PSR Payment Systems Regulator

JOINT REGULATORY OVERSIGHT COMMITTEE

Consultation paper

Expanding variable recurring payments

Call for views

December 2023

CP23/12

We welcome your views on this consultation. If you would like to provide comments, please send these to us by **5pm on 2 February 2024**.

You can email your comments to **a2a@psr.org.uk** or write to us at:

Account-to-account retail transactions
Payment Systems Regulator
12 Endeavour Square
London E20 1JN

We will consider your comments when preparing our response to this consultation.

We will make all non-confidential responses to this consultation available for public inspection.

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You can download this consultation paper from our website:
www.psr.org.uk/cp23-12-vrp-call-for-views/

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1 Executive summary

1.1 We[1] are proposing swift action to extend variable recurring payments (VRPs) to additional low-risk use cases. In April 2023, we committed to consulting on changes to Faster Payments (FPS) rules if necessary to enable a phased roll-out of VRPs by 2024. This consultation proposes the changes we think are necessary.

1.2 VRPs enable customers to safely connect authorised payment providers to their bank account using open banking so that they can initiate recurring payments. These payments only occur with express customer consent, can be made at flexible intervals, and can vary in amount within pre-agreed limits. The Competition and Markets Authority (CMA) mandated nine UK banks to implement VRPs for payments between accounts belonging to the same person (sweeping VRP). We want to extend VRPs to enable payments between accounts in different names (non-sweeping VRP). In this document we refer to this new payment functionality simply as VRPs.

1.3 Informed by the Strategic Working Group (SWG) report[2] and the VRP Working Group (VRPWG) blueprint[3], we propose to initially enable VRPs for payments to regulated financial services, regulated utilities sectors, and local and central government. We currently deem these use cases low risk and will continue work to further understand the existing sectoral regulation. We call this initial roll out 'Phase 1'. In this document we set out our current thinking on what changes are needed to extend VRPs by Q3 2024 and invite views on our proposals. For Phase 1 use cases we propose:

- a multilateral agreement (MLA) that specifies the required functionality, and arrangements for pricing, dispute resolution, and liability
- using our powers to set the parameters for a central price for VRPs based on a cost recovery model for the sending firm[4] that applies our previously published pricing principles[5] and enables sending firms to cover relevant incremental costs. We provisionally identify the FPS charge as the only relevant cost for the initial rollout, which we propose to remove for sending firms
- setting at zero the price sending firms can charge payment initiation service providers (PISPs) for access to customer accounts and payment initiation if we determine the FPS charge to be the only relevant incremental cost for sending firms for the initial rollout
- mandating the participation of the nine largest banks in the UK (the CMA9) in the MLA

1 References to 'we', 'our' and 'us' refer to the Payment Systems Regulator.
2 SWG Report on The Future Development of Open Banking
3 VRPWG Blueprint
4 These are also called sending account servicing payment service providers (ASPSPs).
5 Principles for commercial frameworks for premium APIs

1.4 **The views presented in this consultation should be seen as specific to Phase 1 of expanding VRP use cases.** We see our proposals as a practical approach to scaling VRPs swiftly and seek feedback on these initial proposals, our assumptions for the cost benefit analysis, and the impacts of our proposals on people with protected characteristics. We recognise that higher risk and more complex use cases may need different arrangements to the ones proposed for Phase 1.

1.5 This work is a key enabler of our 5-year strategy. It should **increase choice and competition in payments** which will ultimately mean better prices and payment services for everyone. Phase 1 will also be a key step towards full account-to-account retail payments.

1.6 We will analyse responses to this consultation and **provide updated policy proposals for consultation in 2024.** Stakeholders will be given another opportunity to comment on the updated proposals, their costs and benefits, and equalities impacts as we publish them.

2 Background

In April, we set out our roadmap for unlocking additional open banking payments and identified the expansion of VRPs as a key next step to foster continued growth and innovation. In June, we convened a working group of industry participants, businesses, and a consumer representative to explore how to deliver Phase 1 in 2024. The group produced a blueprint that set out the necessary next steps on functionality, consumer protection, and dispute resolution. We accept the working group's suggestion to focus on so-called 'low-risk cases', subject to further analysis of existing sectoral regulation (including rules on consumer protection, liabilities, and dispute resolution). We also note the lack of consensus on a commercial model beyond a contractual structure and set out our current thinking on pricing principles (Chapter 3) and possible interventions (Chapter 4) in this consultation.

Open banking in the UK

2.1 Open banking is a secure way for consumers and businesses to let authorised third-party providers (TPPs) access their payment account data and make payments. Over 7 million people and businesses in the UK, including 750,000 small to medium-sized businesses, use open banking services to manage their money and make payments.[6] Open banking payments have more than doubled in the first half of 2023 with more than a billion successful API calls per month since May 2022. In its fifth impact report, Open Banking Limited (OBL) shows record use of open banking payments, increased adoption by the UK's consumers and small businesses, as well as the expansion of services in key areas such as borrowing, payment choice, and financial decision-making.[7]

2.2 Open banking allows consumers and businesses to grant TPPs secure access to their payment accounts. This can enable customers to make payments without using cards and fosters the creation of new and user-friendly fintech products, ranging from budgeting apps to investment platforms. Recent developments in this area have allowed some consumers and businesses to have more choice when making payments.

