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Response to: paymentslandscapereview@hmtreasury.gov.uk

Consultation Response

Summary

- Which? welcomes HM Treasury's review of the payment landscape. A robust, comprehensive landscape is essential to achieve the stated aim to ensure end users benefit to the fullest extent from the payments network.
- Despite best efforts it is clear that regulation has not kept pace with innovation and that certain changes to the wider payments landscape are needed in order to meet the government's stated aim.
- In particular:
  - legislative changes are necessary in order to better equip the regulator to protect consumers from authorised push payment fraud.
  - gaps that have emerged within Section 75 card protection need to be addressed. These include purchases via third party payment processors and purchases made by secondary cardholders that are not currently covered.
  - further clarity is needed over the FCA's regulatory perimeter, specifically for emerging product classes that look and function like payment methods such as Buy Now Pay Later schemes; and
  - a strong regulator with appropriate powers and resources to address ongoing concerns within the market, specifically in relation to card schemes and cash.

Introduction

The ability of consumers to access and use payment methods safely and securely is crucially important for consumers to live their lives. A diverse range of payment methods is essential in ensuring that everyone can fully participate in society.

However, it is not simply enough for consumers to have access to these payment methods; they must also be afforded easy to understand and robust protection policies. Policies that will be consistently applied across real life situations. These protections must stand regardless of the method of payment. Whether a consumer has paid by credit card, bank transfer or an e-money platform shouldn't reduce their rights to redress when things go wrong. It is clear that this is not the case currently, as we explore later in our response.

In order for customers to receive this level of redress and protection, there is, and will remain, a need for a strong regulator with an appropriate remit and appetite to intervene. Whilst competition brings benefits to consumers, the network effects necessary for payments to work means the market cannot simply be left to its own devices if the Government's stated aims are to be achieved.

The Contingent Reimbursement Model Code should be made mandatory.

The regulatory landscape has not kept pace with new methods of payment, resulting in consumers being unable to access an adequate level of redress and guarantee across all payment methods.

There are certain interventions in the payments network that are urgently needed which could significantly reduce consumer harm. The first is to ensure that the Payment Systems Regulator has the powers necessary to make the Contingent Reimbursement Model (CRM) code mandatory.

Which? welcomed the CRM Code as a significant step forward. Our 2016 super-complaint highlighted the glaring gap in fraud protection and redress for fraud via authorised push payments compared to other forms of payment such as debit and credit cards. The voluntary code introduced in May 2019 is designed to give victims the chance of fairer and more consistent redress.

In the past year, we have seen an increase in the share of victims being reimbursed. In the full year before the Code launched, just 19% of the amount lost by individuals was returned to them. In the first six months of the Code's launch, signatory firms reimbursed 41%.[1] In the second six months, 38% was reimbursed by signatory firms.[2] Rates of reimbursement were also higher for some types of scam. Which? has also started to see a shift in firms being more compassionate and understanding of the sophistication of fraudsters' practices, as well as the emotional and financial harm caused by this crime.

However, the Payment Systems Regulator has stated that rates of reimbursement are 'well below' what they expected 'given the Code presumes that customers should be reimbursed unless there are clear grounds for holding them liable'.[3] Which? agrees with the Payment Systems Regulator's assessment.

The Payment Systems Regulator has also published anonymised data for individual firms relating to reimbursement rates, which showed huge inconsistency in the application of the code. [4] The sheer scale of the differences between the approaches taken by each firm, as seen

[1] UK Finance (2020), Fraud – The facts 2020: The definitive overview of payment industry fraud, pp.46
[2] UK Finance (2019), 2020 Half year fraud update, p.23
[3] Payment Systems Regulator (2020), Authorised Push Payment (APP) scams conference call – 30 March 2020, p.5
[4] Between May 2019 and February 2020 four of the eight signatory firms fully reimbursed victims in 6% or fewer of cases, with one firm fully reimbursing just 1% of victims; whereas one firm had fully reimbursed 59% of victims. Some firms chose to partially reimburse a significant share of cases,

in the regulator's findings, suggests this is highly unlikely to be explained just by differences in the types of cases that firms deal with or their customer bases. The findings clearly show that some firms are taking a much more supportive approach to the reimbursement of their customers. It is clear the voluntary nature of the Code is undermining its potential success, not least by the lack of new signatories to join the code.

Which? believes that the CRM Code should be made mandatory to establish a set of minimum industry standards. This is a view shared by UK Finance[5] and the Treasury Select Committee.[6] As well as ensuring that all payment providers offer these protections, it would also help enable the requirements to be enforced effectively.

