EU retail payment landscape: prospects and challenges

1. Challenges for integrating the EU retail payment market

1.1 Regulation, infrastructure, and schemes

A Central Bank representative explained that with legislation like Single Euro Payments Area (SEPA), the revised Payments Services Directive (PSD2) and the Digital Markets Act (DMA), legislators aim to foster innovation, fair competition, consumer protection and a single European market. The upcoming review of PSD2 is an opportunity to further strengthen the European payments market. The uptake of instant payment instruments remains below expectations. The solution level offers access to these instruments and provides convenient payment solutions to end users, but it is relatively fragmented. While there are some successful national solutions, big techs and international card schemes successfully deliver payment solutions for consumers across the continent.

An industry representative suggested the industry has done a considerable amount to support economies and people to develop growth and to create jobs. The payments industry supported people during the pandemic.

1.2 Competition enforcement

A policymaker explained that the European Commission has a role to play as a competition enforcer. The entry of big techs into payments initially brought innovation, choice and improved consumer experience to the European market. Since then, some big tech companies and their platforms may have become gatekeepers, reducing innovation and stifling the entry of new competitors.

In May 2022, the Commission launched a statement of objections against Apple for reserving near-field communication (NFC) technology on iPhones and iPads for Apple Pay. In the payments space, big techs are still largely card-based. This raises the question of whether they could be a competitive constraint on the traditional card-based model or rather another transmission grid for it.

1.3 Challenges for new payment solutions in the EU

There is a question about the space which remains for new non-card-based payment solutions. The Commission's role is to be vigilant in this setting to ensure that markets remain open and contestable, and for there to be a level playing field. The main challenge for start-ups in the payment market is how to develop an alternative pan-European non-card-based payment method that is attractive as a business model to merchants, banks and consumers.

1.3.1 Lifting limitations impairing competition

An industry representative confirmed there are significant limitations, as illustrated by the Apple case. Apple's policy limits, or at least heavily constrains, access to 20% of the European market. This means consumers do not have the free choice, as they should have, to choose between NFC and QR codes, which are an established technology. Any new solution will have to use QR codes because there is an ongoing inquiry into NFC. It should be the free choice of the consumer to choose whether they use NFC or QR codes.

1.3.2 Changing EU consumer's mind set

An industry representative explained their organisation is trying to build a European solution based on instant payments. The maturity of cards and the mindset this has created in the population are challenges in the market. Changes in payments take a long time and establishing something new is a question of market education. Cards are also ubiquitous. People will ask why they should change when the current solution works. Consumers know that merchants will accept their Visa or Mastercard. Any new solution must establish acceptance. If consumers have to find out whether a new solution is accepted, they will not use it because they do not want to be frustrated at the point of payment. That is about international acceptance. It is important to recognise that this process will have to happen step-by-step.

1.3.3 Demonstrating that new EU payment means are trustful

An industry representative remarked that new solutions need to address the challenge around fraud. Insecurity is the last thing that is needed.

1.3.4 Compensating for the absence of EU super-players

An industry representative stated the incumbent competitors in this space are super-players and there are no super-players in Europe. This is a challenge because these super-players come with financial means and market power. This issue must also be addressed.

2. Attractiveness of EU instant payments

2.1 Coverage of big tech and fraud

An official confirmed fraud is a key concern. When using instant payments, funds are transferred instantly. This is what consumers want, as shown by peer-to-peer marketplaces, which are not always run by big techs. There are also national marketplaces. It is not inevitable that big tech will run all these marketplaces. However, this is something the public should be wary of. As long as fraudulent goods are not being sold, Europe should be content using instant payment solutions for peer-to-peer transactions.

2.2 Transaction opportunities

From the perspective of the public authorities, there is merit in helping to develop these schemes. There is a demand from consumers. From the business perspective for both small and large e-commerce firms, there is interest in improving cash management and facilitating systems of payment on delivery.

2.3 EU defragmentation and strategic autonomy

As this is a new technology with new use cases and new demands, the public sector and the co-legislators will hope that it spread out on a pan-European or multi-country basis. If it develops natively as a pan-European solution from the outset there is a chance this will help defragment the market. This is in the strategic interest of all European authorities. This has been undertaken with SEPA, and with the portability of bank accounts and the regulation of interchange fees in order to try to create a new integrated market. This would create a more sovereign market and would help authorities ensure that competition is fair.

2.4 EU data sharing

An industry representative noted there will be additional opportunities as PSD3 is considered. Banks could be required to connect to instant payment solutions and offer them to customers. There could also be further work on increasing the levels of data sharing and the ease of sharing data so that non-banks can compete with banks on instant payments. This would move Europe towards an open-finance type system. There will be a requirement for standardisation and harmonisation in order to ensure that the solution can work in all 27 countries.

3. Obstacles faced by the pan-EU instant payment scheme

3.1 Negative impacts of regulation imposing similar fees on domestic and cross-border payments

A Central Bank official stated that currently there are not enough market incentives for local players to offer SEPA instant payments. This might be an unintended consequence of existing price regulation of cross-border euro payments in the EU. As payments is an industry with strong network effects, the incentives will change if there is widespread deployment of instant payments in the eurozone in combination with a scheme or product that is also widely used.

