

# Instant payments and EPI: what is being achieved and challenges ahead

## 1. There are many opportunities linked to the development of instant payments

An industry representative asserted that the use of instant payments could create huge opportunities. ING is rolling out instant payments and they are already the new normal in the Netherlands for payments under the high value threshold. However, there is a need for a scheme on top of this, which is why it is essential to consider every opportunity, including the European Payments Initiative (EPI), and determine how to develop scale and acceptance across Europe.

### 1.1 Instant payments: a solution for cross-border payments?

A Central Bank official suggested that using instant payments to solve cross border payments could drive adoption. Using a fast payment system to solve cross border payment problems could retrofit the usefulness of instant payments within the euro area. Around the world, cross border payments are in 'very bad shape'. The Financial Stability Board (FSB) recently released a paper which established targets for improving cross border payments in terms of cost, access, transparency and speed. An instant payment system would clearly address the requirement for speed and could do this on a cross border basis. The system could improve transparency, because people would know in real time whether a transaction has completed. There is a genuine business case here. There are also many issues with the proposal to connect the world's fast payment systems. There are around 60 fast payment systems across the world. If they could be joined together, the problem of cross-border payments would be solved.

### 1.2 Instant payments can solve problems that are currently not being addressed

A Central Bank official stated that the most interesting use case for instant payments is something that is not easily achieved with batch based SEPA (Single Euro Payments Area) payments: retail payments and point of sale payments. These are often overlooked in the discussion of SEPA payments, because it is illogical to use a credit transfer at a point of sale. With instant payments, that use case becomes feasible. This could enable the creation of a new payment rail for retail payments at point of sale. This cannot be done using the batch based credit transfer system, although the system itself is not bad.

An industry speaker considered that instant payments have the potential to solve problems which are not currently being addressed, such as the emerging needs of unattended commerce and scan-to-go. These

activities are described as omnichannel, but they are often like e commerce in a shop environment. This trend corresponds to the behaviour of the digital age of Europe's population. Instant payments can cater to this demand. As the EPI is proving, instant payments can cater for all the same situations as cards. There is huge potential here, because instant payment can enable these different flows to be unified and harmonised.

A Central Bank official suggested that SEPA Instant Credit Transfer represents an opportunity for the European payments industry to jump into the digital age and support individuals and firms in meeting their daily payment needs. For payment services providers, instant payments can foster customer relationships by focusing on direct account to account transactions. If instant payments are to become the new normal, it is worth considering measures similar to those implemented for the first SEPA instruments.

The Central Bank official described how the European Commission is planning a regulatory initiative later this year or at the beginning of next year which will seek to abolish the hurdles to broader uptake. Nevertheless, it is important to listen to users and the providers of payment services. Only then will instant payments be able to compete effectively. In any case, the uptake of instant payments must not lead to fragmentation. Only a pan European solution will be able to reap the benefits of SEPA and the internal market. EPI could be the right platform to deliver such a pan European solution.

## 2. What has been achieved thus far?

A Central Bank official described how SEPA has transformed the European payments landscape over the last two decades. Plain vanilla euro payments have become faster, cheaper and more efficient. This transformation was made possible by a broadly coordinated effort on the part of both private and public players. While this has worked well for credit transfers and direct debits, national card schemes have not become cross border. Only in combination with an international card scheme are buyers able to pay with these cards outside their home country. Moreover, some countries' national card schemes have been substituted by international schemes. A similar pattern emerged for payment solutions designed for different situations, such as mobile e commerce or push-to-business (P2B) payments. While the harmonisation of credit transfers and direct debits within SEPA was an important step forward for Europe, adoption and usage remain below expectation as a result of the perceived lack of adjacent schemes and supporting arrangements such as request-to-pay or point-of-interaction (POI) payments.

## 2.1 There is a large amount of progress still to make

A Central Bank official described how the public authorities have done what could be done around infrastructure. A system has been created which could form the backbone of instant payments throughout Europe; it is up to the private sector to develop the business case. Today, instant payments, particularly through TARGET Instant Payment Settlement (TIPS), is not a big success. Only 60% of European payment services providers (PSPs) have joined SEPA Instant Payment; instant payments are only 11% of overall STG payments. There is considerable room for improvement.

The Central Bank official stated that the public authorities have to determine what to do, but the market players have to move. This is why this issue is so difficult. There are two dimensions to what central banks or public decision making bodies can do: infrastructure and regulation. On infrastructure, central banks are ensuring that accounts can be connected. Last year, the Eurosystem took two decisions to foster pan European reachability by mandating that SCT Inst compliant PSPs must be reachable in TIPS and Automated Clearing Houses (ACHs) must move their accounts from TARGET to TIPS. The authorities are doing their part, but more can be done.

