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UK's APP scams mandatory reimbursement regime: Why an implementation reset is needed in the face of cumulative project risks

September 2024

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We need effective action on fraud

At Innovate Finance we have identified tackling fraud - and making the UK the most secure place in the world - as a top three priority for continued growth of the UK's world leading FinTech sector. Industry and government should take steps to make the UK the most secure place in the world for consumers and businesses to use digital finance, with a new expanded fraud strategy to tackle the full range of threats. This is critical to:

- **Economic growth**: The cost of payments fraud to the UK economy is at least £1.2 billion.
- **A safe and secure society**: Fraud accounts for almost two in five crimes.
- **Opportunity for all:** The impact of fraud disproportionately affects those on lower incomes and 70% of victims of fraud suffer wider negative impacts including mental and physical health and debt.
- **UK FinTech as a global economic champion**: High levels of fraud in the UK risks eroding consumer confidence in digital finance and is already impacting the UK's international competitiveness as a safe place to invest in FinTech and financial services.

Make the UK the most secure place in the world for consumers and businesses to use digital finance

- Set ambitious targets to tackle payments financial fraud and improve data collection and analysis across the public and private sector
- Shared responsibility and liability for social media and telecommunications companies
- Create a National Anti Scam Centre

The introduction of mandatory reimbursement for payments fraud in the UK on 7 October should be part of this solution.

Unfortunately, the way in which it is being implemented - the detailed design of the rules and the implementation management and timetable - mean that it risks being:

- ***At best, a botched scheme launch which dents consumer confidence and productivity; or***
- ***At worst, a fraudsters charter which increases fraud and moral hazard, favours the most wealthy in our society, and dents growth and investment in our FinTech industry.***

*See our ***FinTech Plan for Government*** here.*

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The reimbursement project: Risk dashboard

We have identified a variety of risks which collectively signal that the cumulative risk of proceeding unchanged on 7 October is too damaging for the UK's core payments system used by tens of millions of customers and SMEs for over three billion payments and over £3 trillion of transfers every year.

		Poor consumer outcomes		Higher costs, reduced competitiveness and growth		Increased fraud and moral hazard	
Design of rules	Consumer standard of caution	✘	*All consumers pay for the most reckless*	✘	*Increased reimbursement costs, harder to proof negligence*	✘	*Fraudsters exploit ease of reimbursement and difficulty in proving gross negligence*
	Disproportionate maximum reimbursement threshold of £415,000	✘	*Reimbursement of wealthiest in society paid for by everyone else*	✘	*A few large claims could bankrupt a small payments start-up; threshold higher than capital requirements*	✘	*Moral hazard - low risk in transferring £400,000 for investment that looks a bit dodgy*
	Lack of action on tackling purchase scams	✘	*Consumer will turn to reimbursement for resolution of buyer/seller disputes for goods*	✘	*Payment provider has no mechanism for assessing dispute between seller and buyer*	✘	*Consumers less cautious about marketplace purchases*
Implementation readiness	No single claims handling system	✘	*Delays and errors in claims*	✘	*Large number of cases will be manual - more expensive on top of investment in new systems*	✘	*Lack of real-time data to spot and stop fraudsters*
	No arbitration and dispute processes	✘	*Sending firm can block claim even if receiving says its a fraud*	✘	*No process for dispute between payments providers or with customers*	✘	*Payments firms have no way of assessing purchase dispute - enabling more reimbursement fraud*
	Uncertain readiness across 1,200 payment firms	✘	*Gaps in coverage, delays in claims*	✘	*Unclear which PSPs are in-scope, leading to disparity in costs/compliance*	✘	*Fraudsters exploit confusion and inconsistency in market. Focus on reimbursement systems has diverted focus from tackling fraud*

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Potential ramifications if the PSR proceeds as planned on 7 October

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Potential ramifications of proceeding on 7 October

Reduced investment, competitiveness and growth

Investors decide to stop investing in UK payments and go abroad, hampering growth, innovation and competition in payments.

Rise in moral hazard

Irresponsible consumers begin to lack vigilance when transacting online.

