Linklaters

Regulating the Digital Economy Series

Payments Highlights

Contents

Online retailers and marketplaces are seizing opportunities to develop their payments capabilities. Regulation is a key consideration, in particular when designing new products and when moving into new markets. While there are many and varied regulatory developments in the sector, we focus on four global macro trends:

"For businesses in the payments ecosystem, ensuring that they can meet the challenge of constant change and keep pace with the incredible rate of developments is a key priority."

Sumit Indwar
Financial Regulation Partner, Hong Kong SAR

1. The rise and rise of Big Tech – the impact of the payment landscape in Asia v Europe

Asia – the pioneer in payments

Rapid digitalisation through the pandemic, and consumer demand for speed and efficiencies, are driving different payments business models.

Big Tech has capitalised on this trend to great success, particularly in Asia. The rise of Super Apps in Mainland China has created an ecosystem which covers almost all aspects of everyday life and the possibility to "live life online".

Innovation in technology is needed to underpin that environment and to support more instantaneous payments. Asian consumers tend to be more open to trying new things, and new forms of payment coming down the line include facial recognition and wearable devices payments.

Together with the sheer population size, this open attitude has created a more competitive environment for payments in Asia. Asian regulators have also had a role to play and have generally supported tech innovation, particularly where it supports financial inclusion.

"Asia has long been the pioneer in digital payments."

Colette Pan
Corporate Partner, Shanghai

Europe – the next frontier in payments

Europeans have not been reliant on cash payments for some time now. Unlike the "big bang" seen in Asia, there has been more a more incremental approach to change in the EU, with innovation being integrated into existing payment rails and card network systems.

The 2020/21 boom in e-commerce has driven European consumer expectations for instant payments. There has been a huge amount of innovation, particularly in the B2B space, and many players have been building payment platforms or adding a payments arm onto existing e-commerce platforms. This innovation in Europe is driving a lot of M&A, as well as structuring and regulatory activity.

As new and more complex payment chains emerge, regulators are increasingly looking beyond banks and demanding higher standards of other participants in the payments sector.

"Covid-19 has brought about a perfect storm in Europe as the next frontier for payments. That is triggering a regulatory response, as regulators seek to address increasingly complex payment chains."

Richard Hay
UK Head of Fintech, London

2. The global regulatory response

Massively increasing regulatory scrutiny is a global theme

Financial regulators, antitrust and data regulators across the world have all been looking at how to meet the challenge of fostering innovation whilst protecting both consumers and healthy competition in digital markets. The typical regulatory and political reaction is the regulation of new technologies themselves and the creation of new or enhanced regulatory regimes in respect of the relevant markets.

Increased regulatory scrutiny is often seen as something negative but the creation and existence of a stable and predictable regulatory framework actually supports the development and acceptance of innovative business models.

> "Regulation and supervision can be a qualitative feature, ensuring legal reliability and security for customers."
>
> **Andre Hofmann**
> Financial Regulation Counsel, Frankfurt

EU and UK payment services regimes

Whilst subject to EU wide harmonised rules on payment services and e-money, there are surprising differences in the way member states have implemented those regimes.

An important development to watch in Europe is the reform of the payments regulatory landscape (the review of PSD2 in the EU and the UK's own payments landscape review) – hopefully with a view to greater harmonisation and regulatory certainty.

At the same time there is greater scrutiny of tech companies after the Wirecard scandal and an increased focus on operational resilience – not just ensuring compliance but asking financial firms to look again at how they deliver their services to clients.

Read more: How the EU plans to use DORA to build operational resilience in financial services (March 2021)

The UK post Brexit is already starting to diverge in its regulatory regimes and needs to be considered separately going forward.

Read more: Why operational resilience is the new tool in the regulators' toolkit (June 2021)

Regulatory developments in Asia

In Asia the key regulatory challenge is that there is no single regulatory regime comparable to the EU's PSD2 which creates a passporting system for licensing across the single market. This is problematic since the majority of the most interesting payment systems are cross-border and without such a passporting system, payments businesses need to navigate different regimes in each jurisdiction.

Hong Kong SAR is an example of a particularly complex jurisdiction where there is a plethora of (sometimes unexpected) regulatory regimes – which can bite on payments businesses and which need careful consideration.

In **Mainland China**, there is a trend to greater enforcement, as both financial and antitrust regulators look to strengthen their positions.

In **Singapore**, there has been a recent payments regime overhaul – creating a single overarching payments regime covering a wide range of payment services – and reform to expand that regime is already being proposed.

Read more: Singapore – Payment Services (Amendment) Bill is passed in Parliament (Jan 2021)

> "Regulators have grappled with regulating new and innovative digital payments models. Singapore's new umbrella payments legislation adopts a risk-based approach and provides welcomed clarity."
>
> **Peiying Chua**
> Financial Regulation Partner, Singapore

3. Antitrust considerations when investing in Europe

Increased merger control scrutiny and enforcement

Against a backdrop of perceived historic "underenforcement" in dynamic markets such as tech, authorities are grappling with how to deal with dynamic markets and whether "traditional" merger control is still fit for purpose. Many authorities feel that tech deals have slipped through the merger control net, including through "killer acquisitions" by incumbents of nascent competitors.

