

## Opening Keynote

### Digital payments in the context of the evolving financial market infrastructure in the euro area

**Marc Bayle de Jessé, Director General Market Infrastructure and Payments, ECB,  
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#### **Instant payments and TARGET Instant Payment Settlement (TIPS) – the sine qua non for innovative payment solutions in Europe**

##### *Introduction*

At a time when digitalisation allows you to call or message anyone across the globe, access up-to-the-minute information and news on the internet, and stay entertained by downloading music, films or books at any time wherever you are, it seems almost anachronistic that cashless retail payments in the EU can still take up to a business day. Why is there a gap in the user experience of instant messages, instant video and Instagram on the one hand and the execution of payments for these services on the other?

In the past year, it's become more and more common at conferences and in publications to say that instant payments will become the new normal in the euro retail payments market. Indeed, in some countries, instant payments seem to be the new normal already. In Denmark, a mobile instant payment solution that was introduced in 2013 is used by more than 60% of the population, with more than 180 million transactions per year.<sup>1</sup> In Sweden, according to statistics

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<sup>1</sup> Interview with Kristian Ring, Head of Department at Finance Denmark, "The Danish payment landscape: When instant becomes the new normal", 3 October 2017.

from the Riksbank, over half of the population uses the instant payment app Swish.<sup>2</sup> In the UK, the share of instant payments in the total volume of credit transfers amounted to about 40% in 2016.<sup>3</sup>

It cannot be denied that the points of departure for instant payments in these countries might have been somewhat different from those in the countries of the euro area. There are both differences in the structure of the banking sector and the payment habits and preferences of the population. However, I will argue that also in the countries of the euro area, the conditions to make instant payments a success can be met. I will demonstrate this by discussing the success factors in the different stages of the instant payments chain. To visualise the process, let me use the image of a pyramid: at its basis, we have the market infrastructure. Here, the settlement of instant payments is effected. Building on this we have the clearing layer, the scheme layer and, last but not least, the layer with the end user solutions. Let me start with the foundation of the pyramid.

### *1. The settlement layer*

The availability of a safe and efficient market infrastructure that can process and settle instant payments across Europe is one of the cornerstones of payments innovation in general and instant payments in particular. The European System of Central Banks has a responsibility here as it is mandated to promote the smooth operation of payment systems by providing the settlement of payment transactions in central bank money.

There are two ways of settling instant payments: real-time gross settlement and deferred net settlement. The Eurosystem will cater for the availability of both options.

As from next month, it will provide an ancillary system interface in TARGET2 where automated clearing houses (ACHs) can settle instant payments of their participants (i.e. intra-ACH settlement) on a deferred net settlement basis. These transactions are collateralised with cash. Accounts for the settlement of instant payments can be funded or defunded by the participants during the operating hours of TARGET2 as needed. Inter-ACH settlement, i.e. the settlement of

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<sup>2</sup> Speech by Deputy Governor Cecilia Skingsley, “How the Riksbank encourages innovation in the retail payments market”, 17 January 2017.

<sup>3</sup> See [www.fasterpayments.org.uk/statistics](http://www.fasterpayments.org.uk/statistics)

instant payments between participants in different ACHs, will also be enabled, provided the necessary interoperability agreements have been put in place by the ACHs.

At broader level, the Eurosystem has undertaken a strategic review of the future developments of its market infrastructure and related central bank services. It led to the decision to launch, in conjunction with a consolidation of the technical and functional components of TARGET2 and TARGET2-Securities services, a pan-European instant payment settlement service in central bank money. The TARGET instant payment settlement (TIPS) service will be launched in November 2018.

#### *What is TIPS?*

TIPS will offer final and irrevocable settlement for instant payments in central bank money around the clock, 365 days a year. It will allow participating payment service providers to set aside part of their liquidity on a dedicated central bank account from which instant payments can be settled 24/7. The balance on these accounts will count towards their required minimum reserve. Instant settlement will eliminate credit risk for all involved parties.

TIPS can provide a high level of reachability across Europe. There is no participation fee; participants will be charged a maximum of 0.2 euro cent per payment for at least the first two years of operation. The actual scope of reachability in TIPS will be determined by the participants and the reachable parties. A reachable party has a contractual agreement with a participant to transmit/receive instant payments on their account.

#### *Why TIPS?*

For the Eurosystem, the biggest challenge posed by digitalisation in the payments industry is to ensure that innovative payment products and services do not reintroduce fragmentation into the European retail payments market. While it is understandable that, initially, innovative solutions tend to focus on national markets, they must have the potential to extend their reach to pan-European level or to be interoperable with other solutions. By providing TIPS, the Eurosystem will make sure that the demand for instant payments can be met at pan-European level and further facilitate integration in the euro area.

In short, TIPS paves the way for the smooth functioning of pan-European instant payments. It gives the market a basis for the provision of products and services that create value for customers and enables more competition among the payment service providers.

## *2. The clearing layer*

Moving from the settlement to the clearing layer of our pyramid, a question we are often asked is whether there is a need for instant settlement if we have instant clearing – and vice versa. Let me answer as follows: instant clearing with pan-European reachability would require two conditions to be met. First, every payment service provider would need to become a participant of an ACH that offers the clearing of instant payments. Second, a full network of links between ACHs would need to be established. Establishing such a fully-fledged network would be a major undertaking and, to be honest, seems rather hypothetical at best.

As I have said, instant clearing will be supported by the provision of an enhanced TARGET2 functionality for the ACHs. But ACHs can also play a role in instant settlement by becoming instructing parties for their participants in TIPS. By acting as an instructing party, an ACH can make its participants become reachable for participants in other ACHs without having to establish links to the other ACHs. For this, ACH participants need to be either participants or reachable parties in TIPS.

