JROC Open Banking Payments Critical Actions 240123

Over the last five months the JROC SWG and its secretariat have gathered and documented a very wide range of views about the current challenges and needs of open banking payments from across the whole industry. Given that this process has not had as a starting point a universally accepted and clear vision and purpose for Open Banking, it has been very difficult for the team to synthesise these views into a coherent action plan. Without this starting point it has not been possible for SWG to separate the 'signal' from the 'noise' in the work it has done – all views and opinions have had equal weight and validity, and the 'noise' is obscuring the 'signal'.

JROC tasked SWG with "Unlocking the potential of open banking payments". Unfortunately, this understates the challenges PISPs face, and the urgency of action needed. Open banking payments has not yet reached a point of critical mass adoption and growth. With the current challenges identified by the SWG work, it is not clear that this point will be reached. Without urgent regulatory action not only will *the potential of open banking payments remain locked* up, but challenger businesses and their investors will exit the market and open banking payments will become a failed experiment in opening up competition and innovation.

To avoid this outcome urgent action is required from JROC to make an immediate difference to the prospects of open banking payments success/survival:

- The vision and purpose of open banking payments needs to be made absolutely clear to all industry participants and ecosystem stakeholders so that the rationale for action and the priorities become clearer. Additionally, the governance, and participation in the governance of open banking needs to be seen as entirely independent and aligned to this vision.
- Against this back drop a small number of practical and deliverable actions, already identified within the SWG work, need to be directed to OBIE/The Future Entity and industry participants to execute.

Finally, at the end of this document we highlight some SWG recommendations that we think could be counter-productive or simply a distraction to unlocking open banking payments.

Based upon our own knowledge of the regulatory development of open banking and our participation in the SWG Payments Experts workgroup we propose below a vision & purpose and the priority actions.

These views and priorities are in line with the government's current thinking as set out in the Call to Evidence regarding legislative reform to the Payment Services Regulations published this month detailing its desire to foster competition in the interests of consumers, specifically via open banking.

The Vision & Purpose of Open Banking Payments

Open Banking payments are a <u>regulatory and technical construct</u> put in place through legislation and Competition Authority remedy to enable greater competition and innovation in payments for the benefit of businesses and consumers by:

- Mandating that ASPSPs (banks) lose the historical direct and indirect (via their participation in card schemes) monopolistic control they have had over their customers' payments, and

- Encouraging challenger businesses (PISPs) and their financial backers to gain authorisation, invest risk capital and create competitive new payments products in order to build successful new services for businesses and consumers.

If the competition remedy is to have been successful, (i) UK businesses and consumers will gain from this competition and innovation through better services and lower costs; (ii) PISPs must earn a risk return from their investments to be sustained; and (iii) ASPSPs (banks) must earn less profit from payments due to greater competitive intensity, and specifically reduced card issuing fees.

In its simplest form, this is a zero-sum game. Value must be moved from banks to PISPs and their business customers and their end-customers. It is not possible for open banking payments to achieve its potential without ASPSPs earning less profit from payments. This is not in their interests and therefore shouldn't be expected to be enabled voluntarily – it has required, and will continue to require, regulatory interventions. These interventions will mean that existing bank profit streams (card issuing fees) are diminished and may also mean that banks will have to make technical and operational investments that don't make a full commercial return. Banks will not make these investments unless regulatorily mandated – banks would not otherwise be meeting their fiduciary duty to their shareholders. The narrative that ASPSPs need a positive return on their "investment in Open Banking" fails to recognise why the CMA required them to fund the development of Open Banking and OBIE and needs to be refuted.

Whilst it is necessary that this greater competitive end-state will require further regulatory intervention, such intervention, if done in the right places, could be limited and narrow.

This vision for open banking needs to be underpinned by appropriate governance. Both JROC, and very importantly, the Future Entity and its leadership need to be, and to be seen to be, entirely independent guardians of this vision. We would not expect a recent leader of either a TPP or an ASPSP to be able to bring all parties in the ecosystem along as either chair or CEO of the Future Entity. We were therefore surprised that a very recent director of payments from NatWest (and previous leader of MasterCard UK) has just been appointed as chair of OBIE, and very much hope that the clear independence required to deliver full confidence in leadership roles in the Future Entity will be properly respected when the time comes to appoint individuals to lead the Future Entity.

Key Actions to Enable Open Banking Payments Sustainable Success

Drawing on the work done by SWG, there are a small number of critical actions required if open banking payments are to grow and become sustainably competitive to banks' card payment services.

A. Enabling PISPs to offer higher value payments while protecting against APP Fraud. Without this the core value proposition of open banking payments full adoption is undeliverable.

