Regulation, technology and product innovation, new players and increasing customer expectations are changing the face of the payments industry in the UK and beyond, and challenging participants to rethink what they must do to be successful.

Payments are central to an effective economy and are a core function for banks in terms of their product offering and service. The world of payments is continually evolving and individuals and businesses are increasing their use of convenient, accessible, electronic payment products.

Now, an ever increasing rate of change is being experienced. This can be attributed to:

- An evolving regulatory vision driving new payments regulations and legislation
- Increasing customer expectations
- New entrants to the payments market
- Increasing cross-border activity and globalization of the payments market
- Innovative use of technology

This changing landscape provides both challenges and opportunities. To understand how opportunities can be effectively seized, participants in the payments market, particularly the banks, need to balance the investment and innovation needed to focus on meeting customers’ expectations with the demands of the regulatory environment.
How EY can help

EY has a highly integrated Financial Services Practice operating across EMEIA with rich experience in the payments domain across business, regulation, IT and operations. We can quickly deploy teams, drawing upon the full breadth of our experience to support our clients.

Ways in which we can help include:

- Regulatory compliance review and assurance
- Risk and controls framework assessment and definition
- Compliance data quality assessment and remediation
- Payments proposition and roadmap development; enhancing payment services in the eyes of the customer
- Regulatory and business change portfolio planning and management
- IT enabled business transformation
- Operating model development and process improvement
- Incident analysis and remediation
- M&A transactions advice
- Domestic, regional and global insight and support

Customer expectations

EY has identified payments as one of the critical customer interactions in its latest Global Consumer Banking Survey of retail banking customers around the world, downloadable at ey.com.

It is one of the basic services banks offer and one of the activities customers want banks to improve to increase overall satisfaction. Our research has shown that errors and inefficiencies related to payments can have catastrophic consequences as customers are increasingly ready to change their main banking relationship.
Customers of the payments industry represent a broad spectrum, from the individual consumer interacting in a branch, online, by phone, at Point of Sale or via their mobile, to global treasurers of large multinational corporate clients. Customers not only want value for money, but also to play an active role in tailoring their products and services. Their demands are increasingly characterized by:

- **Ease of use, flexibility and personalization**: customers used to intuitive, convenient, easy-to-use mobile and internet products are unforgiving of “clunky” experiences. This is particularly challenging when addressing security considerations, for example, card readers for online banking authentication.

- **Immediacy**: there is an increasing expectation for real-time capability from peer-to-peer payments and real-time notifications and balances provision to the treasurers of corporate banking customers.

- **Mobility**: the provision of services across channels is now a hygiene factor, with an increasing expectation placed on the mobile channel. Delivering the right front-end experience and information back to customers is highly dependent upon effective, adaptable, efficiently running payments IT and operations.

- **Reliability**: failures in payments systems can have dramatic consequences. At market level, it can generate issues throughout the economy, and at customer level it can not only be inconvenient but also costly in terms of missed payments or being unable to access funds.

- **Security**: from channel through to back-end processing, the need to pre-empt and respond to the latest threats won’t ease. Banks have historically been seen as trustworthy and reliable in this area, when compared to new entrants, so as innovation is embraced, the robustness of this reputation needs to be protected.

### Regulatory demands

Transparency and fairness to customers are the declared thrust of much of the regulatory change hitting the payments world, along with the ever-present underlying requirements for controls and reporting.

Regulatory developments impacting the UK and Europe include the second Payment Services Directive (PSD2), the second Electronic Money Directive (2EMD), the Single Euro Payment Area (SEPA) and guidelines on internet payment security. This is further complicated by multiple layers of regulation that are not payments centric but have consequential impact, e.g., structural reform such as the Independent Commission on Banking report (ICB) in the UK, intraday liquidity and other international regulation such as the Foreign Account Tax Compliance Tax Act (FATCA) and the Dodd Frank Act in the US; furthermore, ongoing scrutiny of AML and Sanctions measures won’t subside.

Firms need to prepare themselves for changes to the regulatory regime. The existing regime for payments in the UK is largely self-regulated, with roles for the Payments Council and a number of regulatory bodies, including the UK Financial Conduct Authority (FCA), the Bank of England, the Office of Fair Trading and HM Treasury with added input from APACS (the governing body for paper-based check clearing).

In this context, drivers for regulatory change have resulted from:

- Complex regulation and payments structures leading to payment providers being unresponsive to regulation and the needs of their customers
- The need for transparency and fairness to customers
- A desire to improve ease of access to payments systems
- An increased need for payments controls and reporting requirements to mitigate the risks within the industry
- The EU vision to have a harmonized national and cross-border payments system
Taking these drivers into consideration, the UK Government has formulated four objectives:

- Have a UK payments system that benefits all end users
- Create an industry that promotes and develops new and existing payments systems
- Have a UK payments system that facilitates completion
- Have a UK payments system that is reliable, stable and efficient

To assist in meeting these objectives, the UK Government has proposed bringing payments systems under a new regime of economic, utility style regulation focusing on competition. A more intrusive regulatory approach may mean established payment providers, such as banks, will not only be required to evidence their own compliance but could potentially be required to pick up the slack for others in the payment chain, who may not fall specifically under the regulator’s watchful gaze. For example, regarding relationships that banks have with both non-bank providers of payments services and correspondent banking partners, and the level of scrutiny they are applying to those providers to satisfy themselves so that the end-to-end flow of payments is subject to sufficient oversight and control.

