Payments Ecosystem and the Role of Non-Bank PSPs

Executive Summary

The payments landscape has undergone significant changes in the last decades. The introduction of the Payment Services Directive in 2007 and the E-Money Directive of 2009 has led to the emergence of non-bank payment service providers (non-bank PSPs) delivering innovative, convenient, fast and secure payment options for customers. It has resulted in increased competition in the payment market which, in turn, allowed customers to benefit from more choice and cheaper payment solutions.

EU regulation has tried to establish a tailored regulatory and supervisory regime for the industry. EPIF very much welcomes this approach. Despite this and as a result of being a relatively new and innovative sector, there is often not enough understanding by supervisors of the business models of the non-bank PSPs. The industry often faces disproportionate requirements which do not reflect the actual nature and risks of the business. Many of our EPIF members have embraced the EU Single Market operating in a cross-border environment. EPIF members are therefore fully supportive of harmonized rules. Nonetheless, this should not lead to 'a one-size-fits-all approach'. Instead, it is important to adopt a risk-based approach to regulation and supervision which reflects the diverse nature of the 13 business models that EPIF represents.

Below are EPIF's reflections on how the European payments market is evolving and a number of Recommendations for further policy actions. These are aimed at increasing the competition, innovation, safety and reach of European non-bank payment solutions.

1. Competition in the European Payments Sector

Since the implementation of the E-Money and Payment Services Directives, the payments ecosystem has experienced substantial improvements, leading to a more competitive and innovative payment sector in the EU. We welcome the rules allowing for a licensing regime for new types of payment service providers (non-bank PSPs) – Payment and E-Money Institutions (PIs and EMIs) – recognizing that payments can be provided outside the banking sector and without a banking license, especially for payment transfers, card-based payments and electronic money products. The introduction of Open Banking, as part of revisions to the Payment Services Directive (PSD2), recognized new players, such as payment initiation services, that sought to improve the customer experience when conducting account-based payments.

This evolution has significantly broadened the choice of payment options available to customers, businesses and merchants, ranging from cash to card payments to account-to-account transfers. Today, customers enjoy a comprehensive mix of payment methods, reflecting the dynamism and the focus on customer needs of the current financial landscape.

Despite these advancements, the playing field between banks and non-bank PSPs remains uneven. PIs and EMIs are still largely dependent on the infrastructural backbone provided by banks that are both partners and competitors. Banks are partners in that non-bank PSPs rely on bank accounts to safeguard customer funds and to run their businesses. At the same time both banks and non-bank PSPs compete in offering payment services to their customers. While great improvements have been made towards a level playing field, notably by allowing non-bank PSPs direct access to interbank payment systems, the industry continues to face significant challenges.

One example is that non-bank PSPs are still required to hold client funds with banks in safeguarded accounts. The industry has experienced widespread de-risking practices by which banks can close safeguarding accounts without proper justification and accountability. In effect, this prevents our members from offering their services and compete with the various banks that have taken the decision to close the safeguarding accounts. There is also the widespread practice of IBAN discrimination. In practice this means that despite us all operating in the Single Market some operators do not recognise IBANs that originate in another Member State. The failure to recognize this crucial account identifier potentially cuts off non-bank PSPs from providing account-based payments they should be allowed to provide under the EU's regulatory framework. Addressing and removing these barriers is crucial to further enhance competition, innovation and a dynamic financial ecosystem.

Furthermore, several EU regulatory requirements have introduced an artificial bias in favour of the banking sector when it comes to the provision of payment services. The Payment Services Directive recognizes the possibility for some payment instruments to include the provision of credit as an ancillary service and as part of the delivery of the payment service. Any such credit provision is currently limited to a 12-month time limit. This limitation only applies to non-bank PSPs and puts such providers offering credit cards at a clear disadvantage to the banking sector.

Similarly, EPIF continues to advocate for a full EU-wide surcharging ban. Surcharging allows a merchant to pass on the costs of accepting payments to the customer, without any corresponding benefit. By forcing consumers to "pay for paying", surcharging reduces consumers' ability to choose their preferred payment method and misleads them on the true price of goods and services. The heterogenous regulatory landscape leads to the confusion of consumers and un-even competition. 18 Member States, including the UK, have already banned surcharging, while 10 Member States still allow for it. Our members believe that surcharging is detrimental for consumer choice, consumer protection and for the efficient functioning of the payments sector. A total ban would also enhance the level playing field between card and non-card payments, while lowering the fees for digital payments as a whole.

