Law Society of Scotland

Consultation Response

HM Treasury Payment Services Regulations – Review and Call for Evidence.

April 2023

Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied, and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders, and our membership.

Our Competition and Banking, Company & Insolvency Law sub-committees welcomes the opportunity to consider and respond to the HM Treasury Payment Services Regulations – Review and Call for Evidence[1].

We have the following comments to put forward for consideration.

Consultation questions

General Questions:

Question 1. How should the payment services framework evolve – and what should be the government's priorities – to better promote the following government objectives for payments regulation:

The UK's payment services framework has created an accessible yet robust basis for non-bank providers to pursue authorisation to deliver payment and allied services, offering a meaningful and credible alternative to traditional (credit institution) providers. From a thematic perspective, this framework appears to have been largely successful, generally fostering the interests of an increasingly dynamic payment

[1] Payment_Services_Regulations_Review_and_Call_for_Evidence.pdf (publishing.service.gov.uk)

services industry and service users alike. While areas for reform and improvement do exist, it is not anticipated these need necessarily be substantive.

We broadly support the objectives for UK payments regulation as set out in paragraph 14 of the consultation. However, we suggest that the competition objective (Objective D) is amended so that it is more closely aligned with HM Treasury's interpretation of the rationale and aims of PSD2 and the FCA's statutory objectives. This could be something along the lines of 'Promoting competition and investment in the interests of consumers'. This would put payments services regulation on a similar statutory basis as the work of the CMA and other sectoral economic regulators such as Ofgem and Ofcom, which all have a duty to advance the interests of consumers via robust competition.

We now turn to each of the objectives in turn.

A. Achieving agile and proportionate regulation, which facilitates the international competitiveness of the UK economy through growth and innovation in the UK payments sector.

We consider that having appropriate regulation in place will help ensure that there is a well-designed payment regime which is responsive to consumer needs. This approach will also help ensure that competition in the payment services space can be further enhanced and that innovation can continue. This will help to ensure UK payment services remain at the forefront of such services internationally, with a diversity of provision and continued investment.

We also consider that it is appropriate for the UK to maintain and develop a regulatory system that galvanises and supports a competitive domestic payments industry. This is a particularly salient consideration, given the additional policy-making competencies that have been repatriated to the UK, as a corollary of the post-Brexit settlement. However, as certain payment services as well as various payment networks and clearing systems have transnational significance, there is merit in retaining some alignment or equivalence in certain strategic settings. For example, maintenance of the UK's participation in the Single Euro Payments Area Scheme is a critical consideration; an evolving regulatory framework should hence support the industry in retaining favourable access to this Scheme and supranational payments infrastructure, ensuring UK payment users can access a dynamic and competitive payments ecosystem. Additionally, while the payment and e-money industry has adjusted to separate UK and EEA regulatory regimes, from a practical perspective, there may be specific areas where greater alignment to prevailing EEA (or wider) standards is desirable to simplify service provider operating models or, indeed, wider payment user expectations It will be noted that the European Banking Authority published its opinion on the review of the second EU Payment Services Directive ('PSD II') in June 2022 (the 'Review Opinion'), which may identify certain areas of EU regulatory changes that could be similarly beneficial and repurposed within corresponding UK-level measures.

B. Ensuring appropriate trust and protection for consumers.

Ensuring there are adequate protections against fraud is an essential element of any competitive payment services regime. Security and privacy policy should be front and centre to help ensure consumer and user confidence in both the operation of the regime and in the different actors that are present in the marketplace.

The design and delivery of regulation to ensure adequate security and privacy, however, needs to be undertaken in such a way as to not undermine competition. For example, it is imperative that regulation does not create unwarranted and unnecessary barriers to entry and expansion which limit the ability of smaller providers to compete with incumbent service providers. It is also important to ensure that regulatory arrangements do not act as a barrier to customer participation.

By example, this may be particularly topical with respect to authentication of payer-initiated payments. While yielding a material improvement in the integrity payment transaction authorisation standards, the strong customer authentication measures introduced by PSD II invariably required significant and technical revision to pre-existing authentication processes adopted by the payment services industry. These measures also resulted in various substantive downstream adjustments by both users of merchant acquiring services and end payment service customers – see, for example, the FCA's extension (of May 2021) to the implementation period for strong customer authentication. Any further and material revisions to these authentication standards are likely to require particularly careful consideration, to assess whether any implementation complexities, together with the resulting friction arising in payment authentication journeys, can be rationalised. For example, we also consider it is noteworthy that the Review Opinion proposes certain clarifications to the application of strong customer authentication for the purposes of the EEA regulatory framework. While having some utility, if analogous clarifications were proposed to the UK framework, a thorough assessment of the practical impacts of these revisions, with particular emphasis on merchant acquirers, merchants and consumers, would be appropriate, given earlier PSD II-related implementation delays and difficulties.

