Evolving the UK payments landscape: how regulation is meeting modern needs

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Get the inside track on evolving payments regulation in the UK and its impact on global financial institutions, with **James McMorrow** and **Otto Benz**.

What are the biggest changes happening in the UK payments landscape?

JAMES MCMORROW: Since the introduction of the Faster Payments Service in 2008, the UK has seen a string of regulatory changes impacting the payments landscape.

The most recent of these is Open Banking. Implemented in January 2018, it requires the UK's nine largest banks to share transactional data and initiate payments from regulated third parties using Application Programming Interface (API) technology, automating requests in real time. Over time, this technology is likely to become an increasingly big consideration for financial institutions and their clients.

Following Open Banking is the second Payment Services Directive (PSD2) from the EU. It requires the technological implementation of data-sharing and payment initiation solutions by September 2019.

We haven't seen the true extent of the regulations yet in terms of new solutions coming to the market. Once everyone knows exactly what standards look like across Europe, we'll start to see a number of new solutions emerging and I think PSD2 is likely to drive more change for financial institutions and corporate clients.

This could mean adopting new ways of collecting payments, using the instant payment rails for example, alongside the more traditional methods of collection.

Banks are really going to have to think carefully about how they support their future client needs, either in meeting their underlying client's customer's needs or through providing additional actionable insights into the client's day-to-day operational and treasury needs.

What other regulatory changes are ahead?

JAMES MCMORROW:
Another major change is in the consolidation of payment schemes into one service operator, known as the New Payment System Operator (NPSO).

The UK's Payment Strategy Forum recommended the consolidation, which aligns the three payments schemes (Bacs, Faster Payments Service and Cheque Credit & Clearing) under one ownership, enabling a strategy for all the schemes – as opposed to each scheme having its own strategy and roadmap.

The NPSO will also be responsible for developing the New Payments Architecture (NPA), which will bring the payment schemes together for processing using a common message standard (Common Credit Message).

This may also be aligned with the Real Time Gross Settlement (RTGS) review by Bank of England to create consistency across all payment schemes. It is expected to happen around 2021.

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These organisational moves open up the payments landscape, driving harmonisation and making it easier to connect to the payment schemes. New models will be created to enable banks and fintechs to access and integrate into the central payment infrastructure, enabling new solutions to be provided by both banks and third parties to users.

How will this new standardisation be beneficial?

JAMES MCMORROW: To understand the true benefits, we first need to consider the overlay solutions that are to be made available as part of the NPA. These are:

- **Enhanced data** – field length will be increased, allowing more data about a payment to be included in a consistent way. For example, the reference field will likely increase for Bacs payments from 18 characters to 140 and for CHAPS it may eventually increase to 420.
- **Request to pay** – this mobile-based solution will allow corporates to push a notification to customers that they need to make a payment. If they accept, they will be directed to authorise that payment from their bank account. Sort code, account number, amount and reference information will all be captured.
- **Confirmation of payee** – this will match account number, sort code and name, giving greater certainty that a payment is going to the right person.

For corporates, this standardisation will bring benefits in terms of more efficient reconciliation. It will also open up possibilities for automation, with the application of technology, such as machine learning, being used in reconciliation. However, it may be the case that additional system investment is required to benefit from this.

Banks and regulators will benefit from the new standardisation too. There may be opportunities for increased automation in scanning and screening payments, as well as the ability to increase analysis of the data in payments. For example, invoice and tax payments might be tracked and collected more easily by using legal entity and purpose of payment information.

What are the ultimate objectives of regulatory change?

OTTO BENZ: In terms of intent, the regulators wish to support a more level playing field and greater access to the UK domestic payment systems.

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The other major regulatory goal is around improving trust in payments, not just for consumers but for all end users. Regulators want to see the payments industry take a leading role in initiatives, such as enhanced data, requests to pay, and API capabilities, to reduce the opportunities for criminals to exploit banks and payments systems.

If you look at future regulatory expectations there's a significant focus on resilience. One of the key things we need to ensure both as a market participant and as an industry is that the solutions that enable money to flow are highly secure and highly resilient.

In light of some of the central industry outages, one of the aspects of a more immediate payments proposition is that a small outage is very visible. As we move into a more competitive environment where our customers make use of enhanced data and immediacy of payments to manage their cash flow more actively, if you fail to deliver on that promise, it will be a big lapse in customer trust.

The participants in the payment system all have their own objectives. Our objectives as Lloyds Bank would be to provide innovative, secure and resilient payment facilities for our customers.

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Why has the UK been so far ahead in adopting new regulation?

OTTO BENZ: Underpinning these changes is that the UK has been the world centre for financial services. The quality of participants across the industry has been very high in the UK. The innovative firms who wish to make use of payments capability have been there, the market has been there and therefore investment has been sustained.

Different jurisdictions have pushed forward initiatives in their own national styles – some more directive than others, but the style in the UK has been a mixture of government and regulatory push and industry pull.

JAMES MCMORROW: Australia and New Zealand are making decisions to push forward with Open Banking. And we're seeing countries like Malaysia, the US, Canada, Singapore and India, starting to engage and consider whether they should be legislating for the use of this technology and opening up data, or whether market forces will dictate that this happens over time.

Whilst the UK has chosen a particular standard to base Open Banking on, there's nothing to dictate the rest of the world will follow suit.

The UK chose a particular standard, ISO8583, for Faster Payments. However, other countries have used ISO20022 or even other standards. The benefits will really come with adoption of Open Banking in such a way that there's commonality and global harmonisation of standards.

How can banks keep clients informed of changes and what they mean for them?

JAMES MCMORROW: We work closely with our clients to keep them informed about changes so they can factor them into their future investment and decision making.

Timeliness is very key in this market, therefore it is our responsibility to inform and understand our client needs in depth, and how they can maximise the opportunities.

Lloyds Bank does this in two ways. Firstly, we have hosted webinars for our clients to keep them abreast of ongoing developments. And secondly, we have set up 'labs' that work not only to meet the requirements of PSD2 and Open Banking, but also to enhance our client propositions. These labs are deployed in an agile manner, engaging with clients to garner their feedback and ensure we meet their needs as much as the regulator's.

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