Another example can be found in the current plans to launch a digital euro in the EU. EPIF's members welcome this initiative which should further enhance the choice of payment instruments available to customers. EPIF is certain that its members will find the means to develop added-value services on the back of the digital euro in the same way as they have done for transfers, card and account-based payments. Nonetheless, these benefits will only materialize if customers can own multiple digital euro wallets linked to different payment offerings and added values. Without this the digital euro is likely to be linked to customers' existing bank accounts which could end up reducing the choice of available payment services and strengthen the market position of the banking sector. EPIF is also concerned that the compensation model foresees a regulated merchant service (MSC) charge, rather than allowing for competitive pricing through negotiations between payment service providers (PSPs) and merchants. Price regulation should be the last resort to address a market failure and not the starting point for the introduction of a new product. As such, our members call for exploring alternatives to the proposed compensation model.

Recommendations:

- Enforce existing rules against IBAN discrimination and de-risking.
- Recognize the unique business models of EPIF's members. The de-risking rules should be extended to third party agents or distributors where these are involved in the delivery of payment services.
- Allow PIs and EMIs to hold direct safeguarding accounts with a central bank and cut out commercial banks as intermediaries.
- Lift the PSD2 restraints for the issuance of credit and in relation to the provision of payment services. This limitation only applies to non-bank PSPs.
- Install an EU-wide surcharging ban to enable true consumer choice and ensure competition.
- Ensure a level playing field for the provision of services around the digital euro allowing customers to maintain more than one digital euro wallet as long as the overall holding limits are maintained. Additionally, we advocate for a fair remuneration framework for the core services and the ability to charge for added-value services.

2. Innovation and FinTech, Including Open Banking

As highlighted, global payments have undergone significant changes in recent years. An important driver of this development has been the transformation of the economy and the emergence of new digital businesses which have been able to embrace technological innovation. This includes online e-commerce platforms as well as newly emerging sectors, such as new digital applications – a sector that could reach a turnover of just under half a trillion euro by 2027.

Not only are consumers making payments in a broader range of scenarios today (e.g., on-demand services, in e-commerce, supporting crowdfunding, or leveraging FinTech), many of today's consumer journeys also include an integrated payments experience and payments using multiple channels that are made instantly and do not require to present a card or cash. All of this improves safety, speed and convenience. Consumers are increasingly getting used to just tapping their device or using one-click checkout solutions to complete a purchase within seconds. These new payment journeys are facilitated by the technology provided by different payment services providers and a diversity of payment solutions to support them (e.g., subscription models, direct-to-consumer, pay-outs, electronic wallets on the phone or Buy-Now-Pay-Later).

In addition to changing business models and payment behaviours, technology has also transformed how payment service providers operate. Technological innovation supports an increasing range of services and can help the payment industry face new challenges. For example, the massive growth of e-commerce has created a corresponding increase in online payments fraud. Online fraud has cost businesses worldwide an estimated $38 billion in 2023. Fraudsters move fast and will find ever more innovative ways to circumvent rules. Therefore, banks and non-bank PSPs have been deploying a variety of tools designed for modern digital businesses to address this and understand their customers better. This also allows them to detect potentially fraudulent activity through tools such as machine learning and AI. Non-physical biometrics, such as behavioural and environmental elements, are also proving increasingly helpful in supporting customer authentication.

The trend towards increased cross-border payments is also continuing. Despite heightened geopolitical uncertainty and perceived global risks, companies are continuing to grow their market by expanding into other countries. We have seen a substantial increase in the number of global marketplaces and cross-border retail activity which is one of the main drivers for growing demand in seamless cross-border payments. Consumers want to be able to purchase goods and services anywhere in the world with their preferred payment method. Similarly, businesses that want to be successful in today's global economy must be able to accept hundreds of different local payment methods reflecting the different preferences of their customers. By continuously striving to provide new innovative payment solutions tailored to their customers' needs non-bank PSPs are working towards reducing friction in global economic activity and helping businesses leverage the international financial network to scale.

The ability of payment service providers to deliver innovation for businesses and consumers also comes from regulation that supports the development of new technological solutions. For example, the new SEPA Instant Payments Regulation will enable market participants to deliver new customer solutions across the EU. The regulatory push towards the use of alternative payment rails, notably toward instant payments can significantly contribute to the adoption of account-based payment methods and increase the choice and reach of payment solutions for businesses and consumers. Central banks are also at the forefront of innovation by developing central bank digital currencies.

