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EFA Position Paper on the Settlement Finality Directive Review

Introduction

Non-bank players are increasingly playing an integral role in the European payment system, but they are operationally reliant on an intermediary to make payments on their behalf. With that in mind, the European Fintech Association (EFA) fully supports the European Commission's (Commission) planned review of the Settlement Finality Directive (SFD).

The SFD, which came into force in 1998, was aimed at 'contributing to the efficient and cost-effective operation of cross-border payment and securities settlement arrangements.' However, all players do not have the same fair, open, and transparent access to payment systems that would guarantee a level playing field.

The Payments Services Directive 2 (PSD2) went some way in ensuring non-bank PSPs could compete on a level playing field, stating that '*Member States shall ensure that the rules on access […] payment service providers […] to payment systems shall be objective, non-discriminatory and proportionate and that those rules do not inhibit access more than is necessary to safeguard against specific risks*'. However, that equal access is revoked by excluding all payment systems designated under the SFD. If PSD2's intention was to grant equal access to payments for all PSPs, the narrow and outdated interpretation in the SFD of who can be deemed a participant is a legal obstacle for payment innovation.

Key recommendation

To create a truly competitive Digital Single Market in financial services, **FinTechs and payment service providers should be allowed to have direct access to the payment infrastructure, even to those payment systems designated under the SFD.** This would foster innovation in the European payments market, create a level-playing field between market participants, speed up the uptake of instant payments while avoiding a patchwork of national legislation.

EFA recommends that the Commission should propose a legal review of the Settlement Finality Directive (SFD), in which **the scope of the definition of 'institution' is expanded to cover electronic money institutions within the meaning of the E-Money Directive, and authorised payment institutions or small payment institutions as defined in the Payment Services Directive, subject to appropriate supervision and risk mitigation.**

Why direct access matters

- **Direct access levels the playing field and fosters innovation**

The most innovative players, often non-banks, are not allowed to participate in central bank settlements or become direct members of the main retail payment systems. They must enter into commercial agreements with a bank to access fundamental infrastructure. These commercial agreements might require the non-bank

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to notify their banking partner, often their competitor, before making commercial decisions relating to their product. This puts non-banks at a disadvantage if they serve the same market segment as the bank. This can also make sponsor banks bottlenecks for innovation, as they can threaten to offboard (de-bank) a non-bank when differences in approach, product, or implementation arise. De-risking and de-banking have been a critical issue for all payment service providers, but especially for money transmission operators, which struggle to obtain and keep bank accounts to serve their customers.

Furthermore, non-banks might incur credit risk where receipts of funds are held with the intermediary (e.g. due to outages or differing bank holidays), exposing non-banks to imbalances they can't correct themselves. As non-bank players increasingly play an integral role in the European payments system, direct access would also significantly reduce the systemic risk and reliance on banks for processing the payments for both consumers and businesses alike. By being able to reduce the number of non-banks clustered around the few available sponsor banks, more firebreaks are introduced into the payments infrastructure, as any sponsor bank issues will lead to the decline of fewer non-banks.

Direct access would allow non-banks to compete on a level playing field and they would be less dependent on their competitors. Non-banks would also be able to offer a wider range of new or enhanced products, increasing competition and innovation in the market.

EFA recognizes that for a large number of smaller PSPs, it will not be time or cost-effective to join the payment scheme as a direct participant because of a small number of transactions or volume that flows through their systems, which is why indirect access should remain available. It's a viable setup until a certain scale is reached.

- **Direct Access hepls Instant payments become the new norm**

As the European Commission also aims at making instant payments 'the new normal', direct access for non-banks becomes even more important. Any legislative action on instant payments should be made in parallel with allowing non-banks to directly participate in the payments infrastructure. Thus far, it has been impossible for indirect participants to gain access to instant payments unless their 'sponsoring' bank implemented the instant scheme. This prevents the bank's customers from accessing instant payments, but also delays the uptake for the indirect participant's (FinTech's) customers often against their wishes.

- **Direct access across the EU would reduce fragmentation**

Globally, there is momentum around allowing non-bank institutions to directly access the payment infrastructures. The Financial Stability Board (FSB) has recognised direct access to payment systems by non-banks as one of the building blocks to improve cross-border payments and have initiated a workstream on this. The BIS Committee on Payments and Market Infrastructures (CPMI) and the World Bank have stated that payment infrastructures, including those operated by central banks, should permit fair and open access to their services upon risk-based participation requirements. These requirements can't just be to hold a banking license.

In Europe, some markets have already been more open to granting direct access to non-banks. For example, Hungary allows non-bank PSPs to apply for a settlement account if they comply with the necessary requirements. In 2019 Switzerland announced the launch of a new FinTech license that enables direct access to the local payment infrastructure. In the UK, the Bank of England already provided non-banks with direct access to the payment scheme in 2017 by introducing a broader definition of 'institution' in the SFD, including e-money institutions as well as payment institutions.

Consequently, action at the EU level would not only increase competition in the market but also avoid fragmentation in the Single Market.

About us:

The European FinTech Association (EFA) is a not-for-profit organization representing leading FinTech companies of all sizes from across the EU. It brings together a diverse group of 35+ FinTech providers ranging from payments, to lending, banking, robo-advice, investment as well as software-as-a-service for the finance sector, with a clear focus on enabling a single market for digital financial services.

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