Position paper on access of non-bank PSPs to payment systems

(Expert working group[1])

1. State of play – identified problems

1.1. Introduction

Improved access to payment systems for non-bank Payment Service Providers (PSPs) is a key component of the third pillar of the EU Retail Payment Strategy and one of the core objectives in the G20 roadmap for enhancing cross-border payments. In the EU, this policy goal could benefit payments greatly by fostering competition and innovation. It could also aid financial inclusion. However, there are barriers to overcome in order to put authorised regulated payment institutions (PIs) and electronic money institutions (EMIs) on equal footing with banks from an access perspective. In this paper PIs and EMIs are collectively referred to as non- bank PSPs.

By enacting the Electronic Money Directive (EMD) and the Payment Services Directive (PSD), the EU took the groundbreaking decision to establish new forms of payment service providers - EMIs and PIs - reflecting that payments could be facilitated without a full banking licence. This spearheaded a tremendous level of innovation in the financial sector, and in the payments industry in particular. Now, over a decade later, it is right for the EU to continue that progress and reflect the fact that institutions do not necessarily need a *banking* licence to access the *payments* infrastructure. However, in order to facilitate this, all associated risks need to be carefully scrutinised before any adjustments to the current legal frameworks and market settings are made.

In this paper, the working group will set out the current state of play and the different ways in which access to payment systems is facilitated for non-bank PSPs. We will describe the issues with the lack of direct access and the impact of de-risking. Throughout this paper, we will also touch upon the lack of safeguarding options including the ability to safeguard at central banks, an area which we recommend is explored further. However, the core focus of this paper is access to payment systems for non-banks, as is reflected in the recommendations.

1.2. No direct access to payment systems

Today in most jurisdictions, non-bank PSPs cannot directly access payment systems which rely on the settlement of funds in central bank money. The lack of access to a settlement account at the central bank and legal requirements in PSD2 and the Settlement Finality Directive (SFD), forces non-bank PSPs, no matter how sound and large in operations, to open accounts at commercial banks to indirectly access payment systems.

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In general, there are two types of access to payment systems available to PSPs[2]:

1. Direct access, where a direct participant in a payment system is a party that instructs, clears and settles payments on its own behalf; direct participation requires the participant to have a central bank account of some kind (e.g. a settlement account).
2. Indirect access, where a PSP can access a payment system via a direct participant which acts as its intermediary for the submission of payment instructions to the payment system and clearing and/or settlement of funds (indirect participation can take various forms).

Indirect access leads to longer transaction chains, which slows down the payment and increases cost as more intermediaries are involved and take a cut. In addition, indirect participants are dependent on direct participants from a technical and business perspective. The issues stemming from the lack of direct access will be discussed in more detail in section 1.5 of this paper.

However, at the same time, indirect participants do not bear the investment costs of connecting directly to the payment system, nor the operational, technical and regulatory costs associated with running and maintaining the infrastructure. It may not make commercial sense for every PSP to pursue direct access, which is why not only non-banks but also smaller banks make use of indirect access. Therefore, it is crucial that indirect access remains a path PSPs can pursue.

1.3 Central bank account types

Direct access to a payment system with settlement in central bank money requires opening an account at the central bank. The BIS distinguishes three account types:[3]

1. Settlement-only account that is used only for transactional purposes (participants are unable to hold balances beyond those necessary for effecting payments).
2. Reserve account or overnight account that gives participants access to additional central bank services (such as deposit and credit facilities, including access to intraday credit or to overnight deposits).
3. Supplemental account, not used for settlement but for other purposes (e.g. as cash collateral).

While this paper primarily focuses on settlement accounts (which is the minimum needed to directly participate in payment systems), the working group will touch upon reserve accounts (type 2 above) in the context of safeguarding funds for PIs and EMIs. As set out further down in this discussion paper, non-bank PSPs are reliant on banks to submit payment instructions on their behalf and to hold client funds in safeguarded accounts. For non-bank PSPs to be able to safeguard client funds at central banks, they have two options, fund the account using their own funds or fund the account with customers safeguarded funds. Non-bank PSPs therefore would likely need a reserve account or an upgraded version of a settlement-only account (type 1 above) that would allow for holding balances, i.e. client funds, for longer periods.). Furthermore, reserve accounts of banks do not serve only transactional purposes but also other objectives related to conducting monetary policy by central banks which adjust money supply and manage liquidity of banks and their ability to give credit in the economy.

