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1. The EU Commissions Retail Payments Strategy for the EU

In September, the EU Commission has published a *Retail Payments Strategy for the EU*. The paper highlights the importance of payments and criticises that European card or instant payment schemes do not work cross-border. The EU Commission sets an ambitious agenda and contemplates a large number of new regulatory initiatives. In our view, the strategy paper is too much of a wish list and lacks a truly strategic point of view.

Appendix: Update market shares of the domestic card schemes in the EU 2019

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The EU Commissions Retail Payments Strategy for the EU

(mk) In September, the EU Commission has published a *Retail Payments Strategy for the EU*[1]. To motivate the need for such a strategy, the Commission points out that payments are "*the lifeblood of the European economy*" (p. 2) and that there is a strong dynamism of the European payment landscape (p.4).

In particular, it mentions the increased payment-related activities of "Big Techs" and technological innovations such a crypto assets and biometrics. Against this background, the Commission criticises that European card or instant payment schemes do not work cross-border (p. 3).

Moreover, it sees the risk of further market fragmentation (p.4). Therefore, it sees a need for "*a single, coherent and overarching policy framework*" (p. 4). The outline of this "*policy framework*" has been divided into four key pillars (p. 4):

1) increasingly digital and instant payment solutions with pan-European reach;
2) innovative and competitive retail payments markets;
3) efficient and interoperable retail payment systems and other support infrastructures; and
4) efficient international payments, including remittances.

Of course, we could try to summarise the main elements of each pillar. However, as far as market participants are concerned, it is more straight-forward to look at the actions which are contemplated. As the list below shows, the outcome of the discussion of a future retail payment strategy may well be more regulation, a lot more. Lucky Luke could not possibly shoot any faster than the EU Commission is proposing new legislative initiatives.[2]

Contemplated actions:

1. make participation in the SCT Inst. Scheme mandatory for PSPs (subject to certain criteria)
2. require adherence to additional functionalities of SEPA inst. , including standards for QR-codes
3. require a right of refunds for users of instant payments
4. regulate charges for instant payments
5. introduce measures to enhance the effectiveness of crisis management of payment systems (given additional illiquidity risks of instant outflows of funds)
6. introduce additional measures to address money laundering and terrorist financing
7. explore the feasibility of developing a 'label' and a logo for pan-European payment solutions
8. facilitate the development of European specifications for contactless card-based payments
9. support modernisation of payment acceptance facilities (innovation hubs, funding, training)
10. pressure national competent authorities to sanction activities like 'IBAN discrimination'
11. examine ways to promote the use of electronic identity (eID)
12. carry out a study on the level of acceptance of digital payments in the EU (potentially followed by legislative action = compulsory acceptance of digital payments?)
13. take action to protect the acceptance and availability of euro cash
14. work closely with the ECB on the topic of Central Bank Digital Currency (CBDC)
15. review the application and the impact of PSD2 (end of 2021)
16. present a legislative proposal for a new 'Open Finance' framework by mid-2022
17. carefully monitor the implementation of strong customer authentication
18. take stock of strong customer authentication's impact on the level of payment fraud
19. explore whether additional measures should be considered to address new types of fraud, in particular with regard to instant payments
20. propose a Regulation on digital operational resilience for the financial sectors across the Union
21. explore lessons learned from the implementation of the EBA Guidelines on ICT and security risk management
22. re-examine the existing legal limits on contactless payments, with a view to striking a balance between convenience and fraud risks
23. evaluate any new risks stemming from unregulated services, especially technical services ancillary to the provision of regulated payment or e-money services
24. assess the adequacy of the exemptions listed in PSD2 and evaluate the need for changes in prudential, operational and consumer protection requirements
25. align the PSD2 and E-Money Directive (EMD2) frameworks
26. subject issuers of e-money tokens to additional provisions complementing EMD2

