

Agpaytech's Research
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The U.K. Payments Market Landscape



Executive Summary

This paper examines and intensely discusses the prevailing payments system in the U.K. It discusses the usage of the payment's infrastructure in the retail business model and how it will make the processes more convenient. The progress in digitalisation compounded with innovation enables real-time cross-border money transfer. The report also discusses emerging forms of payment transfer and the new architectures being deployed in the payments industry. Its further aids in analysing the traditional way banking and money transfer activities.

Keywords:

New Architecture forms of Payments

Retail payment infrastructure

Digital money (stable coin)



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Introduction

The payments ecosystem is critical for any society to function seamlessly. It enables trading, commerce, and e-commerce, removes multiple hurdles in the movement of money and helps the economy grow. It encompasses financial Institutions such as large and small banks, money service businesses, payments aggregators and money transfer operators that act as cogs in wheels to transfer funds between people and businesses.

The analysis of the traditional payments processing methodology demonstrates a six-corner model involving people, acquirers, Banks, Merchant/Retailers, Payment networks, and Regulators. Payment's system stakeholders are recently experiencing enhanced regulator collaboration and compliance requirements given the higher volumes of money movement that is taking place due to increased internet connectivity.

In the U.K, millions of Pounds move between bank accounts daily. And this complex ecosystem is dominated by three central domestic payment systems,

1. BACS - Banker's automated clearing services,
2. CHAPS - The clearing house automated payment system, and
3. Faster Payments.

These schemes underpin the transactional capabilities of banks and other financial institutions such as payment service providers (PSPs) to ensure secure funds transfers. Despite the systems being built upon legacy infrastructure, they are robust and accessible.

Modes of the U.K Payment System

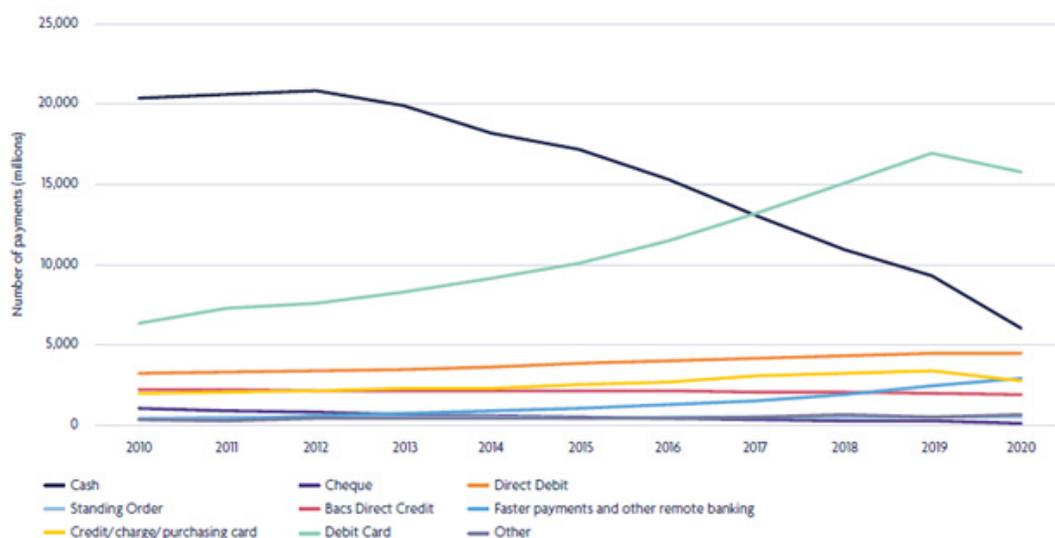
Multiple arrangements of the U.K payment system operate concurrently to transfer funds from one entity to another. The advent and growth of card-related payments are helping decrease the usage of cash in the economy. Similarly, launching digital wallets and emerging innovative channels like BNPL (buy now pay later) is another form of sending money towards making a purchase are also acting as a shot in the arm toward becoming a cashless society.

Covered here under are the systems and details of the component that make up the U.K. payments system.

Usage of Credit and Debit Cards

The payments market was running on traditionally developed processes for a considerable period. However, technological innovation has helped businesses and people access newer payment processing opportunities. Innovations such as contactless payments, mobile wallets, online banking, and mobile banking have played a vital role in paying for goods and services and managing our finances. The usage of card payments is continuing to grow among consumers and businesses. In 2019 for the first time, the U.K. witnessed card payments increase to the point of accounting for 51% of all payments in the U.K. Online and contactless payments continue to act as substantial drivers of this growth, with eight out of ten UK adults now using contactless payments. The debit card is one of the most frequently used payment methods in the U.K. It is currently the mode of payment in over four out of ten transactions. The continued increase in debit cards has driven the popularity of contactless payments.

