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Special Report | Banking Horizons 2023 | In today's world there is no place for slow finance

Miesięcznik Finansowy BANK

On instant payments, access to payment systems, open finance and data and the impact of these solutions on the competitiveness of the EU financial sector with

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interviewed by Krzysztof Grad

The European Union is introducing new payment regulations with aim to accelerate money transfers. How may the introduction of credit transfers in euro change the European Union's financial services market and its global standing?

– Popularisation of instant credit transfers in euro (SCT Inst) will definitely have a positive impact on the financial services market and the global position of the European Union, as it will allow all customers of banks and non-bank payment service providers in the EU to better manage their liquidity (balances in euro). The European Commission estimates, on the basis of data for 2020, that €68 billion per year remains frozen, as money float. Increasing the velocity of money will be a major benefit in a world where everything is speeding up and the customer expects to be best served and in real time, without any delays, which is a legitimate expectation, I would say. There is no place for slow finance in the European Union.

You emphasise that the European Commission's proposal for regulation concerns credit transfers in euro, but what about other currencies, what about payments in Polish zloty?

– Yes, the EU proposal for a regulation of credit transfers in euro, in line with the principle of subsidiarity, targets cross-border payments made in euro. From a legal perspective, this regulation will be an amendment to the 2012 SEPA Regulation. However, inevitably, its provisions will also affect domestic transfers in euro of euro area countries. In contrast, the impact of this regulation on credit transfers in the seven EU countries, whose currency is not the euro, will be limited, as in these countries only a small number of credit transfers is executed cross-border in euro and the vast majority of transfers takes place in national currency.

In my opinion it is a pity that such is only the scope of the proposed regulation, because according to the EU Retail Payments Strategy and the EU Digital Finance Strategy, adopted in September 2020, instant payments (credit transfers) should become the standard (the so-called new normal) throughout the whole European Union. After all, this is not about the Single Market of the Eurozone, but about a Single Financial Services Market across the European Union. Let us beware of a two-speed Europe, at least in this respect.

Would you suggest that the European Commission should be more ambitious with this regulation and propose that all currencies, including the Polish zloty, be covered?

– Exactly, this would be the best option, but unfortunately not so much probable, at least in the first stage. It is unlikely to materialise because of the aforementioned principle of subsidiarity and as a result of a potential opposition of certain Member States from outside of Euroland, which may voice the opinion of selected stakeholders who would not be in favour of widened scope of this regulation (certain central banks, commercial banks or clearing houses). I would draw attention to two non-EU countries that are effectively using the regulatory tools for supporting the development of instant payments. In those countries instant credit transfer are rapidly, by storm, gaining their share, to the benefit of both demand and supply side of the market. We are talking about Brazil with its Pix solution and India with its UPI solution. However, these countries find it easier to operate with a mix of regulatory and market tools, as they are not a community of many separate member states, as is the case in the European Union. I believe that for Poland the best option would be to move by market consensus as quickly as possible to the instant PLN credit transfer standard, bringing it in line with all the provisions of the regulation for credit transfers in euro and with the SCT Inst, including the ISO 20022 messaging standard.

OK, but what are the main objectives of the European Commission's proposal for a regulation on instant payments in euro?

– There are four pillars of the EC's proposal for a regulation on instant credit transfers in euro: reachability, pricing, the IBAN check service and sanctions screening. The first two pillars are crucial for the success of instant payments in euro. Firstly, the more institutions (banks and non-bank PSPs) offer incoming and outgoing credit transfers in euro, the stronger the network effect and the utility (value) of instant payments for both customers (payers, payees) and PSPs. Secondly, euro credit transfers must not be too expensive. As the regulatory impact assessment commissioned by the EC shows, in those EU countries where instant payments cost more than regular transfers and are too expensive in the opinion of payers, the adoption of SCT Inst has progressed very slowly. Therefore, the Commission has proposed that the charges for instant euro credit transfers (SCT Inst) cannot be higher than those for regular SCT transfers (cleared in batches). Thirdly, being aware of the risks of fraud and the irrevocable nature of a credit transfer, the European Commission would like to require payment service providers to implement an IBAN verification service, so that the payer can be sure to whom he or she is transferring money, i.e. whether the account number matches the name of the payee. Fourthly and lastly, the European Commission proposes to improve the sanctions screening process by making it compulsory for PSPs to check their own customers on a daily basis by referring to EU sanctions lists. Practice to date has shown that for instant payments in euro, online sanctions screening for each transaction separately results in the rejection of almost one in ten transfers, of which ex post it turns out that only a percentile should have been stopped and 99.9% should have been executed.

You have presented and explained clearly the pillars of the proposed regulation, although each of these four areas provokes more detailed questions. However, let us try to stay at the level of generality interesting to most - what will be the costs of implementing this regulation and who will bear them?

