Christian Noyer: The contribution of payment infrastructures to the European financial integration and to the establishment of the SEPA (Single Euro Payments Area)

Speech by Mr Christian Noyer, Governor of the Bank of France, at the 20th Anniversary of the European Banking Association (EBA), Paris, 23 June 2005.

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Ladies and gentlemen,

I am very pleased to join you today to celebrate the 20th anniversary of the European Banking Association (EBA), here in Paris at Palais Brongniart. First of all, I would like to give credit to the EBA for its strong commitment in favour of the European financial integration. This commitment has led the EBA to set up the large value payment system EURO 1 and the retail payment systems STEP 1 and STEP 2.

Central banks of the Eurosystem, like any central bank, have a keen interest in securing that the financial system falling under their monetary competence is unified, competitive and stable. This is essential for the European economy, considering that a high degree of financial integration enables an efficient transmission of the monetary policy, a better allocation of financial resources, a minimisation of cost of capital, as well as a fast and safe execution of payments across the so called SEPA, that is to say the Single Euro Payments Area.

Different factors support the development of a fully integrated financial system at the European level. Today, I will emphasise a key driver of this process - payment infrastructures. In particular, I will focus on what has already been done in this area and on what remains to be done.

I will start by underlining the importance, for the European financial integration, of the development of efficient and safe payment infrastructures. Then, I will assess progress made in this field since the launch of the euro. I should mention immediately that my assessment is mixed. On the one hand, I consider that the situation is favourable for large-value payment systems. On the other hand, I can't yet make the same positive assessment concerning retail payment systems. As a consequence, I will end my presentation by elaborating on the further developments needed to strengthen the integration of retail payments.

1. Payment infrastructures are a necessary driver for financial integration

Payment infrastructures cover all procedures and systems used by financial intermediaries to exchange payment orders issued by economic agents. Accordingly, they play a fundamental role for the smooth functioning of the economy as a whole. Indeed, provided that they allow financial transfers to take place between economic agents in an efficient and safe way, payment infrastructures are a key support to one of the core functions of money, namely money as a means of exchange.

In the EU, infrastructures processing payments in euro consist in a number of arrangements, which are of different nature. For example, the exchange of payment orders in euro between financial intermediaries can be handled within multilateral systems or within the framework of correspondent banking bilateral arrangements. Although there is a great number of arrangements that ensure money transfers between financial intermediaries, in practice, financial transfers tend to be concentrated on a few of them.

Thus, the largest volumes and values of payment orders are currently carried out in multilateral payment systems. On the basis of several surveys conducted by the Eurosystem since 1999, we consider that the market share of these systems is nearly 80 %, both in terms of volume and value. However, we should not minimise the role of correspondent banking, which holds the remaining 20 % of the market. Correspondent banking arrangements also show a high degree of concentration: out of all reporting banks to the Eurosystem's survey, the ten largest banks account for about 80 % of the overall value of correspondent banking transactions. Moreover, correspondent activities of some banks are substantial and similar in size to those of some interbank funds transfer systems.

The issue of the infrastructures diversity for payments in euro across the EU was raised prior to, and due to, the introduction of the euro. At that time, it was realised that diversity had drawbacks to the extent that it came together with a discrepancy of service level between national and cross border payments, at the expense of the latter. With respect to the objective of financial integration, it was clear that this situation could not be considered as an optimum.

The issue was taken into account before the launch of the euro. The re-engineering of payments processing, aiming at notably closing identified efficiency and safety gaps between cross-border and national payment infrastructures, appeared as a pillar for ensuring a high degree of monetary and financial integration in Europe.

The Eurosystem has been closely involved in lifting obstacles to the European financial integration in particular with respect to those related to payment infrastructures, in support of market initiatives, including notably those of the EBA. The rationale for such an involvement is in line with the statutory role of the Eurosystem. Indeed, pursuant to the Treaty, the responsibility of ensuring the smooth functioning of payment systems is one of the basic statutory tasks of the Eurosystem. Therefore, the Eurosystem has participated so far in the process of integration under three roles. Firstly, as a service provider for clearing and settlement of large value payments, with the operation of the TARGET system. Secondly, as a catalyst of market participants' efforts for the creation of a SEPA for retail payments. Thirdly, as an overseer of the functioning of systems processing payments in euro.

2. The present situation display a significant discrepancy in the integration of payment infrastructures

Let me now assess the achievements of the integration process of payment infrastructures. The degree of integration depends on the segment of the payment infrastructures market. While the large value payments segment has already reached a high level of streamlining and consolidation and will further progress with the launch of the TARGET 2 system, the retail payments segment is still very fragmented.

In the area of large value payment infrastructures, the degree of integration has increased very quickly. We should bear in mind that EURO 1 and TARGET have been clearly set up to face the challenge of the EMU. It was of great importance for large value payments, in particular those linked to the money market, to rely on systems handling efficiently and safely cross border transactions. Moreover, TARGET was a prerequisite for the effective conduct of the single monetary policy, because it ensures the settlement of monetary policy operations. The timeframe was particularly tight to build up the TARGET system. Therefore, the design of TARGET 1 was based on the principle of minimum harmonisation and on a decentralised architecture, with an interlinking of the national RTGS (Real-Time Gross Settlement Systems).