Figure 1: Payment volumes (millions) 2010 to 2020

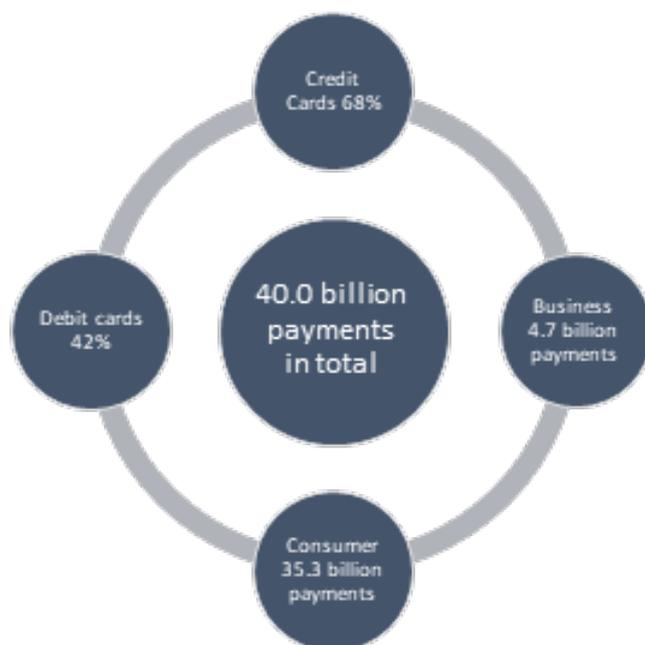


Source: Uk Payment Market 2021

Similarly, Credit cards are also increasing the use cases of contactless payments. Currently, 68% of adults in the U.K. own a credit card, and 3.5 billion payments are made using credit cards (Uk Payment Markets 2020). It is an increase of 7% over the previous year.

Here is a comparative analysis of debit and credit card use percentages in business payments

Figure 2: Analysis of debit card and credit card



Source: Agpaytech Research

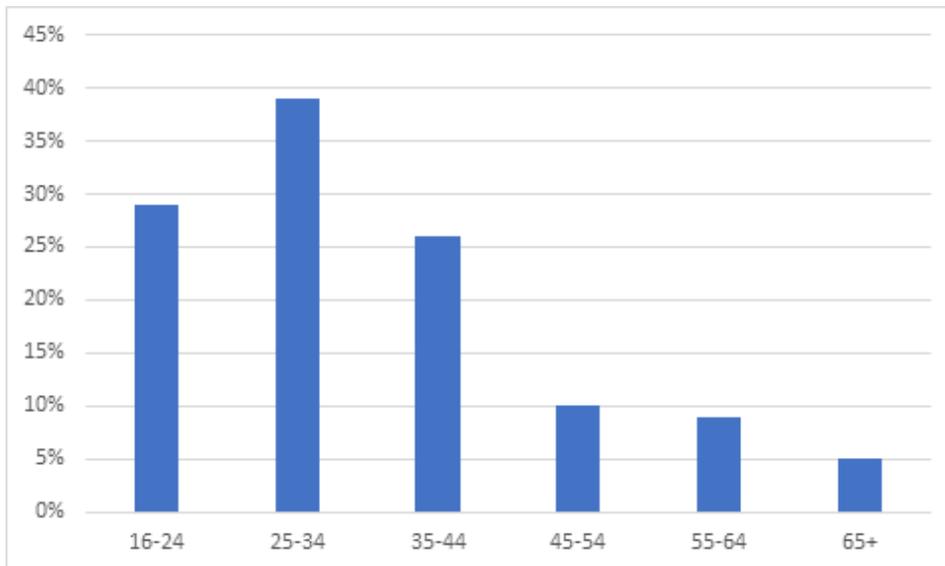
Payments via contactless cards

The number of contactless payments in 2019 in the U.K. increased by 16% to 8.6 billion in revenues. This increase has been driven by the continued roll-out of contactless cards, especially credit cards, in the previous 12 months. Consumers are now very familiar and are at ease with making payments via contactless options. At the end of 2019, 132 million contactless cards were in circulation; 85% of debit cards and 74% of credit cards in the U.K. have contactless functionality. The card industry wants to ensure that every bank-issued payment terminal in the U.K. can accept contactless payments.