[2] BIS (CPMI), 2022, *Improving access to payment systems for cross-border payments: best practices for self-assessments* pp. 5-7 (10.09.2022)
[3] BIS, ibid. p. 7

1.4 Legal blockers & overview of access arrangements

As set out in the SFD (art. 2b), only certain types of institutions (relevant to this discussion these are credit institutions) are eligible to open an account at the central bank and directly access payment systems as defined within the meaning of the SFD. This is the current legal blocker for non-bank PSPs to directly access payment systems in the EU, but it's worth pointing out that some countries have found ways around this issue. We describe two European case studies, Hungary and the United Kingdom, in the Annex.

Moreover, we highlight the results of the CPMI (BIS) survey of central banks on access arrangements conducted in the first quarter of 2021.[4] The survey covered 184 payment systems reported in 76 jurisdictions, 81 payment systems in CPMI jurisdictions and 103 payment systems in non-CPMI jurisdictions.

It comes as no surprise that almost all payment systems allow banks for direct participation. However, there is a growing number of payment systems worldwide which are expanding or are considering expanding direct access to other types of participants, including non-bank PSPs. This is due to several factors including the changing mindset of central bankers, de-risking and an increasing interest from non-bank PSPs in gaining direct access to the payment system. For half of the payment systems in CPMI jurisdictions and more than one third payment systems in non-CPMI jurisdictions non-bank PSPs expressed an interest in becoming direct system participants (table 1).

Increased interest in recent years from non-bank PSPs and/or foreign entities in having access to the payment system[1] Table 1

	All payment systems		CPMI		Non-CPMI	
	Total	%	Total	%	Total	%
Yes	118	64.1%	62	76.5%	56	54.4%
Yes, on direct access	77	41.8%	41	50.6%	36	35.0%
Yes, on indirect access	41	22.3%	21	25.9%	20	19.4%
Both, direct and indirect access	20	10.9%	13	16.0%	7	6.8%

[1] The percentages are computed as a share of the 184 payment systems, of which 81 are in CPMI jurisdictions and 103 in non-CPMI jurisdictions.

Source: CPMI survey.

Around 60% of payment systems reviewed (almost the same fraction in CPMI and non-CPMI jurisdictions), give consideration to expanding access within the next five years, with the aim of fostering innovation and competition. However, few payment systems currently have concrete plans to expand access (table 2).

[4] BIS ibid. p. 9

Potential expansion of the type of institution eligible for directly and/or indirectly connecting to the payment system within the next five years[1]

Table 2

	All payment systems		CPMI		Non-CPMI	
	Total	%	Total	%	Total	%
Yes	110	59.8%	49	60.5%	61	59.2%
Yes, possible if certain conditions are met	67	36.4%	32	39.5%	35	34.0%
Yes, very likely	29	15.8%	12	14.8%	17	16.5%
Yes, there are concrete plans	14	7.6%	5	6.2%	9	8.7%
No	65	35.3%	30	37.0%	35	34.0%
No answer	9	4.9%	2	2.5%	7	6.8%

[1] The percentages are computed as a share of the 184 payment systems, of which 81 are in CPMI jurisdictions and 103 in non-CPMI jurisdictions.

Source: CPMI survey.

The CPMI (BIS) report showcases how different countries, such as Brazil, India, Singapore, Switzerland and the United Kingdom facilitated direct access for non-bank PSPs to payment systems and succeeded in overcoming legal and regulatory, financial, operational and technical barriers.

It needs to be underlined, as the CPMI (BIS) puts it in their report, that "jurisdictions that have expanded their access policy, particularly to non-bank PSPs, did not report major negative impact to the structure or operation of their payment systems. However, next to a growth in transaction volumes, several payment systems reported increased need for help desk support and a rise in operational incidents (including cyber attacks) as an impact of a change in the composition of participants accessing the payment system."[5]

1.5 Overview of issues related to the lack of direct access for non-bank PSPs

The lack of direct access to payment systems causes a wide range of obstacles for non-bank PSPs, most of which have been highlighted by the BIS in their recent report[6] on improving access to payment systems.

These include:

- **Slowing the pace of innovation:** due to dependency on direct participants, some payments innovation can only become available to a non-bank PSP's customers, once their sponsor bank has adopted it. For example, the uptake of instant payments would likely increase if non-bank PSPs were able to settle payments themselves and become participants in instant payment schemes and payment systems directly, as voluntary bank adoption of instant payments has been slow. This would increase pressure in the market to adopt the latest innovation, as companies that do not provide these innovative services will negatively stand out.
- **Barriers to competition:** Today, non-bank PSPs have to enter into a commercial agreement with a direct participant (often a competitor) who can dictate the price of access. This price is often set significantly higher than what the direct participant pays to the system operator, even when taking into account the investment costs needed to gain the access. It is also up to

[5] BIS, ibid. p. 11
[6] BIS, ibid, pp. 13-14

the bank to determine their risk appetite, which can translate into refusal of service (de-risking) or requests for changes in the operating model of the non-bank.