3.2 Including non-euro countries remains an issue

There are questions about whether it is possible to interconnect instant payment systems, as has been done in Singapore with Thailand. Central banks are watching these developments closely. Even more interesting is the work being done by the European Central Bank (ECB) with the Riksbank on introducing a foreign exchange mechanism into the ECB's instant payment system (TIPS) allowing instant payments between the two currencies. The situation of countries outside of the eurozone must be taken into account in relation to EU regulation promoting the uptake of euro instant payments. If there is no demand there for euro-denominated instant payments, it does not make sense to force non-eurozone banks to invest in such payments.

3.3 Further efforts for critical mass

An industry representative stated one key challenge is the fact that this is a two-sided market: it requires merchants willing to accept a form of payment and consumers demanding to use it. The opportunity is the system. Some infrastructure has already been built. SEPA is already able to connect banks across the EU.

4. Lack of regulatory clarity, regulatory heterogeneity and uneven anti-money laundering (AML) legislation

A Central Bank official noted that currently the system involves a considerable amount of extra work due to EU payment legislation not being clear on key points and obligations. EU legislators need to do better if fast implementation is the goal.

The obligations and rights should be made clear as this will avoid the kinds of discussions that happened as part of PSD2, such as on third parties, which slowed down the implementation process.

Regulations should be simpler and easier to use. For many years there have been calls for the abolition of the E-Money Directive, which has outlived its usefulness. There is scope for regulatory arbitrage and endless discussions.

A Central Bank representative stated that it is strategically important that to work together on a pan-European solution in the payments market.

PSD helped create a single market. However, there are barriers that will have to be eliminated to boost the single market and create more opportunity and growth. There is not enough harmonisation, especially in with AML legislation. Whenever there is a new EU AML directive, there are questions around what changes to implement and whether due diligence policies and related measures should be adapted. There is a general framework, but the legislation is implemented in each member state which creates a large amount of additional work and is a pain point for the industry. It does not allow the market to create the openness sought. There is also a loss to the industry because best practice is not widely shared. There are many best practices that could be shared, managed, and implemented across the European Union.

5. The need for swifter adoption of new technologies an increased regulatory adaptability and efficient business models

5.1 Swifter adoption of new technologies

An industry representative noted another key element is how technology is applied in different jurisdictions. During the pandemic, several countries in the Middle East made changes to due diligence for payments and allowed much greater use of technology. European countries are still moving at different speeds. In the Nordics it is much easier to transact online, for people's identities to be verified and for them to undergo due diligence processes. There are some countries where these processes are still done using paper and everything must be sent two or three times. For instant payments, the requirements are worse. It is important to remember that technology can help to support the industry because due diligence and electronic KYC are even stronger when technology is leveraged. This can boost the market and increase consumer protection.

The traditional payments infrastructure was never built in Africa. Bank branches were not built everywhere; many countries had to skip a step and move directly to new technologies. Everyone in Africa has at least one mobile phone, and often they have the latest model that cannot be found in Europe. All these phones are connected to wallets with greater capabilities than people in Europe have today. In Kenya, for example, people use their wallets to pay for their laundry or for taxi fares, as well as to withdraw cash. There is more flexibility and less regulation outside Europe which creates increased levels of innovation. This could challenge the competitive advantage of the European markets.

5.2 Building an effective business model for instant payments

An industry representative noted progress has been made in open banking, as part of PSD2 creates the opportunity for non-financial institutions and payment service providers to offer instant payment solutions to consumers. It is easy to understand the opportunity for merchants: it is a cheaper form of payment for them to accept. However, there is also a need to convince consumers that it is a convenient way for them to spend their money. This will require the private sector to offer the solutions and find a monetary incentive to provide them.

5.3 Agile regulatory processes to catalyse innovation

An official noted less public involvement is required for the solution level. The public sector must continue to act as a catalyst for the solutions developed by the private sector. European authorities should continue to be vigilant about issues like that with Apple, both in terms of contentious cases and the development of new legislation.

The public sector can also play a role by enabling future new solutions. Public bodies should not make political or administrative choices in an attempt to foresee the future. There should be nimbleness when crafting legislation. Nobody knows whether crypto and distributed ledger technology (DLT) will be the backbone of future payment systems in 15 years, but they might be. There is a need for tools to help the private sector innovate, but this has to happen in a safe way. That is the aim of the Markets in Crypto-Assets (MiCA) regulation. There are a number of things in the legislation that will need to be reviewed. Given the long-term changes in payment systems and the fact that the technology is evolving in ever-shorter cycles, the process of crafting regulations will have to change.

5.4 Having the public sector take the initiative

There is sometimes a requirement for the public sector to step in. This should be done with a light touch and not too often. If there is ever a situation in which the payments market is dominated by American and Chinese big tech solutions, it will be of great benefit to have a European public solution to use as a platform to develop other forms of competition in Europe.