27. ensure proper linkages between the supervision of payment services and the oversight of payment systems, schemes and instruments
28. extend the scope of the Settlement Finality Directive (SFD) to include e-money and payment institutions, subject to appropriate supervision and risk mitigation
29. propose legislation aimed at securing a right of access under fair, reasonable and non-discriminatory conditions, to technical infrastructures considered necessary to support the provision of payment services
30. assess, in the framework of the PSD2 review, whether transparency of cross-border international transactions needs further improvements
31. assess, in the context of the PSD2 review, the appropriateness of requiring that the maximum execution time in 'two-leg' transactions also applies to 'one-leg' transactions
32. assess whether it is necessary to make the framework of the European Payments Council on possible further harmonisation of business rules and messaging standards for one-leg transactions mandatory
33. support SEPA-like initiatives in regional groupings of low and middle income countries, and in relevant cases the possibility for Third countries to join SEPA
34. promote the access to payment accounts in low and middle-income countries, which will also facilitate the digitalization of remittances

(Without any claim of completeness.)

Our Comment:

The Commission's strategy paper looks a bit like the result of a thorough brain-storming exercise. And maybe it is meant to be just that.

Principally, there is nothing wrong with this. Everything comes on the table and subsequently there can be an extensive discussion. But the problem is that once all of these ideas have been put on the table, they are likely to stay.

As the list above shows, the amount of items on the table is vast. Ultimately, the proposed "*retail payment strategy*" may imply a plethora of new regulations.

So, a field which is already highly regulated (Do I hear somebody mumble "over-regulated"?) would have to digest yet another large set of new rules or changes of existing rules.

This is unfortunate because a strategy paper should be used not just to consider the "hot topics of the day" (BigTech, CBDC, etc.) but should also look back to put current developments in perspective, including the successes and failures of regulatory action.

Another aspect that would be expected of a strategy paper is the discussion of trade-offs between competing aims such as security and convenience or between the aim of (super) low costs and a state of the art infrastructure with fantastic products.

Below, we will discuss a few topics where we see a wish list rather than a strategy paper. But we will start with a few points where we think that the Commission is right on track

European governance

Using a payment system where some of the nitty-gritty of governance are decided somewhere else has its drawbacks. This has been an issue for many years and the Commission is right in pressing for payment systems with European governance. Should there have been any doubts in the past, the performance of president Trump has made this point crystal clear for the European Union.

So, the rules of the game for card payments, which have overtaken cash as the most important retail payment instrument in some European countries, should be made in Europe.[3] We are not so sure, though, why this needs to be based on instant payments. More on this below.

Open access

The PSD2 has one important aim: open access to bank account data ("Open Banking"). This is an innovative policy approach which may have big benefits. But, of course, open access is not just an issue regarding bank account data.

The Commission rightly presses for more. The most important case is Apple. The Commission does not mention this company but in its statement regarding restrictions of third-party access to Near Field Communication it clearly has Apple in mind: *"The most commonly reported issue relates to some mobile device manufacturers restricting third party access to the Near Field Communication technology embedded in smart mobile devices."* (p. 23)

Another issue which may evolve is access to POS terminals that use Visa/Mastercard standards. Thus, a "right of access under fair, reasonable and non-discriminatory conditions, to technical infrastructures" definitely makes sense.

Complexity

As Bruce Schneier, a well-known expert in the field of network security has put it: "complexity is the worst enemy of security."[4] Complexity is also an issue of the Commission's strategy paper. It points out that *"the financial ecosystem is becoming increasingly complex with a more fragmented value chain. The payments chain involves many players (some regulated, others not) and increasing levels of complexity and inter-dependency"* (p. 19).

The Commission even admits that regulation may be a source of complexity: *"Given the magnitude and the complexity of the transition required by PSD2"* (p. 15). However, it does not seem to be concerned. The Commission simply adds *"these early challenges were to be expected"*. It is unfortunate that the Commission does not follow up on this thought. Regulation has indeed become an important source of complexity.