Spike in fraud

Fraudsters exploit the mandatory reimbursement regime to conduct more fraudulent activities (e.g. fraudulent reimbursement claims).

Confusion on powers

PSPs face uncertainty on whether they have the power to slow or delay “suspicious” payments.

Chaos in system

Claims management communication and settlement issues between sending and receiving PSPs.

Late reimbursement & consumer detriment

Victims get reimbursed late due to settlement challenges, leading to inability to pay bills on time.

Delayed payments & consumer detriment

PSPs slow payments due to concerns about legitimacy of payments, also leading to consumer inability to pay bills or spend on time.

Solutions to mitigate against cumulative design and implementation risks

Risk mitigation:

Delay or reduce maximum amount and use common law definition of negligence

Delay implementation deadline

With a month to go before 7 October, there are too many red lights on the implementation dashboard.

To prevent chaos, the **implementation deadline should be delayed until all issues identified are addressed and resolved**.

We support the need to protect consumers from APP scams and consumer trust is paramount. However, unintended consequences must be avoided.

Reduce reimbursement threshold

The UK is accelerating towards potentially disastrous implementation.

If the PSR is not minded to delay implementation, the **maximum reimbursement threshold should be reduced to £85,000 from £415,000**.

£85,000 will still capture 99.7% of all claims and **prevent widespread PSP insolvencies that will be detrimental to consumers, financial stability and economic growth**.

Amend gross negligence definition

PSR rules governing gross negligence has been set to a higher standard than established under common law.

To reduce moral hazard and prevent fraudsters from exploiting the reimbursement regime and guarantee consistency in with the law, the PSR's **definition for gross negligence** should subsequently be **amended and aligned with UK common law**.

This will deliver a more balanced consumer standard of caution.

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Background to mandatory reimbursement

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What are Authorised Push Payment (APP) scams?

PSR

"APP scams happen when someone is tricked into sending money to a fraudster posing as a genuine payee."

"There are various types of APP scams which are either:

- 'malicious payee', for example, tricking someone into purchasing goods which don't exist or are never received.
- 'malicious redirection', for example a fraudster impersonating bank staff to get someone to transfer funds out of their bank account and into that of a fraudster."

Payment Systems Regulator, *APP scams*, See here:
https://www.psr.org.uk/our-work/app-scams/

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Key facts: Mandatory reimbursement regime

7 October 2024 go-live date

The **Payment Systems Regulator (PSR) mandatory reimbursement regime** for **APP fraud** comes into effect on **7 October 2024**.

This applies to payments made via the **Faster Payment System (FPS)** and CHAPS.

£415,000 maximum threshold

The PSR has set the **maximum reimbursement threshold at £415,000** for **each APP scam claim**.

Sending and receiving payment service providers (PSPs) are to **split equally the reimbursement amount**.

5 business days and 'stop the clock'

APP scam claims must be **processed in five business days**.

PSPs can **'stop the clock' to investigate claims** for a period of **35 business days**.

High bar for gross negligence

Grossly negligent consumers **do not need to be reimbursed**.

The PSR has set rules governing gross negligence to a **higher standard than set out under common law**.

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Position of FinTech and financial services

Support for consumer protection

It is **important for consumers to be adequately protected** in the face of increasingly sophisticated APP scams.

Consumer **trust and safety is paramount** if innovation and competition are to flourish in the UK payments sector.

Our members **support the PSR's intended aim of providing a fair level of protection to consumers** who fall victim to APP scams. They **welcome the introduction of a consistent approach** to consumer protection across the industry.

However, industry is very **concerned about the PSR's approach** to mandatory reimbursement.

Apprehension about PSR approach

Industry has **repeatedly shared concerns that the PSR's approach** to mandatory reimbursement, which is the first of its kind in the world, will have **unintended consequences to the UK FinTech sector** and **wider financial services** industry.

Weaknesses in its implementation plans and a **lack of an economy-wide approach to stopping online scams** will have **repercussions for innovation and competition** in the payments market, as well as the **international competitiveness** of the UK.

These are explained in detail in the following sections.

