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*Towards an Optimal Regulation of Innovative Markets: Challenges of Addressing Market Fragmentation in Online Payments Market in The Context of Reintermediation*

This paper explores the ways of optimising the impact of regulatory intervention aimed at facilitating efficiency enhancing innovation in EU retail (online) payments. The process of economic change, characterised by ‘redomaining’ and manifested through disintegration and reintermediation within payment systems, has led to a number of obstacles to the adoption of payment innovation. Market fragmentation has been seen by regulators as crucial to ensuring that European economy benefits from the efficiency enhancing effects of payment innovation. This prompted a regulatory response – a revised regulatory framework under Directive (EU) 2015/2366 (PSD2) became applicable on 13 January 2018. However, in the context of ongoing technology-driven change, tackling market fragmentation seems to be a serious challenge to the effectiveness of the new framework, which simultaneously pursues the objectives of market integration, competition and promotion of efficiency enhancing effects of innovation. Is efficiency of innovation an unavoidable trade-off in the pursuit of other regulatory objectives? In this paper I highlight these regulatory challenges from payment innovation perspective and discuss the core components of a regulatory intervention with the processes of innovation-driven economic change.