Apart of payment regulations in the narrow sense, there are issues of consumer protection, realisation of the common market, competition policy, anti-money laundering, anti-terrorist financing, systemic risk, monetary policy, data protection, inclusion, etc. In order to reduce complexity, it may occasionally be helpful to consider a streamlined regulatory framework. SCA is a case in point.

The idea to make particular approaches to security mandatory, has led to a situation where regulators have to consider 100s of detailed questions and decide in each case what is lawful and what not. Will this lead to more security? Keeping Schneier's verdict (quoted above) in mind, this is not clear. Will there be other (unintended) consequences? This is highly likely. Is there the slightest indication in the Commission's strategy that, at times, it may be sensible to reduce regulation? No!

As far as the Commission is concerned, what is the solution to this problem? More regulation! *"While regulation must guarantee a level playing field, promote fair competition and low barriers to entry and spur innovation, it must also uphold users' rights and protect the overall ecosystem from financial and operational risks. To achieve these objectives, the regulatory perimeter needs to be well balanced"* (p. 19). Admittedly, "well balanced" does not necessarily mean "more". But after 20 years of following EU policy in the field of payments, I cannot possibly believe that "well balanced" means "less".

Complexity is the worst enemy of security.

The long list above certainly is an indication of what is to come. That is not to say that regulation is the only source of complexity. That would be far from the truth. But regulators should be aware that they also create complexity and that this creates costs for society.

Security

As pointed out above, complexity may reduce security. Unfortunately, regulations get ever more complex and thus make the achievement of security more difficult. But there is more to this topic. "Security" is not a straight-forward concept. Suppose, I have received cloths ordered on the internet in an online shop of a well-known e-merchant. I am able to inspect the goods and afterwards make an online payment safeguarded by SCA.

One could argue that this is a "safe" payment – but for whom? The e-merchant has sent out the goods before receiving payments. So, there is a risk for him. Using a "safe" means of payment does not eliminate this risk.

The same applies when I buy something from a less well-known e-merchant who requires pre-payment. Again, I can use a "safe" payment instrument – but that does not make me feel safe because I may end up not receiving the order.

Instead, use of a supposedly "unsafe" payment instrument such as credit card with CVV number or direct debit would be much safer for me because of my charge-back rights. Using technology to increase security makes sense – but only up to a point. What is more important is risk-management.

Trade at a distance between two parties that do not know each other is inherently risky. In order to cope with the risks that are involved we probably need a mix of

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payment instruments with different layers of security and different risk-distributions. This is more or less what the market supplies at the moment. The Commission should not temper with this solution by providing supposedly "safe" payment solutions.

In the end, we may find this rather unsafe. Incidentally, the idea that we need a good mix of payment instruments rather than "super secure pay" seems to be in line with a recent statement of Bundesbank president Jens Weidmann:

"In my view, consumers should be able to choose from a broad spectrum of payment methods that fit their preferences for safety, convenience, speed, cost efficiency and privacy. To this end, it is first and foremost up to the private sector to develop and provide innovative payment solutions."[5]

Speed

"The quest for speed in payments," – this is the title of an article of BIS economists published in 2017.[6] The authors argue: *"A day or more to pay another person used to be acceptable, but in today's fast-paced environment this seems like an eternity."* (p. 57). This quote nicely summarises the idea that you can find just about in any speech on modern payments.

However, "payments" is a rather broad term. The modern customer truly wants to be able to transact immediately. But does that mean that clearing & settlement (C&S) also has to take place immediately ("instant")? Certainly not!

In fact, the show-case of new services mentioned to underline the need for the PSD2, the famous "PIS" (payment initiation service), clearly demonstrates that a simple confirmation that payment has been initiated is all that is required. In fact, long before PIS, credit cards have also made it possible to transact immediately. So, it is really not clear why it was deemed necessary to carry out the "*replumbing the whole infrastructure*".[7]

One might object that these systems were only useable for B2C transactions. That is true. But how often do you really need "instant" for C2C? My bank has been offering instant payments for some time (since when, I do not remember which shows that it probably was not a "life changing event").

