Gertrude Tumpel-Gugerell: The Single Euro Payments Area in a global context

Speech by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the “The Global Payments Strategies 2008” Conference, hosted by NACHA – The Electronic Payments Association, Brussels, 22 January 2008.

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Ladies and Gentlemen,

It is a great pleasure for me to give a keynote speech at this Global Payments Strategies conference organised by NACHA. This year’s event focuses on global trends in payment systems and the impact of regulatory developments on the evolution of the payment landscape.

More than four and a half years ago, when I joined the Executive Board of the ECB, one of my first speeches was also in Brussels, and it was also related to the development, innovation and security of payments.[1] I concluded that new payment instruments offer significant opportunities. Who would have thought that the industry would change so dramatically in these few years?

In my intervention today, I will address how payment systems are increasingly becoming global in nature, also in a domain which typically used to be purely domestic – namely retail payments. The treatment of other types of payments, such as large value – or wholesale – payments and foreign exchange payments, has been quite international for some time, and is gathering momentum. Now, small value (end-user) payments are also following this direction.

And Europe provides many good illustrations of retail payments becoming international. For example, until recently it was not possible to pay in Austria with my German debit payment card (EC Karte). I had to use either the international Maestro debit card scheme or a credit card. As of this year, I will be able to able to use my debit card all over Austria when I am there for holidays or business.[2]

End-users are increasingly being exposed to global trends, and younger end-users, in particular, are becoming part of a global community through the internet. For example, e-mails, internet search engines – such as Google – and online publishing tools – such as Blogger – are extremely popular, and they are used in the same way, irrespective of where the end-user is located. In addition, internet communities – such as Facebook – are becoming popular, which allow users to keep online contact with each other.

A few years ago, these internet-related developments were not widely known among the general public, but they very quickly caught on worldwide. Their tremendous global success is based on the simplicity of the solutions offered and the real improvements they bring to end-users searching for information or who want to be in contact with each other. Not only were these services simple, cheap and good, in retrospect they also seem very obvious. But, before these services existed, it would have been difficult to explain their usefulness – take online diaries, for example.

[1] “Payments and confidence - the views of the Eurosystem”, 16 September 2003.

[2] On 15 January 2008, a co-operation agreement was signed between Zentraler Kreditausschuss (ZKA) and PayLife Bank GmbH (formerly Europay Austria) on the acceptance of the German debit card EC Karte in all PayLife POS terminals in Austria.

Today, I will focus on far-reaching developments in the field of retail payments in Europe. The developments are grouped under the term "SEPA" – Single Euro Payments Area. SEPA is a key market-driven initiative, which aims to achieve a fully integrated market for euro retail payment services. Market-driven, as I said, but with the considerable support of the European Central Bank and the European Commission.

What does SEPA mean at a global level? For long, the SEPA-vision seemed as remote and dreamy as the paradisiacal Indonesian island that is actually called "Sepa". But the vision of a borderless payments area is now becoming a reality and in the search engines Sepa island has already been crowed out by references to the SEPA-project – much to the annoyance of the Indonesian tourist industry, I guess.

I expect that SEPA will have a significant impact on global developments in retail payments systems. Why? As with the developments in the internet, SEPA will lead to simple, cheap and common services for end-users, which can be used irrespective of the end-user's location. SEPA will also be based on the latest international standards for end-to-end payments and will therefore have a seamless connection with the rest of the world. And, as with internet services, end-users will also find SEPA very obvious in retrospect. Indeed, once SEPA instruments are on offer, in Europe it will be also obvious to have a harmonised set of payment instruments based on international standards, instead of having to cope with national specificities and local payment instruments.

The European banking industry, with the support of the Eurosystem and the European Commission, has embarked on the SEPA initiative, and financial integration has been a strong driver. I will therefore reflect in the first part of my presentation on the significance of financial integration and the effect it has had on Europe and, in particular, the payments industry. The next part of my presentation is related to the key components of SEPA, which are the core achievements so far. In addition, I will address developments related to payment cards and to innovation separately, as they will require special attention in 2008. Finally, I will conclude with the impact of SEPA in a global context.

I. Financial integration

The Eurosystem's interest in financial integration

Financial integration has been – and will be – a major driver for many changes in the banking industry at a global level and this is also the case for SEPA.

The Eurosystem, which comprises the ECB and the national central banks of the euro area, has a keen interest in the financial integration and the efficient functioning of the financial system.[3] Especially for the euro area, which is a "local" financial system, there are many barriers that prevent economic agents from investing or doing business – or at least hamper them considerably – in areas outside their "home turf". By facilitating an open and integrated market economy with free competition, the Eurosystem fosters the efficient allocation of resources.