Apple Pay, Google Pay, and Samsung Pay

Contactless cards and other devices such as mobile phones and watches have been used at the point of sale and online. Nearly ten million people, or 18% of the adult population, registered for mobile payments in 2019, with 79% of these registered users recording an amount. However, nearly half (48%) of registered users made payments fortnightly or more frequently. Similarly, UK finance market research found that younger people are more likely than older people to use one of Apple Pay, Google Pay, or Samsung Pay. According to a survey by Statista 33% of the respondents stated that they have used Google pay at stores, restaurants, or other POS and 19% stated that they used it online in the United Kingdom

Figure 3: Proportion of people in each age group registered for mobile payments, 2019



Source: UK Payment Markets 2020

Faster Payments and other remote banking

The adoption of online or mobile banking continues to grow. Two-thirds of U.K. adults (72%) use online banking, and 50% access banking through their handheld devices. All age groups have high levels of remote banking use cases, ranging from 93% of those aged between 25-34 to 71% over 65. The number of remote banking payments processed via the Faster Payments service (or cleared in-house by banks) during 2019 increased by 24% to nearly 2.5 billion. Over the past few years, the number of businesses using this payment method has grown steadily.

BACS Direct Credit payments

The Bacs Payment System processes Bacs Direct Credits. Its use cases involve payment of salaries, benefits, dividends, and vendor payments into their bank accounts. It can also aid in automating regular payment collection, making it a method of choice for many bill payments in the UK. Since its inception, BACS has processed nearly 150 billion transactions, debits, or credits, into British bank accounts. In 2020, the system enabled 6.5 billion payments, valued at £4.9 trillion. Direct Debit usage has increased by 41 per cent over the last decade, while that figure jumped to a staggering 125 per cent compared to the year 2000. This hike is experienced since BACS is now used to make payments for services such as mobile phone bills, broadband bundles, dual fuel, water, council bills, subscriptions, and different types of insurance. On its busiest day, at the end of



November 2019, the number of transactions processed by the Bacs system reached a new high of 124,000,000, while a new monthly record was set in December 2020 when over 616 million payments were processed, valuing £450 billion. (Source Pay.Uk) This payment method has widespread usage, and eight in ten employees in the U.K are paid via BACS Direct Credit. In addition, the government has also used BACS Direct Credit to spend nearly all state benefits and pensions in the U.K.

■ Usage of CHAPS payments

CHAPS (Clearing House Automated Payment System) is one of the world's most extensive high-value payment systems. There are 30 direct participants and five thousand financial institutions that make CHAPS payments through one of the direct participants. Financial institutions and some of the largest businesses use CHAPS to settle the money market and foreign exchange transactions. Corporates use CHAPS for high-value and time-sensitive payments such as to suppliers or payments of taxes. Solicitors and conveyancers commonly use CHAPS to complete housing and other property transactions. Individuals may use CHAPS to buy high-value items such as a car or pay a deposit for a house. Banks are undertaking a refreshed version of the CHAPS since the reference manual took effect. They are working on renewing the RTGS service by adopting the ISO 20022 messaging standard for CHAPS payments. Furthermore, Indirect participants have access to the CHAPS system through one of the Direct Participants, which is based on a Commercial and contractual arrangement.



The Emergence of the New Payment Architecture

The U.K. is a global leader in retail interbank payments and continuously strives to innovate to improve its systems and processes and make them robust so that it can respond to the emerging industry needs. The Pay.UK is a platform where people can access money faster and resiliently. In 2020, these systems processed a record 9.5 billion transactions. The new payments Architecture (NPA) is the U.K. payments industry's proposed new way of organising the clearing and settlement of interbank payments- transferred directly from one to another. Pay. UK, the operator of BACS, and Faster Payments are responsible for delivering the National Payments Architecture. The Bank of England is working with Pay.UK to make steady progress and will continue providing positive outcomes for people and businesses. In January 2018, BoE also sent an open letter to Pay. UK outlining four targets it considers to be met for the NPA to succeed.

- Increased innovation in the payments industry
- Timely delivery with support and engagement from stakeholders
- Effective competition across all layers of the NPA, with low entry barriers for service providers
- An NPA that is technically robust and resilient

The NPA is an opportunity to promote the interests of the people and businesses who use payment systems across the U.K. by meeting the growing demands for digital payments and supporting increased competition, resilience, and security in payments. NPA infrastructure has been monitored by the Payment Systems Regulator (PSR) and the Bank of England to ensure that the objectives and benefits of NPA are realized.

On the other hand, NPA has defined as a set of products that will be made available for the participants, who will select which ones to implement depending on their individual business needs. These payment types have similar attributes to FPS (Faster payment system) and BACS payments, which will now be built on a richer ISO 20022 format. These interbank systems are owned by Pay. UK and include all real-time transactions between consumers and businesses, as shown below.

