

2023: A PIVOTAL MOMENT FOR PAYMENTS

In this article produced for The Legal 500, we take stock of trends shaping the UK's financial and payment systems, and the regulatory response to those trends.

1. Introducing the current landscape

1.1 The UK payments landscape in 2023 represents the confluence of three broad trends. First, we are rapidly changing *how* we pay in person, as cash payments decline and contactless payments gain in popularity (particularly following the COVID-19 pandemic).¹ Second, some of us have changed *who we trust* to mediate our payments, as high-profile global crypto and decentralised finance ('DeFi') projects continue to launch despite the recent crypto winter.² Third, many more of us have changed the providers that we use to make payments,³ as Big Tech giants like Google, Amazon and Apple broaden their payments offerings,⁴ and nearly a third of UK adults now use mobile payment apps such as ApplePay or GooglePay.⁵

1.2 These trends have sparked public and private action in the UK. Responding to both a decline in cash use—with accompanying implications for the balance between public and private (currently, commercial bank) money—and the emergence of stablecoins, the Bank of England ('the Bank') is investigating the feasibility of a retail central bank digital currency ('CBDC'), the digital pound.⁶ In turn, responding both to the "call to action" of Andrew Bailey, Governor of the Bank, for financial institutions (and particularly banks) not to "leave central banks as the only show in town",⁷ and the proliferation of private digital money initiatives, the private sector is formulating its own proposals. Industry body UK Finance and a number of its members and interested parties have come together with EY to explore the viability of the Regulated Liability Network ('RLN'), a regulated financial market infrastructure ('FMI') that would operate a shared distributed ledger that records, transfers, and settles regulated liabilities of central

¹ Contactless card payments are now used by close to 90% of people in the UK. Sir Jon Cunliffe, 'The shape of things to come: innovation in payments and money' [speech], *Bank of England* (17 April 2023). Available at: <https://www.bankofengland.co.uk/speech/2023/april/jon-cunliffe-keynote-speech-at-the-innovate-finance-global-summit>.

² See, for example, PayPal's launch of a U.S. Dollar stablecoin, PayPal USD (PYUSD) in August 2023: <https://newsroom.paypal-corp.com/2023-08-07-PayPal-Launches-U-S-Dollar-Stablecoin>. See also, the launch of WorldCoin in July 2023, a global decentralized identity and financial network that aims, among other things, to give users access to DeFi and send instant cross-border payments directly: <https://worldcoin.org/blog/announcements/worldcoin-project-launches>.

³ Diversity of choice in payment methods has for a number of years been further supported by the UK's open banking initiative, which seeks to provide a secure way for consumers and businesses to give regulated third-party providers access to their payment account data and to initiate payments, and may in the future be underpinned by the New Payments Architecture ('NPA') initiative,

the UK payments industry's proposed new way of organising interbank payments.

⁴ FCA Feedback Statement, *The potential competition impacts of Big Tech entry and expansion in retail financial services (FS23/4)* (July 2023), Annex 1. Available at: <https://www.fca.org.uk/publication/feedback/fs23-4.pdf>.

⁵ Sir Jon Cunliffe, 'The shape of things to come'.

⁶ Within the decentralised universe, stablecoins are seen as possibly having greater potential to become widely used in payments (owing to the perceived stability in their value), and already underpin activity on many centralised cryptoasset exchanges and DeFi applications. This, however, means that they are also seen as a (potentially) significant threat to financial stability.

⁷ Andrew Bailey, 'New prospects for money' [speech], *Bank of England* (10 July 2023). Available at: <https://www.bankofengland.co.uk/-/media/boe/files/speech/2023/july/new-prospects-for-money-speech-by-andrew-bailey.pdf>.

banks, commercial banks (such as tokenised deposits) and regulated non-banks.⁸

2. Direction of travel

2.1 In sum, we are moving towards a more cashless society, towards increased Big Tech involvement in our financial and payments networks, and potentially towards increased adoption by consumers of digital currencies (most likely stablecoins) and even a digital pound. Taken together, these developments could augur a landscape where the historic predominance of banks and commercial bank money is challenged.

2.2 While the imagined dystopia of the early 2020s—one where we are wearing NFT hats in a virtual pub paying with crypto doubloons—has thankfully failed to materialise, current trends point towards the integration of social media and e-commerce platforms, and payments. At the more extreme end of the scale, Silicon Valley is playing host to a race to build platforms that can do ‘everything’, including financial services and payments, from Elon Musk’s ‘everything app’ X, to Mark Zuckerberg’s Metaverse and Jeff Bezos’s ‘everything store’ Amazon. Of course, some might observe that this race has already been lost to existing super apps developed and adopted elsewhere - including WeChat and others.

