RETAIL BANKING MARKET INVESTIGATION

Summary of hearing with the Payment Systems Regulator (PSR) on 15 September 2015

Introduction

1. The PSR said that it shared the objectives of the CMA in improving markets for consumers and, notwithstanding that the PSR had only been operational for five months, it believed it was already having a positive impact in the market.

2. The PSR said that it had noted the CMA's updated issues statement and barriers to entry working paper regarding access to payment systems and shared the concerns raised by payment service providers regarding direct and indirect access.

3. The PSR said that it was bringing in a package of measures to improve direct access and tackle the issues identified by the CMA. The PSR said it believed that direct access should be an option for a wider range of providers in the future.

4. In addition to its work on direct access, the PSR said that it had a programme of work and policies designed to tackle the issues identified by the CMA (in its working paper) in relation to indirect access. For example, the PSR had improved transparency by requiring greater information provision by sponsor banks. It was also looking at ways to improve the quality of service provided by sponsor banks by improving technical access to payment systems.

5. The PSR told us that it had also launched a market review into indirect access and this was considering, among other issues, concerns in relation to the limited choice in indirect access providers and the fees charged for indirect access. The PSR was in the process of gathering further evidence to feed into this. The PSR said that a new industry code of conduct was now in place which would assist providers that use the services of sponsor banks to access payment systems. The PSR said it welcomed the introduction of this code of conduct.

6. The PSR said that the payments strategy forum it had established should also drive innovation where collaboration was required and give users and other stakeholders a greater opportunity to input to the development of payment

systems than has been the case in the past. The PSR said that five or six key themes were emerging for the forum. One of the important themes was simplification of some of the rules and systems as well as giving consumers/service users more control over their payments. The issue of account number portability was also being considered. The PSR said that it was keen for the forum to focus effectively on key themes: strong governance was important for this and an independent chair had been appointed to help achieve this. Arrangements would be reviewed after six months and, if needed, changes would be made.

7. The PSR noted that some changes had already taken place: the process of becoming a direct member of payment systems was becoming clearer and quicker. The PSR said that [✄] new direct members of the interbank payment systems were expected in the next year and another [✄] direct members of the card schemes were also expected. The PSR said it was aware that [✄] firms were considering starting to provide indirect access services to other payment service providers. The PSR said its general view was that it had made a good start but there was much more to do.

Direct access

8. The PSR said that a combination of factors made direct access difficult: these were mainly around ease of access to information (in order to understand the application process) and timing issues. This in turn placed a burden on firms in terms of costs and timetabling. For non-banks there was also the additional issue of access to Bank of England (BoE) settlement accounts.

9. The PSR indicated that the costs of gaining unilateral direct access to payment systems varied by potential entrant but estimated the cost of developing the required systems to be between [✄] million. The PSR said that sometimes it could be more or less than this and it depended upon what had already been invested in the IT platform. It was, therefore, difficult to separate out the incremental costs associated with direct access to payment systems. The PSR said that if access to payment systems was enabled by developing interfaces to the central infrastructure (eg by technology providers) indirect members or those wishing to become direct members could plug into the central system and this would reduce costs through the creation of scale efficiencies. Several entrants could then benefit from the investment.

10. The PSR said that feedback received from stakeholders to date had been positive and suggested that things were changing in the market. The PSR recognised, however, that there was scope for further improvements. The PSR said that it would collect survey evidence on a regular basis to monitor developments.

11. The PSR confirmed that it also monitored what information providers were publishing under the access rule, how accessible it was and how prominently it was displayed on providers' websites, etc.

12. On costs, the PSR said that some operators were more transparent than others. More information had been published about what potential indirect members could expect in terms of fees. This was an area the PSR intended to look at in order to gain a better understanding of scheme operators' concerns around publishing more information.

13. The PSR confirmed that it was working closely with the BoE and the Financial Conduct Authority (FCA). There was, the PSR explained, a four-way memorandum of understanding in place between the PSR, the BoE, the Prudential Regulation Authority (PRA) and the FCA which underpins the engagement between the regulators.

14. CMA inquiry members queried how the PSR charged the industry. The PSR said it expected to collect its fees directly from the seven schemes that it regulated. A final consultation on the way fees were collected would be undertaken this year but the PSR was proposing an equal split between the seven schemes. The costs would then likely be passed on to direct members who might in turn pass on some of the costs to indirect members.

