European Parliamentary Financial Services Forum

EPFSF Briefing on

"How to make instant payments flourish in the EU"

Introduction

The purpose of this event would be to understand how the European Commission's proposal on instant payments will change the future of instant payments in the EU and what impact it has on the main actors involved. It will also address some elements within the proposal that, need further fine-tuning to ensure a balanced outcome. What follows first is a brief introduction of (instant) credit transfers.

An instant credit transfer, also known as an instant payment, is a credit transfer whereby the funds flow from the payer's payment account to the payee's payment account within 10 seconds. [1] Instant payments are available any time and every day of the year. This distinguishes instant payments from traditional credit transfers, which settle the next business day.

In recent years, the dominance of international cards brands as well as BigTech payment wallets has increased[2] and payments have become more and more a strategic consideration for the EU as part of the broader ambition of increased strategic autonomy. The on-going geo-political crisis adds further critical perspectives to the status quo of the EU retail payment ecosystem. Independent EU-built payment solutions at the point of sale only work at national level – all EU-wide payment solutions are provided by non-EU firms.

In this context, the Commission considers instant payments as an important tool to facilitate a pan-European payment method using instant payment rails as a competitive advantage to provide an alternative the dominant card and wallet brands. In 2020, the Commission and the European Central Bank officially enshrined this political and monetary policy objective as a key pillar in their retail payments strategies. [3][4]

Over 2000 PSPs are currently offering instant payments, which represents around 60% of European PSPs and over 70% of euro area PSPs. The latest figures available (Q3 of 2022) show that 13% of euro credit transfers are instant payments The legislative proposal aims to address the heterogenous progress towards instant payment readiness across EU Member States and the subsequent limited number of instant payment-based payment solutions which lead to low adoption rates of instant payment services. However, this is expected to change tremendously once instant payments are used for payment solutions in shops and e-commerce, which is the key focus of this legislative action.

Proposal European Commission

[1] Instant payments in euro are based on the SEPA Instant Credit Transfer Rulebook of the European Payments Council (EPC). https://www.europeanpaymentscouncil.eu/what-we-do/sepa-instant-credit-transfer
[2] Impact assessment report on amending Regulations (EU) No 260/2012 and (EU) No 2021/1230 as regards instant credit transfers in euro, European Commission, 26 October 2022, https://ec.europa.eu/finance/docs/law/221026-impact-assessment_en.pdf/.
[3] Retail payment strategy for the EU, European Commission. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0592.
4 Retail payment strategy for the Euro-areas, European Central Bank. https://www.ecb.europa.eu/pub/pdf/other/ecb.eurosystemretailpaymentsstrategy~5a74eb9ac1.en.pdf

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On 26 October 2022 the Commission unveiled its proposal which consists of amendments to the SEPA Regulation under four articles that aim to increase the adoption of instant payments and tackle several existing issues.[5] The proposals are summarized below.

1. Article 5a: Instant credit transfer transactions

Currently, it is optional for PSPs to offer instant payments. The aim of article 5a is to a) increase the number of payment accounts ready to receive instant payments and b) increase the number of payment services based on instant payments. Proposals by the Commission:

1. PSPs that offer to their payment service users (PSU) a payment service of sending and receiving credit transfers shall offer to all their PSUs a payment service of sending and receiving instant credit transfers in euro.
2. Instant payments in euro should be offered through the same PSU interfaces as the ones through which payers place a payment order for traditional credit transfers;
3. When providing instant credit transfers in euro, PSPs shall offer to their PSUs the possibility to submit multiple payment orders as a package in case they offer that possibility to their PSUs for other types of credit transfers.

Payment Institutions and E-Money Institutions are outside the scope of article 5(a) of the proposal on instant credit transfers. The de-scoping is a result of the lack of access of these institutions to the settlement system under the settlement finality directive (SFD). PSPs located in a Member State whose currency is the euro shall offer the service of receiving and sending instant payments in euro 6 respectively 12 months after the date of entry into force of this Regulation. PSPs whose currency is not the euro have 30 respectively 36 months to offer the service of sending and receiving instant payments in euro.

2. Article 5b: Charges in respect of instant credit transfers

In some Member States, PSUs are currently charged a premium price for instant credit transfers. The Commission aims to equalize fees between regular credit transfers and instant ones and proposes the following:

- Any charges applied by a PSP on payers and payees with respect to sending and receiving instant credit transfer transactions in euro shall not be higher than the charges applied by that PSP in respect of sending and receiving other, corresponding, credit transfer transactions in euro.

