlikely to provide a sufficient financial incentive for sending firms to participate in Phase 1 voluntarily.

3.22 We highlighted that the CMA9 had already adopted the VRP standard for payments between accounts in the same name. This standard would also be used for Phase 1 VRP transactions. We therefore argued that mandating their participation would ensure that the roll-out reaches a sufficiently large number of payment accounts, capitalising on the existing technological capabilities. We pointed out that the banks already subject to the CMA Order already have the necessary APIs to enable Phase 1. The costs of providing Phase 1 VRP API access would therefore be minimal.

3.23 Finally, we noted that any decision to mandate would not preclude other banks from voluntarily adopting the standard, as had been the case with the open banking standards developed under the CMA Order.

Respondents' views

3.24 Fifteen respondents agreed with us that a sufficiently large pool of VRP-supporting payment accounts would incentivise biller adoption and PISP investment sufficiently; 12 disagreed, and 12 did not express a view. TPPs were uniformly supportive of our assumption, while the majority of sending firms who answered the question suggested alternative factors to consider.

3.25 Supportive respondents suggested that billers were unlikely to invest in a new payment method unless it offered a large pool of customers. They suggested it would therefore be important to ensure a large pool of potential customers. One supportive response, however, argued that an unambiguous commercial model also mattered, as uncertainty about the costs could hinder billers' investment in the new payment method irrespective of the number of potential users.

3.26 Those challenging us argued that a large number of potential customers alone could not drive adoption, identifying the need for consumer education to communicate the features and benefits of VRPs. Moreover, they argued that VRPs need to offer value across the product chain to promote the adoption of VRPs: consumers need to see benefits through features like more flexibility, control and consumer protection; merchants need to derive benefits such as reduced costs; and sending firms need sufficient incentives. Some also questioned the proposed use cases for Phase 1, with some suggesting smaller merchants would be keener adopters and others wanting a wider or unlimited set of initial use cases.

3.27 Only 12 stakeholders responded to our question on what level of coverage would be needed to incentivise adoption. Four of those responses suggested we look beyond the supply side. They argue that it is not the number of accounts alone that will drive adoption. Three respondents suggested that between 60% and 70% of consumer accounts needed to support VRPs to incentivise adoption. A further three suggested between 90% and 99%. One respondent, in turn, suggested we should look to include as many accounts as possible.

3.28 Just over half the respondents (20) supported mandating the participation of some sending firms. Around a quarter (ten) opposed our proposal, with the remaining nine not expressing an opinion. A significant majority of respondents who are currently subject to the requirement to adopt VRP standards for payments between accounts in the same name through the CMA Order expressed their opposition to being mandated to also participate in Phase 1. The majority of TPPs (eight out of nine) supported our proposal. No respondent type, however, was unanimous in their views on our proposal.

3.29 Respondents who supported our proposal argued that mandated participation would enable VRPs to be rolled out consistently and secure investment from TPPs and billers. Several respondents also recognised the pragmatism of our proposal. A limited number of respondents argued that there was no alternative to mandating CMA9 participation.

3.30 However, just over half the responses that supported mandated participation suggested mandating a different set of sending firms. Over one in three suggested mandated participation should go beyond the sending firms currently subject to the CMA Order. Suggested alternative approaches included:

- mandating all sending firms
- mandating sending firms with the technical capability to implement VRPs
- mandating sending firms signed up to the Confirmation of Payee service
- an approach based on current account market share,
- an approach based on Faster Payments outbound payment volumes

3.31 Finally, some respondents suggested that we could choose to focus only on the members of the CMA9 based in Great Britain, excluding those based in Northern Ireland, given the differences between the two markets.

3.32 Respondents who opposed mandated participation argued that it was unnecessary, and that industry should be given the time to develop its own VRP propositions. They suggested that an industry-led approach would better reflect commercial interests. They further argued that the ability to make a commercial return on VRPs would drive innovation and the creation of a good VRP product with market appeal, making mandated participation redundant.

3.33 In response to our question on the risks of mandating participation, respondents argued there:

- were legal risks associated with any compulsion to enter into an MLA
- were risks associated with setting a precedent for future commercial models for open banking payments
- was a risk that sending firms, due to the lack of commercial incentives, could treat Phase 1 as a compliance exercise only and fail to invest in developing a VRP product that appeals to users

3.34 To mitigate these risks, respondents suggested greater clarity on the scope of Phase 1, more transparency on our medium-to-long-term plans, and a possible obligation to maintain minimum levels of service.

