Retail payment services: how is the European market adapting to the new rules?

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Agenda

- Innovation and regulation:
  - What are the drivers for the development of new payment services?
  - What is the role of the regulator?
- The European legislative package:
  - PSD2
  - IFR
- What is going on in the market?
  - new services
  - new technologies
  - new intermediaries

Innovation in payment services

- The development of payment instruments is a continuously evolving dynamic process, driven by technological advances.
- Market players design new services that better adapt to users' needs in order to expand their business.
- In doing this, they try to balance the new opportunities the market opens up with the legal requirements they have to comply with.
- However, private players want to maximize their profits and may not have the right incentives to reach a socially viable equilibrium.

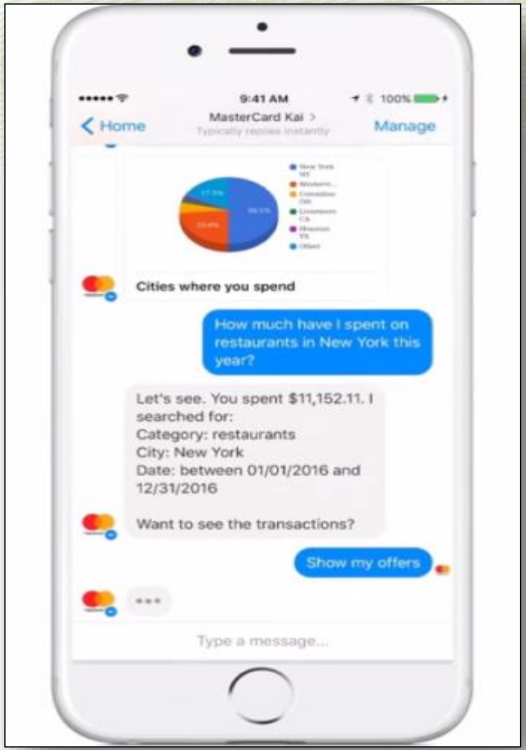
The role of the regulator

- The regulator monitors the development of the market and technological advances to be able to:

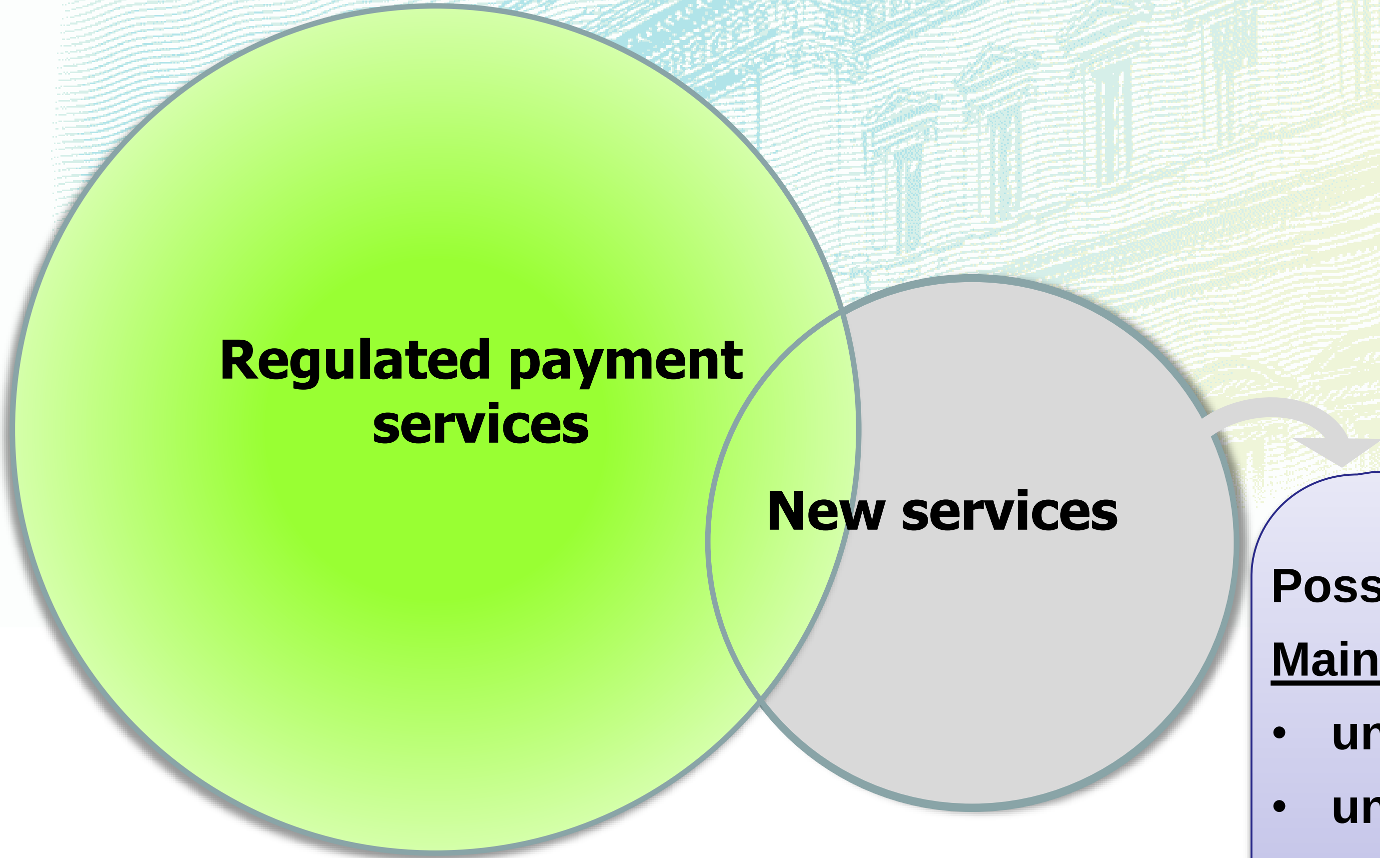
  - foster innovation (and better customer experience);
  - strike the right balance between security and efficiency;
  - adapt the regulation to new services;
  - put in place effective consumer protection measures;
  - ensure fair competition among market players;
  - avoid regulatory arbitrage.