Financial integration is particularly relevant to the four basic tasks of the ECB. It is of vital importance for the conduct of the single monetary policy, since a well-integrated financial

[3] In general, financial integration facilitates a better functioning of the financial systems. It allows a better channelling of funds from those economic agents that have a surplus to those which have a shortage. It also facilitates a better functioning of financial systems, whereby risks are traded, hedged, diversified and pooled more efficiently. Indeed, financial integration is of global relevance, as it leads to an improved sharing and diversification of risk and lays the basis for an increased potential for stronger economic growth. The Eurosystem has included the promotion of financial integration in its mission statement in order to underline its determination in this respect.

system enhances the smooth and effective transmission of monetary impulses throughout the euro area. Furthermore, it is highly relevant to the Eurosystem's task of contributing to the safeguarding of financial stability and the promotion of the smooth operation of payment systems. Finally, financial integration promotes the development of the financial sector – including structural reforms such as SEPA – thereby raising the potential for stronger economic growth.

The Eurosystem believes it is a core task of a public authority to create a framework which fosters financial integration. The Eurosystem therefore closely analyses the state of financial integration and monitors its progress over time.[4] For the ECB, a market – for a given set of financial instruments or services – is integrated when all potential participants in that market are i) subject to a single set of rules[5] when they decide to deal with those financial instruments or services, ii) have equal access to this set of financial instruments or services and iii) are treated equally when they operate in the market.

Financial integration is, first and foremost, a market-driven process. However, it also requires an effective interplay between market forces and public authorities. In Europe, the foundation for market integration was laid more that half a century ago, in 1952, with the creation of the European Coal and Steel Community, which had six members.[6]

Significant progress has been made ever since, and that community has become the European Union (EU) with its 27 Member States. Who would have believed a decade ago that Ireland would become one of the most prosperous countries in the EU? Today, 15 of those Member States form a European Economic and Monetary Union using the euro. And since the introduction of the euro, 15 million new jobs have been created. Participating in a community that becomes ever more integrated is coupled with the ambitious programme of reforms, as pursued under the Lisbon agenda.

I would conclude that financial integration has brought prosperity to an increasing number of countries in Europe. However, in my view, we are still far from realising the full potential of the single currency and the single market considering our goals of greater economic growth and competitiveness. The Eurosystem will therefore continue its efforts to remove the barriers that lead to fragmented markets. We will also share our experiences with other communities that wish to foster improvements in financial sector performance.

Let's now turn to some of the implications of financial integration.

Implications of financial integration

The EU has become a large market, which in terms of population, GDP or capital markets is similar to other large markets, such as the United States. The EU is implementing the latest international rules and standards under the SEPA project. A key question is whether comparable markets could or should also have similar rules.

When looking at the trends in the use of different payment instruments, we notice similar developments on a global scale, namely a clear increase in the number of transactions, especially those involving payment cards, and a noticeable decline in the use of cheques.

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4 Every year around March, the ECB will publish a report on the status of financial integration in Europe. The ECB has developed a set of quantitative indicators to assess progress over time. The first edition of the report, entitled "Financial integration in Europe", was published on 28 March 2007 (http://www.ecb.europa.eu/pub/pub/prud/html/index.en.html).

5 The term "rules" is used in a broad sense and refers to similar laws and regulations, supervisory arrangements, market conventions, standards and practices.

6 Belgium, Germany, France, Italy, Luxembourg and the Netherlands.

For example, over the last few years, volumes of cashless payments in the European Union have increased by 7% per year.[7] By comparison – and this is not presented in my slides – cashless payments have increased by 4.6% in the US.[8] In the case of card payments, volumes have increased by 15% per year for credit and debit cards in the EU and by 17% per year for debit cards in the United States. In Europe, cards have become the most used payment instrument, with over 15 billion payments per year. The use of cheques, on the other hand, has decreased by 5% in the European Union and by 6.4% in the United States.

We notice a clear trend towards cashless payments in many countries, including the EU Member States and the United States. However, despite similar trends at a global level, national payment habits still differ. Indeed, this is the case in the EU, which makes it is a real challenge for the industry to develop common solutions that are capable of coping with the different payment habits in Europe. The newly developed solutions should also give users similar choices between payment services between Member States. Let me briefly illustrate, with four examples, how habits differ in the EU.

First, credit transfers are widely used in Hungary and Romania. However, they are rarely used in Portugal.

Second, payment cards are widely used in Portugal but not as much in Romania.

Third, in some countries, such as Spain and Germany, in relative terms more direct debits are used than other instruments, whereas in others, such as Poland, their use is infrequent.

Fourth, cheques are still widely used in the two new euro countries, Malta and Cyprus, as well as France. But in almost all other countries, little use is made of cheques and their decline is increasing.

While these examples show that EU Member States have different preferences for payment instruments, it is not possible, nor advisable, to present a single payment solution for the EU, or beyond, on a global level. Indeed, in the future we will most likely see the development of different preferences for payment instruments. SEPA will offer the basic payment instruments, and on top, it will offer different options and additional services to meet customer preferences.

