

## **Gertrude Tumpel-Gugerell: Do you SEPA? The ECB's point of view**

Keynote speech by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the 3rd International Payments Summit, Milan, 27 October 2008.

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### **Introduction**

What does "to SEPA" mean? Does it mean to follow a fashion or to pay lip service to an idea? To me, it means more than that: it means being fully committed to creating a more integrated retail payments market in Europe, enabling competition and innovation, and in general making retail payments more efficient, safer and easier to use.

People may wonder why, at a time of unprecedented financial turmoil, we continue to focus our attention and energy on payment issues. I would argue that the payments business, which generates about one-quarter of all banking revenue<sup>1</sup>, is rock-solid. At a time when banks' other sources of income are more volatile, they can count on reliable and regular revenues being generated through payment services. So far, it appears that banks that are active as universal banks have been able to weather the crisis better than specialised banks.

Even at the current juncture, European integration of trade will continue, and the integration of payments has to follow suit. Moreover, there is a need for SEPA at such a time of distress, as it will contribute to a smooth and safe underlying payments infrastructure for stable transactions at the retail banking level and thus to safeguarding financial stability.

At last year's International Payments Summit, SEPA was in its warm-up phase. Is it now going full-steam ahead, or has the engine stalled? Let's have a look at the status of the different components of the vehicle, namely SEPA Credit Transfer (SCT), SEPA Direct Debit (SDD) and SEPA for Cards.

### **Do you SCT?**

In January 2008, we all welcomed the launch of the SEPA Credit Transfer. Now, at a time when banks are under stress, it is tempting to slow down the process of modernisation and innovation of payment services. This reaction is understandable, but, actually, we need to respond in precisely the opposite way.

However, the ongoing financial turmoil is only part of the story. The gap still needs to be closed between being technically ready to send and receive SCTs and actively offering user-friendly SCT products and services to customers. Thus, customer experience of the SCT cannot yet be fully compared with national credit transfers. For instance, it is not always possible to make payments with a scheduled execution date and/or periodic payments. The online banking applications for the SCT – if it is available at all – are sometimes more complex than those for national credit transfers. Often, the SCT is offered in the same way as other cross-border instruments for payments to countries outside Europe, although it should be considered a domestic payment instrument.

Based on data collected by the Eurosystem, half a year after the launch of the SCT, SCT transactions account for only about 1.4% of total credit transfers in the euro area. The use of SCTs seems to be mainly restricted to cross-border transactions. Although corporates which, together with public administrations may bring a critical mass of payments to the SEPA environment, claim that they can see the benefits of SEPA, they are still taking a cautious

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<sup>1</sup> Source: European Payment Profit Pool Analysis, McKinsey & Company, 2005.

approach towards its actual implementation. One of the major difficulties cited relates to obtaining IBAN and BIC information. In this respect, I am happy to observe that in Italy the IBAN became the single, exclusive standard used to identify current accounts in the execution of domestic payments as of January 2008. I expect that the provision of good quality services for deriving IBAN from national account numbers and reliable directory services will also help to overcome this obstacle in other countries.

## **Do you SDD?**

Although some SEPA Direct Debit pilot projects have been launched by banks, infrastructures and IT providers, it cannot be denied that the SDD is having some engine trouble. I have recently discussed the three main problems faced by the SDD, namely the migration of mandates, the uncertainty of users and the multilateral interchange fee for direct debits.

It is claimed that it is a heavy burden to have to sign new mandates when switching from the national direct debit schemes to the SEPA direct debit schemes. Nevertheless, some countries have already found a solution to ensure the continued legal validity of existing direct debit mandates, while others are still looking for an answer. The European Commission and the European Payments Council are gathering information on this issue, and I would welcome more transparency in this regard.

Owing to different national business practices, many opinions were voiced, in particular about the SDD, even before the product was visible: "it is not safe enough"; "it is too safe to be efficient and inexpensive"; "it is not modern enough"; "it is too different from previous procedures". Consequently, direct debit users are somewhat uncertain about what form the SDD would take. All users, including here in Italy, should be reassured that their special needs can be met by means of individual offers from their banks, by transparent additional optional services that are offered by groups of banks or by additional services offered at the level of whole banking communities.

Users are obviously concerned about prices. They will only embrace the SDD scheme if it is clear that the prices of these services will not go up. In this respect, the review of EU Regulation 2560<sup>2</sup> will extend its scope from credit transfers and card payments to include direct debits. Thus, the price of making a cross-border direct debit will not exceed that of making a national direct debit. Increasing the national prices would clearly be against the spirit of the review and would severely affect banks' reputations and credibility in the eyes of their customers.

