

Does the EU need to build its own payment system?

1. The evolving payment landscape

1.1 Dematerialisation, disintermediation and fragmentation

A policymaker outlined the significant pace and scale of innovation of the dynamic payment sector. The act of paying has become less visible and increasingly dematerialised and disintermediated. With digitalisation and changing consumer preferences, cashless transactions are increasing. The COVID 19 pandemic has further accelerated the shift towards digital payments.

Despite substantial improvements provided by the Single Euro Payments Area (SEPA) and the harmonisation of national payments legislation, the EU payments market remains significantly fragmented along national borders.

1.2 The influence of big tech companies

A policymaker highlighted the dominance of global payments players in European cross-border payment transactions, reinforced by the entry of big techs into the payments sector. By benefiting from significant economies of scale and network effects, as well as vast access to their consumers' data, these tech companies are challenging established providers. Moreover, with the advent of asset-backed cryptoassets, they may soon be offering disruptive payment solutions based on encryption and distributed ledger technology, which can present risks for consumer protection and financial stability if not properly regulated.

Apart from large global players, such as worldwide payment card networks and big technology companies, there is virtually no digital payment solution that can be easily used across Europe to make payments in shops and in e-commerce.

2. The European Payments Initiative (EPI)

2.1 Aims

An industry representative explained that 16 banks are currently involved in the EPI, which is aiming to promote independence and sovereignty in payments. At the moment, there are different payment habits amongst European countries, which are exacerbated by the influence of domestic schemes. The EPI is intended to bring about convergence and to create a unified method of paying throughout Europe. The European Central Bank (ECB) and the European Commission are helping the EPI thrive, and this influential support from regulators and policymakers will need to continue.

A public representative underlined the importance of addressing the fragmentary differences between local markets across the EU and of creating a global player that could challenge the incumbent companies. In that regard, the EPI is a step in the right direction.

A Central Bank official stated that a pan-European solution should be usable in various payment situations and via various initial channels, such as cards, smartphones, and so

on. It should also have a pan European reach and European governance.

2.2 Status

A Central Bank official stated that, with the press release in early July the EPI reached an important first milestone, but there is still a long way to go. There are still questions about whether the initiative will succeed in developing a viable business case based on a solution that is suitable for card-based as well as smartphone-based payments, and whether it will achieve a real pan-European reach.

In terms of common payment routes the use of instant payments, which are already built on the pan European SEPA routes, are recommended. With the addition of a mandatory connection to the TARGET Instant Payment Settlement (TIPS), the European Payments Council (EPC) in cooperation with the euro system, closed the last gap has been closed in the pan-European reach by 2021.

2.3 Membership

An industry representative and a Central Bank official stressed that, while the EPI is a private bank-led initiative, it is certainly not a closed and exclusive club. They hoped that more organisations from different countries will join it, especially smaller banks, non-bank acquirers and payment service providers (PSPs). At the same time, it is important to ensure that no weak links are onboarded into the process that would compromise the robustness of the EPI.

2.4. Centralised versus domestic aspects

An industry representative stressed that the EPI is currently construed as one central entity but that the processing will not be centralised. The EPI will not act against the local processors.

Another industry representative stressed the need to find a smart solution and a combination between national processing items and the centralised aspect. It is clear that national systems need to be migrated to a common European system. This is a question about the infrastructure and its migration into something bigger; it is not only about cooperation. The easiest way to convince all the customers and the banks to migrate and to cooperate with other players in Europe is to base it on standards and common infrastructure methods in a centralised space, which also needs to be invested in collectively. Centralised investment, combined with the infrastructure and standards coming together from a national starting point, will allow for the migration to a centralised solution. This will help Europe develop world-class players.

An industry representative warned that market participants and banks in each country will need to accept the consequences on their domestic schemes that the EPI will bring. The EPI is not about the interoperability of domestic schemes but rather it is a pan-European scheme. Resources and talent currently applied to domestic schemes will need

to be redeployed to ensure that the EPI becomes a reality in each country.

3. Competition

3.1 The need for a level playing field

A public representative stressed that payment systems are evolving very quickly. Digitalisation is completely changing the experience for retail investors and the EU should be proud to act as a pioneer of open finance with the Second Payment Services Directive (PSD2). However, these welcome innovations should not be at the expense of the protection granted across Europe. In its recent capital markets union (CMU) report, the European Parliament underlined that a level playing field between traditional and innovative players is crucial to protect European sovereignty and European citizens. Similarly, Europe needs to build its own international payments system. Dependency on non-European actors is detrimental to the independence of European foreign policy decisions and Europe's strategic autonomy.

3.2 The importance of consistency and cooperation

An industry representative stated that his organisation's strong national position would not be enough to secure its future and it would need instead to become a pan-European player. More cooperation with all the other banks in Europe is therefore required. The EPI aims to achieve this, but it needs help. A fair playing field is essential to compete against the oligopoly of the big techs and the international card system (ICS). These players have greater access to customers within closed ecosystems and they are able to generate a great deal of money that can be invested into marketing and product development.

The banks by themselves do not have the same opportunity to make the investments necessary to develop pan-European players. Help is therefore needed in terms of a fair playing field. The situation is even more challenging because of the interchange regulation, which has resulted in all the players in the value chain increasing their profits with the exception of the banks. Those that have increased their profits have done so to a significant degree and are accumulating more power and are creating a stronger oligopoly situation while the banks are losing their profits. The banks want to invest in the EPI but they need help in the form of legislation to do so.

A Central Bank official called for pan-European solutions for retail payments. A healthy amount of competition in the market is beneficial for the customer, and the initiatives in question should apply a holistic approach.

An industry representative stated that the EPI is still at the beginning of its journey. A level playing field versus the ICS is required to ensure that the initiative can come to fruition with no barriers to entry for newcomers.