- **Credit, operational and financial stability risk**: Non-bank PSPs are operationally reliant on direct participants to make payments on their behalf, which entails exposure to credit risk where receipts of funds are held with the direct participant (e.g. due to different bank holidays), operational risk, if/when the direct participant has an outage or the direct participant has to stop all payment operations due to a regulatory bank moratorium. In addition, the CPMI (BIS) highlights that the direct vs indirect participation arrangements could "pose a risk of spillovers if a direct participant's risk to default increases due to the transactions of indirect participants and this could pose risks to financial stability, if systemic, in terms of activity or size *(albeit in Systemically Important Payment Systems, this is monitored closely via a tiering analysis carried out on a yearly basis[7])*. Increased direct participation in the payment system could reduce these risks, which has led some authorities, such as the Bank of England, to work in this direction."
- **Less transparency:** For regulators and oversight bodies, direct non-bank PSP participation in payment systems could provide greater transparency, improving the management of compliance (including with AML/CFT regulations) and reputational risks. It would mean they have a more detailed understanding of and oversight over participants, allowing them to make more informed decisions.

However, it is worth clarifying that for many non-bank PSPs direct access, for various reasons, won't be a viable option to pursue. For example, a non-bank PSP may not believe the investment in obtaining direct access and financially contributing to the maintenance of the payment system is justifiable if their transaction numbers are low. It is therefore crucial that indirect access remains an option.

1.6. Overview of risks related to direct access

It will be of utmost importance to assess the risks that providing direct access to non-bank PSPs could introduce into the ecosystem. The addition of new types of participants to payment systems must be carefully considered and subject to a robust risk assessment by the Commission and by the European system of central banks, prior to amending the SFD.

Payment system operators rely on supervisory and regulatory regimes applicable to bank PSPs to ensure the smooth operation of their payment systems, a core principle for payment systems. This reliance on supervisory and regulatory regimes makes operating payment systems more efficient and cost-effective. Any lack of harmonisation of technical, operational, financial, governance and risk management (amongst others) regulatory requirements applicable to bank and non-bank PSPs will have to be addressed by additional verifications and validations by payment system operators, which will increase cost.

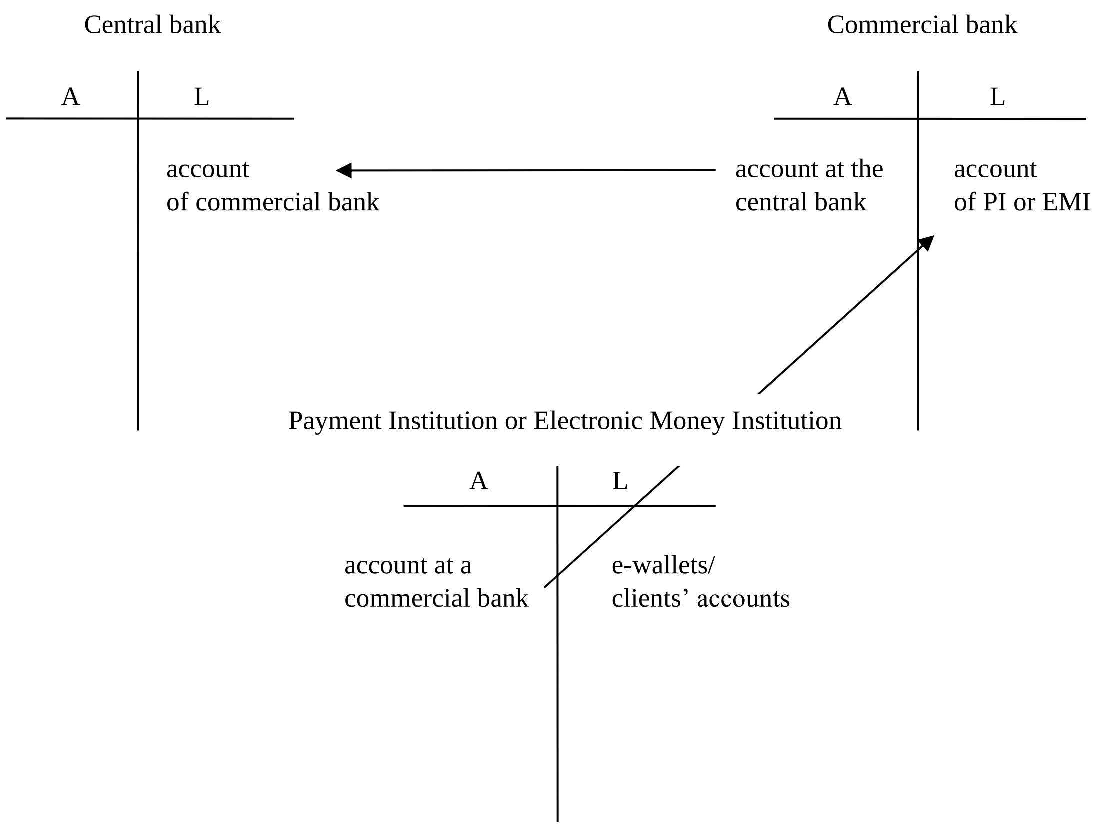
It will therefore be helpful to carry out a gap assessment in regulatory requirements, in order to address these and ensure continued adherence to the principle of *same business, same risk, same regulatory requirements*, as well as the level playing field and proportionality principle.

