Payment Systems Regulator

Policy statement

Fighting authorised push payment fraud

A new reimbursement requirement

Annex 4: Cost benefit analysis

June 2023

PS23/3 Annex 4

1 Cost benefit analysis

We consider that the new reimbursement requirement will provide very substantial benefits overall, with PSPs incentivised to improve their fraud prevention capabilities, customers enjoying greater protections, and fraud victims having their money reimbursed with very limited exceptions.

While the main cost of the policy will be the payment of substantial sums by PSPs to victims, our cost benefit analysis does not focus on this impact, as it is, in a sense, a transfer from PSPs to customers. Instead, our analysis focuses on the costs to PSPs of increased investment in fraud prevention, and the potential increase in friction that customers making payments may experience.

We conclude that benefits of our policy should substantially outweigh costs, particularly considering the inclusion of an excess and a maximum claim limit, which will place some limits on the costs of reimbursement and maintain an appropriate role for customer caution.

How will the policy improve outcomes?

Causal chain

1.1 The policy statement sets our objective to significantly reduce APP fraud. The new reimbursement requirement will give customers greater protection, ensuring that most victims will be reimbursed.[1] We expect the policy to benefit customers by substantially increasing the proportion of customers' APP fraud losses that are reimbursed by PSPs, from the current level of around 60% under the CRM Code.[2] We expect to see increased efforts by PSPs to prevent APP fraud, incentivised by the costs of this greater reimbursement, with the potential to reduce the numbers of customers who fall victim in the first place. They will also incentivise PSPs to improve their fraud prevention capabilities, both for incoming and outgoing payments.

1.2 We expect our policy to work principally by providing incentives for both sending and receiving PSPs to:

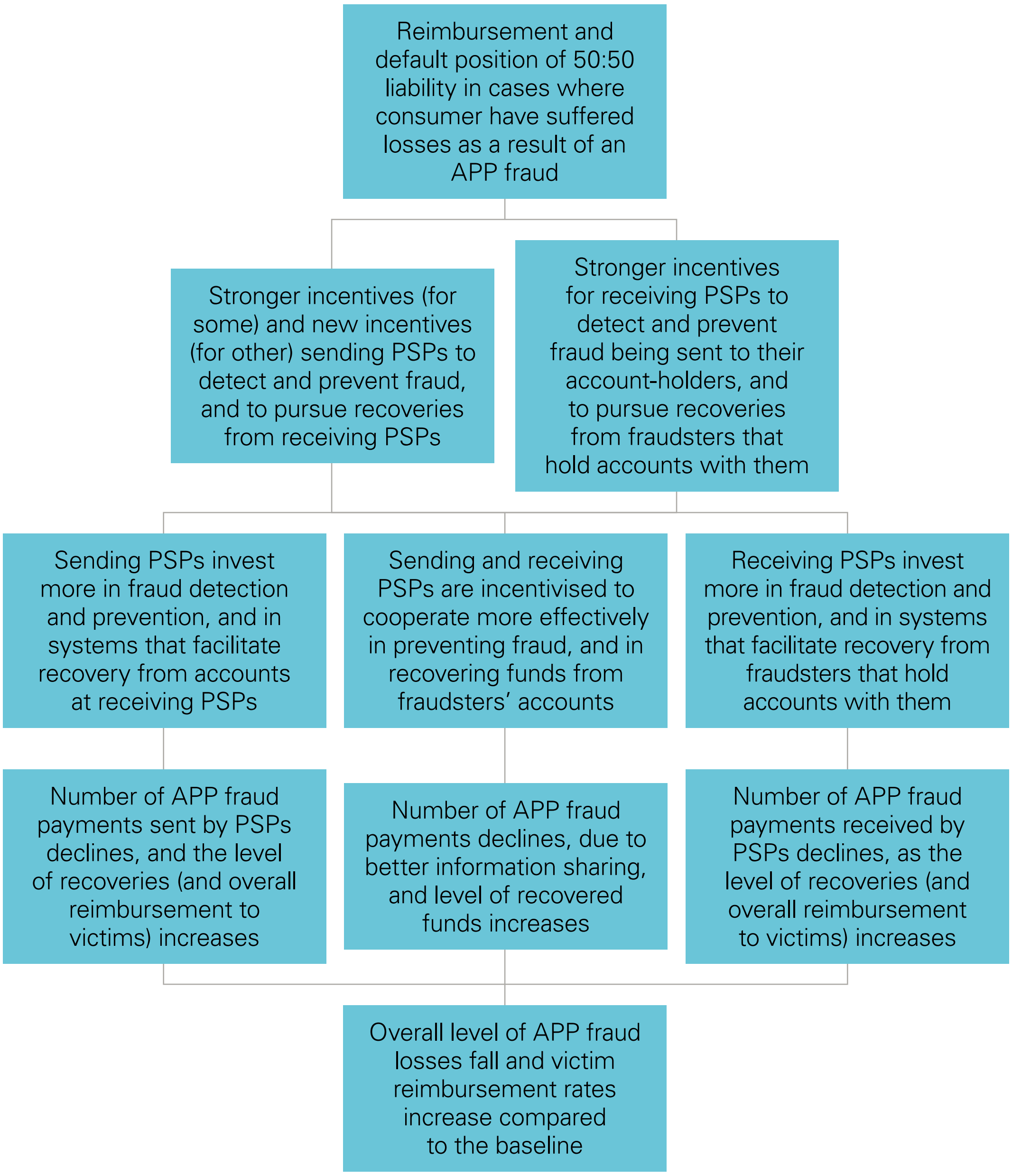
- improve their detection and prevention of APP fraud
- cooperate more effectively in preventing APP fraud
- more effectively pursue and recover lost funds to reduce PSPs' own costs in reimbursing victims

1 The new reimbursement requirement applies to consumers, microenterprises and charities (defined in the policy statement glossary). This cost benefit analysis refers to payers within the scope of the requirement collectively as 'customers'.

2 Among the ten signatories of the CRM Code, 66% of APP fraud losses were refunded in 2022, while in 2021 the share was 48%. UK Finance, *Annual fraud report – The definitive overview of payment industry fraud in 2023* (May 2023).

1.3 We expect these changed incentives on PSPs to lead to a fall in APP fraud over time. The policy places greater emphasis on sending and receiving PSPs' ability to detect and prevent APP fraud, strengthening their incentives to do so. By including a claim excess and a maximum level of reimbursement, it also recognises the role of customer caution.

Figure 1: Causal chain for requiring reimbursement of APP fraud losses



Baseline

1.4 We have analysed the impacts of the policy against a baseline, or counterfactual scenario, where the policy is not implemented. The starting point for our baseline is that PSPs will continue taking some action to prevent APP fraud and reimburse some victims who have exercised sufficient caution. We set out the main assumptions we have made in more detail below, but, in summary, we have assumed that:

- our other measures (Measures 1 and 2) against APP fraud, currently being implemented, will take effect over the course of 2024, with the publication of comparative data on PSPs' rate of APP fraud payments sent and received and their reimbursement performance taking place from late 2023 onwards (see policy statement, Chapter 3)

- the extension of Confirmation of Payee (CoP) checks, also being implemented, will have fully taken effect as planned by November 2024 (see policy statement, Chapter 3)
- PSPs that currently reimburse some of their customers' APP fraud losses incurred voluntarily (under the CRM Code or otherwise), would continue to do so, without the new reimbursement requirement
- current rates of recovery of funds from fraudsters' accounts would remain low, without the new reimbursement requirement
- current shares of reimbursement costs coming from receiving PSPs (as opposed to sending PSPs) would also remain low, without our intervention

Other PSR policy interventions

1.5 In our baseline scenario for this analysis, we have assumed the two other APP fraud policy measures that we are working on (described in the policy statement, Chapter 3) will be in place:

- **Publishing a balanced scorecard of APP fraud data (Measure 1):** Our March 2023 policy statement and specific direction[3] directed PSPs to submit data to us in May 2023, for publication of the first set of data in October 2023. As such, we have assumed, for the purposes of this analysis, that this measure will be in place and having an impact on APP fraud prevention in 2024.[4]
- **Increasing intelligence sharing (Measure 2):** Progress continues on technical design aspects of the new Enhanced Fraud Data (EFD) system. Pay.UK, with the support of UK Finance, are now taking forward a project to deliver EFD. We expect PSPs to start implementing aspects of the system by the end of 2023. We have therefore assumed, for the purposes of this analysis, that this measure is likely to be in place and having an impact on APP fraud prevention in 2024.