Mandatory standards would not preclude firms from providing a greater level of protection. TSB's Fraud Protection Guarantee, for example, already promises to refund all losses, unless customers have been wilfully or recklessly negligent. TSB has said that this has led the firm to reimburse 99% of victims, only rejecting customers whose claims were found to be fraudulent with the customer complicit in the case.[7]

When the Payment Systems Regulator recently concluded that rates of reimbursement are lower than expected, it set out three possible paths forward: working within the current voluntary scheme; changing the rules of the Faster Payments Scheme, developed and proposed by industry; or action by the Payment Systems Regulator.

The Payment Systems Regulator made clear that, in its view, it currently lacks the powers to take action on reimbursement. This is based on the Payment Systems Regulator's interpretation of the EU Second Payment Services Directive; notably that it expressly prohibits EU member states – and the UK, during the transition period – from forcing payment service providers to go beyond the terms set out in the Directive. As a result, the Payment Systems Regulator argues that it cannot currently require reimbursement to be made to APP fraud victims. The Payment Systems Regulator did note that this position may well change in the near future, and as the UK's future relationship with the EU becomes clearer, it is possible that the Payment Systems Regulator will be able to take action.[8]

Which? believes that the Payment Systems Regulator should have the powers to make reimbursement for APP fraud mandatory and as a result the government should amend the relevant legislation once the transition period ends.

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including one firm that partially reimbursed 93% of cases; whereas another firm partially reimbursed just 1% of cases. The value reimbursed also varies significantly, with one firm reimbursing just 6% of the value of cases compared to another firm that reimbursed 63% of the value of cases.

[5] The Guardian (2020), Which? calls for all banks to adopt anti-fraud measures
[6] House of Commons Treasury Committee (2019), Economic Crime: Consumer View, p.29
[7] TSB (2020), TSB reveals 100 percent reimbursement rate for innocent victims through the TSB Fraud Refund Guarantee
[8] Payment Systems Regulator (2020), Authorised Push Payment (APP) scams conference call – 30 March 2020, pp.9–10

The PSR, industry and Pay.UK should work towards providing a new Faster Payments Guarantee

As set out in the Call for Evidence, unlike other payment schemes, Pay.UK's Faster Payments lacks rules or policies related to consumer protection against fraud or error. Other payment schemes have rules that protect consumers against fraudulent payments, including mechanisms for payments to be challenged and reversed. For example:

- Section 75 of the Consumer Credit Act ensures that a credit card company is jointly and severally liable for any breach of contract or misrepresentation by the retailer or trader. Consumers can claim losses back from the credit card company and the protection also applies to foreign transactions and goods bought online, by phone or mail order for delivery to the UK from overseas.
- Direct debits, which are operated by Pay.UK, are covered by the Direct Debit Guarantee. The paying firm is responsible for making any refunds immediately if an error is made in the payment of a direct debit. If the recipient has made the error then the sending firm must raise an indemnity claim to obtain the money back. If the recipient no longer exists, the receiving firm will settle the indemnity claim.

The lack of such scheme rules undermines consumer confidence. The PSR must work with Pay.UK to explore the viability of introducing a new Faster Payments Guarantee into its schemes rules that include protection for victims of payments in error including APP fraud. Members of Faster Payments are required to follow its scheme rules, so this would ensure that the code is adopted across the industry.

This work should be conducted along with the legislative changes proposed above. There have already been efforts to change scheme rules to address some of the concerns raised in this submission. Which? strongly supported a proposal by UK Finance to introduce a Faster Payments Scheme rule requiring users to pay a fee to refund victims of authorised push payments scams in 'no blame' scenarios. We argued that Pay.UK should go further to help to communicate this to consumers in the form of a new Faster Payments guarantee, similar to the guarantee that Pay.UK oversees for direct debits.

However it is clear that this is not an easy path to navigate, the proposals were rejected and no further progress has been made. The government should bear in mind the likelihood and pace of success in addressing the consumer harms in this area when settling upon any recommendations

In considering the funding of any mechanism or guarantee that could result as part of this work, the government should also be mindful of the consumer facing pricing models of other types of payment guarantee and the incentives this has on consumer behaviour.

Clear protection and redress mechanisms must be in place for consumers using Payment Initiation Services (PIS)

Which? supported the introduction of open banking as an initiative which would allow customers more control over their banking data and encourage innovation in a market that has not benefited significantly from competition.