Finally, the development of Open Banking in the Payment Services Directive was an important catalyst for change in the payments landscape. The Open Banking revolution implies the use of bank account data and the streamlining of the payment experience for the customer. This has led to new market entrants, such as Payment Initiation Service Providers (PISPs) that helped streamline the payment process, and Account Information Service Providers (AISPs) that allowed the aggregation of payment data across different payment accounts. These are collectively known as third-party providers or TPPs. Open banking brings increased transparency to consumers.

Open banking is growing fast. Europe has seen the number of TPPs increase from around 100 to more than 450 in less than two years. This growth is expected to continue in the coming years. According to a study conducted in 2023 by Juniper Research, the total amount of open banking transactions in the world will reach USD 330 billion in 2027.

Open banking also benefits banks by partnering with FinTech companies. The SEPA Payment Account Access (SPAA) scheme initiated by the European Payments Council (EPC) in 2022 is a good example of collaboration between banks and TPPs. The scheme covers a set of rules, practices and standards that will allow the exchange of payment accounts related data and facilitate the initiation of payment transactions to provide customers with optimised services.

Open banking is only the first step. Over the coming years, we will transition to Open Finance and ultimately the open sharing of data based on customer consent. The legislative proposal for a Financial Data Access Regulation (FIDA) provides the cornerstone for the adoption of Open Finance at the European level.

Recommendations:

- Adopt a more risk-based, digitally-forward and outcome-oriented approach to regulation, including for strong customer authentication (SCA), for example through the recognition of behavioural biometrics, use of exemptions, and the adoption of a risk-based approach.
- Further advance cross-border payments infrastructure, notably through SEPA Instant Payments connectivity with other real-time payment systems. Noteworthy projects in this area include the EPC Scheme for One-Leg Out Instant Credit Transfers and the ECB's work on the settlement of payments involving cross-currency conversion.
- Leverage the legislative proposal for a Payment Services Regulation to remove the barriers TPPs face accessing customers' account data. A study released earlier this year by French EPIF members estimates that 47% of the transactions by PISP face operational challenges.
- Encourage standardization at the EU level in the Open Banking data sharing arrangements, including through standardized APIs.
- Support a swift and practical implementation of FIDA through a clear identification of first use-cases and the development of the relevant schemes.

3. Making AML Compliance Work

The fight against financial crime, money laundering and terrorism financing (ML/TF) is an important responsibility of banks and non-bank PSPs and is essential to maintain overall customer trust. The non-bank PSP sector continues to heavily invest in this by allocating a large proportion of its resources to improve AML/CTF controls. In doing so our members rely on innovative technologies such as artificial intelligence and machine learning. These technologies are used for back-office activities to analyse and respond in real-time to transaction behaviours and patterns.

As a result, the non-bank PSP sector has made significant improvements in recent years to reduce its risk exposure and residual risks through increasingly sophisticated risk-mitigating measures. Consequently, EPIF strongly supports a risk-based approach to regulation. As highlighted by the Financial Action Task Force (FATF) in its 2012 Recommendations, a risk-based approach is crucial for regulated entities to enhance measures in areas where risks are higher and apply simplified measures for low-risk activities. Therefore, a risk-based approach helps to promote a better understanding of risks, as well as a more efficient allocation of resources to fight money laundering and terrorism financing – for public authorities and law enforcement, as well as the financial institutions.

However, the fight against ML/TF still faces barriers at European level due to the continued fragmentation in the application of the rules and their enforcement across Member States. This is expected to improve with the establishment of the new EU Anti-Money Laundering Authority and the move from a Directive to a directly applicable EU Regulation. However, further work will be required to improve the exchange of information between all parties involved. Such cooperation is crucial for the effective investigation of suspicious transactions. One example is suspicious transaction reports (STRs), that do not necessarily capture international networks of criminal activity due to different country-based requirements. In fact, our members are often required to remove key information when activity touches multiple countries This often results in reports lacking sufficient details for regulators or law enforcement to take the relevant actions.

Our members will often have a unique perspective on how different criminal activities relate to one another. Again, adopting a risk-based approach and enabling greater information exchange could help public authorities, Financial Intelligence Units (FIUs), and law enforcement agencies to leverage this knowledge. A good example are the links between counterfeit and drug trafficking operations in one part of the world and the financing of terrorist activities and illegal arms trafficking in another part of the world. Criminals also have access to increasingly sophisticated technologies. Mapping and targeting those interlinkages can help address the terrorist threat in a more creative and effective way. While the links between financial crimes are widely acknowledged and reported, the use of technologies by the industry, such as AI and machine-learning, can play an important role in developing effective strategies to target, identify, mitigate and prevent financial crime.