Table 1: Real-time transactions between consumers/businesses

Priority Payment	The Standard payment product for payment service provider (PSP) to PSP customer payments, replaces the SIP and will probably replace the majority of standing order Payments (SOP) and Future Dated Payments (FDP).
Instant Payment	A new product which the NPA will make available for Retail/eCommerce payments. The instant payment requires a definite response from recipients in near real time.
Same Day Payment	A new payment type which will be processed when NPA has available capacity and reduces cost. May replace some SOPs/FDPs.
Multi-Payment	Single payment message with multiple individual credits, one debit, may improve processing efficiency (Participants and NPA) may enable early BACS Credit migration.
Bulk Payment	A file-based service which allows Participants to efficiently submit large payment files to the NPA in batch. Bulk files may include Priority or Same Day payments.
Multi-Day Bulk Payment	Allows Corporates and PSPs to submit payments to the NPA for bulk processing with improved efficiency, improved liquidity management, pre-notification of settlement and other functional benefits to Corporate and Government users.

Source: wearepay.Uk/new-payments-architecture-programme

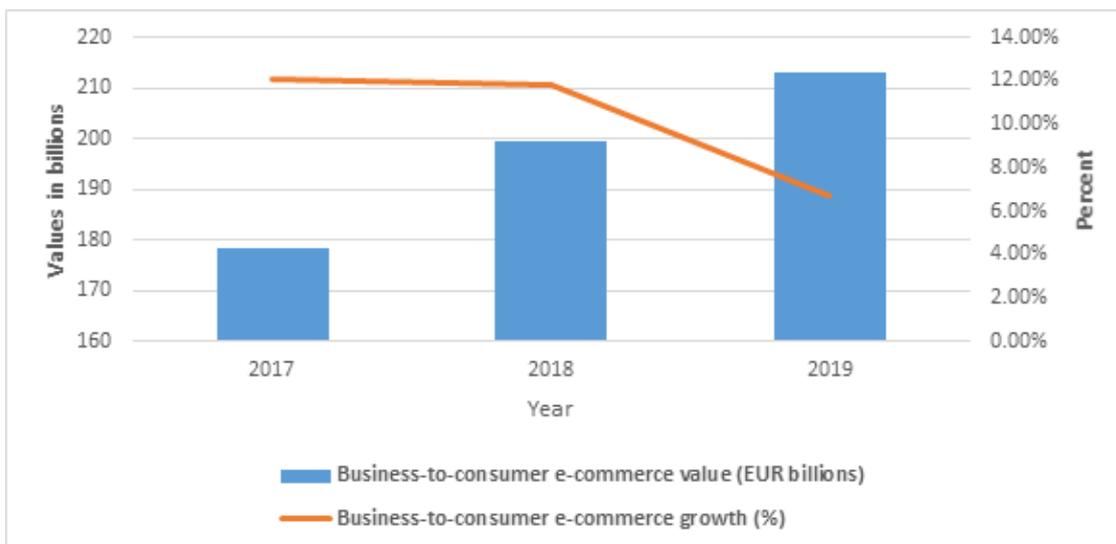
Mobile Payments Usages

The U.K finance released its 2021 payments market report that covered an analysis of payments falling by 11% to 35.6 Billion due to the pandemic for the first time. However, during this time number of payments made by commercial organizations, government, and not-for-profit organizations increased slightly to 4.8 billion, representing 14% of payment volumes. In 2020, the volume of contactless payments made in the U.K. stood at 12%. Contactless payments currently account for more than a quarter (27%) of all U.K payments. The upper limit on the value of an individual contactless payment was also increased from £30 to £45 in April 2020, enabling consumers to make a more significant proportion of card payments this way.

Furthermore, the report highlights that 32% or 17.3 million people of the adult population have registered to use mobile payments by the end of 2020, an increase of 7.4 million people compared to 2019.

The U.K. is the first mobile nation where merchants have been ensured that they offer fully optimised sites for this access method. Social commerce and influencer marketing are vital among younger age groups.

