VIXIO PAYMENTS COMPLIANCE

2021 Outlook

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2020 — The year of the unexpected

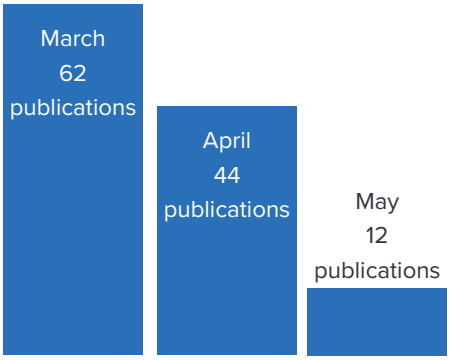
We said goodbye to 2019 preparing for the two biggest industry challenges looming over the EU and UK to come into effect at the end of 2020: strong customer authentication (SCA) and Brexit.

Then, several of the long-term goals of the financial regulators were delayed as a result of COVID-19.

In 2020, the UK's Financial Conduct Authority (FCA) intended to push ahead with Open Finance as an extension and evolution of Open Banking. Review of the retail payments architecture driven by Pay.UK was going ahead, albeit slowly, to pave the way to modernise the payments infrastructure in the UK.

Operational resilience was already on top of the authority's priority list too.

No one could have predicted that the outbreak of a new SARS virus in China would have resulted in a global pandemic. Financial services regulators responded quickly and we saw a spike of activity in March, in what were mainly temporary measures as a direct response to the threat COVID-19 posed to the financial market.



Number of regulatory activity updates published by VIXIO Horizon Scanning during March and April.

**This data has been collected from the following EU jurisdictions: Austria (1); Belgium (2); Croatia (2); Czech Republic (1); Denmark (1); European Union (8); France (3); Germany (3); Greece (1); Hungary (1); Ireland (3); Italy (3); Lithuania (1); Luxembourg (1); Malta (4); Poland (1); Portugal (1); Romania (1); and Spain (5).*

Long-term regulatory activity has been delayed with the confirmation of payee rule moving and the FCA response to consultations around Open Finance and operational resilience being extended, and one cannot forget the controversial decision by the UK to further extend the SCA deadline well into next year.

COVID-19 has also caused the regulators to put their foot on the pedal and accelerated efforts that were already in play. For example, the FCA was already concerned with gaps identified in payment service providers' safeguarding arrangements but with operational risks exacerbated by the pandemic, the authority demanded an urgent review of the measures in place, putting additional pressure on non-bank payments system providers (PSPs).

Expected 2020 events

- 17/03/20 - Closing date for FCA's Open Finance consultation
- 31/03/20 - Confirmation of Payee implementation deadline
- 03/04/20 - Closing date for FCA's consultation on operational resilience
- 31/12/20 - Brexit and EU SCA
- 14/03/21 - UK SCA

