EU ELECTRONIC PAYMENT STRATEGY

1. The digital payments landscape

1.1. The digitalisation of payments offers wide-ranging opportunities

The digitalisation of payments offers wide ranging opportunities to make payments easier and faster, better integrated into daily routines and safer. As the provision of payment services is a network business, some tech players taking advantage of global economies of scale could gain a substantial market share. A number of fintechs have emerged as new competitors but, for the time being, are still dealing with the challenge of reaching critical mass. At the same time, open banking may be a game changer in Europe. People are asking who will win and who will lose, and if it will all end up in a competitive single European market.

A Central Bank official stated that regulators and supervisors need to make sure, in a coordinated fashion, that risks associated with these developments, such as operational (including cyber) risks, legal risks, financial risks, as well as concentration and systemic risks) are addressed. Adequate governance arrangements and effective oversight must be ensured. The objective should be to safeguard a competitive and innovative European market for secure, efficient and user friendly payment solutions to blossom.

1.2. In the EU single market traditional, sometimes domestic, payment channels cohabit with emerging technologies

Another Central Bank official described this as an intriguing moment and potential game changer, as opposed to the more incremental evolutions seen in the past. A wider range of new business models and technologies offer undisputable benefits. New services are being contemplated for efficiency and user convenience, though some envisaage similar results from enhancing traditional payment channels.

A Central Bank official sees three forces shaping payment markets in Europe: new service providers, new products and new legislation. The tech giants have taken their first steps into European payment markets, bringing new payment applications with them, while the underlying systems have remained more or less the same. Most payment applications still use traditional card payments or credit transfers. However, this central banker disagreed with an earlier panel that emphasised the coming revolution; their feeling was it is more likely to be an evolution. Payment habits are traditional and have been slow to change in Europe.

New payment applications have demonstrated a trend for integrating payments seamlessly into the underlying economic transaction. Taking ridesharing companies as example, there is no need for the user to pay any attention to the payment act. This could be a good thing, but might also lead to overconsumption. The Finnish Payments Council has been worried about the levels of financial literacy and education in this changing landscape and has made some effort to encourage consumers to pay closer attention to the potential dangers of new payment applications.

1.3. Regulators target innovation, undue fragmentation, pan-European reach and trust

A central banker argued that the regulatory approach must remain technology neutral and provide a level playing field for incumbents and newcomers.

One critical aspect that needs to be closely followed is the potential both for fragmentation and concentration. This is not a contradiction. In European payments, one still often witnesses a dominance of national players and no EU-wide provision of services. Any new solutions being developed should adopt a pan European reach from the outset and leverage harmonised standards. Besides the fintechs, the tech giants could also cause disruption by locking users into existing platforms. This would exacerbate the fragmentation just mentioned. The attention of regulators is clearly needed here.

Another central banker described payments as a business of trust. It can take a long time to build up trust, but it can be lost very quickly. Central banks want payments that are secure, reliable and efficient – in that order. An industry representative is concerned that the narrative of recent months appears to position regulation as the assassin of innovation, which is a crude and inaccurate reduction. The industry welcomes regulation: it builds standards, creates clarity, sets rules and establishes trust.

This industry representative related how the Libra announcement precipitated a great deal of debate and put a spotlight on access and financial inclusion. It remains the view of some in the industry that there is no reality to an unregulated global payments rail. Much of the discussion of Libra has focused on the enabling technology, which is unfortunate, because it is really about the use case; the technology has been around for years. Regulation needs to be adaptive to keep pace with the threats and opportunities posed by technology and ensure it ultimately benefits consumers, who are becoming increasingly choosy about the services they use. There is a move away from networks with many consumer connections and towards value-exchange mechanisms – if not Libra, something like it. There is nothing like a seism to galvanise the various stakeholders into action.

An industry representative asked how to ensure that consumers are at the heart of every decision when a new payments concept is being built. It is important to take a step back sometimes and talk to consumers. A significant change is occurring in people's financial behaviours, and it is important for everybody to keep pace with it, whether they are part of a bank or regulated institution. The industry has to move fast, but also needs support from regulators and supervisors to ensure those in the payment business are being controlled fairly. Larger incumbents can only innovate faster if the focus of regulators will be on activities rather than on entities. Banks cannot innovate a product if treated like a core banking product.