B. Enabling PISPs to offer VRP enabled services beyond sweeping. Without this the real growth and bank competition opportunity is inaccessible.

A. Actions enabling PISPs to offer higher value payments while protecting against APP fraud

Under pressure to try and contain APP fraud, banks are taking actions that <u>may</u> stop a few fraudulent Faster Payments, but <u>definitely</u> make all legitimate Faster Payments more difficult to use by paying customers. This is having a knock-on effect on open banking payments, particularly making larger value payments very difficult to make via open banking. This is undermining business and consumer confidence in open banking payments and effectively protecting bank card payments in the area banks make most money, and where the greatest savings could be made by businesses with open banking.

1. **Direct all ASPSPs to support simple Transaction Risk Indicators (TRIs).** Direct all ASPSPs to force-train their fraud engines not to flag as risky open banking payments where the PISP has indicated through the TRI that the payee, and provided payee account details, have been validated by the PISP, whether or not this is a first payment, and irrespective of the payment value. PISP adoption can be voluntary, as failure to adopt by a PISP will result

in their payments being treated as 'riskier'. By setting this TRI, a PISP should also accept first level liability for any payments made if their business/merchant customer proves to be operating criminally. If appropriate, the PISP may subsequently seek to independently recover any funds it has repaid from the receiving bank which has been operating an account for a criminal.

2. **PSR to shift APP fraud liability 100% on to the receiving banks who are allowing criminal usage of their accounts.** APP fraud prevention needs to focus on preventing paid funds being credited to criminally operated bank accounts, rather than stopping many payments, a small proportion of which might be fraudulent. This change will benefit all Faster Payments (including open banking) by avoiding false positives interrupting the sending of payments and focussing prevention onto receiving banks properly KYCing their customers and overseeing the operation of their accounts – an existing AML requirement anyway. Receiving banks, unlike sending banks, know who their payee customers are, are in a much better position to spot unusual usage of their accounts, and can trap repeating low value frauds, not just higher values. When a receiving bank is suspicious of a receipt it can prevent those funds being credited to their customer prior to investigation. In this model false positives have almost zero impact on the conduct of normal commerce. Once a bank understands the operating model of a legitimate, but previously suspicious, customer further false positives can be avoided for subsequent payments to that customer.

Even though the SWG process has identified widely divergent views on the current scale of open banking payments fraud, the actions above should serve to reduce overall APP Faster Payments fraud (the second action) and allow well designed open banking payments services to provide even safer payments (the first action) as soon as they are implemented, whatever the true scale of the problem. These actions do not need to wait on the gathering and analysis of further fraud data and prevalence evidence. They should be actioned now.

B. Actions enabling PISPs to offer full VRP enabled services

Both providers and potential business customers across the payments market have identified open banking Variable Recurring Payments (VRPs) as a breakthrough innovation that could provide much enhanced services and lower costs than current Direct Debit and Card-on-File payments arrangements. VRP has only been mandated for the CMA9, and only for a very narrow me-to-me sweeping use case. To fulfil this potential VRPs will need to be offered beyond sweeping by most banks, and at costs that are substantially below the charges banks make for operating cards. For the reasons identified in the vision element of this paper there are strong economic reasons why this is not going to happen voluntarily. This position has been practically confirmed by the refusal of most ASPSPs to offer non-sweeping, and the high (anti-card-cannibalisation) prices and prohibitive contractual positions being proposed by the few (one!) bank contemplating VRP beyond sweeping. Failure to offer economically attractive broad use case VRPs will further undermine confidence in the open banking market, seeming to confirm in the eyes of stakeholders that only services that are <u>not</u> competitive to bank's existing revenue streams will be supported by banks or enabled by regulators.

- **Mandate the CMA9 ASPSPs to offer VRP to PISPs irrespective of the PISP's use case**. As is the case today with single payments where ASPSPs do not restrict PISP use cases, the FCA should provide oversight of PISP's business models and services. This assumes that with the bulk of bank accounts supporting VRP, competitive pressure will encourage non-CMA9 ASPSPs to support VRP.
- **Mandate OBIE/The Future Entity to resolve the 'Software Statement' problem** that will make VRP deployment impossible at scale. This is a simple adjustment to the standard and should require minimal development from ASPSPs or PISPs. Currently this has been side-lined as the Trustee and CMA have deemed outside the scope of OBIE – despite this issue impacting me-to-me sweeping as well as non-sweeping VRP.
- **Direct ASPSPs to use the current open banking Single Payment charging model for all VRPs, not just sweeping.** Each ASPSP is a monopoly supplier of VRPs for its own

customers to PISPs. PISPs need the majority of ASPSPs to provide VRP to have a viable service. One ASPSP is not a substitute for another for a PISP. There can therefore be no competitive market in VRPs and no market-based price setting mechanism. Even were this not the case, ASPSPs would set prices at levels that won't undercut the existing card issuing fees they earn which they would lose with VRPs. Single open banking payments (and historically the Direct Debit service) already provide a fair economic model where ASPSPs cover their costs by charging their own customers for the sending or receiving of the underlying Faster Payments that provide VRP. This model is underpinned by the current and ongoing competition set prices for all Faster Payments.

