Payment Systems Regulator

Harriett Baldwin MP
Chair of the TSC Sub-Committee on Financial Services Regulations
House of Commons
Committee Office
London
SW1A 0AA

14 February 2023

Dear Harriett,

Thank you for your letter dated 25 January 2023. I am pleased to provide further information on our consultation on requiring reimbursement for Authorised Push Payment (APP) scam fraud.

As outlined at the evidence session on 13 December and in the previous correspondence[1], the PSR's proposals to require reimbursement for victims of APP scams are not final and are subject to change. As such, this letter reflects the concept behind the proposals not our final position. We set out below our own analysis, and a summary of the views and evidence from respondents to our consultation. We are currently considering all responses, including your recent report and recommendations and will publish our final policy statement in May 2023.

Our proposals will put in place incentives to ensure that a payment system, and the firms that participate within it, are taking appropriate action to prevent fraud and that customers are protected. In our proposals we considered the balance of these measures in the round, in particular on: the standard of customer caution; the high bar for exceptions to mandatory reimbursement (gross negligence and first party fraud); and the introduction of reimbursement thresholds, excess, and time limits to claims.

As well as undertaking our own analysis, we sought views and evidence from a wide range of stakeholders through our public consultation process. We sought evidence of whether our proposals would result in customers taking less care; and whilst we have received strong views on whether this is the case, we have received very limited firm evidence to support this view. In making our final decision, we are considering all the views put forward in response to our consultation.

We look forward to keeping the Sub-Committee on Financial Services Regulations to up to date on our approach on delivering mandatory reimbursement and realising the benefits of these incentives on industry to prevent fraud.

Yours sincerely

Chris Hemsley
Managing Director

[1] letter of 24 November and letter of 9 January

PSR

PSR question responses:

1. **What analysis did you undertake to determine that the £100 threshold for reimbursement was the appropriate level?**

We expect that mandatory reimbursement will incentivise Payment Service Providers (PSPs) to prevent APP scams from happening in the first place. Innovative approaches to fraud prevention, such as data sharing, are giving firms greater insight about suspicious payments and the PSR is working with industry and Pay.UK to help deliver the technical solutions to fight fraud and we expect to see more of this.

Where a fraud does occur, we considered whether it was appropriate to put in place mandatory reimbursement with only limited exceptions. As part of this package, we also consulted on reimbursement thresholds and what was appropriate for these levels to be. Following extensive engagement with consumer groups and industry we consulted on a £100 minimum threshold with no upper limit on claims taking into consideration the following factors:

- Lower value scam payments are typically the hardest for PSPs to detect and prevent, so they may have the least scope to mitigate the costs of mandatory reimbursement.
- this may allow PSPs to focus on preventing and reimbursing higher value scams which often lead to greater harm due to the size of the financial loss and the level of social engineering and betrayal criminals use.
- the threshold could also mitigate against potential unintended consequence of increased moral hazard – consumers taking less care when making payments. In our consultation, we sought concrete, including quantitative, evidence on the risk that consumers would take less care.

This was supported by analysis undertaken by seven of the Contingent Reimbursement Model (CRM) signatory firms, covering approximately 85% of payment market share. The analysis showed that in 2021, 21% of all reported APP fraud was for purchase scams below £100. Subsequent analysis shared with the PSR by UK Finance from eight of their members showed that 24% of APP scams cases were for those below £100 – representing 1% of the value of these firms APP scams cases.

Respondents to our consultation called for us to consider a range of alternatives, with PSPs suggesting levels between £200 to £1,000. Some respondents told us that mandatory reimbursement could lead to moral hazard, but we were provided with very limited evidence.

However, we recognise that a loss of up to £100 can still be a high-impact and life-changing event for many consumers, particularly due to current pressures on the cost of living. Submissions from consumer representatives called for the threshold to be removed entirely and that the proposal would have significant impacts on those most at risk of harm and should be removed. The proposal outlined in our consultation gave firms the ability to not impose the £100 threshold.

