PRIORITIES FOR THE NEXT EU LEGISLATURE IN THE PAYMENTS AREA

1. The changing market and the competition from BigTech

1.1. Increasing digitalisation and the use of data

A public representative believed that there are gaps in roles for dealing with customer data and keeping it secure. PSD 2 and GDPR are heavy-duty pieces of legislation that were drafted independently of each other and, as a result, do not quite marry up as well as they perhaps need to. GDPR asks for consent whilst PSD 2 asks for explicit consent. However, there is no guidance as to what explicit consent is.

1.2. Instant payments

Regarding innovation, a speaker noted that the hope is for instant payments to become a new norm in Europe. A Central Bank official explained that the ECB looked at the development in the market of payments. The main issue is an increased digitalisation of the way payments are made, how that affects the manner of paying in Europe today and how efficient it is within Europe. There was consideration of how the new generation of payment services should be developed in TARGET.

In the context where there were different projects and different enhancements of the current services, provided by TARGET 2, which settle the transactions of the financial market in Central Bank money, a new generation of payments, an instant settlement function called TIPS, introduced in TARGET. is being developed. A landscape is being developed that will allow each bank to have good access to Central Bank money and have an optimal use of their Central Bank liquidity for the diverse purposes in the financial market.

The capacity to manage liquidity will be completely integrated for the whole area, in a domestic manner, with a single technical access, single network access and single process that allow a maximum optimisation in interacting using ISO 20022.

It is difficult to see how much the coming regulation will be able to catch up with all of the recent developments with the introduction of instant payment. However, that is being attempted with good coordination among the market participants and stakeholders. A contact group with the markets has been created.

There are attempts to allow innovation to flow in Europe and to allow innovative payment solutions to come to Europe. It is important to develop a context for innovation where it has certainty. In a digitalising world, without cash as a way to have the Central Bank 100% involved in the retail space, there needed to be a mechanism with digital transfer of retail payments available to citizens and integrated in Europe. That capacity has been allowed with TIPS. The aim now is for all of the banks to connect to TIPS for further services to the market.

2. The role regulation plays in the industry

2.1. Innovation versus regulation catching up with rapidly changing technology

A Central Bank official noted that payments have been regulated mostly with the aim of harmonising European payments in order to make a more competitive marketplace. On market dynamics, the whole regulatory burden placed on banks since the financial crisis should be considered. The regulatory changes are always mandatory for the banking sector and, depending on the bank's capability for making revenues, there is the question of how much room there is for innovation and business development.

It takes years to write regulations like PSD 2 and the technical standards. The more rapid the technological change, the more challenging it is for authorities to keep up. The question is what the incentive is for the banking sector to invest in innovation. A major concern is whether such actions are making payments an unattractive business for the existing players, opening the market for institutions which are not tied by all of the regulatory burdens that the banks are.

If there is room for it, innovation comes from outside the banking system. The competent authority responsible for technical standards has indicated how challenging it is to understand the new technologies coming forward and to meet the requirements with regulations and technical standards.

An industry representative queried whether there is a need to be more proactive. The industry needs to help policy-makers to understand the products, though it will be difficult for that dialogue to be structured around anticipating issues rather than trying to solve problems. Regulating technology might stifle it. Sometimes regulation with the best intentions can generate unintended consequences.

A public representative noted that there has been a suggestion that explicit consent can take the form of a clause in a contract, but the lack of clarity leads to banks erring on the side of caution to avoid fines or breaching. There is a need to establish answers to questions on where liability resides, what consent is and whether due diligence needs to be done before transferring information. High-profile breaches will allow case law to be established and guidelines to be written. That is a slightly controversial approach, but it will provide some needed clarity for the market.

Strong Customer Authentication (SCA) is a fantastic area where there also still needs to be plenty of guidance from regulators. From the industry perspective, all parties in the ecosystem are struggling to get to terms with the regulation. This ambitious framework that has very long-term implications is not sufficiently clear even today, five months from the SCA entering into force. PSD 2 is a maximum harmonisation tool, but that may not be achieved, at least not in the short-term, because without clarity each jurisdiction can take the approach that makes sense in a specific context.