Consistency is required in terms of industrial policy. There has been a great deal of noise about central bank digital currencies, which could compete as an alternative to the EPI. Fortunately, a number of central banks have said that they would not apply this to retail.

3.3 The concern over additional regulation

An industry representative stated that the announcement from the Directorate-General for Competition regarding the interchange will help finance the investments that are required to make the EPI happen. There is still some concern, however, over the regulatory 'creativity' that is still possible. Banks are currently having to cope with the impact of PSD2 in terms of customer identification and so on, and they do

not wish to spend more money and energy in coping with a potential PSD3 or other 'creative' ideas.

3.4 The impact of tech companies

An industry representative stressed that banks are dependent on mobile devices from international companies in accessing their customers because these devices are now essentially 'remote controls' for the lives of the customers. These big tech companies may allow large banks with strong market shares to provide services through their devices, but this is not necessarily the case with the smaller banks. It is important to ensure that these mobile devices are open to everybody.

The big technology companies are also using artificial intelligence, machine learning and data collection in order to deliver better customer experiences and to create better business models. Financial institutions have to knock on their door to ask whether they are allowed access to that knowledge. This makes it very difficult for the banks to build better business models and to generate profits. The only solution to this is cooperation between European banks on standards in order to attain scale at the European level, alongside legislative support.

4. The Commission's priorities regarding the EU retail payment strategy

A policymaker stated that the Commission will unveil its retail payment strategy together with the digital finance strategy. As the retail payment sector is at the forefront of innovation in finance, the Commission believes that it requires specific and targeted policy measures that go beyond the horizontal scope of the digital finance strategy. The Commission's aim is to create an innovative, integrated and more competitive retail payment sector in Europe. It is hoped that, in due course, there will be homegrown European payment solutions that can be used globally. The capacity to drive cutting-edge innovation, with European solutions able to compete with global players, will determine Europe's autonomy. European sovereignty is a major strategic objective for the Commission, and payments have a major role to play in this respect.

Instant payments are an important area of the strategy in order to support the emergence of pan-European solutions. The Commission is teaming up with the ECB in their role as payment system operator and catalyst. Currently, even the strongest European operators have to work with large non-European operators if they want to offer pan-European payments. The Commission is determined to change this and intends to do so by leveraging the opportunities offered, in particular, by instant payment systems.

Beyond cross-border instant payment solutions, the Commission also wants a vibrant payment services market where fintechs, such as those providing payment initiation or account information services, can thrive. All efforts are being put towards ensuring that PSD2 produces its full effects, in particular with respect to open banking.

The Commission also plans to address important restrictions on the access and use of certain technologies enabling contactless payment, such as near-field communication, which can undermine the development of the retail payments market and jeopardise the level playing field between banks and big techs.

Ultimately, it is hoped that this strategy will provide an opportunity to boost the international use of the euro and contribute to the global efforts to improve cross-border payments.

5. The role of legislation and regulation

A public representative stated, with reference to the Wirecard scandal, that European leaders in the field of payments will not be developed if trust is not rebuilt in the capacity of EU supervisors to spot clear breaches of law. Consideration needs to be given to the supervision of all areas related to payments, financial reporting, financial innovation, audit, anti-money laundering and countering terrorism financing.

A policymaker stated that the Commission believes that the Wirecard affair needs to be looked at closely. Building on the inquiry initiated by the European Securities and Markets Authority (ESMA), the Commission plans to take a stance on the issue in the CMU action plan. The scandal raises a number of complex corporate governance, audit and supervisory issues that need to be properly addressed.

A public representative stressed the importance of aligning the regulatory approach on payments with the broader picture in Europe, including the Digital Services Act and the ongoing debate on reforming competition policy.

There have been discussions with the Committee on Economic and Monetary Affairs (ECON) on the best approach to move towards more European integration while respecting nuances across Europe. A balanced view on this sensitive topic will be provided in the final own-initiative report on the CMU.

On one hand, cooperation between national authorities and European authorities is crucial, particularly with payments where several authorities are involved in every country. On the other hand, Wirecard shows that national regulators tend to protect their national champions. Reform of the governance of the European supervisory authorities (ESAs) is therefore needed, particularly by way of independent voices on the boards of the ESAs. It is hoped that Wirecard will be the 'last wakeup call' on this issue. In order to develop global leaders, true European supervision is required, which means that national sensitivities need to be put aside.

A Central Bank official explained that the current direction of travel is towards what is required for pan European projects like the EPI. There are many good proposals on the table but what is needed now is political action.

6. The role of central banks

A Central Bank official stressed that central bankers recognise the importance of the EPI project as it feeds into the promotion of European champions that are able to compete with global legacy and emerging actors. That does not mean that central banks have no role to play, however. The payment system has been built on a set of important principles. One of those principles is the coexistence of settlement assets with, on the one hand, private settlement assets dominated by commercial bank money and, on the other hand, central bank money. Central bank money plays a vital and anchoring role in ensuring the stability of the payment system. Central bankers therefore acknowledge the importance of understanding the dynamic and the technological evolution.

This is the rationale for the review of the conditions and the challenges of the introduction of a retail central bank digital currency. The review is currently underway by a number of central bankers across the world, looking into the ways to provide central bank money in the retail field.

Fragmentation, sovereignty and stability are the most significant challenges currently being faced. Addressing those challenges requires adapting the legal framework to disruptive technologies and actors with the triple objective of covering all legal and financial risks, sharing a level playing field with legacy actors and maintaining good financing conditions.

Europe does not host global social networks, which means that European authorities will need to develop a coherent and comprehensive European payment strategy in order to create a stronger, more independent and more innovative financial sector and payment system. ■