



COADEC RESPONSE

Financial Services and Markets Bill Written Evidence

About Coadec:

The Coalition for a Digital Economy (Coadec) is the policy voice of tech startups and scaleups in the UK. Since 2010, Coadec has worked to engage on behalf of tech startups in public policy debates in the UK across a range of priority issues for startups including access to finance, immigration and skills, and technology regulation.

Coadec has an engaged ecosystem of financial services technology (Fintech) firms based in the UK and has in-flight campaigns on open banking, regulation of buy now, pay later (BNPL), creating a pro-innovation regulatory environment in the payments sector, and regulation of cryptoassets.

1. Response Summary

1.1. Coadec is generally in favour of the Financial Services and Markets Bill (hereafter “the Bill”).

1.2. In particular, Coadec is a passionate advocate for the UK’s Fintech ecosystem and supports the Future Regulatory Framework Review (FRFR). The Financial Services and Markets Act model of financial services regulation has enabled Fintechs to thrive in the UK and it makes sense as a foundation for the industry going forward. Coadec favours a regulatory approach that is clear, consistent, and technologically agnostic to ensure clear conditions of entry for new firms.

1.3. In line with the approach to policy and regulation espoused by the Government, Coadec supports a principles based, outcomes-focused regulatory framework. This has been the approach to financial regulations since 2007, and we believe the FRFR is the crystallisation of this approach. Along with the introduction of the Designated Activities Regime (DAR), the comprehensive FSMA approach will embed firm foundations for innovative products and services, including those that Coadec sees on the horizon, notably cryptoassets and decentralised finance.

1.4. Unfortunately, however, Coadec regrets that the Bill represents a missed opportunity to advance a number of high priority areas in Fintech innovation, including:

- The reform of the Consumer Credit Act (CCA)
- The safeguarding of open banking payments beyond the Open Banking Implementation Entity’s (OBIE’s) roadmap



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1.5. Coadec would also like to bring the issue of the uncompetitive payments sector to the Bill committee's attention.

2. The Positives

2.1. We believe it is sensible to introduce a new growth and international competitiveness objective for the PRA and FCA. As we look towards a post-Brexit future, ensuring that we maintain our position at the forefront of financial services and financial innovation and introducing this as an objective ensures this is prioritised by regulators going forward.

2.2. Coadec is generally in favour of measures to combat the pernicious presence of Authorised Push Payment fraud (APP) and is pleased to see this focused on in the Bill.

2.3. However, it will be important for HMT to ensure that these measures do not compromise the growth of open banking payments through Payment Initiation Services Providers (PISPs). Coadec has heard anecdotal evidence from members of its ecosystem that Account Servicing Payment Service Providers (ASPSPs) have been using fraud concerns as justification for inconsistently and arbitrarily blocking open banking payments.

2.4. In the event that banks become even more risk averse, as a result of potentially increased costs associated with mandatory reimbursement of APP fraud, Coadec is concerned that this behaviour could become more prominent. It is vital that consumer protection is placed front and centre in financial services, not least because of the new Consumer Duty, but it is also critical that proportionality is maintained. HMT must always recognise the trade offs and how measures may lead to different patterns of incentives.

2.5. We are pleased that, as a result of the revocation of EU-derived legislation, it will be possible to create a new, "Solvency UK", regime for British insurance firms. We view this as a critical step in supporting the burgeoning insure-tech sector or startup insurance providers.

2.6. We would also like Solvency II reforms to be used as an opportunity to explore further policy updates to support the sector, including enabling smaller insurance startups to access carrier licences through the Prudential Regulation Authority (PRA). Since 2013 only 12 new insurers have been authorised in the UK. The timescale to receive a licence is up to 12 months which is often too long for young and innovative, but resource constrained, businesses. Coadec believes it is aspirational for there to be a more accessible and fast-paced way to access these carrier licences.

2.7. Coadec broadly welcomes the inclusion of measures relating to cryptoassets in the Bill, and sees this as a positive indication that the Government recognises the need for the Treasury to engage with one of the fastest growing elements of the UK technology sector.



2.8. Giving the responsibility of regulating digital settlement assets to the Treasury is a necessary step for the use of stablecoins as a means of payment - a step we support from both the perspective of increasing access to the use of cryptoassets, as well as increasing consumer and business choice in payment methods.