– There is no doubt that the costs will be borne by payment service providers, mainly banks. However, some of the costs will be offset by savings, such as those arising from solving the problem of the current cost-intensive sanctions screening system, in which banks refer to many sanctions lists and which result in many errors requiring subsequent interventions that generate additional unnecessary costs. I estimate that the novelty and at the same time the challenge and the biggest investment for banks will be to implement the IBAN check service, which in my opinion should cover all credit transfers, not only instant ones. I wonder how this goal will effectively be achieved on a European scale on the basis of a market-driven solution. So far, such a service has been introduced in the Netherlands (SurePay) and in the UK (Confirmation of Payee, CoP). It remains to be seen what model will become more widespread on the market - whether a model based on a central, frequently updated database of account numbers and account holders or a model based on the real-time exchange of messages between the payer's PSP and the payee's PSP using an API. The future will tell.

But what about countries such as Poland, which do not have the euro as currency and whose majority of payments takes place in their own national currency. Will in these countries compliance with the regulation introducing obligations for banks to receive and send euro credit transfers, designing and implementing the IBAN verification service, etc. will not entail disproportionately high costs?

– Of course this is a legitimate question and, thinking short-sightedly, Polish banks could stand against and deny the sense of this regulation. However, I referred earlier to the idea of a

two-speed Europe and the fact that even with its own currency, Poland is an important and integral part of the Single European Digital Market for Financial Services. We boast about the innovativeness of Polish banks and on the same time we would be giving the go-ahead for the Eurozone to enjoy a standard of instant payments, and we would still be making clearing and settlement of credit transfers by netting, no matter than three times and not once per day? We would still be using payment messages not in an XML format compliant with the ISO 20022 standard, which notabene allows for including more necessary data being thus better suited from an AML compliance perspective? I don't think this is the way to go. Let's be future-oriented and think ahead about the Polish banking sector and about Polish customers who deserve the best solutions. At the same time, I would like to mention that an instant payment service - if it is to be widespread and largely replace regular credit transfers – must not be treated by banks as a premium service. It should be cheap, in fact offered free of charge. You do not earn money on commodity. A source of revenue should be sought elsewhere.

Once you talk about banks and then about payment service providers, a broader category that also includes payment institutions and e-money institutions, which, after all, are on the rise in the European Union and successfully provide many payment services to EU consumers and businesses. Should they not also be covered by the proposed regulation and bear the cost of complying with it?

– Sure, if a payment institution (IP) or an electronic money institution (EMI) would provide a payment account service and offer instant payments, I see no reason why it should be treated differently from banks. However, it would only become possible to bring payment institutions and electronic money institutions under the full scope of the instant payments regulation if a level playing field were created for these non-bank PSPs so they could start competing with banks in the payments area on equal footing. Without this symmetry it is difficult to expect symmetry in the burdens associated with the introduction of the EU regulation on euro credit transfers.

Forgive me but I do not understand what you mean. Could you better make your point?

– Sure. Currently only banks can be direct participants to designated payment systems, such as SORBNET2 or ELIXIR in Poland. Payment institutions and e-money institutions are forced to use banks as intermediaries by opening a payment account with them. Non-bank PSPs cannot open an account with a central bank and participate directly in central bank’s money settlement. This gives rise to unnecessary risks and puts non-bank payment service providers in a subordinate position vis-à-vis banks, which, with regard to certain services - e.g. the operation of a payment account and the execution of credit transfers - are in direct competition with non-bank PSPs. For banks this situation is not comfortable either, because, for example, they are not always in a position to identify the ultimate beneficiaries of payments and to guarantee that there are no breaches of money laundering regulations. This is why a so-called de-risking in the EU occurs, sometimes unfortunately also unjustified, as the EBA (European Banking Authority) points out. De-risking or de-banking takes place when a bank terminates a payment account contract with a non-bank PSP, while at the same time indirectly causing problems for the customers of the non-bank PSP as well.

How coud this be remedied?

– The solution is simple - amend article 2b of the Settlement Finality Directive (SFD). It contains a list of institutions that can be direct participants to so-called designated payment

systems. This list should be extended to include payment institutions and e-money institutions. The problem is not new. I already pointed it out a few years ago, in 2016.[1] The European Commission is also aware of the problem. In 2022 Directorate General for i.a. Financial Services (DG FISMA), as part of the work of the Payment Systems Market Expert Group (PSMEG), set up a subgroup to prepare a report on the issues arising from the lack of access to payment systems by non-bank PSPs. I had the pleasure to chair this subgroup and present both the report and the recommendations to DG FISMA at the PSMEG plenary meeting in October 2022. Also, the European Central Bank confirmed that granting non-bank PSPs access to payment systems such as TARGET2 or TIPS requires a legislative amendment to the SFD.

So will this change be introduced at the time of PSD2 revision and enactment of the EU regulation on instant payments?

– Let's hope so. In support of this idea the *"EU direct access coalition*" was formed.[2] On 1 February 2023 nine European organisations: EDFA, EDPIA, EFA, EPIF, EMA, ETTPA, OFA, PayBelgium and the Smart FinTech Network sent a joint open letter to the European Commissioner Mairead McGuinness calling for action in such a timely fashion that European consumers and businesses could start benefiting from this positive change as soon as possible. It is as much about instant payments, the digital euro as it is about contributing to the quality of other payment services and about increasing the competitiveness of the EU payments market.