2.3 VRPs are one innovation that is enabled through open baking. They are payment instructions that lets customers safely connect authorised payment providers to their bank account to make recurring payments on the customer's behalf. These payments only occur with expressed customer consent, can happen in flexible intervals, and can vary in amount within pre-agreed parameters. The CMA mandated nine UK banks (the CMA9) to implement VRPs for payments between accounts belonging to the same person, which are called 'sweeping'. We want to expand VRP use cases to enable payments between accounts in different names. We refer to this new payment functionality simply as VRPs in this document.

6 https://www.openbanking.org.uk/news/uk-reaches-7-million-open-banking-users-milestone/

7 https://openbanking.foleon.com/live-publications/the-open-banking-impact-report-october-2023/

Expanding VRPs

2.4 Existing VRPs have given consumers more transparency and control over their payments because the CMA requires firms to provide accessible dashboards, clear payment parameters, and the ability to grant time-limited permissions. In February 2023, the Strategic Working Group (SWG)[8] published a report[9] that captured strong industry appetite to expand VRPs into use cases where payments are made between accounts in different names.

2.5 There is currently no obligation on sending firms to enable VRPs for payments between accounts that are in different names. The SWG however suggested the introduction of such VRPs in low-risk use cases. The report suggested low-risk use cases because it recognised the potential barriers of insufficient customer protection and liability arrangements to wider scaling.

2.6 In April 2023, we published our recommendations for the future of open banking in the UK.[10] In the report, we identified the promotion of additional services and the unlocking of open banking's potential for payments as key priorities for us in the next two years. We see the expansion of VRPs as a pilot for a wider roll out of additional use cases and ultimately as an enabler for account-to-account retail transactions. Scaling VRPs is also a key next step in fostering continued innovation in open banking.

The VRP Working Group

2.7 To support our ambition of extending VRPs, we chaired a working group (the VRPWG) of industry participants, businesses, and a consumer representative.

2.8 The VRPWG considered which low-risk use cases could support an initial rollout, and whether changes to functional capabilities, dispute resolution, and commercial models would be needed to support this rollout. The group and its subgroups submitted their recommendations in the VRPWG blueprint.[11]

2.9 The blueprint considers three low risk use cases: payments to regulated financial services, to regulated utilities sectors, and to local and central government. The VRPWG concluded that such cases would have existing consumer protections and sectoral regulation that may reduce fraud and insolvency-related risks to consumers and sending firms. The blueprint identified payments in the three use cases as possible low-risk options and saw value in extended VRPs to these use cases in Phase 1 given the benefits for consumers.

2.10 The blueprint also notes that existing functional capabilities are largely sufficient to enable our proposed scaling of VRPs in these use cases. It suggests some enhancements to maximise functionality.

8 The SWG was convened by us to collate views and input from industry and broader stakeholders into the vision and strategic roadmap to further develop open banking. It published its report in February 2023.

9 SWG Report on The Future Development of Open Banking

10 Recommendations for the next phase of open banking in the UK

11 VRPWG Blueprint

2.11 The VRPWG reached broad consensus on three further points:

1. The need for a contractual arrangement that binds ASPSPs and PISPs into a clear set of obligations.
2. The need for billers to contract with PISPs while accepting that the PISPs' contracts with sending firms would shape the PISPs' terms with billers.
3. The need for sufficient sending firm participation to make VRPs sustainable and commercially viable.

2.12 However, the VRPWG did not reach consensus on five topics:

1. Definition of pilot
2. Contractual structures
3. Participation
4. Charging
5. Regulatory intervention

Definition of pilot

2.13 There were varying views on the precise use cases to include in Phase 1 and the timeline of this initial rollout. Some argued for a clear time limit to allow for analysis of initial performance. Others argued for an open-ended design to give billers confidence in adopting this new payment method.

Contractual structures

2.14 There was no agreement on which contracting structure would be preferrable, nor on the composition of a possible multilateral agreement or framework. The group considered a multilateral agreement, multiple multilateral agreements, an overarching multilateral framework, or agreement underpinned by bilateral contracts. The group broadly fell into three camps:

- Those who felt some standardisation was helpful, but that contracts should generally be left to the market.
- Those who argued for a more encompassing agreement. There were varying views on structure and pricing, with some making the case for standardised guidelines for contractual relationships between more than two parties.
- Those who preferred an all-encompassing agreement that would set a central price via regulatory intervention or through a third-party scheme operator.

Sending firms and PISPs did not collectively converge into aligned views with their peers. It was agreed by members of the subgroup and the working group that any work on developing a multilateral agreement should not preclude further bilateral arrangements.

Participation

2.15 Members agreed that sufficient uptake by sending firms, PISPs, and billers was critical to successful expansion. However, there were varying opinions on what sufficient uptake would look like for each group.

- Suggestions on the uptake by sending firms required to make Phase 1 viable ranged from four sending firms (including one or two of the largest banks) to 70% of the current account market. The subgroup was also divided on whether pricing alone could achieve this level of uptake, or if regulatory intervention was necessary to ensure adequate sending firm coverage.
- Members agreed on the need for uptake by a broad range of PISPs to enable sufficient biller and consumer participation but did not define a minimum number. They felt that Phase 1 should also not preclude any of the different go-to-market strategies used by PISPs.
- Members identified sufficient biller coverage as crucial to the success of Phase 1, agreeing that PISPs would drive biller adoption through product offers. However, the group did not define a minimum level of biller adoption or discuss biller adoption beyond the need for PISPs to provide a value proposition at an affordable cost (if charged).

Charging

2.16 The working group limited itself to discussing how the market might function and did not explore pricing, having regard to the application of competition law to interactions between actual and potential competitors. In general, the group supported a model where PISPs would charge billers but not consumers. There was also broad agreement that the market for billers choosing ASPSPs was working well. The group was divided on possible charging of PISPs by sending firms.