2.9. Additionally, we support Andrew Griffith MP's Amendment 22, which is designed to bring cryptoassets under regulation by Part 5A of the Financial Services and Markets Act 2000 (designated activities). This is only the first step in comprehensive cryptoasset regulation, as it simply provides the Treasury the power to specify certain activities as regulated rather than providing a firmer framework or comprehensive list of regulated activities. However, this power gives a wide scope to the Treasury to deal with cryptoassets as a whole, rather than certain elements of the sector, and aligns with our view that any regulation of cryptoassets needs to take into account the sector in its entirety, rather than regulating certain elements in a piecemeal manner.

3. The Missed Opportunities

3.1. While in favour of the new international competitiveness objective, we are unconvinced that this should be a *secondary* objective, however, as secondary objectives will inevitably be deemed less important than primary objectives. In the absence of specific objectives around increasing competition and innovation, Coadec believes that a new growth and international competitiveness objective may be important enough to justify being introduced as a new primary objective.

3.2. Alternatively, we would propose introducing an additional objective around promoting competition and increasing innovation. We disagree with the conclusion that this is not required due to evidence of innovation facilitated so far. Firstly, there is evidence of markets experiencing sub-optimal competition today, for example the dominance of Visa and Mastercard in payments.

3.3. Secondly, innovation is limited in some sectors due to regulatory barriers or incomplete regulation that could be remedied in the event that promoting competition was an objective. Examples include the capital requirements for challenger banks, and the fact that consumer data portability is limited to payment accounts (under the CMA Order and PSD2) today. Indeed, to some degree innovation has flourished in some sectors in the UK in spite of regulations, rather than because of them.

3.4. The introduction of a new growth and international competitiveness objective must not come at the expense of our world leading consumer protections. It must be a race to the best products and services, and not a race to the bottom.



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3.5. Coadec is disappointed at the lack of progress on the long overdue regulation of Buy Now, Pay Later service providers. Since we published our report in July 2021,¹ Coadec has been an ardent supporter of the robust and proportionate regulation of BNPL.

3.6. Frustratingly, it has now been nearly two years since the publication of the Woolard Review, which found regulation of the sector was required. The narrative around BNPL is often lazy and trope-ridden, with commentators critiquing users of BNPL using ad hominem attacks, or alternatively picking flaws with the concept of lending as a whole, rather than the BNPL specific manifestation of lending. In a recent debate on the Bill, one MP referred to providers of BNPL services as “Legal Loan Sharks”,² a lazy critique which Coadec fears risks diluting necessary debate and scrutiny of legitimately sub-optimal behaviour by selected BNPL providers.

3.7. In January 2022, HMT’s consultation on regulating BNPL closed, with its findings published in June 2022. In their response, HMT outlined that they intend to consult further before the end of 2022 on the proposed regulations.

3.8. While Coadec is under the impression that no further legislation is required, the continued stalling of BNPL regulation means that the long term issue of inadequate and antiquated regulation of consumer credit remains unsolved.

3.9. The CCA is one of the few, but notable, remaining legacy regulations that is at odds with the approach espoused by the Government, and embodied in the FRFR. The CCA was passed in 1974 when Harold Wilson was commencing his second term in office and it remained legal for lenders to request female applicants have a male guarantor. Despite subsequent updates and revisions, large swathes of its original requirements remain. Critically, these requirements are prescriptive, outdated and fail to accommodate innovative products and services. These shortcomings notably manifested themselves in the debate around regulating Buy Now, Pay Later products which to date have leveraged a regulatory exemption originally designed for invoice payments and club memberships.

3.10. Instead of recognising the inadequacy of the CCA in its 2019 review of retained provisions of the Consumer Credit Act,³ the FCA has so far been reluctant to take meaningful action to replace the regulatory framework.

3.11. Coadec believes that repealing the CCA entirely and replacing it with an updated FSMA and FCA rules would bring the consumer credit regime into line with the approach of the FRFR.

¹ <https://coadec.com/news/bnpl-regulate-now-reform-later/>

² <https://www.theyworkforyou.com/debates/?id=2022-09-07c.278.0#g284.0>

³

<https://www.fca.org.uk/publication/corporate/review-of-retained-provisions-of-the-consumer-credit-act-final-report.pdf>



3.12. The review of the CCA announced in June 2022 was a positive step forward but must be committed to.⁴ Coadec fears that the Bill is a missed opportunity to lay the foundations for the result of a review of the CCA to be implemented by the FCA.

3.13. Further, Coadec is concerned that the Bill was also a missed opportunity for the future governance and oversight of the open banking regime to be confirmed.