[7] Article 17 Tiered participation arrangements of the Regulation of the European Central Bank (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28)

1.7. Indirect access and the negative impact of de-risking

Due to the lack of direct access, non-bank PSPs are in a subordinate position vis-a-vis a competitor group – commercial banks (figure 1) because their payment orders must be processed through a commercial bank to settle in payment systems.

Figure 1 Current *modus operandi* of non-bank PSPs.



Source: 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, p. 199.

Another important element is that non-bank PSPs are legally required to safeguard all customer funds. In practice, non-bank PSPs generally achieve this, as required by the first and second PSD, through bank accounts held at credit institutions (CIs), despite the fact that according to the PSD non-bank PSPs should theoretically be able to rely on low risk securities, an insurance policy or other equally strong guarantees from an insurance company or a credit institution. In reality, the insurance policy is not viable alternative given that it is - if available at all - expensive due to limited competition in this space. In addition, considering the nature of client funds protection, a guarantee seems to be the desired protection given that funds need to be 100% protected. In contrast, insurance policies are subject to deductibles so do not necessarily provide 100% protection. Regarding the option for non-bank PSPs to invest in highly rated securities, not all jurisdictions in the EU issued a PSD2 delegated regulation containing a list of low risk assets. Some Member States have (e.g. Poland, Belgium), which has had a beneficial impact.

In addition, CIs' concerns about compliance with money laundering and terrorist financing (ML/TF) laws in the EU (AMLD) and other jurisdictions has led to de-risking. After conducting a market investigation, the European Banking Authority (EBA) found that CIs in the EU refuse to start, or decide to unilaterally terminate, business relationships with some types of customers (often including PIs and

EMIs), which they judge to be associated with higher ML/TF risk[8]. Blanket de-risking of an entire category happens most frequently in relation to so-called non-bank PSP money transmitters, negatively impacting remittance senders and in-country recipients.

The EBA concluded that unwarranted de-risking adversely affected different types of bank customers – from respondent banks, PIs, EMIs, to individuals (e.g. asylum workers) or not-for-profit organisations. Unwarranted de-risking can have serious consequences. In a worst-case scenario, it can put non-bank PSPs out of business, as banks can choose to terminate relationships with very little advance warning. This means that the PI's or EMI's customers have to find an alternative payments provider at short notice, which can lead to a suboptimal customer experience. The EBA found that unwarranted de-risking occurs across the EU, having a detrimental impact on the achievement of the EU's objectives, not only in terms of enhanced competition in the single market but also in relation to fighting financial crime effectively and promoting financial inclusion.

Non-banks are in effect required to 'purchase' safeguarding accounts from direct competitors to meet regulatory requirements. They are charged a maintenance fee, as well as transaction fees to move money in and out and are required to make product and procedural changes to meet their sponsor's risk appetite. This also means that established banks then have disproportionate oversight over their competitors' models, and a direct impact on their service and compliance. In addition, CIs can profit from the holding of non-bank customer funds. The pass through of the interest (or other type of investment income) generated by banks from investing these funds is not incentivised due to the lack of competition in the market.

A solution is to change the law so that non-bank PSPs can access central bank settlement accounts via which they are able to safeguard client funds. However, as stated in the Annex, it isn't always practically possible to do this and it may require access to other central bank accounts. This is why, there may also be an argument to expand access to reserves accounts to non-bank PSPs. Direct access to central bank accounts removes barriers to entry for non-bank firms and establishes a more level playing field between banks and non-bank PSPs. Opening up access to the central bank balance sheets reduces the dependency of non-bank PSPs on a small number of banks for safeguarding purposes and increases the protection of client funds.

