CURRENT EU RETAIL PAYMENT INITIATIVES: STAKES AND CHALLENGES

1. Retail payments in the EU: context and stakes

1.1 Most national retail payment solutions lack scale in the EU

An official noted the dramatic changes in the European payment landscape fuelled by COVID-19, the waning use of cash and new technologies like instant and crypto, in addition to the growing market dominance of digital platforms. Most payment solutions are still domestic. National cards or digital solutions for e-commerce or peer-to-peer (P2P) payments lack scale to compete with big techs from outside of Europe. There is a risk of a growing dependence on those.

1.2 Payments digitalisation has been accelerated by lockdowns

An industry representative highlighted the acceleration in payment digital alternatives and digital payments. This is primarily due to e-commerce, driven by the lockdown, and a change in customer behaviours, driven by a desire for a more secure experience at the point of sale. There has been an acceleration of the previous, already significant, growth in e-commerce. Cards in general have gained share at the expense of cash and bank notes. Use of contactless has been driven by the health authorities recommending usage and an uplift in the threshold. P2P payment system payments are also increasing in some markets. These changed behaviours will likely continue after the health crisis.

An industry representative commented that the last year would have been very different if digital payments had not been available. Economies need to be resilient, and payments play a vital role in this.

1.3 Regulatory challenges in the EU retail payment area to reduce existing fragmentation

A policymaker commented that the pandemic has accelerated change in the payment sector. The regulatory framework must remain fit for purpose. Despite the progress made on the harmonisation of the regulatory framework for payments in recent years, in particular the single euro payments area (SEPA), the retail payments markets in Europe remain fragmented along national borders. International card schemes are dominant in the cross border EU payment world, reinforced by the arrival of big techs. Risks of crypto-assets include issues of consumer protection and possibly even financial stability and monetary sovereignty if they are not properly regulated.

2. EU policy priorities

2.1 Eu policymakers are currently focused on fostering competition and innovation, EU payment autonomy, consumer protection, resilience, AML and instant payments

An official noted that legislators, central banks, regulators, and competition authorities are working towards a more appropriate framework for a resilient, innovative, diverse, and competitive payments landscape. This includes supporting emerging pan-European payment solutions, such as the European Payments Initiative (EPI). The market power of big techs, international card schemes and payment markets is increasing.

A public decision maker stated that fair competition and European autonomy are a priority. The impact of the Digital Markets Act (DMA) and Digital Services Act (DSA) is ongoing. The aim is to be fully aware of how services, including payment services, are used in the EU and to act to mitigate any dependency. The Payment Services Directive (PSD2) demonstrated that opening segments of the financial markets can be positive for consumers. Competition must be fair and should not disadvantage incumbent players relative to newcomers. For example, reciprocal access to relevant data should be pursued. New fintech solutions should respect European values and rules on consumer protection and anti-money laundering (AML). At the European level, action is being taken around dependency, for example the EPI and the Digital Operational Resilience Act (DORA). DORA ensures supervisors increase their awareness of their dependence on information and communications technology (ICT) providers outside the EU.

A policymaker stated that the specific and targeted measures in the retail payments strategy aim to create an innovative, integrated, and competitive retail payments sector in Europe. Instant payments play a key role in this strategy and can become the new normal in Europe. Enablers include adequate consumer protection measures, effective ways to address instant fraud and a smooth sanctions screening process. The European Commission does not intend to simply impose a date for the introduction of instant payments but takes a holistic look at the issue. A targeted public consultation is ongoing. The European Commission will then consider the possibility of a legislative proposal. A comprehensive review of PSD2 will be carried out.

2.2 Achieving an effective level playing field across the EU and developing the EU retail payment market agility, require further political efforts

An industry representative stated that driving the level playing field and ensuring competition has been a key objective of the latest batch of EU regulation on retail payments, such as PSD2 and IFR; however, it has not yet materialised, so it is important to get it right this time around.

2.2.1 Simplified licencing rules in the single market

An industry representative noted that the removal of the exception acknowledged by legislators in PSD1 on open access rules, led American Express to exit the licensing partnership in 16 European member states. The rules make it more difficult for innovative fintech players to enter the space and compete with dominant four-party schemes, which has directly contributed to less competition in the sector and was acknowledged in EY's IFR report last year. A one-size-fits-all approach does not make sense. The open access rules issue is important as it links to EPI, since a combination of parties might be required in order to make EPI work outside of Europe.

An industry representative stressed that openness is essential as the future is unknown and resilience is a key concern. Permanent pieces of kit that have the seeds of their own obsolescence in them should only be built very cautiously. Visa Europe used to be owned by 441 banks. There were no fintechs on board. There are now 200.