Costs and prices are not only a matter of concern in the customer-to-bank domain, but also in the bank-to-bank domain. The multilateral interchange fee for the SDD has proven to be a controversial issue. To encourage the market to move ahead, the European Commission and the European Central Bank have proposed an interim solution. The objective of the interim solution is to have, right from the start, a level playing-field in place for the both the SDD scheme and the national, legacy direct debit schemes.

Allowing a properly justified multilateral interchange fee (MIF) for cross-border SDDs during an interim phase would help to get the engine running. At national level, the existing legacy MIF could remain in place and be applied to both legacy direct debits and SDDs. Any changes to the legacy MIF should be applicable to the SDD scheme, too. Given that most direct debits will initially still be conducted at the national level, the vast majority of direct debits would thus be treated in the same manner. Customers, in particular, creditors, would not need to be afraid of price increases.

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<sup>2</sup> Regulation (EC) No 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro.

In the long term, an alternative compensation model for SDD will have to be devised, as it is understood that the transaction-based MIF will have to be phased out for both the SDD and for legacy direct debits at both national and cross-border levels.

Different models can be conceived or are already in use for covering costs and providing incentives for those involved in offering and using direct debits. If this compensation is based on a proper calculation and methodology, it should also be acceptable to the competition authorities.

Unfortunately, public perception of the problems faced by the SDD has deflected attention away from the considerable achievement that the design of SEPA Direct Debit represents. For the first time, customers will have access to a direct debit instrument that can be used not only at the national level, but also on a pan-European level. Banks, CSMs (clearing and settlement mechanisms) and IT providers have launched pilot projects for the SEPA Direct Debit, and I am convinced that SDD will bring great benefits to its users in 2009.

### **Do you SEPA for cards?**

The SEPA for Cards scheme started officially on 1 January 2008. However, although several individual card schemes have adapted their rules to SEPA requirements, SEPA for Cards is difficult to perceive and is even invisible to merchants and cardholders. This is mainly owing to the fact that the EPC did not create a scheme for card payments, but rather a framework, which owing to its more general nature, leaves some room for interpretation.

The Eurosystem has repeatedly voiced its expectation that the banking industry will set up at least one additional European card scheme. At the moment, I know that several projects are underway on one or more European card schemes, and I hope that they will soon release their prototypes to the public. For the interlinking of existing schemes, a degree of determination is required to move beyond an interim solution towards a long-term merging of the schemes.

As with SEPA Direct Debit, the main obstacle to the work towards a European card solution seems to be the gridlock regarding the future of the multilateral interchange fee.

To bring SEPA for Cards to fruition, it is necessary to surmount these obstacles, as national card schemes are at risk of extinction, and competition might decrease to a duopoly of international schemes with similar business models.

Again, discussion of these obstacles should not divert attention away from the great benefits that SEPA for Cards will bring to banks, merchants and cardholders. Better security standards, more choice and higher acceptance levels will be an incentive to increase card usage which, in turn, also has the potential to lower cash usage, which can be quite costly for banks and for society as a whole.

### **Who drives SEPA?**

Having discussed what “to SEPA” means, let me turn to the question of who is in the driving seat of the SEPA process. The creation of SEPA is a major European policy objective for the European Commission and the Eurosystem. Thus, we are closely monitoring the developments, assessing the state of preparation and providing guidance to the market where necessary. Here, I refer back to the guidance we recently gave in the SDD dossier. Also, in the upcoming weeks, we will have a further exchange of views on the possibility and necessity of a migration end-date for the SCT and the SDD.

Notwithstanding the aforementioned political objective, I wish to emphasise that the establishment of SEPA is a market-driven project. It is up to the banks to win over their customers and convince them through marketable and user-friendly SEPA products and services. Likewise, service providers to banks, such as clearing and settlement

infrastructures, and information and communication technology suppliers are expected to drive SEPA. One of the organisers of this Summit, SIA-SSB, has underlined its commitment to the SEPA project. It is one of the first CSMs to have published its self-assessment against the Eurosystem's Terms of reference for the SEPA-compliance of retail payment infrastructures. I expect others to soon follow suit.