The Commission, the European Central Bank (ECB) and the national central banks should consider the impact of a potential solvency issue of a participant and the impact of how the safe return of safeguarded funds would be handled. Whilst this will require them to intermediate to a certain extent operationally, the normal process in such a situation would be led by the national regulators. This is not dissimilar to a bank solvency event, but the process itself is likely simpler than a typical bank's procedure. Customer funds are required under PSD2 to be separated immediately from company funds. A trustee would be appointed and act as temporary custodian to the funds at the central bank, and to redistribute balances back to users. PSD2 also provides explicit guidance preventing both the co-mingling of customer and business funds, and ensuring that other creditors can not claim customer balances should insolvency occur. It is unclear how this works in practice if the safeguarding account is held with a central bank.

On the other hand, expanding overnight access to non-banks PSPs would open up questions around storing client money with central banks, a position that would need to be explored and assessed from various aspects. A thorough analysis of granting PIs and EMIs the right to store client funds at the

[8] EBA, 2022, *Opinion of the European Banking Authority on 'de-risking'*, 22 January, EBA/Op/2022/01 (10.09.2022)

central banks is beyond the scope of this paper, but it is worth highlighting it in the context of de-risking and opening up access to non-bank PSPs.

1.8. Ambiguous status of client funds held in accounts of non bank PSPs at a commercial bank in the case of a bank insolvency or bail-in

At the time of the wording of PSD1 (before the Lehmann bankruptcy and financial crisis of 2008), safeguarding funds in the case of insolvency of a non-bank PSP was a heavily debated topic. This led to the current safeguarding requirements, which remained largely unchanged in PSD2.

As set out in art. 5 (1) of the EU Directive from 2014 on Deposit Guarantee Schemes (DGSD) deposits of certain categories of financial institutions, including PIs and EMIs, are excluded from deposit guarantee schemes' coverage. On the other hand, DGSD art. 7(3) says that "where the depositor is not absolutely entitled to the sums held in an account, the person who is absolutely entitled shall be covered by the guarantee, provided that that person has been identified or is identifiable…" These two articles clash with each other and leave room for different interpretations in Member States (MS), hence different approach to guarantee coverage of client funds deposited by PIs and EMIs in CIs' safeguarded accounts. Some of DGSs in the EU countries guarantee client funds while the others do not guarantee client funds, oftentimes noting that they are not able to identify ultimate beneficiaries, because they do not receive from CIs single customer view (SCV) files with information suitable for identification of account holders at PIs and EMIs.[9]

Only certain countries, including Germany, have historically had unlimited PI and EMI client fund protection through voluntary, additional special protection regimes for German saving and cooperative banks. Therefore for many countries, in the case of a bank insolvency or bail-in, PI and EMI client funds safeguarded in banks will not be guaranteed at all and might be lost. This distorts the market towards banks, as the funds held with banks are usually guaranteed (up to a limit), including when bank customers use payment services.

In 2021, the EBA conducted a survey between national deposit guarantee schemes designated authorities to find out whether client funds placed with CIs by different types of financial intermediaries, including CIs, PIs, EMIs, investment firms and other financial institutions are currently covered by the national DGSs. The survey also asked other relevant questions, such as the amount of client funds in proportion to other bank deposits or the identifiability of ultimate beneficiaries holding funds with a PI or EMI.

With respect to PIs and EMIs, the survey results showed that out of 27 EEA countries that responded to the survey[10]:

- In 16 Member States (MSs) client funds placed by payment institutions with CIs are covered, in 10 MSs they are not, and in one MS the authorities were not sure.
- In 13 MSs client funds placed by e-money institutions with CIs are covered, in 13 MSs they are not, and in one MS the authorities were not sure.

The results of the EBA survey also revealed that of the 19 EEA countries for which the EBA managed to gather quantitative data:

[9] EBA, 2021, *Opinion of the European Banking Authority on the treatment of client funds under Deposit Guarantee Schemes Directive*, 27 October, EBA/Op/2021/11
[10] EBA, ibid. p. 5-7

- In 13 MSs the amount of client funds constitutes (or is estimated to constitute) less than 1% of all covered deposits in that MS.
- However, in almost all cases where client funds constitute (or are estimated to constitute) at least 1% of all covered deposits, they would already be covered by the respective DGS.