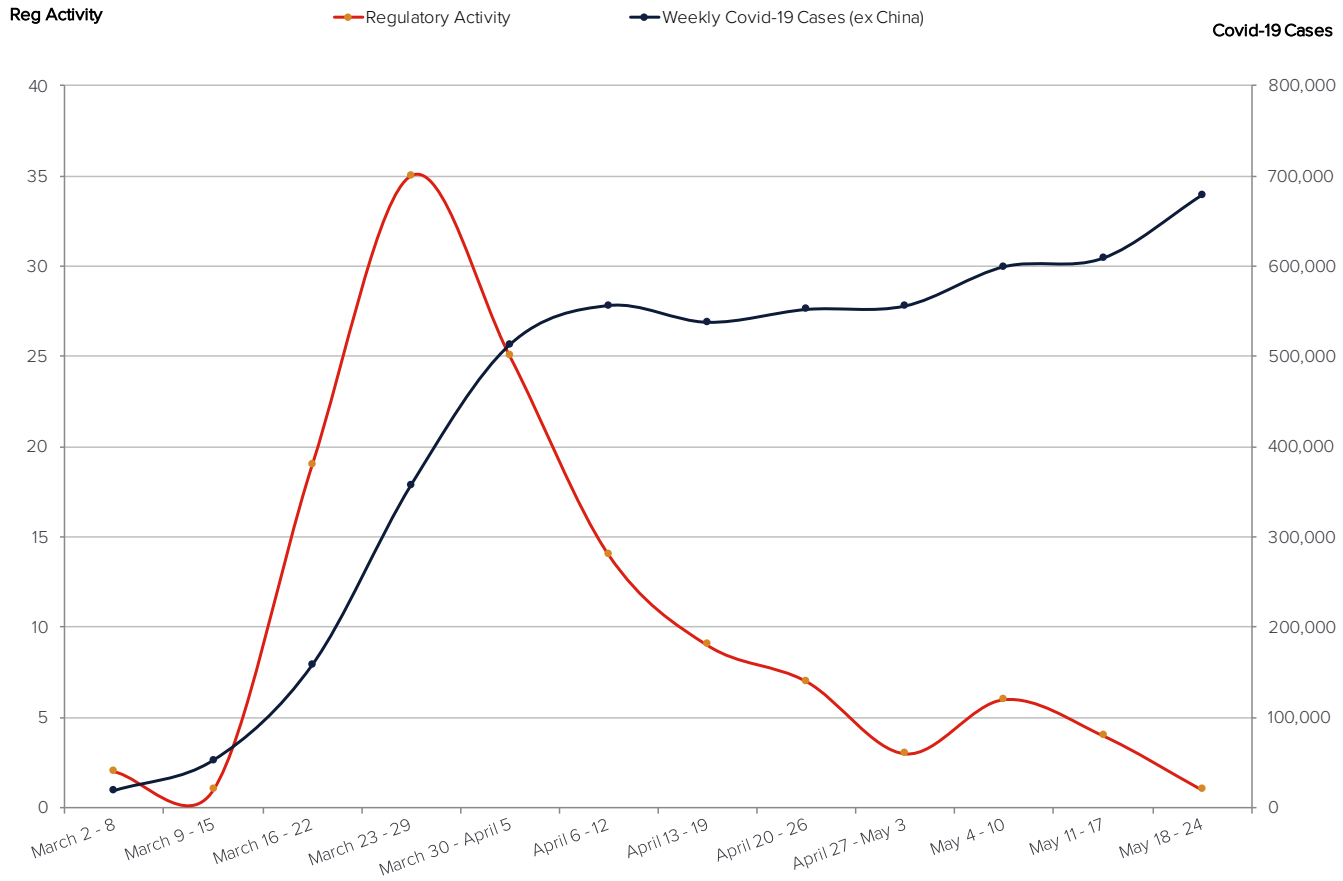
Events that transpired in 2020

- 15/02/20 - Nationwide lockdowns in China
- 11/03/20 - First entry in the Coronavirus tracker
- 23/03/20 - UK Lockdown
- 01/04/20 - UK contactless limit increase
- 30/06/20 - New Confirmation of Payee implementation deadline
- 05/07/20 - FCA Demands Urgent Action on Safeguarding
- 27/08/20 - HMT Payment Landscape Review
- 01/10/20 - Response deadline to FCA consultations extended
- 31/12/20 - Brexit and EU SCA
- 14/09/21 - UK SCA

Regulators leading the way

We have seen a multitude of temporary COVID-related measures; regulatory activity peaked in March and had a steady decline eventually tailing off. What we saw, however, was that the regulators' response under these exceptional circumstances was equally unusual — they started imposing temporary measures before anything was known about the virus or its potential impact on the consumers and their access to the financial market.

Regulatory Activity — March to May 2020



Source: European CDC, VIXIO Horizon Scanning

However, as the reality of the threat became apparent, governments around the world began imposing lockdowns. Regulators decisively and swiftly passed temporary measures to keep the economy moving, as consumers still needed essential items and paying in person or with cash was often not an option.

Move towards digital

Digitalisation of the economy has only been accelerated by the pandemic and is not going anywhere. Measures to facilitate this transformation will become more widespread, but will likely look different in the long term as regulators get to grips with the impact of the temporary measures, and as they attempt to right size them against the new context.

