EU electronic payment strategy

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What does digital transformation mean for European payments?

The European payments industry is undergoing profound and substantial change. Its main driver is the wide-ranging digitalisation of almost all areas of business and everyday life. The increasing digitalisation will affect European payments along various dimensions:

- As ever more business moves to the digital space, payment solutions will need to adjust to the evolving needs of users, who are increasingly expecting instant execution of payment and seamless integration into digitalised business processes and end-user applications. In some EU countries, this development has contributed to a marked decline in the use of cash;
- The unprecedented availability of data, coupled with fast-evolving AI and ML techniques, has enabled new business models driven by data analytics. As payment data are inherently valuable, the payments industry has become increasingly attractive to non-traditional data-savvy firms whose business models rely on the monetisation of data rather than on fees;
- Technological innovations, such as cloud computing and new API-focused IT infrastructures, combined with regulatory reforms, have significantly lowered entry barriers to retail payment markets. As a result, new players, such as young FinTech start-ups and large global tech firms, are now competing – as well as cooperating – with traditional payment service providers (PSPs);
- In an interconnected world that offers virtually unlimited opportunities to obtain information and do business, online platforms that efficiently match demand and supply play a key role. This crucial role is further accentuated by strong network effects and significant economies of scale. For platform providers acting as intermediaries between supply and demand, integrating the payment process into their product range is a natural step.

While these developments have the potential to enhance efficiency and user experience in European payments, they may also pose a number of serious challenges.

Cyber resilience of electronic payment services is bound to gain ever greater importance. The market entry of large tech firms that rely heavily on data-based business models may not only fundamentally challenge the current economics of payments but also raise significant privacy issues. Key players in the digital economy, such as online platform providers or smartphone producers, may act as gatekeepers to digital payment services and use their market power to the detriment of payment service users. >>>

>>> Moreover, even five years after the completion of SEPA, the European payment market re-mains fragmented along national borders. To date, intra-EU cross-border retail payments at the POS and in the increasingly important area of e-commerce rely heavily on non-EU providers. As well-positioned foreign tech companies leverage their large user bases and offer their services throughout and beyond Europe to exploit network effects and economies of scale, they may become increasingly become a factor in domestic payments as well.

The political implications of this dependence of the EU retail payments market need to be investigated more closely. However the trend towards open banking might further boost com-petition and innovation in the European payments landscape. In addition, new solutions based on instant payments could support the independence and sovereignty of European payments.

The EU payments market is on the verge of a sea change. For European PSPs it is crucial to now plot the right course in order to deliver safe, efficient and user-centred pan-European payment solutions and remain relevant now and in future. While, now that SEPA Instant Payments has been developed, the necessary basic infrastructure is already in place, it is now up to European PSPs to develop such pan-European solutions.

Importantly, these private sector endeavours have to be supported by a regulatory framework that ensures that the openness and competitiveness which characterise the EU payments market will allow pan-European players and solutions to thrive and not unduly favour large, global companies with wide networks. ●

Paolo Marullo Reedtz

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Will new POS payment solutions replace cash? The Italian perspective

App-based payments, contactless transactions, e-money wallets and payment initiation services: the payment ecosystem is changing rapidly. While innovations are spreading far and wide, divergences in the use of cash or electronic instruments persist among European countries. Although Italy remains a cash-based country, promising developments have emerged recently, spurred by technological innovation and the new legal framework supporting security, efficiency and transparency in digital payments.

The growth rate for electronic transactions is in double figures, at 11 per cent in 2018 with respect to 2017. Payment cards remain the most widely used instrument, experiencing 16 per cent growth in 2018. The Italian debit card scheme is launching a new project, Bancomat Pay: tokenized debit cards will be used to pay via a smartphone; the same app will allow transfers between individuals, whose their accounts will immediately be debited/credited. We expect a further increase in the volume of proximity payments (especially for contactless applications) and through Remote POS.

The growth of payment cards has been favoured by both the diffusion of c-less technology and the implementation of the IFR regulation. The latter, according to estimates carried out at Banca d'Italia[1], appears to have contributed between 30 to 40 per cent to the increase in merchant acceptance observed over the last years[2], spurred by a reduction of merchant fees. Studies on the impact of the IFR on cardholder fees are in progress: anecdotal >>>

>>> evidence seems to indicate an increase in fees for consumers to compensate the reduction in the interchange fee. Other studies have remarked[3] that the pass-through between interchange and cardholder fees is not perfect, given that consumers can change payment service provider more easily than merchants can. In any case, the IFR has increased transparency and competition, fostering more balanced pricing models.