2.2.2 An effective ability of payment services providers to issue credit lines across the EU

An industry representative noted the disadvantage and unlevel playing field caused to non-bank PSPs by the restriction in PSD2, which says that Payment Institutions (PI) can only issue credit up to 12 months in their home member state. This severely restricts and places PIs at a serious disadvantage compared to banks when offering personal loans and credit cards, and further limits customer choice. Furthermore, consumers tend only to seek credit in their home market and not shop cross-border for credit. The lack of a cross-border credit market also undermines one of the Consumer Credit Directive's main goals and EU's vision. The upcoming review of the CCD is a good opportunity to fix this. How non banks or cross-border firms can access national debt registers should also be explored.

2.2.3 A swifter on-going adaptation of payment-related regulations to actual progress, technology, business models and markets is necessary

An industry representative commented that, since legislation started around 15 years ago, including PSD2 and Interchange Fees Regulation (IFR), the payment landscape has evolved. There are still some opportunities to be optimised, such as those around competition, transparency, choice for the customer, rules, and harmonisation.

2.3 It is also necessary to address the consequences of the Wirecard scandal regarding citizens' confidence in EU financial supervisors and regulators

A public decisionmaker stated that the Wirecard scandal has had a devastating effect on the reputation of the EU in the fintech space. Strong action is needed to ensure consumers retain trust in financial institutions, supervisors and legislators. The governance of the European supervisory authorities should be reviewed, not just the powers. Wirecard has cast serious doubts on what was thought to be an adequate architecture for supervision and cooperation at European level. The main message to the soon-to-be-chosen new leaders of the European Securities and Markets Authority (ESMA) is that the European Supervisory Authorities (ESAs) should be more ambitious and feel confident asking challenging questions of national authorities.

3. Respective roles for the private and public sector

An industry representative suggested that payments can be considered in a similar way to Maslow's hierarchy. Maslow talks about water, air and security. Security is also discussed in payments. The second level of Maslow's hierarchy is love and belonging. In the context of payments, it can be thought of as openness and access, which is what engenders competition. The last level of Maslow's hierarchy is about self-esteem or self-actualisation. The equivalent in payments is the things different people want from payments and how to engender the innovation that enables that. All use cases are different. The top of Maslow's hierarchy is where the private sector needs to thrive. At the bottom of the hierarchy, the public sector needs to be deeply involved in conversations around resilience, security, and fraud prevention.

3.1 Central banks are partnering with the private sector to close existing infrastructure gaps on the payment area

3.2 Wholesale payments are essential to make effective monetary policies

An official noted the role of central banks as providers of market infrastructure. A Central Bank official (Juan Ayuso) commented that market infrastructures are in some respects, like real-sector infrastructures as there are fewer than socially needed and usually the best way to fill in the gap is collaboration between the private sector and the public sector. Central banks however use central bank money to build the infrastructures. This material is the highest possible quality. The soundness of the infrastructure has a direct effect on the central banks' ability to fulfil the tasks they have been assigned. Wholesale payments are at the core of the monetary policy transmission mechanism, which may be why many central banks provide the infrastructure for wholesale payments.

3.3 The current fragmentation of retail payments in the EU requires Central Bank action

A Central Bank official stated that retail payments are not so crucial in the monetary policy transmission mechanism, but the Eurosystem has also been assigned the task of promoting the smooth operation of payment systems. When economic and monetary union (EMU) was launched, most retail payments took place within the boundaries of the different countries. As such, fragmentation at the end of the 90s was not a big challenge. It was more of a problem with the advent of the SEPA initiative. The current degree of fragmentation in retail payments in Europe is a serious obstacle.

3.4 While TIPS targets helping to achieve the European reach of instant payments and supporting cross currency retail payments, the private sector focus is on value-added services

A Central Bank official commented that central banks are better equipped to provide the rails, leaving to the private sector the provision of the value-added services. This is the principle behind TARGET Instant Payment Settlement (TIPS), the market infrastructure that Eurosystem provides for instant payments.

A Central Bank official stated that central banks are aiming to ensure pan-European reach for instant payments through the TIPS infrastructure by the end of 2021. All payment service providers in TARGET2 that adhere to the SEPA Instant Credit Transfer (SCT Inst) scheme will be reachable in TIPS. In addition, Automated Clearing House (ACH) instant payments settlement will move from TARGET2 to TIPS. The intention is to support the G20 roadmap on cross border payments. The Eurosystem is investigating what role central banks can play, for instance investigating the use of TIPS for cross-border instant payments in Swedish krona and euro together with the Swedish central bank.

A Central Bank official commented that payment service providers should offer instant payments under attractive conditions rather than treating them as premium services, and also with additional functionality being provided.

4. Data is a major issue for an efficient digitalisation of the EU economy

An official commented that data opens a wide range of new business models, but also drives the market power of digital platforms. Personal data must be protected while data monopolies are broken up.

A policymaker commented that data is an issue for competition policy. Potential data usage has increased exponentially, and data has already become an essential input for many activities. Those holding data may become gatekeepers. Big tech companies have access to increasing amounts of data and are attempting to gain a foothold in the payment market with this. In addition, platforms create network effects that may be detrimental to consumers.