3.35 Some respondents (both for and against our proposals) questioned the relevance of the use of the 'CMA9' concept outside of the specific context of the CMA Order. They referred to the large number of payment accounts that sit with sending firms outside the group.

Our response

3.36 Respondents supported our assumption that a large pool of potential users is needed to incentivise adoption. However, we recognise that additional factors such as consumer education, promotion, and biller education are important too. We still think that realising network effects is crucial to drive the adoption of VRPs in Phase 1. Evidence from other payment systems emphasises the importance of a self-reinforcing cycle of widespread adoption and acceptance, where more users attract more merchants and vice versa. We also note that only limited agreements between sending firms and PISPs to provide non-sweeping VRPs exist to date. This is despite respondents' indication that initial conversations on expanding VRPs had started, with some respondents saying they paused work on agreements because of the ambiguity surrounding the JROC's possible interventions. Finally, we recognise the difficulty in estimating the number of payment accounts that can be reasonably expected to realise network effects. We will continue to develop our thinking on these issues over the few next months.

3.37 We note the relative support for some form of mandated participation for some sending firms, with respondents arguing that it would help achieve a consistent roll-out of VRPs across the market and help TPPs secure investment for the development of new products and services. We also note submissions that an alternative approach would be to incentivise sending firms to participate in Phase 1 through a commercial return.

3.38 We recognise that the necessity or otherwise of mandated participation depends in part on the financial incentives available to sending firms, and whether they could reasonably result in sufficient voluntary adoption to benefit both consumers and businesses. Given the current uncertainty on the investment required to roll out Phase 1 VRPs, and on the level of associated financial risk, we remain concerned that the financial incentives necessary to motivate a sufficiently large number of sending firms to voluntarily provide TPPs with access to their VRP APIs may make Phase 1 VRPs uncompetitive.

3.39 We recognise the broad set of respondents who challenged our use of the concept of 'the CMA9' when considering potential mandated participants. We initially considered that this group of sending firms would be able to build on the existing VRP standard and scale VRPs to the new use cases at minimal cost. However, we agree with respondents that the legal basis for the CMA Order, which created the CMA9 concept, is different from that for the proposals under consideration, and that, therefore, the term 'CMA9' may not be appropriate. We will continue to develop our thinking on whether mandated participation is necessary and how to identify firms we might mandate, keeping in mind the need to generate network effects as well as the costs and benefits of including and excluding particular sending firms. As we develop our thinking further, we will engage with those sending firms potentially within scope to establish a constructive dialogue on any potential concerns.

The pricing principles

Our proposals

3.40 As our proposed extension of VRPs in Phase 1 goes beyond the existing open banking regulatory requirements, sending firms will be able to set charges for API access to their customers' account data and for payment initiation. In June 2023, in response to concerns about the prices sending firms may set, as part of the JROC, we published a discussion paper on the pricing we wanted firms to use as a guide to piloting commercial models.[6]

3.41 In our call for views, we explained our intention to apply these principles to guide our thinking on what an appropriate price for VRP API access might be. We also set out that we did not intend to intervene on other elements of the value chain, including the prices charged to billers. We explained that we believe these prices are already subject to sufficient competitive pressures and are therefore likely to reflect the underlying costs.

Respondents' views

3.42 Just under half the respondents (18) did not provide a view on the pricing principles. Just under a third of respondents (12) supported our intended application of the principles, while nine opposed it.

3.43 While respondents agreed it was necessary to determine a sustainable commercial model, some raised concerns about the compatibility of different principles. Some respondents pointed out a likely tension between our principle of prices reflecting long-term costs (Principle 1) and the principle of prices incentivising innovation and investment (Principle 2). In addition, some doubted whether a pure cost-recovery approach was sufficient to foster innovation. Others felt that the link between our particular proposals and the pricing principles was not apparent. Finally, some respondents suggested that the pricing principles were not necessary given the FCA Consumer Duty already makes provisions regarding pricing.

3.44 Respondents suggested alternative approaches, either recommending different pricing principles (such as pricing based on what service VRPs potentially substitute) or suggesting that the open banking ecosystem could determine a sustainable price without the need for specific principles. Others suggested that price transparency was more important than agreement on specific pricing principles.