Further boosts for developing POS electronic payments in Italy can come from the operation of limited circuits. According to PSD2, merchants may issue instruments to pay within limited circuits: there are no supervision requirements but there are reporting obligations to competent authorities when transactions exceed €1 million. So far in our country, 86 companies (i.e. big retailers, vending machines) have sent reports. The total value of transactions within limited circuits in Italy is around €15 billion on an annual basis, accounting for over 6 per cent of the total value of card transactions. Data confirm customers' readiness to pay with electronic instruments if they are easy to use, convenient and well promoted.

Although the use of POS instant payments (i.e. SCT Inst) is still in a start-up phase, we expect new developments in the near future if the industry adopts more appropriate business models (the service cost is currently an issue) and implements additional value added services (i.e. payment guarantee mechanisms in the event of error and fraud).

Finally, innovation in security is a key driver for all new developments. The widespread use of new security features has resulted in a decrease in fraud rates over the last few years in Italy and Europe[4]. Confidence in digital money is indeed crucial to replace cash. ●

1. Source: Bank of Italy, banking statistics.
2. Source: Bank of Italy, banking statistics.
3. European Commission (2006), Sector Inquiry on retail banking – Interim Report I Payment Cards, Brussels.
4. See ECB 2018 (Fifth Report on Card Fraud).

Kari Kemppainen

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European payment landscape in a change

Digitalisation is shaping almost every sector of the economy enabling new ways of doing things by digitising old, often manual, processes. Payment services also belong to this category: in recent years numerous new digital payment applications have emerged in retail payment markets but the underlying payment infrastructures have remained almost unchanged. Nevertheless, technological advances combined with increasing competition enhanced by regulatory changes will shape retail payment markets in the coming years.

Regarding the European payment markets, three forces are likely to shape the market in the future: i) new service providers, ii) new products, and iii) new regulation. First, we have already witnessed steps taken by new service providers (i.a. BigTech and FinTech firms) to enter into the European payment markets. Second, we have also seen a multitude of new payment products, mainly new payment applications, being offered by both newcomers and, to a certain extent, also by incumbents. Third, this development has been enhanced by the updated Payment Services Directive (PSD2) aiming at increasing competition in the payment markets.

It is very likely that the effects of these three forces will further materialize after the complete adoption of the PSD2. This evolving new environment will set up new requirements and competences to authorities for safeguarding the security, reliability and efficiency of payments. It is important to bear in mind that payment business is heavily based on people's trust that their payments are executed and delivered in a reliable and secure manner no matter who is the service provider.

Therefore, it is crucial that all payment service providers and systems are properly supervised and overseen by the relevant authorities also in this new environment.

At the same time, it must be ensured that there remains a level playing on supervisory and oversight requirements imposed on service providers so >>>

>>> that the competition landscape is not distorted. As more and more service providers seem to come outside of the traditional financial sector, it could be advisable to move on towards activity-based regulation over the entity-based regulation. This would prevent the emergence of competitive distortions in the payment markets. When building the future regulatory framework for payments, we should make sure that it accounts for the inherent network economic characteristics of these markets. These characteristics lay ground for a "competition–cooperation" prevailing in these markets. On the one hand, competition among payment service providers and systems is needed in order to have contestable markets. On the other hand, a certain degree of cooperation is required in solving the chicken-and-egg problem and achieving user critical mass for new payment products.

Recognising these network characteristics is essential to ensure that "socially efficient payments" are available and usable throughout the whole society also in the future. To this end, an adequate dialogue among payment service users, providers and authorities must be possible. Therefore, multi-stakeholder bodies, like the Euro Retail Payments Board (ERPB) and national payment councils, will play an important role in the future digital payment world. ●

Klaus Löber

Head of Oversight,
European Central Bank (ECB)

New providers, new products and new technologies call for a new approach to oversight

Technological innovation in financial services – often referred to as fintech innovation – has led to the introduction of new financial products and services by both incumbents and new market entrants, especially in the field of payments. Regulatory, and in some instances legal reforms have helped to open the market to new payment service providers able to compete with their established peers. While new technologies, such as distributed ledger technology, are still at an early stage of development, they offer many opportunities while challenging some of the basic concepts of the current regulatory approach.

