

PAYMENT SYSTEMS: EFFICIENCY AND FAIRNESS

Summary

Card payments and Credit transfers are already well functioning in a pan-European area and correctly charged by intermediaries as provided by the Regulation on cross-border payments in euro.

Since 1997, when the directive relating to the cross-border credit transfers was adopted, the European environment and the regulatory framework for payments have evolved considerably. The introduction of the Euro and the development of e-commerce were the first material conditions towards more retail cross border low value payments. Though the European banking sector was prepared and already organised for high-value cross border credit transfers (TARGET and EURO1), it was not as developed for retail payments which while increasing in number, still represent a very small part of the total number of transactions, which for the most part remain national and heterogeneous.

In the perspective of developing a Single European Payment Area (SEPA), with the help of a New legal Framework adapted to the commercial activity of financial service providers, the Banking industry has organised itself within the European Payments Council (EPC), created in mid-2002 to answer these issues.

Currently the EPC works to provide European consumers with a pan-European direct debit instrument and a set of European standards for a SEPA to be fully established by 2010 at the latest.

Background

On the 2nd December 2003, the Commission published a consultation paper¹ as a step towards creating a “Single Euro Payment Area” (SEPA) in the European Union. Rules protecting payments services users, providers and systems need to be clear and simple across the internal market and at fair conditions for payment instruments/systems providers and intermediaries.

There have been several recent regulatory and commercial steps bringing Europe closer to becoming a single payment area. These include the implementation at a high cost for European banks of the EU Regulation on Cross Border Payments in euro, which has brought the cost of cross-border card transactions for consumers, electronic cash withdrawals and bank transfers in euro into line with the cost of national transactions, and the EU Directive of 27 January 1997 on cross-border credit transfers.

The banking sector, in June 2002, created the **European Payment Council (EPC)** as the platform mandated by the European banking industry, represented by the three European Credit Sector Associations (ECSAs), to create the architecture, instruments and processes necessary for the Single Euro Payment Area (SEPA). This development was the result of the SEPA Workshop, organised in March 2002 in Brussels by the ECSAs and some 40 European banks. The EPC, organised in five Working Groups, addresses the whole gamut of payment instruments, from cheques to credit transfers to cards and cash, including emerging instruments such as e- and m- payments, in a cross-sector and holistic approach, and from a banking business perspective.

In 2004 European citizens and companies will benefit from two types of facilities in terms of European Payment Market offer:

¹ COM (2003) 718, Commission Communication on New Legal Framework for Payments in the Internal Market

⇒ High value payment operations

The European Market has been prepared since early 1999 to deal with credit transfers, in order to ensure a clean first step changeover from legacy currencies to the euro. In this perspective central banks and commercial banks have put in place, at the same time, two High Value Payment Systems: TARGET (from the Euro-System) and EURO1 (from the EBA Clearing Company).

Both systems were built from existing market infrastructures which facilitated their technical, organisational and legal implementation: “EBA Ecu Netting System” for EURO1 and the 15 national banks infrastructures for TARGET.

This Market is a small one of less than a million operations per day throughout Europe. It is commonly agreed that high value payment transactions are always to be considered as urgent. Thus, orders have to be initiated, treated, and settled one by one in real time on an intraday basis.

As they represent more than 80% of the daily amounts exchanged between banks and are related either to money market, capital market deals or intra – group cash flow management, these systems are watched over very closely by all participants.

Consequently, a number of financial value added services are dedicated to this category of transactions, mainly oriented around “Treasury and/or Cash Management services”, as required by the companies. Conditions are negotiated bilaterally between banks and/or banks and their customers. In this respect, Euro operations are not technically different from operations in other currencies.

The remaining barriers on efficiency arise primarily from reporting requirements such as the regulatory reporting by the intermediaries to the financial authorities of cross-border transfers exceeding certain amounts. Such rules slow down the process by preventing it from being automated “end to end”.

⇒ Retail payment operations

It should be recognised that this market is today well functioning. Provided that a few transparent requirements are fulfilled by ordering customers, like providing IBAN and BIC in their payment orders, these credit transfers are processed according to domestic price conditions and in line with the EU directive from 1997.

This market is still different to the high value payments market for the following reasons:

- It continues to be based on 98% to 99% of pure domestic national payments.
- Historically each national market has developed its own means of payment, without the necessity to look at those existing in other countries. Even for cheques, these worldwide known and used means of payments, each market has created standards which differ from one another. Thus at the European level, the payment market remains heterogeneous
- It is commonly agreed that this market represents between 300-500 million operations per day, of which 40% are issued within 3 countries (France, Germany and United Kingdom).

There are nevertheless means of payments that are today widely used cross-borders by consumers: the card payments (face to face or remote) and the credit-transfer (from a bank account to another).

Card payments are numerous and all market participants work to combat the fraud in this area, with the purpose of widening the use of secured smart cards throughout Europe.