PSR

2. In your consultation you point to the analogous £100 minimum threshold applied to protections under section 75 of the Consumer Credit Act 1974. How effective is that threshold at achieving its objectives?

When developing the proposed threshold, we considered any relevant comparisons for consumer protections in payments – such as Section 75 of the Consumer Credit Act (CCA) 1974; a statutory instrument in 1983 [2] uprated the 'lower exemption limit' for Section 75 protections from £30 to £100. The limit has not been uprated since. We noted that aligning with the CCA had some benefits, as £100 would be a level of protection that would be well understood by many consumers[3]. A £100 threshold also aligns our policies with the PSR's strategy of promoting competition between payment systems – consumers have meaningful choice between using their credit card or a bank transfer, knowing that they will be protected for payments above £100.

In 2019, the Financial Conduct Authority (FCA) published a report[4] on the retained provisions of the CCA which was presented to Parliament. The report reviewed all provisions within the CCA and whether their repeal would adversely affect the appropriate degree of consumer protection for consumers, including if they were transferred into FCA rules. We have spoken with HM Treasury, and they are not aware of any recent review into the effectiveness of the Section 75 £100 threshold.

HM Treasury is currently consulting on reform of the CCA[5]. The consultation paper stated that the scope of Section 75 could be reviewed as part of this reform work. We await the outcome of the consultation to allow us to properly assess the effectiveness of Section 75 protections. Responses to the consultation are due back by 17 March 2023 and we will work alongside the FCA and Treasury to inform future policy development.

In responses to our consultation some stakeholders understood and agreed with the rationale for the basis of the £100, but others argued that an APP scam is different to the cases covered under Section 75, and preferred no de minimis at all, or wanted a higher threshold.

As a long-standing consumer protection policy, it is not possible to comment on all the original rationale for setting protection at £100, and the extent to which the policy has achieved its stated objectives. Consumer protections for credit card purchases were partly implemented to help inspire trust and confidence in a then nascent payment method. Likewise, the PSR's strategic objective of building greater confidence in account-to-account payments will mean developing policies, like APP scams reimbursement, which offer appropriate consumer protection from the risks that system users may encounter.

3. Has the PSR conducted any distributional research into the income levels of victims who lose less than £100 to APP scams? To what extend are those victims able to absorb these losses?

APP scams can affect all consumers regardless of their personal circumstances. Our consultation included a cost-benefit analysis and as well as a public sector equality assessment. We have also provided an analysis (Tables 1 and 2) of data published by the Victims' Commissioner as part of

[2] The Consumer Credit (Increase of Monetary Limits) Order 1983 (legislation.gov.uk)
[3] Consumers were asked as part of research commissioned by the FCA whether they had been aware of Section 75 protection before being interviewed. 68% said they had been aware. This included 70% of consumers with a credit card, 72% a store card and 86% other retail credit https://www.fca.org.uk/publication/corporate/review-of-retained-provisions-of-the-consumer-credit-act-final-report.pdf
[4] https://www.fca.org.uk/publication/corporate/review-of-retained-provisions-of-the-consumer-credit-act-final-report.pdf
[5] https://www.gov.uk/government/consultations/reform-of-the-consumer-credit-act-consultation

their report – *Who Suffers Fraud?*[6] The Victims' Commissioner's report uses data from the 2017/18 and 2018/19 Crime Survey for England and Wales to segment fraud victims into nine clusters based on their level of vulnerability - including risk factors related to their personal circumstances.

Table 1 shows the extent to which the nine victim clusters reported being a victim of fraud above and below £100. For instance, 14.8% of people in Cluster 1 (severely harmed victims) reported losing less than £100, with 85.2% of victims in this Cluster reported losing more than £100.