Furthermore, the application of regulatory requirements in the past has been a challenge for some firms, where a disconnect between the payments servicing department and compliance/legal departments has led to discrepancies in interpretation and application of regulation into compliant business solutions.

As long as there is regulatory change, there will be implications for payments businesses and their enabling IT and operations. To manage this, banks and other payment service providers should take a holistic view of the breadth of changes that payments businesses, IT and operations will need to absorb.

The FCA’s focus on payments

There is an increasing focus on how banks conduct their business. In the UK this is driven by the Financial Conduct Authority (FCA). Payments are instrumental to this at different levels across the operating model:

- The overall operational strategy
- Specific processes
- People and organization
- Technology and data
- Managing the performance of payment services

The FCA recognizes that regulation should not stifle innovation; however, they have noted that some firms have found the move to “conduct of business regulation” a culture shock.

The FCA’s Retail Outlook cites increased reliance on technology as potentially leading to conduct risks, as follows:

- Increased reliance on technology without a full understanding of the consequential risks and dependencies
- Technology interfaces and infrastructures in financial markets that rely on global networks over which firms do not have oversight
- Reliance on technology-based infrastructures that use systems outside financial markets, e.g., mobile phone providers for mobile payments
- Technology enhancements that facilitate faster, less well-considered decisions by consumers

As per its 2013 business plan, the FCA will work to assess resilience of market infrastructure and the risks associated with trading, through an increase in supervision and analytical work. Firms need to be prepared for this increased regulatory focus.
The balancing act

As new products, services and players continue to emerge, the payments environment will become increasingly complex to navigate as business imperatives and regulatory requirements need to be continually balanced. In an environment where many organizations have limited funds to invest, the business agenda can be slowed as investment is channeled toward mandatory regulatory programs.

Challenges are often compounded by aging legacy systems. These systems do not typically have the flexibility to address the breadth of demands now being placed on them, and the specifics of how they work are not clearly understood. As a result, adapting to the new landscape can be costly and time consuming. Similarly, aging systems can introduce instability and risk of failure that carries with it regulatory, business and reputational risk.
A new payments regulator, multiple layers of regulation and industry innovation are converging to impact on payments systems and operations. Payment providers need to form a view of how these dimensions of demand will impact their payments IT and operations. They also need to establish a holistic portfolio management approach, set up not only to deliver change driven by what is known today, but also to effectively phase in future regulatory demand and business need.

Taking this approach, any investment made will help a firm respond not only to new regulatory requirements but also to business need and enable the creation of innovative and forward-looking payments systems.

Payment providers are being challenged to meet the regulators’ expectations while delivering against their strategic agendas – centered on the customer, fueled by product and technology innovation.
The future

The fundamentals will not change, with payment services required to be efficient, convenient, timely, secure, reliable and transparent in the transfer of funds. More innovative products, services and channels will also be core to every bank and payment services provider.

Through the changing dynamics of the industry, customer expectations and regulation, the future of the payments world will evolve:

- Providers will increasingly need to view customers through an international lens as they become more “globalized” in their attitudes. Customers are intensifying their search for the best rates, products and services.
- Banks and other payment providers investing in technology and product innovation will need to meet the growing demand for domestic and international low-value real-time transfers and information provision at low cost.
- Some processors may need to offload volumes as processing becomes increasingly more commoditized, driving down processing fees and revenues in an area that requires significant investment.
- Differentiation will come in the channel with improved customer experience and value-added services.
- There will be a search for additional products and services to create new revenue streams and to face off against the challenge of alternative providers.
- Technology and operations, which are the foundation of the payments business, will have to be increasingly adaptive to change.
- The overhead of ongoing response to regulation will continue and will need to be managed as an integrated, ongoing portfolio of change alongside strategic investment.
- There will be an increase in use of transaction data analytics to provide insight into spending behaviors and patterns in order to create the basis for loyalty programs and targeted marketing.
- The “who does what” in the value chain will continue to be dynamic as the landscape of players changes with successes, failures, mergers and acquisitions.
- New entrants, innovation and development of new products and services will come increasingly under pressure from the regime of regulation and control.

Ultimately, the most successful firms will be those who deliver payment products and services, which provide excellent, compliant customer service. With the future of payments still evolving, the winners will be those who can strike the balance between innovation and regulatory compliance, managing the two in concert.
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EYG No. EK0181
1374188.indd (UK) 10/13. Artwork by Creative Services Group Design.
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