Most banks are in favour of making international payments easier. Having an available, instant, trustworthy and safe service is key. For people using payment services every day, there is a need to cater for what is natural. It is not natural for an 18 year-old today to be searching for an IBAN, swift code, account number or bank address. Sending money should be as simple as sending an email. These types of leaps forward are necessary and possible.

1.4 Financial inclusion should also remain a priority

There are compelling reasons to move away from cash and into digital payments, but care should be taken to ensure that the benefits do not outweigh the societal costs of excluding the economically vulnerable. Globally, about 1.7 million adults do not have access to a bank account. While innovation can address the needs of consumers, it should do so regardless of their place on the financial spectrum. The industry must be mindful of this as the pace of innovation increases.

2. How the architecture of payments is evolving in the EU

2.1. Open banking should further level the playing field notably making all the sources of data available

There has been much debate about the benefits of open banking. It is clear to one industry representative, from talking to customers, that other sources besides banking data make a difference. If one applies for a loan, bank transactions and statements form only part of the decision. There are many other crucial sources out there. Consequently, it is important to apply this same lens to non-financial data and focus on making these sources available. Open banking is one piece of the pie; there is much more needed.

Another industry representative is excited about the potential of open banking to change the payment landscape, encourage more competition and spur innovation. It is the most dramatic shakeup of the industry in years. Some good has happened already, as well as some unintended consequences. Costs have certainly come down, but unevenly. Large merchants have benefited most. Small merchants are seeing some reductions, but these are being offset by scheme fees and annual charges. There are barriers at the point of sale, where the regulations have been implemented unevenly. This creates an un-level playing field, lack of transparency and a bad customer experience. This industry representative therefore does not believe the goal to increase competition has been accomplished. There are no meaningful new players in the region and the small players are struggling to achieve scale.

Open banking regulation ought to be focused on levelling the playing field. This can be a great platform for Europe to be more advanced than any other region of the world but, so far, the pace of change has been slower than expected. To encourage choice and competition and allow market forces to take hold, the system needs stakeholders, merchants and consumers to have better visibility of what they are paying for. A complete surcharging ban would create a good customer experience at the point of sale and drive adoption of payments, so it is critical, in this industry representative's view. Smaller players would be more encouraged to enter the field if they knew they would be able to scale up, while traditional financial institutions would need to sharpen their focus more on the customer experience.

2.2. In the payment applications area fragmentation is increasing

One central banker argued that the payment market is becoming more fragmented, at least in the diversity of applications. Choosing which application to use when hundreds of alternatives exist appears impossible, so there needs to be convergence. Whether that comes from the tech giants, new efforts by the banks or the fintechs remains to be seen.

2.3. The evolutions expected in the EU card market

A central banker reminisced on the critical moment when the first Payment Services and Directive (PSD) and Single Euro Payments Area (SEPA) projects were initiated. The number of transactions supported by these two pan European initiatives is growing fast, even across borders, but the SEPA Card project was not a success. Card payments are still highly fragmented in Europe and national schemes cannot be used in other countries. European citizens can only use their debit cards abroad thanks to co-badging with international schemes.

The service-level offered by international card schemes does not appears poor at all. Cards are accepted everywhere – physically, electronically and globally. The business case for change is not appealing to European communities, given the low number of cross-border transactions.

However, there is more concern for the card payments market in the longer-term. When domestic card schemes are replaced by international variants, competition may gradually reduce, concentrating powers in the hands of a few entities. European intermediaries and institutions would have little control over the development of the market. There are advantages from increasing the cross border acceptance of national schemes or developing a new pan-European scheme.

An industry representative compared trends in consumer card payments to those for digital payments. Some dramatic developments have already been seen and more are likely over the next few years. By 2020, there will be over 20 billion connected devices, and the story about paying at point of sale will no longer be true. Almost everybody now has a smartphone or drives a high tech car able to make payments. There is increased access to cheaper technology and a consumer appetite to make this a market opportunity worthy of development. However, the secret ingredient to ensure the rise of digital payments will still be trust. Consumers need to retain control and will get what they are paying for.