- Some felt that charging is competitive and should be left to the market.
- Others argued that charging must be centrally set. Views varied on whether a regulator, scheme, third party, or central body should do this.
- Other members felt that sending firms should not charge PISPs, and that both parties should charge other parties in the supply chain.

2.17 Subgroup members also questioned whether the market could deliver a charging structure that incentivised sufficient participation for Phase 1's success. Some argued that given time, the market could develop a sufficiently attractive VRP proposition for Phase 1. Some TPPs, however, felt current market structures made such innovation unlikely. They were particularly concerned if sending firms sought to charge a price aimed at recovering lost card revenue, as such a price would prevent PISPs from offering billers a competitive price on VRPs, which would stifle uptake by billers.

Regulatory intervention

2.18 Finally, views varied on the necessity and appropriateness of regulatory intervention to support Phase 1. The group considered a range of options:

- A fully regulated price to avoid multiple negotiations and misaligned incentives in the market.
- A regulated set of industry-wide rules on contractual arrangements, consumer protection, and dispute resolution.
- Regulatory intervention to ensure sending firm participation (potentially only in case of a market failure).
- No regulatory intervention.

Our Response to the VRPWG

2.19 In our response to the blueprint[12], we have tasked OBL and Pay.UK with establishing implementation groups to make the VRPWG's proposed changes to functional capabilities and dispute resolution processes. We expect these changes to be in place by Q3 2024 to enable the initial scaling of VRPs.

2.20 We believe that the implementation groups should consider additional technical challenges. These include questions on how it may be practically possible to limit VRPs to the specific use cases of Phase 1.

2.21 We also note the blueprint's broad agreement that the three proposed use cases would be lower risk and thus are suitable for the initial scaling of VRPs. We currently deem these use cases low risk and will continue work to further understand the existing sectoral regulation ahead of implementation. We base our policy thinking for Phase 1 on the assumption that use cases will include payments to regulated financial services, regulated utilities, and local and central government.

12 JROC response to VRPWG Blueprint

3 The pricing principles

As the extension of VRPs to Phase 1 use cases is beyond the existing open banking regulatory requirements, sending firms can set charges for access to their customers' account data and payment initiation.

We have heard concerns from ecosystem participants about how sending firms price data access and payment initiation. We published pricing principles in June 2023, which we expect sending firms to adhere to.

We intend to apply the pricing principles to the price sending firms can charge PISPs in Phase 1 and invite stakeholder input on them.

3.1 Sending firms can charge for access beyond the existing open banking regulatory requirements. However, we have heard concerns about how such access may be priced. Ecosystem participants have raised concerns with us that sending firms may use their position as gatekeepers of their customers' accounts to set a price for data access and payment initiation that could disincentivise investment and adoption. We have heard these concerns through the VRPWG and in bilateral stakeholder engagement.

3.2 In June 2023, we set out principles we believe sending firms need to use to agree a price to charge TPPs for access beyond existing requirements.[13] We think the principles we published should apply to Phase 1. We think that in Phase 1:

- Prices should broadly reflect relevant long-run costs: Charges for VRPs should broadly recover directly attributable and efficiently incurred economic costs, ensuring fair value for TPPs. Pricing should reflect relevant internal costs and exclude those unrelated to providing VRPs.
- Prices should incentivise investment and innovation: Charges should support a sustainable, long-term return for sending firms, compensating for risks, and rewarding innovation.
- Prices should promote adoption and encourage network effects: Pricing is crucial to achieving these important goals.
- Fair treatment of TPPs: Charges should avoid unfair competitive advantages and foster healthy competition. Pricing should not hinder TPP entry, growth, or investment in open banking. Transparency and potential standardisation of prices may contribute to equitable treatment.
- Transparent fees: Pricing should be transparent and straightforward to create a level playing field and to facilitate the uptake of VRPs. Clear pricing helps TPPs make informed decisions and encourages competition.

13 Principles for commercial frameworks for premium APIs

3.3 We think these principles:

- will ensure a sustainable commercial model that supports our growth ambitions for open banking.
- mitigate the risks associated with sending firms' ability to limit and control access to customer accounts.
- strike an appropriate balance between incentivising the necessary investment and encouraging network effects in Phase 1.

3.4 At the moment, we intend to apply these principles to the prices sending firms charge PISPs. The principles have therefore been used to guide our thinking on what an appropriate price for VRPs might be in Phase 1. We do not currently plan to intervene on other elements of the value chain – including the prices charged to billers as we believe these are currently subject to enough competitive pressure and are, therefore, likely to reflect their underlying costs.

Question 1

Do you think the pricing principles as published in June 2023 support delivery of a sustainable commercial model for Phase 1? Please explain the reasons for your answer.

3.5 As we develop our policy thinking further, we intend to reflect on feedback received in this consultation and use these principles in our policy development. We will review the evidence submitted in response to the above question and we will consider whether the proposed principles are the right ones to support delivery of a sustainable commercial model for Phase 1. We will publish our updated thinking on the pricing principles in 2024.

4 Proposals for consultation

The work of the VRPWG has highlighted the challenges to agreeing a commercial model for Phase 1. For VRPs in Phase 1, we have considered several options and welcome comment on our proposals. We currently propose:

- an encompassing MLA that sets a central and regulator-set price
- setting at zero the price sending firms can charge PISPs and removing the FPS fee sending firms would otherwise be charged
- mandating the participation of the CMA9 banks

We also set out and seek feedback on our assumptions for the cost benefit analysis, and the impacts of our proposals on people with protected characteristics.