C. Ensuring the resilience and integrity of the UK's payment market

We consider that the continuing development and promotion of the UK's payment and e-money industry should achieve an optimised balance between (i) promoting an open, diverse and competitive ecosystem of regulated services and providers, while also (ii) ensuring the long-term sustainability of authorised firms and avoiding undue market fragmentation or disruption, due to firm failure. There is, hence, some intrinsic tension in facilitating the emergence of new and ambitious market participants against ensuring the long-term soundness and continuity of authorised providers, and the stability of the payment services industry.

As recent liquidity difficulties within the banking sector may imply (re. Silicon Valley Bank (UK); Credit Suisse), further steps may be desired to underscore the intrinsic distinctions amongst credit institutions and e-money institutions. Per the Financial Conduct Authority's earlier 'Dear CEO' correspondence (18 May 2021), it is conceivable that both consumer and commercial customers will continue to misunderstand these distinctions, which, in the setting of e-money safeguarding versus depositor protection, may become particularly salient upon a resolution of either form of institution. Introducing standardised and clear disclosure requirements highlighting the non-applicability of the Financial Services Compensation Scheme (FSCS) may help to clarify this specific distinction; for example, through usage of a prescribed and user-friendly 'badges' on key product materials. It is, however, appreciated that parallel consultations, concerning the scope of the FSCS may ultimately extend coverage to e-money and ameliorate this issue, given that e-money institutions that choose to safeguard client funds using the segregation method effectively follow the fortunes of their safeguarding credit institutions. Further consideration to this item is given as part of our response to Question 22.

D. Fostering competition, in the interests of consumers.

We consider that achieving competition across the breadth of financial services is important and recent years have seen this strengthened in banking markets, with new entrant retail banks offering innovative services to consumers, and service providers in a range of areas being able to offer innovative services utilising Open Banking. Indeed, the expansion of Open Banking into other areas of financial services can provide further benefits to consumers, and we welcome the government's initiatives to deliver this.

We also support steps to ensure that consumers can make informed choices. This is an important aspect of ensuring that competition can work well and deliver outcomes that meet consumer needs.

Question 2: To what extent would you support rationalising and/or removing the distinctions in regulation between payment institutions and electronic money institutions – in effect, combining the two sets of legislation? Would this be easier for the sector to navigate and/or lead to better outcomes?

We consider that as a threshold consideration, achieving some simplification of the existing licensing distinction and simplifying the underpinning legislative framework would be sensible. It is noteworthy that the governing legislation spans several statutory instruments. While this is partially a consequence of the separate introduction and successive recasting of the Electronic Money and Payment Services Directives, the maintenance of separate legislative frameworks regulating e-money and payment services does create

some practical and interpretive complication, even if only superficial. Revising and re-enacting the relevant regulations within a consolidated instrument (or alternatively transferring the same to a regulatory rulebook) would provide authorised providers, particularly newer and less sophisticated providers, with a single, codified legislative framework that would likely aid comprehension and adherence to prevailing requirements.

The codification of existing payment and e-money legislation could conceivably lead to the amalgamation of the regulatory payment and e-money framework, resulting in a single category of authorised provider, rather than retaining the existing authorised payment institution and e-money institution classifications. Recasting both the relevant legislation and licensing arrangements may streamline the administration of and adherence to the regulatory regime. For example, a single nimble framework may remove perceived entry hindrances to new authorisation applicants (as noted above), while also simplifying applicable procedures for existing authorised payments institutions who may choose to vary their licence permissions to become an e-money institution (or vice-versa).

Scope and definitions:

Question 3. Are (a) the definitions and (b) the scope of the regulated activities in the payments services and e-money framework clear and do they capture the right actors and activities within regulation?

Turning to the technical nomenclature and the scope of the regulated activities perimeter applicable to payment and e-money services, for established service providers and other industry actors, it is anticipated that the contours of the defined activities and related definitions are reasonably clear. However, for consumers and less sophisticated commercial clients, alongside new industry entrants, seeking authorisation, there may be some latitude to improve the comprehension and applicable of technical terminology.