PSR policy on the extension of CoP checks

1.6 In October 2022, the PSR published a policy statement and gave a specific direction requiring more than 300 PSPs to begin providing CoP checks. This will take place in two tranches: the first by the end of October 2023; and the second tranche, which involves a large number of small PSPs, by the end of October 2024.[5] For the purposes of this analysis, we have assumed that this expansion will take effect, as directed, by the end of October 2024, noting that relatively larger PSPs are being directed to provide CoP checks by the earlier date in Q4 2023. As such, even without the new reimbursement requirement, we should expect some decrease in the level of APP fraud, at least those that are likely to be affected by the wider use of CoP checks, for example, impersonation scams.

3 PSR PS23/1, *APP scams: Measure 1 - collection and publication of performance data* (March 2023)

4 We note that our November consultation included a draft cost benefit analysis of the impact of the information publication under Measure 1, including pointing to its likely impact on reimbursement and fraud prevention.

5 PSR PS22/3, *Extending Confirmation of Payee coverage: Response to consultation CP22/2* (October 2022)

1.7 The broader scope of our reimbursement requirement (in terms of covering all types of APP fraud) and the financial incentives that it provides to PSPs means that it is likely to have a greater effect on APP fraud overall than this extension of CoP checks.

Voluntary reimbursement

1.8 Some PSPs currently reimburse APP fraud victims. Currently, around 60% of customer APP fraud losses are reimbursed by signatories under the CRM Code.[6] In addition, the incentives on PSPs to increase their reimbursement rates voluntarily in response to the publication of APP fraud data may also lead to higher levels among sending PSPs absent our new reimbursement requirement (see 1.5). However, the new reimbursement requirement will, by definition, lead to a greater increase in overall reimbursement rates than the incentives that publication of reimbursement rates would be likely to achieve.

Recovery of funds from fraudsters

1.9 In 2021, funds recovered from fraudsters' accounts at receiving PSPs provide less than 5% of funds reimbursed to APP fraud victims (under the CRM Code).[7] This low level of recoveries prevails despite the incentives that already exist for sending PSPs to pursue receiving PSPs in attempting to recover these lost funds. Publication of APP fraud data (Measure 1) is likely to increase reimbursement rates. In turn, increased reimbursement rates may incentivise them to pursue recoveries from fraudsters' accounts in order to offset their greater costs. However, how far Measure 1 alone will increase recovery rates is unclear as many sending PSPs already incur significant costs in voluntarily reimbursing their customers, yet this has not led to material rates of recovery from fraudsters' accounts.

Reimbursement from receiving PSPs

1.10 In 2021, reimbursement from receiving PSPs accounted for under 5% of all funds reimbursed to victims of APP fraud (under the CRM Code).[8] In the absence of any material change in receiving PSPs' incentives to provide greater reimbursement to victims, we do not expect this low rate to increase, absent this new requirement.

Respondents' views

1.11 We received 45 responses expressing a view on the cost benefit analysis in our September consultation paper.[9] Most stakeholders' views are reflected in the relevant sections for each benefit and cost. Where a stakeholder had a view that does not relate to categories of costs and benefits that form part of our analysis, we have set out our view in this section.

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6 Among the ten signatories of the CRM Code, 66% of APP fraud losses were refunded in 2022, while in 2021 the share was 48%. UK Finance, *Annual fraud report – The definitive overview of payment industry fraud in 2023* (May 2023).

7 UK Finance, *Annual Fraud Report* (August 2022), page 49: Repatriation from beneficiaries' accounts to victims accounted for £12.4 million out of total reimbursement of £467.5 million under the CRM Code in 2021. That is around 2.7% of the value reimbursed came from funds recovered from fraudsters' accounts at receiving PSPs.

8 PSR analysis of UK Finance data on CRM Code outcomes, 2021.

9 PSR, *Consultation CP22-4: Authorised push payment (APP) scams: Requiring reimbursement*, (September 2022), Annex 2.

Agreed with our cost benefit analysis

1.12 Eight respondents agreed with our cost benefit analysis. Specific points raised included: the importance of improving incentives on receiving PSPs to tackle mule accounts; and the negative impact of fraud on victims' mental and physical health.

Argued that costs had been understated

1.13 Thirty-two respondents argued that costs had been understated in our cost benefit analysis. They raised six main issues:

Risk of increased friction in the payment system

1.14 Twenty-five respondents raised this point and the need to take greater account of the costs of delayed and declined payments, including penalties that payers may face. None suggested a way to quantify this harm nor an estimate of how much our proposals would increase any such friction. Specific points and our views are set out where we discuss the costs of increased friction (see 1.83 to 1.87).

Reduction in competition and innovation

1.15 Twenty-two respondents argued that the proposals would reduce competition and innovation, pointing to the potential impacts on smaller PSPs, the creation of barriers to entry, expansion and innovation, and the risk that the adoption of account-to-account (or open banking) payments for retail transactions could be impeded. These points and our responses are dealt with where we discuss the cost of reduced competition and innovation (see 1.88 to 1.100).

Increased administrative costs for PSPs

1.16 Seven respondents pointed to the costs of implementing and administering the policy, with a number pointing to the impact on PSPs that are not already signatories of the CRM Code. Some respondents also pointed to the costs to PSPs of interacting with customers to query suspicious payments – in addition to the costs that such friction introduces (see 1.14). We set out our revised analysis of the administrative costs for PSPs (see 1.78 to 1.82).

Risk of vulnerable customers being 'de-banked'

1.17 Ten respondents (representing a diverse set of stakeholders) referred to the risk of 'de-banking' vulnerable customers or limiting the services available to some customers. Consumer organisations, trade bodies and five banks raised this as a risk. These potential effects are set out where we deal with the cost of excluding some customers (see 1.106 to 1.110).

PSPs passing cost increases on to all customers

1.18 Four respondents pointed to the risk that higher costs of reimbursement would be passed on to all customers of the PSPs in question. We have not included this as a separate point in our analysis of costs, as the increased costs to PSPs from reimbursement is not explicitly included in our analysis. The extent to which related costs, such as, PSPs' administrative costs or investment in fraud prevention measures, might be passed on to customers is reflected in those costs.[10]

Increased risk of first-party fraud

1.19 Two respondents pointed to an increased risk of first-party fraud that should be given greater weight in the cost benefit analysis. We have not included a separate cost category to reflect the increased risk of first-party fraud, as we do not consider that this is likely to materially increase as a result of the new reimbursement requirement (see policy statement, Chapter 4).

Argued that benefits had been overstated

1.20 Five respondents questioned the scale of the expected benefits. The points they made included:

- Suggesting that the level of APP fraud could increase as PSPs are required to reimburse both victims and, in some cases, fraudsters, with fraudsters exploiting customers that are now protected
- PSPs would have to allocate funds to reimbursement rather than to fraud prevention.

1.21 We address these in the sections on the reduced incidence of APP fraud (see 1.40 to 1.58) and on moral hazard and customer caution (see 1.103 to 1.105).

Disagreed with our approach to the cost benefit analysis

1.22 Six respondents raised concerns about our approach to the cost benefit analysis, with two main themes emerging: the lack of quantification of the relevant costs and benefits; and a more fundamental disagreement with the policy rather than a view on the cost benefit analysis itself.