## *3. The scheme layer*

Let me move on now from the clearing layer to the scheme layer.

At the request of the Euro Retail Payments Board (ERPB), the high-level forum for European dialogue between payment service providers and end users, the European Payments Council published a pan-European instant payment scheme, the SEPA Instant Credit Transfer (SCT Inst), in November 2016. Payment service providers are encouraged to build on the scheme by making instant payment solutions in euro available to end-users across Europe starting from next month.

How is this going to work in practice? Well, I think the representatives of the payment service providers here today are in a better position than I am to answer that question. But I can at least tell you how I expect it to work.

First, I expect that any national instant payments project or strategy in the euro area will ultimately come under the umbrella of the SCT Inst scheme. National instant payment solutions should allow for the extension of services across Europe after reaching a certain level of maturity or become interoperable with other instant payment solutions. There should be no silos or closed loops.

Second, to generate the necessary volumes, I expect that instant payment solutions will cater for different payment situations: for person-to-person mobile payments, person-to-business payments at terminals and in e-commerce, and also for business-to-business payments. Offering only the basic SEPA Instant Credit Transfer will probably not generate enough revenue for payment service providers to recover their investment.

Third, I expect that providers will develop end-user applications for instant payments that are both user-friendly and allow compliance with the security requirements of the revised Payment Services Directive (PSD2). On that subject, let me briefly say a few words.

We welcome the fact that PSD2, which is to be transposed into national law by January 2018, aims to increase pan-European competition and participation in the payments industry, including by non-banks. At the same time, it is intended to provide a level playing field by setting out the requirements for consumer protection and the rights and obligations of payment providers and users.

In recent years new third-party providers (TPPs) have started offering payment initiation and/or account information services at the front end of the value chain. To ensure strong customer authentication and secure communication in this field, the European Banking Authority has produced draft regulatory technical standards. These are designed to provide the necessary safeguards. They are currently being finalised. After adoption, market participants and the supervisors will have 18 months in which to make the necessary preparations. Standardisation of the technical, operational and business elements of the payment initiation and/or account information services is a key issue here, too.

#### *4. The end user solutions layer*

Let me return to my main theme. We have now reached the top of the instant payments pyramid – the part that's visible to the end user, the actual instant payment solutions. The lower levels – the settlement, clearing and scheme layers – are largely invisible. End users can safely ignore these parts of the payments chain.

Due to the two-sided nature of payments, the problem we face at this level is that both payers and payees have to be persuaded to use any new solution. For person-to-person mobile payments, payer and payee have to subscribe to the same service in order to be able to transfer money. If the payee has not subscribed to the same solution, a message is usually sent with a request to register. If the payee is already using another payment service provider that offers a different mobile payment solution, he or she may be unwilling to subscribe to an additional service.

This problem could be overcome by making the different mobile payment solutions interoperable. The Euro Retail Payments Board invited the Mobile Proxy Forum to work on implementing a common proxy IBAN database. This kind of database links mobile phone numbers to IBAN and already exists in some countries on a national basis (e.g. in the UK, Sweden and Spain). By November this year, the ERPB expects a proposal from the Mobile Proxy Forum on the timeline, technology approach and governance for this standardised lookup service for IBAN.

Person-to-person mobile instant payments can provide the user with the same experience as cash in terms of speed and – hopefully – convenience. As with cash, customers will expect these P2P mobile payments to be provided (virtually) free of charge. However, for the payment service provider, it might bring new business opportunities in the form of value-added product offerings, stronger ties with existing customers and a broadening of the customer base.

In e-commerce, payers will only sign up for a new payment solution if there is a wide range of merchants that accept this payment solution, and vice versa. This makes it quite challenging to create a sufficiently large payments network to bring significant volume to any new payment solution and thus realise economies of scale, in particular because merchants already have at hand a number of established providers. Still, I see potential for instant payment solutions to compete with other payment instruments, such as cash on delivery, cards or direct debits.

Instant payments in e-commerce can eliminate the risk for online merchants of non-payment as the release of goods and services can be synchronised with the payment.

As for point-of-sale payments, the market is currently dominated by card-based solutions. Nevertheless, instant payments may gain a competitive edge here if they are attractively priced.

As regards business-to-business payments, the Faster Payments Scheme in UK has shown that instant payments are attractive to businesses as they can improve their cash flow, optimise working capital management, reduce late payments and speed up the payment of invoices.

#### *5. What's next?*

Having reached the top of the pyramid, I would like to tell you about our next steps. Having said that the Eurosystem will launch the TIPS service in November 2018, we want to further boost awareness of instant payments. The European Central Bank is therefore inviting interested service providers to develop mobile apps which can initiate instant payments that are settled, for example, in TIPS. On 6 February 2018, we will organise an event to present app prototypes. The event will comprise a conference and a marketplace and will bring together banks in the EU, national central banks, financial market infrastructure providers and industry associations. Service providers who would like to exhibit their prototypes at the event should send their proposal to us by 1 December 2017.

#### *Conclusion*

Building a pyramid is no easy task. To be sustainable it needs stability at the basis as well as vision at the top. If we meet the conditions to make instant payments a success at the different layers, we create something valuable that will benefit European citizens and businesses. In developing the TIPS service, the Eurosystem will work closely with the market in order to benefit from its knowledge and experience as well as to ensure that Europe's future financial market infrastructure fully meets the needs of its users and – ultimately – the people of Europe.