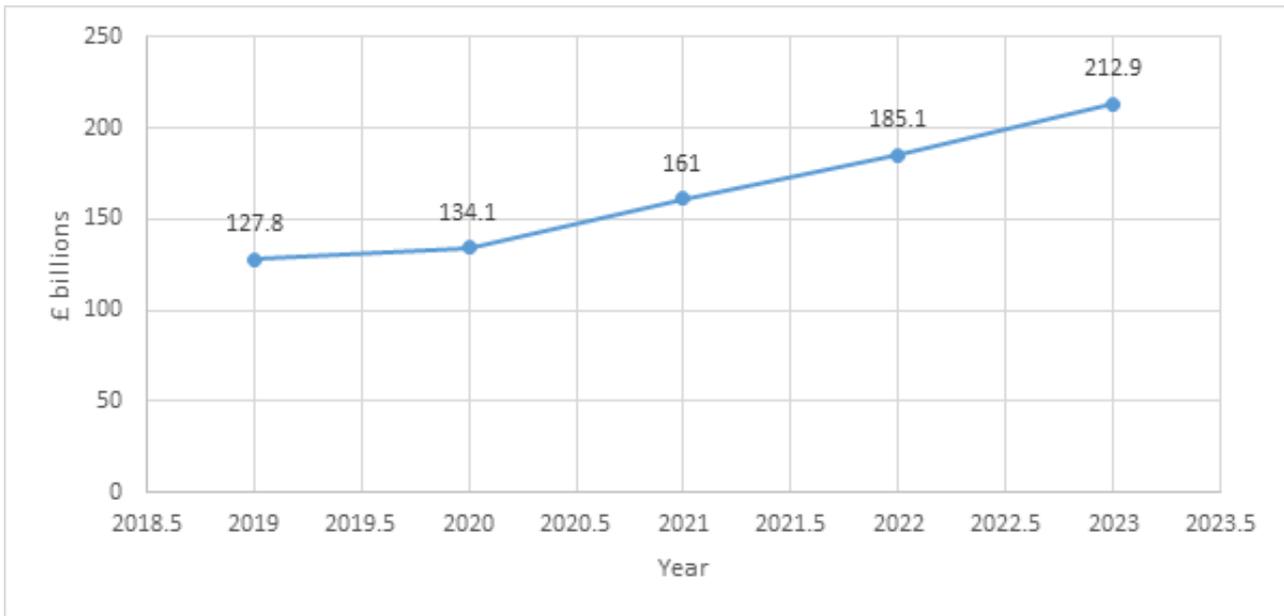
Figure 4. Business-to-consumer e-commerce value (£ billion)



Source: J.P Morgan 2020 E-commerce payments

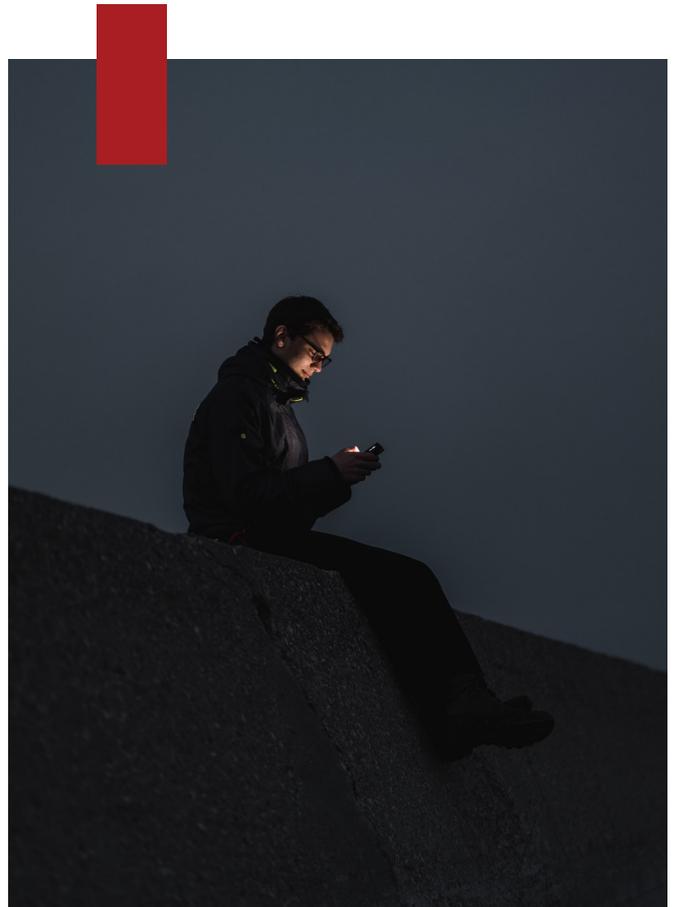
Merchants are optimising their mobile online shops, helping to support this sector. It is growing at a compound annual growth rate of 13.6 %. Major grocery brands, including Ocado and Morrisons, have integrated voice commerce options, such as Amazon's Alexa, into their sites in 2020. In addition, 5G launched in May 2019 in major UK cities will further boost mobile payments volumes in the U.K

Figure 5. Forecast of mobile commerce market size (£ billions)



Source: J.P Morgan 2020 E-commerce payments

Furthermore, smartphones are the most popular device for accessing the internet across all age groups. Six out of ten online transactions in the U.K are carried out using a mobile device. Mobile apps are rising in prominence and browser dominance. Shoppers are acclimatising to using chatbots powered by artificial intelligence for customer service queries, both in-app and desktop sites and when shopping via social media.



