

15 May 2023

Third meeting of the European fintech payments dialogue

The 3rd meeting of the European fintech payments dialogue took place on 28 March 2023, where representatives of six European fintechs and of European central banks held a discussion on the theme of *'The use of stablecoins and unbacked crypto-assets for retail payments'*. During the meeting, the fintech participants confirmed that the use is growing steadily and highlighted that it could accelerate if the challenges that arise when the 'crypto world' meets the 'fiat world' are addressed, thereby opening up for new opportunities. Moreover, the meeting covered innovation trends relevant to the European fintech ecosystem.

Ahead of the meeting, an agenda with key questions¹ was distributed to structure the meeting. Moreover, introductory slides about the fintech participants and their companies' main activities were distributed amongst all participants to replace spoken introductions. One or two fintech participants were asked to provide opening statements for each of the questions. This was followed by additional comments and follow-ups by other fintechs and participants from central banks.

¹ The key questions raised in the agenda were:

- What opportunities and challenges do you see for the use of stablecoins and/or unbacked crypto-assets, specifically for retail payments in Europe? What could be promising use cases (e.g. in e-commerce, physical retail such as supermarkets, specific markets, other payments use cases)?
- What are, in your view, the most likely scenarios for the development of crypto-assets as a means of payment in the foreseeable future? To what extent are efforts taking place to reduce costs and improve customer trust, user experience, availability, and accessibility (especially for users unfamiliar with crypto assets)?
- What are the dominant business models in this market today? And as far as technical set-up is concerned, what type of acceptance mechanisms are preferred, how is volatility at the time of the payment transaction dealt with, to what extent are retail payments executed on or off the blockchain, what is the settlement mechanism, how does conversion to fiat currency take place, and how does interoperability work with traditional retail payment methods? Which measures are adopted to address/mitigate financial and/or operational risks?
- Do you see the need for standardisation and, if so, are you engaged in/aware of any initiative in this regard?

Opportunities and challenges

The participating fintechs discussed the opportunities and challenges for the use of stablecoins and/or unbacked crypto-assets for retail payments in Europe. The main challenges identified relate to when the 'crypto world' meets the 'fiat world'. Several fintechs mentioned de-risking by banks as a challenge, for which legal clarity is needed to overcome difficulties and for getting regulated entities such as banks involved in providing their services also to fintechs active in the 'crypto world'. These difficulties are related to setting up AML/KYC procedures, particularly when there are unknown counterparties in a payment transaction. Unlike card payments, where regulated entities are on both ends of the transaction and can be questioned if there is any suspicion of an illicit transaction, proper due diligence is more complicated with crypto payments if there are unknown counterparties such as unhosted wallets. However, a few participants noted that de-risking is not exclusive to the crypto space. One participant emphasised that, despite challenges on costs and security, the technology has the potential to perform due diligence more efficiently because transactions are registered transparently on the blockchain.

Several fintechs were optimistic about the upcoming Markets in Crypto-Assets (MiCA) Regulation providing a first step towards more legal clarity. Moreover, one participant mentioned that the transparency of transactions should be further emphasised as a strong point which creates opportunities. Furthermore, besides the challenges of de-risking, one participant pointed towards the other side of the coin where de-risking in the financial sector brings forth opportunities for the crypto ecosystem. When access to banking and payment services is becoming increasingly difficult for small and medium-sized enterprises, crypto-related services may become more attractive to these 'unbanked'. One fintech participant observed that discussions tend to emphasise the challenges, while these could also focus on how to improve the wider financial and payment system, by using the opportunities offered by DLT, e.g. by smoothing the exchange of funds.

With regard to opportunities, the participants see a prospect to go beyond the limited current use cases and discussed e-commerce as a promising use case because merchants are generally eager to offer as many payment methods as possible if this increases their revenue. In general, crypto payments are more natural for younger age segments of the population, such as 'Generation Z'. They more often hold crypto-assets, increasing the probability that they will experiment with making online crypto payments out of curiosity if merchants offer this possibility.