1.23 On the lack of quantification of the relevant costs and benefits, respondents argued that:

- There were no substantiated cost figures nor any justification for the lack of quantified costs for PSPs.
- Future growth in fraud and Faster Payments volumes should be reflected in the cost benefit analysis.
- The cost benefit analysis fails to consider the level of unreported APP fraud.
- The cost benefit analysis was 'very high-level' and lacking robust analysis of the impact on 'start-up and scale-up' PSPs.
- We should produce a more detailed cost benefit analysis on the final policies with a particular focus on the impact on account-to-account and open banking.

10 Estimating the costs to PSPs and then assuming that (some of) these would be passed on to customers would not affect the overall level of costs incurred as a result of the policy.

1.24 Our consultation in September 2022 stated that we would welcome additional evidence on quantification of benefits and costs we had set out.[11] No respondents submitted their own estimates for these, or for costs or benefits that their own responses identified.

1.25 As set out below, we have now included indicative estimates, based on our own analysis, for two additional cost categories: PSPs' administrative costs; and the costs of increased payment friction. On the specific points raised above:

- Reported APP fraud levels have been quite volatile in recent years, while Faster Payments transactions have grown strongly. It is not clear what reasonable assumptions would be for those numbers over the next five to ten years. In any case, our quantitative estimates are not at a level of precision where applying small annual rates of change would have a material impact on the overall analysis.
- The issue of unreported fraud is dealt with in paragraphs 1.101 to 1.102.
- The impact on entrants to the sector and on the development of account-to-account payments is dealt with in our assessment of the effect on competition and innovation, from paragraph 1.88.

1.26 Some respondents fundamentally disagreed with the policy, rather than with the detail of the cost benefit analysis. The costs that they pointed to – including the impact on competition and increased risk of moral hazard – are included in our analysis. Specifically, respondents argued that:

- The proposals would not incentivise investment in fraud prevention. PSPs' budgets will be allocated to reimbursement, while costs (for example, from reduced competition and from payment friction) will be high.
- The 'logic and analysis is flawed', 'not fit for purpose' and 'Wednesbury unreasonable', arguing that the policy will reduce competition and innovation, underestimates the costs of gross negligence by vulnerable customers which 'will introduce enormous liability to all banks', increase moral hazard, and will impose costs on customers to cover PSPs' additional costs of reimbursement and implementation.

Changes to the policy since the consultation

1.27 Proposals in our September consultation included a minimum claim threshold of £100, a claim excess of £35 and no maximum level of reimbursement.

1.28 The policy now includes:

- no separate minimum threshold
- a claim excess – level to be set after a further separate consultation in Q3 2023
- a maximum level of reimbursement – level to be set after a further separate consultation in Q3 2023

11 PSR, *Consultation CP22-4: Authorised push payment (APP) scams: Requiring reimbursement* (September 2022), Annex 2, paragraph 2.12.

1.29 The main financial impact of setting a claim excess and a maximum level of reimbursement is that these limit the overall level of reimbursement going from PSPs to APP fraud victims. The scale of this impact depends on the scale and the design of the excess and maximum level of reimbursement. In our draft cost benefit analysis in the September consultation paper, we took account of the effect of a minimum claim threshold, in that it had a material impact on reducing the volume of reimbursed claims, but a small impact on the overall value of reimbursement being paid to victims. The differential impact of now having no separate minimum claim threshold but retaining an excess depends on whether the excess is set at a similar level to this now-defunct minimum claim threshold of £100. Likewise, the impact of the maximum level of reimbursement depends on the level that is set. For example, if it is set at a high level, the effect could be negligible, in terms of unreimbursed claims and overall share of losses reimbursed to victims.

1.30 While the overall impact of the claim excess and maximum level of reimbursement depends on the levels set, there are two benefits which are likely to be reduced by their introduction:

- Lower liability on PSPs may reduce their incentives to invest in fraud prevention. PSPs' overall reimbursement costs would be lower as a result, so the reduction in APP fraud as a result of the new reimbursement requirement may be reduced.
- Lower liability on PSPs may also reduce their incentives to recover funds from fraudsters' accounts – again, reducing the benefit from the new reimbursement requirement in terms of recovery and repatriation of funds from fraudsters' accounts back to victims.

1.31 For costs to PSPs, the impact from a claim excess and a maximum level of reimbursement is likely to be greater, with reductions in a number of areas:

- Reducing PSPs' overall liability weakens their incentive to invest in fraud prevention, so their costs in this area are likely to be lower.
- An excess that reduces the number of low-value claims would lower PSPs' administrative costs. By way of illustration, a £100 excess applied to claims at the current number could mean almost a quarter were not reimbursed.
- A maximum level of reimbursement would mean that a small number of high-value claims would not disproportionately affect a small PSP. This would reduce the risk of prudential impacts that might otherwise affect competition and innovation.
- A material excess could reduce the risk of moral hazard and incentivise greater customer caution, reducing costs on PSPs from claims where the customer had not shown sufficient caution.

1.32 Without knowing the levels at which the excess and maximum level of reimbursement will be set, it is not possible to give a definitive indication of the impact of any change from the consultation proposal.

1.33 We expect that the main impacts flow from any change in the overall level of reimbursement going from PSPs to customers. There will be specific impacts of a material excess on PSPs' administrative costs (where claim numbers are materially affected), and of a maximum level of reimbursement on prudential risk (impacting competition and innovation), and of both an excess and a maximum level of reimbursement on the risk of moral hazard. Our consultation on the maximum level of the claim excess and the maximum level of reimbursement will include an updated cost benefit analysis that takes account of these impacts.

What is our assessment of the impacts?

1.34 We have analysed the impacts of the new reimbursement requirement against a baseline scenario with no such requirement (see 1.4 to 1.10).

1.35 It is outside the scope of this cost benefit analysis to assess the relative likely impacts of our various APP fraud policies on the levels of APP fraud and voluntary reimbursement, but we note the following:

- Different elements of our measures against APP fraud affect outcomes differently. For example, Confirmation of Payee (CoP) checks are likely to have an impact on some types of APP fraud (for example, impersonation scams) but not on others (for example, purchase scams).
- There is a degree of complementarity between our different measures against APP fraud. For example, while requiring reimbursement will give PSPs financial incentives to reduce APP fraud, the publication of data (under Measure 1) will give PSPs reputational incentives to improve their performance.
- Of all the measures we are putting in place, we expect the financial incentives under the new reimbursement requirement to have the greatest impact on how PSPs tackle APP fraud.

1.36 We have not taken the approach of directly balancing the costs of increased reimbursement that PSPs will face against the benefits of increased reimbursement that victims will receive. Focusing solely on this would simply find a large cost on one side cancelled out by the same scale of benefit on the other – of the order of £200 million to £250 million per annum.[12] In a sense, this is a transfer of the current costs that victims bear into additional costs on PSPs that will have to reimburse them.

1.37 Our approach has instead focused on the benefits and costs that the new reimbursement requirement will generate. The following sections set out our assessment of the likely costs and benefits of the policy relative to the baseline, noting:

- Our assessment is based on a combination of qualitative, as well as quantitative, evidence. It has not been possible to estimate the likely impacts of all the relevant benefits and costs with precision, but we have given indicative numbers where possible.
- In the absence of estimates from consultation respondents who cited additional costs, where we consider these relevant to the assessment, we have set out our own indicative estimates of their likely scale.

12 At present, reported APP fraud losses are around £500 million per annum, of which around 60% is voluntarily reimbursed by PSPs.