■ Retail Payment Infrastructure

Uk payment strategy forum, under the umbrella of the payment systems regulator, sets The U.K. payments Industry into a core group that would be analysed and worked through by the various working bodies established under the Payment Strategy Forum. The wholesale payments were out of the scope of the Bank of England, which had already announced in January 2016 that it would produce a blueprint covering an upgrade to the U.K. Real Time Gross Settlement system. There is an initial round which will be held in November 2016. The Payment Strategy Forum published its Payments Strategy for the 21st century, which can be briefly summarised under the following heads:

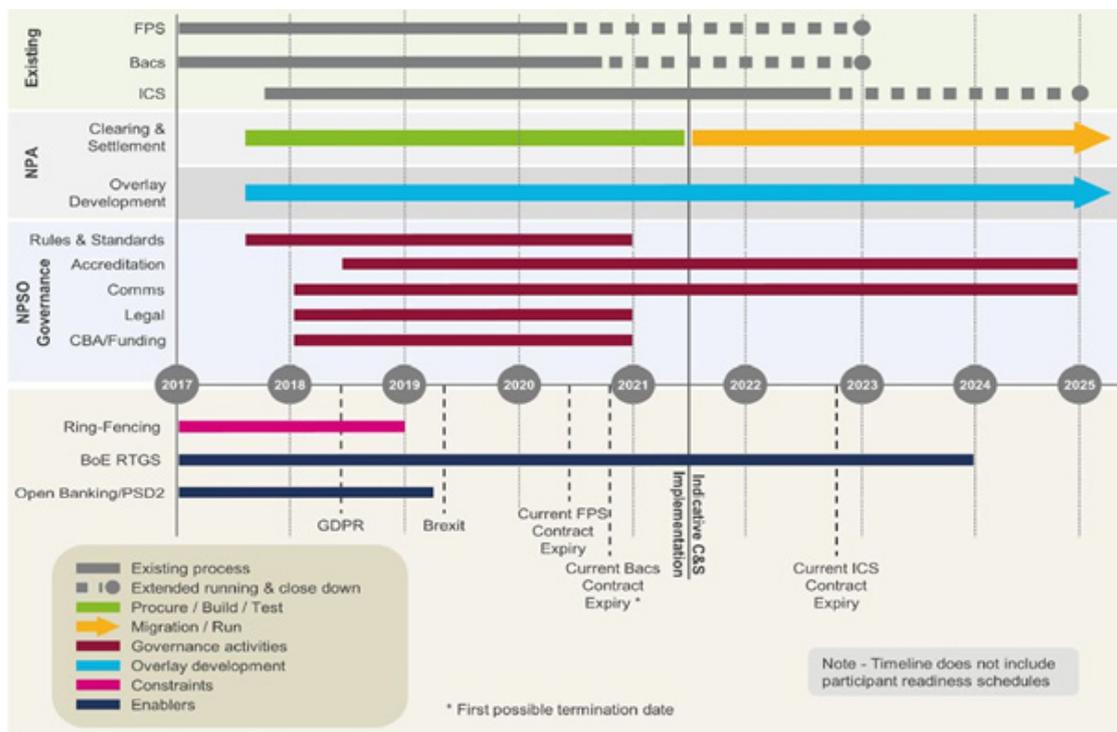
- Responding to End-user Needs: There is a need to address solutions with current and Future end-users needs.
- Improving Trust in Payments: Solutions to engender trust in the safety and certainty of payments.
- Simplifying Access to Promote Competition: Solutions to streamline access and enable participation in the market for Payment Service Providers to foster competition and innovation.
- A New Architecture for Payments: Solutions to enable the development of the future payments' architecture.

Steady progress has been made toward these objectives to address the following points:

- The existence of Retail Payment Systems (FPS, BACS, and cheque & Credit Clearing/ ICS) have brought under a single entity pay.uk, consequently, simplified participation rules and member attestations are implemented.
- Confirmation of Payee has been introduced, which, together with the EU-wide implementation of Secure Customer Authentication, will contribute significantly towards fraud prevention.
- The Bank of England has worked with Pay. UK. to establish common ISO20022-based messaging standards for future payment messaging (including formulating a Common Credit Message).

In addition, The Bank of England has worked towards the introduction of its new RTGS system. In July 2020, Accenture was appointed to develop and build the new service. Since then, the Bank's progress towards its launch has continued (with commercial banks beginning a series of attestation stages to prove their readiness for its launch). However, some industry-wide developments took place during this time, where-in the New Payment Architecture (NPA) emerged as the flagship of the Payment Strategy. Its unique design provides a layered approach to a core central settlement platform by underpinning several service layers and channels, encouraging open competition from different service providers.

Figure 6. Existing retail payment systems



Source: Bank of England

FPS and BACS were due to commence their run-down during 2020 with complete closure at the end of 2022, and Image Clearing would close at the end of 2024. Migration to NPA would begin in the latter half of 2021.

Overview of the new form of digital money

The demand for new forms of digital money, such as stable coins, is driven by various non-financial factors, such as the convenience of making payments. Some commercial bank deposits could not compete with the rates of return; still, people prefer them for the store of value reasons, which is unrelated to remuneration. Similarly, non-financial factors generate the highest demand for new forms of digital money as a means of payment and a store of value. A PwC Survey in 2019 found that people take a relatively low interest in financial services products compared to other industries. In that survey, 48% of respondents said they would not consider purchasing any financial product from a fintech provider.

