

The Future of Payments Regulation: Divided we fall

A special guest article by Justin Cash

A few hundred years ago, payments were easy. If you wanted a goat, and I wanted some tools, we could barter for them.

Now, there are obvious flaws in that system. What if you don't have what I want right now? What if the person who does lives thousands of miles away? What if my goats have a very short shelf life, and we can't agree on what they are worth anyway? If your tools are only worth three-quarters of my goat, what am I going to do with the other quarter of it?

Centuries later, technology has done what technology does: make life easier. But it has also made life harder for one group in particular: regulators.

Make no mistake, the challenges watchdogs face in monitoring the roughly \$1.8 quadrillion that sloshes around the global payments system every year are mounting. It is going to take huge cooperation between regulators and industry, and between regulators themselves, to make sure fragmentation doesn't end in disaster.

For a start, how payments are regulated matters if we ever want to stop the scourge of financial crime.

Authorised push payment scams, where fraudsters pose as genuine payees, cost UK consumers more than £450m last year. Such cons are only likely to get worse as criminals increasingly use artificial intelligence, and with increasing sophistication, to trick people out of money.

“Robust ‘Know Your Customer’ (KYC) protocols are becoming more essential and more difficult, as fraudsters exploit AI to generate convincing deep fake IDs in bulk, similar to the proliferation of social media bots.” comments John Higgins, CEO of Pathlight Associates. “Deep fake IDs, including responsive AI video characters, are increasingly being used in romance scams, a particularly damaging type of fraud which exploits emotionally vulnerable people. Like other forms of APP fraud, the challenge here is that the payer (on whom the KYC is traditionally focused) is genuine, whilst the payee is false, making the fraud harder to detect.”

More broadly, money laundering is estimated to cost the UK economy £100bn a year. That's as much as 5% of our entire GDP, according to the International Monetary Fund.

But to hear regulators tell it, many firms still aren't set up to deal with those risks. Starling, Santander and Metro Bank are just some of the household names to be hit with multi-million pound fines for failed money-laundering checks in recent years.

Financial News revealed three years ago that the Financial Conduct Authority had concerns about how much turnover there was among staff holding the all-important money laundering reporting officer role, while a subsidiary of major law firm Herbert Smith Freehills was recently penalised authorising payments to sanctioned Russian banks.

At the same time as such threats are mounting, the faces of the regulators themselves are changing.

The Treasury more than doubled the number of staff in its sanctions unit in the year after Russia's invasion of Ukraine, while the Payment Systems Regulator will soon be no more, subsumed into the much-larger FCA.



Yet tackling these challenges head on is too much for one regulator - or indeed one member of the payments industry - alone. Scammers and money launderers don't respect geographical boundaries, so the regulatory net shouldn't either.

Global pressure has been proven effective. There was a reason that cutting Russia off from SWIFT at the beginning of the conflict with Ukraine was described as the "nuclear option", and why Russia is now demanding some of its banks are allowed access again as part of ceasefire talks. A truly international policy response is the only thing that might move the needle in such a globalised world as payments.

The answer to some of these problems, ironically, lies in more innovation. Many regtechs are already looking at how to make payments more secure or customer vetting more robust.

Revolut was famously granted a banking licence back in March, showing how fintechs are branching out into more and more parts of the financial value chain, including payments. But as we've already seen, not all innovation is a good thing. A host of payments upstarts have already gone to the wall in their young lives.

As a supervisor, whose new firm application do you approve, and whose do you reject? As one former top regulator recently told me: "some people are doing it really well, and some people are absolute lemons."

It's not just the neobanks, it's some of Wall Street's biggest players who are looking to get in on the action when it comes to innovative payment models. JPMorgan Chase, Bank of America, Citigroup and Wells Fargo are in talks about issuing a joint stablecoin, the Wall Street Journal reported earlier this month. That was before Societe Generale announced it would become the first major bank to launch a dollar-pegged stablecoin, and reports surfaced that Walmart and Amazon were looking at issuing their own stablecoins.

That could all potentially claw huge volumes of cash and card transactions away from the traditional financial system, into areas watchdog have less oversight.

Some corporates will take a less innovative path. But they will all face the same dilemma: how do you manage liquidity on a global basis when the dollar is seesawing and Donald Trump might change his mind over breakfast? And how do you satisfy regulators over your operational readiness for everything from a pandemic to a cyberattack?

Regulators face similar dilemmas. The UK wants to be at the cutting edge of finance. With listings racing off to America, plenty of experts have suggested that stablecoins and crypto payments are areas where the City could steal a march on the Wild West US and sclerotic EU.

Regulators want to help the Square Mile get there. But they understand there is a trade off between growth and risk. The regulatory pendulum has a tendency to swing too far one way - see the financial crisis - before swinging too far the other - see the arguably disproportionate response today in some areas including payments.

But it's never been more important that the pendulum falls in the right place. Everyone, from governments to industry to technology and compliance specialists, needs to chip in to make sure we get that right.

Pathlight Associates supports firms across the financial services sector with financial crime risk and controls. Get in touch at contact@pathlight.associates.

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