Gertrude Tumpel-Gugerell: The single euro payments area – where do we stand?

Speech by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the European Payments Council offsite meeting, Brussels, 14 October 2010.

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In 1970 the first blueprint for a monetary union – the Werner report – was presented. Almost twenty years later, the Delors Committee report shaped the way to the start of Stage One of the European Monetary Union in 1990. In 1999, the European Central Bank was established and the euro coins and banknotes followed in 2002. The euro came a long way.

The logical next step of the introduction of the euro, a single cash instrument, is the introduction of single non-cash payment instruments facilitating greatly payments in euro across the single currency area and beyond.

Obviously, the euro was not realized in one day. But once introduced, it became our currency replacing the currencies of the participating member states. The same should apply to SEPA. We cannot assume implementation over night but we do not have another 30 years to complete the euro introduction. Hence, SEPA payments instruments (SCT and SDD) must become the payments instruments for euro payments fully replacing national legacy instruments.

Since the publication of the sixth SEPA progress report in November 2008, a number of major milestones have been reached in the SEPA project. For instance, the launch of SEPA direct debits in November 2009 has made cross-border direct debit payments possible for the first time. By 1 November 2010 the reachability of payment accounts for SEPA direct debits will be legally ensured across the EU. This will allow the effective use of SEPA direct debits throughout Europe. The governance structure of SEPA has been improved with the creation of the SEPA Council, which further formalises the involvement of high-level representatives of consumers, retailers, corporations and SMEs in the SEPA dialogue at the European level. Progress has also been observed in the transposition and implementation of the Payment Services Directive and in standardisation. However, there are also areas where developments have been unsatisfactory and greater efforts are required. In some of these areas, much still needs to be done in order to further integrate the euro area retail market.

A regulation setting an end date for migration to SEPA

There is a need for a realistic but ambitious end date to be set for migration to the SEPA credit transfer and direct debit schemes in order to reap the full benefits of SEPA.

Although the potential benefits of the SEPA project are substantial, migration to SEPA cannot be described as fully successful yet.

In August 2010 only 9.3% of all euro area credit transfers were processed as SEPA credit transfers, and only a share of well below 1% of all euro area direct debits were processed as SEPA direct debits.

On the positive side, in November 2010 adherence and reachability will be ensured for the SEPA direct debit scheme, as banks will be legally obliged to be reachable. A number of public administrations have committed themselves to migrating their payments to SEPA by the end of this year.

Still, this will not be sufficient to achieve critical mass as regards migration to SEPA and will not, therefore, bring about a significant increase in the rate of migration.

There are several reasons why migration to SEPA has been slow: the prevailing market uncertainty; the difficult economic climate; potential disadvantages for “first movers” in a network industry; and resistance to migrating fully from legacy to SEPA payment systems in the absence of a commitment to a specific end date.

Two years ago, the banking community was unanimous in calling for an end date to be set for migration to SEPA by means of EU-wide legislation.

Having a regulation is one thing. However, appropriate communication and services for end users are also required. The negative perception of the IBAN and BIC standards in Germany could have been avoided by means of appropriate communication and measures that make the transition easier.

Multilateral interchange fees for the SEPA direct debit scheme have proven to be a controversial issue that is difficult to resolve, and a long-term financial business model for the SEPA direct debit scheme still needs to be established.

I hear the industry’s legitimate calls for legal certainty on this issue. Whilst much has been done to provide clarity under the competition rules, the requirement of a case-by-case analysis under these rules may still substantially delay the true achievement of a level playing field. Maybe this is one of the issues where the best way to obtain clarity is not by self regulation nor competition enforcement, but precisely within the framework of the legally binding rules themselves?

As regards, the migration end date itself, the ECB still has a preference for two different migration end dates for the SEPA credit transfer and direct debit schemes. On the basis of an assessment of the migration efforts deemed necessary, the ECB preferred migration end date for the credit transfer scheme would be November 2012. As a logical consequence of this, the ECB would envisage an end date of November 2013 for the direct debit scheme.

However, the actual end date for migration to SEPA will be determined by the European Council and the European Parliament by means of the co-decision procedure.

Overall, not having a regulation is not an option. We all look forward to the upcoming draft legislative proposal by the European Commission and we hope that the proposal is published as soon as possible.

2. Towards a competitive European payment card market

Calls for an additional European card scheme

The SEPA card framework developed a few years ago presents three ways of establishing a card scheme that achieves the overall objective of citizens being able to use the scheme’s cards anywhere in the euro area. This could be achieved by:

1. replacing a national scheme with an international scheme (assuming the latter complies with the principles of SEPA);
2. developing a payment card scheme covering the entire euro area, either by means of alliances with other card schemes or through expansion;
3. co-branding with an international card scheme.

The Eurosystem expressed reservations regarding the first and third options. It was felt that the first option – the “replacement strategy” – would lead to a situation where Visa Europe and MasterCard progressively became the sole providers of card payment services offered by banks in the euro area.

The third option – “co-branding” – was deemed less favourable because it would perpetuate the existing situation, where schemes are protected from competition by national borders. If the majority of schemes were to opt for co-branding and this situation were to become permanent, the market would remain highly fragmented. SEPA customers would not benefit from economies of scale or competition. National schemes would, in all probability, retain national business. Cross-border transactions would be effected only through Visa Europe and Mastercard.