Indirect access

15. The PSR said it had not come across an example of a potential entrant to the retail banking market being deterred from entering due to the difficulties associated with obtaining indirect access to payment systems. Five new banks had been authorised in the last two years and all had secured access to payment systems. Similarly, recently authorised credit institutions had also secured some form of access.

16. The PSR said that providers that had indirect access to payment systems cited the terms and conditions of their access and the quality of service they received as problems associated with indirect access. Cost of (indirect) access did not appear to be the main concern. There was a willingness to invest in obtaining access to payment systems if the service quality was right. Rather than place requirements around service quality on providers of indirect access, the PSR said it was looking to stimulate competition in this area – if there were more providers offering indirect access that should give those seeking access more choice.

17. The PSR said there were a number of difficulties for direct members who wished to grant indirect access. Not least, indirect access providers (sponsor

banks) must consider whether their own systems and accounting platforms could practically provide those services to indirect users. The PSR said that there were also regulatory and risk considerations. Finally, indirect access providers had to consider their ability to acquire customers (ie indirect members). However, judging by the number of providers entering the retail banking market (with indirect access to payment systems) in the last six to eight months these issues did not appear to be insurmountable.

18. On the code of conduct, which was developed by Payments UK, the PSR said that this was a step in the right direction but it would be monitoring the outcomes to understand the impact on the market. The PSR said that what was important was whether the code provided the right level of transparency for people to really engage in the market more effectively. While the code should be able to help improve the quality of service, it was important that innovation was also improved through effective competition.

19. Payments UK would be involved in an annual effectiveness review and would collect self-certification confirmations from those that had committed to the code. The PSR said it would monitor the outcome of that process. Evidence would also be fed into the PSR policy programme and the code would be amended where necessary.

20. The PSR said that its ongoing market review of indirect access is focussed on three key areas: the number of suppliers of indirect access and choice; the terms and conditions of access; and competition in the provision of those services. Evidence was currently being analysed. The PSR said that it expects to publish an interim report in January or February 2016, and a final report in May or June 2016.

21. In light of these timings and the implications for issues being considered in the CMA's own market investigation into retail banking, the PSR agreed that it was important to continue to work closely and to share emerging thinking.

Ownership and governance market review

22. The PSR said that its review into ownership and governance was ongoing. Some meetings had been held with parties and responses would be considered. The PSR said that it was still considering what a 'good' market model might look like and it was too early to have a definitive view at this stage. The PSR wanted to listen to industry and gain a better understanding of the market dynamics. The PSR said it was aware that it might not be appropriate to regulate for today's technology because technology was changing so fast; it wanted to understand how competitive payment systems infrastructure could be in the future.

23. The PSR said that different industry players had different ideas about how the future market might develop – ranging from some thinking that technology could bypass the infrastructure system to others believing there needed to be a bigger, more centralised infrastructure. Regardless of the model the industry moved towards, the PSR said it would always have due regard for financial stability and that security remained at the heart of the payment systems framework. New technical solutions needed stringent assessment. Any changes to the technical requirements would be considered by the BoE.

Other issues

24. The PSR said that the current legislation anticipated that there could be tensions around the different priorities and objectives of various regulators (eg PSR, BoE, PRA and FCA) in terms of financial stability and promoting competition, for instance. However, engagement between the regulators to understand their different perspectives was very important. The PSR said that its relationships with the other regulators were working well and the PSR was required by law to have regard to the stability of, and confidence in, the UK financial system and the BoE's role as monetary authority in discharging its functions. While there was no conflict at present, the PSR was aware that theoretically such conflict could arise, and it would be addressed at that point through constructive engagement.

25. The PSR said it welcomed disruptive innovators such as Apple Pay into the market as the PSR has an objective to promote innovation, and new business models could contribute to that. The PSR recognised that the group of people it regulates today may not be the group of people it directly regulates in the future.

26. Finally, the PSR said that it was engaging with the FCA on the incoming second Payment Services Directive (PSD2). The FCA was the lead authority for transposing PSD2 and implementing it in the UK but where it related to the PSR's remit and indirect access in particular, the PSR was taking a close interest. The PSR said that the provisions currently in PSD2 were supportive of its own initiatives; nothing in it would impact or restrict the PSR's abilities as a regulator to pursue its own objectives.