An industry representative stated that payments are at the core of the trust-based relationship of banks and their customers. That relationship is the banks' most valuable asset, so much attention should be paid to anything that might endanger it. Banks are not experiencing any specific demand from customers regarding a potential new European scheme. That may be because customers do not limit their payments to the Eurozone.

A speaker noted that the new payment services directive will soon come into force, and queried whether the market is prepared, especially the smaller merchants. An industry representative explained that six years ago their organisation started with the very simple idea of making money digital and electronic. Today it is looking at new innovations and what consumers are asking for, which is to pay in the way they want whilst being safe and secure. It decided to be an open platform as it is convinced that cooperation and partnership are key to helping the industry to be innovative and to shift from payment with plastic cards at point of sale to payment with mobile, with your watch and IT using tokenisation. To be successful in the next decade, there is a need to continue to listen to, anticipate and understand consumer demand in order to be able to create what consumers expect. The changes in the next few years will be more material than those of the past decades.

The industry has a significant responsibility. PSD 2 means increased security, but consumers acting to pay the way they want cannot be forgotten. Internet of Things (IoT) is coming. With IoT devices and wearables there remain open questions. The industry has to help consumers advance, but regulators have a responsibility to ensure the regulatory landscape will be shaped in a way that reflects the new dynamics.

A holistic approach should be taken, and the current position should be considered before any new legislation is adopted. A 2018 McKinsey report indicated that the opportunity for digital payments in the next years in Europe will grow to $750 billion. From a policy perspective, there should be consideration of where the weights are placed.

An industry representative noted that in any case, PSD 2 has catalysed the activity required in the financial industry to learn about the technology, deploy it, etc. If banks are going to take their place in these digital ecosystems and provide value, they will need to change large parts of their business model and the way they think.

2.2. The impact of PSD2 and interchange fee regulations (IFR)

An industry representative explained that IFR and PSD 2 are complementary and were enacted together. The process of implementing them was not quite simultaneous, but as with any regulation there were some positive outcomes and some downside consequences.

One of the unintended consequences is the result of the open access provision of PSD 2. It was intended to increase competition amongst the banks and acquirers in the Visa and MasterCard modelled networks. However, it does not fit with closed-loop payment networks and three-party schemes. For a small percentage of transactions, it sets up what is effectively a franchise operation. That is true in Europe and other countries around the globe. The open-access requirement would have forced three-party companies to fundamentally shift their business model toward a four-party scheme by letting all acquirers and all banks onto the network. Three-party companies chose instead to end that portion of its business, which resulted in roughly 7 million card members being phased off of the network, therefore diminishing competition.

A second impact concerns merchants, particularly on the interchange fee regulation. There has been a reduction in the cost of acceptance. However, some of that benefit has been eroded by price increases. Indeed, there has been some disparity between the benefits that large merchants and smaller merchants have seen. For the next round of regulation, transparency of pricing and pricing increases would make things easier, particularly for small merchants.

The third, consumer-focused, area is surcharging. The last round of regulation prohibited surcharging in most, but not all, instances. It left to the member states a choice as to how they want to address the remaining transactions that are not banned EU-wide. Markets have taken different approaches. For the next round of regulation, and for consumer benefit so that they are not surprised when moving from a market to another one, similarly surcharging the consumer for those transactions would be beneficial as well.

A Central Bank official noted that the interchange fee regulation is a global trend whereby the burden on merchants is growing significantly. The only way for consumers or merchants to make right decisions is to have sufficient transparency on the fee structures. The SMEs should be treated somewhat differently from large companies because their capabilities are different.

An industry representative believed there is a need for an impact analysis on Multilateral Interchange Fees (MIF) because it is unclear whether the lower fees that have been passed have a direct impact on customers.

In terms of reduced cost, an industry representative noted that there is a recent study from the Bank of Italy which indicates that the cost for merchants has been reduced quite substantially, by 22%. The missing element is the impact on consumers. There needs to be more transparency in analyses. Interchange fee regulation needs to be measured against impact on the banking sector, the merchant sector and the consumers as well as the evolving dynamics of the market.

