



BANCA D'ITALIA
EUROSISTEMA

Innovation in the EU retail payments' market: the new regulatory landscape



Costanza Iacomini

Banca d'Italia

**Money as a means of community
belonging**

Università di Siena

12-14 December 2018

Market and Payment System Oversight Department

Agenda

- Innovation and regulation:
 - What are the drivers for the development of new payment services?
 - What is the role of the regulator?
- From PSD1 to PSD2
- What's going on in the market?
 - new services
 - new technologies
 - new intermediaries

Innovation in payment services

- The development of payment instruments and services 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 need to maximize their profits and may not have the right incentives to reach a socially viable equilibrium

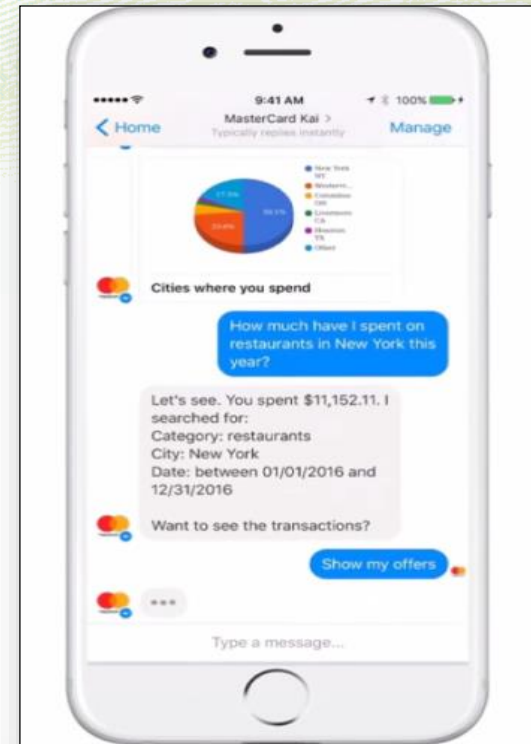
The role of the regulator

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

- foster innovation and improve 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 customer to take financial decisions



Regulation and regulatory gaps

Regulated payment services

The diagram consists of two overlapping circles. The left circle is light green and contains the text 'Regulated payment services'. The right circle is light grey and contains the text 'New services'. The intersection of the two circles is shaded in a darker grey. An arrow points from the intersection area towards a text box on the right.

New services

Possible regulatory gaps

Main Issues

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

The drivers of PSD1 (2007)

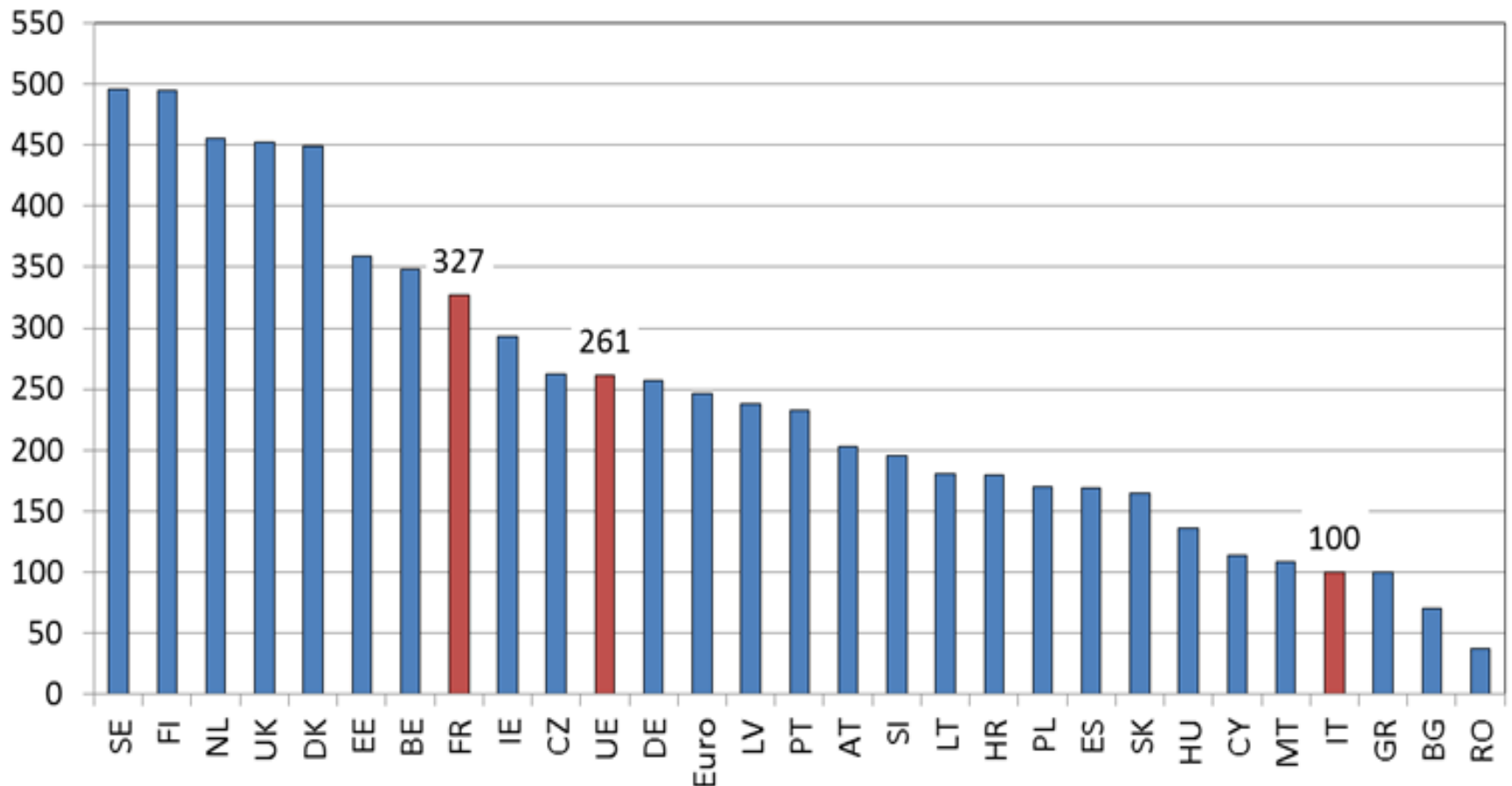
- PSDI was the first fully-fledged legal framework of European payment services aiming at
 - increasing competition by introducing payment institutions, a new category of authorized payment service providers with European passport
 - harmonizing the EU market by defining characteristics of payment instruments (credit transfers, direct debits, cards) and negative scope of application (cash back, limited networks)
 - enhancing consumer protection by cutting execution times, strengthening refund rights and clarifying the liability regime between providers and users