Note: *You may find all our responses to PSR consultations on APP fraud on our Policy & Regulation page* ***here****.*

Serious concerns with the design and implementation of the PSR’s mandatory reimbursement regime

Design risk 1

Consumer standard of caution: Unprecedented bar to prove consumer negligence risks moral hazard and creates new opportunities for fraudsters

Consumer standard of caution: Consumer vigilance and common law

Background

- Under the PSR's rules, grossly negligent consumers do not need to be reimbursed. The PSR has set out broad standards of care that PSPs can expect of consumers.
- However, it has also said that not meeting one of the standards of care is not in itself sufficient reason for PSPs to refuse reimbursement. PSPs are expected to look at why consumers did not meet the standards.
- The PSR has said that its standard for "gross negligence" is intended to be *"a higher standard than the standard of negligence under common law"*.

Challenges due to the PSR's approach

- The bar for gross negligence is too high. This incredibly high bar runs the risk of bringing extreme cases within the scope of mandatory reimbursement. This includes when consumers fail to act with caution or refuse to answer truthfully about specific transactions.
- The Supreme Court in *Philipp v Barclays Bank UK PLC* has also set limits on what PSPs can do in relation to monitoring and pausing payments, stating that "*Where the customer has authorised and instructed the bank to make a payment, the bank must carry out the instruction promptly. It is not for the bank to concern itself with the wisdom or risks of its customer's payment decisions.*"
- Common law is Britain's most powerful tool of economic statecraft. The PSR is arguably disregarding it in relation to gross negligence.

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Consumer actions that do not preclude receiving reimbursement

*The following scenarios would potentially **not** meet the PSR's definition of gross negligence and would still allow for reimbursement*

Dishonesty	A consumer lies to the PSP during the intervention process about a payment.
Disregard	A consumer does not take steps requested by the PSP before making a payment, such as checking an investment opportunity via the FCA's SmartScam tool.
Recklessness	A consumer willingly allows a fraudster to access their bank account via remote access.
Overruling PSP	A PSP may hold a payment because they believe the recipient is a fraudster. It legally cannot pause a payment for long. The consumer authorises the payment anyway.
Repeat victim	A consumer is repeatedly scammed via the same type of fraud but is considered vulnerable rather than grossly negligent.

Gross negligence definition: Implications

- **Moral hazard:** The PSR's proposals may have the unwelcome effect of increasing the risk of moral hazard. Consumers will have limited incentive to exercise caution when making payments.
- **Complicity and empowering fraudsters:** It may also encourage more complicit fraud and exacerbate the problem as fraudsters capitalise on the opportunity of near-100% reimbursement. This will increase the attractiveness of the UK to criminal entities.
- **Risk warnings by FinTechs:** Putting in place robust and definitive risk warning signals that a transaction is likely to be fraudulent will require the utilisation of a huge amount of transaction history data. Many FinTechs are new market entrants and simply do not have the amount of transaction data history to identify whether a recipient of a payment is likely to be a fraudster.
    - Transaction history data alone from individual PSPs are unlikely to be effective in identifying fraudsters.
    - It will require a more comprehensive approach to data sharing. This is even more challenging without the new RCMS case handling system being immediately mandated across industry (see below) and social media platforms being involved.
- **Payments friction:** Banks and PSPs could be forced to de-risk by increasing friction in consumer journeys. This will make Open Banking payments less convenient and affordable for consumers and undermine the PSR's own strategy of increasing competition in retail payments.

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Design risk 2

Maximum reimbursement threshold: Lack of proportionality which does not protect the average consumer

Maximum reimbursement threshold of £415,000: Proportionality and protecting the average consumer

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Background

- The PSR has set the maximum reimbursement threshold at £415,000.
- Much of industry is united in supporting a lower threshold of £85,000. This would align with Financial Services Compensation Scheme (FSCS) protection offered for deposit accounts, which would also create consistent consumer expectations.
- Pay.UK data shows that a threshold of £85,000 would cover 99.7% of all claims.
- Based on data from Pay.UK, the vast majority of payments made via the FPS are below even £10,000, with just 1.4% being over that amount in 2022.