All panel members were asked how long people might continue using plastic cards to make payments. Two central bank officials and one industry representative anticipate plastic only having a few years left, while another central banker thinks the answer depends on the type of payment. One industry representative noted that their card is not plastic anyway. Plastic is just a form factor. Others commented that consumer behaviour should be allowed to decide the answer, and these vary depending on the jurisdiction. More relevant is what lies behind the plastic, which is a powerful, global, secure service able to cross borders.

McKinsey recently carried out a study that predicted the volume of digital payments will rise to €750 billion worldwide. Some 55% of this will be outside the traditional rails, meaning neither the banking nor card sectors. The regulators need to make sure that they are looking at the right landscape, whether at incumbents or disruptors. Some big traditional players are already working with the smaller innovators to provide new capabilities across their existing networks.

2.4. Instant payment volume is still limited

Some commentators are speculating that cards might diminish in relevance given instant payment opportunities. On the other hand, contactless payments themselves seem to have spurred electronic payments.

Given that SEPA instant credit transfer is by design a pan-European payment scheme, the volume of transactions still seems lower than expected, which may be related to banks' need to bear the burden of adapting to the second PSD (PSD2). In any case, the industry can revert to the traditional SEPA instruments. A central bank official highlighted two specific areas on which the industry and regulators can act: first, user friendly solutions should be available at the point of interaction; and, second, a clear legal framework must be established that protects consumers. The possibility of instant credit transfer in the c2c domain calls for improved protection measures to reassure the user. These could come either at the contractual level, in refund arrangements, or through regulatory initiatives. A balance between the two has to be found in this basic framework.

3. The policy priorities for a future payments area

3.1. The success factors for defining an efficient regulatory framework for payments in the EU

An industry representative urges caution with respect to consumer protection. Over the next five years, any legislation in place in Europe should be consolidated and be shown to have demonstrated its effects before being amended. PSD2 is a complex and ambitious project that still needs to be tested. In addition, regulators have to employ principle-based legislation that understands the needs of consumers, the industry and the market, and reacts to them. Finally, the regulators should act to prevent fragmentation, which also means avoiding data localisation.

Another industry representative welcomed the increasing trend towards harmonisation in the Commission's anti money laundering (AML) packages. The landscape is fragmented and this creates challenges in operating across borders. It is important to address cyber -security risk in the context of consumer protection and fraud. Increased international cooperation is needed within a defined legal framework that permits the exchange of relevant information. This area needs improved focus over time, as it is currently being hamstrung by the prevailing legislation.

A further industry representative explained that, ultimately, costs from the current regulation have come down, but better transparency is also needed so that the entire market can have free choice. This representative also felt that some fragmentation is needed so that smaller players can break through, fostering competition. One- size-fits-all regulation fails to encourage new entrants that might offer customers a better experience at the point of sale.

A central banker argued for regulation to adapt to new situations. It must be activity and not entity-based and, if possible, technology-neutral. There should be competition and cooperation at the same time to find out which payment solutions are socially optimal, available and easily usable. This can be discussed by payment system users, providers and the relevant authorities at other established bodies, such as the Euro Retail Payment Board.

A Central Bank official reported that authorities already cooperate closely on payment services. They can leverage their experiences of regulatory measures in the field, such as the PSD or, to a minor extent, the E-Money Directive, in moving this forward. There is also a case for regulators and central banks to be more innovative in their approaches towards regulation, such as taking a more functional approach. These discussions have outlined how a functional approach may allow existing regulation or oversight to extend to a new arrangement, such as Libra.

With this in mind, The EuroSytem is undertaking a review of its oversight approach towards framework for payment instruments, schemes, and arrangements. In this context the current oversight frameworks such as credit transfers, card payments, direct debits and e-money schemes are being reviewed, taking into consideration new developments. The aim is to develop a more holistic, agile and future-proof oversight framework for payment instruments, schemes, and arrangements.

3.2. Meeting operational and cyber resilience challenges

With the advent of global players, there is also a need for even closer global cooperation across authorities and central banks. They can promote a framework that addresses the risks and challenges being posed to a safe payment ecosystem. The industry is investing massively in cyber and operational resilience, which are even more essential when the payment is untethered from the point of sale.

There can be no compromise on this if payments are to remain simple, secure and speedy. Operational resilience is key. The bad guys are working globally, and companies too have to share their data to anticipate fraud patterns, which tend to repeat across different regions. Regulators were told to think twice before implementing an initiative on data localisation.