PSPs located in a Member State whose currency is the euro have 6 months after the date of entry into force of this Regulation to comply. PSPs whose currency is not the euro have 30 months. In terms of potential conflicts with the price interventions in the existing EU Cross-Border Payments regulation the Commission defines a number of additional clarifications for those Member States.

3. Article 5c: Discrepancies between the name and payment account identifier of a payee in case of instant credit transfer

Instant payments, as regular credit transfers, can be subject to certain types of fraud and due to the irreversibility of credit transfer, consumers are concerned to unintendedly transfer money to the incorrect person, e.g., because of a typo. In some Member States, this is partly mitigated with the IBAN-name check: When making a transfer, the payer will receive an alert when the payee's name and IBAN-account number do not match. This can reduce typo errors and certain types of fraud. The Commission aims to make the IBAN-name check mandatory for instant payments:

[5] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 260/2012 and (EU) 2021/1230 as regards instant credit transfers in euro.

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- A payer's PSP shall offer an IBAN-name check for instant payments. When there is no match, the PSP shall notify the payer of any discrepancies detected and the degree of the discrepancy.
- PSPs shall ensure that the payer is not prevented from authorizing the instant payment in any case.
- PSPs shall ensure that PSUs have the right to generally opt out from receiving this service. PSUs that opted out should have the right to opt in again.
- PSPs shall offer this service regardless of the interface used by the payer.

PSPs located in a Member State whose currency is the euro shall comply 12 months after the date of entry into force of this Regulation, Member States with a different currency have 36 months.

Article 5d: Screening of PSUs with regard to Union sanctions in case of instant credit transfers

Currently PSPs have the obligation to screen transactions against applicable sanctions lists, and both the payer and payee PSP screen each individual transaction. This practice leads to a large percentage of rejected EU cross-border instant payment transactions due to the impossibility to investigate an alert created in transaction screening, given the ten-second execution time of instant payments. This method is incompatible with instant payments and therefore the Commission proposes to move from transaction screening to client database screening. This would align the screening practice for instant payments with that for card payments. PSPs will screen (at least) once every 24 hours all clients on sanction lists. The Commission's proposal:

- PSPs executing instant payments shall verify whether any of their PSUs are listed persons or entities.
- During the execution of an instant payments, the payer's PSP and payee's PSP shall not verify whether any of their PSUs are listed persons or entities.

All PSPs should comply within 6 months after the date of entry into force of this Regulation.

Key points in the discussions

There is a vivid debate regarding the Commission's proposal because of the impact it will have on consumers and the industry beyond the initial intention of the legislative action. Even though the number of requirements is limited, the expected impact on the industry is considerable. Much of the discussion is centered around proportionality in relation to the goal of the proposal – a pan-European payment solution.

Scope

From an industry perspective, account servicing payment service providers (ASPSPs) should, broadly speaking, fulfill two requirements to facilitate pan-European payment solutions built on instant payments: (1) PSUs should be able to send and receive instant payments via their payment account and (2) PSUs should be able to send instant payments via *electronic* interfaces to ensure payment at the point of interaction[6] is possible. The European Commission goes beyond these requirements. PSPs will be obliged to offer instant payments through non-electronic channels also (if regular credit transfers are offered through such channels), which include ATMs/self-service machines, phone, mail etc. whilst in 17 out of 20 Euro-area Member States 5% or less of all credit transfers are initiated through these channels[7]. Moreover, none of those channels is used for payments in shops or e-commerce. Added value for European consumers would be very limited for non-electronic channels, as due to the nature of these transfers, they will not be processed within ten seconds but significantly slower. Corporate payments sent as 'bulk' payments would have to be processed as instant payments as well. Moreover, credit institutions (i.e. banks) that focus on a specific market segment or niche (e.g. mortgages) and are not active in retail payments are also obliged to offer instant payments under current proposal.

[6] The point of interaction includes point of sale payments at physical stores and e-commerce payments made online.
7 ECB Payment Statistics 2021. https://sdw.ecb.europa.eu/reports.do?node=100000764

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PIs and EMIs can play an important role in delivering new innovative instant payment services that would further enhance competition in the market, and in fact some do so already on a voluntary basis.