## 3. The challenges ahead: creating the new normal

### 3.1 Searching for the optimal model for instant payments

A Central Bank official noted that there are three possible models for cross border payments. One is a 'spaghetti' model, in which all participants connect with each other. This would require a huge number of connections and is not a viable model. The second model is one with regional fast payment systems. This is becoming an interesting reality. The Bank of Italy recently conducted an experiment in which TIPS was connected to Bunu. With one link, 19 countries in Europe were joined to 16 countries in Bunu. This is an interesting model, because it is manageable and does not require huge agreement. Thirdly, there is a very ambitious project run by the BIS Innovation Hub Centre in Singapore called Project Nexus, which aims to develop a platform which can connect to the rest of the world. The Bank of Italy is joining this project with the Monetary Authority of Singapore and the Central Bank of Malaysia to understand how this could work. A system that uses one rail for domestic and international payments would create a real business case and would be a boost to the business case for instant payments within Europe.

Additionally, the Market Infrastructure Board (MIB) of the Eurosystem is currently defining a plan for how to remove the stumbling blocks in this area. The Central Bank official noted that PSPs have made instant payments a premium product rather than the new normal. As payments are instant, the checks for fraud, for example, may be more expensive. There is no data on this, which means it is important to talk to firms about this. The

public authorities must talk to the private sector and understand what is happening, if instant payments are indeed going to become the new normal.

An industry representative highlighted three key priorities for the creation of a pan European solution. First, it is important to address the current issues in instant payments. At present, instant payments work smoothly on a domestic basis, but a large proportion of cross border transactions are not executed in real time. This is due to the requirement to conduct pre transaction screening. This leads to false positives, because there is a very small timeframe to check each transaction. If there is any doubt, the transaction does not complete. Currently, 11% or 12% of transactions do not happen, which for a commerce solution is unacceptable. This compares badly to cards, where post transaction screening is possible. This is clearly one area where it is vital to level the playing field.

### 3.2 Defining roles: the public sector must set the regulations and maintain fair competition while the private sector has also a key role to play

A Central Bank official explained that the public sector could play a role. For example, in Europe it is not common for governments to make transfers using instant payments. This could be a huge boost to the sector. The Commission is also considering some action at a normative level to boost instant payments. More must be done in order to expand instant payments. This will be essential to prevent European citizens becoming trapped in the 'walled gardens' being built around the world. It is important to ensure there is interoperability and that people can choose their means of payment. There is no magic bullet, however. There must be continuous dialogue between the public authorities and the private sector to determine the appropriate solution. It is very important to address peer to peer e commerce, which is an area where there is a large reliance on non European solutions. Ultimately, the most important priority is to ensure there is dialogue with the private sector. It is imperative to design a system which is compatible with the needs, costs and business models of the private sector. Banks and PSPs are the organisations that will deal with customers. If there is no business case, there will be no possibility to foster this business.

An industry speaker noted that many banks have already implemented instant payments internally, but these systems are not commerce ready. The next step is to develop rules and functionality which are ready to be implemented in commerce. This will require rulebooks which can cater for all the situations a merchant wants to address, which means not only having the functionality but also liability rules, special situations, refunds, returns, fragmented payments and all of the other issues that arise in commerce. The industry speaker acknowledged that the EPI received a considerable amount of support from the central banks of various countries, the European Central Bank (ECB) and the Commission, but more must be done than warm words of support. Instant payments are a challenger. If the system is going to work, the ECB and the Commission will have to offer more support and get more markets involved.

An industry representative described how the governments in ING's home countries have opted to implement fixed fees per transaction at a low level. ING had discussed the possibility of joining the EPI. The EPI's scheme would have the same transaction cost wherever the transaction is, because that is the logical thing to do. It will benchmark relative to the European average and be competitive versus other solutions. However, the envisaged transaction fee under an EPI scheme could still easily be higher than what ING earns on a given transaction. From the perspective of competition law, this would mean selling transactions below cost, which, with ING's market share, would mean that ING was engaging in dumping, which is forbidden. This is why levelling the playing field on interchange is a key concern.

A Central Bank official conceded that there are limits to what the public sector can do. The public sector is not the best at innovating or providing customer facing solutions. Those need to come from the private side. In a nutshell, the public sector can provide the regulatory framework and certain foundational infrastructures, but, beyond that, it is the responsibility of the commercial entities, including banks, to provide the services that citizens will ultimately use.

### **3.3 Any fragmentation of the European payments landscape will slow down the process**

A Central Bank official stated that the fragmented payment landscape is limiting the possibility of having a competitive EU digital market in the global context.