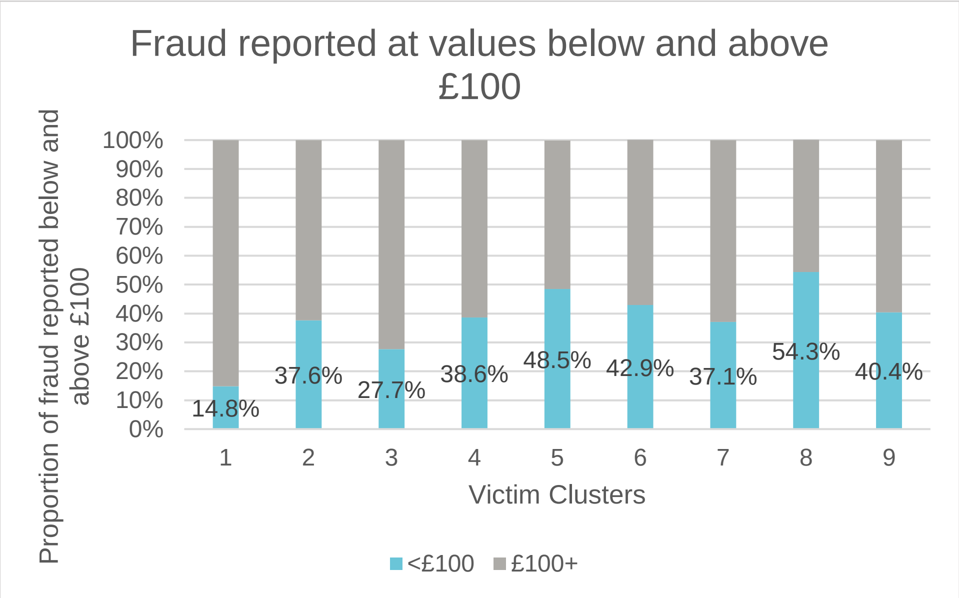

Table 1 – PSR analysis of *Who Suffers Fraud?*

[6] https://victimscommissioner.org.uk/news/who-suffers-fraud/

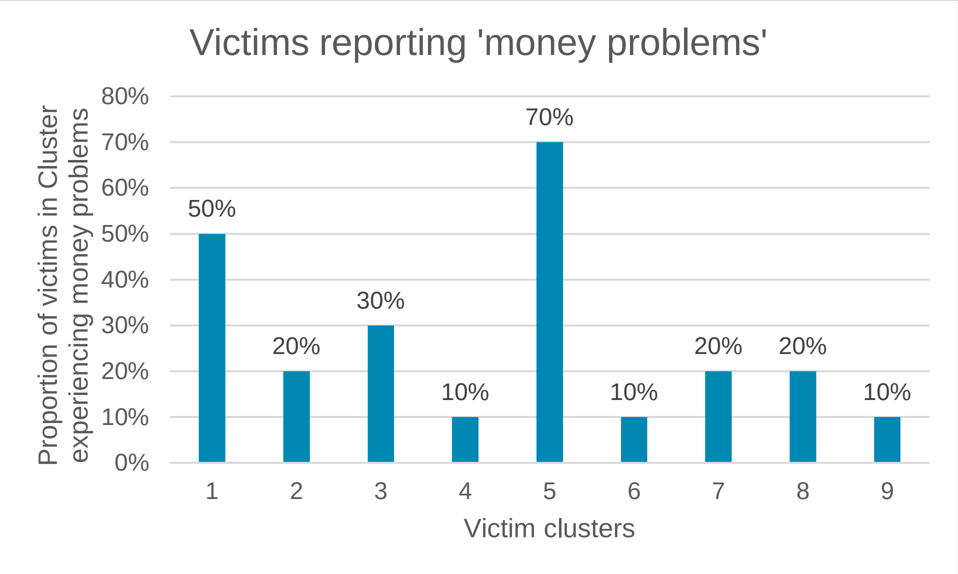

Table 2 – PSR analysis of *Who Suffers Fraud?*

Table 2 shows the proportion of victims within the nine clusters who reported experiencing 'money problems' - that it would be a problem to find £100 to meet an unexpected expense (impossible to find or a bit of a problem). For instance, 70% of those in Cluster 5 (younger, urban and less affluent victims)

Cluster 1 and Cluster 5 were most likely to experience 'money problems'. However, when comparing the two charts, the likelihood of experiencing a lower value fraud is felt across those with greater or more limited financial resilience.

