

# NEW EU RETAIL PAYMENT ERA: REGULATORY CHALLENGES AND INFRASTRUCTURE ISSUES

## 1. EU payment landscape

### 1.1 Competitive challenges in the payments area that trigger regulatory challenges

A policymaker remarked that the competitive challenges in the payments area are enormous, and that is probably what makes it so exciting and interesting. There is a very interesting combination of incumbent operators, some with a high degree of market power and who must fend off the competitive threat from new entrants. There are disruptive new entrants with new business models and new consumer experiences with which they can bring real added value, but some struggle to find their way and their position in the market. There are other new entrants that are, at the same time, disruptive and incumbents, namely the digital giants who are leveraging their market position on the data side.

The challenges for regulation and enforcement are numerous. One is more on the traditional side of regulatory and enforcement work, which is interchange fees. The Interchange Fee Regulation (IFR) has been hugely successful and has brought competition to Europe in the payment area. The question of whether putting a limit to interchange fees has resulted in an increase in other types of fees by international schemes is being investigated. The Commission is in the fact-finding phase regarding the revised Payment Services Directive (PSD2) and next year there will be a study. The Digital Markets Act is much more advanced and is now being discussed by co-legislators. This is starting from the point that regulation is also needed to ensure interoperability, non-discriminatory access and to prevent self-preferencing and the undue exploitation of data for a host of services, including payment services.

A public representative remarked that work is ongoing on establishing the Parliament's position on the Digital Markets Act in various committees. It should help to level the playing field between the financial services providers and the giant digital services providers acting globally. The Parliament will call for open access and for the ability to have much broader interoperability between those who are providing various digital services and those who are focusing on financial services.

For some of the other initiatives that are important for payment services providers, there is the Commission's digital financial services package from September 2020 and Parliament is actively discussing its position on the Digital Operational Resilience Act (DORA). The issue of crypto assets linked to the preparation for central bank digital currencies (CBDC) is also being discussed in the European Parliament as part of the work on the Markets in Crypto Assets (MiCA) regulation.

### 1.2 Efforts for broad reachability

A Central Bank official noted that in the second quarter of the current year 10% of all credit transfers were instant. However, empirical evidence shows that there

are huge differences between euro-area countries. There are a couple of very well-advanced countries and then there are others that are lagging. To unlock the full potential of instant payments, there is a need for broad participation.

There being differences in reachability in instant payments between countries impedes cross-border usability and may prevent instant payments from becoming a truly European payment instrument. Making participation in the Single Euro Payments Area (SEPA) credit transfer instant and mandatory for all euro-area payment service providers might seem like an easy solution to the problem, but a more holistic approach is needed. Even in countries with comparably low adherence rates, instant payments could be available to most customers if those banks that have signed the SEPA Instant Credit Transfer (SCT Inst) scheme have most clients. There are already several countries where nearly all banks offer instant payments but where the usage is still relatively low.

Payment service providers must ensure that attractive service offerings based on instant payments are available and convenient. The estimated share of instant payments is, according to European Payments Council (EPC) statistics, rising continuously. One of the most promising initiatives for a pan-European solution is the EPI, which heavily relies on instant payments. This can and should be a booster for the use of instant payments in the near future. Additionally, the Eurosystem will solve the SCT Inst interoperability problem at the back end of payments starting in November. It is no longer necessary for banks to be the client of more than one clearing house to reach all payment service providers, due to TARGET Instant Payment Settlement (TIPS) serving as an interoperability hub.

### 1.3 The ECB's strategy

A Central Bank official noted that the European Central Bank (ECB) published an explainer of its retail payments strategy in May 2021. A key element of the strategy, which was first announced in November 2019, is the full deployment of instant payments. An important aspect of that, where the ECB plays the role of operator, is in moving the automated clearing houses (ACH) from TARGET to TIPS to ensure that cross-border instant payments go through with the same ease as domestic ones. Banks also have to become reachable in TIPS as of year-end.

Another issue in cross-border intra-euro-area instant payments is compliance. Instant payments have a significantly higher rejection rate if cross-border, because of differing applications of anti-money laundering (AML) regulations and as compliance rules are not homogeneous. In normal SCT (SEPA Credit Transfer) payments things are manageable, but with instant payment there is no time for a manual intervention to remove false positives. Further pillars of the retail payments strategy are notably (i) the

improvement of cross-border payments and (ii) the support for innovation, digitalisation, and a European payment ecosystem. The latter also relates to legislative initiatives like reaping the full potential of PSD2, open banking / open finance, and electronic identity.

