The payments regulatory landscape.

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Payments becoming increasingly unbundled...

Saving

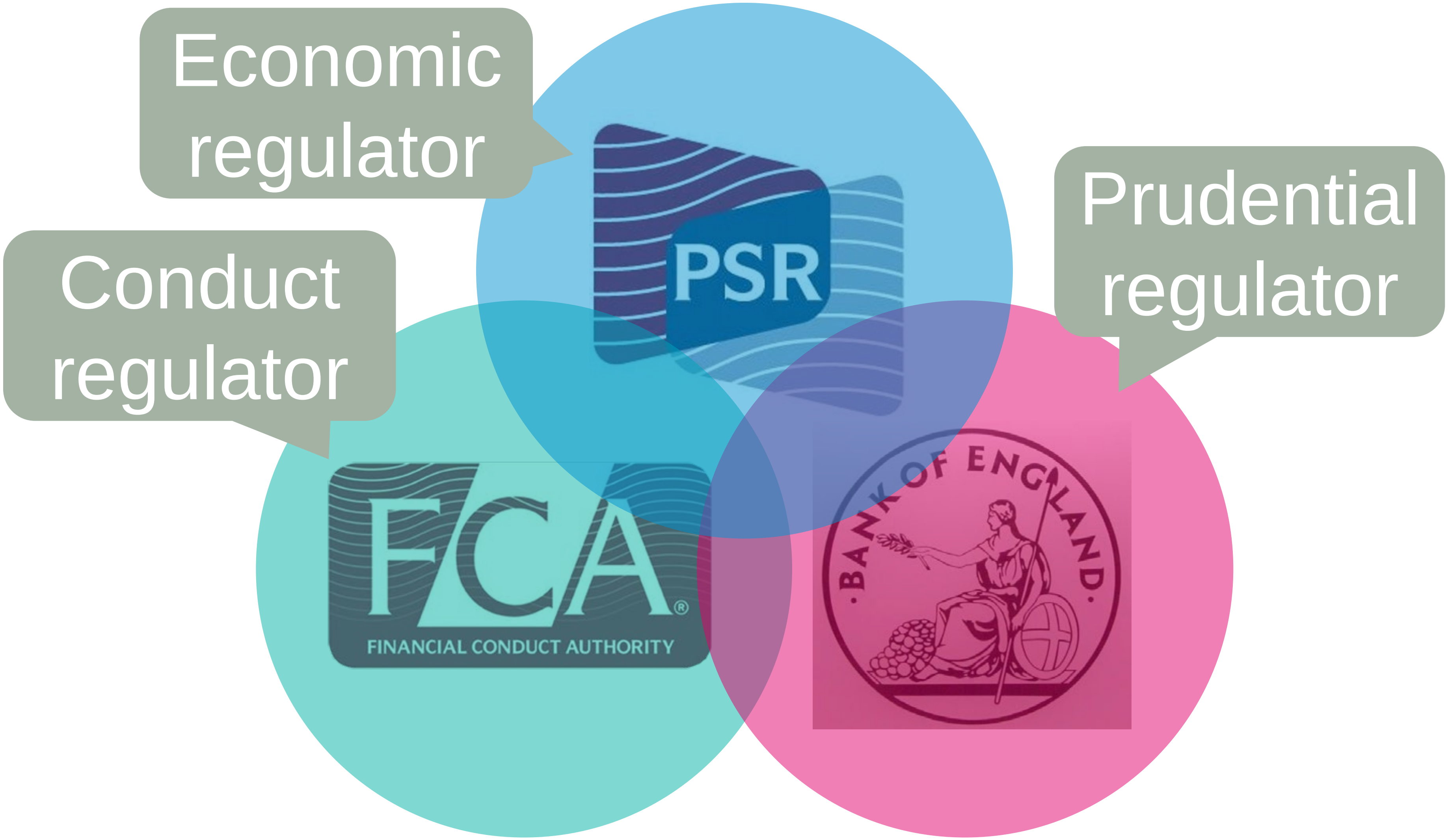
Payment

Credit

...Regulators have had some part in this...

Regulation	Unbundling	Example
Competition	Banks | Schemes	MasterCard VISA
Competition	Infrastructure | Schemes	VOCALINK
Competition	Banks | ATM providers	CARDTRONICS
State aid	Banks | Acquirers	worldpay

...But multiple overlapping payments regulators...



…1. Prudential regulation: to limit systemic risk...

…2. Economic regulation: to promote competition...

…3. Conduct regulation: to protect consumers direct...

…Payment System Regulator challenge #1:

bacs | CHAPS | Cheque & Credit Clearing Company | Faster Payments | LINK | MasterCard | VISA

Promote competition between payment systems

...Payment System Regulator challenge #2:

Promote innovation

Thank you.

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Mark Falcon, Former Executive Director, Regulatory Policy & Strategy, the Payment Systems Regulator

1. The payments regulatory landscape

- Thanks Steven. Good morning. It's a pleasure to be here.
- So, I want to help explain why payments is getting much greater regulatory attention at the moment, the roles of different regulators and some of the challenges facing regulators. And how this can help – or hinder – the payments industry.

2. Payments becoming increasing unbundled…

- It goes without saying that payments is getting more attention from everyone: customers, industry, investors, regulators.
- But why now? Payments have been around as long as banking, about 2,000 years. They've just been unloved and unnoticed.
- This has largely been, as, up to now, payments have been not a distinct product, but only part of a larger bundle.
- The main example is: a bank account. A bundle of a saving, credit and payment product.
- It's always difficult to disentangle the payment bit, because the nature of payment is debit from one account and credit to another.
- This has now changed and has been changing for a while. Standalone payment providers can sit in between account providers.
- We all use the likes of PayPal or TransferWise to transfer from one account to another, rather than just use our bank.
- So what explains this unbundling?