Challenges due to the PSR's approach

- £415,000 is disproportionate to the vast majority of APP scam claims.
- It is also higher than the capital requirements required for many PSPs (e.g. the initial capital requirements for electronic money institutions (EMIs)) is €350,000.
- The policy question is whether the protection of an additional 0.27% of cases is proportionate to the additional cost imposed on businesses and consumers.
- The PSR has not adequately justified its rationale for the £415,000 reimbursement threshold. Their cost benefit analysis also did not consider the impact of the threshold on PSPs.

Maximum reimbursement threshold of £415,000: Proportionality and protecting the average consumer

Implications

- **Operational risk:** The introduction of a £415,000 threshold could have a disproportionate impact on operational risk requirements. For small PSPs, a single claim of £415,000 could result in insolvency.
    - In terms of the growth agenda, this will be detrimental to investment, growth and innovation in the UK's world leading payments sector.
    - Investors would rather invest outside the UK due to concern that their investments in UK payments would be used to pay out defrauded wealthy individuals.
    - Other jurisdictions, such as the EU, Australia and Singapore have decided against blanket reimbursement but instead focus on shared liability for telecommunications providers.
- **The average consumer:** Ultimately, all customers pay for reimbursement. Enabling reimbursement for very high value transactions will create a liability which will have to be covered through fees and charges levied on all users.
    - In effect, **compensation for *very wealthy individuals will be paid for by the average user who is unlikely to ever be able to make online transactions amounting to £415,000***.
    - ONS data in the financial year ending 2022: The median household disposable income in the UK is £32,300. The richest 20% of people only have a median disposable income of £66,000.

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A potential example of disproportionality and impact on the average consumer

An investment scam occurs

A wealthy individual loses £400,000 in an investment scam after ignoring warnings from his PSP.

He makes an APP scam claim that succeeds due to PSR rules which set a higher bar for 'gross negligence' than under common law.

The individual has £400,000 reimbursed by his sending PSP.

The sending PSP recoups £200,000 from the receiving PSP under PSR rules.

A PSP received a few high value APP scam claims

One of the reimbursing PSPs is small and nascent. It has invested millions in fraud prevention systems.

Nevertheless, the PSP has faced multiple high value reimbursement claims in a short span of time.

The PSP collapses and goes into insolvency due to the costs it incurred reimbursing high value APP scam claims.

Other consumers at risk of losing their life savings

If the PSP in question is a Prudential Regulation Authority (PRA)-regulated bank, all its depositors are guaranteed to receive £85,000 under FSCS rules in the event of bank collapse.

For EMIs, there is no absolute guarantee on the amount that safeguarding requirements will deliver for compensation.

Ordinary consumers could lose a big portion of their savings due to the bank or EMI collapse. The wealthy individual gets back his £400,000 in full in any case under PSR rules.

Design risk 3

Failure to address growing problem of purchase scams on online platforms

Purchase scams: Inaction and limited regulatory coordination

Background

- Industry data shows that 77% of all APP fraud cases originate online, of which social media platforms are estimated to account for over 60%.
- Member data shows that Meta is the single largest source of fraud origination. Fraud originating from Meta constitutes 60.5% of all reports of fraud one member firm received, amounting to a value of 33.2% of all scams.
    - This data shows that 61.1% of fraud cases (by volume) originating from Meta relate to purchase scams (e.g. Facebook Marketplace purchases), while investment scams are worth 61.3% (by value) of all scams originating from Meta.

Challenges due to the PSR's approach

- The PSR's proposals do not consider the source of fraud origination and methods to prevent that. It has simply decided to take punitive action against PSPs who play no part in hosting fraudulent online marketplace listings such as those on Facebook Marketplace.
- There is also a lack of regulatory coordination with counterparts at Ofcom (who regulate compliance with the Online Safety Act 2023) on introducing shared responsibility and liability for social media and telecommunications firms. Prime Minister Sir Keir Starmer MP expressed support for shared liability during the general campaign.
- The policy question is whether it is right that PSPs alone pick up the costs of lax action against fraud by overseas Big Tech.

