Regulatory development in payment services and fintech

Published 01-Apr-2016 by
Jacob Ghanty

Recent years have seen exponential growth in the payment services industry. In the UK, the payment systems sector now transmits approximately £75 trillion in payments according to the Payment Systems Regulator (PSR).

This growth would not have been possible without the development of new financial technologies and the increasing use, by both consumers and business, of fintech solutions. For example, mobile/digital payment solutions (such as Apple Pay™) are now recognised as instrumental in enabling commerce and financial inclusion.

For regulators such as the Financial Conduct Authority (FCA), consumer protection is paramount. Equally however, regulators across the developed world are anxious to enable, rather than disrupt, the growth of new digital payment services and financial technology platforms.

An illustration of this is the FCA's "Project Innovate", which has been developed by the FCA to foster competition and growth in financial services by supporting both small and large businesses that are developing new products and services that could genuinely benefit consumers.

A cornerstone of Project Innovate is the FCA's 'regulatory sandbox', which seeks to encourage disruptive innovation by providing a 'safe space' in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of pilot activities.

Scope of the Payment Services Directive 2

Arguably however the most important regulatory development in the payment services and fintech space in the past year was the publication on December 23, 2015 of the second Payment Services Directive (PSD2). PSD2 replaces and repeals the original payment services directive 2007/64/EC (PSD) and builds on it in a number of respects.

The general effects of PSD2 will be to broaden the scope of regulation in this market and to lower barriers to the provision of account-based services by non-bank payment service providers (PSPs). This is in keeping with European regulators' attempts to maintain competition in the industry by increasing the scope for new third party PSPs to provide services.

The corollary of this is that many more firms will be brought within the scope of payments regulation. Most importantly, PSD2 represents a recognition that the payments market is growing and changing at a pace which will rapidly render aspects of the PSD obsolete.

The importance of promoting competition in particular, has informed much of the regulatory and judicial intervention in the payment services industry in recent years. The risk of anti-competitive practices in this sector has been deemed particularly acute, given the established dominance of major PSPs.

The UK is the only jurisdiction with a dedicated payment services regulator (PSR). Like the FCA, the PSR has enforcement powers under Part 1 of the Competition Act 1998 and market study and market investigation reference powers under Part 4 of the Enterprise Act 2002, as far as these powers relate to participation in payment systems. These powers can be exercised concurrently with the Competition and Markets Authority.

Indirect access

The publication in March 2016 of the PSR's interim report on indirect access to payment systems (MR 15/1.2) illustrates how seriously the PSR takes competition as a key enabler of innovation and access in both the payments and banking sectors.

At present, PSPs rely mostly on Barclays, HSBC, Lloyds and RBS to provide indirect access to the major UK retail payment systems. Some have suggested that this creates unnecessary burdens for many indirect PSPs (IPSPs) and in fact, represents an anti-competitive barrier.

Specifically the PSR is concerned that the limited choice available to smaller IPSPs constrains their ability to negotiate on price or find an alternative provider when they are dissatisfied with the service they have received.

The review covered all main interbank payment systems and its aim was to ensure that all PSPs get a good deal in the market for indirect access to payment systems.

The PSR hopes to address this issue by supporting existing initiatives rather than regulating further at this stage. In particular it intends to lend support to a number of businesses that are planning to start offering indirect access or expand their current services, bringing more choice to banks, building societies and other PSPs that require these services.

It has also committed to encourage development of improved and alternative access models for interbank payment systems that are emerging, including the development of aggregator arrangements for Faster Payments.

Market infrastructure

The interim report on indirect access follows hard on the heels of the PSR's publication of its interim report into ownership and competitiveness of infrastructure that supports the UK's payment systems.

The PSR is concerned that the ownership of (i) Bacs, FPS and LINK, and (ii) the central infrastructure for these systems (Vocalink) is concentrated in the hands of a small number of banks. Although the PSR recognises that this has assisted the development of a robust and relatively cost-effective payments infrastructure, it feels that this concentration of ownership limits competition and innovation and may allow the banks to influence developments in a manner consistent with their own interests rather than those of all PSPs and consumers.

The remedies proposed by the PSR include a competitive procurement process for the provision of infrastructure services, potential divestment by the banks of their interest in Vocalink and a common international messaging standard adopted for Bacs, Faster Payments and LINK.

Closing thoughts

Regulation of the payments space is undoubtedly changing rapidly, however some themes are consistent. Principally, regulators are keen to foster competition but are reluctant to use a stringent and inflexible rules-based approach to achieving this. This is in keeping with HM Treasury's commitment to fostering a flourishing fintech sector in the UK, underpinned by payment systems which enable innovation.

Produced by Thomson Reuters Accelus Regulatory Intelligence 14-Apr-2016