A radical and wholesale revision to the scope of the regulatory regime is unlikely to be necessary or desirable. However, certain discrete areas may benefit from some additional clarification. For example, and in respect of consumers, the (more limited) role of account information and payment initiation services providers, together with the underpinning regulated activities, may still remain relatively uncertain. The liberalisation of account data access and establishment of an initiation-based payment vector, achieved through the existing Payment Services Regulations and the ‘CMA-9’ Open Banking remedy, represented substantial milestones in the development of the UK’s payment service framework. It is, however,

uncertain whether payment service users are accustomed to, or even acquainted with, the flexibilities offered by these activities and service providers.

In terms of the regulated activities themselves, our understanding is that these seem to be reasonably well-understood and entrenched amongst industry participants. While the regulatory framework is sufficiently malleable to characterise even new and emerging payment solutions under a well-defined arrangement of regulated activities, a review of the same may be beneficial to (i) identify scope to clarify any perceived ambiguities or (ii) re-scope certain provisions to better reflect prevailing policy requirements.

As a practical example, in the setting of cardless cash withdrawal services, usage of certain cardless payment instruments may not be easily reconciled to the existing framework. In addition to permitting payment service users to withdraw funds from their payment accounts using a cardless payment instrument, other more specialised providers appear to offer cardless solutions that are available to customers of their own payment service users. In other words, an e-money user may authorise their provider to issue a limited payment instrument to enable the withdrawal of their funds, by a third party customer of the user, from their e-money account. Though fairly nuanced, this arrangement may proliferate as a means of enabling certain businesses to easily render cash refunds, or public and third sector organisations to make cash payments to beneficiaries. In supporting likely more vulnerable or less sophisticated customers of such payment service users to access cash, such cardless payment arrangements are likely to support a valuable public good.

However, turning to the relevant regulated activity that is most likely to underpin this arrangement – namely, 'issuing payment instruments or acquiring payment instruments' at para. 1(e), Sch. 1, Payment Services Regulations 2017 – this may not presently anticipate issuing of cardless withdrawal tokens to a third party against the payment service user of an e-money institution. The statutory formulation of the 'issuing payment instruments' limb of the regulated activity indicates this reflects arrangements '…with a payer to provide a payment instrument to initiate payment orders and to process the payer's payment transactions;', which implies that the activity only extends to a payer (e-money customer in this scenario) themselves receiving the payment instrument for initiation and processing of the payer's payment transaction (cf. issuance to a third party to enable their execution of a cash machine withdrawal). This formulation correlates with the overlaying definition included within PSD II.

Similarly, while a wholesale and thorough review of all relevant regulated activities and corresponding legislative provisions is unlikely to be necessary, targeted consideration of any identified interpretive ambiguities or other uncertainties would be beneficial. This would enable a refinement of the pre-existing regulatory perimeter and legislative provisions, which industry participants are already familiar with.

Question 4. Do the exclusions under the PSRs and the EMRs continue to be appropriate (includes limited network, electronic communication, commercial agent etc)?

We have no comment to make.

The regulatory treatment of payment services and e-money:

Question 5. How, if at all, might the framework for the authorisation of payment institutions and electronic money institutions be reformed?

We have no comment to make.

Question 6. How, if at all, might the framework for the registration of small payment institutions and small electronic money institutions be reformed?

We have no comment to make.

Question 7. How, if at all, might the registration requirements for account information service providers be reformed?

We have no comment to make.

Question 8. Does the regulatory framework for payment initiation service providers (PISPs) and account information service providers (AISPs) sufficiently support the growth of this sector, and ensure a level playing field, and fair access to payment accounts, to support competition and growth?

We have no comment to make.

Question 9. How, if at all, might the registration requirements or wider regime for agents be reformed?

We have no comment to make.

Information requirements for payment services:

Question 10. Is the current framework for the provision of information to payment service users effective? If not, how should its scope change?

We have no comment to make.

Question 11. Are there particular changes that you would advocate to the Cross-border Payments Regulation in relation to the transparency of currency conversion, and what would these entail?

We have no comment to make.

Rights and obligations in relation to the provision of payment services:

Question 12. What has been the experience of a) providers and b) users/customers in relation to the termination of payment services contracts? Does the existing framework strike an appropriate balance of rights and obligations between payment service users and payment service providers, including but not limited to a notice period applying in such cases?

We have no comment to make.

Question 13. With reference to paragraph 31 of the accompanying review, do

stakeholders have any feedback on the government's view:

- **That, as a general principle, a notice period and fair and open communication with a customer must apply before payment services are terminated?**

- **That the regulations and wider law operates here as set out under paragraph 29?**

We have no comment to make.

Question 14. How and when do providers cease to do business with a user, and in what circumstances is a notice period not applied?

We have no comment to make.