6. Regulatory improvements

6.1 The Digital Market Act

A policymaker noted that the DMA covers gatekeepers, and its provisions largely derive from antitrust enforcement. There is a close link between this regulation and the practice that has developed in Europe. The DMA will cover financial services and payment services offered by gatekeepers. There is an interoperability requirement. There are also several data-enabling provisions in the DMA which will stop gatekeepers from siphoning data from their ecosystem and preventing others from accessing their data.

6.2 Payment Services Directive and Open Finance

DG FISMA recently completed a public consultation on PSD2 and open finance. The principle of 'same risks, same rules' should guide the work. To create a level playing field, it will be essential to ensure that actors carrying out the same kinds of activities and creating the same risks are subject to the same type of regulation. This is an important question for traditional banks. The Commission is also considering an initiative on instant payments.

6.3 Consistent implementation of legislation and reactive supervision

The new AML package will include a regulation and create a European authority to implement. A digital euro would be an excellent complement to the diversified European payments landscape.

An industry representative suggested further harmonisation will move much of the legislation on payments from directives to regulation, but it will also create more harmonisation among the different sets of rules. Some elements of PSD are not completely aligned with the General Data Protection Regulation (GDPR) or elements of GDPR which are not completely aligned with the AML legislation, especially in relation to obtaining cross-border information. GDPR has been a great innovation in Europe, but it has also created challenges in complying with AML legislation.

There remain areas in Europe, and especially outside Europe, that require a physical presence to network. There are still remote areas where people do not have access to financial means. It takes a very long time to register as an agent under PSD2. The host regulator has 90 days to provide a response. The process requires a firm to find a potential partner, undergo due diligence, wait 90 days for a response and then train the agent on how to offer the service, on AML legislation and on everything related to cross-border. On average, this takes six months. Many of these agents are not interested in waiting six months.

6.4 Possible unintended consequences on non-dominant players

An industry representative explained that from the perspective of a smaller and more niche player regulation is sometimes intended to address a market with dominant players. This can have unintended consequences which harm the smaller competitor. For PSD3 it will be important to focus on the existing non-dominant players in order to avoid unintended consequences such as the surcharging rules that allow them to be surcharged in certain circumstances in which a dominator players' products would not be. Focusing on such issues will ensure start-ups can continue to compete, make the case for merchant acceptance and encourage consumers to use their products.

6.5 Bank service accessibility

An industry representative opted de-risking is critical for the cross-border payments remittance industry. Many banks completely de-risk this activity. Many operators go out of business because they do not have any access to bank services. That is not because they are not respecting the rules or because they do not have a strong compliance programme; it is because banks prefer to de-risk completely and avoid future issues. This should be addressed with a measure that permits small operators and the remittance industry in general to secure proper access to banking services.

A Central Bank official called for the changes in the Settlement Finality Directive to allow some non-banks into payment systems as part of the G20 cross-border payments initiative, which is important for increased efficiency. Czechia is unique because it does not have an automated clearing house. All retail payments go through real-time gross settlement. There are several non-banks that would like to do this.

6.6 Clarity in EU regulation

A Central Bank official suggested that Czechia probably makes the most use of PSD2 due to the fact that a BankID solution was built on top of the PSD2 APIs.

7. Decisive success factors for Instant Payments in the EU

7.1 Moving towards a full payment solution

An industry representative suggested that everyone would agree that instant payments are a fantastic opportunity for the market because they are an opportunity to change the payments landscape. This has happened in other regions of the world. The uptake of Pix in Brazil is stunning. These technologies can transform markets. Europe should not miss this opportunity. Instant payments can address any use case. They can be used for commerce and P2P, but they can also be used for bill payments or anything else.

The payment means alone will not be the decisive factor. If only the means of payment counted, instant payments would already be successful. Instantaneousness is a nice feature, but it is not sufficient. The payment means must be taken to the payment solution level, and it must compensate for some of its weaknesses, such as the benefits of cards that consumers enjoy today. Instant payments do not offer guarantees or insurance services.

7.2 Articulation between instant payment and the digital euro

In some discussions, the digital euro is seen as unfair competition for instant payments. This topic requires a separate debate, but it is important to consider in the design of the digital euro.

7.3 Leveraging the existing network of EU banks

An industry representative explained that their organisation can bring the distribution and marketing power of the banks, given the difficulties that exist and the challenges that must be addressed. The banks and the big acquirers are driving this project. They want this to happen and will put significant effort behind it. Somebody has to push this technology out to the market. The banks can also bring standardised integration for merchants, which does not exist across all of the national solutions. The banks can also address fraud. They also have a willingness to align with public authorities.

Particularly in combination with user-friendly value-added services, instant payments can bring benefits to both consumers and businesses. There is a need to create smart and convenient payment solutions, possibly based on instant payments, that can meet individuals' and firms' payment needs. Sound regulation is the key to fostering innovation, protecting consumers and ensuring healthy competition in the payments market. A regulatory initiative concerning instant payments is on its way, and the review of PSD2 will happen soon. While the public sector and the industry might take different approaches, they are united in seeking a prosperous retail payments market that serves the needs of payment users.