Recommendations:

- Further harmonize the requirements for STR reporting, allowing the industry to include information from all jurisdictions and not only the information relevant to the country-specific report.
- Consider implementing a one-stop-shop for information exchanges between financial institutions, FIUs and relevant authorities. This should also include deploying a centralized, interactive IT platform.
- Recognize and provide incentives for the investment in new technologies and their application to anti-money laundering and terrorism financing, by promoting a risk-based approach to the application of the rules and recognising in European law the benefits of risk-mitigating techniques.
- Specifically, use dynamic product and customer risk assessments to implement risk-based customer due diligence controls at the time of customer onboarding and through the lifetime of the customer's relationship with the financial institution.

- Revise the approach to the EU's Supra-National Risk Assessment to reflect the risk-based approach and risk mitigation techniques.

4. Strengthening the Single Market

As already mentioned, e-commerce and digital payments are on the rise across the EU. According to Eurostat, in 2023, 75% of EU citizens purchased or ordered goods and services online. The rapid rise of e-commerce has been closely linked to significant advancements in digital payment systems, alongside the introduction of new regulations designed to meet EU standards. A significant part of the rise in e-commerce payments consisted of cross-border payments in the EU. Payment services are an important infrastructure in making the Single Market a success.

The EU boasts a modern and evolving payment ecosystem, where both card-based payment services and alternative payment methods have flourished. This growth has provided consumers with a wide variety of payment options, including digital wallets and account-based solutions, that are gaining considerable traction due to their convenience and speed. As digital commerce continues to grow, the availability and diversity of these payment options are expected to further expand across borders, but also in national markets where domestic solutions are tailored to local consumer behaviour. Non-bank PSPs are innovating to meet changing customer needs and expectations.

Despite these successes, the EU payments ecosystem would benefit from further harmonisation and standardisation. The diverse API and SCA standards across the 27 Member States pose a significant challenge for payment service providers operating throughout the EU. Moving from the Payment Services Directive to a Regulation is a promising step towards reducing these barriers and clarifying the responsibilities of home and host supervisory authorities for EU-wide non-bank PSPs, banks and merchants. In addition, national authorities should work to reduce regulatory fragmentation and promote cross-border payment interoperability to support a more unified digital economy across the Single Market.

In tandem, the development and adoption of a Central Bank Digital Currency, such as the digital euro, has the potential to drive innovation and competition while offering a seamless, interoperable payment solution across the EU. To ensure its success, the digital euro should offer clear and tangible benefits across the EU payments supply chain such as instant settlement, enhanced privacy, innovation and financial inclusion, while ensuring competition by allowing customers to take advantage of multiple wallet solutions within the overall holding limits. The digital euro should also be based on a fair remuneration model.

To enable technological advancements, regulation should be more outcome and risk-focused than prescriptive. While SCA has played a positive role in reducing certain types of fraud, the current SCA provisions can make it disproportionately difficult for customers to complete legitimate e-commerce transactions. Regulations that take an outcome-focused approach can help meet policy objectives like promoting security, while also ensuring the continuity and growth of e-commerce by allowing for a streamlined and efficient customer experience (i.e., reduce risk of payment timeouts, abandonments and declines). Digital identity wallets, such as the one introduced by the newly adopted eIDAS Regulation, could serve as an effective tool for SCA, minimizing friction in customer verification and enhancing the overall e-commerce experience.

Recommendations

- Accelerate the harmonization of API and SCA standards across the EU to streamline regulatory frameworks and foster cross-border payment interoperability.
- Prioritize the development of the digital euro to provide an interoperable and inclusive payment solution that drives innovation across the EU, while maintaining access for customers to multiple wallets and a fair pricing model.
- Adopt a more flexible, outcome-focused approach to SCA rules to enhance security while reducing payment timeouts, abandonments and transaction declines.
- Promote the use of digital identity wallets under the eIDAS Regulation to streamline SCA, reduce customer friction and improve the security of online transactions.

5. Conclusions

We believe that the non-bank payment sector is providing a crucial infrastructure to make the Single Market for payments a reality. We hope European decision makers will consider our Recommendations as we embark on the next five years of European integration with the aim to deliver safe, smooth, innovative and cost-effective payments to our customers in the EU and beyond.

EPIF represents the non-bank payment sector in the EU covering a wide range of business models from remittance companies, to card issuers, acquirers, processors and innovative payment providers. In total, we have over 300 direct and indirect members and about 60% of the overall market. The recent growth in membership has come from the FinTech and innovative business models in the payment sector.