The EBA opined that based on the results of their study the DGSD should be clarified to ensure that client funds placed by non-bank PSPs on behalf of their customers should become subject to DGS protection. Moreover, a see-through approach should be applied across the EU to make all ultimate beneficiaries identifiable. Lastly, given the small amount of client funds-based deposits of non-bank PSPss to all covered deposits at CIs, client funds ought to be taken into account when calculating contributions of CIs to DGS funds. CIs are able to recover costs from non-bank PSPs and they already follow this pricing strategy. Also, higher contributions to a regular DGS fund would lower resolution fund contributions and liquidity coverage ratio (LCR) requirements.[11]

In addition, in most cases non-bank PSP customers are not aware where and at which institutions their funds are safeguarded, so those customers are not able to evaluate the insolvency risks of the respective banks or insurances. The “risk-free” alternative of safeguarding PI and EMI client funds with central bank accounts (for example by safeguarded accounts at EU central banks) is currently not possible in most EU jurisdictions.

2. <u>Remedy – recommendations for the European Commission and for other legislators</u>

1. <u>*Expand catalogue of institutions in art. 2b SFD following a risk-based approach*</u>

The expert working group recommendation is for the definition of ‘participant’ in Article 2b of the Settlement Finality Directive to be expanded. If the definition of ‘institution’ is expanded to cover electronic money institutions within the meaning of the E-Money Directive, and authorised payment institutions as defined in the Payment Services Directive, the legal blocker to enable direct access to payment systems for non-bank PSPs is removed.

Aligned to the change above, the Expert working group believes that the exemption under PSD2 Article 35 (2a) regarding payment systems designated under Directive 98/26/EC (Settlement Finality Directive) should be removed. At the same time, central banks should work with payment systems operators to reconsider the participation criteria for the payment system they operate.

However, the group acknowledges that the addition of new types of participants and amendments adapting the SFD for alternative technologies, should be assessed against the objective of avoiding systemic risk. Such amendments should only be considered following a robust risk assessment by the European Commission together with the ECB and the Eurosystem central banks, and the amendments should incorporate risk mitigation measures, as appropriate.

[11] EBA, ibid., p. 9

In the event that the definition of "participant" is indeed broadened, payment system operators should retain the right to set reasonable and proportionate[12] risk-based requirements for the access by such new types of participants[13].

Any amendments to the SFD should ensure that the principle of "same business, same risks, same regulatory requirements" is respected, to maintain a level playing field and follow a proportionality rule in the market.

2. *Support the BIS (CPMI) recommendation to improve direct access*

Expert working group supports the recommendation of the BIS (CPMI) to improve direct access to payment systems by encouraging authorities and payment system operators considering expanding access to undertake self-assessments of domestic frameworks against the best practices. The BIS (CPMI) provides a useful tool – a self-assessment framework consisting of steps and guiding questions:

Step 1: Set the main objectives and determine the scope of the self-assessment

Step 2: Evaluate the benefits of expanding direct access to payment systems

Step 3: Assess potential barriers and risks of expanding access to payment systems

Step 4: Develop conclusions

This could be a useful first step for EU central banks in order to develop a path forward.

3. *Explore introducing the right for PIs and EMIs to safeguard client funds at central banks*

Expert working group believes that the right for non-bank PSPs to hold a safeguarded account at a central bank would exert a competitive pressure on the EU commercial banks which currently, in an overwhelming majority of the EU Member States, serve as the only viable depository of client funds at PIs and EMIs and their gatekeeper to payment systems. It remains for further consideration what type of account would be most appropriate - whether a reserve account would be needed or whether it would suffice for PIs and EMIs to have a settlement account or another new type of account that would facilitate holding balances overnight (client funds at a central bank).

This issue requires a more detailed investigation, because it connects with various aspects important from the perspective of a central bank, its role and different types of risk it is bound to induce. Typically, central banks have not been keeping funds of non-MFIs (non-monetary financial institutions) such as individuals or businesses. Even, as evidenced by the first movers - see the UK - this option is not yet in its full swing, because maintaining safeguarded accounts by the Bank of England poses practical issues. Keeping client funds directly at a central bank in safeguarded accounts requires addressing a number of issues related inter alia to responsibilities of a central bank in case of a non-bank PSP's insolvency.

[12] Article 16 of the Regulation of the European Central Bank (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28) requires that payment system operators shall, in compliance with the principle of proportionality, set requirements that restrict access to the minimum possible extent.

[13] Reference is made in this context to CPMI-IOSCO Principle for Financial Market Infrastructure KC 2 ("An FMI's participation requirements should be justified in terms of the safety and efficiency of the FMI and the markets it serves, be tailored to and commensurate with the FMI's specific risks […]").