4.1 We are seeking further stakeholder input to test and inform our developing policy proposals for Phase 1. This section explains our current views and invites comment on the contractual format we currently consider is best suited for Phase 1, possible interventions on pricing, and possible interventions on sending firm participation. We also seek to better understand stakeholder preferences in relation to the handling of competition law implications of such discussions. We will seek further input on more developed policy proposals in 2024.

Contractual design for Phase 1

4.2 We agree with the VRPWG that a contractual framework to regulate the relationship between relevant parties is needed. We currently consider the best contractual option for Phase 1 to be an all-encompassing MLA that, at a minimum, sets out required functionality, arrangements for pricing, dispute resolution, and liability. Our current preference is for a single standard set of rules that includes a mechanism for a specified and centrally determined price.

4.3 We recognise that any MLA and any mechanism for a centrally set price must be set up and operated to comply with all relevant competition laws. While the application of competition law will depend on the arrangements ultimately adopted, it will be important to ensure that the implementation groups have appropriate guardrails in place.

4.4 We think our proposal overcomes inefficiencies associated with the number of sending firms and PISPs in the market and maximises participation. We currently consider it would be costly and inefficient for parties to bilaterally agree terms and conditions for Phase 1. Such bilateral arrangements could also limit PISPs' and smaller sending firms' ability to enter the market for Phase 1, given the resource requirements of negotiating a series of bi- or multilateral agreements. We are also concerned that a bilateral approach (even if it included an independent third-party adjudicator) is not scalable. Given our perception of the differences in bargaining position between sending firms and PISPs, which we outline at paragraph 4.9, we are concerned that a bilateral approach could risk higher prices and ultimately dampen biller uptake in Phase 1.

Question 2

Do you think that cross-industry coordination is necessary for Phase 1 and that an MLA is the appropriate vehicle to achieve this? If not, please explain what approach you think is more appropriate and why.

4.5 We currently think that Pay.UK is best placed to operate the MLA for Phase 1. As the existing payment system operator (PSO), Pay.UK has the capabilities to deliver an MLA for Phase 1 in the timescale required. Pay.UK currently runs the national retail payment systems Bacs (including Direct Debit), Faster Payments, and the Image Clearing System that clears and pays cheques digitally. For each of these, Pay.UK operates rule books, pricing, and dispute resolution processes. We believe this experience and Pay.UK's existing expertise make them best placed to help deliver Phase 1. This is a practical choice and should not be seen as determinative of any future decision on who would operate other open banking payment systems.

4.6 We have also considered OBL and a newly created third-party operator for Phase 1. We note OBL's effective delivery of the open banking standards, but we consider that ownership of a payments MLA would require significant additional capability and capacity. We believe it would be difficult for OBL to stand up this extra resourcing in the time available. We do not believe it would be feasible or practical for a third party to develop an MLA in the timelines envisaged.

Question 3

Do you think Pay.UK is best placed to operate the MLA for Phase 1? Please explain your rationale and whom you think might be better placed if you disagree.

Possible price intervention in Phase 1

4.7 We believe pricing will be key to the success of Phase 1. We currently assume billers will only invest in adopting VRPs if they offer better value for money or other benefits than existing payment methods. The price to billers will partly depend on the cost to PISPs of offering the service. The costs to PISPs include the charges for access to customer account data and for initiating payments by sending firms.

4.8 Submissions to the SWG and discussions within the VRPWG highlighted concerns about sending firms' ability to set this price for data access and payment initiation. We have also heard concerns from PISPs about the lack of progress on VRPs and the level of charges that sending firms have imposed to date.

4.9 In considering the value chain of VRPs, we have concerns that sending firms may have a 'bottleneck monopoly'[14] in relation to VRPs that require access beyond the existing open banking regulatory requirements. Sending firms control access to their customers' account data and to the initiation of payments from their accounts. TPPs cannot choose the sending firm from which an individual payment is initiated but must use the sending firm chosen by the customer making the payment. We further think TPPs have very limited ability to influence the customer's choice of sending firm. This currently suggests to us

14 In economic theory a 'bottleneck monopoly' exists when a firm controls access to a facility that is essential for reaching customers, and there is no alternative way of reaching these customers.

that sending firms may have a 'bottleneck monopoly' over payment initiation from their customers' accounts.

4.10 We consider that the market features we have provisionally identified mean there is a risk that, without regulatory intervention, sending firms could limit access to their customers' account data and/or charge a price for initiating payments that may not generate the outcomes found in competitive markets without regulatory intervention. We have concerns that sending firms may default to pricing VRPs at or above the price of the card interchange fee. Such pricing would aim to recover lost card fee revenue and not reflect the relevant long-run costs of VRPs. This would not meet our pricing principles, risk making VRPs too costly for widespread biller adoption, and would not meet our objective of promoting innovation and competition between payment systems, nor our hope of lower prices for consumers. We also note that in many cases we expect the scaling of VRPs in Phase 1 to replace direct debits and bank transfers, for which sending firms do not usually receive any direct revenue from the payment system.

4.11 Our current view is that regulatory intervention is likely to be necessary in relation to the price sending firms can charge PISPs. We also think regulatory intervention may be needed to ensure PISPs can initiate payments from customer accounts.

Question 4

What do you think of our current view of the market structure and sending firms' position in it? What do you think we could do to mitigate risks or overcome misaligned incentives?