1.38 As set out in Table 1, there are five main areas where we expect the policy to lead to relevant benefits and eight areas where we expect it to potentially generate relevant costs. This summary is updated from the version that we consulted on[13], in three ways:

- Our assessment has been updated, based on responses to the consultation in particular, and we now include a separate cost category for the costs to customers of increased payment friction, as well as the cost from reduced competition and innovation.
- Our assessment of the relative magnitude of some of the categories has also been revised to take account of changes to the policy, in particular, the introduction of a maximum level of reimbursement.
- We have updated our assessments and included indicative quantitative estimates for two cost categories: administrative costs faced by PSPs and the costs that increased payment friction could impose on customers.

1.39 Overall, we consider the benefits of the new reimbursement requirement are likely to outweigh its costs.

Table 1: Summary of main benefits and costs

Benefits	Relative magnitude	Costs	Relative magnitude
Reduced incidence of APP fraud cases	High – indicative estimate £100 million to £150 million per annum	Increased investment in fraud prevention by PSPs	High/medium overall – at the PSP level, proportionate to the scale of fraud being tackled
More consistency and certainty in relation to reimbursement for victims	High	Administrative costs of investigating and delaying suspicious payments, pursuing completed payments and resolving disputes	Medium – indicative estimate £13 million to £30 million per annum
Increased recovery of APP fraud funds at receiving PSPs	Medium	Costs to customers of increased friction and delayed payments	Medium – indicative estimate £2 million to £30 million per annum
Level playing field across different PSPs	Medium	Reduction in competition and innovation	Low/medium

13 PSR, Consultation CP22-4: Authorised push payment (APP) scams: Requiring reimbursement, (September 2022) , Annex 2, Table 1.

Benefits	Relative magnitude	Costs	Relative magnitude
Improved reimbursement rates for victims		Increase in reported APP fraud	Low
		Moral hazard and lack of customer caution	Low
		Potential exclusion of customers in opening new accounts or accessing certain services	Low
		Migration to other payment methods	Low

Benefits

Better prevention of APP fraud

1.40 We have considered the changed incentives for PSPs to prevent APP fraud from three perspectives:

- from the sending side for those PSPs that currently offer little or no reimbursement to customers
- from the sending side for those PSP that currently voluntarily reimburse a material share of their customers' losses (for example, CRM Code signatories)
- from the receiving side, where currently receiving PSPs very rarely reimburse victims

1.41 Broadly speaking, all relevant PSPs are both sending and receiving PSPs, although different customer bases and business models will mean that different PSPs have different ratios of transactions sent to transactions received.

Sending PSPs that already reimburse customers

1.42 Ten PSP groups (accounting for more than 80% of Faster Payments transactions) are signatories of the CRM Code and, as such, they reimburse some of their customers who fall victim to APP fraud. The reimbursement rates differ very widely but currently average around 60% – the vast majority of this (over 95%) coming from the sending PSPs.[14] There are also some PSPs who are not signatories to the CRM Code that offer reimbursement to their customers.[15]

14 Among the ten signatories of the CRM Code, 66% of APP fraud losses were refunded in 2022, while in 2021 the share was 48%. UK Finance, *Annual fraud report – The definitive overview of payment industry fraud in 2023* (May 2023).

15 For example, TSB offers their Fraud Refund Guarantee. TSB, *Fraud Refund Guarantee*

1.43 We expect the new reimbursement requirement to increase the overall rate of reimbursement. But the change for some of these PSPs may not be substantial. Considering the 50:50 split of reimbursement costs between sending and receiving PSPs, for some sending PSPs, this could mean that their costs of reimbursement (as a sending PSP) may be lower than at present. A number of PSPs currently reimburse in excess of 50% of their own customers' APP fraud losses.

1.44 However, this is only looking at these PSPs from the sending side of APP fraud transactions. They would still have increased liability for reimbursement costs from APP fraud due to the APP fraud transactions that they would be liable for as a **receiving** PSP. A PSP that currently voluntarily reimburses, for example, 80% of its customers' losses on the sending side is likely to see an increase in its overall reimbursement costs if it faces the cost of reimbursing only 50% on the sending side but now also 50% on the receiving side.

Sending PSPs that currently offer little or no reimbursement

1.45 The new reimbursement requirement will lead to PSPs on the sending side of transactions that currently offer little or no reimbursement to their customers becoming liable for reimbursement. These PSPs currently account for c.13% of Faster Payments transactions, and these are likely to be the PSPs that have the most marked change in their incentives to tackle APP fraud due to the cost of reimbursement. As such, they should have the greatest incentives to increase their investment in fraud detection and prevention.

Receiving PSPs

1.46 Under the new reimbursement requirement, PSPs on the receiving side of transactions will have a much stronger incentive to detect and prevent APP fraud than they do at present. In 2021, receiving PSPs reimbursed a negligible amount (less than 5%) of overall APP fraud losses. Funds recovered from fraudsters' accounts at receiving PSPs also accounted for a very low share (about 5%) of funds reimbursed to victims.

1.47 In addition, there are very substantial differences in the rates at which different PSPs receive APP fraud payments. Some of the PSPs with the highest rates receive more than ten times the rate of those PSPs that receive proportionately lower levels of APP fraud. While there may be a number of reasons why PSPs experience different rates of fraud, this high level of variation indicates there is significant scope for many PSPs to improve their performance in reducing APP fraud.

1.48 Requiring receiving PSPs to share 50% of the costs of reimbursement provides a strong incentive on them to increase their investment in fraud prevention and detection, and to increase their cooperation with sending PSPs in detecting and preventing APP fraud.

Overall effect of changed incentives on PSPs

1.49 As set out in the preceding paragraphs, all PSPs – even those that voluntarily reimburse at present – will face stronger incentives to detect and prevent APP fraud, and to recover funds from fraudsters' accounts under the new reimbursement requirement. These are in addition to the incentives to prevent fraud and recover victims' funds that PSPs already have. As such, the benefits, in terms of reduced APP fraud, that result from the new requirement will also be incremental to the level of APP fraud prevention that PSPs are achieving at present.

Respondents' views and our response

1.50 Five respondents explicitly questioned the scale of the expected benefits, pointing to:

- the risk that the level of APP fraud could increase as PSPs are required to reimburse both victims and, in some cases, fraudsters
- the scope for fraudsters to exploit customers who are now protected
- PSPs would have to allocate funds to reimbursement rather than to fraud prevention

1.51 While we recognise the risk of moral hazard and of increased reporting of previously unreported APP fraud, and have reflected these in our assessment of costs, our assessment remains that greatly increased levels of reimbursement and the sharing of that liability between sending and receiving PSPs will incentivise more effective investment in APP fraud preventions, leading to a substantial fall in the level of losses.

Quantification of reduction in APP fraud

1.52 We have analysed data collected from a number of PSPs and have found a wide variation in the rate at which different PSPs report their levels of APP fraud payments sent by their customers and the levels of these APP fraud payments received by accounts at other PSPs. Using this data, in combination with data on the total volume and value of Faster Payments transactions at the relevant PSPs, we have calculated rates of APP fraud payments sent and received by different PSPs.

1.53 These rates varied widely on both the sending and, especially, on the receiving side. Although not perfect indicators of effectiveness in fraud prevention, these rates are likely to reflect real differences. They indicate the scope for some PSPs – those that display high rates of APP fraud being sent and/or received by their accounts – to improve their performance.

1.54 Taking this as a starting point, we took the average (median and mean) rates of APP fraud sent and received by the PSPs for which we had data. We then looked at those PSPs that displayed rates of APP fraud sent and received that were higher than these averages and calculated how much the value of APP fraud would fall if these poorer performing PSPs managed to cut their APP fraud rates to the average levels. We found:

- for sending PSPs, if those PSPs with above average rates of APP fraud reduced their rates in line with the median rate, APP fraud losses would fall by almost £150 million per annum
- for receiving PSPs, if those PSPs with above average rates of APP fraud reduced their rates in line with the median rate, APP fraud losses would fall by almost £100 million per annum

1.55 These are two ways of looking at the effect on the same set of fraudulent transactions – from the sending and receiving sides, respectively. So, these estimates should not be thought of as separate impacts that can be aggregated. Rather, they indicate the overall magnitude of the potential impact of stronger incentives on sending and receiving PSPs, and of stronger incentives for PSPs on both sides to cooperate.

