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Account to account payments: Is it time for takeoff?

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The PSR is grappling with the Gordian Knot of competition in card schemes, such as Visa and Mastercard, through a series of reviews into their fees, as we set out in the summer.

But the PSR has a second string to its bow. As well as intervening within the card schemes, its strategy statement makes clear that it wants to promote competition between UK payment systems, in particular via the (relatively) nascent account to account (A2A) payments system. The competitive pressure from an entirely alternative payment method should, in the PSR's mind, reduce card scheme fees and promote innovation in payments.

What are the key differences between card schemes and A2A payments? And what does the PSR need to do if it wants to unlock competition between the two?

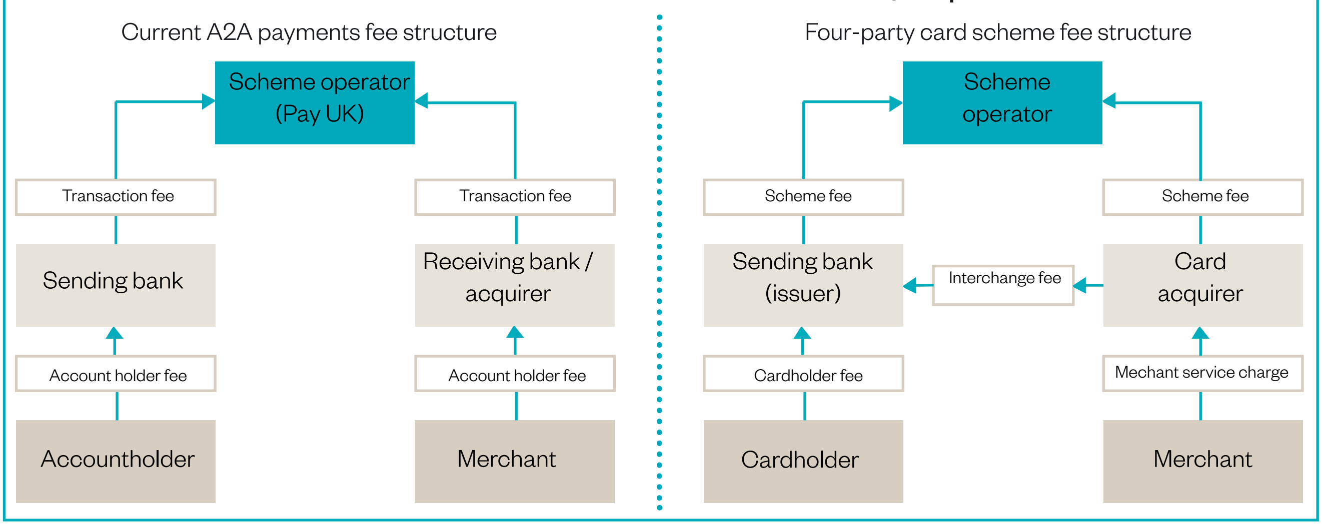
Different strokes for different folks

In card schemes, the primary moment of competition is when a bank chooses whether to put Visa or Mastercard on the cards it issues to its customers. When the customer uses this card, the merchant then pays an acquirer to facilitate the payment, and the acquirer pays both the card schemes (for setting and overseeing the rules of the system) and the issuing bank (an 'interchange fee').

In A2A transfers, competition between A2A and card schemes occurs when a customer - perhaps at the prompting of the merchant - makes a choice to initiate a payment. If customers choose A2A, they instruct a Payment Initiation Service Provider (PISP) to manage the payment through an A2A process. The PISP instructs the customer's bank to pay the merchant's bank, with the merchant likely paying the PISP for the service.

Because the moment of choice and competition differs between A2A transfers and card schemes, there is a real chance that a viable A2A ecosystem could start to put downward pressure on the fees charged by card schemes, which amounted to approximately £5.3bn[1] in the UK in 2021 alone.

Different commercial incentives and moments of choice/competition



[1] Estimated from figures published in the PSR's "Market review of card scheme and processing fees - An update and draft terms of reference", May 2022: £884bn of card transactions (paragraph 1.3) and assuming that the average merchant charge is 0.6% of the transaction value (Figure 2).

Three keys to getting it right

A2A payments will only be a success if banks make the process easy and trustworthy, merchants see a benefit in offering the payment method, and customers see the benefit in choosing it. We address these in turn below.

1: Incentivising banks to invest in A2A

The first hurdle to making A2A attractive is getting the plumbing right, and that requires customers' banks buying into the system. They currently have no incentive to do so. Under the card schemes they receive an interchange fee for each card payment made. Under A2A they receive…nothing, and indeed likely incur some processing cost when acting on the PISP's instruction. Resolving technical difficulties in A2A has been a slow journey, and one that is not yet complete, as exemplified by the need for the PSR to direct the industry to implement 'confirmation of payee' and continue to work on fighting against Authorised Push Payments (APP) scams.

If A2A is going to work, banks need an incentive to address these issues. In part, this should be the stick of regulation, but the PSR might also need to consider if carrots should be part of the equation. If banks could make money from A2A payments, even if it's less than what they would make from a debit card, we might see far more proactive support for the development of an A2A ecosystem. A look across the Pond suggests that the market can deliver support for A2A payments even in the absence of regulation. As such, it may also be time to consider the scope for commercial APIs, while recognising that the free APIs (originally mandated under the Open Banking order) have helped establish the A2A system as a credible contender.

2: Co-ordination to make it easy for merchants

The second problem is making it easy for merchants. Enabling A2A at the physical point of sale is particularly important since these transactions are generally considered lower risk than distance purchases. Incentivising banks to try and make A2A work will be part of the solution, but the PSR may wish to take on a more explicit coordinating role, for example to ensure interoperability of terminals.

3: Information and protection to empower consumers

It will ultimately be the consumer who chooses between an A2A and a card payment. Consumers need to be empowered to make that choice with confidence and to reap the benefits of their choice. This requires consumers to have clarity on the level of fraud and product protection, and for merchants to be able to incentivise consumers to choose between payment options. The question for the PSR is the degree of top-down intervention required; heavy-handed imposition of PSR-defined standards of protection may be ill-suited to such a nascent market, where competition is likely to drive innovative consumer protection approaches. The PSR could set out the principles and outcomes it expects, while leaving the fledgling industry to deliver innovative solutions. The PSR could then monitor how these solutions are implemented, ready to intervene if progress stalls (as it did for the introduction of confirmation of payee').

A rose by any other name

The PSR may be concerned that the combination of a) an interchange fee, b) coordination between parties of the A2A ecosystem and c) consumer protection and information could steer A2A towards something that looks like a card scheme, run by the Open Banking Implementation Entity and Pay.uk, with the PSR's oversight.

This shouldn't be seen as a barrier. A2A stands to create a differentiated alternative to card schemes, benefiting consumers, businesses, and the economy, so long as the interchange fee is proportionate to the differentiated offering, coordination in A2A payments is relatively light touch, and consumer protection standards are flexible. The increased payment innovation and competitive fee structures that follow would help cement the UK (and the PSR) as leaders in financial innovation.

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