2.3 There is also more mainstream acceptance that non-financial firms could have a role to play in the payments ecosystem of the future. The rapid growth of embedded finance is a case in point, with one notable example being the Bank’s proposed ‘platform model’ for the digital pound. Under this model, digital pounds would be recorded in a core ledger built and operated by the Bank, and regulated private sector companies would provide the interface between the Bank and users via digital ‘pass-through’ wallets. It is suggested that non-financial firms—from sectors including media and social media, broadcasting and content sharing

platforms, and e-commerce—might add a digital pound wallet to their services as an ancillary offering, thus embedding CBDC capabilities within their platforms.⁹

2.4 Indeed, back in 2021 the Bank for International Settlements (‘BIS’) contemplated the possibility that the economy may come to centre around digital platforms—that is, “*ecosystems...in which consumers, merchants, and service providers interact*” and which may involve commercial and social elements—rather than (just) banks.¹⁰ This may in turn have an impact on consumer choice of currency, as “*digital payment instruments associated with platforms will effectively combine the functionalities of traditional money with the platform’s functionalities and data*”, and “*currencies will no longer simply grant payment services—they also grant access to interactions with other platform users*” leading to a digital currency becoming “*inseparable from the characteristics of the platform on which it is exchanged*”.¹¹ Under this hypothesis, which is termed the re-bundling of money, “*a currency’s appeal will likely be governed by other platform features, such as the platform’s information processing algorithms, its data privacy policies, and the set of counterparties available on the platform*” rather than “*traditional features, such as its ability to store value*”.¹²

2.5 It has not escaped the Bank’s attention that consumers may (for whatever reason) come to prefer stablecoins or digital pounds over bank deposits, with attendant implications for existing banking business models. In its discussions on the digital pound, the Bank refers to this phenomenon as ‘bank disintermediation’, and considers the implications for financial stability and the cost and availability of credit.¹³ More recently in October 2023 Chris Hemsley, Managing Director of the Payment Systems Regulator (‘PSR’), suggested that “*technologies such as Distributed Ledger will eventually move from its current wholesale use*

⁸ UK Finance, *Regulated Liability Network UK Discovery Phase* (4 September 2023), p.3. Available at: <https://www.ukfinance.org.uk/system/files/2023-09/Regulated%20Liability%20Network%20-%20UK%20Discovery%20Phase%20report%20.pdf>.

⁹ Bank of England and HM Treasury, *The digital pound: a new form of money for households and businesses? Consultation Paper* (February 2023). Available at: <https://www.bankofengland.co.uk/-/media/boe/files/paper/2023/the-digital-pound-consultation-working-paper.pdf>.

¹⁰ Brunnermeier, M.K, James, H., Landau, J.P. *BIS Working Papers No. 941: The digitalization of money*. BIS (May 2021), p.12. Available at: <https://www.bis.org/publ/work941.pdf>.

¹¹ *Ibid.*, pp.12-14.

¹² *Ibid.*, p.14.

¹³ Bank of England, *The digital pound*, pp.38-39.

cases to become a more mainstream payments method”, flagging the fact that Sterling Finality has become the first newly designated payment system harnessing distributed ledger technology.¹⁴

2.6 Whether we are in fact barreling towards an economy dominated, ordered and/or intermediated by digital platforms (including social networks) rather than banks, and a world where we might not be wearing NFT hats, but could buy a round of drinks in a (real) pub with the digital pound, remains unclear. The digital pound is not yet greenlit, and projects like the RLN (alongside other forces) may work to keep the banks in pole position. A paper published by EY cites as a potential benefit of the RLN that it “would defuse the disintermediation effect of “narrow” CBDC proposals”,¹⁵ and UK Finance et al. are exploring “how ‘upgraded’ commercial bank money could sit alongside a retail CBDC”.¹⁶ Yet while the future is far from certain, the regulators have been far from idle during this gestational period.

3. The regulatory response: a summary

3.1 The FCA and PRA have rolled out a number of workstreams to keep abreast of this changing landscape. On the payments side, information is being gathered. The FCA is considering the potential competition impacts of Big Tech’s entry into and expansion in retail financial services, and HM Treasury has both conducted a review into how UK payments regulation should evolve and has launched an independent report into how payments

are likely to be made in the future.¹⁷ This work is complemented by a new regime to assess and strengthen the resilience of (primarily technological) services provided by critical third parties to regulated firms and FMIs.¹⁸ This regime, among other things, targets concerns about the increasing enmeshment of payment mechanisms and (a concentrated number of) technology providers, such as Amazon Web Services, Microsoft Azure and Google Cloud.