1.56 These estimates of the likely benefits are substantial, but they could well underestimate the scope for improved APP fraud prevention, for several reasons:

- The estimates are based on PSPs improving to the level of current median rates of fraud sent and received. The new reimbursement requirement will strengthen the incentives for all PSPs – those that perform well, average and poorly at present – to take further steps to prevent fraud. As such, those median rates would be expected to fall in the future, pointing to greater scope for poor performing PSPs to improve further.
- Even PSPs with low rates of APP fraud payments sent and received would face stronger incentives to prevent fraud, so we could expect reduced APP fraud among those PSPs too. Our simple analysis does not consider this reduction.
- Our analysis is based on data covering the majority of Faster Payments transactions (73%) and a similar proportion of reported APP fraud over Faster Payments (75%).[16] We have not made any assumption about the transactions and the PSPs that fall outside the analysis. As such, the estimated impact, in terms of reduced APP fraud losses, only relates to those PSPs covered in our data set. Any reduction in APP fraud sent or received by other PSPs as result of the policy is not reflected here.
- We have not made any assumption about future changes in APP fraud numbers (which rose by 39% in value terms between 2020 and 2021 but fell by 17% in the first half of 2022)[17] nor about future changes in Faster Payments transaction numbers (which rose by 24% in value terms between 2020 and 2021 and 25% in value terms between 2021 and 2022).[18]

1.57 On the other hand, there are also several reasons why these estimates may overstate the likely impact on APP fraud:

- Fraudsters may target the PSPs with the weakest controls, so even where they improve their systems for detecting and preventing APP fraud, these PSPs may not reduce fraud to the level of the average-performing PSP.
- There is a risk the new reimbursement requirement could lead to some customers exercising less caution when making payments. Such a potential increase in APP fraud losses could offset some of the potential gains from enhanced detection and prevention by PSPs. The customer standard of caution combined with excess (level to be determined) should manage the risk that moral hazard leads to material losses and claims by customers (see policy statement, Chapter 4).
- The policies to allow PSPs to apply a claim excess and to apply a maximum level of reimbursement may reduce the costs of reimbursement to PSPs and so reduce PSPs' incentives to invest in improved APP fraud prevention.

16 UK Finance, *Annual Fraud Report 2022* (June 2022), page 68.

17 UK Finance, *Annual Fraud Report 2022* (August 2022), page 47. APP scam fraud increased by 27% in terms of case numbers between 2020 and 2021. UK Finance, *2022 Half Year Fraud Update* (October 2022), page 8. APP scam cases fell by 6% between H1 2021 and H1 2022.

18 Pay.UK website (accessed on 5 September 2022): www.wearepay.uk/what-we-do/payment-systems/faster-payment-system/. Faster Payments transactions rose by 20% in volume terms between 2020 and 2021 and 15% in volume terms between 2021 and 2022.

1.58 Overall, we consider our estimates usefully indicate the likely scale of the impact of the new reimbursement requirement. We also note that the reduction in fraud is a benefit that persists. Customers and PSPs avoid the costs of prevented fraud over time – in that preventing APP fraud worth £100 million per annum is a benefit in all of the years where those anti-fraud measures remain effective – whereas some of the relevant costs are more short-lived and may be incurred mainly in the early years of the policy.

Increased recovery of APP fraud funds by receiving PSPs

1.59 Less than 5% of APP fraud losses that are reimbursed come from recovered funds. Given that reimbursement (under the CRM Code) does not apply to all APP fraud losses, the overall level of recoveries is likely to be lower than 5% overall.

1.60 At present, those sending PSPs that voluntarily reimburse their customers when they fall victim to APP fraud have an incentive to pursue the receiving PSP and seek recovery from the fraudster's account. With a broader requirement on all sending PSPs to reimburse their customers and, more importantly, a new requirement on receiving PSPs to reimburse sending PSPs 50% of the claim, the incentives for PSPs to pursue successful recovery of funds is significantly increased. An increase in successfully recovered funds should act as a disincentive to fraudsters, which should lead to fewer APP fraud cases and lower costs for PSPs in reimbursing victims.

1.61 We have not been able to quantify a likely effect from these strengthened incentives, as we do not have data on different PSPs' level of recoveries. In any case, the low level across the sector suggests that most PSPs are achieving a very low rate of recovery of funds from fraudsters' accounts at present. This low level suggests that there is room for substantial improvement, but we have not been able to quantify the scale of any likely increase in response to our policy.

More consistency and certainty for victims

1.62 We have previously pointed to the wide variation in reimbursement rates across individual PSPs.[19] This continues to be the case. Among CRM Code signatories, reimbursement rates vary substantially – from less than 20% to over 70% in terms of the value of losses reimbursed, based on annual data for 2021.[20] A more consistent approach would benefit victims – and customers more broadly – as there would be more certainty about how APP fraud losses are treated by PSPs. This will increase trust in Faster Payments for customers, through an increase in their confidence that they will be reimbursed where they have exercised sufficient caution.

1.63 We have not been able to quantify the scale of the benefits that this increased consistency and customer certainty would bring. However, given the current wide variation in reimbursement rates (even within the same PSP across different time periods) moving towards a consistent level of reimbursement will lead to a substantial improvement in the welfare of all customers.

19 PSR CP21/3, *Authorised push payment (APP) scams – Call for views* (February 2021), page 16, Figure 4.

20 PSR analysis of UK Finance data collected from CRM Code signatories, 2021.

Level playing field across PSPs

1.64 In principle, we might expect competition between PSPs to lead to higher and more consistent levels of reimbursement for APP fraud victims. This might particularly be the case if customers expected this to be provided as a standard feature of their current account service. However, many customers are unlikely to make the decision of which PSP to open an account with based on their expected level of fraud reimbursement. The wide variation in reimbursement rates across different PSPs is evidence that competition on this parameter is not effective at present.

1.65 At present, ten PSPs are signatories of the CRM Code, and, as such, voluntarily provide reimbursement, in certain cases, to their customers. In addition, some PSPs outside the Code also provide material levels of reimbursement to their customers. However, that leaves a large number of PSPs, accounting for a material share of Faster Payments transactions, providing little or no reimbursement to their customers. In addition, even among those PSPs that provide material levels of reimbursement at present, the rates of reimbursement vary widely.[21] A reimbursement system with a consistent set of criteria will provide a level playing field between PSPs. This will benefit both customers and those PSPs that currently already focus on protecting their customers from APP fraud.

Improved reimbursement rates for APP fraud victims

1.66 The volume of APP fraud has been increasing over time, with victims losing life-changing sums of money. Any improvement in reimbursement rate would likely have a significant positive impact for victims. In addition to money lost to the fraud itself, customers may face psychological and other costs or impacts associated with these crimes. Even if they are fully reimbursed, they will still suffer a cost for losing the money in the first place (e.g., overdraft or interest costs, late-payment penalties, or loss of interest on savings) and will face the stress and anxiety of not knowing if and when they will be reimbursed. Making fraud less likely to happen in the first place will mitigate these issues, which are likely to have a particular impact on vulnerable customers. So will the increase in confidence and certainty – for victims and customers in general – with the new reimbursement requirement.

Costs

Increased investment in fraud prevention by PSPs

1.67 The 50:50 split of reimbursement costs between sending and receiving PSPs will lead to a substantial increase in the costs of reimbursing APP fraud for almost all PSPs.

1.68 As set out above, in considering the direct costs of PSPs increasing their rates of reimbursement as being a relevant cost for this cost benefit analysis, but we have not taken the approach of directly balancing the costs of increased reimbursement that PSPs will face against the benefits of increased reimbursement that victims will receive. That approach would simply find a large cost on one side cancelled out by the same scale of benefit on the other. Rather, we have focused on the change in incentives and their effect that will be caused by the new reimbursement requirement.

