

John Hurley: The challenges ahead - SEPA and NPIP

Speech by Mr John Hurley, Governor of the Central Bank and Financial Services Authority of Ireland, at the National Payments Conference, Dublin, 12 December 2006.

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Ladies and Gentlemen,

I am delighted to be able to address this inaugural national payments conference, hosted jointly by the Department of the Taoiseach and the Irish Payment Services Organisation in the historic surroundings of Dublin Castle. At the outset, I would like to say that the Central Bank fully supports the conference's broad objective of having open, ongoing and productive discussions involving everyone with an interest in Irish payment systems.

I'd like to use the opportunity of this conference to address three payments-related topics, namely:

- the Central Bank's role in relation to payment systems;
- the Single Euro Payments Area - or SEPA, and
- to share some thoughts from the Central Bank's perspective on the National Payments Implementation Programme.

Role of the Central Bank

The Central Bank has significant responsibilities in the payments area. These take a number of forms. At the broadest and most important level, the Bank acts as the overseer of payment systems. My remarks today will concentrate on this function. Apart from this oversight role, we also have a significant operational function.

With regard to the latter, we operate, manage and participate in the Irish real-time gross settlement system, IRIS - the system for the settlement of wholesale payments at the interbank level. We are also a participant in the local retail paper clearing system, and, of course, we fulfil the traditional central bank role of supplying cash. We have also recently agreed to take on the role of settlement agent in respect of euro-denominated securities transactions, mainly Irish equities, settled in the UK-based CREST system. This role is currently carried out by the Bank of England, and will move to the Central Bank in 2008.

I should probably also mention our involvement with the recent Eurosystem initiative known as TARGET2 Securities. This is aimed at the provision by the Eurosystem of settlement facilities in central bank money for all euro-denominated securities transactions. Discussions with the banking and securities communities on this initiative are ongoing.

Oversight

The oversight of payment systems is a core central banking function. In carrying out this task, central banks seek to minimize systemic risk, that is the risk that the failure of any payment system participant could result in other participants being unable to meet their obligations, leading to a potentially disastrous chain reaction of failures.

Minimizing systemic risk in payment and settlement systems is not only an objective in itself. It is also a precondition for achieving financial stability and for the efficient conduct of monetary policy. These, in turn, are necessary for the integrity of the euro as a major global currency.

Our oversight role is enshrined in both domestic and European legislation. Domestically the legal basis is the Central Bank Act of 1997. In the broader European context, one of the basic tasks of the European System of Central Banks (of which the Bank is a member) is "to promote the smooth operation of payment systems". The Eurosystem is further empowered "to ensure efficient and sound clearing and payment systems within the Community and with other countries".

Back in the early 1990s, central banks focussed on large-value netting systems where the safety concerns were more evident. Gradually, however, the focus of oversight has been extended, to varying degrees in different countries, to:

- real-time gross settlement systems,
- retail payment systems,
- payment instruments such as payment cards, direct debits and credit transfers,
- third-party service providers,
- central counterparties, and
- securities clearing and settlement systems.

The extensive range of activities now subject to oversight reflects their potential impact on financial stability and their links to the smooth conduct of monetary policy. Central banks are organised so that their operational role in payment systems does not conflict with their oversight role.

The Bank currently directly oversees the Irish real-time gross settlement system, IRIS, and the two retail payment systems concerned with paper and electronic clearing. In doing so, it applies the provisions of the Central Bank Act, 1997 that require all payment systems operating in the State to be approved, and have their rules vetted, by the Central Bank. In approving any payment system's rules, we must have regard to the "...proper and orderly regulation of the payment system concerned and of competition between payment systems...". In assessing the soundness of these domestic payment systems, we use as reference the internationally recognised principles developed by the Committee on Payment and Settlement Systems of the central banks of the G10 countries.

In addition to these direct arrangements, the Central Bank is involved in a number of co-operative oversight roles. Thus, in relation to the TARGET system, which interlinks all EU euro-denominated real time gross settlement systems, we participate in the Eurosystem's oversight arrangements. The Central Bank will continue this oversight role in relation to TARGET2, the successor to the existing TARGET system, which is due to come on stream in November 2007.

