Promoting competition and choice in payments services and the dangers of retaining historical approaches

Prior to the creation of the Payments Systems Regulator (PSR), the UK's payments industry could be divided into two distinct domains, card payments and interbank payments. The card domain was characterised by some competition at all levels: multiple card schemes, multiple card issuers and multiple merchant acquirers. Businesses had some choice and competitive offerings in how they accepted card payments and consumers had some choice in the cards they could use. This contrasted with the interbank domain, where for technological and economic reasons choice was extremely limited. There was only one way to process cheques and only one way to make a slow or fast interbank payment. This meant that while competitive pressures were driving some innovation in the card domain, for example with new merchant acquirers entering the market, there was essentially no opportunity for competition led innovation in interbank systems. Not only was regulatory or government pressure needed to drive change (for example the introduction of the Faster Payments service, cheque imaging and the Confirmation of Payee service), even with this pressure, change happened slowly due to the need to collaborate and coordinate technology change across multiple industry players to introduce ubiquitous new services.

However, over the last five or so years the PSR and the Competition and Markets Authority (CMA), have overseen significant changes that have narrowed the difference in competitive effect in these two domains, and indeed support greater competition between the two domains.

- Working with the payments industry through the Payments Strategy Forum, the PSR endorsed a new architecture for interbank payments (the NPA) which disaggregates those elements of the interbank system that remain natural monopolies, the clearing and settlement services, from those elements that can increasingly be serviced through normal competitive markets, the so called overlay services, especially those that do not directly touch clearing and settlement, indirect-overlay services which are being enabled by the second change below.
- In parallel with these changes, the CMA oversaw the introduction of Open Banking to reduce the oligopoly of the largest UK banks, allowing newly regulated Account Information Services Providers (AISPs) and Payment Initiation Service Providers (PISPs) to compete in offering new services to UK businesses and consumers that had previously only been available from banks and where such banks provided little or no innovation for users. The latter, for the first time, allowing appropriately FCA regulated third parties to provide payments services to their customers that exploit the interbank clearing and settlement services, but are abstracted away from them by the Open Banking protocols, and therefore not needed to be subject to the technical and other operational constraints of direct participation in central interbank payments systems.

Taken together, these initiatives mean that the proportion of interbank payments services that for safety, security, settlement finality and ubiquity of offering, need standardised, collaborative service development and delivery options has shrunk, basically to the clearing and settlement services themselves and the direct connection by Account Servicing PSPs and their technical aggregators.

Beyond this narrow zone, a new, more effective, operating model for the broader payments ecosystem is possible. Through Open Banking technology and the FCA's conduct and prudential regulation of PISPs a new dynamic exists.

- PISPs can provide innovative payments services to their customers where the movement of money is executed by the Faster Payments service, and in due course the NPA clearing and settlement service, without needing to be direct or indirect participants in the central schemes. The standardisation and security of this connection has already been put in place by the Open Banking Implementation Entity.
- Not only can PISPs offer payments services without the historical constraints of central payments systems membership, PISPs can now offer ubiquity of service provision to their payer customers without additional collaboration or coordination with their payer customer's banks. Any new PISP delivered service will immediately be accessible to the vast majority of UK businesses and consumers, irrespective of who they bank with.
- Value added innovations on top of the UK's very capable real time payments infrastructure can be tried in diverse ways by different competitors for different groups of potential customers without the need to coordinate risky and time-consuming changes in both central infrastructures and connected participants. Barriers to innovation have collapsed.

The nature of these changes means that the innovation it is enabling is already happening, more than a hundred new businesses have been authorised as PISPs by the FCA, and competitive solutions that overlay Faster Payments are already coming to market. But we have to guard that old-school thinking and the desire of some industry players to retain control and indeed slow the rate of innovation and growth of competitors does not undermine these new opportunities.

It is interesting to note the significant parallels between these emerging changes in UK payments and the evolution of mobile services over the last twenty years.