6 Principles for commercial frameworks for premium APIs

Our response

3.45 We note the support for our pricing principles across different types of respondents. We also recognise we may need to explain how the principles inform our policy proposals. We will take this into account when publishing our updated proposals (see 4.1).

3.46 We recognise that the tension between individual principles exists, as we acknowledged in the original discussion paper, where we explained that these principles should be considered together, rather than individually. We acknowledged that there will probably be trade-offs between the different principles, and that it may not be possible to meet them all simultaneously – especially while also trying to achieve a sustainable and pragmatic commercial model that can be implemented relatively easily. Therefore, we do not intend to revisit the principles themselves, but we will clarify how they inform our thinking on this subject.

3.47 Finally, we recognise that the FCA's Consumer Duty contains a price and value outcome, which may partially encompass the same aim as our pricing principles. From initial conversations with the FCA, we understand that the Duty's provision on pricing may apply to VRP payments in some circumstances, especially when services are offered to retail customers. However, we currently believe that our pricing principles do not create any conflict with the Duty and can therefore be considered supplementary. We will continue to work closely with the FCA to ensure that any interaction between our updated policy proposals and the FCA Consumer Duty is clearly understood before we publish these proposals later in the year.

The need for a price intervention

Our proposals

3.48 Participants in the sector had raised concerns with us that sending firms may use their position as access providers to their customers' accounts to set a price for data access or payment initiation that could disincentivise investment and adoption in VRP. They also shared concerns that this would be uncompetitive. We shared our concerns that sending firms may have a 'bottleneck monopoly' in relation to expanded VRPs, as they would control VRP API access to their customers' payment accounts.

3.49 TPPs must use the sending firm chosen by the customer making the payment without the ability to influence that customer's choice. We therefore identified a risk that, without regulatory intervention, sending firms could limit API access to their customers' accounts or charge uncompetitive prices for initiating Phase 1 VRP payments.

3.50 We also observed that due to a lack of competitive pressure for API access, sending firms might be able to price API access at or above the card interchange fee, aiming to recover lost card fee revenue rather than reflecting the relevant long-run costs of VRPs. This would not meet our pricing principles, risk making VRPs too costly for widespread biller adoption and would not meet our objective of promoting innovation and competition between payment systems.

3.51 We therefore suggested there may be a case for regulatory intervention on the price that sending firms can charge PISPs for VRP API access.

Respondents' views

3.52 Just over a third of respondents (16) agreed with our current view of the VRP API access market structure and sending firms' position in it. Thirteen respondents did not offer an opinion. The remaining ten respondents disagreed with our view of the market. Seven out of eight sending firms disagreed with our description of sending firms' position in the VRP API access market.

3.53 Respondents who agreed with our description were concerned that sending firms' strong position in controlling VRP API access could limit PISPs' access to payment accounts or subject them to high fees for that access. This would limit their ability to provide competitive products for their customers.

3.54 Other respondents – including a large proportion of sending firms – disagreed that sending firms may have a 'bottleneck monopoly' and VRP API access market power over payment initiation from their customers' accounts. They argued that there is sufficient competition in the retail banking market and that therefore no intervention was needed. Others suggested it was unfair to suggest that sending firms had a 'bottleneck monopoly' in relation to a product that does not yet fully exist. Respondents also said that the industry's appetite to progress VRP was evident from industry-led initiatives such as UK Finance's work on model clauses. Finally, some respondents argued that we needed more evidence in order to analyse the VRP API access market and that we should look at all elements that would encourage the growth of VRPs and not just pricing.

Our response

3.55 We note that a number of respondents (particularly TPPs) supported our view of the VRP API access market. Others (particularly sending firms) disagreed, pointing to the competition in the market for the provision of current accounts. We recognise that the retail banking market is subject to a degree of competitive pressure. However, we still think that sending firms' position as providers of VRP API access may result in prices that could discourage wider adoption.

3.56 Sending firms control access to their own customer data and to payment initiation from their customers' accounts. In order to provide a service, PISPs need access to these accounts and must use the VRP API of their customer's sending firm. It is highly likely that PISPs need access to multiple sending firms to provide a service that businesses want to adopt. This means PISPs will need to contract with multiple sending firms simultaneously.