In addition to oversight of payment systems, the 1997 Act makes the Bank responsible for the oversight of securities settlement systems. However, apart from the NTMA's settlement system for Exchequer Notes, Ireland actually has no domestic securities settlement infrastructure. Trades in Irish Government bonds are settled in the Belgium-based Euroclear Bank, while trades in Irish equities settle in CREST which is located in the UK. Because of this, we have made arrangements whereby we co-operate with the National Bank of Belgium in relation to the oversight of Euroclear Bank, under the terms of a Memorandum of Understanding. Discussions are on-going with the UK's Financial Services Authority in relation to a similar Memorandum of Understanding on the oversight of CREST.

These arrangements illustrate the increasingly cross-border nature of payments and settlement activities that require co-operation among central bank overseers. In my view, central banks have successfully met these challenges, as can be seen in the examples that I've mentioned showing the variety, flexibility and co-operative nature of the arrangements in which the Central Bank here is involved.

As I've already mentioned, the role of payment system oversight has expanded in recent years, and the Eurosystem is becoming increasingly involved in the oversight of payment instruments such as debit cards, credit cards and cheques and payment networks. As a consequence, the Central Bank will also become more active in this area. Naturally, the intensity of this oversight will be commensurate with the perceived potential systemic impact of these instruments.

I hope that this summary of the Central Bank's payment systems role has gone some way towards explaining just what it is that we do in this field. In order to reach a wider audience it is our intention to publish, in the coming year, a detailed report on our work in the area of payments systems oversight.

Our oversight role - covering, as it does, payment systems and payment instruments - leads naturally to an interest in the issues being covered here today, SEPA and the National Payments Implementation Programme.

SEPA

Moving on to the Single Euro Payments Area (or SEPA) initiative, its aim is to advance European integration by putting in place a competitive and innovative euro-area retail payments market that should bring with it higher service levels, more efficient products and cheaper alternatives for making payments.

The origins of SEPA lie in the introduction of the euro in 1999. Although wholesale - or interbank - payments were catered for by TARGET, citizens of the participating countries did not have a comparable facility for making cross-border, non-cash, low cost, retail payments in euro, even though they shared common banknotes and coins once the euro cash changeover took place in 2002.

Even now, each national retail payments market remains essentially isolated from those of other euro-area member states, with levels of efficiency and service varying from one euro-area member state to another. As a result, cross-border retail payments in euro can be slower and less efficient than comparable payments made within any one country. This is because payment systems rules, procedures, standards and technical systems vary from country to country. Therefore, while goods and services can be traded freely across the euro area, the underlying payments are still hampered by national borders and arrangements, so that the completion of the 'internal market' is to some degree frustrated.

The SEPA project aims to ensure that all consumers throughout the euro area, whether individual citizens or corporate entities, will have available to them common retail payment instruments. In principle, at the end of the process in 2010, all euro-area bank customers will be able to use one payment account and one set of standardized instruments. This simplified payments world that will result from SEPA will be a major benefit for those who make cross-border payments.

When the SEPA project is completed, all euro area payments will, in effect, become domestic and the current differentiation between national and cross-border payments will disappear. Competition should be enhanced, since all consumers using payment services, and not just those making cross-border payments, will be able to choose between payment service providers throughout the euro area, regardless of where they might be located. This should foster innovation in the provision of payment services. It should also not be forgotten that SEPA will bring the benefits associated with a very real modernisation of payment functionality throughout the euro area. Thus, while it is acknowledged that SEPA undoubtedly involves large-scale investment by the banking industry, in the longer-run, the opening up of the euro area payments market to competition means that the industry itself should share in the benefits of this project.

One very topical debate in the SEPA arena relates to how payment cards - in particular debit cards - can become SEPA-compliant. In this regard, the Eurosystem recently issued a progress report on its views on the development of the "SEPA for Cards". The challenge in this area is to ensure a successful transition to a more integrated market while at the same time preserving the efficiency and low cost levels that characterise existing national payment card schemes. SEPA migration should not lead to any deterioration in conditions for cardholders and merchants. This is an area that is being closely monitored by the Eurosystem and will be the subject of discussions with all of those involved.

While there is strong support from the Eurosystem and the EU Commission for SEPA, it remains primarily a market-driven project. The role of the Eurosystem (of which the Bank is part) in relation to SEPA is that of a catalyst, or facilitator, while leaving its implementation to the private sector. However, the Eurosystem works actively with the EPC - the European Payments Council - and market participants to ensure that the necessary planning and preparatory work is carried out in a co-ordinated way.