TARGET 2, which is due to go live in 2007, will further improve the degree of integration of wholesale payment infrastructures. It will provide fully harmonised settlement services across Europe in real-time in central bank money, supported by a single price structure for domestic and cross-border payments and a single processing platform. This single platform will be used by all central banks of the ESCB to provide services to their banking community. TARGET 2 will enhance cost-efficiency and meet state-of-the-art business continuity procedures.

As a result, in less than ten years since the launch of the euro, the number of large value payment systems in euro operating in the EU will have been dramatically reduced: this number is to drop from 21 (i.e the 16 components of TARGET1 plus 5 privately-owned systems) down to 2 (TARGET2 and EURO 1). To sum up, we should shortly be on the same footing as the United States in terms of the integration of large-value payment infrastructures.

On the retail side, the situation is quite different. Indeed, there are today in the EU, 15 multilateral clearing and settlement systems in euro, almost the same number than 10 years ago, and there is no clear sign for the time being that this number is going to fall significantly in the short to medium run. The market is therefore characterized by this multiplicity of national multilateral retail payment systems, coexisting with various other payment arrangements such as bilateral schemes, international card schemes or banking "clubs".

It is fair to say that significant steps towards integration have nevertheless been made since the introduction of the euro banknotes and coins. In 2002, the European banking community launched the SEPA project, with the final objective that by 2010 "all payments are treated as domestic as far as speed, security, convenience and cost are concerned".

However, meeting this ambitious objective implies a significant evolution of the current retail infrastructures towards a pan European infrastructure, the so called PEACH, which will aim at reinforcing the global efficiency of payments in Europe. The main achievement with regards to infrastructures until now has been the launch of STEP2, since it is the first infrastructure compliant with the PEACH requirements, as defined by the EPC. But there is still a significant way to go since STEP2 handles low volumes, 170.000 payments in May 2005, and can still not offer the same level of service as national ACHs.

In that context, it must be seen as a positive prospect that most national retail payment systems are now preparing themselves to the implementation of SEPA, through the spreading use of standardisation, which will allow the interoperability of infrastructures. In France for example, several banks have initiated the STET project in view of SEPA. However, one should note that the idea of consolidating the retail systems platforms is for the time being not really at the forefront of market initiatives, even though consolidation is a source of cost savings and efficiency.

Why such a gap in the level of integration between large-value payment systems and retail payment systems? I see two main explanations. First, large value payment systems have benefited from the incentive of the adoption of the single monetary policy in the Euro area, which made the creation of TARGET mandatory. Second, the integration of retail payment infrastructures is a more complex issue. Large value payment infrastructures handle only one type of payment instrument, the fund credit transfer, whereas the diversity of retail payment instruments makes the integration of national retail infrastructures more difficult. In addition, the transition costs are significant and the coordination problems to be solved are important.

3. The integration of retail payment infrastructures has become a priority on the agenda of the Eurosystem

It is particularly important that the European banking community now focuses on the retail payment issue and takes up in particular the challenge of creating a fully integrated retail payment infrastructure. The stake is obvious - the success of the SEPA. Tools to build a SEPA for infrastructures are known by all of us, but I would like to mention them briefly: it deals with enforcing standardisation and interoperability between systems on one side, with ensuring equal access of financial intermediaries without considering national locations on the other side.

The EPC expressed its commitment to deliver two pan-European payment schemes - one for credit transfers and one for direct debits- and to develop a framework for cards that will be available for clients by 2008. Furthermore, the EPC expects that “a critical mass of transactions will naturally migrate to these payment instruments by 2010 such that SEPA will be irreversible through the operation of market forces and network effects”.

From my point of view, to be successful, the new strategy of the EPC requires that two main conditions are fulfilled. The first condition is to make sure that the pan-European instruments are attractive for consumers. As regards this first condition, I just would like to draw your attention on one point: in order to be really attractive, the pan-European payment instruments need to be the “best of breed” that is to say that the service level to be provided should converge towards the best service levels in Europe. The second condition is that infrastructures are ready to support the critical mass effect expected in terms of adoption by customers of pan-European payment instruments. The 2010 deadline for infrastructures to be “SEPA compliant”, as recommended by the Eurosystem, is therefore very important.

This “SEPA compliance” of infrastructures implies in particular that interoperability between all retail infrastructures is ensured. Defining and enforcing requirements for interoperability can certainly be part of the self-regulation space claimed by the EPC. In line with its supportive stance of market efforts, the Eurosystem, as Jean-Claude Trichet has already explained to you this morning, stands ready to assist the banking industry in the definition and implementation of such requirements.

To conclude, I would like to stress that it is essential that the efforts put together by the banking industry since 2002 bear their fruit so that the SEPA becomes shortly a tangible reality for citizens, companies and other economic agents. Change in the functioning of payments infrastructures is to be a key enabler if such a result is to be obtained. The sector of wholesale payments is about to enter a crucial stage of consolidation due to the launch of TARGET 2 by central banks. A breakthrough is also necessary on the retail side: in the field of infrastructures this breakthrough should notably mean interoperability so that through increased competition, the market selects the best infrastructures for the SEPA.

Thank you for your attention.