3.57 In addition, PISPs usually cannot influence the customer's choice of sending firm, as this decision usually predates the customer's decision to use a VRP for a particular transaction. Even if a customer has accounts with multiple sending firms, the PISP may have a limited ability to influence the customer's choice over which account to use for any individual transaction.

3.58 Finally, PISPs may have lower levels of negotiation power when seeking to contract with sending firms. For example, PISPs compete with each other to provide payment services but sending firms do not compete with other sending firms to win the PISP's business for access to their customer's account.

3.59 For now, we therefore still think regulatory action on a VRP access price may be warranted. As we continue to consider this, we will keep in mind the relevance of VRP API access market dynamics. We will offer another opportunity to provide feedback on our reasoning and evidence for any potential intervention when we publish our updated proposals.

A possible price intervention

Our proposals

3.60 We proposed that a cost-based approach to setting a central price for VRP API access would be pragmatic, efficient, and align with our pricing principles. We felt that sending firms broadly should be able to recover material costs that were directly attributable to expanded VRP use cases. We considered sending firms' own costs, Faster Payments-related costs, and OBL-related costs. We noted that different approaches to setting the central price could be used for different future use cases.

3.61 We concluded that the only relevant costs that all sending firms would incur are fees related to the use of Faster Payments. We explained that sending firms' own costs were likely to be relatively small, as expanding VRPs for Phase 1 will build largely on existing open banking functionality. We also said that during Phase 1, the costs of dispute resolution, fraud prevention and fraud reimbursement were likely to be negligible on a per-transaction basis, because the initial use cases are limited to regulated industries with minimal risk of fraud costs to sending firms. In addition, sending firms' potential costs relating to legal liability were also likely to be limited. Finally, we noted that we were unaware of any significant direct costs to OBL from providing VRPs in Phase 1, beyond those it had already considered in its non-Order budget.

3.62 As we identified the Faster Payments fee as the only relevant marginal cost to sending firms, we proposed to remove this fee for sending firms that initiate Phase 1 VRPs. We explained that we were exploring how to implement this with Pay.UK, with options including passing the sending firm's share of the Faster Payments charge to the receiving firm or removing the sending side of the charge entirely.

3.63 Assuming that sending firms indeed incurred no other relevant costs beyond the Faster Payments fee, we also proposed to set at zero the price that the sending firms could charge PISPs for access to payment accounts and payment initiation during Phase 1. We acknowledged that this would not enable sending firms to make an explicit return for Phase 1 but would not prevent them from innovating elsewhere in their businesses to commercialise VRPs. We also argued that Phase 1 could reduce costs to sending firms, for instance, by replacing Direct Debits and bank transfers.

Respondents' views

3.64 We asked whether there were further relevant costs for sending firms we had not yet considered. Fifteen respondents indicated that there were additional costs to consider, six said there were none and two said it was difficult to determine which costs (and to what level) would be incurred to provide VRP Phase 1 access given a lack of active VRP propositions in the market. The remaining respondents did not offer opinions on the costs of VRP provision.

3.65 Those who felt all costs had been captured argued that the costs of fraud prevention and dispute resolution would be negligible due to the lower risk of Phase 1 use cases. Others supported our assessment but suggested that Phase 1 could help identify currently unknown costs that could then be reflected in future commercial models.

3.66 Respondents who felt there would be additional costs to sending firms pointed to the costs of technical development, upgrades to IT infrastructure, staff training, customer education, fraud prevention and dispute resolution. Others identified costs relating to customer support and the legal and compliance costs of joining an MLA. Some respondents argued that there might well be further costs to consider, but that it was difficult to accurately identify costs in the timeframe available.

3.67 Almost half of those who responded (17) disagreed with our proposal to remove the Faster Payments charge for sending firms. Ten responses supported our proposal, and twelve did not express a view. A large proportion of sending firms (six out of eight) rejected our proposal.

3.68 Respondents who supported our proposal saw it as a pragmatic step to drive adoption during Phase 1 and support a rapid rollout. Some respondents also felt shifting the fee to the receiving side was justified, as the receiving side was the beneficiary of the transaction. Some also saw this as avoiding cross-subsidy between products, which might otherwise result in market distortion.