But I think in 2020 there was only one transaction for which "instant" really was a value added for me. Of course, other people may have more occasions when "instant" is important. But really a lot? Would these transactions pay for the costs of implementing instant payments?

Regulation versus Market

Be that as it may, "instant" is here to stay and it is widely believed to become the "new normal" which in all likelihood will imply a zero transaction fee for households. So the question arises how the banks are going to generate revenues to recover their investments.

This question is all the more pressing because there are more investments in the pipeline. As the Commission notes, *"when providing instant payment services, payment service providers must ensure that they have in place appropriate and real-time fraud and money laundering/terrorist financing prevention tools, in full conformity with existing legislation."* (p. 8) Sounds like a piece of cake, doesn't it?

Well you might wish to have your cake with some topping. The Commission has also thought of that: *"In order to be more attractive to consumers, instant payment services should offer features that put them on an equal footing with other payment instruments (e.g. cards) that offer chargebacks, …"* (p. 8)

European schemes

Fourteen years ago, we published the first edition of this report. One of the articles analysed a speech given by Gertrude Tumpel-Gugerell (then member of the Executive Board of the ECB).[8] What were the topics of this speech?

One important topic was the need for a European card scheme "*the ECB would see as necessary the creation of at least another European scheme, so that the expertise and efficiency of national schemes is not wasted.*" Sounds familiar, doesn't it? In fact, many paragraphs in this speech would fit one-to-one into the new strategy paper of the Commission.

As the requirements get ever demanding, the business case remains elusive.

However, 14 years have passed since this speech has been given and nothing much has changed. We still have a number of domestic European schemes and x-border card payments are carried with cards carrying a Mastercard or Visa brand.

There were a number of European initiatives. All of them have failed and little by little it is difficult to remember all of the acronyms. But now there is a new contender, the European Payments Initiative (EPI). And once again regulators are delighted to see a European payment initiative: *"The Commission and the European Central Bank (ECB) had given this initiative their political support from the beginning and welcomed its launch."* (p. 3). So, there is a lot of applause, but surprisingly, there is no word about all the past failures.

If we want a successful European card/mobile payment scheme we should ponder why the earlier attempts have failed. But the strategy paper has no room for this. It sticks to the old (and as of December 2020 completely unsuccessful) script that European players should coordinate ex ante to ensure full European reach.

In the US, the spread of PIN-debit systems has followed a different model. These systems started with a limited regional range and expanded – often via mergers and acquisitions. This does not seem to work in the EU and a serious strategy exercise would have to raise the question why this is the case.

Why are even the latest and most innovative schemes (like Swish in Sweden) national in nature and do not seem to be able to expand across borders? Why is the largest domestic European card scheme (Cartes Bancaires) not able to expand across the border of France?

The Commission has no time for this. Rather, it sets the mark ever higher. We have not been able to build a pan-European card /mobile payment system. So, now the plan is to have one that is pan-European and international. As a first step, it contemplates extending provisions for 2-leg transactions also to 1-leg transactions.

The Eurosystem seems to support this policy stance: *"Moreover, citizens and businesses should be able to send and receive cross-border payments to and from countries beyond the euro area under the same conditions and with the same ease as within".*[9]

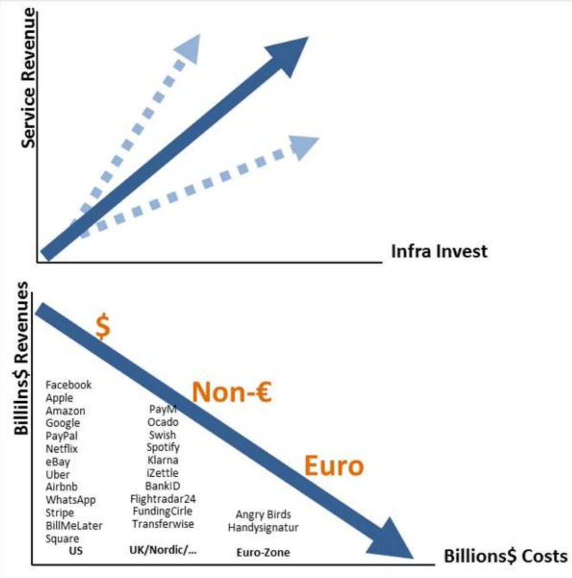
As the requirements get ever demanding, the business case remains elusive. As outlined above, one part of the Commission defines the requirements and the other, DG Competition, sets important limitations regarding business rules. "*Competition versus co-operation in the provision of network services*" is a complicated topic.