4. *Amend art. 36 of PSD2 as suggested by the EBA*

Expert working group concurs with the view of the EBA that for the sake of tackling effectively the de-risking problem, PSD2 article 36 should be enhanced to increase its applicability by:[14]

- mandating the EBA to develop technical standards to ensure consistent application of art. 36 across all EU countries (clarifying 'duly justified reasons' for refusing access to PIs/EMI to accounts with credit institutions or terminating contracts on accounts of PIs/EMIs that have already been maintained by the CI (criteria such as demonstrable shortcomings in ML/TF controls, the risk profile of the CI or PI/EMI, a breach of contract, the particular business model of the CI or PI/EMI, lack of information and documents received from the PI/EMI, and others),
- obliging CIs to notify competent authorities not only about rejecting to open an account during the PI/EMI onboarding process but also about an intended closing of an account when a CI takes a decision to offboard a non-bank PSP.

Dedicated guidance for CIs that make decisions to de-risk could well address the unwarranted de-risking problem and limit its scale in Europe. Some Member States, e.g. Denmark, have already taken steps to include stronger wording of PSD2 article 36 in their national payment services acts.

5. *Cover client funds at PIs and EMIs with DGS's guarantees*

Expert working group supports the EBA recommendation to clarify the DGS Directive in order to ensure that client funds deposited with a CI by non-bank PSPs are covered by a DGS in case the CI holding the client funds were to fail. Thus, from a technical perspective, DGSs need to be capable of identifying ultimate beneficiaries by obtaining SCV files with all the necessary data. Also, as the EBA states, the estimated impact of additional contributions paid to DGSs by CIs, based on the funds kept by PIs and EMIs in safeguarded accounts with CIs, would be minor. Therefore shouldering on non-bank PSPs another cost burden associated with DGS contributions should be avoided, especially given the fact that PIs and EMIs are charged different fees within their business relationship with banks that operate non-bank PSPs' accounts.

6. *Establish additional measures in safeguarding options that would create a more level playing field between bank and non-bank PSPs*

Expert working group is of the opinion that indirect access to payment systems for PIs and EMIs puts banks in an advantageous position, since this allows them to negatively affect the business of non-bank PSPs, by charging excessive prices or by pursuing an unwarranted de-risking strategy, among other things. Therefore, it seems reasonable to establish additional measures helping non-bank PSPs seek alternatives to holding client funds in safeguarded accounts at banks. According to the law (PSD2), there are two alternatives for PIs and EMIs: either investing in low risk assets or securing an insurance policy or guarantee. For the former, it would be recommendable for the EBA to set a list of low risk securities in order to make this option uniformly available in all Member States, including those that so far have not yet set clear rules in this respect. For the latter, it would be advisable prior to any revision of PSD2 to engage in a dialogue with the insurance industry to identify and remove obstacles to offering such a safeguarding insurance policy at a reasonable price. We also recommend that the

[14] EBA 2022, ibid., *Opinion on 'de-risking'*

EU Commission considers providing further clarity on how non-bank PSPs should manage safeguarding given the challenges of maintaining the funds in the safeguarding account at the correct level.

In conclusion, in order to create a level EU-wide playing field between banks, EMIs and PIs providing payment services, improvements should be evaluated both in a PSD2 and SFD review.

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Annex I: Direct access for non-banks PSPs in the United Kingdom

The United Kingdom was the first country to consider changing its payment system access requirements to include non-banks. Competition and access has long been a theme under consideration and this process has been driven by the establishment of the Payment Systems Regulator (PSR). To spearhead increased access to the payment system, the UK's Faster Payment System pioneered its New Access Model, which enables non-bank PSPs to access the network via partnerships with sponsor banks. This was an interim measure while the Bank of England worked on delivering upon its objective to open up the payments infrastructure to non-banks.

In 2016, the UK Treasury confirmed it was going to include payment institutions (PIs), defined as "non-bank payment service providers such as some 'fintech' firms" within the scope of the Settlement Finality Regulations (the national implementation of the Settlement Finality Directive) to "allow PIs[15] to participate in central bank settlement at the Bank of England and become members of the main UK retail payment systems"[16]. The Regulatory Policy Committee confirmed this didn't require an impact assessment as it was classified as a "non-qualifying regulatory provision". This cleared the path to direct access in the UK.

In 2017, the Bank of England committed to allow non-bank PSPs to apply for a settlement account. In April 2018, Wise became the first non-bank to obtain a settlement account with the Bank of England, enabling it to become a direct participant in the UK's Faster Payments System. This policy change significantly lowered processing costs for non-bank PSPs as they now pay the wholesale cost per payment rather than a multitude of this to its intermediary bank.

As part of the process to obtain a settlement account and become a direct participant in the payment scheme, non-bank PSPs have to go through a supervisory assessment process with the UK's Financial Conduct Authority (FCA). The assessment areas include governance and risk management arrangements, safeguarding of customer funds and financial crime. After the feedback process, the FCA confirms to the Bank of England that it is satisfied before the Bank and payment scheme can agree access to a settlement account and the relevant payment scheme.