Customers' habits when purchasing goods and services are nevertheless changing. More competition, more choice and new business opportunities – for example in the cards market – will influence their habits and could encourage a greater use of cards. Innovative payment solutions, such as online payments, are also likely to change customers' habits. The banking industry jointly will therefore have to develop innovative solutions for international online payments, which would meet customer needs.

II. Key components of SEPA

In this second part of my presentation, I will illustrate the key components of SEPA in more detail, as they provide a good example of the concrete steps that are being taken to create a more integrated market in Europe. SEPA is designed for a market in which it should be possible to make payments in euro under the same basic conditions, regardless of location.

With SEPA, the banking industry has come up with a single set of instruments for euro payments, based on the latest international arrangements.

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7 See "Statistics on Payment and securities trading, clearing and settlement - data for 2006" (16 November 2007). The trends in payment transactions reflect developments between 2000 and 2006.

8 See "The 2007 Federal Reserve Payments Study", The Federal Reserve System, 2007. The trends in payment transactions reflect developments between 2003 and 2006.

An important distinction is made in SEPA between i) "business rules", which define interbank agreements among participants of a payment scheme – typically banks – and ii) "standards", which define the technical agreements for the transfer of a payment from one customer to another (namely end to end involving end-users).

- The SEPA business rules, which are interbank, have been made publicly available by industry, in the form of "Rulebooks", and have already attracted global interest. The business rules therefore have the potential to become a global reference for other countries that wish to modernise their retail payment systems.
- The SEPA standards, on the other hand, were developed by the industry as technical standards under the ISO umbrella, and are therefore already international. Indeed, with SEPA, banks are also preparing for the global payment landscape by introducing international ISO 20022 XML standards.

The first concrete deliverable of SEPA will be SEPA Credit Transfer, which will be launched on 28 January 2008. For this deliverable, the banking community has developed a single set of business rules for Europe. The industry will also use a single international ISO standard, for which they have developed European implementation guidance. So far, the vast majority of banks in Europe that are involved in payment handling have implemented this single SEPA credit transfer rulebook.[9] A successful launch is expected.

The second deliverable of SEPA is SEPA Direct Debit, for which banks have developed two options: one for ordinary direct debits and one suited to corporates´ needs. These schemes will be launched towards the end of 2009.[10]

Finally, the third deliverable is the SEPA Cards Framework. As of January 2008, the industry, including all banks and schemes that follow this framework, has undertaken to offer EMV chip cards and has agreed to separate the management of the scheme from the processing of transactions. The framework lays the foundations for the gradual creation of a pan-European cards market.

How will these new SEPA arrangements influence the future payments market? With SEPA, we will most likely see an "industrialisation of financial services" in Europe, and potentially also in the rest of the world. Similar developments are already apparent in the automotive industry, where more car models are produced on fewer common platforms. Indeed, Mercedes Benz, for example, used to produce three basic types of cars, but more recently they have expanded their range of products and "flavours" extensively to suit customer needs. In the case of the financial industry, this implies that the range of products will likely expand significantly, but the basic processing platforms and rulebooks will not.

III. SEPA cards framework

One of the most challenging issues currently faced by the industry relates to the future development of payment cards in SEPA, so let me briefly elaborate on the ECB's views on this topic. For the ECB, it is important that the industry does not loose sight of the ultimate goal: the creation of an integrated and competitive market where you can use "any card at any terminal".

Currently, almost every European country has one or more locally developed and often efficient card schemes, but the tendency is towards a high multilateral interchange fee in

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[9] Over 4,000 banks have applied the SCT Scheme Rulebook so far in January 2008 (see www. Europeanpaymentscouncil.eu).

[10] By November 2009, the Payment Services Directive should be fully transposed into the legislation of the EU Member States.

some countries. Currently, there is also uncertainty about how far banks can go in collective agreements on cards, as competition authorities are becoming increasingly attentive to developments in card markets. I think that the recent MasterCard decision of the European Commission is a case in point. It can provide the basis of a constructive dialogue between the European competition authorities and the financial industry on the conditions of acceptable business models for cards.

Additionally, national schemes are often owned by banks and therefore the schemes themselves have often little room for manoeuvre. Finally, the standardisation process is not yet complete, and efforts have to be stepped up to agree upon a common set of standards by the end of 2008.

A certain similarity can be found between the EU today and the United States in the 1990's, when almost every US State had its own network for PIN debit card payments. At that time, the industry in the United States failed to create a common debit card network with national coverage, because of the lack of vision of local market players.[11] What happened instead was the consolidation and "survival of the fittest", and the biggest.

