



## **BANK OF ISRAEL**

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### **Position paper on the issue of banks' payment application activity**

#### **Background**

In recent years, digital means of payment, through applications installed on mobile devices, have been developed worldwide at a rapid pace. In Israel, there are 3 main applications that make it possible to transfer money: Bank Hapoalim's **bit**, Bank Leumi's **Pepper Pay**, and Discount Bank's **PayBox**. In the first stage of installing the product, the said means of payment were limited to P2P (person to person) transfers, with the money-transfer in the application carried out from the payment card of the customer sending the payment to the bank account of the customer receiving the payment. The business model that led the banks to develop the applications was based on the future ability to expand the means of payment to paying businesses as well. This is an ordinary process in the development of such means of payment, and has occurred in many countries.

The Enhancing Competition and Reducing Concentration in Israel's Banking Sector Law established that the two largest banks must sell the credit card companies they owned, under the assumption that the separation itself will create two additional financial players in the financial system, and thus enhance competition in the areas of payments, credit to small businesses, and in other financial areas. Accordingly, the separated credit card companies are required to develop an independent and sustainable business model, which will compete with the banking model, including in the means of payment area. In this regard, it should be noted that currently credit card companies are limited in terms of their ability to access the Masav (ACH) payment system or customer accounts directly, in contrast to banks.

#### **The considerations at the basis of the position regarding the payment market structure**

In formulating a position on the payment market structure at this stage, which will lead to enhanced competition in the medium term and the long term as well as to innovation in the market, we must balance several considerations. We consider the possible adverse impact on the competitiveness of credit card companies or other potential payment services providers, which is liable to be created by the immediate expansion of banks' service to payments via the applications to businesses in Israel, and in particular on the ability of the separated companies to

compete against the banks, especially in a period in which the credit card companies are still building the business model for their independent activity. In this regard, the concern arose that the banking applications will take over the payments market in the short term. In contrast, it was taken into account that blocking banks' ability to operate in the area of payments to companies is liable to adversely impact both consumers and companies. A delay in advancing innovative means of payment will widen the Israeli economy's lag vis-à-vis the world with regard to introducing innovative means of payment, which improve the customer's welfare, and is liable to negatively impact the lowering of costs to the merchant in the short term. Moreover, the banks' developing and launching the applications, is in and of itself a result of enhanced competition in the sector, and has promoted the good of the consumers who benefit from a more convenient and lower cost option to make payments. In the background, it should be noted that the assessments are that the payments market worldwide, and in Israel as well, is expected to develop rapidly, with structural changes in the payment systems, the entry of new players—including some notable ones, collaborations between players and value proposals to customers.

The Banking Supervision Department held discussions on the issue with the Ministry of Finance, the Competition Authority, the banks, credit card companies, and the relevant players in the payments market. In these discussions, the need arose to expand the infant industry protection accorded in the law to the separated credit card companies to the payment applications area as well, and in parallel to enable the payments market to develop gradually, without enabling a small number of entities to gain broad control of the market.

### **A framework for banks' payment applications activity in the coming years**

In accordance with the considerations above, and the discussions held on the issue with the main relevant participants, the following principles for banking payment application activity were agreed upon for the coming years:

- **The banks will act in only a limited manner to integrate application-based payment activity at companies** in the coming 3 years. In 2019, 2020, and 2021, the activity of each bank in the area of payments applications among businesses will be limited to a maximum of NIS 2 billion, NIS 2.5 billion, and NIS 3 billion, respectively. This is a very limited scope relative to the means of payment existing in the market (in comparison, the activity turnover by credit card companies is more than NIS 300 billion per year, of which 20 percent is in respect of small businesses).
- Beginning in 2021, the activity threshold limit shall not apply to companies in which payments are conducted on the basis of the international standard for carrying out smart transactions (the EMV standard). The switch to the EMV standard is expected to enhance the

competitive ability of credit card companies in the market, so that in such companies infant industry protection will not be needed.

- During this period, the Bank of Israel, Ministry of Finance, and the Competition Authority will promote the possibility of initiating payment activities by nonbank entities. This means that new and existing players will be able to offer new payment services (to consumers and merchants) directly from the customer's bank account, and thus expand the range of means of payment, enhance the competition in the area, and reduce costs. In order to allow initiated activities, appropriate regulation and legislation is needed, as well as a technological infrastructure that will make that possible (which is coming about, among other things, as part of the open banking project being led by the Bank of Israel).

In parallel, the Bank of Israel is working to allow access to Masav to nonbank entities so that they will be able to compete with the banking entities in providing payment services. In this regard, the banking applications for paying at a business won't operate on the basis of immediate payment services, if Masav develops such a service, unless access to said service is possible for nonbank entities as well.

- The credit card companies will be able to operate via applications for payment to businesses, to the extent such applications will be developed, or through collaboration with nonbank entities, based on credit cards, without limitations on the scope of activity.
- If there will be significant changes in the market during the period, including if **nonbank entities will be allowed to provide payment services and initiated activity services**, if nonbank entities' access to **Masav** will be regulated, including immediate payment services, or if the EMV standard will be installed at merchant terminals, **the necessity of the limitations on banking applications will be reconsidered.**