3. …Regulators have had some part in this…

- I suggest three main causes: technology, regulation and market opportunity.
- Internet and mobile is part of the technology opportunity, but not just these.
- My focus is regulation.
- A big driver been competition regulation, leading for example unbundling of:
  - Banks and card schemes: Visa and MasterCard's move from member organisations to public companies largely regulation driven
  - Payment infrastructure and schemes, such as VocaLink and its host payment schemes
  - Banks and ATM providers, leading to huge new entry of non-bank providers
- Divestment of Worldpay from RBS largely opportunistic result of the financial crisis.
- Nevertheless, all these examples created significant new investment and innovation opportunities, and much greater attention to payments providers in their own right.

I would have added the Payment Services Directive to this list, until I came across the European Commission's own 2013 PSD impact study, which found:

"No substantial impact of the PSD can so far be observed with regard to market entry of new providers, technical innovations, and efficiency of the provision of payment services. […]

A review of the date of incorporation of the [current authorised payment institutions…], shows that more than 85% of current [payment institutions] existed before 2008. Therefore, the PSD has not yet had a discernible impact on the entry of new players into the market."

So, I hope you'll tell me that's not true and of course we shall need to wait to see what impact PSD2 has on new market entry.

4. …But multiple overlapping payments regulators…

- So, before the Payment Systems Regulator was created, most people thought that payments already had enough regulators
- But they do each have different roles to play, although this is not always clear, and do still greatly overlap
- Neither is it well understood what economic regulation, conduct regulation, prudential regulation actually means
- So will try to give an overview

5. …1. Prudential regulation: to limit systemic risk…

- First, prudential regulation is to limit systemic risk: that when one financial institution or payment system fails, it doesn't bring down the rest of the financial system
- Prudential regulation is mainly the job of central banks, having responsibility for protecting both major banks and payment systems
- We all know unfortunately this didn't work very well during the
- The Bank of England has specific responsibility for regulating Bacs, CHAPS, CLS (the multi currency settlement system), Faster Payments Service and most recently Visa

6. …2. Economic regulation: to promote competition…

- Second, economic regulation
- The job of economic regulation is to promote competition and if, this doesn't work, to be a proxy for competition, eg through price regulation
- So, how is this relevant to payment systems?
- Well, if you're a payment service provider, then payment systems are an essential utility input, just like water or telecoms pipes and wires. In order to promote fair competition, there needs to be fair access to payment systems.
- So this is essentially the role of the Payment Systems Regulator.

7. …3. Conduct regulation: protect consumers direct…

- Lastly, conduct regulation is the backstop – the life raft – when competition fails to protect consumers interest.
- For payments, this is primarily the role of the FCA. The big example is security and fraud prevention.
- But all these regulatory roles are overlapping with each other or even in conflict.
- For example, implementation of the EU Interchange Regulation falls across the PSR and FCA (as well as the Competition & Markets Authority and Trading Standards…)
- And the PSR – and competition regulators' – duties to promote competition can be directly at odds with the Bank of England's duty to protect the stability of the financial system.
- That's the challenge of regulation and the 2007-08 Financial Crisis demonstrated how wrong regulators can get this.
- So, lastly, some specific challenges facing the UK Payment Systems Regulator.

8. …Payment Systems Regulator challenge #1…

- First, the PSR has a statutory duty to promote competition between payment systems.
- This is in addition to the PSR's duties to promote competition among payment service providers and among infrastructure providers.
- However, competition between payment systems is much more fundamental and much harder than these to achieve, as requires a comprehensive assessment of the whole payment systems market.
- For example, a subset of this problem is: how should regulator promote competition between MasterCard and Visa? This is the problem that nevertheless took the European Commission 20 years to try to solve, culminating in the Interchange Regulation. And we know it isn't over yet.
- However, a large majority of the work the PSR faces depend on answering this question.

9. …Payment System Regulator challenge #2…

- Secondly, the PSR has a statutory duty to promote innovation, namely, "to promote the development of, and innovation in, payment systems in the interests of those who use, or are likely to use, services provided by payment systems, with a view to improving the quality, efficiency and economy of payment systems."
- No mean feat and you might well ask how it is going to do that..!
- Indeed, promoting innovation is a novel objective for any regulator.
- Promoting innovation is nevertheless an essential public policy objective, especially in network infrastructure industries, such as payment systems. To quote the recent best-selling economist, Thomas Pikketty: "All economic growth depends on the pace of innovation and rapidity of its implementation."
- So, the PSR's approach to promoting innovation is two-fold: first, through greater competition. That's the easy bit. But second, where competition won't work to achieve this – where innovation needs cooperation and collaboration – this is where the newly launched Payments Strategy Forum come in.

- But as the payments industry has found in the past – collaborative innovation is very hard, for a whole set of reasons:
  - Any major payment systems innovation will always involve big winners and losers – so why would the losers want to agree?
  - Industry is often the loser, as collaborative innovation typically means a cost but no revenue benefit – which means no individual or collective incentive to innovate and invest – even though payments users might be big winners.
- These are all what economists call a "market failure", where regulators and government needs to step in.
- And this is why the Strategy Forum needs the complete backing, leadership and resource of the PSR (and Government if necessary) to help achieve what the industry is unable to achieve on its own.

10. Thank you