21 PSR CP21/3, *Authorised push payment (APP) scams – Call for views* (February 2021), page 16, Figure 4.

1.69 We looked at the likely increase in PSPs' reimbursement costs from three perspectives:

- PSPs that already reimburse a material share of their customers' losses on the sending side may face increased average reimbursement costs as sending PSPs, but the change may not be substantial. However, they will face substantially increased costs on the receiving side.
- PSPs that do not reimburse a material share of their customers' APP fraud losses at present (as the sending PSP in the transaction), will become liable for significant new costs.
- PSPs on the receiving side of transactions currently account for a negligible share of reimbursement (less than 5%), and so will face substantially increased reimbursement costs under our policy.

1.70 From all three perspectives, these increased reimbursed costs will mean that PSPs will now have much stronger incentives to invest in their fraud detection and prevention systems. The policy will also lead to much stronger incentives for sending and receiving PSPs to cooperate effectively in fraud detection and prevention. It is these additional costs – from increased spending by PSPs on their fraud detection and prevention systems – that represent the relevant cost for the purposes of our cost benefit analysis and is likely to be the most significant relevant cost that arises due to the policy.

1.71 While we have not been able to quantify the likely costs with precision, we note a number of relevant points in assessing the likely overall magnitude of these costs.

1.72 The rates at which individual PSPs send and receive APP fraud varies widely. Given this, some PSPs will face much higher potential reimbursement costs than others. As a result, the incentives to invest in fraud detection and prevention will vary widely across individual PSPs. This will lead to the costs that different PSPs are incentivised to incur also varying widely, depending on the scale of the APP fraud that each PSP is sending and/or receiving.

1.73 Related to this, the costs that individual PSPs are incentivised to incur will be proportionate to the scale of their fraud issue. For example, a PSP that currently sends £8 million of fraud and receives £12 million of fraud per annum would be incentivised to invest in fraud prevention measures that are proportionate to the costs of reimbursing victims in relation to that scale of fraud. This is in contrast to some other policies, where PSPs may be required to incur a fixed level of additional costs regardless of the scale of the problem being addressed at that individual PSP. For example, PSPs that are required to provide CoP checks will face the cost of introducing and maintaining the system regardless of the level of relevant APP fraud or of misdirected payments that they face. Under the new reimbursement requirement, PSPs are incentivised to incur costs in proportion to the scale of the problem to be tackled. Importantly, PSPs are likely to invest in fraud prevention in proportion to its effectiveness. As such, the costs that PSPs (in aggregate) incur in APP fraud prevention will be lower than the effective reduction in APP fraud losses that results.

1.74 PSPs already expend resources in fraud detection and prevention, and many already incur the costs of reimbursing victims, at least partially. Given this, our policy will provide incentives to invest in additional measures, over and above what PSPs are already doing. It is these incremental costs that are relevant to our assessment, not PSPs' current or total spending on APP fraud detection and prevention. To take the example above, a PSP that currently sends £8 million worth of fraud and receives

£12 million worth of fraud per annum: this PSP may already voluntarily reimburse £5 million of the losses that its customers incur as victims on the sending side. Our policy would increase the PSP's reimbursement costs by £15 million (from the voluntary level of £5 million to £20 million). It is this additional reimbursement cost that incentivises incremental spending on fraud prevention, rather than necessarily the full £20 million of annual APP fraud losses.

1.75 Costs are likely to be higher in the early years of the policy, as PSPs invest in their fraud detection and prevention systems and set up processes to cooperate with other PSPs in detecting and preventing fraud and in pursuing funds and successfully recovering lost funds from fraudsters' accounts.

1.76 The new reimbursement requirement allows PSPs to withhold a claim excess, apply a maximum level of reimbursement (the levels of both of which are being consulted on), and to set a time limit for claims (of no less than 13 months). These implementation options may help PSPs ensure that customers take appropriate care in making payments and maintain proportionate costs, while ensuring their customers are appropriately protected.

1.77 Overall, while we cannot fully quantify the likely scale of the costs to PSPs, we consider that:

- these costs are likely to be proportionate to the problem being tackled (as reimbursement costs and so incentives to prevent fraud are directly linked to fraud sent and received at each PSP)[22]
- only those additional costs that PSPs are incentivised to incur are relevant, not all spending on anti-fraud measures that PSPs incur
- much of the cost will arise in the early years, whereas the benefits of reduced fraud will continue to accrue, relative to a baseline of APP fraud levels remaining high or even increasing further, absent our intervention

Administrative costs to PSPs

1.78 At present, in many cases of APP fraud, there is little or no contact between the sending and receiving PSPs. Increased reimbursement costs on the sending side and the introduction of significant reimbursement costs on the receiving side will mean that PSPs will have much stronger incentives to pursue recoveries, possibly following the trail of funds through multiple accounts and PSPs after the initial transaction which triggers the report of an APP fraud.

1.79 Our policy is likely to lead to PSPs incurring additional costs that they do not face at present. It is also likely to lead to increased administrative costs for Pay.UK. As set out above, a number of PSPs argued that the administrative costs on PSPs would be substantial, pointing to implementation costs – especially for PSPs that were not already CRM Code signatories – and costs to PSPs of interacting with customers to query payments.

22 We have also completed a proportionality assessment of the new reimbursement requirement (see policy statement, Box 2).

1.80 While we explicitly requested evidence that would help with the quantification of any of the benefits and costs of the policy, none was submitted.[23] On the likely scale of such costs, we note that:

- CRM Code signatories – who account for over 80% of Faster Payments transactions – should already incur most of the relevant costs, as they are already committed to reimbursing victims, informing receiving PSPs, etc.
- These CRM Code signatories account for c.79% of reported APP fraud on the sending side and c.42% on the receiving side, so the majority of incremental costs on PSPs should fall on those smaller PSPs that are outside the current CRM Code.[24]
- Only those with fraud above a material level are likely to incur material costs, with many PSPs only dealing with one side to a material extent; that is, some smaller PSPs are likely to be receiving APP fraud, and so dealing with PSPs informing them of fraud received but may have little or no additional costs from dealing with their own customers/victims reporting frauds, as some do not offer individual current accounts.

1.81 Based on these assumptions, we have conducted an illustrative assessment of the potential scale of the increment costs that PSPs are likely to face. Our key assumptions relate to:

- **CRM Code signatories**: As above, the incremental costs for CRM Code signatories are likely to be lower than for other PSPs, so we have calculated total costs both excluding and including the ten PSPs that are CRM Code signatories.
- **Costs per PSP**: We have assumed that these will be (broadly) proportionate to PSPs' liabilities, but that there are likely to be some economies of scale. As above, we have not received any quantitative evidence on the likely level of these costs but have assumed 'baseline' costs for each size category of PSP, as well as assuming costs based on a 10% share of the liability of the average PSP in each category.

1.82 These assumptions produce a wide range of values – between £13 million and £33 million per annum – which, while not estimated with precision, do provide a useful illustration of the potential overall scale of the incremental costs faced by PSPs.

23 PSR, *Consultation CP22-4: Authorised push payment (APP) scams: Requiring reimbursement* (September 2022), Annex 2, paragraph 2.12.

24 Share of APP scam fraud sent by CRM Code signatories is for H1 2022 from the UK Finance, *2022 Half Year Fraud Update* (October 2022). Share of fraud received by CRM Code signatories based on Measure 1 trial data covering H2 2021 is 43%, while share of fraud received by CRM Code signatories using CoP data for 2022 is 42%.

