

The reform of the French payment system

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The existence of a secure and efficient payment system is necessary to ensure confidence in the currency and contribute to the development of the economy. In particular, the proper functioning of the payment system is crucial for the execution, under optimal conditions, of economic agents' payments, and for the development of the money and securities markets. In France, the modernisation, organisation and supervision of payment systems has for some years been one of the major areas of interest for the central bank and the authorities.

Characteristics of the French payment system

The characteristics of the French payment system explain, in part, the way in which the reforms have been carried out, and the priorities which have been set in this area.

The chief characteristic of the French payment system is the relatively small number of cash payments and the correspondingly large number of cashless payments.

The share of notes and coin in the money supply (M1) is 15%. This rate is lower by half than those in the United States, Japan or Germany. This situation arises out of the large "banked" proportion of the population (96%), the result both of legislative and regulatory measures by the authorities, which required the use of cashless settlement for certain transactions, and of the establishment by banks, in the 1970s, of very dense branch networks across the country.

Given the share accounted for by cashless instruments in economic agents' payment practices, their efficiency and low cost are clearly a decisive factor. This explains why one of the main objectives in reforming the payment system is to try to achieve the complete dematerialisation of cashless payment instruments. This objective has now virtually been met for all means of payment except cheques.

Another feature of the French payment system is the inadequate control of settlement risk, since the clearing systems do not yet have sufficient means to prevent the risk of default by one of their participants, and since banks with an account on the books of the Bank of France could generally, until recently, obtain an unsecured daylight overdraft.

The second major objective in reforming the payment system was therefore to make interbank settlements secure. For a number of years, considerable progress has been made in this area thanks to the progressive implementation of a risk reduction programme, *inter alia* as part of the preparation of the French payment system for the transition to European economic and monetary union.

The role of the central bank

Central banks are usually called upon to play a very active role in payment system modernisation, as:

- owing to their neutrality they can play an extremely useful role in encouraging competition between banks;
- they are also responsible for the security of the payment system. In particular, they have to ensure that the means of payment placed at the public's disposal are sufficiently secure. They must also make sure that the exchange and settlement systems are protected effectively against the risks associated with interbank settlements, in order to prevent systemic risk;
- finally, central banks can act as the operators of certain exchange and settlement systems.

With regard to the Bank of France, one of its fundamental missions, according to its statutes, is to "ensure the smooth operation and the security of payment systems". Although this provision does not give the bank any regulatory power – this resides with the Banking Regulatory Committee, chaired by the Minister of Economy and Finance – it does legitimise the Bank of France's interventions in this area vis-à-vis both the authorities and the banks, and confers on it strong powers of guidance, which can extend to a right of veto when the integrity of the payment system is threatened.

The Bank of France also manages the clearing houses installed across the country for the exchange of cheques. On the other hand, since 1994

it has no longer managed the system for exchanging automated low-value transactions. The Bank of France is now focusing its operational role on the management of systems for large-value operations.

Cooperation between banks

In the area of payment systems, cooperation between banks is necessary to ensure that payment orders are executed under optimal conditions in terms of speed and security and at low cost. To achieve this, banks must make efforts to define jointly the best possible organisation, participate in financing the infrastructure required and bear the operating costs. This cooperation between banks must not, of course, hinder competition between them.

In France, cooperation between banks, which we call “interbancarité”, is highly developed. This approach, which preserves and reinforces competition between banks on services and prices, encourages the universal use of payment instruments and exchange systems, the definition of common rules and the standardisation of procedures. This cooperation has given a great boost to the modernisation of the French payment system over the last 20 years. It chiefly takes place within CFONB (“Comité Français d’Organisation et de Normalisation Bancaire” – the committee for banking organisation and standards), which brings together all the commercial banks and the Bank of France.

Thanks to the efficiency of this cooperation, it has been possible to set up new systems requiring large scale collective investment. It has, for example, allowed the creation of the national system for exchanging automated payment orders for low-value transactions, the SIT (“Système Interbancaire de Télécompensation” – interbank teleclearing system). This system is based on a telecommunication network which permits the direct exchange of transactions between the banks’ computer centres. It allows the exchange at very low cost (around FF 0.03 per operation), 22 hours a day, of up to 30 million transactions daily, representing an annual volume of some 5 billion operations.

The creation of the French card-based payment system is another example of this cooperation. In 1984, the French banks decided to issue their customers with a card equipped with identical technical characteristics, the “Carte Bancaire”, to ensure that all merchant

hardware and all ATMs accepted this card (i.e. to achieve “interoperability”) and to draw up common arrangements for monitoring fraud and authorisations. Today, this interbank cooperation has borne fruit, since more than 2 billion card-based payments are carried out every year.