Question 15. How effective are the current requirements in the Payment Services Regulations, notably under Regulations 51 and 71 – are these sufficiently clear or would they benefit from greater clarity, in particular to ensure that notice-periods are given, and customer communication is clear and fair?

We have no comment to make.

Question 16. Should there be additional protections for payment service users against the termination of contracts? Should anything be specific to protect their freedom of expression – e.g., to ensure that adequate (or longer) notice is given in such cases, and what communication requirements should apply?

We have no comment to make.

Wider considerations in relation to the provision of payment services:

Question 17. What provision, if any, should the regulatory framework make regarding charges for payment services?

We have no comment to make.

Question 18. Does the existing framework strike an appropriate balance of rights and obligations between:

- **Sending and receiving payment service providers?**

- **Account servicing payment service providers and payment initiation service providers/account information service providers?**

We have no comment to make.

Question 19. Are consumers adequately protected from evolving fraud threats under the existing legislation – is further policy needed to ensure this, and how should that policy be framed?

We have no comment to make.

Question 20. In relation to payment transactions which payment service providers suspect could be the result of fraud, is there a case for amending the execution times for payments to enable enhanced customer engagement? What requirements should apply here to ensure the risk to legitimate payments is minimised and that such delays only apply to high-risk, complex-to-resolve cases?

We have no comment to make.

Question 21 In relation to fraud, whether unauthorised or authorised, is there a need to a) complement rules with data sharing requirements; and b) for further reforms be made to make Strong Customer Authentication work more effectively and proportionately?

We have no comment to make.

Issuance and redeemability of electronic money:

Question 22. Are the requirements regarding issuance and redemption of electronic money still appropriate?

Echoing the feedback to Question 3, concerning the solvency risks associated with funds posted against the issuance of e-money, in light of prevailing economic challenges, there would be a compelling basis to revisit both the integrity of existing safeguarding arrangements, mandated under the existing e-money and payment services legislative framework, together with disclosure of the same to clients, particularly where safeguarding is achieved through placement of a segregated deposit with an eligible credit institution. As noted, certain clients, particularly consumers and smaller commercial customers, may not comprehend or have difficulty fully understanding the distinctions amongst (i) safeguarded funds held by a credit institution via an e-money institution and (ii) traditional deposits remitted directly by the depositor to the credit institution.

As noted, only the latter scenario provides the relevant client with FSCS coverage. In the former scenario, while the safeguarding arrangements should, notionally, protect the client against the e-money institution's insolvency, these offer no mitigation against the resolution of the underlying credit institution. This distinction may not be recognised by affected clients. Moreover, poorly framed safeguarding disclosures may, in fact, suggest that the safeguarding offers superior solvency protection as against FSCS. While safeguarded arrangements have no manifest fiscal limitations (cf. FSCS coverage to £85,000, subject to higher exceptions), these remain contingent upon the repayment covenant of the safeguarding credit institution. In contrast, FSCS is overseen by the Financial Conduct Authority and the Prudential Regulation Authority, and administered in accordance with an entrenched regulatory rulebook, implying a more robust protection arrangement.

As indicated, the usage of express and uniform disclosures could be explored to underscore the differential in these protection regimes. Similarly, subject to further (and separate) consultation, the FSCS regime could conceivably be enlarged to protect both e-money institutions themselves, together with funds safeguarded through qualifying credit institutions. Appreciating e-money balances are not deposits hence,

ipso facto, FSCS should not logically cater for these sums (without further provision), an extension of the existing deposit protection scheme may nonetheless yield a more equitable outcome, particularly if the risks are substantively equivalent and the differences in treatment are under-appreciated (or not understood) by consumers. Without such an extension, conceivably, e-money institutions are and would remain at a competitive disadvantage against FSCS-underwritten credit institutions without objective justification for the difference in treatment. Moreover, this is a core issue for consumer protection and choice. While the systems of e-money, payment and banking regulation have dissimilar origins and policy drivers, the distinction is increasingly anachronistic given the increasing overlap amongst the transactional banking and payment activities undertaken by e-money, payment and credit institutions, a colourable basis may exist to explore greater harmonisation of the compensation arrangements underpinning the same, as part of the wider review of payment services and e-money regulation within the UK.

Miscellaneous:

Question 23. Noting the intention to commission an independent review in due course, do you have any immediate observations on the efficacy of the operation of the Payment and Electronic Money Institutions Insolvency Regulations to date?

We have no comment to make.

Question 24. Finally, do you have any other observations relating to the payments framework not encompassed above, and how this could be further improved, in line with the government's objectives?

We have no comment to make.

For further information, please contact:

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