4.12 In developing a possible price intervention, we currently believe a cost-based approach is a pragmatic approach that aligns with the pricing principles set out above and that enables us to deliver Phase 1 efficiently. This approach does not enable sending firms to make an explicit return for Phase 1, but we think that it also does not limit sending firms' ability to innovate elsewhere in their business to commercialise VRPs further. We also note that, with the potential removal of FPS fees, Phase 1 may reduce costs to sending firms elsewhere in the business by replacing direct debits and bank transfers.

4.13 Our current view is that in the long run sending firms should be able to broadly recover material costs that are directly attributable to expanded VRP use cases. We consider there are likely three sources of relevant costs for sending firms:

1. Sending firms' own costs
2. FPS related costs
3. OBL related costs

4.14 We have had discussions with stakeholders to understand possible costs to sending firms. The costs to sending firms fall into two categories: initial investments and running costs. We acknowledge that there will be some investment costs associated with enabling VRPs. However, we believe these costs to be relatively small because the expansion of VRPs we propose for Phase 1 builds largely on existing open banking functionality. We therefore currently expect investment costs to be low particularly for those sending firms who have already implemented VRPs today, given existing functionality can likely be scaled with minimal costs.

4.15 We also believe that there may be additional costs associated with processing VRPs and are interested in views on which of these would be material on a per transaction basis. For Phase 1 we, however, consider that the costs of dispute resolution, fraud prevention and fraud reimbursement are likely to be negligible because the three initial use cases are limited to regulated industries with minimal risk of fraud costs to sending firms. We also believe that potential costs relating to legal liability, outside of transactions, are relatively low fixed costs and therefore can be discounted for Phase 1. We also consider that any internal processing costs a sending firm incurs for Phase 1 are likely to be limited and the costs of accounting for such costs may not be consistent with the pragmatic approach we are taking to deliver Phase 1 VRP efficiently.

4.16 While we think that costs are likely to be limited, we have also considered the impact of the shift of payment methods in the proposed use cases to VRP. In the case of substitutes from Direct Debit and bank transfers, we think that any incremental costs incurred by sending firms in Phase 1 are unlikely to be additional, as they substitute volumes from one payment method to another, and do not impact sending firms' cost base.

Question 5

Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.

4.17 We think that the only relevant costs that all sending firms would incur are fees related to the use of FPS. We currently see two approaches to addressing this cost: allowing sending firms to charge to recover this cost or removing the FPS charge. Our current preference is to remove the marginal costs of FPS charges that sending firms would incur for VRP payments in Phase 1. We are working with Pay.UK to understand how this could be implemented and the implications of different approaches. We are discussing different options including passing the sending firm's share of the FPS charge to the receiving firm or removing the sending side of the charge entirely, recovering costs across FPS users.

Question 6

Do you think allowing sending firms to charge for FPS related costs or removing the costs where possible is a better approach? Please explain why.

Question 7

Our current preference is to remove FPS 'price per click' charges from sending firms for VRPs. Do you think this charge should be switched to the receiving side or recovered through wider Pay.UK charging, and why?

4.18 We have also considered possible OBL related costs involved in enabling VRPs for Phase 1. We are not currently aware of any significant direct costs to OBL related to the provision of VRPs in Phase 1 beyond those considered in OBL's current budget for non-Order activities; the funding for which is currently under separate discussion. The FCA-chaired Future Entity Working Group (FEWG) considered possible funding arrangements for the Future Entity of open banking. Following the competition of the FEWG's recommendations, we are carefully considering the report along with other inputs. Alongside other Joint Regulatory Oversight Committee members, we will finalise detailed recommendations for the design of the structure, governance and funding of the future entity, publish these refined views and set out the next steps by the end of the first half of 2024.

Question 8

Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.

4.19 In developing our policy, we also considered:

- Placing regulatory guardrails on bilateral price negotiations
- Setting a fee that replicates the revenue sending firms earn on the payment methods replaced by VRPs (for example, setting the fee at 0.2% based on the debit card interchange fee)
- Directing Pay.UK, as the PSO, to calculate a price for VRPs in Phase 1.

4.20 We consider placing regulatory guardrails on bilateral price negotiations between sending firms and PISPs will likely hamper scaling beyond low-risk use cases and could limit the ability of new or smaller PISPs to enter the market. We also consider setting the price based on a benchmark (e.g., a sending firms' revenue on alternative payment methods) is difficult to justify economically and may result in a price discouraging adoption at this crucial early stage. Finally, we currently consider that tasking the PSO with calculating a price for VRPs in Phase 1 is likely to take an extended period of time and delay the benefits to consumers and businesses.

4.21 We think our current proposal is a pragmatic approach that aligns with our proposed pricing principles and that will allow the rollout of Phase 1 to the timeline we set out in April 2023. If the FPS charge is removed for sending firms, and if we – following the analysis of responses to this consultation – conclude that it is the only relevant costs sending firms conclude, we propose that the charge the sending firm can recover from a TPP is set at zero. The proposal to set the charge at zero is consistent with our suggested cost-based approach, the existing arrangements for other open banking use cases and makes this proposal simpler and more practicable to implement. While this is a pragmatic approach to Phase 1 of VRPs, we consider that higher risk and more complex use cases may need different approaches.

Question 9

What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

4.22 Our proposed approach will require sending firms to flag relevant FPS transaction to identify them as VRPs. We are working with Pay.UK to understand the process for introducing new FPS payment sub-type codes that could be used to identify different types of VRPs. We encourage sending firms to work constructively with Pay.UK on its preparatory work to understand how sup-type codes could be used to facilitate Phase 1.