4. The PSR's rationale for imposing a £100 minimum for reimbursement is to encourage consumers to take 'sufficient care'. Do you have evidence that people who lose larger amounts have taken more care than those subject to smaller losses?

As stated in our response to question 1 above, limited evidence has been submitted to us about how a minimum threshold could influence customer behaviour. We have engaged with TSB who in 2019 launched their Fraud Refund Guarantee. TSB have told us, and reported[7], that they have not seen evidence of moral hazard or consumers taking insufficient care since launching their guarantee.

In October 2022, the PSR commissioned Britain Thinks to conduct qualitative consumer research on our proposals. The purpose of these focus groups was to allow the PSR to hear from end users of payments and understand their starting views and spontaneous concerns in relation to APP scams, as well as to hear their responses to the PSR's APP scams proposals and what they believed we should prioritise.

The research captured a range of views from participants and there was tentative support for the £100 threshold, though some questioned the extent to which this was affordable for all

[7] https://www.tsb.co.uk/media-centre/insights-and-views/tsb-tackling-fraud-together.pdf

consumers. The threshold and £35 excess were seen to potentially help keep the cost down for firms, thus reducing the risk of any additional costs being passed on to consumers.

When prompted, some consumers in the group could also see how having a minimum threshold and ‘excess’ amount could incentivise consumers to take greater care when making or transferring payments (i.e., if they know they have to cover those costs if they fall victim, or that they will not be reimbursed if they lose less than £100). For some, with prompting, the idea of a £100 threshold and £35 excess was also felt to effectively prevent against consumers “exploiting” the system.

Although most felt the amounts suggested were reasonable, some felt these are *not* fair for very low income and/or vulnerable consumers, who may consider £100 to be a very significant sum of money. In our consultation, we proposed that PSPs would be able to exempt vulnerable consumers from any ‘excess’ they chose to implement.

5. Did you consider other approaches to promoting consumer caution?

The focus of our work remains the prevention of APP scams and incentivising PSPs to put in place effective preventative measures to ensure their customers don’t fall victim in the first place. This will prompt more payment firms to improve the information provided to their customers; something we have already started to see following the introduction of the voluntary Contingent Reimbursement Model.

In addition, the PSR has implemented Confirmation of Payee (CoP) to provide consumers with greater insight about whether the payment they are making, or the payee they are sending money to, is legitimate. This allows consumers to take better-informed choices but has also led to payment firms offering their customers different warnings, linked to whether the CoP check was successful or not.

An example of the types of preventative steps we would expect to see is the use of effective and targeted warnings before and throughout the payment journey. Targeted consumer information and advice campaigns can help promote the right messages about how to take care when making payments. Appropriate aftercare which includes practical and emotional support can help prevent those who experience an APP scam from being a repeat victim.

In weighing up the arguments on customer caution we will also consider the extent to which many APP scams have become increasingly sophisticated, frequently involving social engineering of the victim who often do not realise they are at risk. Research by Which?[8] found that “scams often occurred when the victims were beyond their emotional ‘window of tolerance’ i.e., they were especially stressed, tired, or distracted. This meant victims were more susceptible to being defrauded and often not able to perform the same level of checks they otherwise would have.” Which? reported on a European Commission survey[9] which found that 79% fraud victims experienced a negative emotional impact, while a quarter (24%) experienced a negative financial impact. More than half (57%) of those surveyed experienced only emotional or physical harm,

[8] https://www.which.co.uk/policy/money/9245/the-psychology-of-scams-understanding-why-consumers-fall-for-app-scams
[9] https://www.which.co.uk/news/article/devastating-emotional-impact-of-online-scams-must-force-government-action-aRSZo6V8HPaD

"showing that even where no money is lost - or where it is ultimately returned - the very act of betrayal represented by a scam often causes significant suffering"[10].

6. What was the rationale for proposing a £35 excess for reimbursement payments? Why should someone found to have been defrauded not be reimbursed in full?