We have commented on it in this newsletter and elsewhere and do not want to repeat all of the arguments.[10] But one thing is clear: If the banks are jointly creating a scheme for cards and mobile and if they are subsequently forced to negotiate individually with Apple, Google and the likes, the business case does not look promising – except for the BigTechs.

Given required investments anywhere between a few hundred million and a few billion Euro what can banks do? Play a game called "wait and see" – a game they have been playing the past 14+ years.[11]

Instant payment as a game-changer?

Europe has certainly reason to be proud of its payment infrastructure (and also other infrastructures). But this comes with a caveat. As Michael Salmony (Equens) has pointed out, the US may be behind with respect to important infrastructures such as the internet (i.e. when looking at fibre optical penetration or average internet speed).



Infrastructure investment: Theory and practice
Source: Michael Salmony: The future of instant payments: Are we investing billions just for mobile peer-to-peer payment?, Journal of Payments Strategy & Systems Vol. 11 No. 1, 2017, p. 61.

But in terms of revenues of internet-related services ("applications") the US are far ahead of Europe. And he adds: *"In Europe new services largely seem to have emerged only in non-Euro countries"*. So, in terms of services, i.e. services with a business case, the euro area is lacking behind.

The surprising fact is that there is no automatic relationship between infrastructure investments and innovative (and revenue-generating) applications. In fact, the experience of the past suggests that the opposite is true. Application revenue falls with infrastructure investment! That is not what one would expect. But it should give food for thought for somebody who ponders a new retail payments strategy.

Europe may put a well-functioning payment infrastructure in place but the main beneficiary may well be US companies. Consider PayPal. This company has already benefitted from the introduction of SEPA Direct Debit because that has helped to direct customers away from expensive credit card funding to low cost direct debits. But direct debits have the disadvantage that they may be reversed.

Thus, PayPal is exposed to risk. But with the use of instant payments, the risk that the payer cannot pay PayPal is completely eliminated. Of course, the same applies to European PSPs. But the point is that PayPal already has a successful and profitable product. It has a huge base of consumers and merchants that are regularly using it.

PayPal does not have to set up a new brand and logo. It does not have to acquire 100.000s of merchants. Everything is in place, already. So is PayPal going to benefit from instant payments? Certainly!

Will European initiatives such as EPI benefit? Well they might. But they would have to invest large amounts of money and success is uncertain. And regulators must be willing to accept a reasonable business model.

Conclusion

The strategy paper shows that there seems to exist an entrenched reluctance to learn from past mistakes and a wholehearted enthusiasm for micro-management. The Commission is also not willing to accept an "either or". It always wants it both ways. As a result it comes up with a huge list of new regulations. But a smoergasbord of measures is not a strategy.

Appendix

Update: market shares of the domestic card schemes in the EU 2019

(hg) In the May/June 2019 issue of this report, we discussed the ECB's analysis of market shares of "national" and "international" card schemes in the EU. We analysed the market share of the main domestic card schemes in 7 Member States in their home market and the total market share of the domestic schemes as percentage of all card payments generated by European cardholders (including cross-border card spending outside the EU). The results were updated by 2018 figures in issue 8/2019. Below you will find the next update for 2019.