Scenarios for development of crypto-assets as a means of payment

The fintech participants talked over the most likely scenarios for the development of crypto-assets as a means of payment in the foreseeable future. According to one fintech, 80% of the sales made by his company are for Bitcoin as the chosen crypto-asset for purchase with fiat currency. On the other hand, when making payments to merchants using crypto-assets, their customers use the stablecoin USDT approximately 50% of the time. One fintech participant observed consistent growth rates of 10-15% for crypto-assets used for payments over the last nine years. Moreover, it is expected that these growth rates further accelerate when younger generations are becoming more involved with payments. As already noted, adoption of crypto-assets for payments is observed more for younger generations and thus will probably increase gradually. Hence, it is not expected that there will be a radical shift from traditional payment methods towards payments in crypto-assets.

Several fintech participants mentioned that consumers are exploring crypto for payments and therefore merchants, and their PSPs, are increasingly interested in their companies' services, especially for e-commerce payments. Typically, however, crypto payments are not the most convenient option for payments at the physical POS. For instance, in the Bitcoin network, it takes around ten minutes to complete a transaction and receive confirmation, which may not be practical if you want to quickly grab a coffee. Although innovations have made it possible nowadays that transactions can be settled almost immediately, the participants acknowledged the superiority of NFC technology commonly available for card payments over QR-codes for payments at the POS. While QR-codes are commonly used for crypto payments at the POS, one participant regarded it as impossible to reach the convenience of NFC-technology. Therefore, he would rather foresee a completely new alternative, for crypto- as well as traditional payments, to ensure an even more seamless user experience where no manual actions by the user are required. However, it was not clear what form this 'completely new alternative' would take.

The fintechs discussed the apparent absence of EUR stablecoins and the dominance of USD stablecoins. One participant mentioned that the initially low availability or adoption rate of euro-stablecoins is natural, given that the USD is the world's biggest reserve currency, and the development started from the US. Another participant added that they had issued a euro-stablecoin, but there was currently no demand for it. Another participant explained that historically a lot of new markets were priced in US dollars before moving towards local currencies. The same evolution could apply to stablecoins, where it takes time before certain services become priced in 'local currencies', i.e. euro-stablecoins. He believes that the entry into force of MiCA would not radically speed up this process.

One fintech participant stressed the need to get rid of the notion that crypto payments are exclusively used by individuals and companies with high-risk profiles. They observe a broadening of their client base in the past year, that suggest that crypto payments are especially suitable for certain niches. Other fintech participants added that their services improve accessibility, e.g. a cross-border payment from Latin-America to Europe where crypto-assets can improve the transaction speed, lower the costs, and provide more transparency. Another participant argues that this argument is only true when looking at crypto as a closed-loop system, but less relevant when also looking at the preceding or subsequent crypto-to-fiat processes. In the latter case, a crypto-asset payment would face challenges similar to a regular cross-border payment via correspondent banking. Moreover, he notes that crypto-assets are not that revolutionary in this respect given that for example PayPal is also a closed-loop system with similar features and advantages.

Asked whether there will be any role for crypto-assets advancing the development of Internet-of-Things payments, and more specifically Machine-to-Machine payments, a few participating fintechs were aware of start-ups active in this field but could not pinpoint any mass-market solution yet. Whereas the technology could address use cases for micropayments, this is hardly a viable business case given the costs per transaction. Regarding the potential fragmentation of the payment landscape, the participating fintechs acknowledged that there are thousands of coins and tokens present in the market, but that 99% of all payment transactions are covered by a fraction of all coins and tokens out there (around 85% in bitcoin, 10-12% Ethereum, others at maximum 1% each). They suggest that this is an improvement considering that there are currently many hundreds of payment solutions available worldwide. Moreover, they expect

that there will only be a few financial institutions that will function as a bridge between the 'fiat world' and the 'crypto world', as this is a highly specialised role.

Dominant business models and the technological set-up

The participating fintechs discussed the dominant business models in the market and the different technical set-ups. Several participating fintechs stressed that it is difficult to mention a single dominant business model because companies active in the market found their own niche. For example, most coins and tokens in the market emerge because they try to solve a specific problem inherent to another coin, token, or technology.