3.2 Regulatory efforts are also being made to create the conditions for issuers and service providers of stablecoins used as a means of payment to operate and grow in the UK, and to enable consumers to use stablecoin services with confidence.¹⁹ To this end, the Financial Services and Markets Act 2023 (‘FSMA 2023’) has laid the foundations for stablecoins to be brought within the regulatory perimeter. This regime will address issuance, custody and payment-related activities in respect of such stablecoins and, within a longer timetable, exchange and trading activities may also be covered, alongside activities in a far broader range of cryptoassets.²⁰ In addition, the Bank’s Financial Policy Committee has set two expectations for systemic (or likely to be systemic) stablecoins: (i) that payment systems that use stablecoins should be regulated to standards equivalent to those applied for traditional payments, and (ii) that stablecoins used as money for payments should meet equivalent standards to those provided by commercial bank money in relation to stability of value, robustness of legal claim and the ability to redeem at par in fiat.²¹

¹⁴ Chris Hemsley, ‘Chris Hemsley’s speech at the Payment Leaders’ Summit on 11 October 2023’, PSR [speech]. Available at: <https://www.psr.org.uk/news-and-updates/speeches/speeches/chris-hemsley-s-speech-at-the-payment-leaders-summit-on-11-october-2023/#:~:text=I%20welcome%20the%20significant%20changes,is%20also%20presenting%20other%20challenges.>

¹⁵ EY, *Regulated Liability Network (RLN: A potential strategic roadmap for cross-border payments)* (April 2023), p.8. Available at: [ey-regulated-liability-network-strategic-roadmap.pdf](https://www.ey.com/en-gb/financial-services/regulation/regulated-liability-network-strategic-roadmap.pdf).

¹⁶ UK Finance, *Regulated Liability Network UK Discovery Phase*, p.4.

¹⁷ HMT, *Payment Services Regulations Review and Call for Evidence* (13 January 2023). Available at: <https://www.gov.uk/government/calls-for-evidence/payment-services-regulations-review-and-call-for-evidence>.
HMT, *Future of Payments Review 2023* (11 July 2023). Available at: <https://www.gov.uk/government/publications/future-of-payments-review-2023#:~:text=The%20Future%20of%20Payments%20review%20aims%20to%20consider%20how%20payments,further%20boosting%20UK%20fintech%20competitiveness.>

¹⁸ PRA, FCA, *DP3/22, 22/3 - Operational resilience: Critical third parties to the UK financial sector* (21 July 2022). Available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/july/operational-resilience-critical-third-parties-uk-financial-sector>.

¹⁹ HM Treasury, *UK regulatory approach to cryptoassets, stablecoins, and DLT in financial markets: Response to consultation and call for evidence* (April 2022) p.3. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1088774/O-S_Stablecoins_consultation_response.pdf.

²⁰ HM Treasury, *Future financial services regulatory regime for cryptoassets: Consultation and call for evidence* (February 2023) pp.21-23. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1133404/TR_Privacy_edits_Future_financial_services_regulatory_regime_for_cryptoassets_vP.pdf.

²¹ Sir Jon Cunliffe, ‘The shape of things to come’.

Limits on stablecoins used for payments are also being considered in order to guard against “*rapid, disruptive change that does not allow the financial system time to adjust*”.²² This thinking on stablecoins is in addition to, and complements, the Bank’s work on the digital pound highlighted above.

- 3.3 Future consultation on this stablecoin regime, expected later this year, will also include the PRA’s intended approach to tokenised bank deposits, with implications for initiatives like the RLN.²³ HM Treasury has further consulted on a proposed approach to managing the failure of systemic digital settlement asset (including stablecoin) firms,²⁴ and a proposal for a ‘Digital Securities Sandbox’, an FMI sandbox to facilitate the testing and adoption of digital securities across the financial markets.²⁵

4. Route planning

- 4.1 It seems clear that the worlds of financial services, payments and digital services are coalescing on several fronts. Keeping track of how (and whether) these moving parts are coherent and fit together is likely to keep regulators and advisers busy over the coming years. Beyond this, we are struck by five overarching observations.