However, it is not yet clear what the impact of open banking will be for consumers. Take up has increased, with open banking passing two million users in September 2020[9]. However, PIS have yet to become mainstream and makes up a small proportion of overall faster payments transactions[10].

On this topic, the Competition and Market Authority has set out that for PIS to take off, the question of consumer protection needs to be properly considered[11], a view that Which? endorses. However, the CMA noted that it was not the appropriate body to conduct such an assessment and that the Payment Systems Regulator is the right regulator to look into these questions[12]. Clearly, the question of consumer protection for PIS is therefore very much a question of consumer protection for Faster Payments[13].

Which? agrees that there needs to be strong consumer protections in place for PIS and that ensuring a consumer focused approach to such schemes with clear protection and redress mechanisms in place will help ensure that consumers sign up for and are able to truly benefit from open banking.

To enable PIS to receive significant uptake in the UK, it is vital that regulators and the government recognise the risk and concerns of consumers. While consumers do understand the theoretical benefits of open banking enabled services, they also have hesitations about using such products, including:

- A lack of confidence in setting up or using these services
- Concerns about security risks
- A lack of awareness or understanding

Many of these concerns are due to the difficulty for consumers in reconciling the necessity of sharing their sensitive financial data, particularly in a market where APP and other fraud is a constant threat, with having been consistently told for decades to never share such sensitive

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[9] Open Banking (2020), Real demand for open banking as user numbers grow to more than two million. Available from: https://www.openbanking.org.uk/about-us/latest-news/real-demand-for-open-banking-as-user-numbers-grow-to-more-than-two-million/

[10] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878451/Open_banking_roadmap_decision_footnote_redacted2.pdf p11

[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878451/Open_banking_roadmap_decision_footnote_redacted2.pdf p11

[12] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878451/Open_banking_roadmap_decision_footnote_redacted2.pdf p11

[13] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878451/Open_banking_roadmap_decision_footnote_redacted2.pdf p11.

information with third parties. The legacy of such privacy concerns could lead to a depressed uptake of open banking services.

If consumers cannot be confident of better outcomes as a result of engaging with open banking, including being safe in the knowledge that they have the necessary protections in place if something goes wrong, there will be limited customer uptake and, consequently, limited effects of competition. Therefore, it is vital that there are clear protection and redress mechanisms in place for consumers. The absence of appropriate protections, such as some form of Faster Payments Guarantee as highlighted above, risks undermining the aims of Open Banking.

Gaps have emerged with Section 75 card protection need to be addressed

An area where there are risks not captured by the Call for Evidence is Section 75 of the Consumer Credit Act. Section 75 is a vital piece of consumer protection which helps consumers to access refunds and redress when things go wrong.

Which? agreed with the FCA's view that Section 75 should be retained in the Consumer Credit Act. Keeping Section 75 in legislation, rather than transferring it to FCA rules, also offers many benefits, including: decades of case law to refine the legal interpretation of the Act; a relatively stable system, owing to the need for Parliament to make any changes; and relatively high general awareness of Section 75 compared to other forms of consumer protection for payments.[14]

Section 75 also provides reimbursement for any additional losses incurred as a result of the breach of contract or misrepresentation. In cases involving travel, for example, this 'consequential loss' can be significant, as consumers might be forced to purchase alternative travel and accommodation at short notice, and often for extended periods. Without this protection, consumers would suffer significant detriment through no fault of their own. The protection offered by Section 75 has been absolutely critical during the recent pandemic in protecting consumers from significant financial loss.

However, some parts of Section 75 have not fully kept pace with how consumers make payments and need to be addressed as part of any landscape review. In particular:

- **Purchases via third party payment processors are not always covered by Section 75.** For section 75 of the Consumer Credit Act to apply, there must be an unbroken chain between the buyer, credit provider and seller. Some modern forms of payment can break this link. The Which? Money Helpline regularly hears from customers who have lost section 75 protection because they have paid for goods using a credit card via payment processors such as PayPal and Skrill, or card readers such as iZettle and Sum

[14] In a survey of 11,573 Which? members, only a third (36%) said they were aware of the protection offered by card chargeback, which is provided by the card schemes rather than a legal right, compared to 69% who were aware of Section 75. Which? (2018),
'The card protection banks don't tell you about', Which? Money, October 2018, pp.21-22; Previous research has also shown that consumer awareness of specific features of Section 75 is relatively high.