Uncertainties are counterproductive, and this is why the ECB and the Eurosystem have joined the discussion. We have emphasized that the industry should work together with one common goal, namely the creation of at least one additional pan-European card scheme. This would increase the choice of stakeholders and allow for diversity in products, business models and governance arrangements.

Since the start of a more intensive debated about the possible merits and challenges of a new pan-European card scheme – or schemes – the number of supporters has increased. I would encourage the industry to compile the relevant numbers and to investigate the business case – better now than later.

The Eurosystem is aware that a new pan-European scheme takes time to build. This is why we need to distinguish between what can be done in the short to medium term, and what can be done in the long term.

As from 2008, the SEPA Cards Framework has to be applied by the card schemes active in Europe, and the industry has to define its strategy to adapt to SEPA. Adapting to SEPA typically involves the possibility to be co-branded with an international scheme for international reach, or the gradual alignment of the different business models to join alliances of national card schemes. Adapting to SEPA would also imply the adjustment of current arrangements to achieve the separation of scheme and processing. Finally, adapting to SEPA also implies the adoption of common card standards, such as EMV.

In the long run, the gradual alignment of business models would be followed by the progressive merger of national card schemes, which at national level have been successful but individually cannot meet the SEPA challenge.

IV. SEPA and innovation

Before I conclude, let me briefly present my views on the remaining developments on the payments horizon, in other words concerning SEPA and innovation. SEPA has come a long way in terms of the harmonisation and modernisation of payments, but the process is far from complete. SEPA must evolve further in order to become a fully integrated and innovative market. I see, in particular, a need to broaden and deepen SEPA.

- With the broadening of SEPA in mind, the industry has already taken several steps to involve corporates, merchants and consumers in the process. A separate

[11] The "National Interchange Network" initiative failed in the 1990's.

stakeholder forum has been set up, both at European and national levels. This allows a wider view to be had, beyond the interbank rules and standards. The current dialogue on the further harmonisation of the initiation of payments and their reporting is strongly encouraged by the Eurosystem, as this would allow a fully automated end-to-end straight-through processing of payments. I also see, however, the need to further formalise the involvement of stakeholders, making it less voluntary and more binding.

- In terms of the deepening of SEPA, the basic SEPA instruments have to be complemented with additional services that involve innovative solutions and reduce the use of paper. The European Payments Council, as the decision-making body for the European payments industry, is expected to play its role.

Several initiatives are already under way:

- SEPA online payments: Last December, the EPC agreed to work on a framework outlining the rules and standards relating to SEPA online payments. This could lead to a common "e-payment channel" for web retailers based on SEPA Credit Transfer.
- Mobile payments: It is also encouraging to see that the European Payments Council is looking for viable models for mobile payment solutions and is exploring the possibilities of cooperation with the GSM Association. We will follow with great interest potential developments for a common framework for mobile payments. The industry should also look beyond its own borders. For example, I understand that NACHA has also started a project on mobile payments.[12]
- E-invoicing: An expert group has been set up by the European Commission to analyse the introduction of electronic invoices. Concrete examples can be found particularly in the Nordic countries especially.

Conclusion

Let me now conclude with the following three points.

First, SEPA is necessary and inevitable. SEPA will start on 28 January 2008 with SEPA Credit Transfer, and other instruments will follow. In retrospect, we will all find it normal that national legacy instruments have disappeared and to have a harmonised set of payment instruments across Europe, based on international standards. However, it requires end-user stakeholder involvement to be strengthened and formalised even further.

Second, SEPA is a global relevance. It introduces, in a large, mature market, a single set of business rules and the latest international standards. I expect that other markets will follow in the same direction. SEPA also ensures that participants in this market have equal access to the SEPA payment schemes. Furthermore, it ensures that market participants are treated equally when they operate under the SEPA rules, which facilitates the entry of new market players and will increase the competitiveness of service providers.

Third, SEPA is innovative. We are already benefiting from innovative projects, such as e-payments and m-payments. A global exchange of views – for example on mobile solutions – could be useful. I expect that markets will develop towards an increase in the range of products, based on fewer and similar platforms (ACHs).

So, SEPA is bringing about major changes in the payments sector, both in Europe and globally. In the coming years we will see a further broadening and deepening of SEPA. I

[12] On December 13 2007, NACHA announced today that it has formed a Mobile Banking Work Group under the leadership of its Internet Council to develop an ACH payment platform strategy for mobile banking.

expect to see a transformation from a banking industry with a single focus on interbank transactions only, towards an industry that strives towards a holistic service approach.

To close my speech, let me quote the English poet Lord Byron, whose 220th birthday is actually today. He used to say “ready money is Aladdin's lamp”. Nowadays, we are not relying on Aladdin’s lamp, but on efficient payment systems to receive our money efficiently and safely. I am grateful for your work in ensuring that this is the case.

Thank you for your attention.