2.3. Ensuring a level playing field for market participants and avoiding unintended consequences

Regarding the safety of data, an industry representative stated that GDPR regulations should be imposed on all actors that gain access to the personal data of customers through the payment change. It is the same for the new CLOUD regulations. There are regulations and consequences from GDPR which impact banks' ability to use big schemes. It is very difficult to have an open discussion with the big American actors, because they do not want to take the GDPR regulation into account in the way they manage the cloud-services.

A speaker asked whether an argument can be made that banks also benefit from the customer data that an independent payment service provider does not have access to, such that they can provide their own additional services. An industry representative agreed that is correct. However, a service like Airbnb can make great use of all of the information on the use customers make of its own services. That is different in the banking sector, which is quite limited in its ability to use the personal data of customers.

Regarding the variety of business models, an industry representative noted that it is important for Europe to ensure a level playing field among all actors. The new actors in the payment industry have a very dynamic use of the data that they capture through the payment system, to improve their core business. They can then under-price the service of payment and compensate with the added value that they create on their own business. That business model is not open to banks. It is important, when planning the future of payments in Europe, that all of the different actors receive equal treatment.

Regarding the risk, it is also a matter of the independence of the Eurozone and ensuring there is not 100% dependence on non-European actors in the field of payments. An industry representative explained that there are currently discussions on a potential new European scheme. However, there is no demand coming from the customers themselves in that field. One suggestion is to make sure that all actors in the payment system are submitted to exactly the same groups.

A Central Bank official noted that a functional approach to regulation is very important. However, even though the discussion is not about introducing a card scheme for Europe today, there is an intuition that customers want to be able to pay globally but be independent from a global scheme. It seems that there would need to be an alternative scheme in that case.

With instant payments, there is a solution which can help in developing routines and probably capacity to pay, which can probably integrate the world of cards with the current national schemes. It could have a connection to a solution like TIPS, which would allow it to have the pan-European reach in Central Bank money instantly while using the card as a means of identification or allow better management of fraud.

Having a European approach without creating a card scheme will eventually open the room to a card scheme without having to restart a big project that is difficult to lead in the field. It could bring an answer to the dilemma of having capacities to pay outside, but also with a European way of doing so. That is how independence is preserved. The international role of the euro, which is at the top of the agenda these days, will also be preserved and would allow for development of internal capacities.

One question is also how the competition traditional banks and service providers face from big technology firms from outside Europe, and the use of platforms for payments and other financial services, will affect the payments market.

A Central Bank official explained that it seems that the data is more interesting than the payment and queried what will happen if the payment as a business is not interesting. Banks often say that they are going to provide a platform for different service providers. The payment provision or the service provision, which is linked to payments, are going to be provided by various entities and the bank may just provide a platform for them.

When banks say that they may provide a platform for various services, they also say that in the future they would actually join another platform. There is then a question of who will provide the payments and whether they are providing them for the payments' sake or for the data's sake. There is also a question of who is liable for doing what, requiring to know who is providing the service so that it is known who is liable if something goes wrong.

3. Future developments for the industry

3.1. Standardisation and the development of APIs

A public representative believed the right rules are in place. However, there is an expectation that in September there will be a seamless transition into open banking, and everything will be fine, which is unlikely. Open banking is a process that is being worked through and has only just started.

The first hurdle to overcome is application programming interfaces (APIs). There are many banks in Europe, many of which are small. Not all of them will have developed fully functioning APIs by September. It is up to the member states and the national competent authorities to determine what a good API is, what a bad API is and how to resolve that. There is little guidance there. Feedback will be required to develop the standards and fine-tune the framework for open banking to function.

Regarding standardisation, an industry representative stated that with the CMA 9[1] there has already been a slight rehearsal in the UK of what might be expected in September with PSD 2. The bulk of the banks are ready, but perhaps not ready enough and not as interoperable as they might have been. This concerns large companies that are hyper-connected and doing business with one another, the way that is growing and the share of the economy that it is making up. There are figures from McKinsey showing that $60 trillion in annual revenues is expected to be distributed through these kinds of actors by 2025. That is a third of the year's total. Businesses are combining and interacting in a way that has not been seen before.

One thing that all of these players share is that they have a need for financial services. The institutions that are going to service them are going to have to meet them where they live, which is in the cloud. It is about being able to provide 24/7 digital services that are easier to integrate. Financial institutions that get past the compliance aspect of PSD 2 and start to recognise that this is transformational and puts them in a good place will start to realise some real benefits by being able to fit into these ecosystems and apply these APIs.