Table 2: Estimated administrative costs for PSPs

APP fraud received (2021)	All PSPs	CRM signatories	Admin cost per PSP – baseline	Admin cost per PSP – 10% share of liability
>£10 million	10	4	£1 million	£2.4 million
£5 to 10 million	7	4	£500,000	£785,000
£1 to 5 million	13	2	£250,000	£252,000
£500,000 to 1 million	2	0	£100,000	£66,000
£100,000 to 500,000	10	0	£50,000	£24,000
<£100,000	87	0	£25,000	£1,000
Total – excluding CRM signatories			**£13 million**	**£20 million**
Total – including CRM signatories			**£20 million**	**£33 million**

Costs to customers of friction and delayed payments

1.83 As we set out in our September consultation paper, there are likely to be costs to customers if PSPs introducing stronger fraud controls lead to a higher number of payments being queried, delayed or even declined.

1.84 A large number of respondents pointed to the potential for material costs to arise here, with 25 respondents arguing that we should take greater account of the costs of delayed and declined payments, including penalties that payers may face. None suggested a way to quantify this harm nor estimated how much our proposals would increase any such friction. Specific points put forward included:

- PSPs on the sending side were likely to identify many false positives, as the receiving PSP has limited information that it can use.
- There could be a particular risk of higher-value payments migrating to cards due to increased friction.
- Some types of vulnerable customers could be particularly affected. For example, customers with limited digital literacy or who are digitally excluded could struggle to react to messages about suspicious payments.
- A customer standard of caution set at gross negligence could also lead to increased friction with PSPs requiring evidence, by for example requiring proof for purchase of second-hand goods.
- The cost benefit assessment needs to consider the cost of delayed and refused payments.

1.85 As we set out in the September consultation, any increase in friction in the system, even if effective in reducing APP fraud case numbers, could also impose costs on other customers and businesses due to delayed or missed payments. We note that:

- Some of the friction that is likely to be introduced will be beneficial, where it prevents fraudulent payments from being made.
- Customers tend to be aware of the benefits of introducing a degree of friction and, in some cases, welcome the inclusion of security checks when making payments.[25]
- The current industry initiatives to improve data sharing between PSPs (including Measure 2) and increased incentives to improve fraud detection and prevention should help to minimise the number of payments delayed unnecessarily.
- There are a number of examples, in payments and in more general banking sectors, where new security features led to increased friction initially, but where this dissipated over time, as PSPs and customers got used to the new feature.
- For certain types of transactions – and for certain PSPs – friction has been increasing for some time, due both to other regulatory interventions and PSPs reacting to increasing fraud levels. Most of the largest PSPs already reimburse a material share of their customers' APP fraud losses, so, for many transactions, PSP incentives to introduce friction into customers' payment journeys already exist. As such, it is not clear if a substantial amount of additional friction will result from the new reimbursement requirement.

1.86 While we have not received any evidence from respondents on the likely increase in friction that would result from the new reimbursement requirement, we have conducted an illustrative assessment of the potential scale of the relevant costs. This is based on current rates of APP fraud and some reasonable assumptions of the possible costs to customers from delayed payments. Our estimates are based on the following considerations:

- The current level of APP fraud losses is around £500 million across around £2.6 trillion-worth of Faster Payments transactions, giving a rate of just under 0.2%.
- No respondent has submitted any evidence of the likely rate of 'false positives' that might lead to friction in non-fraudulent payments, but we have looked at rates of 10, 20 and 30 times – that is, where a PSP delays 10, 20 or 30 unproblematic payments for every fraudulent payment.
- In the absence of empirical evidence, we have looked at delays of two, three and five working days, although we consider that these are likely to substantially over-estimate the typical delay that a customer is likely to face.
- We have also looked at interest costs for these delays, based on 5%, 8% and 10% APR. We note that, for many delays, there may not be a financial penalty, while for others it may be substantial, but we do not have the empirical evidence to reflect this more precisely.

25 See, for example, survey evidence from the US that a lack of security checks on online payments makes many customers nervous. Paysafe, *Lost in Transaction: Consumer Payment Trends 2021* (2021).

1.87 These assumptions lead to a wide range of potential costs, between £2 million and £30 million per annum. As discussed, we would expect the level of friction to fall over time, but, on a conservative basis, we have not assumed that these costs will fall as the system is implemented. We also note that the upper end of our range is the product of applying an extreme value for all three of our assumptions – that is, that PSPs delay 30 payments for every fraudulent transaction, that payments are delayed by a week, and that an interest rate of 10% APR is levied for those late payments.

Table 3: Estimated cost of delayed payments due to increased friction

	Low	Medium	High
Actual APP fraud rate	0.02%	0.02%	0.02%
False positives (relative to true rate of APP fraud)	10 times	20 times	30 times
Length of delay	2 days	3 days	5 days
Interest rate for late payments (APR)	5%	8%	10%
Total cost	£2 million	£9.6 million	£30 million

Reduction in competition and innovation

1.88 In our September consultation paper we included the benefits to competition of a more level playing field between PSPs in terms of reimbursement[26], while also recognising the prudential risk if some PSPs face reimbursement liabilities that they cannot afford to cover.[27]

1.89 Twenty-two respondents argued that the proposals would reduce competition and innovation, pointing to three risks:

- Most pointed to the effect on smaller PSPs, and the barrier to entry that would be created, especially for start-up and 'scale-up' firms.
- A number also pointed to the effect on account-to-account/Open Banking payments, with PSPs potentially delaying PIS transactions and slowing the adoption of account-to-account retail transactions.
- Some noted that additional costs of account-to-account payments would be passed on to merchants, impacting the competition that these payments can provide to card payments in the context of retail payments.

26 PSR, Consultation CP22-4: Authorised push payment (APP) scams: Requiring reimbursement (September 2022).

27 PSR, Consultation CP22-4: Authorised push payment (APP) scams: Requiring reimbursement (September 2022).

1.90 In assessing the likely impact on competition and innovation of the new reimbursement requirement, we have considered:

- whether there are any PSPs where reimbursement liabilities are likely to raise prudential risk and hence lead to exit from the UK market
- whether additional reimbursement costs for PSPs are likely to reduce innovation and competition between PSPs, including deterring entry and expansion
- whether the administration of the reimbursement system is likely to affect sponsor banks' willingness to provide access to Faster Payments for indirect PSPs on reasonable terms
- whether the reimbursement rules are likely to affect PISPs' ability to gain new business in account-to-account retail, due to any increased friction imposed by PSPs or increased costs associated with PIS transactions

Prudential risk and PSP exit

1.91 Based on data that we have collected on APP fraud sent and received by PSPs in 2021 and 2022, we have sought to identify any PSPs where the estimated future reimbursement costs may raise prudential risks. While this exercise is imperfect, it does indicate that there are a small number of PSPs which are likely to face material liabilities and where this liability is large relative to their current financial position.

1.92 We are working closely with the FCA to ensure that such PSPs are aware of their likely future liabilities and are taking steps to improve their APP fraud detection and prevention measures in advance of this policy taking effect. Given this early intervention, we do not expect that competition in the market will be negatively impacted by the new reimbursement requirement.

1.93 The policy is designed to impose financial costs on those PSPs that are least effective in preventing fraud to and by their account holders. As such, the potential exit of a firm that performs particularly poorly in this regard does not reduce effective competition across the market. Poorly performing firms losing market share and potentially exiting a market is how effective competition works.

Impact of reimbursement costs on innovation and competition

1.94 A number of respondents to our consultation argued that there was likely to be a substantial negative impact on competition and innovation from the policy. One of the key points of the policy is that the reimbursement costs incurred by specific PSPs will reflect the levels of APP fraud that their accounts are sending and receiving. These costs will not distort or prevent competition between PSPs with different business models or of specific types or sizes, but rather ensure that customers of all PSPs benefit from the same protection.

1.95 Consistent treatment of victims and consistent incentives for all PSPs to detect and prevent APP fraud will benefit competition. In relation to barriers to entry and innovation, as above, the additional costs are proportionate to the levels of APP fraud that a PSP sends and receives – be it an entrant, an innovative provider or any other type of firm. However, it is likely that some new entrants will find it harder to detect APP fraud, as they will have less historical data on their account holders with which to spot patterns and unusual transactions. We do not consider that this will have a material impact on their ability to enter the UK market and to compete effectively.