4.23 We are not currently considering regulatory intervention on pricing for other areas of the value chain for VRPs. We think there is sufficient competition in the remainder of the value chain for Phase 1 including competition between PISPs for billers, and between receiving banks for providing payment receiving services to them. We intend to monitor prices in these areas in the future.

Possible mandated participation in Phase 1

4.24 We believe that a sufficiently large number of consumers having accounts that support VRPs during Phase 1 will be key to its success. We think a large pool of potential customers will incentivise PISPs and businesses to invest to offer VRPs, maximising the benefits to businesses and consumers. These are known as network effects, where the benefit of a service increases the more people can use it.

Question 10

Do you think that a large number of consumers with accounts that support VRPs in Phase 1 will sufficiently incentivise PISPs and/or billers to invest in offering VRPs? If not, please explain why.

Question 11

What number or share of consumer accounts do you think need to support VRPs in Phase 1 to incentivise sufficient PISP and/or biller investment to realise network effects? Please explain your rationale.

4.25 Our current evidence, including from the VRPWG, suggests that that without strong financial incentives too few ASPSPs would voluntarily offer the required functionality. We are also aware of only limited agreements between sending firms and PISPs to provide VRPs to date. This is despite there currently being no restrictions on sending firms' ability to implement VRPs independently or agree a price bilaterally.

4.26 We think that our currently proposed commercial model for Phase 1 is unlikely to provide as strong a financial incentive to sending firms as those models that would charge a price equal to the card interchange fee or that left prices up for negotiation. We also note that some in the VRPWG preferred these alternatives. To ensure a sufficiently large number of customer accounts that can support Phase 1, we are therefore considering whether we might need to follow the precedent of the CMA Order and mandate the CMA9 banks to participate in Phase 1.

4.27 These banks have already adopted the VRP standard for payments between accounts in the same name, which the expanded VRP use cases in Phase 1 will also use. They should, therefore, be able to enable VRPs for approximately 90% of consumer accounts in Phase 1 building on existing functionality and process. We believe that other banks may also voluntarily adopt the standard and further expand coverage. This assumption is based on the observation that non-CMA9 banks voluntarily adopted the APIs set out by the CMA Order. Similarly, over 50 non-directed firms voluntarily adopted the name checking service Confirmation of Payee between 2019 and 2022.[15]

Question 12

Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.

15 PSR directs 400 firms to introduce the payment protection measure, Confirmation of Payee

Question 13

If we do not mandate the CMA9 banks, how do you think we can ensure a sufficiently large number of customer accounts will support Phase 1 to realise its full potential?

Question 14

What do you consider to be the main risks and costs of mandating participation in Phase 1? How could such risks and costs be mitigated?

4.28 We also considered:

- not mandating any firm to participate in a centralised MLA in Phase 1
- commercial models with stronger financial incentives for sending firms to sign up to the centralised MLA. This could include bilateral negotiations with regulatory guardrails and setting the price at the level of the interchange fee
- mandating all sending firms to participate in a centralised MLA in Phase 1

4.29 We do not currently consider that voluntary participation would provide sufficient sending firm coverage. We think without possible intervention there would be a significant risk that not enough sending firms would be financially incentivised to sign up voluntarily to create the necessary network effects. We also think there is a risk that the other commercial models we considered might not lead to sufficient coverage for VRPs given the complex commercial models of banks.

Question 15

Do you see advantages in any alternative models? If so, please describe the models and explain their advantages.

4.30 We recognise that our preferred approach's limited financial incentives may weaken the incentives of sending firms to invest in VRPs beyond the minimum prescribed requirements. We also have concerns that in the absence of strong financial incentives, sending firms may not actively promote VRPs in Phase 1. We currently believe the proposed MLA can address some of these risks by setting out relevant rules alongside existing OBL requirements. While we expect sending firms to act in good faith in ensuring that Phase 1 is rolled out to the required standard and in the agreed timeframes, we are interested in stakeholder views on this risk and its mitigation.

Question 16

Do you think there are additional risks associated with our proposed commercial model that we should consider? Do you have additional insight on how we best mitigate the risks identified or any additional risks you may want us to consider?

Costs, benefits, and equality impacts

4.31 It is important to consider the costs and benefits of our proposals. As we develop our complete cost benefit analysis, which will accompany any policy proposal in 2024, we welcome additional stakeholder input on:

- our initial assumptions, including the scope of potential use cases to include in our analysis
- the costs and benefits of VRPs
- the possible impacts of VRPs on people with characteristics protected under the Equality Act 2010.

Cost benefit analysis

4.32 As part of our cost benefit analysis, we will develop assumptions on the adoption of VRPs in Phase 1. We plan to assess the market outcomes in the absence of regulatory intervention as the comparator for our regulatory option(s). We will seek to capture the costs and benefits of VRPs in each use case, for sending firms, PISPs, billers, consumers, and the PSO.

4.33 Our assumptions on the use cases for Phase 1 are as follows:

- The utilities use case will encompass payments across the water, gas and electricity industries that are regulated by Ofgem and Ofwat.
- The government use case will encompass payments made by consumers and businesses to HM Revenue and Customs and payments made through Gov.UK Pay.
- The financial services use case will encompass payments to FCA regulated firms, but not payments into unregulated investments.

4.34 We expect further work to be done on the use cases. We also propose to take a conservative approach to including specific transactions within each of these use cases for the cost benefit analysis. This should not be interpreted as an indication of our final views on the inclusion or exclusion of specific transactions, rather it is a provisional assumption on which we seek views from stakeholders.

Question 17

Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis? Please provide reasons for your response.