The participating fintech participants mentioned that almost all merchants want a crypto payment converted into their local fiat currency immediately, including for accounting requirements, and to ensure safe storage. Price volatility of crypto-assets is complicated or too costly for merchants when the margin on their sales is tight. Also, for the payers, a few fintechs mentioned that they allow a time window such as 15 minutes or one hour to make the payment transaction for volatile coins. This approach is suited for e-commerce, but a different approach is preferred for payments at the POS. A fintech participant gave an example of using the Bitcoin Lightning network for low-value payments like buying a coffee. Although this approach allows for fast settlement, it may come at the cost of compromising the security aspect which is offered by the Bitcoin network.

Another fintech participant mentioned that they guarantee the merchant almost instant conversion of the payment, although the subsequent settlement depends on the agreement with the merchant. They use SCT (Inst) for settlement in euro, which allows the customer to receive their funds almost instantly. In addition, the confirmation that a payment is executed on the blockchain leads to settlement finality. Hence, the fintech participants argue that this is an advantage for merchants because it is claimed that there will be no chargebacks possible and less payer fraud relative to credit card payments. Asked whether it is difficult to compete with incumbent credit card companies, the fintech replied that it depends, given that the fintech can flexibly display the optimal crypto-asset and corresponding blockchain where they can guarantee fast settlement. These arguments were further developed by another participating fintech with the notion that funds move where the transaction fees are the lowest, e.g. a USDT transaction will be settled on the cheapest blockchain at that time. Often, these costs would be between 1-3% for the merchant and he argues that these costs could be lower than the credit card charges.

Finally, one participating fintech stressed that the technological set-up needs to be further explored within a safe regulatory framework which allows for innovation. The traditional payments industry has many years of experience with improving their technological set-up within a regulatory framework, while the latter is largely missing for crypto-assets.

Standardisation

Multiple fintech participants raised what they see as a need for standardisation, and some are already involved in standardisation initiatives. One fintech participant emphasised that technological innovation will

lead the way, considering the standardisation work already being done with the help of technological innovation, e.g. interoperability solved by building 'bridges' between different blockchains. On the contrary, another fintech participant identified the need for a regulator to lead the way in standardisation, e.g. via licensing or a regulatory sandbox. He argues that typically, however, the market simply needs time to adopt a specific protocol, drawing comparisons with the internet where there were many protocols for TCP/IP. If there was a leading company, it could speed up this process; otherwise we would have to wait to see which standard gets more adoption. However, initially there should be competition between multiple aspects such as costs, settlement time, and security. The price of security is hard to account, e.g. Bitcoin is the most secure blockchain around, for which hundreds of millions of euros are needed to attack the Blockchain. However, for smaller chains, usage costs could be smaller yet are uncertain and difficult to calculate; which serves as an example of how complicated it is in practice to standardise.

A few fintech participants discussed the 'travel rule' for crypto payments, which requires companies involved in a crypto-assets transaction exceeding a specific threshold to share customer information with each other. They stressed that they have the obligation to share this data, although no one knows how to receive the data. The fintech participants agreed that it is difficult for the industry to adhere to a rule when there is no technological solution at hand. One participant brought up the e-ID initiative as a possible solution to the problem faced by the crypto travel rule.

Innovation trends

Participants had an exchange of views on emerging and future (technological) innovation trends affecting the provision and use of crypto-assets and stablecoin services for retail payments. One participating fintech outlined great opportunities for the EU, also in terms of jobs creation, and preventing regulatory arbitrage with other jurisdictions. The innovation is to be seen as a 'currency' with a *built-in* settlement/payment infrastructure. Hence, he argues that it should not be regarded or even dismissed as yet another asset, but rather as 'money' which settles in a bearer instrument function and challenges the traditional four-corner model. This technology enables translating anything that represents value into a digital format and subsequently use this in a payment.

Moreover, another participant adds that the EU has an opportunity to promote its currency. He argues that blockchain settlement is a big topic. In the past, European countries disregarded or underestimated the possibilities of the internet, which ultimately led to US companies dominating the market. Hence, the EU should promote blockchain innovation, e.g. via subsidies or regulatory sandboxes. Education should also not be underestimated, as consumers need to be informed that these services exist and how these can improve their lives. Furthermore, the same fintech participant suggested to have a closer look at the potential improvement of foreign exchange markets. He argues that forex markets are currently a black box where it may be unknown at what price the euro/dollar trades, where opening times are restricted, and where a confirmed price still might not lead to an actual transaction. DeFi markets and products like stablecoins could improve this situation, as they are running 24/7 and cross-border settlement could generally be possible without any counterparty risk.