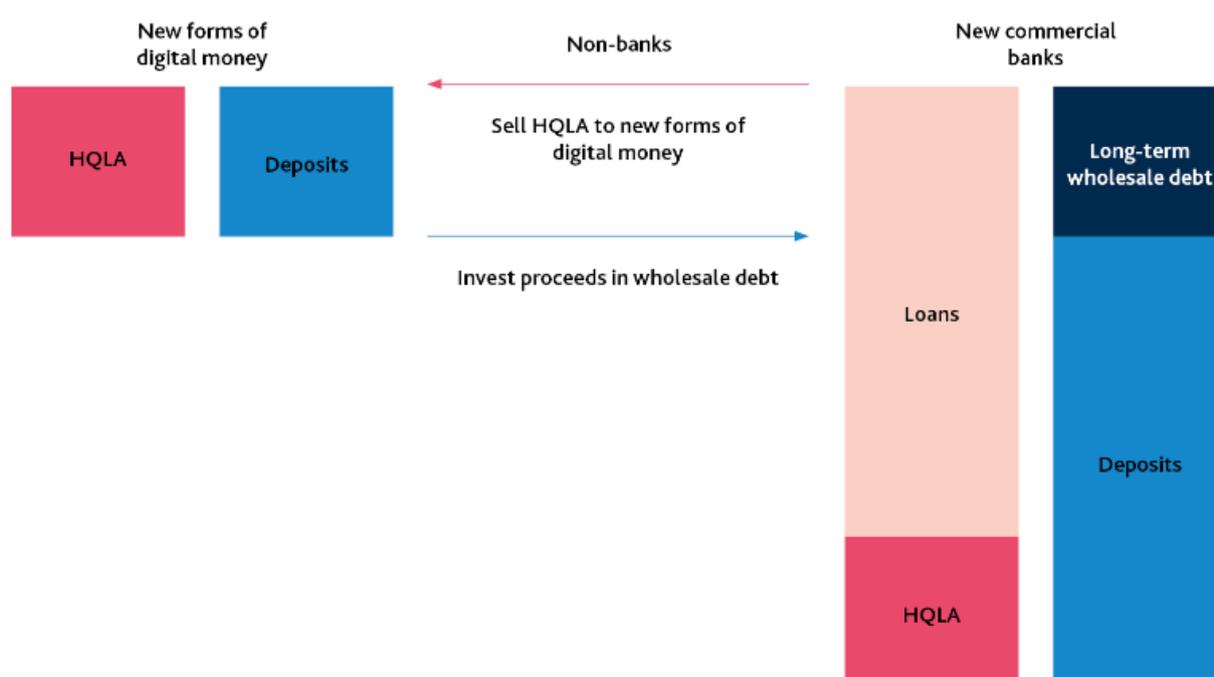
Furthermore, depositors feel safe using new forms of digital money. Depositors believe digital money is more secure because it is a part of the regulatory framework. Overall, 21% of total household and corporate deposits are assumed to migrate because of safety.

Furthermore, adopting new forms of digital money by commercial banks may lead to a loss of deposits. Therefore, banks are adapting their balance sheets to these emerging circumstances. These positions



depend on the short-term liabilities of banks- including deposits and on the high-quality liquid assets (HQLA) held to meet those liabilities - such as gifts and central bank reserves. Widespread adoption of new forms of digital money may lead to a loss of deposits for commercial banks. Therefore, banks are adapting their balance sheets to these emerging circumstances.

Figure 7. The proceeds from sales of HQLA to purchase wholesale debt issued by banks



Source: Bank of England

As per the description of the diagram, banks' liquidity ratios are still impacted. HQLA need to be held against them than against retail deposits.

Regulatory requirements for Stable Coins payments

A stablecoin payment involves the stablecoin issuer, wallet provider, payer, and payee. However, CBDC is also likely to be used in the private sector, which must integrate with the Payment Interface Providers as intermediaries between the central Bank and the end user. These new entities affirm the protection of the data law. Such emerging

challenges warrant new regulations, especially in data protection, are required. Data related to each entity in a stablecoin or CBDC payment system access is held and processed. The data protection and AML regulatory frameworks are outside the Bank's remit. The stablecoin and CBDC must be integrated with commercial entities to help access end-user personal data. For example, to analyse individual data or spending patterns across different demographics. Therefore, under the considerations of the technical or policy choices, the Bank must work closely with H.M. Government and other authorities.