The result is that enforcers around the world have been doing a number of things to ramp up their enforcement in tech mergers to allow them to look at more deals (with reforms at German and European level to allow the authorities to review deals that would otherwise fall below relevant thresholds).

In addition, when they are reviewing deals, the authorities have been adopting a more interventionist approach, in particular where these involve acquisitions by incumbents of nascent competitors. In Europe, there have been a number of competition reviews of high-profile mergers in the payments sector such as Visa/Paid (which received CMA clearance in the UK but was blocked in the U.S.), Mastercard/Nets (which was cleared with remedies in the EU after being referred by several national competition authorities). Given the heightened security, many other deals will not have left the boardroom.

Increasing foreign investment controls

Foreign investment is now a significant issue for M&A transactions as an increasing number of countries have new or strengthened regimes, many of which affect payments M&A such as companies holding sensitive data, develop critical or emerging technologies (such as AI and cryptographic authentication), or data infrastructure.

A number of regimes introduced tighter foreign investment controls in 2020, including new rules aiming to protect the tech sector, and governments are using their tools to intervene more aggressively than ever before.

Across Europe more changes are proposed.These controls are resulting in record numbers of filings needing to be considered and deals subject to longer review processes. These regimes are particularly key for Chinese based companies expanding in EU markets, but the new rules are relevant to all payments investors given the broader scope of some of these regimes.

Antitrust enforcement and digital regulation

Need for a twin track

There have been a host of high profile investigations in the payments space, in particular into Apple's payment ecosystem, which accompany a range of broader investigations into tech companies. However, there is also a general recognition that antitrust intervention alone is not enough to ensure markets are competitive. The systems are cumbersome and slow, and even eyewatering fines aren't having the required effect or moving quickly enough to address perceived consumer harm.

The new frontier is a suite of so-called "Gatekeeper" regulations which are being developed by the EU, Germany and the UK. All three of the proposals try to identify dominant platforms that control an ecosystem and act as gatekeeper between businesses and customers.

These regulations are not primarily designed with payments markets solely in mind but will have spill-over effects in these markets. The German regime is the only one that is already in force from January this year, with the EU and UK proposals not expected to come into force this year.

Impact of the gatekeeper rules

In the short term, the gatekeeper regulations combined with EC investigations are likely to limit self-preferencing, increase data access/interoperability and impose restrictions on bundling. This could have the effect of opening up opportunities within payments markets involving gatekeepers and may have a chilling effect on Big Tech's long-heralded expansion in financial services and payments markets in the EU.

In the longer term, we might expect these regulations to capture a broader suite of players in the future, with significant impacts on payments markets.

"Europe has experienced significant big ticket payments M&A in recent years, but the antitrust and regulatory environment has become increasingly complex"

Jonathan Ford
Antitrust and Foreign Investment Counsel, London

4. The future of money is payments

Designing digital cash

To what extent will cash remain cash? Proposals for "stablecoins" and similar types of private money outside the regulated banking system (such as Facebook's Diem) present risks and governments are responding with proposals for state issued digital equivalents to cash or Central Bank Digital Currencies (CBDCs) with a few already having been launched.

There are a number of fundamental design choices that need to be taken in relation to a CBDC and it's hard to overstate the importance of the potential impacts of those design choices. They raise fundamental geopolitical questions and major financial stability considerations:

1. How does the banking sector fund itself if consumers deposit money with central banks and no longer with the private banking sector?
2. How does monetary policy operate under that sort of framework – does it change monetary policy as we know it?
3. Could a cross-border CBDC even threaten the U.S. dollar global reserve currency status?

The journey to CBDC adoption

We are at the beginning of the journey with CBDCs and the jury is out on many of the most of these questions including the most fundamental question of all: what is the benefit for users and intermediaries and why should they use or support a CBDC?

There is, however, a clear trend towards CBDC development – studies are underway at 86% of the world's major central banks surveyed by BIS. **Mainland China** has already launched a pilot of the digital Yuen and is looking at a broader trial run at next year's Winter Olympics. **Hong Kong SAR** is collaborating with Mainland China, the United Arab Emirates and other jurisdictions on CBDCs for cross-border payments. **Singapore** has been exploring the use of CBS for faster settlement and payment in the wholesale market. The **UK** has set up a taskforce to explore the potential of CBDC and similar activity has been going on in France.

Read more: Hong Kong extends international collaboration on CBDCs for cross-border payments (March 2021)

Read more: Bank of England papers on new forms of digital money: our key takeaways (June 2021)

However, it's important to note that this development is not going to manifest as a "big bang". We are likely to see the Mainland China model of testing and pilot expansion imitated in other countries where eventually the take up in the real world will rise gradually over time.

> "With CBDC development there may be an element of self-fulfilling prophecy – the more time and energy that is put into their development, the more likely they are to happen."
>
> **Simon Treacy**
> Senior Fintech PSL, London

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