Change has so far been incremental, and existing regulatory, supervisory, and oversight approaches have served their purpose well. Complacency should nevertheless be avoided, and authorities must be prepared for more disruptive developments going forward. Developments taking place in the field of crypto tokens serve as a good example of this guiding principle. Ten years after the arrival of Bitcoin's open source software, this year's release of the Libra white paper and its open source software could be seen as a watershed moment. Originally envisioned as an accessible and borderless way to pay, first-generation crypto assets have generally suffered from severe price volatility and limited capacity to process transactions compared with existing arrangements.

Consequently, they function primarily as risky investments or a niche payment instrument, and have not achieved a scale that could entail a material imprint on the payments and financial system. New types of settlement tokens labelled "stablecoins", such as the aforementioned Libra, seek to reduce volatility by anchoring the "coin" to a reference asset (e.g. a sovereign currency) or a basket of assets. While the issuance and usage of stablecoins to date have been limited, a number of new stablecoin initiatives backed by large technology companies or financial institutions could have the potential for widespread adoption, both for retail and wholesale payments.

A global stablecoin for retail purposes could in theory pave the way for faster and cheaper remittances, spur competition in payment services and thus lower costs, and support greater financial inclusion. In this regard, stablecoin initiatives highlight the need to step up ongoing public and private efforts to upgrade existing payment systems.

As a fairly nascent product, stablecoins are largely untested at scale in a real-world environment. Moreover, they give rise to a number of serious risks relating to public policy priorities, particularly anti-money laundering and counter terrorist financing, as well as consumer and data protection, cyber resilience, fair competition and tax compliance. They may also raise issues relating to monetary policy transmission, financial stability and the smooth functioning of and public trust in the global payment system. As large technology or financial firms would be able to leverage vast existing customer bases to rapidly achieve a global footprint, authorities must be vigilant in assessing the risks and implications of stablecoins for the global financial system.

Given their potential impact, authorities are following these developments closely. A G7 working group is currently assessing stablecoins in coordination with the relevant standard-setting bodies, the G20 and the Financial Stability Board. As regards digital innovations from a broader perspective, the Committee on Payments and Market Infrastructures has established a dedicated working group on this topic. The Eurosystem is taking a leading role in this international work. As a result of these trends, it has taken steps to review its oversight policy approach and to start developing a new framework for the oversight of payment instruments, schemes, and arrangements (PISA oversight framework).

Upon finalisation, the PISA framework will replace the current oversight framework for payment instruments and will complement the oversight of individual payment systems and/or the micro-prudential supervision of payment service providers with aspects that are relevant from a payment scheme and arrangement perspective.

This new holistic, agile and future-proof framework is designed to apply to traditional and new payment products, providers and technologies alike, and contribute to the safety and efficiency of the overall payment system. ●

Sujata Bhatia

Senior Vice President & General Manager for Global Merchant Services Europe, American Express

Towards a pro-competition & outcome-oriented EU payments strategy

It is an exciting time for payments in Europe. With a backdrop of rapid developments in everything from instant payments, to open banking and e-commerce, the European Union has the opportunity to lead the world in regulation that promotes innovation and truly serves consumers. But to be most effective, and unlike some of its antecedents, new regulations should be genuinely pro-competition and outcome-orientated, focusing on achieving specific objectives (e.g., fraud rates to stay below a certain level or expanding the single market for non-bank payment services) without mandating any one particular solution (e.g., two factor authentication) or business model (e.g. restricting the ability of payment institutions to passport payment services involving the extension of credit).

The payments industry shares that outcome-oriented ambition, and over the last decade has driven increasingly frictionless payment and more effective, unobtrusive, security to European consumers. There have, however, been a number of recent examples where policy-makers could have taken a more strategic approach, taking into account the complex interdependencies in the payments eco-system and the potential for innovative technology to provide a solution to existing problems, rather than locking in old tech or shutting out smaller, innovative market players.