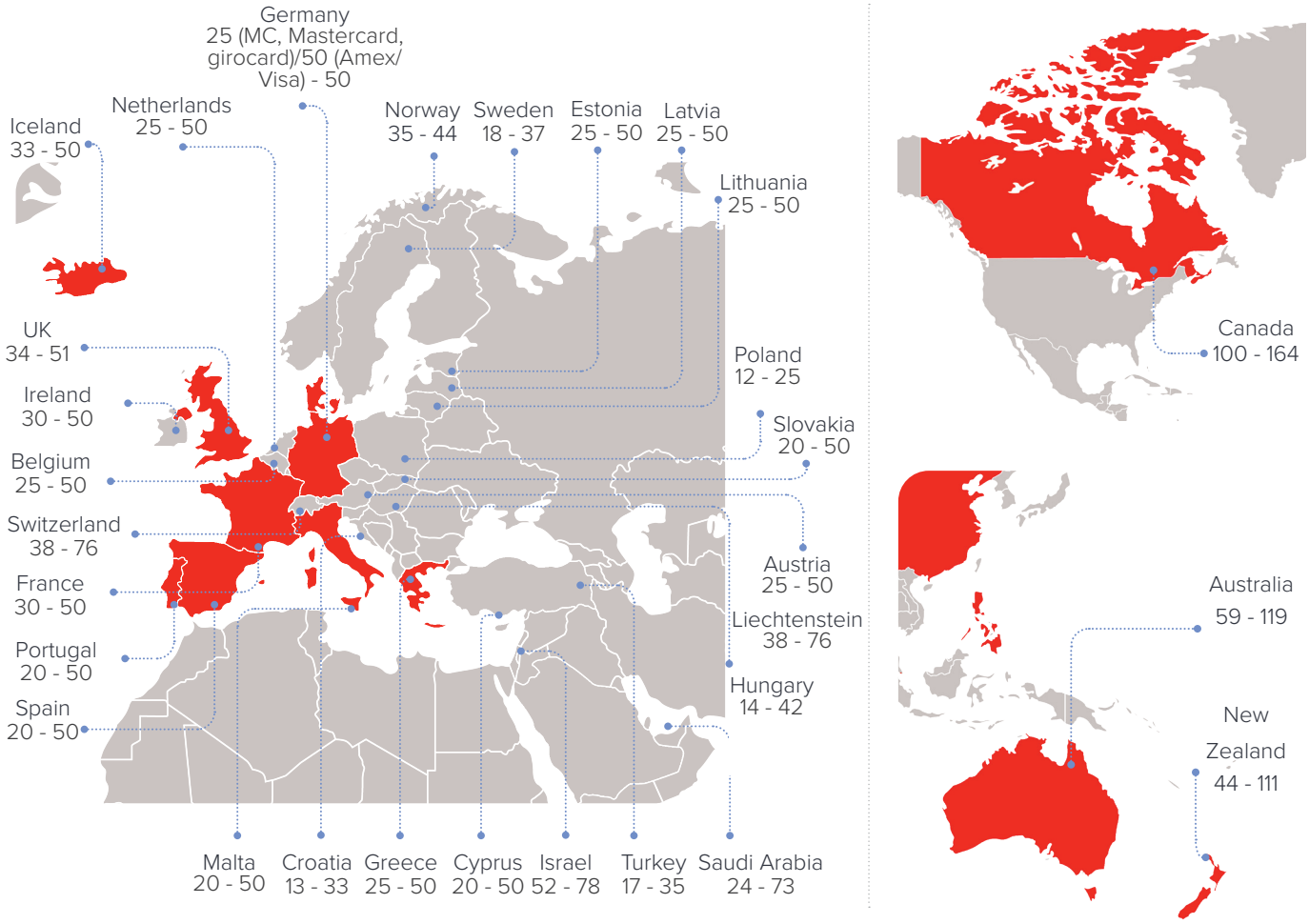
The opportunities for PSPs are obvious — more people using digital payments, more people using cashless and contactless payment methods, a huge rise in e-commerce with first time buyers getting online. However, these inexperienced users can easily fall victim to fraud.