Access for indirect PSPs

1.96 Our policy is focused on incentivising PSPs that hold the relationship with account holders to take steps to detect and prevent fraud being sent from or received into its accounts, including incentivising PSPs to ensure that KYC checks and mule account controls are effective.

1.97 As set out in the policy statement (see Chapter 6), all relevant PSPs – both direct and indirect participants in Faster Payments – will be directly subject to the new reimbursement requirement. As such, sponsor PSPs will not be impacted by any reimbursement that may be required from their indirect PSPs. More broadly, the issue of access for PSPs to Faster Payments (and other payment systems) is one that the PSR monitors closely.[28] As such, we do not consider that the new reimbursement requirement is likely to lead to a material change in the ability of PSPs to access Faster Payments through indirect access providers.

Impact on PISPs and account-to-account payments

1.98 As set out in the policy statement (see Chapter 2), the importance of consistent protection for customers making Faster Payments transactions means that PIS payments will be treated the same as other Faster Payments (see Annex 2).

1.99 Any additional costs associated with account-to-account retail payments, as a result of the new reimbursement requirement (for example, reimbursement costs for APP fraud payments), will be proportionate to any APP fraud occurring over those channels. Civil disputes are out of scope of the new reimbursement requirement.

1.100 More broadly, ensuring that the conditions are in place for account-to-account payments to provide a competitive alternative to card payments is a focus of the PSR's work.[29] At present, PIS payments account for around 2% of Faster Payments transactions and the volume of these transactions has been growing.[30] Increasing customer confidence in these payments will help provide a competitive alternative to card payments for retail transactions.

Other potential consequences of the policy

Increase in reported APP fraud numbers

1.101 The new reimbursement requirement could lead to a short-term increase in the volume of reported APP fraud, as set out in the policy statement (see Figure 1, Chapter 1).

1.102 At present, where reimbursement levels vary widely across PSPs and with many customers not being aware of the likelihood of their being reimbursed, it is likely that there is a material quantity of APP fraud going unreported. Greater clarity and consistency for customers is likely to lead to an increase in the level of reported APP fraud. This represents additional costs to PSPs, but it also represents a benefit to those victims who were previously left out of pocket having decided not to report their loss. As such, the net costs, if any (for example, increased administrative costs to PSPs), are likely to be modest.

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28 See, for example, the PSR's *Access and governance report on interbank payment systems* (January 2022).

29 See, for example, the PSR's *Annual plan and budget 2023/24* (March 2023), pages 10, 30-32.

30 Based on OBIE and Pay.UK data for the second half of 2022.

Customer caution and moral hazard

1.103 Moving to a system of consistent reimbursement could lead to an increase in payments where customers have not exercised sufficient caution, in the knowledge that any losses will be fully reimbursed. We are not aware of conclusive evidence that, if customers are more confident of being reimbursed, they will take less care in ensuring that their payee is not a fraudster, as set out in the policy statement (see Chapter 4).

1.104 In our consultation, we stated that we would welcome any concrete, including quantitative, evidence of the risk that customers would take less care, but none was submitted. However, we recognise it is a valid risk that should be managed, and we believe customers and PSPs share the risk. PSPs should put effective protections in place and can take many actions to prevent APP fraud, such as introducing more effective warnings when customers are making payments. Recognising that many victims are socially engineered into being scammed, we have introduced policies to encourage customer caution, where appropriate, including:

- **A customer standard of caution (gross negligence):** Gross negligence does not mean automatic reimbursement and provides an appropriate incentive for customers to take care.
- **A claim excess (at a level subject to consultation):** We judge this is appropriate to manage the risk of moral hazard alongside the many actions PSPs can take to prevent APP fraud.

1.105 As set out in the policy statement (see Chapter 8), we will monitor the effectiveness of the policy to capture any evidence that the risk of moral hazard has changed as a result of the new reimbursement requirement.

Potential exclusion of some customers

1.106 As set out in the policy statement (see Chapter 4), in response to requirements for reimbursement some PSPs might consider restricting services to certain customers, such as older customers, because they may be perceived as being more likely to fall victim to APP fraud. We have also considered this risk as part of our equality impact assessment (see policy statement, Annex 1).

1.107 Ten respondents referred to the risk of 'de-banking' vulnerable customers or limiting the services available to some customers, with a diverse set of stakeholders including consumer organisations, trade bodies and five banks raising this as a risk. Three potential effects were identified:

- A number of respondents took the view that PSPs would apply more stringent conditions to new customers, and so some types of customers could face additional barriers in opening an account.
- Three PSPs and two trade bodies pointed to the risk that customers who were considered more vulnerable to fraud, or who had been repeat victims, could face barriers in accessing payment services.
- Two consumer organisations and a PSP argued that increased security measures for existing customers could impact certain types of customers. For example, customers with limited digital literacy or who are digitally excluded could struggle to contact their banks or react to messages about suspicious payments.

1.108 Several PSPs dismissed the risk of the full removal of services or 'de-banking' users, as they reported that there is no typical high-risk service user for APP fraud. We accept that there is a risk that some PSPs may conclude that certain groups not classed as vulnerable are higher risk, and subsequently implement greater friction with payments or remove some services. Based on the evidence provided through the consultation, we think this risk is manageable and we will consider this as part of our post-implementation review (see Chapter 8).

1.109 We also expect PSPs to continue to treat all current and prospective customers, including vulnerable customers, fairly and according to their obligations in the Equality Act 2010.

1.110 An important aim of the policy is to incentivise receiving PSPs to maintain robust policies around new accounts (for example, 'know your customer' checks) in order to prevent fraudsters setting up accounts. There is a risk that enhanced scrutiny could lead to certain customers finding it more difficult to access some services. While we expect the overall cost to be small, this could have an impact on some customers. Existing regulatory requirements – for example, FCA requirements for PSPs to consider the needs of their customers, including the recently introduced Consumer Duty, as well as PSPs' obligations under the Equality Act 2010 – should minimise this risk.

Migration to other payment methods

1.111 There are a number of ways in which our policy could, in principle, lead to some switching away from Faster Payments for some payments:

- As set out in the policy statement, if our policy is successful in incentivising reduced APP fraud, there is the potential for fraudsters to migrate to other payment schemes, including credit or debit cards, and CHAPS.
- The potential for payments to be delayed or stopped as PSPs exercise greater caution in processing suspicious payments (as set out above) could also lead to customers switching to other payment methods.
- The potential for PSPs to nudge payers away from Faster Payments and towards, for example, card payments, could lead to increased costs for payees.

1.112 While we have not sought to quantify the potential costs, if any, of any such migration, we note that these alternative channels have some existing customer protections in place – for example, the customer protection in card schemes, and the greater level of engagement with the PSP that typically takes place when making a CHAPS payment. As set out in the policy statement (see Chapter 2), we are working closely with the Bank of England and the FCA on aligning reimbursement requirements across Faster Payments, CHAPS and 'on-us' payments. We will monitor any trend for increased fraud in other payment systems to inform any action that is needed.

Conclusion

1.113 We consider that the benefits of our new reimbursement requirement are likely to outweigh the costs of the policy.

1.114 In undertaking this analysis, we have sought to account for the likely timeframe in which these impacts will be realised. We recognise that some of these impacts may occur immediately and materialise mostly in the beginning of the policy, particularly the costs to PSPs of increased investment in fraud prevention and in enhanced cooperation with other PSPs in tackling fraud and pursuing defrauded funds.

1.115 On the other hand, most benefits may take time to fully materialise, but we envisage that they will continue throughout the period – for example, reduced incidence of APP fraud, due to better prevention, is an impact that will continue to generate substantial benefits for providers and customers over time.

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