New opportunities for the market are also new challenges for the regulator

- 27 June 1967: the first Automated Teller Machine
- 2018: ChatBot: a robot that helps customers to take financial decisions



Regulation and regulatory gaps



Possible regulatory gaps.

<u>Main Issues:</u>

- uncertainty;
- uneven playing field
- regulatory arbitrage
- risks (consumer protection, AML/TF measures….)

The drivers of PSD1 (2007)

- PSD1 was the first fully-fledged legal framework of European payment services.
- It aimed at :
  - increasing competition by introducing a new category of authorized payment service providers with European passport, the so-called payment institutions;
  - harmonizing the European market by defining the characteristics of payment instruments (credit transfers, direct debits, cards) and the negative scope of application (cash back, limited networks, commercial agents…);
  - providing enhanced consumer protection by cutting execution times, strengthening refund rights and clarifying the liability regime between providers and users.

From PSD1 to PSD2

- PSD1 provided:
  - the legal foundation for the Single Euro Payments Area (SEPA);
  - economies of scale in the supply of payments;
  - more choice, transparency and information for consumers;
  - shorter execution times and reduced fees for intra-EU transactions;
  - a clear liability regime for the use of payment instruments.
- PSD2 (2015) updates and complements PSD1 to take into account new regulatory needs.

Innovative services

- PSD2 regulates two innovative payment services that bring innovation and competition in the market providing alternatives for Internet payments:
  - account information services (AIS) which allow users to have an overview of their financial situation and better manage their finances;
  - payment initiation services (PIS) which allow to pay online via credit transfer providing the merchant with the assurance of the payment initiation.
- These services can now be offered by banks, electronic money and payment institutions. Payment institutions that only offer AIS and/or PIS need to hold a professional indemnity insurance covering risks.