3.69 Respondents who disagreed generally noted that there would probably be more costs than just the Faster Payments charge, and therefore preferred sending firms to recover these costs by charging the PISP. They believed the PISPs could then efficiently recover the costs from the biller. Some respondents voiced concern about setting a precedent for low or no charging between sending firms and TPPs, which would not allow effective cost recovery for wider open banking use cases in the future.

3.70 A number of respondents were against either transferring the charge to the receiving side or recovering lost revenue through wider Pay.UK charging. They told us that this could increase charges to merchants and therefore hinder adoption. Respondents also worried about costs that are recovered through wider Pay.UK charging being borne by the largest users of Faster Payments. They suggested this could obscure the real costs of VRPs and could risk distorting the VRP API access market. They also expressed concern about Pay.UK's ability to adjust charging in the time scales required.

3.71 Others supported recovery through wider Pay.UK charging, as this would result in more firms incurring costs at a lower level, avoiding a situation where the transfer of costs to the receiving side could ultimately disincentivise billers from adopting VRPs, as they, in turn, would be expected to cover costs incurred by receiving firms. Finally, some recommended that we undertake further analysis into how Pay.UK levies charges on its participants.

Our response

3.72 The responses have highlighted that sending firms may incur relevant costs beyond the Faster Payments charge. The responses also made evident the difficulty of costing a service that is not yet offered by most respondents. We recognise that, due to the uncertainty around the costs involved for Phase 1, it would be challenging to determine a price for VRP API access which fully reflects the likely efficient costs incurred by a sending firm.

3.73 To develop our evidence base and following the closure of the call for views, we conducted some bilateral engagement across the payments industry. This included investigating the costs of adopting Phase 1 VRPs and the price participants would be willing to pay.

3.74 We spoke bilaterally to those five respondents who had shared cost data in their responses to our call for views. All five offered to share more cost data. This exercise has provided useful additional information and insights to inform our analysis and policy development.

3.75 Responses to our proposal to remove the Faster Payments charge for sending firms have highlighted its complexity. Respondents raised concerns about the consequences of either moving the cost onto receiving firms or recovering it through wider Pay.UK charging. We initially proposed to remove the Faster Payments charge for sending firms only if we established that it was indeed the only relevant marginal cost. As some responses to our call for views suggest there may be other relevant costs, we are currently reconsidering our approach.

3.76 While we still think that further regulatory action may be needed to determine a price for VRP API access (see 3.55), we will be analysing the merit of respondents' suggested alternative approaches. We explore these options in more detail in the next section.

Alternative ways of pricing VRP API access

Our proposals

3.77 We outlined the alternatives we had considered before proposing a cost-recovery approach. These included:

- placing regulatory guardrails on bilateral price negotiations
- setting a fee that replicates the revenue sending firms earn on the payment methods replaced by VRPs
- directing Pay.UK, as the PSO, to calculate a price for VRP API access in Phase 1

3.78 We assessed that placing regulatory guardrails on bilateral price negotiations would probably hamper scaling beyond low-risk use cases and could limit the ability of new or smaller PISPs to enter the market. We considered that setting a price based on a benchmark (for example, sending firms' revenue on alternative payment methods) would be difficult to justify economically and could result in a price that discouraged adoption. Finally, we concluded that directing the PSO to calculate a price for VRP API access in Phase 1 would probably take an extended period of time, delaying the benefits to consumers and businesses.

3.79 We asked for stakeholder feedback on alternative commercial models that might better deliver a sustainable economic model for Phase 1 without risking scalability.

Respondents' views

3.80 Although just over half of the respondents (21) supported the need for a central price, only five respondents endorsed our initial suggestion for a cost recovery approach to pricing. 28 respondents proposed an alternative approach without any one option emerging as a clear favourite.

3.81 Most respondents who agreed with our proposal argued that our suggestion was a pragmatic first step towards a more sustainable model in future. They mentioned the limited time available to develop a pricing model and concluded that our proposals could be delivered quickly.

3.82 Those who proposed alternative models did not coalesce around a single option. Their proposals included different cost recovery models, outcomes models that focus on competition between payment methods or consider the entire transaction life-cycle, an industry-set price cap, price caps at a nominal fee to allow some cost recovery, a price cap at the card interchange fee and independent price-setting. On this last suggestion, three respondents suggested we should follow the 'black box' approach taken by the European Payments Council (EPC) in relation to its development of a commercial model to underpin the SEPA Payment Account Access scheme.[7]

3.83 Respondents who did not support any price cap advocated primarily for bilateral price negotiations. These respondents also argued that we could introduce a requirement for transparent pricing arrangements between sending firms and PISPs. Alternatively, one respondent was in favour of regulatory guardrails on bilateral price negotiations. This respondent suggested we could publish a list of outcomes for firms to work towards when developing a commercial model and then let the open banking ecosystem determine a price.