Raising the limits for contactless payments was one of the first steps taken by payment authorities in response to the coronavirus pandemic.

Despite conflicting scientific advice on the issue, the move was made to reduce the use of cash out of fears it could transmit the virus.

In many EU member states, raising the limit did not require regulatory intervention, as institutions in those countries were already operating below the maximum €50 currently permitted by the revised Payment Services Directive (PSD2). In such cases, local banking associations or other relevant trade bodies coordinated the limits increase.

The map below illustrates changes to contactless limits around the world. For comparison, all contactless limit amounts (pre-pandemic - during pandemic) have been converted into €.



Sources: VIXIO PaymentsCompliance, EPSM

Europe

As with any change in spending patterns, the winners are those who are able to adapt quickly to take full advantage of these opportunities. We know that some payments companies continued to grow in terms of value and volume of processed transactions.

In August, LINK (UK's largest ATM network) reported a 60 percent year-on-year drop in cash withdrawals during the lockdown, with the chairman of LINK writing in the company's annual report: "We shouldn't expect cash to bounce back to levels before late March."

Some industries, such as airlines, found themselves more reliant on instant payment methods as a consequence of the crisis, having to quickly process large volumes of bookings and refunds at short notice.

As a response, we can expect for regulators to focus on innovation through launching digital identity measures led by the positive impact on financial inclusion of Aadhaar in India, or MyInfo in Singapore.

84%

of respondents to a survey conducted by VIXIO said that stricter regulations in mature markets will have at least a moderate impact on their business and will be one of the biggest challenges for their organisation.*

They can facilitate use of biometrics in payments, already considered in relation to the use of behavioural biometrics for authentication under SCA rules for online transactions, and encourage the use of regtech, such as the Hong Kong Monetary Authority promoting the use of innovative solutions. Automating compliance reporting from organisations is another area anticipated to grow significantly in 2021.

They can also tighten regulation — 84 percent of respondents to a survey conducted by VIXIO said that stricter regulations in mature markets will have at least a moderate impact on their business and will be one of the biggest challenges for their organisation*.

**In Q4 2020, VIXIO conducted a survey of payments firms to find out their priorities for the year ahead and where they see opportunities.*

Opportunities in technology

Modernisation of payment systems and real-time payments infrastructure is seen as the biggest driver of new opportunities in 2021, according to the survey, with 95 percent of respondents indicating that it is highly likely to create new opportunities for non-bank payments service providers.

This should not come as a surprise given that it is the underlying infrastructure and technology that really matters.

This has not escaped the attention of regulators.

25%

of respondents to our survey indicated account-to-account payments at point of sale is a product they would consider launching within the next 12 months.

The European Central Bank (ECB) chose to make it mandatory for the largest European banks to adopt the TARGET Instant Payment Settlement System after a low rate of voluntary sign-up, to accelerate the development of instant payments in Europe.

In the UK, work on the New Payments Architecture is moving ahead, while HM Treasury is also undertaking a payments landscape review, which has the potential to overhaul the payments infrastructure — one of its primary goals is to leverage open banking to allow consumers the option to pay for goods and services, in shops and online, directly from their accounts. These efforts are disruptive and would cut out card networks as intermediaries.

It is an opportunity that survey respondents are planning to seize: 25 percent of respondents indicated that account-to-account payments at point of sale is a product they would consider launching within the next 12 months.

These types of efforts are taking place around the world, from South Korea to Australia, to Canada and India.

The South Korea Financial Services Commission announced in July plans to review the payments market to create new types of payment licences for PSPs to facilitate digital payments and to reflect changes in the market.

Canada is upgrading its retail payment systems with an instant payment system, but also using the ISO 20022. The Bank of England plans to implement the standards with the go-live date of April 2022, and SWIFT plans to implement it later that year.

The European Payments Initiative is led by the private sector but with the blessing of the ECB, as well as the European Commission. It aims to create competition for card networks to reduce the EU's reliance on external players.