Up. Some card issuers and payment processors have even disputed what types of payment are covered.**The Financial Ombudsman Service, which can rule on Section 75 disputes, says it must judge every complaint on a case-by-case basis due to the complexity of the law.** So it can be extremely difficult for consumers to be certain when making a transaction whether they will be covered by Section 75, even if they are aware of the potential weaknesses emerging in the system. The Financial Ombudsman Service asked the Law Commission to review this issue.[15] But the Law Commission did not take this forward for its most recent programme of law reform.[16] When many consumers pay by a credit card they expect to be covered. Ensuring that levels of consumer protection are consistent should form a key part of the regulatory landscape.

- **Purchases made by secondary cardholders that are not covered by Section 75.** The rules around this are complex. Secondary cardholders can be covered if the purchase is made with the primary card holder's authority and if they expressly request the purchase and will benefit from it. But this can be difficult to define, and for consumers to understand. This loophole in the protection should be closed.

Further clarity is needed over the FCA's regulatory perimeter, specifically in relation to emerging product classes such as Buy Now Pay Later (BNPL) schemes.

In the longer term, greater clarity over the FCA's oversight of certain products and schemes is required to ensure that consumers are appropriately supported, regardless of the payment method they choose to use. Whilst regulation must strike a balance between innovation and protection, this must not come at the cost of consumer support. Some modern payment methods do not fall under any regulatory remit which can lead to significant consumer harm.

This is particularly relevant with BNPL schemes, which are growing rapidly in the UK - with one in five shoppers using such a scheme over the past year. [17] Such schemes offer people the ability to spread out the costs of goods and services interest-free, usually giving the option to pay after 30 days or in instalments - although the precise details vary from scheme to scheme. However, as a result of a lack of regulatory oversight, there are a number of potential consumer harms which BNPL schemes may present:

- Most Buy Now Pay Later products are not covered under Section 75 of the Consumer Credit Act. This means that consumers using Buy Now Pay Later do not have the same legal protections as consumers paying with a credit card if something goes wrong with the purchase[18]. This is true even when a consumer uses a credit card to pay their

[15] Financial Ombudsman Service (2016), Law Commission 13th Programme of Law Reform consultation, pp.5-6
[16] Law Commission (2017), Thirteenth Programme of Law Reform
[17] Which? (2020) Can shopping with Klarna, Clearpay or Laybuy hurt your credit score? https://www.which.co.uk/news/2020/01/can-shopping-with-klarna-clearpay-or-laybuy-hurt-your-credit-score/
[18] Which? (2020). Shopping Temptation: The new buy now, pay later. Available at: http://intranet.which.co.uk/magazines/which/2020/06_June/p34-37_Buy_now_pay_later_R3.pdf/

instalments, since Section 75 rules don't apply to products not purchased directly from the retailer. [19]

- Most BNPL products are not regulated by the FCA. This is because the majority of the new BNPL firms do not charge interest and are paid back in less than a year, thus falling beyond the FCA's remit.[20] However, to all intents and purposes, BNPL is treated by customers as a payment product and a credit product. Consequently, there is the possibility of consumer harm arising from the fact that the FCA does not have the powers to intervene if it finds that BNPL markets are not working well for consumers. There is also the potential for confusion for consumers who may assume that, like many other credit products, BNPL schemes are FCA regulated.
- With some BNPL firms allowing customers to spread the cost on a minimum spend of just £10, there is potential for late fees of up to 60% on top of the original purchase price. [21] Online complaints service Resolver says that it has received more than 15,000 complaints about BNPL schemes over the past two years, with the many relating to charges and fees .[22]

Whilst BNPL and other newly developed payment methods may increase competition in the market, it is clear that the regulator must be able to ensure that this does not come at the expense of adequate protection and pathways to redress for consumers. The current lack of FCA regulation over these payment methods could lead to notable consumer harms and confusion.

A strong regulator is required to address competition issues within the payments landscape.

As the Cruickshank Review highlighted 20 years ago, there is a natural limit on the competition that can take place between payment systems. The Review detailed problems with competition in the market, noting that "the UK payments system market… consists of a series of unregulated networks, mostly controlled by the same few large banks who in turn dominate the market for services to SMEs and personal customers."[23]

While we acknowledge that there have been substantial structural reforms to the payments landscape, some key concerns from the Cruickshank Review remain. In particular, we remain

[19] Money Saving Expert (2020). What is buy now, pay later? Available at: https://www.moneysavingexpert.com/loans/buy-now-pay-later/

[20] Shoosmiths (2020). Buy now, pay later services: the regulation debate. Available at: https://www.lawcareers.net/Explore/CommercialQuestion/Shoosmiths-Buy-now-pay-later-services-the-regulation-debate