The results are based on figures from the ECB and the respective domestic schemes. Both sources cannot be used uncorrected for the analysis. In the ECB statistics, the figures on card payments of British cards are still far too high because they include ATM withdrawals. We have already pointed out the error to the ECB statisticians several times. Unfortunately, without success so far. Therefore, we took the British card payment data published by the Bank of International Settlement (BIS), which are correct. In addition, we have added the card-based ELV payments for Germany as a complementary domestic card system to the scheme "girocard". The observed high growth rates of girocard in the years 2018 and 2019 are mainly due to the substitution of ELV card payments.

Compared to the last update in 2018, the figures of the previous years for individual countries (especially for Spain) have changed. The figures for individual domestic schemes often also include cross-border transactions. These transactions are usually carried out via the brands of the international schemes and may therefore not be attributed to the national schemes.

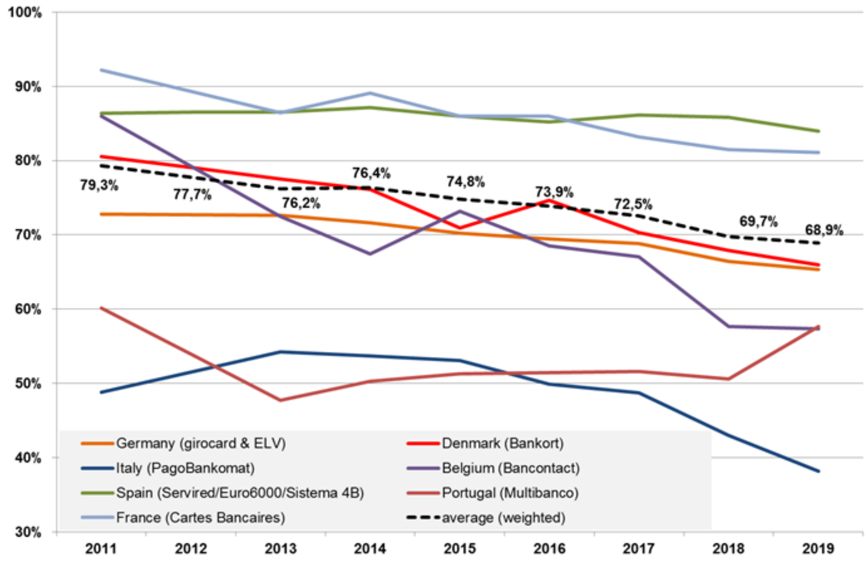


Fig. 1: Market share development of domestic card schemes as percentage of the total value of payments (sales) by cards issued by resident PSPs per country (2011-2019)

Except for the Multibanco scheme in Portugal, all schemes have lost market share in 2019, sometimes significantly as in Italy. See Fig. 1. The increase of the market share of Multibanco in Portugal is statistically due to a decline in total card payments.[12]

If the market share of domestic schemes is expressed as percentage of the entire EU card market it comes down to around 35%. What is more, our estimates show that, since 2015, the market share of domestic schemes has remained relatively stable at approx. 35% to 36% (see Fig. 2).