An industry representative agreed that instant payment will not be successful if the AML cross-border problem in the EU is not resolved. If consumers experience one out of 10 transactions being rejected, they will not use the process as their major payment means.

A Central Bank official added that the broader Eurosystem strategy also contains support for the continued usability of cash, which remains important. There are people who may also in the future prefer to not (or be unable to) use digital payments, and for those the availability and usability of cash should be maintained in any case.

## 2. Digital payment provides everyone opportunities

An industry representative stated that this is a new era, and it can be a European one because there are elements of what Europe has already put in place that put it at an advantage over many other regions. Over the past months, some of the opportunities have been properly grasped, including using digital payments to create virtual foodbanks when the physical ones could no longer exist, or giving the vulnerable and those who were shielding the ability for others to shop on their behalf. When businesses, particularly small businesses, digitise they can reach more customers beyond those who just walk through their doors.

### 2.1 Payment effectiveness and reliability

An industry representative remarked that in all the technical discussions about all the aspects there is a need to stay anchored on those elements that the EU has always focused on: consumer trust, competition and, increasingly, how to build a sustainable economy. With regards to trust, focus must remain on the core things that people expect, which is that whatever form of payment they are using works. The environment has changed from a cybersecurity point of view, even over the last three or four months. That is something that will have to be worked on by the private and public sectors together, and something where data is going to be increasingly important.

An industry representative noted that the biggest demands consumers have are for the system to work and for it to be secure. There are more requests on complete consumer protection, for example on merchant disputes. That is an area that is not developed equally everywhere or for all payment situations.

### 2.2 The single EU payment market and the Consumer Credit Directive

An industry representative suggested that one of Europe's biggest assets is the single market. Significant progress has been made thanks to PSD1 and PSD2. Though there remain some barriers and challenges, there is also a major opportunity by creating a single credit market, which would allow non-banking financial institutions to have a credit licence and be able to passport that licence across Europe.

In 2008, the objective of the Consumer Credit Directive was to create that single market. Unfortunately, it has not really materialised, and the Commission is launching a revision. There must be caution not to use too broad a regulation brush, which paints products that are very different the same colour. There is a need to distinguish between products that can drive indebtedness and bear a cost, and those that come for free and are not as risky from an indebtedness standpoint. The proposal to introduce a cap on interchange is concerning. It conflicts with the principle of open and competitive markets. The proposal to allow the 27 member states to determine, on a country-by-country basis, the formula that would define that cap would create unnecessary barriers.

### 2.3 Data ethics

An industry representative emphasised that the EU led in terms of the General Data Protection Regulation (GDPR) but the questions of ethics and how data is used need to be worked through. There are ever more choices for payments at point of sale, but that choice must be enforced because it does not always exist. Choice is important for competition and innovation, and in a world where resilience should not rely on single points. The brilliance of open banking is that it is not just about creating new financial services, but also about making the existing ones work better. Open banking, because of its use of data, is enabling a completely different experience that existing institutions, as well as new ones, can take advantage of.

A sustainable economy looks like an inclusive economy. All businesses should have access to some of form of taking digital payments. As society eases or lifts restrictions, the one constant is the need for a Plan B, and it needs to be digital. Equally, there must be consideration of the potential that digital gives consumers in terms of agency over their lives. What people do every day and how they shop is how they express a form of agency, and digital payments can increasingly allow that.

### 2.4 Enhancing customers' payment choice and control

An industry representative noted that consumers demand wallets or envelopes for all kinds of digital payments, including currency conversion that is easy, smooth and on demand, with the choice to determine which currency services to use and which payments to make. Whilst there is an appetite there is also a great deal of questioning about whether it is safe, so there is a need to educate consumers. Consumers want control. They want to be able to manage their finances and see immediately what is going on. The biggest overall challenge for instant payment will be the move from a cash and card world. Instant payments have to be introduced into the commercial environment. A whole set of digital rules need to be defined around liability, refunds and recharges.