The £35 excess was proposed to align our requirements with Section 77 of the Payment Services Regulations 2017[11] which state that a PSP 'may require that the payer is liable up to a maximum of £35 for any losses incurred in respect of unauthorised payment transactions arising from the use of a lost or stolen payment instrument, or from the misappropriation of a payment instrument'.

The excess was proposed to mitigate against potential increased moral hazard, reduce administrative costs for firms, and to reduce the likelihood that PSPs were reimbursing civil disputes.

7. How do you intend to measure whether the gross negligence exception is being applied fairly and consistently across the industry?

Under the proposals we consulted on, we expect Pay.UK to monitor on an aggregate and individual level the number of times firms are alleging a customer was grossly negligent. We are working closely with Pay.UK on the appropriate approach to monitoring and enforcement, but we will expect Pay.UK to investigate any firms which are claiming gross negligence significantly more often than others and escalate firms for regulatory enforcement action where necessary. Pay.UK will also share data and information with us, that will allow us to monitor extent to which the customer standard is meeting our objectives.

Individual customers will also be able to take their case to the Financial Ombudsman (FoS) if they are unhappy with how their case has been dealt with. Reflecting this, we will also be working with the FoS to monitor their APP scams case load and the application of gross negligence by firms. The FCA as a conduct regulator will assess firms' approach and application in relation to regulatory principles such as treating customers fairly and the consumer duty. They will work with firms to help improve standards across the industry.

In our consultation we proposed not issuing guidance and for firms to work to existing definitions and interpretations as well as our expectation that the vast majority of customers would be reimbursed. Our final policy statement will outline our approach to ensuring that there is a consistency of interpretation and outcomes relating to the gross negligence standard.

8. Do you expect Pay.UK rules to define "gross negligence"?

Our policy statement in May will set out our decision on whether we impose our reimbursement requirements through directions on participants, by requiring Pay.UK to changes its scheme rules, or a combination of both.

We stated in our earlier consultation, that we expect decisions from the FoS to help define gross negligence. Several responses to our consultation asked for guidance around the concept of

[10] https://www.which.co.uk/news/article/devastating-emotional-impact-of-online-scams-must-force-government-action-aRSZo6V8HPaD
[11] https://www.legislation.gov.uk/uksi/2017/752/regulation/77/made

gross negligence in relation to APP scams and we are considering how we can provide further clarity to best ensure consistency of interpretation and outcome. As set out above, our final policy statement, scheduled for May 2023, will outline our approach to ensuring that there is a consistency of interpretation and outcomes relating to the gross negligence standard.

9. Do you have a target reimbursement rate you expect PSPs to achieve?

Reporting[12] from UK Finance showed that in 2021, 182,976 cases were assessed and closed under the CRM Code with a total value of £467.5 million. £238.1 million of losses were returned to victims under the Code, accounting for 51% of reimbursement in these cases. Whilst the Code has improved reimbursement rates, further action is needed to drive greater consumer protection.

Within the scope of our mandatory reimbursement requirements, we expect victims to be reimbursed in the vast majority of cases. We believe this will help meet our objectives of:

- Incentivising PSPs to improve prevention of APP scams
- Incentivise innovation
- Increase protection of Faster Payments users
- Increase confidence and competitiveness of Faster Payments
- Create agile rules which can be applied consistently

We also note the high rate (73% in 2020/21) of APP fraud cases overturned by the FoS in the customers' favour[13]. We expect that our proposals will lead to more victims being reimbursed at the first instance. FoS is already seeing falling uphold rates as firms seek to apply the learning from FoS decisions and engagement.

We also note the 99% APP fraud reimbursement rate[14] achieved by TSB with their Fraud Refund Guarantee.

[12] https://www.ukfinance.org.uk/system/files/2022-06/Annual%20Fraud%20Report%202022_FINAL_.pdf
[13] https://www.financial-ombudsman.org.uk/data-insight/annual-complaints-data/annual-complaints-data-2020-21
[14] https://committees.parliament.uk/writtenevidence/18464/html/