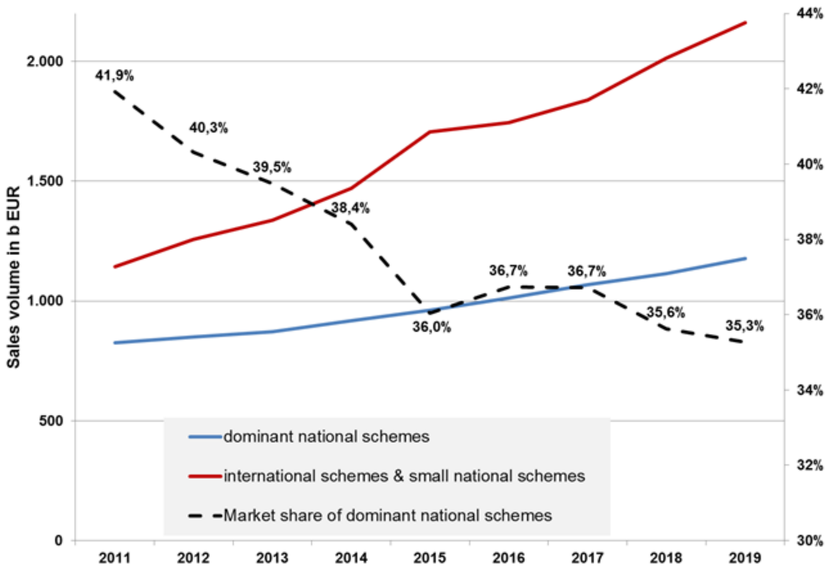


Fig 2: Market share development of ICS (incl. small national schemes) and the dominant national schemes based on the value of card payments (sales) (2011-2019)

Brexit will change this picture significantly. Excluding the UK, the market share of domestic schemes in the EU (27) for 2019 is 49.2% (2018: 50.1%).

Notes

1 European Commission: COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUR.OPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS on a Retail Payments Strategy for the EU, Brussels, 24.9.2020, COM(2020) 592 final.
2 If you are not familiar with Lucky Luke ("The Man Who Shoots Faster Than His Own Shadow"Re) you may consult https://www.com-icon.com/2020/06/12/euro-reviews-its-lucky-luke-the-man-who-shoots-faster-than-his-own-shadow/
3 See PaySys Consultancy: A question of governance, PaySys SEPA Newsletter (precursor of the PaySys Report), September/October 2011 (https://paysys.de/wp-content/uploads/2019/06/sepasepoct11.pdf) and PaySys Consultancy Donald Trump – Father of the European Card Scheme?, PaySys Report October 2018 (https://paysys.de/wp-content/uploads/2019/11/2018_7reportokt18.pdf).
4 Bruce Schneier; Secrets and Lies. Digital Security in a Networked World, Wiley: Indianapolis, 2004, p. 1.
5 Jens Weidmann: Shaping the future – Challenges in the European payments market. Speech at the virtual conference "Future of Payments in Europe", 27.11.2020 (https://www.bundesbank.de/en/press/speeches/shaping-the-future-challenges-in-the-european-payments-market-851850)
6 Morton Bech, Yuuki Shimizu and Paul Wong (2017): The quest for speed in payments, BIS Quarterly Review, March, 57-68.
7 Michael Salmony: Banks taking back control, Journal of Payments Strategy & Systems Volume 13 Number 1, 2019, p. 15.
8 PaySys Consultancy: ECB: EFMA-speech on a SEPA for Cards and interchange fees, PaySys SEPA Newsletter (precursor of the PaySys Report) November 2006 (http://paysys.de/wp-content/uploads/2019/06/newsletternov06.pdf)
9 Burkhard Balz (Member of the Executive Board Deutsche Bundesbank): Closing remarks. Speech at the virtual conference "Future of Payments in Europe", 27.11.2020 (https://www.bundesbank.de/en/press/speeches/closing-remarks-851898).
10 PaySys Consultancy: Apple versus the banks: "Lex Apple Pay" and beyond, PaySys Report December 2019 and Malte Krueger: Multilateral interchange fees: Don't throw the baby out with the bathwater ", Journal of Payments Strategy & Systems, Vol. 13, No. 2, 2019, 138-150.
11 See also Ewald Judt and Malte Krueger: A European Card Paymemts Scheme – forever a phantom?, Journal of Payment Strategy & Systems, Vol. 7, No. 4, 2013.
12 This change was due to the change in status of an important issuer, which can no longer be considered a "resident PSP in Portugal" de jure. However, it can be assumed that these cards will continue to be issued in Portugal by another country (Spain?) (cross-border issuing). For this reason, these de facto Portuguese card transactions are de jure attributed to the issuer's country in the ECB statistics. If this bank also issues Multibanco cards, the transactions are still counted in the Multibanco statistics.

We wish all our subscribers Happy New Year!

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