Purchase scams: Inaction and limited regulatory coordination

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Implications

- **Rise in purchase scams:** The PSR's *APP Scams Performance Report, July 2024* noted that 2023 saw a 32% increase in purchase scams by volume. The PSR is not working with other regulatory bodies to take action against purchase scams which means that purchase scams will continue to fester online.
  - However, from October 2024, PSPs will be forced to subsidise losses indefinitely because of limited coordination on tackling purchase scams through shared liability.
- **Questions for the PSR:** Purchase scams being reimbursable also raises issues for PSPs:
  - How will they know and prove whether a product did not arrive?
  - How can they determine that a payment was *"not for the purpose the consumer intended"* as per the PSR's guidance?
  - What truly constitutes a civil dispute versus a reimbursable APP scam claim under the PSR's guidance?
  - How do they prevent APP scam rules from becoming a proxy for 'chargeback' where consumers are not satisfied with goods and services?
    For purchases on online marketplaces, PSPs have no way of ascertaining whether a payment was to a scammer or was a case of consumer dissatisfaction.
- **Misuse of APP fraud rules:** In his independent review of the future of UK Payments for HM Treasury, Joe Garner warned that the APP fraud rules might be *"misused and invoked to cover a much wider range of claims than the intended scope"* which could be *"severely problematic"*. This is now clear in relation to the rules becoming a proxy for chargeback.

Implementation readiness risk 1

Claims management: No single, mandated industry-wide case handling system

Claims management: No single mandated system

Background

- Introducing mandatory reimbursement will require an sending and receiving PSPs to communicate and share data securely to settle APP scam claims.
- For efficiency and effectiveness, an automated system used by all PSPs is needed.
- The PSR assigned Pay.UK as the FPS operator to build and oversee this system.
- Pay.UK has built a Reimbursement Claims Management System (RCMS) for PSPs to communicate, share data, settle claims and meet compliance reporting obligations.

Challenges due to the PSR's approach

- Pay.UK has delivered RCMS ahead of the PSR's 7 October 2024 implementation deadline. It was not initially clear that RCMS will be fully operational ahead of time.
- The PSR has decided not to mandate industry to use RCMS on 7 October. They initially proposed to mandate RCMS on 1 May 2025, but this mandation is now unclear. The PSR will be consulting and exploring whether mandating RCMS on 1 May 2025 is achievable after mandatory reimbursement goes live on 7 October 2024.
- Even if the PSR mandated RCMS on 7 October, most firms will not be ready to test and train using RCMS.
- In the interim, RCMS might largely be used as a directory for PSPs to contact each other.

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Claims management: No single mandated system

Implications

- **Chaos:** Claims management will be chaotic and inconsistent across PSPs. From 7 October there will be three systems used for case management:
    - **RCMS:** Large numbers of FinTech PSPs are expected to eventually use RCMS. There is broad support for RCMS once adequate testing and training has been conducted.
    - **UK Finance Best Practice Standards (BPS) platform:** Most of the big banks, plus some FinTechs as a backstop solution, are expected to use the trade body's pre-existing platform.
    - **Manual:** A number of PSPs are expected to settle claims manually. It remains unclear how many PSPs have not been onboarded to either RCMS or BPS.
    - If there is **no unity between the claims management system used** between the sending and receiving PSP, **manual case settlement will be the default method**.
- This raises a **number of questions** in terms of outcomes that the PSR has not addressed:
    - Impact on efficiency & meeting reimbursement deadlines (including 5-day claims settlement)?
    - Impact on consumer outcomes? Will this hinder reimbursement especially in the run-up to Christmas and the New Year?
    - What additional costs will PSPs incur with manual claims management?
    - What does this mean for real-time data sharing to stop fraud at source?