Reassessment of risks

Some 95 percent of respondents to the VIXIO survey agreed that non-financial firms threaten their ability to grow and expand services because of the imbalance in the regulatory burdens. This trend is not only recognised by competitors but also by the regulators.

We are already seeing interventions from the UK's FCA; for example, the CEO letter regarding safeguarding requirements following the Wirecard scandal, to double down on existing regulations.

Authorities are realising that as the market is moving at an increasingly swift pace, they have to accelerate their own efforts not to be left behind.

Although the reaction to Facebook's plans for the launch Libra is understandable, the question remains if that knee-jerk reaction was too risk-averse.

The potential opportunities of such a payment instrument to increase both the ease of payment, as well as the level of financial inclusion, were clear from the beginning.

No matter what happens with Libra, now Diem, there is no question that it has launched a trend of its own — central bank digital currencies (CBDCs).

Even though a majority of our survery respondents agreed it is likely that development of CBDCs will result in new opportunities (only 20 percent see it as not likely at all), there is a lack of consensus as to the degree of CBDCs becoming a reality.

Most regulators are still in very early development stages and, as such, there is a feeling among payment companies that this will not affect them anytime soon.

VIXIO has seen a rise in consultations around CBDCs in our monitoring. As regulators are looking to the industry for input on future developments, it is important companies do not miss their chance to become part of the conversation.

This tells us that now would be a good time to consider this trend to understand its potential impact on their organisations and help future-proof them further down the line.

Meanwhile, traditional financial institutions are working to ensure they do not get left behind other players in the burgeoning sector. Spanish banks are banding together to issue a single collective stablecoin in an effort to prevent market fragmentation and dominance by bigtech entities.

Supposedly driven by Libra, although denied, the ECB has accelerated work on the digital euro.

A digital euro could not just be a success for EU citizens but could also enhance the currency's attractiveness internationally.

At the EU level, the Markets in Crypto-Assets legislation proposal, part of a bigger Digital Finance Strategy Package, aims to update current regulations and make it fit for the crypto-age.

The long-awaited P27 project, which would enable cross-border, multi-currency, real-time payments to take place among countries in the Nordics, is yet to receive merger clearance.

P27 insists that the launch will take place in 2021 as planned.

Regulators are also looking much closer at the sustainability of the business models of the so-called challenger or digital banks.

Regulators acknowledge that the traditional classification of financial firms is quickly becoming outdated and we expect there to be a long-term shift from regulating by entity type to regulating by products and services they offer, as well as their size, to accurately reflect the risk they pose to the stability of the financial system.

During the recent Association for Financial Markets in Europe Digital Finance breakfast, EU officials agreed that to properly address the reality of the market the regulatory regime needs to work based on the principle of "same activity, same risk, same rules".

Firms cannot grow to be too big to fail through exploitation of gaps in regulation to avoid regulatory burden.

2021 Outlook

Payment institutions' place in the market

Respondents to the VIXIO survey expect that consumer confidence in payments will rebound; however, stricter conduct rules for payment providers in developed markets were identified by a majority (68 percent) of respondents as having a high impact on their expansion.

Safeguarding and consumer protection should be high on firms' agendas for 2021 to help rebuild trust shattered by Wirecard scandal.

Firms will be required to respond to increasing regulatory scrutiny as authorities are re-evaluating their supervisory approach. This is connected to the idea of risk-based instead of activity-based regulation, which would allow regulators to assess potential harm to customers posed by a company or its relative importance for financial market's stability and regulate accordingly on this basis, rather than based on what kind of licence they hold.

Priorities for the next 12 months

We would expect to see efforts prioritised that contribute to growth, such as new market entries and new product launches. Organisations are bracing for more, but organised, chaos, as they tighten controls and procedures to ensure a smooth and resilient ride.

Back in December 2019, the UK's FCA, Prudential Regulation Authority and Bank of England published their joint consultation paper on new requirements to strengthen operational resilience in the financial services sector. In September 2020, the European Commission proposed the Digital Operational Resilience Act, which aims to ensure that all participants in the financial system have the necessary safeguards in place to mitigate cyber-attacks and other risks.