4.1 Emerging strong network effects and data portability asymmetry and interoperability issues exist

A policymaker commented that data portability can be an effective remedy for anti-competitive conduct. The General Data Protection Regulation (GDPR) includes the principles of purpose limitation and data minimisations. In the context of open banking, PSD2 limits the kind of data and the purpose for which it must be provided. Competition and data protection concerns are complementary. Competition authorities have started using data protection as a benchmark for assessing competition.

The policymaker noted in addition the perceived asymmetries in regulations around data portability. Fintechs and big techs are not subject to the same requirement that banks are under PSD2. Interoperability is important so different ecosystems can provide access to data to different operators.

4.2 Private stablecoins require close monitoring to ensure populations benefit fully from them

A policymaker commented that the main advantage of private stablecoins from a competition perspective is that they bring efficiencies to payments. Consumers will benefit from more competition, leading to lower prices and more innovation. Populations that are currently unbanked may get increased access to payment methods. Private stablecoins may raise issues related to financial and monetary stability, AML and combating the financing of terrorism (CFT). EU legislation aims to embrace innovation through regulating and supervising crypto assets and to address security threats, for example in the proposal for DORA. Regarding competition between private stablecoins and central bank currencies, private stablecoins need to be monitored. There is currently no competition enforcement, but products such as Diem and Novi are being reviewed proactively.

5. EPI

5.1 EPI is an essential EU initiative

An official stated that EPI will better balance competition and contribute to European autonomy. European standards could be integrated throughout the payment chain.

5.1.1 EPI challenge for banks and success factors

An industry representative commented that interlinking existing national payment solutions has been found not to work. European or international players have more money for innovation and to convince merchants and people to use their systems. The European banks understand that there is a need to invest together to compete with the big players.

A Central Bank official stated that a main goal of the Eurosystem retail payments strategy is the development of a pan-European solution for payments at the point of interaction (POI). Other goals include the full deployment of instant payments, the improvement of cross-border payments and support of innovation and digitalisation in the European payments' ecosystem. Concurrently, the case for a digital euro is being explored.

5.1.2 The ECB and the Eurosystem have welcomed the launch of the EPI

A Central Bank official noted that EPI meets all the European Central Bank's (ECB) objectives. The ECB remains open to other initiatives that would meet its objectives. It is crucial that EPI extends beyond the current set of the participants.

The CEO of the EPI Interim Company commented that international competition is the biggest challenge in the retail payments space. Banks are being disintermediated, not just in payments but now in financing. European players cannot easily compete on innovation and new technology in payments but also in financing. The European market is still very fragmented, which does not allow European players to compete with international players. The business model for banks no longer enables the substantial investments that are necessary. Dependency is another challenge. EPI can address these challenges and aims to be a competitive European solution. EPI will bring the size to invest collectively in innovation. Aligning will overcome fragmentation, helping European players to become independent.

5.2 EPI's key success factors

5.2.1 Addressing first consumer and merchant needs and efficient decision making

The CEO of the EPI Interim Company stated that EPI includes 'the rules', the 'rails' and the standards, but also a value proposition that is meaningful enough to compete for the interest of the consumers and merchants. This will only work if the banks respect the needs of the merchant and the consumer. Alignments will provide efficiency and the synergies that are crucial to become more competitive. TIPS is already present, but the front-end side is also needed. EPI can contribute to the e-commerce and m-commerce spaces, where banks are underdeveloped and there is no European solution, and in the cross-border space. The evolution of EPI is a massive process. It is difficult and complex to align different markets coming from heterogeneous environments, potentially with diverging priorities, leading to some kind of nationalism.

5.2.2 A wait-and-see attitude of too many banks and payment service providers hampers swift progress regarding instant payment and EU autonomy, and weighs on the role of EU banks on e commerce

A Central Bank official commented that the attitude of 'If it is not broken, let us not fix it' leads to complacency. Europe has become dependent on international card schemes and banks have missed an opportunity to develop a presence in the e commerce space.

An industry representative stated that EPI needs help to develop a viable business model and reduce investment uncertainty. The regulator should prevent any attempts by market players to unfairly limit the rollout of EPI across Europe, as some of the big market players oppose EPI, and underline the importance of adopting the open international standards.

5.3 EPI's timetable

The CEO of the EPI Interim Company indicated that new members will be welcomed to EPI by the end of the year. A market launch is expected in the current year. The aim is to go live in 2022, initially in the P2P space and then in e commerce and face-to-face retail transactions. There will be a migration phase of a couple of years.

6. CBDC

6.1 CBDC should also support future evolutions of an EU digitalised economy

The Chair indicated that the Eurosystem and a growing number of central banks worldwide are considering the potential issuance of central bank digital currency (CBDC). CBDC could provide future proof payment solutions.

6.2 Among the various scenarios requiring Central Banks to issue CBDC many feature negative developments in retail payments

A Central Bank official noted that a recent ECB report on CBDC identifies seven possible medium-term scenarios, many of which include elements related to negative developments in retail payments. The back end part of CBDC infrastructure could or should be provided by central banks. The private sector could then focus on providing the front-end part of the service.