From PSD1 to PSD2 (2015)

- PSD I provided
 - 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 (2016) updates and complements PSD I to take into account new regulatory needs and to further support the use of electronic payment instruments

Use of non-cash payment instruments

Number of transactions per person with non-cash payment instruments (2017-ECB, Datawarehouse)



Innovative services (1)

- PSD2 regulates two on-line payment services that bring innovation and competition in the market
 - 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 (an alternative to card-based Internet payments)
- These services can now be offered by banks, electronic money institutions and payment institutions

Innovative services (2)

PISPs and AISPs

- access clients' account held by other PSPs (typically banks)
- never manage clients' funds

PSD2 provides for an ad-hoc supervisory regime

- no own funds requirements
- payment institutions that only offer AIS and/or PIS need to hold a professional indemnity insurance covering risks
- no rules on safeguarding of funds

New security rules

Technological advances make payments faster, user- friendly, easily accessible, but also more risky and prone to fraud

PSD2 sets the general security requirements and mandates the EBA to draft secondary regulation on

- Strong Customer Authentication (SCA) requirements and exemptions (amount, risk analysis...) and real time antifraud measures
- standards for secure communication channels (APIs)
- notification of security incidents to authorities
- operational and security risk management

New security rules: SCA (1)

To validate the identity of the user, PSPs are obliged to apply SCA when a payer accesses its payment account online or initiates a electronic payment transaction. SCA is based on the use of three independent elements

- something only the user knows (e.g. password or PIN)
- something only the user possesses (e.g. a card)
- something only the user is (e.g. fingerprint)

Authentication based on two or more of such elements shall result in the generation of an authentication code only accepted once by the PSP

New security rules: SCA (2)

- For electronic remote transactions, such as online payments, the security requirements set by PSD2 prescribe the adoption of a dynamic link to the amount of the transaction and the account of the payee. This further protects the user and minimizes risks in case of mistake or fraud
- Exemptions to the principle of SCA are possible, as it is not always necessary and convenient to request the same level of security (low value, c/less, trusted beneficiaries, recurring transactions, low risk operations after performing transaction risk analysis...)

New security rules: Standards for secure communication

ASPSPs have to grant PISPs and AISP secure access to clients' accounts through

- customer on-line interfaces (modified to ensure that PISPs and AISPs are able to identify themselves towards the ASPSP and communicate securely) or
- dedicated interfaces (Application Programming Interfaces – APIs) with the same level of performance and availability as customer interfaces

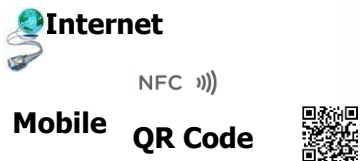
Banking communities are working to implement market solutions for the development of common interfaces allowing access to PISPs and AISPs in line with PSD2/EBA RTS standards

What's 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
- After Internet and e-commerce, Fintech is developing
- Many innovations fall in the scope of the regulation



Innovative devices



New technology

- **Wallet applications**
- ***Instant payments***
- ***Mobile payments***
- ***Contactless payments***
- ***ePayments***
- ...

What's new in the retail market?

Fintech* allows for digital, mobile, real time and frictionless services and as a result banking services evolve



* FSB's definition for Fintech: "technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services"

Banks and Fintech: three main scenarios

1. Fintech firms offering financial services directly, competing with banks on specific services; in Europe they need an authorization as payment institutions
2. Banks adapting and developing Fintech-like solutions, to improve provision of financial services; some banks are themselves active players in technological innovation applied to finance, research and development of new products
3. Partnerships between independent Fintech firms and traditional banks, combining the innovative and user-experience focus with reputation, risk management capabilities and strong customer relationships of traditional banks

Challenges for regulators

- **Static regulation vs dynamicity of technology**

Two-layer approach in PSD2: 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 to e-payment developments (user experience)

- **Risk of shift to unregulated sectors**

Same activity, same rule principle



Conclusions

- Technological advances offer significant opportunities for individuals, enterprises and, in general, for the economy
- A sound legal framework is important for the development of secure and efficient payment services and for authorities to maintain users' confidence in the regular functioning of the payment system
- Regulation should foster and support innovation (e.g. proportionality principle, technological neutrality, general principles and technical standards)
- Authorities should engage in a constant dialogue with the market to monitor relevant developments and, if needed, intervene promptly