4.35 In addition, we currently assume that:

- in the absence of the potential regulatory intervention set out in this document, the current provision of VRPs by sending firms would not change, and that potential additional benefits and costs would not materialise.
- any costs and benefits would be incurred by payers, billers, PISPs and payment facilitators, ASPSPs, Open Banking Limited, and Pay.UK.
- the relevant time horizon to assess costs and benefits is ten years.
- migration costs related specifically to the New Payments Architecture can be disregarded for VRPs.
- payment methods that we deem to be alternatives to VRPs in Phase 1 will not significantly improve in functionality or benefits to billers and/or sending firms during the ten-year period.

Question 18

Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response.

4.36 Our initial high-level analysis indicates that some of the key benefits of introducing VRPs in Phase 1 are:

- easier finance management for users, with greater flexibility on payments and the reduced need to make payments via credit
- reduced costs to payees due to late or misdirected payments, through improved payer finance management and greater transparency
- an important step towards the development of account-to-account retail payments

Question 19

What do you think are the key benefits of VRPs for each of the components of the value chain: consumers, merchants, the PSO, PISPs and sending firms? How should or could these be measured?

4.37 We currently believe the key high-level costs to consider are:

- potential loss of revenue from product displacement for sending firms
- upfront costs to billers from adopting or switching to VRPs
- familiarisation and training costs for participants

Question 20

What do you think are the key costs of VRPs for each of the different components of the value chain: consumers, merchants, the PSO, PISPs and sending firms? How should or could these be measured?

Equalities impact assessment

4.38 We are mindful of our obligation under the Public Sector Equality Duty (PSED) to have due regard to the need to eliminate discrimination, advance equality of opportunity, and foster good relations between different people when carrying out our activities. We are therefore interested in views on how the different options under consideration might affect people with the protected characteristics set out in the Equality Act 2010.

4.39 We recognise that people with different characteristics may be affected in different ways, but we do not currently think our proposals disadvantage anyone (see Annex 2).

Question 21

How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?

5 Beyond Phase 1

5.1 This consultation seeks stakeholder input to inform our continuing policy development on Phase 1 of enabling VRPs. Our current policy thinking is focused on the three use cases identified in the SWG Report and validated by the VRPWG.

5.2 However, we are mindful that the purpose of Phase 1 is to advance the promotion of additional services in the open banking ecosystem. We want to ensure that our proposals do not damage the development of any other open banking services.

5.3 We do not believe that we currently risk stifling innovation or hindering the scaling of new open banking functionality. The thinking presented in this consultation is specific to Phase 1 of VRPs. We see our proposals as a practical approach to deliver VRPs swiftly. We recognise also that higher risk and more complex use cases may need different commercial models.

Question 22

Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase 1? If so, please explain why.

5.4 In the longer term, we are working to increase the choices available to people and businesses when they make payments. We believe VRPs will support the development of account-to-account payments as a viable competitor to card transactions and improve choice for users who currently rely on those payment methods. This increased choice and competition will ultimately mean better prices and payment services for everyone. Our work to deliver Phase 1 of VRPs will help to address gaps in open banking retail infrastructure that could prevent people using account-to-account payments.

6 Next steps

How to respond

6.1 We are asking for feedback on the issues set out in this consultation by 5pm on **2 February 2024.** We continue to welcome feedback from all stakeholders and interested parties, not only those entities that we regulate.

6.2 You can provide feedback by emailing us at **a2a@psr.org.uk**. Please provide your response in a Microsoft Word document format, or similar format, rather than as a PDF.

6.3 We will make all non-confidential responses available for public inspection. If your submission includes confidential information, please also provide a non-confidential version suitable for publication.

6.4 After the consultation closes, we will consider all the feedback we receive before publishing and developing our policy proposals. We plan to consult on the updated proposals later in 2024.

Timetable

Q1 2024	• We will consider responses to this consultation in developing its policy proposals on the commercial model for VRPs in Phase 1 • We will publish an updated set of pricing principles if the evidence submitted suggests a need to update them.
Q2 2024	• We will publish a consultation with a policy proposal on the commercial model for VRPs in Phase 1 • We will publish its cost-benefit analysis and Equality Impact Assessment for its policy proposes on the commercial model for VRPs in Phase 1.

Annex 1
List of questions

Question 1

Do you think the pricing principles as published in June 2023 support delivery of a sustainable commercial model for Phase 1? Please explain the reasons for your answer.

Question 2

Do you think that cross-industry coordination is necessary for Phase 1 and that an MLA is the appropriate vehicle to achieve this? If not, please explain what approach you think is more appropriate and why.

Question 3

Do you think Pay.UK is best placed to operate the MLA for Phase 1? Please explain your rationale and whom you think might be better placed if you disagree.

Question 4

What do you think of our current view of the market structure and sending firms' position in it? What do you think we could do to mitigate risks or overcome misaligned incentives?

Question 5

Do you think there are relevant sending firm related costs we have not yet considered? If so, please provide evidence.

Question 6

Do you think allowing sending firms to charge for FPS related costs or removing the costs where possible is a better approach? Please explain why.

Question 7

Our current preference is to remove FPS 'price per click' charges from sending firms for VRPs. Do you think this charge should be switched to the receiving side or recovered through wider Pay.UK charging, and why?

Question 8

Do you think there are relevant OBL related costs we have not yet considered? If so, please provide evidence.

Question 9

What alternative commercial models could better deliver a sustainable commercial model for Phase 1 of VRPs without risking scalability, and why?