EU Regulation on cross border payments applies to those two means of payments and European banks have reviewed their tariffs in accordance to it.

But national rules applying to these means of payment still differ between member states, and apart from them, no other means of payment is used cross-border. Anyhow there appears to be little demand from European consumers for such other means.

To reflect on the rules to apply to credit transfers and to card payments, and on possible proposals for pan-European instruments, such as the direct debit, the European banking sector decided in June 2002 to launch an enormous new project called: **Single Euro Payments Area (SEPA)**.

SEPA: What does it mean?

- ⇒ SEPA means a Pan-European Payments Area within which all the instruments for payments denominated in euro are the same. This requires consistent standards and rules under the same law, including reporting obligations throughout the 25 member states. On this SEPA basis banks will provide competitive payment products in the best interest of their clients.(note: 'same banking products' might apply from the viewpoint within a single bank or banking group but not throughout all 'SEPA banks' as this is an area for competition to play)
- ⇒ SEPA means that the European citizens accept to abandon some of their existing national practices and to move towards a new way of paying their bills. This new pan European way of paying will touch both "face to face" and "remote", and national and cross border (within EU) transactions.
- ⇒ SEPA has to be built by the European banking sector in order to cover: local and cross-border electricity / telecommunication / insurance bills, supermarket, or tax payments.

How to make SEPA a reality and what is the influence of Payment Systems within SEPA?

To treat hundreds of millions of cashless payments' each day requires:

- The existence of fully automated end-to-end processes; and
- The removal of existing organisational, technical and legal barriers.

Such a project requires some huge investments from the principal actors in the value chain and stretches over a number of years.

The banking sector has to:

- invent, develop and deploy a new set of pan European means of payments, their related rules and standards (in particular those related to the liability of the intermediary and the revocation of orders;
- put in place adequate market infrastructure in order to facilitate the exchange and the settlement of these new types of transactions as reflected by the EPC Pan European automated clearing house(PE ACH) concept;

- adapt its electronic tools to their use by the European consumers. In other words, home banking and cash management services will also move to SEPA services.

Companies, administrations and tax offices, will have to:

- support some non-negligible investments when using this new set of means of payments and for moving to new European standards (e.g. they should keep a leading role in pushing the governments to migrate quickly from the national uses to the pan European method of paying bills). The New Legal Framework² will be a key factor in the success of such a complex change process. In particular, an “achieve more with less complex rules” approach by the European Commission would not only support making SEPA happen in a market oriented environment but could also strengthen Europe’s framework conditions in the global payment markets.

Conclusion: Efficiency of the first results

Since its creation in mid-2002, the EPC has already achieved some significant results in the area of retail payments, principally it:

- ⇒ issued a first set of pan European inter-bank standards and rules concerning credit transfers (Format rules for Basic cross-border credit transfers denominated in euro).
- ⇒ issued a description of what should be the architecture, the governance etc. of the future Pan European Automated Clearing House infrastructure within SEPA: the ***PE-ACH concept***.
- ⇒ validated for the first time a European market infrastructure for payments (EBA STEP2) as compliant with this Concept. After 8 months of live operations, this new payment system registers, by the end of 2003, more than 80.000 credit transfers every day, these transactions being the first ones applying the European standards and rules. As of the 1st January 2004 it will reach every banking credit institution within EU (except Ireland) and as a consequence every beneficiary customer account will benefit from this new market infrastructure even if his bank is not a direct or indirect participant of STEP2.

The efficiency of this system is equal to current national automated clearing houses, as far as basic credit transfers are concerned, due to the use of pan European standards and the presence of the IBAN + BIC beneficiary references which enable a fully automated end to end treatment from the ordering bank to the beneficiary account.

It is now commonly agreed that the SEPA project requires huge investments from the banking sector, which will be done only if a return on investment is foreseeable, in the context of a new legal framework that should be drafted in a fair way, taking account of the interests of all market participants, as it concerns an economic and commercial area. Such projects needs also the involvement, active support and buy in of all users of payment instruments: consumers, small, medium and large companies, national and European administrations and regulators.

Finally, the 2010 target set by the banks for completion of the Single Euro Payments Area will, to a large extent, be dependant on the willingness of customers to adapt their habits and practices. Only then is the very aggressive timeline for SEPA achievable.

² Discussion paper issued by the European Commission, concerning a new legal framework for payments in the Internal Market

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Chairman Financial Industry Committee

Dr. Rainer Boden
Deutsche Bank, EU-Representation
17, Avenue Marnix
B – 1000 Brussels
Tel: 0032 2 551 60 06
Fax: 0032 2 551 61 08
E-mail: rainer-w.boden@db.com

Secretary

John Houston
Houston Consulting Europe
Av. de la Joyeuse Entrée, 1-5
B – 1040 Brussels
Tel: 0032 2 504 80 40
Fax: 0032 2 504 80 50
E-mail: secretariat@epfsf.org

Founding Members

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