Claims management: No single mandated system

FinTech data points

- Evidence from FinTech members has illuminated some of the implications without a single, mandated industry-wide claims management system.
- A FinTech onboarded to BPS as a backstop solution has shared with us the following data:
    - **APP scam claims managed as a receiving PSP:** Only 2% will be outside BPS.
    - **APP scam claims managed as a sending PSP:** The percentage is expected to be a lot higher as a greater proportion of fraud sent tends to go to "non-directed" firms (who are not in scope of the PSR's reimbursement regime).
        - Based on its top 10 firms where victims sent fraud to, of the 70.56% of fraud sent, only 11.91% were sent to non-directed firms. Among that 11.91% in-scope claims, many of these firms are not on BPS. They might also not be ready to use RCMS.
        - This will therefore require manual case management.
    - **Cost of manual case management:** Likely to require hundreds/thousands of staff and multiple millions in sunk costs. This depends on whether there is unity in case management system and whether fraud volumes increase significantly.
    - **RCMS cost:** Only an indicative cost of using RCMS has been given, coming into force in 2025. Pay.UK has suggested a per Faster Payment cost of £0.07 for every FPS received and sent. The cost is irrespective of whether RCMS is used or not.

Claims management: No single mandated system

Conclusions from FinTech data points

- **Efficiency and meeting obligations:**
  - With a significant number of claims requiring manual case management, industry will face inefficiencies.
  - Given that RCMS is only functional if both parties use it, some will use BPS as a backstop solution. This is also because RCMS has not been mandated and was not ready in time for adequate testing and training.
  - Smaller FinTech PSPs (who are not onboarded to the fully tested and functioning BPS) will face significant hurdles in meeting their obligations efficiently.
- **Consumer outcomes:**
  - Consumer outcomes are expected to be poor, forcing them to potentially turn to the Financial Ombudsman Service (FOS) despite a regime that should reduce this redress route.
  - The Christmas period could see a spike in APP scams. Consumers could get reimbursed late which will be challenging for cash strapped households with festive plans.
- **Additional manual case management costs:**
  - Significant costs are expected even by high growth FinTechs that can afford higher costs.
  - This does not bode well for competition and innovation. Smaller PSPs might eventually be forced out of the market not just because of high value mandatory reimbursement, but also exorbitant business sunk costs.
- **Real-time data sharing:**
  - Delayed without RCMS mandated across all PSPs and without all of its functionality being utilised. This delays the ability to spot and stop scams in real time.

Implementation readiness risks 2, 3 & 4

Other pressing issues: Lack of readiness, dispute resolution and arbitration mechanisms

Other pressing issues

Issues & implications

- **Industry readiness:** Are all the c.1,200 PSPs ready and aware of their obligations under the PSR's mandatory reimbursement regime? Has adequate action been taken to identify these PSPs and onboard them to RCMS?
  - The PSR and Pay.UK left it to PSPs to determine for themselves whether they are in-scope of the regime.
  - If in-scope PSPs are not onboarded to the RCMS, claims management on 7 October will be especially challenging due to their absence on the contacts directory.
  - Frontline staff also have not received adequate guidance on what constitutes a civil dispute. Final rules are expected one month or less from go-live.
- **Arbitration mechanism (between PSPs):** Under PSR rules, sending PSPs possess all decision-making power in determining whether a claim is a reimbursable APP scam or civil dispute. The sending PSP may also decide against evidence provided by the receiving PSP
  - The PSR needs to set out an arbitration mechanism to resolve disputes between the sending and receiving PSPs. This is lacking in the PSR's guidance and Pay.UK has to provide details.
- **Dispute resolution (between consumer and PSP):** There is still a lack of a functioning dispute resolution mechanism.
  - Pay.UK is currently developing a dispute resolution mechanism, but it is not being developed with adequate due process and input from scheme members.
  - Industry is worried that Pay.UK lacks the capacity develop this in time for 7 October alongside all requirements placed upon it by the PSR. The PSR's timetable also does not allow for the development of all required systems and processes.

Implementation risk 5

Potential challenge to legal basis on which PSR has established rules

Shaky legal basis that can be challenged

Background

- Some firms believe the legal basis upon which the mandatory reimbursement regime has been set up is wrong.
- Under the Financial Services (Banking Reform) Act 2013 (FSBRA), the PSR can only issue directions in writing (such as Specific Direction 20 for mandatory reimbursement) to *"participants"* in regulated payment systems. The definition of *"participants"* include:
  - The operator of the payment system;
  - Any infrastructure provider; or
  - Any payment service provider.
- The definition of *"payment service provider"* in FSBRA is:

"in relation to a payment system, means any person who provides services to persons who are not participants in the system <u>for the purposes of enabling the transfer of funds using the payment system</u>."