New security rules

- Technological advances make payments faster, more user-friendly, easily accessible, but also more risky and prone to fraud.
- PSD2 sets the general security requirements and mandates the European Banking Authority (EBA) to draft regulatory technical standards and guidelines on:
  - SCA requirements and exemptions (amount, risk analysis…) - RTS
  - real time antifraud measures - RTS;
  - notification of security incidents to authorities and data fraud reporting to authorities - GLs
- Payment service providers will have to asses on a yearly basis the operational and security risks at stake and the measures taken to address them

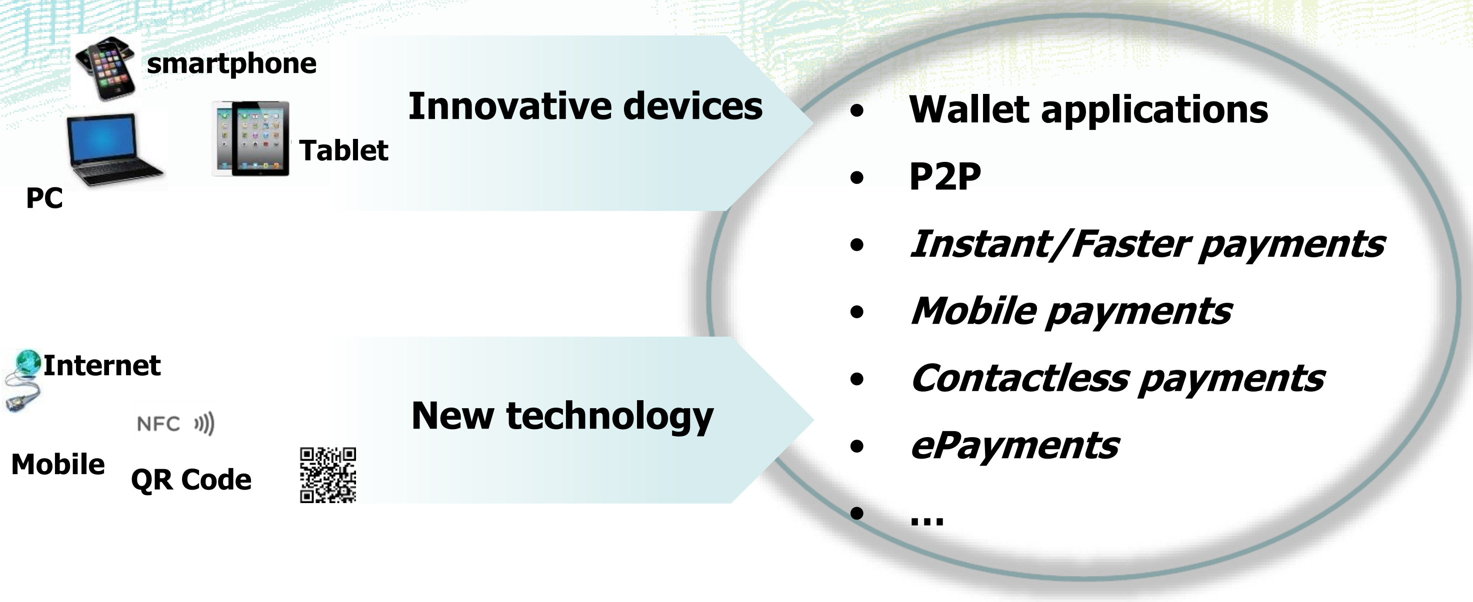
Interchange fees regulation

- Main objectives:
  - reducing market fragmentation
  - promoting the use of payment cards increasing competition and lowering costs
  - increasing transparency and freedom of choice for the card user

- IFR sets:
  - interchange fee caps (0.2% on debit cards; 0.3% on credit card transactions)
  - harmonized business rules (processing, transparency, co-badging, ...)
  - enforcement by competent authorities, plus sanctions

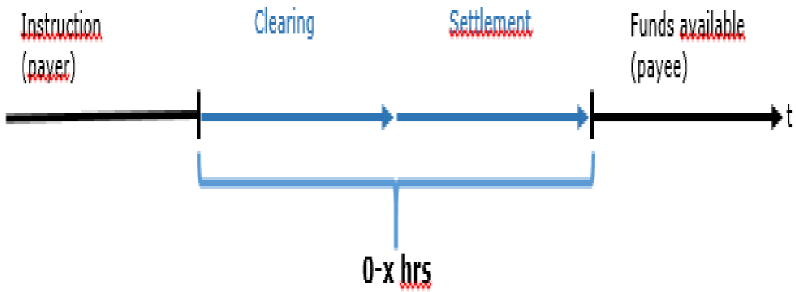
What is new in the retail market?