The reduction of settlement risks

In order to reduce significantly the risks associated with interbank settlements, the Governor of the Bank of France decided, in 1990, to initiate a programme of risk reduction with two main objectives:

- making intraday irrevocability possible through the introduction of a real-time gross settlement (RTGS) system;
- protecting the other payment systems, with the measures taken being geared to the estimated risk.

When the risk reduction programme was presented to the French banks in 1990, even before the publication of the Lamfalussy Report, the awareness of the risks associated with payment systems was then not as developed as it perhaps is today. The discussions with French banks were thus not always easy. The Bank of France’s attitude has always been to try and convince the banks of the need to introduce reforms, rather than imposing a solution. These long negotiations had the merit of revealing the constraints on the user banks, which allowed us to put in place a large-value settlement system which best met the banks’ needs.

The reduction of risks relies above all on the introduction of the RTGS system, TBF (“Transferts Banque de France” – Bank of France transfers), which went into operation on 27th October 1997. Managed by the Bank of France, this system now allows French banks to obtain final settlement in central bank money of their large-value transactions within a short time period. The other settlement systems in operation in France, in the areas of retail transactions, securities and fixed-term financial instruments, ultimately settle in the TBF system, thereby achieving finality of the transactions exchanged there. All large-value transactions initiated by the Bank of France are, of course, routed via the TBF system.

One of the organisational features chosen for the execution of large-value transactions is the possibility for banks, from a common platform linked to the S.W.I.F.T. network, to issue payments to either the TBF

RTGS system or the protected net settlement system SNP ("Système Net Protégé"). The latter system, for which security arrangements in compliance with the Lamfalussy standards are currently being put in place, transfers its end-of-day balances to the TBF system in order for them to be settled with finality in central bank money.

The message routing circuit is "Y"-shaped. The credit institutions asked to be provided with detailed information on events concerning their accounts at the central bank and to be able to integrate this information automatically into their own information systems. To this end, upon receipt of an order – irrespective of how the operation is handled (executed or queued) – the TBF system immediately transmits a message to the issuer (in the form of an advice) and the recipient of the order (who receives the original payment order together with information on the status of the transaction). Any subsequent change in this status also triggers the immediate dispatch of an advice to both institutions. This information allows the participants to maintain an up-to-date information database on the status of all their transactions – executed or queued, sent and received – so that they can manage their intraday liquidity in an optimal way. The participants also have the possibility, in particular in cases of desynchronisation with the system, to monitor the status of their accounts or their queue by means of specific enquiries.

The conditions under which participants in an RTGS system can obtain intraday liquidity in central bank money represent one of the most important questions for the proper functioning of such a system. The need for liquidity results from lags between settlements to be made and settlements expected.

In addition to the necessary control of flows that the banks perform during the day, the arrangements for managing their accounts at the Bank of France enable them to consolidate a number of accounts in real time in order to monitor their overall liquidity. The TBF system also manages a queuing facility equipped with two levels of priority. Finally, optimisation is carried out periodically to ease the banks' liquidity constraints.

The transactions handled by the TBF system (large-value funds transfers, balances from other systems, Bank of France transactions) are booked to special accounts, called settlement accounts, which in the majority of cases replace the ordinary current accounts opened for banks

with the Bank of France in Paris or at its branches. Settlement accounts have the following features:

- they are managed centrally on a single computer in order to allow banks to consolidate their assets in central bank money at any time during the day and in real time;
- they always form part of a group of accounts, which contains one or more settlement accounts. Only the consolidated balance of the group's accounts, which must not be in debit, is taken into consideration by the Bank of France in booking orders.

The existence of compulsory reserves, together with the possibility of using the funds during the day, constitutes a first source of intraday financing. In France, given the current very low level of compulsory reserves, this source of liquidity is insufficient. Consequently, the Bank of France grants secured intraday loans to banks by means of intraday repurchase agreements. These repos can be entered into and repaid at any time during the day. This therefore allows banks to mobilise their securities only for as long as it strictly necessary, and they regain the use of the securities once the intraday repo has been repaid. In contrast to the technique of posting collateral, repos are well suited to the Paris financial market-place, where credit institutions are heavily involved in arbitrage on their securities portfolios.

This new infrastructure will enable the French payment system to change over to the euro on 1st January 1999, as the TBF system will form the French component of the TARGET settlement system of the European System of Central Banks. Thanks to this arrangement, the participants in the TBF system will be able to send a large-value transfer in euros to any EU bank participating in a national RTGS system as easily as if it were a domestic payment.