A Central Bank official added that that is being attempted with the Euro Retail Payment Board (ERPB). A scheme on how the API, in context, could be broadly defined in a harmonised way by the industry, and not by regulation, is being attempted. Consultation among the industry to define a scheme for APIs broadly could be a way forward.

The bank will have to invest in new technologies. The digitisation is there, whether it is liked or not. Globalisation is there as well and therefore there needs to be integrated solutions that reuse the same technology. Those technologies could also be reused beyond Europe thanks to ISO 20022.

There is collaboration across Central Banks, at least for Central Bank services, in the G20 and CPMI contexts. This also brings value to the investment, which can be made here and reused there. Consultation is the way forward; a scheme for APIs found together with industry will help everyone.

A speaker suggested that there might be a more general question when it comes to new standards for all sorts of innovative new services and the new technologies that can be used, about how to find the right balance between the regulators setting the standard and the industry coming up with a solution on its own. The question is whether Europe has the right balance.

An industry representative suggested that for APIs a way is being found going in one direction and then the other. However, at some point the right balance between what needs to be imposed at the regulatory level, what can spontaneously come from the industry and what structures are needed to achieve that, will be figured out.

A Central Bank official noted that the ECB has three ways in which it can act: it can regulate, operate or be a catalyst for change. Typically, in this circumstance it is a catalyst for change. It is not there to regulate. It needs to create a dialogue among the different parties of the industry to find an appropriate scheme for APIs that services both parties and is able to deliver something useful for the market.

3.2. The amount of investments suggests leveraging more evolutive standards

The euro systems were early adopters of the norm ISO 20022[2]. The lessons learnt from the standardisation of the SEPA and international payments, suggests a need for standards in the API space as well. They have been allowed to evolve so far. There have been various different actors involved in trying to corral the different implementations.

Instead of having rigid standards that cannot be changed, the EU needs data standards that allow ecosystems to coalesce and inter-operate cleanly, rather than having to constantly have break points where different organisations actually have different interpretations. It is a new world, but it is also a continuation of the old world. It is something where, from a standards perspective, there needs to be improvement.

An industry representative explained that the difficulty banks are facing with the new regulations is the cost of implementation. The costing for the core banking system and IT is very large. In a context where there are already a number of investments to be made and other regulations and demands from the supervisors. All of these new burdens have to be coped with. It is understood that it is ultimately the best thing for the system as a whole. However, a hierarchy between all of these investment needs should be created. The industry is just coming out of IFRS 9, which was very demanding for all of the teams in the banks and for the IT systems. All of these investments need to be furthered, and it is quite a challenge for banks in the low interest rate environment.

A speaker believed investing and providing those new services will be inevitable because competitors will offer them. A Central Bank official noted that there has been agreement on the SEPA subset of ISO 20022, but it was not accepted before strict regulation was made that the standard has to be implemented. The question is whether that will happen with the PSD 2 APIs. There are technical standards, but they are quite broad. For anyone who wants to connect to the account-holding bank, it has to be tested bank by bank.

An industry representative believed the SEPA example is a good one. It did take an imposition. The hope is that that will not be needed in the case of APIs, and that the industry can converge over time to allow the necessary level of interoperability. One of the difficulties with SEPA is that the standard that was implemented is the same today as it was at the outset. It has been very difficult to make that service evolve as a result, though there is some evolution coming.

With the notion of digital ecosystems and cloud-based businesses that the industry is trying to serve, the added flexibility from the API technology is needed. However, it cannot be a free-for-all either, so there has to be a middle way. One area of experimentation is having standards less rigid than the messaging standards from before, where what the data is going to be is exactly specified. There may be reusable building blocks, based on ISO 20022, which allow the data to be easily tagged, validated and passed on. Everybody in the value chain will understand what it means without necessarily rigidly imposing what will be transported.