Since its formation in 2002, the EPC has acted as the European banking industry's decision-making and co-ordination body for SEPA, and has made significant progress towards making the project a reality, and creating a solid foundation upon which it can be built. In practical terms, the EPC is the body responsible for defining the rules, procedures and standards that will apply to the new SEPA-compliant payment instruments that the banks will use to develop competitive products to offer to their customers.

As the body with primary responsibility for the implementation of SEPA in Ireland, I'd like to take this opportunity to commend IPSO on the speedy preparation of the Irish national SEPA migration plan, which was agreed and signed off by the chief executives of all IPSO member banks in December last year; Ireland was in fact one of the first countries to complete its national SEPA migration plan.

It is essential that the SEPA implementation and migration process include the necessary degree of engagement with all interested parties. In this regard, I am pleased to see that a SEPA Stakeholder Forum has been established by IPSO and has already held two meetings, at which government departments, public utilities, other direct debit originators and business organisations have all been represented. This is a development that the Central Bank very much encourages, and I hope that the Forum, and conferences like this one, will play a significant role in increasing public awareness of SEPA over the next couple of years. I also strongly support the focus on communication that, I understand, is planned for 2007.

The European banking industry cannot, however, operate in a vacuum. SEPA is a major European objective in every sense, and public authority support for SEPA is therefore vital. As with the Eurosystem, SEPA is firmly rooted in EU Commission policy, and strongly supported and promoted by both institutions. The EU Commission sees SEPA as part of the European integration process, and will facilitate the initiative by providing a common EU legal environment via the proposed Payments Services Directive. Strong support for the SEPA project has also been expressed recently by the EU Council of Ministers of Economic Affairs and Finance, the ECOFIN Council.

National Payments Implementation Programme

Finally I'd like to turn to the National Payments Implementation Programme. In undertaking this programme of work, IPSO has stated that its intention is to develop a future payments infrastructure in Ireland that would be seen as a world class payments environment 'which delivers efficiencies to all sectors of the economy, is inclusive of all sectors of society, and shares the benefits universally'. The Central Bank fully shares this objective and stands ready to assist, in any way that it can, the efforts of all involved in delivering the goals of the strategy. Rapid progress in implementing the Programme would do much to enhance the efficiency of the whole payments area and impact most positively on the competitiveness of the entire Irish economy.

The importance of developing Ireland's payment systems infrastructure has been recognised at the highest level; as well as IPSO and its member banks, various Government departments, the Central Bank and the Financial Regulator have all been involved from an early stage. It is encouraging to note that there has been extensive consultation with many other groups. The involvement of as broad a constituency as possible is undoubtedly the best way to achieve a successful outcome.

The development of Ireland's payment systems infrastructure - particularly in the area of retail payments will be very much influenced by external factors, principally driven by the SEPA project. There is significant common ground between SEPA and the national payments implementation programme, with the focus in both being very much on electronic payments. Both initiatives suggest that there is little future for the cheque as a payment instrument, and certainly not in the context of making cross-border payments.

Cheques have been characterised as both expensive and relatively inefficient, and the Central Bank and the Eurosystem concur with this view. Indeed, in its SEPA 4th Progress Report, the Eurosystem went as far as to state that "Cheques...will...ultimately disappear when it becomes clear to their users that other means of payment provide better service. By 1 January 2008, it is expected that national banking communities in the euro area will have put in place a strategy for promoting the use of alternative electronic means of payment..." and that "By the end of 2010...the use of cheques...is expected to follow a clear downward trend...".

To ensure that the national payments initiative achieves its full potential, the Irish banks must offer electronic payment methods that are:

- safe and efficient;
- easy to use;
- accessible to all, and
- no more expensive than existing national instruments.

The public authorities also have an important role to play in ensuring the success of the Programme by promoting, in respect of their own payments business, the use of electronic means of payments.

Conclusion

To conclude, I hope that I have been able to clarify for you the role of the Central Bank in the payments area. I will reiterate that we stand ready to assist IPSO, the Irish banking community and others involved in any way possible to deliver on SEPA and the National Payments Implementation Programme. I would like to thank you for your attention, and also would like to extend to the participants in this afternoon's 'breakout sessions' my best wishes for a successful outcome to their deliberations.