One particularly potent live example is Strong Customer Authentication (SCA), where from mid-September new rules will come into play). Here, those complex interdependencies in the payment's ecosystem have caused significant problems, not least since Payment Service Providers cannot control the entire payment process and must rely on merchants to implement many of the necessary updates. While the objectives of SCA are one standard industry solution, an outcome-orientated approach, allowing market participants greater flexibility in finding solutions, could have achieved the same objective without the disruption that many merchants are currently facing to implement SCA rules.

"The European Union has the opportunity to lead the world in regulation that promotes innovation and truly serves consumers."

- SUJATA BHATIA

The review of the Interchange Fee Regulation (IFR) provides another opportunity to foster electronic payments in the E.U. But for that to happen, the European Commission needs to take a different approach in comparison with previous years. While the IFR created many opportunities, arguably it did not achieve many of its core objectives in terms of increasing competition, innovation and choice in the cards market. Price regulation is a blunt tool, and should not be seen as the way forward, nor should big-tech be excluded from bringing innovation into payments. Rather, introducing for example new mechanisms that would improve the transparency of merchant fees would help competition by allowing merchants, especially smaller ones, to compare the full cost of accepting cards. Similarly, from the consumers' perspective, adopting a full ban on surcharging across the E.U. could be beneficial and would also tackle fragmented rules in the single market.

As we have seen with Open Banking, where regulation is both pro-competition and takes a flexible outcome-orientated approach, the European Union can be a leader in global payments innovation and regulation. ●

Bobby Chadha

Head of Fin-Tech Labs, Banco Santander

Towards the future of fair and competitive digital payments

As the debate intensifies over rules of the game for digital payment services in a digital age, a thorough reset of the financial services regulatory and policy environment is required. As a guiding principle to foster a prosperous and inclusive society, rules for the digital economy should lay the foundations for fair competition that encourages a diverse economy and avoids excessive concentration of economic power.

Consumers and businesses demand instant payment solutions that provide a good customer experience with global reach. The EU should foster a solution with these features:

- Availability (365x24x7) and Speed (instant settlement for low-medium value payments, commitment for "same day" for the rest). Payments below a certain value between countries deemed to have equivalent compliance standards, should benefit from proportionality.
- Reachability. Instant connectivity also for payments originating outside of Europe, including direct connectivity for non-European participants, which may need to comply with collateral requirements.
- Addressability. Provide secure address systems throughout Europe >>>

>>> to reduce fraud and other risks based or linked to a personal identifier that is independent of the bank account number. This will facilitate switching.
- Single European Register. Europe needs a pan-European repository where instant payment services can match an email address or phone number to a bank account.
- Interoperability. Real time transactions, traceable end-to end.
- Fees. Transparent, predictable fee structure with no hidden fees.

"As a guiding principle, rules for the digital economy should lay the foundation for fair competition."

\- BOBBY CHADHA

As payments are the most frequent interaction with customers in digital finance, the regulatory framework should also be holistic. Key areas to be addressed now are:
- All payments providers should be subject to the same standard of accountability and responsibility in anti-money laundering, security, privacy and consumer protection.
- Banks' payments units that do not take deposits should be treated like those of non-bank payments providers. Activity-based rules should be put in place and the additional layer of prudential regulation be eliminated.
- Just as they do in the context of PSD2, users should be empowered to share their transactional data with companies across different sectors to ensure fair competition, increase choices for users and opportunities for businesses. Combining payments and non-payments raw data such as online searches, purchases or travel, banks and other players can provide better, safer, more targeted products and services, including more lending to SMEs, enhancing competition and consumer choice.
- Any payments platform that becomes a systemically important financial markets infrastructure should be regulated and supervised as such to safeguard financial and economic stability. Given the propensity of platforms to dominate in their respective spaces, we risk creating a too-big-too-fail payments provider without too-big-too-fail regulations and backstops.

Banco Santander offers competitive, safe and efficient payment systems wherever we operate, to foster financial inclusion as part of our responsible banking commitments. We are accelerating the development of our retail peer-to-peer payments services, ensuring our 144 million customers can pay easily in a simple, personal and fair way. We believe all these initiatives will ultimately help people and businesses prosper.