3.14. Now is a particularly important time for the future of open banking to be clearly articulated and defined to promote certainty and clarity for firms and investors alike, and to ensure the UK's lead is not eaten away. As outlined in our 2021 paper on smart data, Coadec is acutely aware of markets around the world having embraced the concept of open banking, often inspired by the UK's experience, but now thinking more ambitiously and moving more rapidly than the UK has done in the last 12 months.⁵

3.15. Additionally, payment initiation has emerged as an exciting and compelling alternative to established payment mechanisms, and Coadec believes that the introduction of clear next steps in the governance of open banking payments should be a critical priority. We agree that the PSR should “promote competition between payment systems ... including [through supporting] Open Banking... [which] appears to have the greatest chance of providing a credible alternative for retail...payments.”⁶

3.16. While we support and have fed in to the Joint Regulatory Oversight Committee (JROC) on Open Banking's call for evidence through its Strategic Working Group (SWG), the Bill could have been a superb opportunity to clearly articulate the future direction of open banking, with a mandate for the expansion of Variable Recurring Payments (VRP), for example.

3.17. Finally, Coadec also regrets the absence of measures in the Bill to promote competition and innovation in the payments sector.

3.18. Coadec believes that the payments sector in the UK is currently uncompetitive and structurally imbalanced against innovative payment providers and, crucially, that open banking payments offer a compelling alternative only if set up for success by robust regulation.

3.19. Over the last eight years, card payments have come to dominate retail transactions in the UK, now constituting two-third of all retail payments annually.⁷ This has largely come at

⁴ <https://www.gov.uk/government/news/uk-commits-to-reform-of-the-consumer-credit-act>

⁵ <https://coadec.com/news/fintechs-and-the-smart-data-right/>

⁶ <https://www.psr.org.uk/media/m2kfxfg/psr-strategy-jan-2022.pdf>

⁷ <https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/uk-payment-markets-2021>



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the expense of cash payments, and other forms of payments have not seen nearly as rapid an increase in market share as card payments.

3.20. For every card payment made to a UK retailer, a slice of the transaction is taken by the payment supply chain. This includes three main fees: acquirer net revenue, the interchange fee, and the scheme and processing fee. Coadec estimates that the overall merchant servicing charge has increased by 13% since 2015, however the scheme and processing fee, charged directly by the major card scheme providers to the retailers, has increased by 600% in the same period.⁸

3.21. Despite the introduction of the Interchange Fee Regulations in 2015, the fee's continued existence means that there is a structural imbalance between incumbent card payments and insurgent payments initiation providers. Importantly, as it currently stands, the banks are incentivised to maintain this lucrative status quo at the expense of building innovative new payment rails, as the interchange fee ensures that they receive a percentage of every card payment transaction. Estimates have this fee resulting in an annual income of £3bn.⁹ In contrast, a similar interchange construct is typically prohibited in law for payment initiation under the open banking regime.¹⁰

3.22. Coadec does not believe the answer is to introduce an equivalent free construct for PISPs, but it is imperative that the SWP recognises the uneven playing field in which payment initiation technology has been introduced.

3.23. This challenge is further exacerbated by the prohibition of surcharging introduced in 2012 that consequently makes it harder for retailers to steer consumers to cheaper payment methods. If the Payment Systems Regulator's ambition to ensure interbank payments can compete with card payments is to be realised, this challenge must be tackled head-on.

3.24. To further raise awareness of this structural imbalance, in October 2022, Coadec partnered with the British Retail Consortium, the Federation of Small Businesses, the British Independent Retail Association, the Charity Retail Association and the Association of Convenience Stores to launch the Axe the Cards Tax campaign, bringing attention to this structural issue which both limits innovation in payments and has increased the cost of taking payments across the economy for many years.¹¹

3.25. We believe it pertinent to raise this issue to the Bill Committee to reaffirm the need for legislation that promotes payment competition and innovation to deliver value to retailers in the UK. Coadec sees the Bill as a missed opportunity to progress this aim.

⁸ Based on 2014-18 data from the PSR Card-acquiring market review final report (Figure 11, p. 69); and 2019-22 data from BRC/EuroCommerce member data

⁹ UK Finance, Card Spending Update for May 2022 (Debit & credit card value of transactions); and PSR, Market review into card-acquiring services: Final report, 2021

¹⁰ For example, see EU Regulation 260/2012

¹¹ <https://www.axethecardtax.com/>