## 3. Key success factors

### 3.1 The added value for consumers

An industry representative explained that the overall question is whether to have something that copies the card or whether to create a second, differentiated

product. The whole journey of introducing instant payment to commerce and making it an equal or even a substituting proposition for cards will take some time. There must be readiness for managing two infrastructures at the same time. Consumers want the choice between cash and cards, as well as instant payments in different forms such as the request-to-pay form or just sending money. It is an area of diversification in Europe and this diversity or the solutions there will have to be lived with.

### 3.2 EU priorities regarding the digital euro and cash

An industry representative noted that there have to be stable conditions in Europe for the business model. There needs to be viable over time because all the changes in payments take quite a long time. Though there is a need for new regulations and changes, overall, the challenge is that many of the solutions have to be implemented. There is a need to collectively set up priorities and deadlines. Europe is not talking about instant payment but, at the same time, it is talking about the digital euro and about getting rid of cash. Clarification of how all of this should happen, how it fits together and how to complete the different elements is crucial.

### 4. A digital form of money is a missing link within the eurozone digital value chain

A Central Bank official stated that the pace of digitalisation has never been faster. Digitalisation calls for a safe and efficient settlement asset, including the appropriate infrastructure with a digital form of money that is efficient and cost-effective, and can be seamlessly integrated into almost any kind of business process. This will also lead to the question of whether central-bank money needs to be digitalised. The Eurosystem has to be prepared to ensure the provision of safe and efficient payments in the future. In addition, the digital euro has the potential to protect European digital and monetary sovereignty.

A digital euro could counter potentially dominant big-tech market positions, based on their platforms and their commercialisation of data in the payments space. It could also potentially serve as a backup in a situation where a dominant non-European payment-service provider might exclude Eurosystem users from its services, based on extraterritorial regulations or even extraterritorial sanctions.

An industry representative noted that currencies are not only a very important part of monetary policy and financial stability but are also a part of communities and a representation of sovereignty.

#### 4.1 Digital forms of money and central bank money

A Central Bank official noted that the retail-payment world has, in the past, relied on a mix of central bank money usage in the form of banknotes and the provision of electronic payments by the market, and that the trend is towards digital payments. Extrapolating that trend ends in a world where the availability and usability of both central-bank money and private means of payment would be lost. The ECB remains convinced that the availability of both

to citizens is crucial. The investigation phase, as of 1 October, will answer the question of what the functional scope and design of a digital euro should be, along with the potential use cases. The question then is how the usability of central bank money would be preserved in this new world, where the private sector offers various good solutions. One conclusion is to not replicate the entire front-end universe that the industry has developed. The digital euro solution should maximise the added value of central-bank money in the retail-payments space. The idea is to not 'crowd out' existing providers.

An industry representative highlighted the need to analyse the challenges in order to make CBDC commerce-ready, to find out how it would impact other payment means, what it would mean for the full set-up of the European market infrastructure and how this would complete the set-up so far seen on instant payments.

#### 4.2 Competition and regulation or CBDCs

An industry representative noted, on the question of acceptance, that currently there is the settling in of digital fiat currencies. It is possible to settle in any fiat currency, whether it be a retail CBDC or something that, ultimately, could be translated into a banknote. Working together on thinking about acceptance, but also making sure that consumers can use it and settle into it, is something to support.

An industry representative stated that digital currencies, like instant payments, are thought of as exciting opportunities, as they create a new level playing field for new players to come in and to innovate. This is a good thing, and a framework to define some rules and to bring in some infrastructure is welcome. However, this is where the regulator should stop because the players then need to work on the use case and to find opportunities. Competition is key. It is what brings more products, services, and choice to the consumer. In some markets, the IFR, which was meant to lower competition, strengthened the market share of incumbent schemes. There has to be caution about what is defined as a digital currency.

A policymaker suggested that the ideal is to regulate that part of the infrastructure where market power is built. In the digital world, that is typically the markets where there are very strong network effects and tipping points where, after a certain point, there is no space for competition. What should not be regulated is where there is competition and different operators, because there will be more innovation and better conditions for consumers. The real difficulty is that things constantly change.

A public representative remarked that it was not known that the COVID-19 pandemic would enormously accelerate the development in the real world in terms of the uptake of digital payment technologies. There must be a very careful investigation of possible use cases of a digital euro. Then there should be a rapid implementation phase because there is currently a time horizon set by the ECB of 10 years following the investigation phase, and that may already be too late to be in the lead in the area of digital public or private currencies.