Another Central Bank official suggested that there is a need for pan European instant payments due to the challenge around fragmentation. This is the most significant challenge in the European payments landscape. There have already been many national and regional instant payment solutions across Europe, but it is not possible to achieve a truly single market in this way. The systems could even be interoperable, but this would be a 'half baked' solution, because the market would still remain fragmented. It is not only the payment market that will remain fragmented, however; the European market as a whole will remain fragmented unless the payment landscape is fixed. SEPA has been very successful, but it only addresses a subset of use cases. It is essential to create another success story like SEPA to address the remaining use cases, which are currently somewhat underserved.

An industry speaker outlined the problems caused by fragmentation. First of all, successful payment solutions are global, unified and they have one function rather than multiple local adaptations. This is not because it is more beautiful to have a single system; it is because it is essential to create synergies, to enable volume pooling and to achieve economies of scale. If the system is composed of different solutions in an interoperable model, this level will never be reached, and therefore the system will never reach the critical mass and volumes necessary.

The industry speaker described how this fragmentation could have significant impacts. First, a fragmented system would prevent commerce from having a single

integration. Commerce wants to have a single integration, especially in Europe where there are specific standards and protocols functioning in every market. If public authorities and market participants do not pay attention, that is exactly what will be reproduced in instant payments. If these systems are implemented with small but nevertheless important differences, it will be cumbersome for merchants. Secondly, there is an even more important impact on innovation. If there is not a single solution, there will never be the innovation pooling, budget and financing that is necessary to remain competitive with the big players. This impact on innovation is massive, because none of the national or fragmented solutions can support the kind of innovation need that exists in today's digital age.

A Central Bank official emphasised that the intentions of all the actors involved are aligned. Everybody understands what is needed; the difficulty is in getting all of the actors around the same table and getting the project moving. The European landscape is multi currency, multi instrument, multi language and multi standard, and it is a private public partnership. It is a very complex landscape.

### **3.4 The need for a European scale**

A Central Bank official highlighted the clear commitment by Commissioner McGuinness on this issue. There is reason for optimism that the European Commission will continue to work in this direction and acknowledge that until now not enough has been done or achieved.

An industry representative observed that, despite the fact that iDEAL in the Netherlands now has a 70% market share in e commerce and m commerce, the system is only or largely used in the Netherlands. This year, iDEAL is aiming to process around 1.2 billion transactions. This is a significant number, but it will never produce the economies of scale of global schemes. Ultimately, the system will always be at a cost disadvantage. The same amount of money will have to be invested regardless of the number of transactions. This demonstrates why scale matters. Secondly, while consumers like the system, they cannot always use it abroad. Dutch web shops, which use iDEAL for what it brings, cannot use iDEAL to service international customers who want to buy from the Netherlands. This means they must accept other payment methods. This also means that banks have to supply extra payment methods to their consumers to enable them to pay everywhere, which is inefficient. Lastly, as a pan European bank, ING is not able to leverage its scale, because it must also service the domestic solutions in each of its countries. For ING, it would be an excellent idea to look at fast payments from a much bigger and at least pan European scale.

Another industry speaker highlighted the importance of creating a platform for all institutions to connect to, because this is about exchange. There must be direct connectivity, which requires a huge platform.

A Central Bank official considered that retail payments has been one of the key challenges in integrating the single market generally. SEPA Instant Payments is an example here, though this is not the same as retail

payments. SEPA Instant Payments has been implemented for five years, but there is still not complete coverage. Even in countries which are nominally covered or reachable, some banks have not implemented both incoming and outgoing instant payments. The goal here will only be reached if both of those aspects function and there is complete coverage on a pan European basis. What is perhaps missing is the motivation for commercial entities to think about payments on a pan-European level. Not every business does business in every European country. It is important to have standards, regulatory initiatives and shared infrastructures through which alignment can be achieved, even if a business focuses only on a certain part of the market.

### **3.5 The need for a new fraud prevention model**

An industry speaker emphasised the need for any platform to be able to handle fraud prevention. Fraud prevention is crucial. If it is not addressed, fraud will become an issue for instant payments in the future. The fraud prevention model must be reinvented for instant payments, ideally combining data from cards and instant payments, because that will be a much more efficient system.

An industry representative explained the issue around data. Previous speakers mentioned the need to integrate data more deeply in commerce and networks. These solutions should also be able to supply instant credit for buyers. This could be things like buy now, pay later. If all of the European and international responsible lending rules are applied, banks will be unable to offer the same seamless experience as the newcomers that deliberately sidestep these regulations. As long as no interest is charged, it is suddenly not a loan. That means there is no requirement to register with a credit bureau or check whether people are able to repay. This is a second key challenge around the level playing field.