- 4.2 We have previously reflected on the complexities that will emerge when non-traditional financial service providers, with their unique backgrounds and cultures, become part of the UK’s financial ecosystems (whether that is as part of the digital pound network, as a stablecoin issuer, in the form of payment platforms with e-commerce and/or social media offerings or in other as yet unforeseen ways).²⁶ Communicating and translating the strictures of financial regulation—including, potentially, prudential and cultural requirements—will be no small task, nor will upskilling management. Crucially, these players will likely have different incentives and priorities to traditional payment service providers and banks, and regulation may have to evolve in certain facets to reflect this. It should not be assumed that what

has worked in the past will work in a new, potentially re-ordered environment.

- 4.3 Second, operational resilience must be front and centre of the regulatory approach, building on the regulators’ existing momentum around the regulation of services provided by critical third parties. Digital platforms and digital pound networks, should they emerge and prevail, are likely to present new genres of operational disruptions that will require a fresh approach to impact tolerances.
- 4.4 Third, regulatory regimes around recovery, resolution and insolvency will need to develop and adapt. What does recovery and resolution look like in the context of an ‘everything’ app, or a private financial infrastructure, where the consequences of failure could affect every aspect of an individual’s life? What kind of ramps with the traditional banking system, if any, might be necessary? These questions are further complicated by the potential emergence of ‘enhanced’ digital money, to which executable (including contingent) actions might be attached via smart contracts.²⁷ As the web of rights and obligations imbued by money (and fuelled by smart contracts) thickens, so too will the legal analysis.
- 4.5 Fourth, it is important to query how the Bank’s investigations into a retail CBDC, driven in part by a decline in public money, interact with the Bank’s and PRA’s roles in banking supervision. What does it mean should the Bank become a competitor to the banks? Andrew Bailey has stated that “*I don’t think we should be using enhanced digitalisation materially to shift the mix of commercial bank and central bank retail money towards the latter. Commercial banks support credit creation and lending in the economy, and I do not wish to see this impaired*”.²⁸ It remains possible, however, that the Bank’s thinking on a retail CBDC could come into conflict with the role of commercial banks in future.

²² Sir Jon Cunliffe, ‘The shape of things to come’.

²³ Ibid.

²⁴ HM Treasury, *Managing the failure of systemic Digital Settlement Assets (including stablecoin) firms* (31 May 2022). Available at: <https://www.gov.uk/government/consultations/managing-the-failure-of-systemic-digital-settlement-asset-including-stablecoin-firms>.

²⁵ HM Treasury, *Consultation on the Digital Securities Sandbox* (11 July 2023). Available at:

<https://www.gov.uk/government/consultations/consultation-on-the-digital-securities-sandbox>.

²⁶ Slaughter and May, *How would you like to pay? Moving towards the digital pound* (14 February 2023). Available at: <https://thelens.slaughterandmay.com/post/102i7ix/how-would-you-like-to-pay-moving-towards-the-digital-pound>.

²⁷ Andrew Bailey, ‘New prospects for money’.

²⁸ Andrew Bailey, ‘New prospects for money’.

4.6 Finally, it is important to acknowledge that despite the broad uptake of cashless payments in the UK, around 6% of UK adults used cash for most things or for everything in 2022.²⁹ They should not be left behind in the rush to develop CBDCs or other innovative payment solutions. This is reflected in the provisions of FSMA 2023 which seek to ensure access to cash notwithstanding the closure of bank branches, and in the important work of UK finance and Cash Access UK Limited, the company formed by a number of UK retail banks to ensure the continued availability of branch banking services in underserved communities.

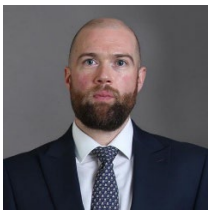
5. Conclusion

5.1 The impact of these developments on the architecture of the UK economy, transmission of

monetary policy and financial stability are potentially seismic. Lawyers as well as economists and technologists, have an important role to play when thinking through some of the complexities thrown up by this change.

5.2 As well as the regulatory position, there are other areas that require lawyers' attention, including data privacy, IP, IT and competition law. Leaps in the area of artificial intelligence may render these analyses yet more complex, as social media, e-commerce and payments data is co-mingled. Suffice to say, there will be plenty more thinking for us to do in this area in the years to come.

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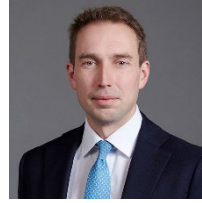
²⁹ House of Commons Library, *Statistics on access to cash, bank branches and ATMs* (1 September 2023). p.5. Available at:

<https://researchbriefings.files.parliament.uk/documents/CBP-8570/CBP-8570.pdf>.

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