3.3. Lowest-cost, faster and ubiquitous payments will extend the demand and reduce cash and cheques

One issue is how the competition between card payments and services based on instant payments, is seen for the future. An industry representative suggested that there is so much activity in payments because there is a blending of commerce and payments. When the first charge cards were created, they were replacing cards or accounts that were used for specific merchants. It was connecting and creating a global marketplace where general-purpose card products could be used everywhere. Today the marketplace is creating its own payment solutions. Apple, Amazon or Alibaba are creating a large marketplace. They create a unique payment institution that can be the dominant or favoured player in that marketplace.

In those countries where instant payment has been introduced that competition is not really taking place. Card payments continued to develop progressively while instant payments were catching up, even in countries where they started quickly, like England, Denmark and Sweden. Those mechanisms are complementing what is already available, rather than replacing card payments. They are answering a use case which could have been answered by cards or a normal credit transfer.

At some point, there will probably be some payment done today by default in one way or another. Cheques, physical payments and payments that cannot be done due to a lack of capacity are good examples. Parents could wish to give money to their children who are far away but not be able to do so in real time.

There are new capacities and new use cases offered. They are answering consumer needs that were not there yesterday. Cards have a lot of value in all of the anti-fraud technology that has been developed with them. With cards it is clear who is paying, whereas instant has the speed of settlement. They can be complimentary and offer use cases that are not available today. If someone wants to be in control of their cash flow in a secure and convenient way, that can deliver a very good service to the consumer. How this comes together is an important development. There is a competition element, but not only that.

Combining the lowest-cost payments and the faster payments initiatives that are taking place in Europe and other areas of the world, will extend the demand. However, one question is whether there are solutions where the interoperability of market schemes becomes a competitive alternative. Another is whether they compete in some of these marketplaces and provide value to both the online and offline solutions. It can be asked whether they provide value that the consumer can see in other forms of payment. There is room for it, but some demand has to be found.

Competition in network industries is very challenging because the value of the payment scheme as a network is directly linked to size. It is very difficult to compete with a vast network without a network; that is why social media networks have been promising candidates.

Layering the convergence of offline commerce and online commerce on top of that, for existing payment systems to maintain relevance and provide value to the consumer, requires accessing the benefits they have with the full relationship with both the merchant and the consumer. It can be asked where value for the merchant can be combined with value for the consumer, and if the data can be used in a way that marries the two and is beneficial to both. Regarding the ease of payments, especially when the easiness regards credit, the flipside is the cost of adapting, which needs to be tackled when looking at the rapid development of ubiquitous payments[3].

Cash is still needed in order to give a benchmark for electronic payments, because cash is an instant settlement, completely technology neutral and always works when someone has it. That is also a very good benchmark for electronic payments in the future.

An industry representative stated that whatever a consumer needs makes sense. Today that is security, convenience and being in control. Even if a consumer is paying for their fridge, they want to know where their money goes. They want to know what happens if whatever they order with their fridge does not get to their door and what their protection is. Today there is a lack of clarity. The ultimate goal should be driving innovation and digitalisation of payments. $17 trillion is spent globally on cash and cheques. This is something that needs to be tackled. Provided the consumer is asking for it, there is security, resilience and other important points. However, there is no innovation that could be trusted unless there is heavy investment in cyber resilience.

3.4. Innovation goes hand in hand with cyber security challenges

Indeed, cyber resilience is an issue. Central Banks see a role for cash going forward. The question is whether instant payments will become electronic cash, and whether consumers can be sure that they are in control of where the payment is going and that it is always secure.

A Central Bank official agreed that cyber is very important when speaking of digital and agreed with consumer needs covering security, convenience and control. If Europe is moving on instant payment, with part of the market being covered by a Central Bank settlement service, that is because there is belief that the marketplace may be out of control. The trust in the currency should not be jeopardised by a non-bank's outside space that Central Banks cannot control, so the way the banking system is working is the best way to ensure the trust and the security in the functioning of the currency.

1. In the UK the Competition and Markets Authority (CMA) found in report that the market is "still not as innovative or competitive as it needs to be". In response the report outlines a package of remedies which includes mandating that larger banks (CMA 9) adopt and maintain a common standard for open APIs (Application Programming Interface).
2. ISO 20022 is a methodology, which can be followed when creating financial messaging standards.
3. Ubiquitous payments enable consumers to pay through any Internet-connected device present anywhere.