Our response

3.84 We understand from the responses that there is a diversity of views on how best to price API access for Phase 1 VRPs. While no single approach garnered wide support, we note the support in respondents' submissions for various forms of a central price. We also acknowledge that participants may not yet know all relevant costs in relation to the operation of Phase 1 VRPs (see 3.72). Therefore, establishing a price based on a cost recovery approach may be challenging. We thank respondents for their input and will continue to evaluate the suitability of alternative VRP API access prices or approaches, including by analysing their suggested alternatives.

3.85 At present we are considering:

- access prices based on pricing models in other payment systems
- pricing based on a cost-recovery approach (including a price cap to allow a return on investment for sending firms)
- an arbitrated price (including a 'black box' or regulator-led approach).

3.86 We will continue to be guided by the principle that pricing should allow for increased competition and not obstruct further innovation in payments.

7 European Payments Council - SPAA Scheme Status Update

The cost benefit analysis (CBA)

Our assumptions

3.87 We committed to undertaking a CBA and welcomed additional stakeholder input on our initial assumptions about the costs and benefits of Phase 1 VRPs. We also asked for stakeholder feedback on possible impacts on people with protected characteristics under the Equality Act 2010.

3.88 We explained that our CBA would assume that:

- the utilities use case will include payments across the water, gas and electricity industries regulated by Ofgem and Ofwat
- the government use case will include payments made by consumers and businesses to HMRC and payments made through GOV.UK Pay
- the financial services use case will include payments to FCA-regulated firms, but not payments into unregulated investments

3.89 We also shared our assumptions that the provision of VRPs would not change without our proposed intervention. We identified payers, billers, PISPs and the payment facilitators, ASPSPs, OBL and Pay.UK as the key agents incurring costs or reaping benefits. We proposed a timescale of ten years to assess costs and benefits, and we suggested disregarding any costs specifically related to the New Payments Architecture. Finally, we proposed that the payment methods we consider alternatives to Phase 1 VRPs would not significantly improve in functionality or benefits to billers or sending firms during that ten-year period.

3.90 We also shared our view on key benefits and high-level costs. We highlighted the benefits of easier financial management for users, reduced costs to payees and progress towards developing account-to-account retail payments. We identified the cost of potential lost revenue from displacement for sending firms, upfront costs to billers for adopting or switching to VRPs and familiarisation and training costs for participants.

Respondents' views

3.91 Respondents broadly endorsed our use cases for Phase 1, 18 respondents agreed with them in their entirety. Seven agreed with our proposals but suggested additional use cases such as telecommunications and six respondents disagreed with our proposals. One respondent agreed but suggested certain financial services sub-use cases were excluded. One did not comment on Phase 1 use cases, but suggested the focus should be on retail and e-commerce sectors, whilst seven did not comment. Some respondents questioned whether the use cases would enable VRPs to scale, as the proposed use cases were associated with high Direct Debit usage.

3.92 Respondents' views on whether or not VRPs would be meaningfully adopted without regulatory intervention were mixed. Some argued that there were already initiatives underway to expand VRPs. They referenced their own experience of bilateral negotiations, work in the framework of SEPA SPAA and the work by UK Finance to develop model contractual clauses as evidence of industry-led momentum.[8] Others, however, agreed that regulatory intervention was needed.

3.93 Five respondents agreed with our assumption that the payment methods that are considered alternatives to VRP will not significantly improve functionality or benefits. Seven disagreed, while the remaining 27 did not opine. TPPs broadly supported our assumption, noting the lack of disruptive changes in the last ten years. Sending firms and PSOs, in turn, tended to disagree. They raised the fact that Pay.UK is currently working on a Future Bacs Strategy so it would not be possible to assume that there would be no improvement in the Bacs offering in the next ten years. They pointed to recent innovations such as digital wallets, and the proposed changes to the payments infrastructure through the New Payments Architecture (NPA).