### **Who will “go SEPA”?**

The expectation is for SEPA to be more than a policy vision. It should address the needs of all users of payment services, irrespective of whether they are corporates, SMEs, merchants, public administrations or retail customers. However, in order to reap the benefits of SEPA, users need to “go SEPA”. By “going SEPA”, I mean be ready to change: change habits, change national practices, even change focus, if necessary.

For corporates, SEPA is expected to enable bank relationships and account structures to be rationalised. A centralised treasury, better liquidity management and optimised payment processing will be made possible. Even for smaller, mainly nationally-oriented corporates, SEPA is expected to provide benefits as competition in the banking sector will increase, leading to a broader range of banks and banking services to choose from. However, in order to realise these benefits, corporates may have to adapt their customer-to-bank interfaces and internal processes to SEPA standards. The direct cost of making these adaptations might be considerable. Another reason for the reluctance to “go SEPA” that I touched upon earlier is the difficulty of obtaining the IBAN and BIC information of business partners and clients.

Public administrations, i.e. tax authorities, customs and social security systems, initiate and receive large volumes of payments for salaries, social benefits, taxes, pensions, etc. As political actors, it is essential that public administrations “go SEPA”. I understand that there is quite some frustration on the part of the market regarding the lack of operational involvement of public administrations to date. Yet there are countries where public administrations do participate closely in SEPA implementation structures and actively promote SEPA, for example through the mass distribution of information on SEPA in letters regarding taxation or the provision of dedicated web pages explaining SEPA to citizens. This is what I understand by “going SEPA”.

### **Will SEPA keep going?**

At the moment, SEPA is at a crossroads. Contention over sticky issues, such as the interchange fees for card payments and the SDD, has the potential to stall progress in other areas of the project. Waiting for a final verdict and insisting on positions that will not be sustainable will lead the project up a dead-end street. SEPA will only get up and running if appropriate action is taken in a timely manner. Before I conclude, let me mention three crucial action points:

- a migration end-date for SCT and SDD;
- communication; and
- eSEPA.

### ***Migration end-date for SCT and SDD***

For SEPA to be ultimately successful, it is important to have a schedule for replacing the national payment instruments with SEPA payment instruments. We all know that it is inefficient and costly if two schemes continue to run in parallel for a prolonged period of time. Dual processing will not generate the economies of scale that SEPA is capable of delivering and will hinder stakeholders in fully reaping its benefits. Maintaining national instruments means that fragmentation along national borders will be preserved.

Continued national fragmentation will prevent the opening of the European retail market to pan-European competition. Hence, the focus in the debate on a migration end-date for SCT and SDD from a competition authorities' point of view should not be on the setting of an end-date, but on the consequences if no end-date is set. Currently, different options for a migration end-date are being discussed. A migration end-date, whether it is staggered by individual instrument or common to both the SCT and the SDD, may be achieved through self-regulation by the banks or through regulation by the authorities. Banks and regulation authorities will discuss what is the best way forward. The migration end-date(s) should be communicated in early 2009.

### ***Communication***

The public at large still knows very little about SEPA and its advantages. Yet, users need to know more about SEPA, SEPA instruments and the different possibilities that exist to add features to core schemes so that they fulfil specific needs. In short, information about SEPA needs to be communicated more effectively to users: SEPA must be "sold" to users. Continuous and increased efforts are called for to explain the changes and advantages that SEPA will bring.

It is up to the banking industry to provide more information to customers and to convince them with concrete, marketable and high-quality offers. Banks have direct contact with their customers and are best placed to inform them. Naturally, public authorities should also play a role in disseminating information and lead by example by actually using SEPA products. However, it is crucial for banks to effectively communicate what SEPA is about to users.

### **eSEPA**

SEPA does not stop at the development and implementation of the core SEPA payment schemes. In order to ensure a competitive, forward-looking and innovative SEPA, it is necessary to develop Additional Optional Services (AOS) that add features to the core SEPA payment schemes. Designing and offering payment services for specific contexts and channels will allow customers to realise cost-savings, reduce their risk and save liquidity. To be concrete, this is about priority payments, e-invoicing and e-reconciliation, mobile payments or payments at online merchants. Studies have shown that e-services promise substantial economic benefits both on the demand and the supply side. Thus, I expect that, in the future, this International Payments Summit will change its slogan from "Do you SEPA?" to "Do you eSEPA?"

### **Conclusion**

I am convinced that SEPA is more than just a passing fad. It acts as an engine for creating a more integrated retail payments market in Europe, enabling competition and innovation, and making retail payments in general more efficient, safer and easier for users. Let's keep it running, let's SEPA!