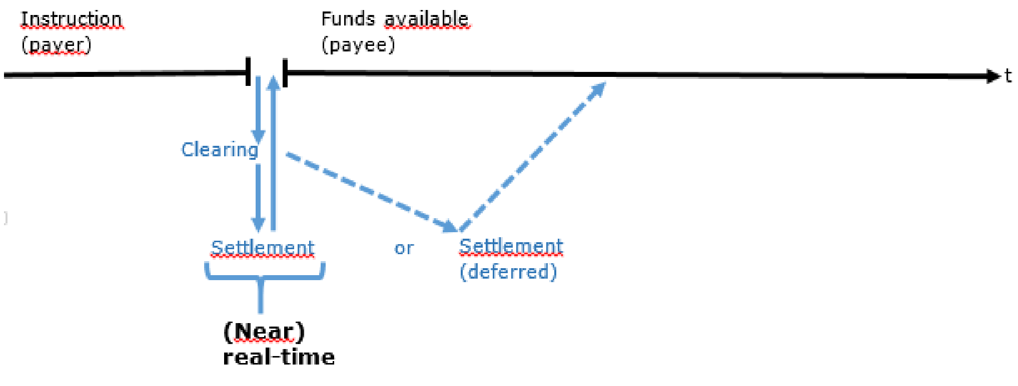
- The retail payments market is undergoing rapid progress: both globally and in Europe, innovative solutions focus primarily on the “mobile” channel
- Many innovations fall in the scope of the regulation



The new "normal"?

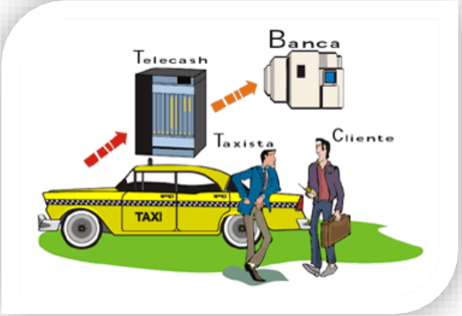
- Instant payment services:
  - make funds immediately available to the payee and can be used on a 24/7 basis for P2P, P2B and P2G transfers;
  - can be build upon different payment instruments, such as credit transfers, direct debits, payment cards or e-money products although current implementations are based mainly on the use of credit transfers.
- Instant payments overturn the traditional credit transfer process and induce a change in the inter-banking relationships





Different kinds of E- wallets

- The increasing use of mobile phones to initiate payments fosters the diffusion of e-wallets, that can be based on:
  - the virtualization of one or more credit/debit or prepaid cards (e.g. Apple and Samsung pay). In this case phone companies/Fintech partner with financial institutions to offer payment services
  - the use of payment accounts opened at a financial institution:
    - “interoperable”: payer and payee should not be adherent to the same wallet/circuit
    - “closed loop” (e.g. Satispay): payer and payee should be adherent to the same wallet/circuit.



Banks and Fintech: three main scenarios

1. Fintech firms offering financial services directly; they compete with banks, but only on specific services; in Europe they must be authorized.

2. Banks adapting and developing Fintech-like solutions, to improve their provision of financial services; some banks are themselves active players in technological innovation applied to finance, research and development of new products and technologies.

3. Partnerships between independent Fintech firms and traditional banks, combining the innovative and user-experience focus with the reputation, risk management capabilities and strong customer relationships of traditional banks.

Challenges for regulators

Static regulation vs dynamicity of technology

Two-layer approach in PSD and IFR: general rule at level 1 - guidelines and regulatory technical standards at level 2 (EBA)

Security vs efficiency

Higher security standards are not to be a constraint of e-payment developments (user experience)

Impact on business model

Market players need to maintain sustainable business models and meet the needs of stakeholders

Risk of shift to unregulated sectors

Same activity, same rule principle

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Conclusions

- Technological advances offer significant opportunities to individuals, enterprises and, in general, to the economy.
- A sound legal framework is important for private service providers to develop secure and efficient payment services and for authorities to keep the confidence of users in the regular functioning of the payment system.
- In order not to undermine the possibility for the market to offer better services it is important to design the regulation in such a way as to foster and support innovation (e.g. proportionality principle, general principles and technical standards).
- Authorities should engage in a constant dialogue with the market to monitor relevant developments and, if needed, intervene promptly.