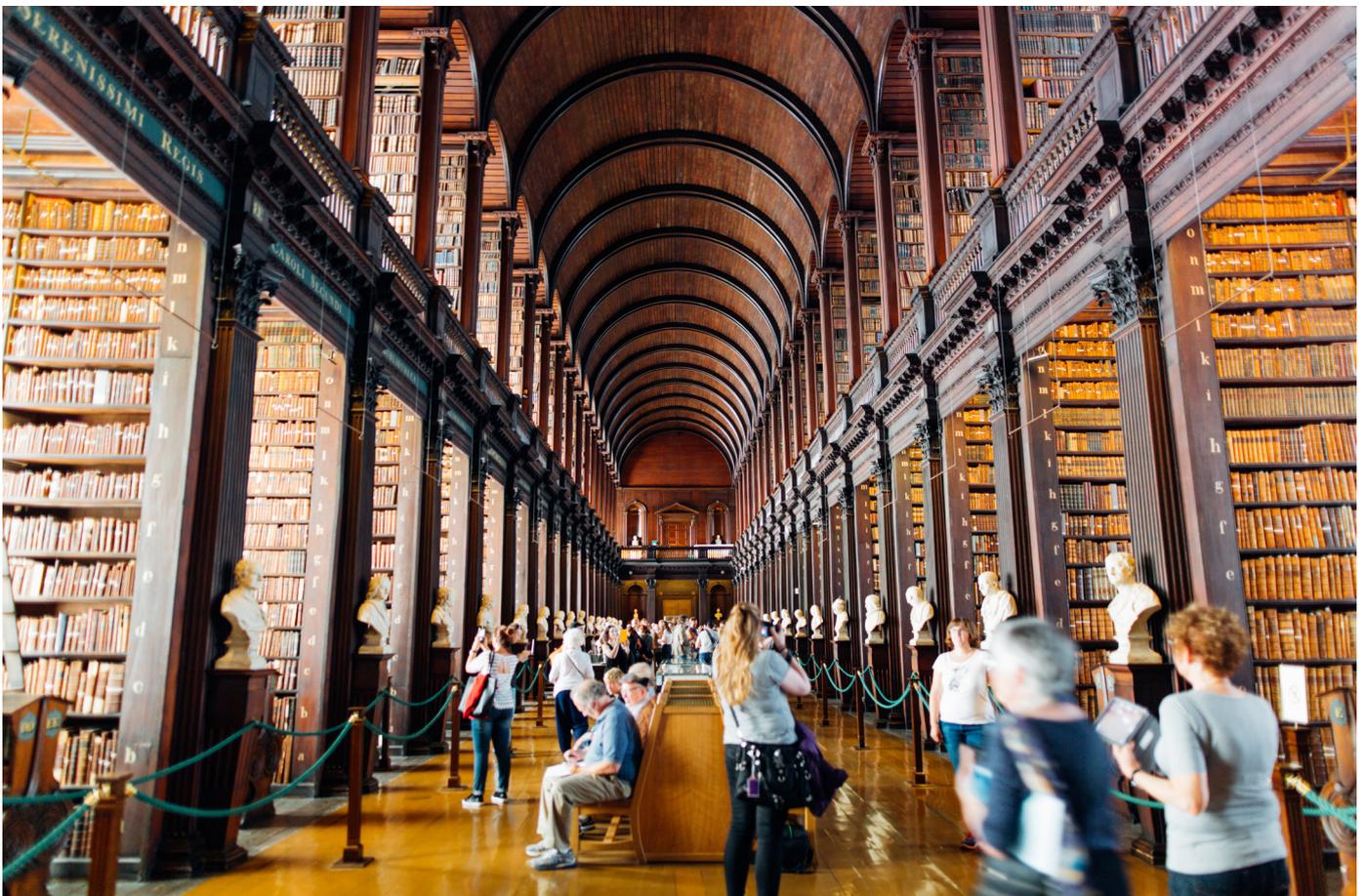
■ Conclusion

The payment system must continuously change or develop as per the emerging situations in every daily routine. The BoE is still working on updating new features regarding the payment systems. Furthermore, The Bank of England and H.M. Treasury have announced that the joint creation of a central Bank of Digital currency would be a new form of digital money that is only used for household and business chores. The Bank of England has not yet decided whether to introduce a CBDC to engage stakeholders towards their benefits.



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About Agpaytech

Agpaytech Ltd. is a company pioneering in the Fintech Space with a focused approach to building robust technologies for eCommerce Card Processing Solutions for Payment Service Providers (PSPs). Additionally, we provide Compliance and Regulatory Umbrella, Remittance-as-a-Service White-Label Solution, Foreign Exchange, Cross Border Payments, and digital currency technology. We have partnered with multiple banks, non-banking financial institutions, and corporate organizations to create a solid service delivery model for them and their customers to ease their international remittances and payments concerns. Website www.agpaytech.co.uk

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