Asked whether any Artificial Intelligence innovation, beyond application to AML, is expected in the field of payments, one participating fintech does not see this happening in the foreseeable future, expecting that AI innovations will be limited to improved AML, more seamless customer experiences, and to cut administrative costs. A few fintech participants found it too early to pinpoint a specific innovation which will change their business. One participating fintech believes that unhosted wallet solutions, which can utilise the technology so that users can hold the assets themselves and have the appropriate amount of security, will challenge the payment industry more.

Having been asked how they perceive card payment companies, the replies by fintech participants were mixed, pointing toward the different services they offer. A fintech participant mentions that they could be competitors when a consumer at an e-commerce checkout has to choose between a card payment or using any of the crypto payment gateways, while on other occasions they rely on the services of card payment companies for conversion of crypto-assets into fiat and vice-versa. Another fintech participant does not perceive the card payment companies as direct competitors, as the fintech solely provides the interface for merchants and clients to access the blockchain. One fintech participant states that they can learn something from how banks perceive card payments companies, and emulate those aspects, in order to co-exist on equal grounds, and not regard each other as competitors.

Asked whether Big Techs would see any appetite to enter the 'crypto world', the fintech participants generally agree that Big Tech would enter any market where they can apply their technology to address significant real-world problems. Looking back at the Libra/Diem initiative, which failed eventually after a few years, but allowed legislators to develop MiCA to put a legal framework in place. However, considering what might happen if a similar initiative were to emerge, just outside the boundaries of MiCA, and prove successful, the adoption rate would be incredibly fast, as we can see from the rapid emergence of ChatGPT. This would leave little to no opportunity for a possible MiCA 2.0 to arise.

Fintech participants would welcome a level playing field, whereby crypto payments are treated as a means of payment. In that way, the traditional payment industry would better understand this type of payment.

Annex – List of participants

| <u>Participant's organisation</u> | <u>Name of participant</u> | <u>Position</u> |
|--|---------------------------------------|------------------------|
| Deutsche Bundesbank | Mr Dirk Schrade | Chair |
| Banking Circle | Mr Michael Boel | |
| Bitnovo | Mr Javier Castro-Acuña | |
| CoinGate | Mr Justas Paulius | |
| Coinify | Mr Hans Henrik Hoffmeyer | |
| Eligma | Mr Luka Planinc | |
| Stasis | Mr Gregory Klumov | |
| Nationale Bank van België/ Banque Nationale de Belgique | Mr Vincent Lanthier | |
| Bulgarian National Bank | Mr Mihail Dimov | |
| Česká národní banka | Mr Jiří Ambrož | |
| Danmarks Nationalbank | Ms Julia Seixasl | |
| Deutsche Bundesbank | Ms Inga Schultze Mr Julien Novotny | |
| Eesti Pank | Ms Linda Lelumees | |
| Central Bank of Ireland | Mr Batt Moriarty | |
| Banco de España | Ms Lourdes Cremades | |
| Banque de France | Ms Sophie Allain des Beauvais | |
| Hrvatska narodna banka | Ms Iva Kopecki | |
| Banca d'Italia | Ms Francesca Provini | |
| Lietuvos bankas | Ms Jūratė Butkutė | |
| Banque centrale du Luxembourg | Ms Li-Chun Yuan | |
| Magyar Nemzeti Bank | Ms Zita Ubránkovics | |
| Bank Ċentrali ta' Malta/ Central Bank of Malta | Mr Stefano Savo | |
| Oesterreichische Nationalbank | Mr Christoph Gluszko | |
| Banco de Portugal | Mr Rui Pimentel | |
| Banka Slovenije | Mr Domen Božeglav | |

Národná banka Slovenska

Ms Iveta Behunova
Ms Lenka Sidorová

Sveriges Riksbank

Mr Anders Mølgaard Pedersen

European Central Bank

Ms Karine Themejian

European Central Bank

Mr Iddo de Jong

European Central Bank

Ms Mirjam Plooij

European Central Bank

Mr Jorgen Eijlander