[21] Which? (2020). Shopping Temptation: The new buy now, pay later. Available at: http://intranet.which.co.uk/magazines/which/2020/06_June/p34-37_Buy_now_pay_later_R3.pdf/

[22] Resolver News (2020). Alex's blog: will you buy now and pay for it later? Available at: https://news.resolver.co.uk/alexs-blog-will-you-buy-now-and-pay-for-it-later/

[23] Cruickshank (2000), *Competition in UK Banking: A Report to the Chancellor of the Exchequer*

concerned by the lack of sufficient regulatory scrutiny of aspects of the major card schemes, Visa and Mastercard, which account for 98% of all card transactions in the UK.

Almost all UK consumers hold a Visa debit card, and almost all consumers hold either a Mastercard and/or Visa credit card. Correspondingly, almost all retailers in the UK accept both Mastercard and Visa. Almost all ATMs (in the UK and globally) also accept both Mastercard and Visa. Mastercard and Visa's ubiquity creates large benefits to consumers and retailers, of a secure and convenient payment method accepted at large numbers of retailers and held by large numbers of consumers.

However with such a network comes significant market power. It is unclear that the market power of Mastercard and Visa is leading to the best outcomes for consumers and other end-users. This is reflected in the increasing costs associated with processing card payments. The British Retail Consortium's latest Payment Survey shows that the cost to retailers of accepting payments reached £1.1bn in 2019, of which £950m was from card payments. While card payments account for 4 in every 5 pounds spent in retail, they also incur the largest charges with shops charged an average of 18.4p per credit card transaction (up 15% from 2016), and 5.9p for every debit card transaction (up 6% from 2016).[24]

The increase in card handling costs creates perverse incentives for merchants, which could lead to detriment for consumers. Firstly, increases in card handling costs incentivise merchants to pass these on to consumers through higher prices for goods and services. We are also concerned about the impact of rising card costs on cash acceptance. As demand falls for cash, the per unit cost of handling cash will increase. We are concerned that some retailers, faced with rising cash and card costs, will make the decision to stop accepting cash to reduce their overall costs for accepting payments. This would be hugely detrimental to the millions of consumers who rely on cash to pay for essential goods and services.

The PSR has yet to intervene on card schemes, despite finding evidence in its market study of card acquiring services which suggests that scheme fees are not working well for merchants. The PSR's review found that scheme fees for Visa and Mastercard approximately doubled between 2014 and 2018, even after controlling for various factors. The review also found that these costs were passed on in full to merchants, regardless of their annual turnover[25]. However, the PSR refused to make any assessment of whether the fees paid to Visa and Mastercard are excessive due to the scope of the review. It has also not proposed any remedies to address increases in scheme fees.

The Cruickshank review also noted that "Those who control payment systems have an incentive to use this power to reduce competition in related markets, for example ... cash withdrawal out of an ATM."[26] Which? has expressed significant concerns about the impact of competition

[24] British Retail Consortium (2020), Payments Survey 2020, available at: https://brc.org.uk/news/corporate-affairs/retailers-pay-11bn-to-accept-customer-payments/
[25] PSR Market Review into Card Acquiring Services
[26]https://webarchive.nationalarchives.gov.uk/20050302022221/http://www.hm-treasury.gov.uk/media/380/1A/BankReviewPrologue.pdf

issues on cash access. For example, Visa has been open about its ambition to try and hasten the decline of cash. A Financial Times interview with Visa's European Chief Executive, published in June 2020, noted that "Visa ... is hoping to offset some of the decline in cross-border payments by encouraging a further shift away from cash in domestic spending."[27]

Which? has warmly welcomed the government's commitment to legislation to protect access to cash. Legislation is vital for ensuring that that cash can still be accessed by the millions of people who rely on it, for as long as it is needed. However, it is vital that these wider competition issues are tackled otherwise the proposals the government is making on cash risk being undermined. Therefore it is vital that there is a strong regulator with both the appetite and resources to tackle the market concerns highlighted above.

About Which?

Which? is the UK's consumer champion. As an organisation we're not for profit - a powerful force for good, here to make life simpler, fairer and safer for everyone. We're the independent consumer voice that provides impartial advice, investigates, holds businesses to account and works with policymakers to make change happen. We fund our work mainly through member subscriptions. We're not influenced by third parties – we never take advertising and we buy all the products that we test.

[27] https://www.ft.com/content/90d666a2-621e-487e-8048-e86c047bb3c7