- **Apply the Single Payment TRIs above to all VRPs and establish a JROC led working group to review any unclear incremental liability issues.** With the confidence provided to ASPSPs by TRIs, JROC should lead a fast review of ASPSP fraud and liability concerns to establish if there are indeed incremental risks that are not adequately covered by existing regulations, and if there are, generate a single liability and fraud prevention protocol for all ASPSPs and PISPs to adhere to. There is no reason why this should delay deployment of full VRPs if VRP deploying PISPs are prepared to accept the liability position of A1 above. This should be policed by the Future Entity, just as OBIE and the FCA police current open banking. There is no need for a new scheme or multi-lateral agreement to be put in place to achieve this.

The ASPSP led focus solely on alleged incremental consumer risks of deploying VRP more widely ignores the potentially significant and immediate consumer benefits of doing so, and doing so quickly:

- In the utility bill payment use cases VRP enabled services can remove the fraudulent set up risks of Direct Debits and put consumers back in full control of these payments in a way that they are not with Card-on-file or Direct Debit. With the growing cost of living crisis and concerns about forced switching of consumers on to pre-pay meters this could not be more urgent.
- Likewise in the subscriptions market space, replacing the hard-to-control and expensive card-on-file payment option with VRP enabled services can bring immediate consumer control and business cost reduction benefits at this important time.
- There are no doubt many other use cases where the consumer and business benefits of VRP enabled services are likely to outweigh the risks of deployment.

Reiterating the point made above, provided PISPs are prepared to accept liability for payments errors made by their business customers (and are therefore economically incentivised to properly KYC and manage these business customers) there is no reason to over restrict VRP usage. Its worth noting that where a bill has been paid by cash, Faster Payments transfer, or even Direct Debit, and the supplier goes bankrupt before supplying the service there has never been any payments specific protection offered to customers, nor real demand for such protection (counter arguments about protecting consumers from APP scams are a conflation – APP scams are driven by failures of KYC, not known businesses going bust, and should be fully covered by the shift to receiving bank liability proposed above where receiving banks are wholly liable for serving criminal customers).

Delaying all the benefits identified above by years while a full, cross industry liability and purchase protection framework is developed for VRP would simply delay the substantial economic and customer control benefits of broad VRP with little offsetting gains and undermine investor confidence in the future potential of open banking at a key point in its development. It will also reinforce the ASPSP's view that they can control/limit the intended introduction of competition in the payments markets as outlined in the vision section.

Potentially Counterproductive or Distracting SWG Recommendations

For clarity, Ordo sees no pressing ecosystem performance issues that must be resolved in the short to medium term. We are not aware that any first or even second tier ASPSPs are failing to pass on the full Faster Payments payment status information they collect to PISPs when they make a payment. While a ‘Now or Never’ instant payment is potentially useful, this cannot technically be delivered by Faster Payments and will have to wait until eventual roll out of the NPA, provided the capability has been prioritised in the NPA by Pay.UK.

The SWG seems to suggest that open banking payments cannot/do not serve the e-commerce use case. While there is a small subset of e-commerce use cases that would benefit from a future ‘Now or Never’ instant payments capability (particularly in the gambling market), there are very many e-commerce situations where open banking could and does already provide a good alternative to cards (subject to the problems of higher value payments already identified). We see no case to establish a ‘scheme’ for these payments – it is not clear what problems and issues such a scheme would be addressing.

Finally, we disagree that any voluntary, PISP subgroup to ASPSP subgroup, multilateral or other types of agreement should be set up. As SWG identifies elsewhere, such subgroups will fragment open banking, and in our view are not necessary. To the extent that further agreement/rules are required between PISPs and ASPSPs, they should be delivered by the Future Entity in the same way that single payments have been standardised, overseen and compliance enforced by the OBIE and regulators to date. Voluntary agreements will not happen given the fundamental positioning of PISPs as challengers and ASPSPs as incumbents in payments. Non-ubiquitous agreements simply present another tool for ASPSPs to fragment and slow down market developments - In payments, as the choice of paying bank sits with the payer, not the payee, new payments services demand ubiquitous or near ubiquitous paying bank coverage to have any chance of adoption. Also, given the position of ASPSPs as incumbents that will lose share from innovative new payments services, firm, regulator driven compliance enforcement will be required to allow and then protect this new competition.