Question 10

Do you think that a large number of consumers with accounts that support VRPs in Phase 1 will sufficiently incentivise PISPs and/or billers to invest in offering VRPs? If not, please explain why.

Question 11

What number or share of consumer accounts do you think need to support VRPs in Phase 1 to incentivise sufficient PISP and/or biller investment to realise network effects? Please explain your rationale.

Question 12

Should we mandate the CMA9 banks to participate in Phase 1 of VRPs? Please provide reasons for your answer.

Question 13

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Do you agree with our proposed list of use cases for inclusion in the cost benefit analysis? Please provide reasons for your response.

Question 18

Do you agree with these initial assumptions for the cost benefit analysis? Please provide reasons for your response.

Question 19

What do you think are the key benefits of VRPs for each of the components of the value chain: consumers, merchants, the PSO, PISPs and sending firms? How should or could these be measured?

Question 20

What do you think are the key costs of VRPs for each of the different components of the value chain: consumers, merchants, the PSO, PISPs and sending firms? How should or could these be measured?

Question 21

How do you think our proposals might affect people with protected characteristics? What approach might better serve their interests?

Question 22

Do you think our current policy proposals poses any risks to the scalability of VRPs and open banking beyond Phase1? If so, please explain why.

Annex 2
Equalities impact assessment

Introduction

2.1 The PSR has a statutory duty to comply with Public Sector Equality Duty requirements. This means considering the impact of our decisions on those with protected characteristics, as defined under the Equalities Act 2010.[16]

2.2 We're interested in your views on both how our overall objective, and the decisions we are consulting on currently, might impact those with protected characteristics. We recognise that people with different characteristics may be affected in different way by the unlocking of new VRP use cases.

2.3 We also have a duty to ensure payment systems meet end user needs. As referenced in our strategy "we expect systems and services to be developed with the needs of users in mind. However, we understand that decisions made by payment systems and participants may lead to different outcomes for different groups of users."

Objective

2.4 We are looking to unlock greater competition in retail payments – by offering payment system users – new more flexible payment methods.

2.5 Phase 1 of VRPs allows us to better understand how new ways of paying can better support the needs of payment system users and how they may impact those with protected characteristics.

Existing evidence and engagement

2.6 We've undertaken significant work to understand consumer needs.

2.7 In July 2021, we commissioned a report[17] from the PSR Panel, which highlighted barriers to people using digital payments, and made a range of recommendations for us to address them. Many of these recommendations focused on unlocking the benefits that open banking and VRPs could bring to those that are digitally excluded and/or may have a protected characteristic associated with digital exclusion such as age or disability. The report states that VRPs could offer greater control over recurring payments against income and this management may encourage consumers to use it instead of non-digital alternatives.

16 Equalities Act 2010

17 Summary report of the digital payments initiative

2.8 With our JROC partners, we have commissioned "consumer research to identify critical and future use cases and risks for (vulnerable) consumers". The findings of this research will allow us to better assess the impact of policy decisions and the development of VRPs on those with protected characteristics.

2.9 A consumer representative co-chaired the VRP Working Group sub-group on consumer protection meaning there was direct consumer input on how VRP services can be safe, trusted and understood by users.

2.10 As part of developing our response, we held a roundtable with a range of consumer groups, charities, advocacy organisations and ombudsmen services on the VRP Working Group's blueprint. We also met with other regulators through UKRN to understand the needs of consumers in different sectors, as well as engage with a range of public and private bodies through the Collaboration Network.

Evidence we seek

2.11 Responses to the consultation will be a key component of the evidence gathering process and allow us to best assess the impact of our proposals.

2.12 We intend to use future consumer research and engagement to develop and test our proposals.

Impact Assessment

2.13 VRPs are likely to only support those that have access to and are confident and able to use digital banking. One potentially relevant protected characteristic here is age. Research has shown that older people may be less willing or able to switch to VRPs.

2.14 This consultation is, however, focused on the commercial model for VRPs and how system participants are bound together in a ruleset. With payments free at the point of sale for consumers, we currently do not envisage a commercial model which would impact on any protected characteristic.

2.15 We ask for comments from respondents on whether that assessment is accurate and/or any wider evidence on the impact VRP may have on protected characteristics.

Impact on protected characteristics

2.16 Limited access to technology, physical or mental disability, age, and income levels – among other things – may affect a user's experience of making payments. It is important that the system as a whole – system operators, technology providers, participants, and PSPs – considers the experience of those consumer groups when designing and implementing payment services.

2.17 VRPs, if implemented well, could have a positive impact on those living with a disability, with the accessibility controls that smart phones and tablets offer, better suiting their needs than using a desktop/laptop for online banking, or banking via telephone or in-branch.

2.18 VRPs could increase access to flexible ways of paying for those at both ends of the age spectrum who may also face digital exclusion, as well as other vulnerable characteristics such as reduced financial resilience, capability, or inclusion. We understand that there is often a link between financial resilience and other protected characteristics such as age, disability, race, and gender.

2.19 At this stage, we have little evidence to suggest that our overall policy objective, and the recommendations for a commercial model we are consulting on now, have a negative impact on those with protected characteristics. As part of the further development of Phase 1, we will seek further evidence to understand whether protected characteristics are impacted and whether any appropriate mitigations are warranted.

Next Steps

2.20 We will assess the evidence captured in this consultation. This is ahead of a more detailed consultation next year as we develop a commercial model, set out the consumer protection regime, and look at how key functional enhancements can improve the user experience.

2.21 We will ensure appropriate monitoring and evaluation of the development and roll-out of VRPs, including the impact of policies and decisions on those with protected characteristics.

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