Bird & Bird

UK: The FCA and PSR publish a joint call for information on digital wallets

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The Financial Conduct Authority (**FCA**) and Payment Systems Regulator (**PSR**) have published a joint Call for Information on the opportunities and risks that digital wallets such as Apple Pay, and Google Pay bring to consumers and businesses. This Call for Information follows on from the recent work on mobile payments and digital wallets. Specifically, the PSR had previously examined contactless mobile payments and how these impact consumers' choice of payments options (2018) whereas the FCA had previously reviewed the use of digital wallets as part of its discussion paper and feedback statement on big tech entry and expansion in retail financial services (2023) and the Call for Input on data asymmetry between big techs and firms in financial services (2024).

Digital wallets have become a key part in the recent evolution of the payments landscape. They are a popular, easy, and convenient way of paying for many people, with more than half of all adults in the UK using them. Both regulators have a keen interest in this sector and see recent trends as presenting both risks and opportunities, particularly in terms of promoting competition and innovation. The findings are likely to influence the regulatory landscape and debate in the UK.

What is in the Call for Information?

The PSR is particularly interested in how digital wallets impact consumers' ability to choose between different payment methods at the point of sale. They are interested in understanding if digital wallets, particularly those operated by big tech firms, create unfair competition dynamics or barriers to entry for other payment service providers, thereby restricting consumers' choice. The PSR is also looking into how digital wallets could facilitate account-to-account payments, which could serve as an alternative to traditional card payments.

The FCA have expressed some preliminary concerns in relation to digital wallets' ability to affect financial resilience and systemic risk in the broader financial system (e.g. in circumstances where they could suffer from an operational failure or outage). The FCA is also scrutinising the extent to which the current regulatory framework is effective, so that digital wallets develop and work to promote the best interests of service users.

Both the PSR and FCA are engaging with the Competition and Markets Authority (**CMA**) to ensure a coordinated approach towards regulating digital wallets, especially under the new digital markets competition regime created by the Digital Markets, Competition, and Consumer (**DMCC**) Act 2024.

Types of digital wallets

Digital wallets can differ significantly, including in the types of payments they enable. Some are designed for retail transactions, like in-store contactless payments or online purchases, while others facilitate peer-to-peer payments, or even offer mixed capabilities. Some of the most common subcategorisations of digital wallets are the following:

1. Digital wallets using NFC chip v. wallets using QR code or barcode technology

   The technology used by digital wallets can vary significantly, with some of them using the mobile device's near-field communication (**NFC**) chip to communicate with POS terminals (in a similar to contactless cards), while others deploy QR code or barcode technology.

2. Pass-through v. staged wallets

   Based on whether they do hold funds themselves, digital wallets can either be pass-through or staged wallets. Apple Pay and Google Pay are typical examples of "pass-through" digital wallets as they **convert** user card details **into secure tokens** for mobile payments without storing funds themselves. In contrast, PayPal is a "staged wallet," capable of **storing funds** that can be transferred between PayPal accounts. While Apple Pay and Google Pay primarily rely on card scheme networks such as Visa and Mastercard for settlements, PayPal offers a way to pay that follows a two-stage process, where funds are first added to the digital wallet in the form of e-money and are then transferred from the payee's digital wallet account to the recipient's digital wallet account at the point of purchase.

3. Digital wallets that are linked to a user's debit or credit card v. digital wallets that are connected to a bank account

   According to the payment instrument they are connected to, digital wallets can either be linked to a user's debit or credit card or be directly connected to a bank account. Digital wallets that are connected to a bank account often facilitate account-to-account (A2A) transfers by using regulated open banking payment methods.

Features that could impact competition, innovation and service users

Alongside understanding the range of benefits that digital wallets have, the PSR and the FCA are also interested in understanding whether there are any features of their supply that could cause harm to consumers, businesses, or any other service users. In this respect, the UK regulators are scrutinising the likes of, respectively, Apple and Google with a view to understand whether the fact that these players operate their own mobile ecosystems is something that could potentially stifle competition by raising barriers to entry to alternative digital wallet providers.

As indicated by some recent enforcement action, this topic is not new to the UK (or EU) regulators. For instance, the European Commission accepted commitments from Apple to address competition concerns related to NFC access on iOS devices, previously reserved exclusively for Apple Pay. Apple accepted legally binding commitments to allow rival wallet providers in the EEA to access the NFC technology on iOS devices free of charge. The FCA and PSR have also shared similar concerns, although no final decision has been made in relation to this topic.

Both regulators are now seeking feedback on various issues that may shape their regulatory approach vis-à-vis the big tech firms that have expanded in the payments space. This includes examining (i) whether practices that restrict access to mobile device functionality, such as NFC, raise barriers to entry for digital wallet providers, and/or (ii) whether these practices can be justified on the grounds of security benefits and convenience. The CMA, which has long examined mobile ecosystems, will also play a crucial role. With new responsibilities to promote competition in digital markets, the CMA is expected to work closely with the FCA and PSR in the development and rollout of the relevant regulatory framework for digital wallets, as well as through the Digital Regulation Cooperation Forum.

Unlocking account-to-account payments

One of the PSR's stated strategic priorities is to promote greater competition in and between payment systems, including by unlocking the potential of A2A payments as a viable alternative card payment. The regulators have recognised that despite the potential benefits of A2A payments, such as reduced transaction fees and improved payment speed, several barriers to widespread adoption remain. According to the regulators, one key issue is functionality. A2A payments must be quick and convenient, with robust dispute resolution processes in place. This needs high operational and technical standards to ensure reliability and security. Additionally, a commercial and regulatory model that fosters competition and innovation is essential. Such a model should incentivise providers to invest in and adopt A2A payment solutions.

Another significant factor is the integration of A2A payments in digital wallets. While digital wallets in countries such as China (e.g. through WeChat Pay and Alipay), and several European countries have successfully incorporated A2A systems, there does not appear to be similar levels of adoption for A2A in the UK market. In this respect, the PSR is keen to understand to what extent a potentially increased use of digital wallets could also drive a more widespread adoption of A2A payments in the UK as well. This includes an evaluation of potential barriers such as the need for new infrastructure investments (e.g., QR code readers) and a determination of whether existing infrastructure such as POS terminals can support A2A transactions.

The regulators have further noted that there might be certain blockers behind a more widespread adoption of A2A payments. These include financial and regulatory challenges. By way of illustration, digital wallet providers that currently earn a commission from the initiation of card-based payments would need to recoup these fees if they were to offer A2A payments. Additionally, integrating A2A solutions may require digital wallets to become FCA-regulated payment initiation service providers (PISPs), which could involve significant compliance costs and operational changes specific to the UK market.

The PSR is also investigating whether the fees involved in A2A payments, the commercial agreements underlying digital wallet usage, and the choice of underlying payment systems could impact the competitive landscape. Questions about whether consumers would prefer using one digital wallet for multiple retail settings or different wallets for specific transactions, and how payment information would be secured, also appear to be crucial in shaping the future of A2A payments.

Next steps

The FCA and the PSR are inviting stakeholders to respond to the call for information by **Friday 13 September** and intend to provide an update on their work by Q1 2025.

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