The regulators' view is that operational risk and resilience are now a shared priority issue, equivalent in importance to financial stability.

Commercial compliance

We asked executives what the most important activities are in their role in the next 12 months, and 58 percent of respondents said that leveraging regulatory compliance to deliver competitive advantage was in the top three - just as important as fulfilling compliance requirements and staying abreast of regulatory trends.

We believe this signals a shift in how the compliance function is evolving to become more commercially driven.

Leveraging regulatory compliance data and analysis can offer forward -ooking insights into how organisations can improve risk management, increase competitiveness and gain efficiencies.

Once considered a cost centre to senior management, compliance, risk and legal functions are proving to support strategic decision-making and growth plans. This is a defining moment for many executives and those who turn regulatory compliance into competitive advantage will come out on top.

Expect frequent and quicker regulatory interventions

With the swift reaction to COVID-19, the blocking of Libra or the approach to crypto in the European Digital Strategy proposals, we are seeing that regulators are willing to be more interventionist in their treatment of the payments market.

The velocity of regulatory change will have to increase to match the rapidity of changes. The UK Treasury outlined plans for the post-Brexit FCA to be given more delegated powers, and so UK-based companies can expect the regulator to act faster and more decisively.

2021 will be a year of regulatory reviews

The impact of ongoing reviews may not be immediate, but leading organisations are getting ahead of pending changes and getting involved in consultations.

It is the existing permissions regimes that are under review and non-traditional PSPs need to prepare for the potential reshuffling of the market. Especially if they are a rapidly growing payment institution, or a payments operator who has so far remained largely outside the regulatory remit.

Operational resilience takes on a new meaning

The diversification of the types of entities in the payments value chain, combined with the digital economy taking off, means that customers are increasingly relying on non-bank PSPs for essential services. As a consequence, regulators are reassessing their impact on the financial stability of the market, something that payment institutions did not have to worry about before.

AML, fraud, cyber and data breach risks are not new. However, with the rise of digital payments, these threats have become a top priority for payment providers. The regulators are eyeing up this area as well, with the EU AML Action Plan, implementation of the 6th Anti-Money Laundering Directive and similar regulatory activity around the world in motion already.

Digital is a competitive advantage

Digitalisation can be the key to efficient management of the top risks that PSPs will face in the coming months. What is more, we have seen signals from the regulators that they will continue investing in supervisory technology solutions and encourage the use of regtech by regulated companies. Governmental initiatives such as the use of digital IDs or CBDCs may still seem far away, but the sooner PSPs realise their potential, the better prepared they will be to take advantage of the opportunities they offer.

Development of payment infrastructures will have to go into higher gear to respond to the needs of the market.

We have seen regulators prioritising these initiatives as part of a larger agenda to reduce the number of intermediaries of payment transactions - all with the aim of improving the customer experience, reducing costs for the end user and promoting financial inclusion.

This, in turn, creates opportunities for PSPs to launch new payment products which go beyond the traditional structures, such as account-to-account POS solutions.

UK and Brexit

Behind the bright flash of the COVID-19 pandemic, Brexit approached its inevitable conclusion with no evidence of the kind of comprehensive agreement which the financial services sector has consistently said is needed for businesses to look beyond the end of the year with any real confidence.

There were spots of resolution: the FCA updated its rules to help settle issues around the use of eIDAS certificates by third-party providers, and cross-border payment providers could breathe easier after last year's announcement of the UK's continued inclusion in the Single Euro Payments Area.

But a host of other issues continued to niggle.

From divergences in application of SCA to sanctions to data protection, 2020 was the year when it became irrefutably clear that Brexit would remain a headache for payment firms operating between the UK and EU for some time to come.

Some of steps taken by UK regulators and policymakers could be divined as indicators of just what the country's future payments regime might look like: former Worldpay chief executive Ron Kalifa will seek to ensure that the UK maintains its position as a leading venue for fintech innovation.