- This definition is different to the definition in the Payment Services Regulations (PSRs) 2017.

Shaky legal basis that can be challenged

Legal issues

- Some PSPs have argued that EMIs are not operators of faster payments or infrastructure providers to the Faster Payment Scheme.
- These PSPs believe they do not fall under the FSBRA's wording in defining *"payment service provider"*.
- They argue that EMIs do not provide their customers with services for the purpose of enabling transfers of funds using the payment system. Instead, the service EMIs provide include:
    - Providing the issuance of e-money; and
    - Provision of e-money wallets for customers to be able to store e-money they have purchased.
- Although customers of EMIs can use FPS to make purchases of e-money from EMIs, this is not the EMI offering the customer a service "enabling the transfer of funds using Faster Payments".
- The EMI is simply receiving funds as the recipient into the EMI's bank account, sent from the customer, to purchase e-money.

Shaky legal basis that can be challenged

Implications

- **Legal question by EMIs:** Specific Direction 20 derives from Section 54 of FSBRA. If the PSR does not have the power to give Specific Direction 20 in respect of EMIs under section 54 of FSBRA, some firms argue that Specific Direction 20 does not bind EMIs.
  - EMIs are regulated by the FCA under the PSRs 2017. The definition of a 'payment service provider' under FSBRA and PSRs 2017 are not the same.
  - These firms believe that the PSR has no power to direct EMIs using its Specific Directions.
  - They believe the PSR must pause the mandatory reimbursement regime to address this issue.
- **Our position as Innovate Finance:** We neither have the capacity nor the legal resource to assess whether EMIs are in scope of the PSR's regime or not.
  - However, the fact that some PSPs have raised this means that the **legal basis upon which the PSR has established the mandatory reimbursement regime is shaky**.
- **Legal challenge:** PSR rules if left unchanged or unclarified could be subject to legal challenge which will add to further uncertainty.

Impact on growth and investment in the UK

Impact on growth and investment

Background

- Under the Financial Services (Banking Reform) Act 2013 which established the PSR, the PSR has three statutory objectives:
    - Promote competition; promote innovation; and ensure that payment systems are operated and developed in a way that considers and promotes the interests of all the businesses and consumers that use them.
- Section 72 of the Financial Services and Markets Act (FSMA) 2023 mandated the PSR to introduce mandatory reimbursement in “qualifying cases”.
- Essentially, the PSR needs to promote innovation and competition as well as protect consumers.

Concern due to the PSR’s approach

- Industry is concerned that the PSR’s approach to mandatory reimbursement means that they are failing to meet these objectives.
- The PSR is stifling competition and innovation with the £415,000 maximum reimbursement threshold as it could force out FinTech PSPs who pioneer innovative solutions such as Open Banking and digital challenger banking in the financial services sector.
- Future investment into FinTech and payments might also be jeopardised, thereby harming competition, innovation, market diversity and consumer choice.

Impact on growth and investment

Implications

- **Investment:** The UK digital payments sector contains a number of global champions, who require a stable and consistent policy making environment to continue contributing to UK economic growth.
  - The ≥ 1,200 payments firms in the UK have attracted £20 billion of investment funding in the last 10 years. These include some of our largest and most successful scale-ups.
  - The FinTech payments sector accounted for 30% of all investment in UK FinTech in 2022.
  - A steady flow of investment provides these firms with the necessary resources to innovate and compete with traditional market players.
- **Investor withdrawal:** Anecdotally, investors have begun expressing their concerns about the scope and degree of financial risk that is being transferred to firms, compared to other jurisdictions like the EU, Singapore and Australia.
  - Competitiveness: Concern about the PSR's proposal and handling of APP fraud puts at risk future inward investment to support the payments sector, a critical piece of our national infrastructure.
  - Investors are deterred by how reimbursement could render many PSPs economically unviable, and international investors question whether is it worthwhile to invest in the UK payments sector where some of their investment will be lost to higher levels of reimbursement than anywhere else in the world.
- FinTech is not only at risk, but also the government's plan to drive growth and investment into the UK.

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Thank you.

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