It is important to ensure the alignment of this proposal with other legal initiatives in the payments area, such as the Anti-Money Laundering Regulation (AMLR) and PSD2, to ensure consistency. For example, the alignment with the AMLR proposal provisions on targeted financial sanctions as well as a risk-based approach which is one of the key AMLR principles. Moreover, in terms of timeline, credit institutions not yet instant payment ready on the receiving or sending side will require more time to adjust their infrastructures and processes.

IBAN-name check and the prevention of fraud
This check can prevent only certain types of fraud and cannot be expected to generally mitigate all types of fraud risks. It is therefore important to introduce proportionate obligations keeping in mind all other fraud-preventing measures a PSP applies for payments.

Obligations to perform the IBAN-name check must be introduced for both the payer and the payee PSP. The current proposal only obliges the payer's PSP to offer this service, whereas only the payee's PSP has the relevant data.

In the case of payment solutions at the point of sale, which are based on instant payments, the IBAN-name check will result in an additional and inconvenient step during the payment process whilst these situations impose no fraud risk. Similar to the same type of exemption for the anti-money laundering measure under the Funds Transfer Regulation, instant payments to purchase goods and services should be exempt from the IBAN-name check obligation.

Additionally, similar to the obligations to send and receive instant payments, the IBAN-name check is technically not implementable for paper-based and self-service terminal payment orders nor for bulk-payments.

Finally, in order to define a standardized and efficient IBAN-name check procedure amongst all PSPs in the EU, the payment industry will need time to build an infrastructure. From the experiences with similar legal obligations in the context of the EU Funds Transfer Regulation to prevent money laundering this will take at least 24 months.

Charges for instant payments
Instant payments can pave the way for new payment solutions that could strengthen Europe's strategic autonomy. Their adoption rates remain however low partly because of a low number of solutions that can be used in the day-to-day payment use-cases.

At the same time, the banking industry argues that there are significant cost implications for the EU payment industry to implement and maintain the instant payments infrastructure that would be required by the legislation. For a credit institution, to process an instant payment transaction costs more compared to traditional credit transfers: processing on a transaction-by-transaction basis eliminates efficiency gains from batches and netting, and 24/7 operations for the end-to-end infrastructure requires comprehensive support systems and staff.

On the other hand, many of the benefits of instant payment compared to traditional credit transfers are on the payee side in a consumer-to-business (C2B) context. A 10-second finality of a payment eliminates cost of defaulting payments, improves the cash flow and reduces operational cost for merchants compared to direct debits or traditional card payments. These businesses will likely be willing to pay for instant payments because of the benefits, if its fees are competitive.

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Interaction with the Digital Euro

For the digital euro, the ECB project prioritizes 3 key use cases: in-shop, e-commerce and peer-to-peer payments - exactly the target use cases for payment solutions based on SEPA instant credit transfers.

In a study published in November 2022, the International Monetary Fund (IMF[8]) highlights the risk of the simultaneous push for instant payment readiness and the issuance of central bank digital currency for retail payment use as "too strong to be ignored". They compromise each other's success. In light of the existing geo-political context of the EU retail payment system, the EU must act quickly and efficiently. It cannot afford a failure of any of the ongoing highly relevant initiatives including the Digital Euro and the European Payment Initiative (EPI).

Therefore, the banking industry calls for alignment between the two initiatives. The legislative initiative on instant payments should focus on the key items necessary for the industry to offer individual electronic instant payments.

Sanctions
Generally, the industry has positively welcomed the Commission's proposal to change from transaction screening to client database screening, as this will reduce the number of false positive hits and further facilitate instant payments.
It has been pointed out that some amendments to the Commission proposal would provide further clarity and legal certainty, for instance to ensure alignment with current sanction law, compliance standards and best practices.
In addition, non-EU headquartered banks, including some with a significant presence in the EU, have an obligation to screen their home jurisdiction lists as well as international lists such as OFAC or HMT. Therefore, the new EU requirements could create confusion and even be contradictory in certain circumstances.

<u>Conclusion</u>
This event will debate the above themes, and will help to inform the current debate on the proposal among the European Parliament Members.

Questions to be addressed include:
1. What would the benefits and challenges of pan-European instant payments be?
2. How does this initiative align with other (legislative) initiatives in payments, such as the Digital Euro and the European Payments Initiative?
3. What would be the biggest challenges in terms of implementation?
4. Is the IBAN-name check an effective way to address fraud?

[8] IMF Study on instant payments. https://www.imf.org/en/Publications/WP/Issues/2022/11/18/Instant-Payments-Regulatory-Innovation-and-Payment-Substitution-Across-Countries-524032

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