Tim Keane

Chief Operating Officer,
Western Union Payment Services Ireland

Financial inclusion in a digital world

Financial inclusion is close to my heart and that of Western Union. The company was founded in 1851, when the New York and Mississippi Valley Printing Telegraph Company was formed to build a telegraph line from Buffalo, N.Y., to St. Louis, Mo. Overcoming geography was the foundation of our business. Today, Western Union offers fast, safe and secure payments in all but a few countries and territories in the world, including in regions where there is conflict, natural disaster or no traditional banking or other financial services network.

Western Union operates within many cultural contexts, following our customers as they move to where they find employment and ensure they can support their families and communities back home. Increasingly we also support small and medium size businesses in their aspirations to expand globally. This helps integrate many individuals and companies into the wider global economy, brings opportunities for greater inclusion and fosters social mobility.

Technology is becoming an increasingly important part of our lives. What does this mean for Western Union and financial inclusion? Technology, such as the wide availability of mobile phones, makes it easier for people to connect. Technology therefore plays an important role in fostering financial inclusion. It is of course important that the access to these technologies is not restricted but made widely available.

"Technology therefore plays an important role in fostering financial inclusion."

\- TIM KEANE

Western Union has adapted to this new reality by offering mobile and online remittance services. The proportion of remittances sent via such services is continuously growing. Nonetheless cash remittances still remain very important. Technology also helps us to improve our services, be it around fraud detection, the know your customer requirements or meeting our reporting requirements. All of these are important cost drivers in our industry and any efficiency gains will have a positive impact on our service delivery.

Technology also has its challenges. It brings choice to our customers and fosters competition. It can open the door to new channels of fraud or introduce new ways of circumventing detection. EU regulation needs to keep up with these challenges. Allow me to make a number of concrete suggestions.

The EU should:
- ensure regulation is technology neutral and designed to encourage investment in new technologies;
- enable the use of eID for cross-border transactions;
- adopt an activity based approach to regulation meaning new providers should be subject to the same rules thus ensuring a level playing field;
- ensure that core functions, such as anti-money laundering requirements, cannot be outsourced without a clear allocation of responsibilities.

Pia Sorvillo

Director of European Affairs, Visa

Partnerships will define the next generation of retail payments in Europe

The payments market in Europe is unique for its combination of technology, consumer trends and regulation. Whilst fragmentation between markets remains, as in many sectors, digitalisation is helping to erode the traditional barriers to commerce and allow goods and services flow more freely across national borders. In doing so digital payments have evolved from a convenient and secure way to pay, to open payment networks providing new opportunities for growth and have attracted interest from FinTech and BigTech players. These players may in turn adopt data driven business models which poses new challenges and considerations for regulators.

Irrespective of the direction of travel for payment networks, the true driver of industry trends remains consumers. Commercial partnerships have been a staple part of the digital payments landscape for some time to offer new services, and target new customer bases, around the world. As an example, Visa partners with European banks and innovative FinTech firms to offer payment solutions which leverage our best-in-class fraud detection capabilities and cyber resilient network. These partnerships keep European consumers up to date with some of the safest and most innovative retail payment technologies.

Innovation brings challenges as well as opportunities, particularly where the pace of technological change is both fast and novel. Digital payments are one such area. There are a number of buzzwords which, whilst not new ideas, are increasingly cropping up in conversations about the future of retail payments. "Crypto assets", "digital fiat currencies" and "real time payments" to name but a few are entering the conversation alongside the traditional card payment experience. These are welcome additions to the payments landscape but do not yet offer the same level of consumer protection.

These new areas are evolving fast, and in all regions of the world, which is why a different type of partnership is encouraged. One between policymaker, regulator and innovator to make sure that this global landscape is understood – both in terms of risks and opportunities – and can thrive in Europe.

"Growth in Europe will require partnership between industry and policymakers."

- PIA SORVILLO

Partnerships are a feature of the digital economy but to truly promote growth and innovation in Europe partnerships must involve more than commercial relationships, and include dialogue between industry and policymakers. The cycles of evolution in these emerging digital payment networks is rapid, and a new approach to policy is needed to keep retail payments competitive and able to expand. Policymakers should react to the emerging trends of digitalisation and take a holistic, and principle based, view to regulation which sets clear rules but provides flexibility to innovate. ●