Since this policy change, many non-bank PSPs have opted for direct access. In fact, all onboarding slots that the UK's Faster Payment System has available for non-bank PSPs to become direct participants have been booked up for the next two years. This shows the value for larger scale non-bank PSPs and it is probable that this could create a similar watershed moment in Europe if this policy change is pursued.

It is also worth noting that non-bank PSPs are now also able to facilitate indirect access for other non-bank PSPs who may not want to pursue direct access because of the financial or technical investment required. In 2019, the first non-bank PSP started providing indirect access, encouraging more competition in the market and reducing the levels of de-risking.

The Bank of England has indicated that longer term, the innovation stemming from expanded access should promote financial stability by:

- Creating more diverse payment arrangements with fewer single points of failure
- Identifying and developing new risk-reducing technologies

[15] EMIs were already permitted such access under the transposed settlement finality regulations.
[16] HM Treasury, 2016, *Including payment institutions as 'participants' under the Settlement Finality Regulations*

- Expanding the range of transactions that can take place electronically and be settled in central bank money.

Currently, the Bank of England states that "Authorised electronic money institutions and authorised payment institutions (as defined below) are ineligible for participation of the SMF [Sterling Monetary Framework], and therefore can only hold a settlement account. These institutions are required to manage client funds in a manner consistent with relevant safeguarding regulations."[17] While the Bank has established a "Customer Funds model", enabling non-bank PSPs to hold customer funds in a Bank of England pre-funding account, some firms have practical concerns with this approach, which are outside the scope of this paper, but which make safeguarding via settlement accounts at the Bank not a viable option.

<u>Annex II: Direct access for non-bank PSPs in Hungary</u>

Hungary's path to direct access differs from the UK's example. While Hungary adopted the Settlement Finality Directive in 2003, in preparation of becoming a member of the European Union, it did not explicitly expand the participant list to include categories beyond credit institutions. However, the Hungarian parliament adopted Act CXXXIX of 2013, which sets out primary objectives of the central bank of Hungary, Magyar Nemzeti Bank (MNB). In Article 159 of the Act, it's clarified that "the MNB shall be entitled to manage forint and foreign currency accounts on behalf of a) payment service providers as defined in the Act on payment services [...]".[18]

The MNB describes its tasks in its Account Management Policy (AMP) in the following way: "the MNB, acting exclusively as a settlement bank, manages forint payment accounts for credit institutions having a registered seat in an EEA country, other payment service providers offering payment services in Hungary [...]".[19] This allows the MNB to provide a settlement account to payment service providers, without requiring those institutions to hold a banking licence. The AMP explicitly mentions that for this group of institutions, the "MNB manages payment accounts exclusively in relation to direct participation in the Hungarian real time gross settlement system (Valós Idejű Bruttó Elszámolási Rendszer, VIBER) operated by the MNB and being the central bank's basic settlement platform. Account holders may use their payment accounts exclusively for such purposes, i.e. for executing, and settling payment transactions executed directly in VIBER." PSPs are explicitly mentioned as potential participants in VIBER.

Obtaining direct access and becoming a direct participant in the Hungarian payment schemes and the local clearing house (Giro) requires an account that allows for settlement in VIBER. Before this can be enabled, PSPs need to be assessed by the MNB. Following this assessment, there is an extensive test procedure to ensure a PSP's technical capabilities are sufficient to contribute to the smooth functioning of the payment system. This includes testing to certify that the applicant is technically able to send and receive VIBER messages.

In its Payment Systems Report, the MNB recognised that there is now a pan-European push to explore direct access. They highlight that allowing non-bank actors to have access to critical financial infrastructures "is already provided by the MNB", hinting at its progressive role in opening up the

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[17] BoE, 2021, *Bank of England Settlement Accounts*
[18] MNB, 2022, *Act CXXXIX of 2013 on the Magyar Nemzeti Bank*, unofficial translation
[19] MNB, 2020, *Account Management Policy*

payments infrastructure. In addition, Hungary implemented a decision to make their new instant payments scheme (Giro Instant) mandatory when it launched in 2020. This ensured that all direct participants (including banks and other PSPs) offered instant payments to all consumers in Hungary at the same time.

One area worth highlighting is that the direct connection to the payment schemes is not technology agnostic. One of the local requirements is to only allow for that connection to be established via physical data centres based in Hungary. This makes resolving any potential outage much more difficult. To make payment systems future-proof as well as accessible, cloud-based services need to be part of that offering and the EU should be wary of making access requirements too prescriptive and not tech-neutral.