Are you saying that allowing non-bank PSPs for direct access to payment systems would have a positive impact on the offering and competitiveness of the payment services market, exerting positive pressure on banks?

– This is exactly what I am saying. Consider the wave of innovation in the European financial services market, and - as its result - benefits for customers, brought about by the EMD and PSD introducing the category of electronic money institution and payment institution respectively. In these legal forms, thousands of European fintechs have provided high-quality services to European financial services users. It is now a question of these fintechs being able to further improve their offering of payment accounts and money transfers, including instant payments. I have already mentioned that network effects are crucial for the success of instant payments. The more instant payment providers there are - banks and payment institutions - the better for customers, because the stronger the network effect and the value, the utility of this service for customers is.

Is this change beneficial for banks and would you advocate that any non-bank payment service provider should be given access to designated payment systems?

– Yes, innovative banks should support such a systemic change and seek synergies in cooperation with non-bank fintechs. While it is key to broaden the catalogue of institutions in article 2b of the SFD, changes are also needed to improve indirect access to payment systems, improving cooperation between banks and non-banks. Various problems in this area need to be solved - e.g. regarding easier identification of the ultimate beneficiaries of a non-bank PSP for the purpose of compliance with AML as well as deposit guarantee schemes' regulations. In response to your second question, it is absolutely not the case that every non-bank PSP should be given direct access to payment systems, because this involves investment costs and entails meeting legal, financial, operational and technical requirements. It is likely that many

non-bank providers, similarly to smaller banks acting so to date, will still prefer to access payment systems via banks (indirect access).

Are there already cases of central banks that facilitated access to payment systems for non-bank PSPs?

– Yes, the central banks of Brazil, India, Singapore, Switzerland, the United Kingdom and, in the European Union, acting on the basis of some exceptions, Hungary and Lithuania. The Bank for International Settlements (BIS) encourages authorities, central banks and payment system operators to improve direct access to payment systems for non-bank payment service providers. In doing so, it points to the experience of countries that have already opened access and to the self-assessment framework prepared by the Committee on Payments and Market Infrastructures (CPMI). The BIS argues that jurisdictions that have chosen to open direct access to non-bank PSPs have faced no major problems, and have benefited from, among other things, greater innovation, shorter transaction chains and faster settlement. Allowing non-bank PSPs to directly access payment systems is one of the objectives of the G20 roadmap for enhancing cross-border payments adopted by the G20 in October 2020. I therefore invite banks and non-bank PSPs to support the "EU direct access coalition".[3]

Since we are talking about opening up access to payment systems to non-banks, the question of open banking, open finance and open data comes to mind. Do you think we should go further here too, beyond the second Payment Services Directive (PSD2)?

– There is no denying that the PSD2 has contributed to the development of the open banking market in the EU, but we cannot stop with what we have. Dedicated application programming interfaces (APIs) in the EU need to be further improved, enabling even better and wider provision of payment initiation services (PIS) and account information services (AIS). However, these two services are only a prelude to a revolution aimed at transforming not only the financial sector, but all sectors of the economy, e.g. energy, healthcare, transport, education, etc. Currently, the market itself and the European regulators are both working towards an Open Finance Framework (OFF), which will cover all financial institutions (including insurers and investment funds, not just banks) and then other sectors of the economy, including bigtechs. De facto, the regulation should be designed horizontally, being primarily based on the General Data Protection Regulation (GDPR) and the Data Act (for the time being existing as a proposal). PSD2 and, in the future PSD3 or the PSR are to be only complementary here to the OFF. The GDPR already provides a legal basis for data portability, but there would need to be a legal obligation for data holders in each sector of the economy to develop quality APIs through which data owners could easily and automatically retrieve data using dedicated software or rely on an authorised third party provider (TPP).

So what would be at the heart of open finance and open data?

– Customer data ownership and the client-centric model. Open finance and open data are based on the principle that the customer has the right to an easy and automated access to his or her data at any service provider, optimally not only in the read access mode, but also in the write access mode. I encourage everybody to keep an eye on market initiatives. In mid-March 2023 you can expect to see the publication of proposals from market players who on a daily basis provide services in this area. As part of a broad pan-European group of experts, we are working towards an Open Finance Framework (OFF).

[1] *Vide Górka J. (2016), IBANs or IPANs? Creating a Level Playing Field between Bank and Non-Bank Payment Service Providers, in Górka J. (ed.) „Transforming Payment Systems in Europe", Palgrave Macmillan, London 2016, pp. 182-213*

[2] ***https://www.eudirectaccess.com/***

[3] ***https://www.eudirectaccess.com/*** *On the website you can express your support by becoming a member of the coalition, as well as read the open letter to Commissioner Mairead McGuinness and the extensive article (position paper) available in the 'Our position' section, which analyses various aspects of the topic.*

DeepL machine translation with Jakub's Górka corrections

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