Prior to the advent of mobile data services and smartphone platforms, innovation in mobile was delivered collaboratively by Mobile Network Operators (MNOs) who controlled the technology and user experience. In the area of messaging, innovation was slow, over more than ten years simply evolving the Short Message Service (SMS) to Multi-Media Messaging (MMS), a service for end customers that could send relatively small pictures and videos between individual mobile users, at 50p or more per message. In the calling market, MNOs delivered a similarly expensive and inflexible video calling service with their deployment of 3G services. Both MMS and video calling remained niche services with high prices and low levels of consumer adoption.

With the deployment of 4G networks, and smartphone platforms opening up the market for Over the Top (OTT) services, everything changed. Competition on data rates, prices and network coverage between MNOs drove data prices down and coverage up, while OTT players large and small started to better serve the communications needs of mobile consumers with services like WhatsApp, Facetime, Skype, iMessage, Teams and Zoom that continue today to innovate and meet new and emerging customer needs at very low cost.

All this innovation was achieved without any oversight from MNOs, no multi-year standardisation processes and at the application layer, no competitor collaboration.

- Communications innovations have been driven by competitive success and failure.
- Consumers and businesses have not had to pick a single long-term supplier and hope that interworking gives them access, they've simply adopted and accessed multiple platforms like Teams, Zoom, WhatsApp and Facetime for video conferencing services – everyone can use every service if they desire – the ultimate competitive market.

- By unbundling application services (including even voice calling) from MNOs, MNOs have been forced to compete more directly in their core service provision – the delivery of good quality connectivity, good coverage, cost effective mobile data services.

A similar revolution in the provision of payments services in the UK is now upon us. One of the most important economic areas that this revolution can impact, delivering enhanced payment services for businesses and their customers, is in the rapidly developing Request 4 Payment/Request 2 Pay market space. A market area that can enable competition with card services, and with the right developments in Open Banking the traditional monolithic Direct Debit service.

However, competitive market entry and development in this important space is being put at risk by the continued application of 'planned collaborative innovation' by the interbank payments system operator Pay.UK though its Request to Pay programme. The Pay.UK RtP programme is constraining competition, limiting innovation and adding costs into a market that no longer needs 'management'.

- All the necessary payments standards needed to provide Request services are already in place and managed through the Open Banking protocols.
- Because of Open Banking Payments Initiation Services, request services that are ubiquitously accessible can be launched by a single PISP, selling directly to a business, who can then receive payment from the vast majority of their small business and consumer customers.
- Multiple competitors can coexist. Different business billers can use different providers as can payers, as they can typically make payment via any system without pre-registration or app download using the Open Banking protocols. Specifically, there is no need now to build payment functionality into every bank's mobile payment service, it is there automatically with Open Banking.
- With a competitive market, customer feedback and gain and loss of market share can drive the evolution of the function, capability and pricing of services. Businesses and payers can also switch providers over time with minimum switching costs. This means that going through an extensive one-off requirement gathering and proposition standards setting process is neither needed nor advisable. Feedback in use will drive the best outcomes for consumers and businesses.

Given these dangers to good outcomes for consumers and businesses, it is vital that strategically, central collaboration programmes in interbank systems are carefully governed and boundaries delineated, and tactically, that the current Pay.UK RtP programme is brought to a swift conclusion, sharing any insights it has gained with all market players. This will allow competition to do its job and will ensure that the objective of the Payments Strategy Forum and PSR, that wherever possible competitive solutions should meet market needs, is not compromised.

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Prior to establishing Ordo in 2018, Craig was chief executive of the Faster Payments Scheme from 2012, overseeing the introduction of open access, including the opening up of the scheme to non-bank PSPs like Transferwise. He was also a founding member of the PSR Panel from 2014 to 2018, executive chairman of Paym, the banking industry mobile proxy service, and a contributor to the work of the Payments Strategy Forum. Prior to his work in Payments, Craig was an executive board member of T-Mobile and then Vodafone in the UK, and originally a strategy consultant with McKinsey & Company.