There have also been suggestions around how the UK might use Brexit to diverge on the payment regulations handed down from Brussels.

This is particularly the case around Open Banking, where the UK might be able to address widely accepted issues like the 90-day re-authentication process quicker and more efficiently than Brussels.

United States

The United States has taken big steps towards the inclusion of crypto in traditional financial services. The Office of the Comptroller of the Currency (OCC) clarified that national banks and federal savings associations can provide cryptocurrency custody services for customers, and can hold reserves on behalf of customers who issue certain stablecoins.

During the summer, the acting comptroller hinted at his plans to introduce a federal money transmission licence that would allow payments firms to obtain one single licence for all US states.

While the OCC is working on expanding its national chartering authority to fintech and payments firms, the Conference of State Bank Supervisors (CSBS) aims at overcoming the fragmentation and inconsistency of the state-by-state regulation model through the introduction of a new State Examination System (SES) platform for the supervision of fintechs.

Later in September, the CSBS announced the MSB Networked Supervision programme, which would allow nationwide payments firms to undergo a single comprehensive exam to satisfy all state regulatory requirements. Forty states joined the initiative, which will launch in 2021.

While central banks around the globe are in a race to be the first to adopt central bank digital currencies (CBDCs), the US is taking cautious steps, arguing that "it is more important to get it right than to be the first". The agency is at the stage of investigating potential impacts on the payments ecosystem and building a hypothetical CBDC to assess risks and opportunities.

Lagging behind Europe with regard to Open Banking, the US has launched a consultation concerning regulations that allow consumers to grant fintech firms access to their financial records. The consultation is open until February 4, 2021.

Californians also voted to adopt a new privacy act. The California Privacy Rights Act (CPRA) upgrades the state's current privacy act, bringing it in line with the protections granted by the EU's General Data Protection Regulation (GDPR).

There are also numerous federal bills before the US Congress, but it is unlikely they would pass before the session ends on January 3, 2021. Although both parties recognise the need for a federal level privacy law, their views differ on two accounts: the questions of federal pre-emption and the privacy right of action.

The July ruling of the highest European court invalidated the EU-US. Privacy Shield that allowed companies to transfer data from the EU to the US.

It is still in question whether all companies need to negotiate their own Standard Contractual Clauses or the US can adopt a privacy act that brings its data protection up to the same level as the GDPR.

Ending 2020 with a bang, US lawmakers overhauled the country's AML rules, requiring all companies to disclose the beneficial owner and shifting the burden from compliance away from banks. The Corporate Transparency Act was passed in Congress with a veto-proof majority.

VIXIO PAYMENTS COMPLIANCE

Regulatory Intelligence at your fingertips

As a trusted source of regulatory intelligence for the global payments industry, we enable organisations to manage the growing volume and velocity of regulatory risk with confidence, empowering more informed and effective decision making, in an efficient and cost-effective way.

Our in-house team of experts bring you the **latest insights** affecting the payments industry. Combining our unrivalled knowledge and deep understanding of the sector, we provide the critical and timely intelligence that helps you make sense of the complex and rapidly changing global regulatory environment. Our trusted insights enable you to understand and interpret what's happened and what it means for your organisation.

Make the right decision without delay, and turn actionable intelligence into business advantage.

Our **horizon scanning tool** helps you track upcoming regulations, simplifying the research process so you don't have to spend time sifting through vast amounts of irrelevant information. By automating the processes associated with gathering, analysing and evaluating upcoming regulatory and legislative changes, you are able to understand and quantify risks and opportunities more quickly and efficiently, helping you to mitigate risk and make informed decisions with confidence.

We monitor hundreds of regulatory bodies across multiple jurisdictions and languages. With customised alerts and a real-time feed of regulatory content, you'll never miss a new obligation or opportunity.

Trackers & guides help you stay fully informed about a specific development affecting the regulation of payment services. Understand all the details of a complex chain of events to create a fully appraised strategy, and use our expert research and practical content to better inform your decision making.

In addition, our regulatory intelligence team have created timelines. These allow users to immediately understand chains of regulatory events and identify interdependencies.

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