Our response

3.94 Since the publication of our call for views, we have continued to analyse and consider the costs and benefits of VRPs in Phase 1. We welcome the feedback on our initial assumptions and have undertaken extensive bilateral engagement with stakeholders to better understand their views. We have gathered additional evidence to inform key assumptions and obtained data to input into our modelling.

3.95 We recognise that there is a level of uncertainty among some respondents regarding the potential costs of implementing Phase 1. Due to this, we have received a wide range of estimates from stakeholders. Over the next few months we will explore the assumptions underpinning these estimates so that we develop an informed view of Phase 1 implementation costs and assess the proportionality of any regulatory intervention. We may also model the economic impacts of certain counterfactual scenarios.

3.96 We will also aim to assess impacts across a broader range of stakeholders than identified in the call for views. This may include card schemes, acquirers and direct debit providers.

3.97 We will therefore develop our cost benefit analysis in parallel with our finalised policy proposals.

8 UK Finance Model Clauses

The Equalities Impact Assessment

Our assumptions about equalities impact

3.98 In the call for views, we set out our belief that our initial proposals would not disadvantage anyone protected under the Equality Act 2010. We sought stakeholder feedback on whether there were possible impacts on people with protected characteristics and sought suggestions for how their interests might be better served.

Respondents' views on the EIA

3.99 In response, ten respondents agreed with our assessment, seven disagreed with our assessment and 22 expressed no opinion.

3.100 Among the respondents who disagreed with our assessment, most indicated that there was a likely overlap between those with protected characteristics and the digitally excluded. As open banking products are digital, they suggest there is a risk that such exclusion is replicated by our proposals. Other respondents indicated that those who have protected characteristics could be more susceptible to fraud. Finally, one respondent suggested that the absence of a sufficiently attractive commercial model for sending firms prevented them from being incentivised to invest in VRP Phase 1, which in turn could prevent consumers with protected characteristics from accessing the benefits of VRPs. Those who agreed with our assessment, in turn, questioned the link between protected characteristics and barriers to digital inclusion. Others indicated that VRPs may be uniquely beneficial for people with protected characteristics, by offering control and flexibility which could reduce the users' reliance on carers. Additionally, people with protected characteristics may be affected by poverty and VRPs may be beneficial, particularly to those who are locked out of other payment methods.

3.101 On alternative approaches that might better meet the needs of consumers with protected characteristics, respondents offered several approaches. Some argued that the commercial model should be adapted to provide incentives for sending firms and PISPs to keep all consumers in mind. Others suggested special rules, which may need to be imposed, to address any possible discrimination and exclusion. Finally, a mirroring of consumer protections in payment methods, such as Direct Debit, and a monitoring process of possible negative impacts on consumers with protected characteristics were suggested.

Our response

3.102 We take note of the concerns raised about digital exclusion and its possible interaction with other characteristics that are protected under the Equality Act. We will continue to consider our obligation to have due regard to the need to eliminate discrimination, advance equality of opportunity and foster good relations between different people when carrying out our activities. Later this year, we will therefore seek stakeholder input on an updated Equalities Impact Assessment that will assess in detail the possible impacts of our updated proposals. In the meantime, we are keen to understand from all stakeholders - and those with specialist knowledge of consumers with protected characteristics in particular – what we should consider as we refine our policy proposals.

4 Next steps

4.1 We would like to thank respondents for their valuable input. We will use the feedback we gathered as we continue to develop our updated proposals. We have published all non-confidential responses to our call for views alongside this publication.

4.2 We aim to share updated proposals in the autumn. We will explain:

- the specific rules and provisions an MLA should include - if we continue to believe that one is required
- which organisation we think may be best placed to operate any such MLA
- our view on whether mandated participation may be required and whom we may mandate to participate in Phase 1
- our plans for determining a VRP API access price – if we decide that this would be required
- the costs and benefits we expect from any proposed intervention – if we decide that this would be required

4.3 We will also publish a draft CBA.

4.4 As we develop our updated proposals, we will also continue to engage with the VRP implementation group's work on further developing open banking services. We will also monitor the work underway to set out recommendations for OBL's transition to a Future Entity.

4.5 We welcome and will seek further dialogue with stakeholders over the next few months. Interested stakeholders who would like to get in touch with us ahead of our publication in the autumn can do so by emailing a2a@psr.org.uk.

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