Instead, the Eurosystem expressed a preference for the emergence of an additional European card scheme. This was the position of the Eurosystem four years ago, and it remains its position today.

There is a clear risk of the vast majority of the national card schemes – some of them rather efficient as they are – leaving their market share to Visa Europe and Mastercard and competition being reduced to a duopoly. This would mean less choice, less competition, and less European governance.

Therefore, an additional European card scheme can have a lot of benefits. Three initiatives are currently under way with a view to creating an additional European card scheme: the Euro Alliance of Payment Schemes (EAPS), Monnet and PayFair. Further initiatives are obviously not excluded.

It seems that the development of a proper financing model is probably the most important issue from banks' point of view.

And here again, uncertainty about multilateral interchange fees is considered an obstacle to any progress in this field. The criticism that there is a lack of clarity in this area does not fully recognise the commitments made recently by MasterCard and Visa Europe on multilateral interchange fees. One should also recognise that the European as well as national competition authorities have already provided some guidance.

However, here too, regulation might provide a solution of last resort and a possibility to look at the business model in the context of other business rules and market circumstances that presently stand in the way of an effective market providing efficient services against optimal prices to consumers and other customers.

Overall, I believe that an additional European scheme – safe and efficient as the best performing existing ones – is a necessary element of an integrated and competitive market.

Separating card schemes from processing entities

The concept of separating schemes from processing entities is one of the core elements of SEPA to guarantee open access. The SEPA credit transfer and direct debit schemes are built on this principle. This concept should be applied in the card market, too.

Indeed, banks should have a range of options to choose from as regards the processing of card payments.

The separation of schemes from processing entities has many dimensions, comprising operational, informational, financial/accounting, commercial and legal separation.

Major efforts need to be made by individual schemes in order to achieve effective separation in these various domains.

Three things are needed in the area of card processing.

1. First, the processing of card transactions should use the same set of message standards as the processing of direct debits and credit transfers (i.e. the ISO 20022 standard).
2. Second, a framework is needed for the processing of card transactions.
3. And third, the various infrastructures need to develop the rules and standards that are needed in order to establish technical interoperability. In December 2009 the

European Payments Council (EPC) agreed to update the PE-ACH/CSM framework to include card transactions. However, work still needs to take off on this.

Cards standardization

Another important issue is cards standardisation and a security certification framework. The standardization of cards is a crucial element to ensure the interoperability of cards and a harmonized use of cards across Europe.

In the area of standardisation, the EPC remains in charge of the strategic vision and business rules for cards, while the Cards Stakeholder Group establishes functional, security and procedural requirements and deals with the maintenance and development of the "Book of Requirements". This document provides the basis for the technical SEPA standards necessary to allow any card to work at any terminal. Various market initiatives have developed implementation standards and specifications in the card-to-terminal, terminal-to-acquirer, acquirer-to-issuer, and certification and type approval domains. However, work on the implementation of these specifications is lagging behind.

In the field of security certification for cards and terminals, the implementation specifications have been developed by CAS. The Eurosystem welcomes this work. However, governance-related aspects of the SEPA security certification framework are still under discussion. The Eurosystem expects the EPC and CAS members to agree on concrete proposals for a permanent governance structure.

From a European perspective, it is of strategic importance to adopt a more coordinated approach to global standard-setting bodies such as ISO and EMVCo.

3. Secure retail payments are key

The security of retail payments is a key issue as regards consumers' and businesses' trust and confidence in SEPA.

The risk-based approach adopted by individual banks may be sub-optimal. Commercial risk tolerance may differ from social risk tolerance.

SEPA requires a harmonised minimum level of security for retail payments in Europe.

With regard to the level playing field for the security of payments, there seems to be a need for greater clarity about both the actors involved in defining security requirements across Europe and the requirements set by these actors. Moreover, there needs to be a common understanding about the substance of certain security requirements. The ECB supports the establishment of a forum to monitor market developments and foster further harmonisation of security standards within Europe.

Market participants are expected to implement state-of-the-art measures to improve information security and prevent payment fraud.

For online "card not present" payments, market participants should introduce state-of-the-art authentication procedures and migrate to them by end-2012. In this respect, a liability shift (which has, for example, been used as an incentive for EMV migration) should apply.

The ECB is also of the opinion that from 2012 onwards, all new SEPA cards should, by default, be issued as "chip-only" cards. This view is shared by Europol.

If the industry decides to keep the magnetic strip for practical reasons, any data enabling magnetic strip transactions should be removed. In both cases, the industry will have to be prepared to offer cardholders cards with legacy magnetic strips on request for as long as there are still regions outside the SEPA area which have not fully migrated to EMV.

Concluding remarks

It is the role of the ECB, acting as a catalyst, to point out what remains to be done. We will do this in a new SEPA progress report, which is currently under preparation.

The most important issue for now is to get clarity on the end date for migration. The ECB welcomes the fact that the Commission is about to issue a draft regulation. This should be done as soon as possible.

Furthermore, the market should focus on cards, and the EPC needs to play a key role – from the standardisation of cards and certification to the involvement of end users and the representation of Europe in global standardisation initiatives. We expect the EPC to remain active in these domains.

At its introduction, the euro was – to some extent – confronted with criticism and scepticism. Today, the euro is a solid currency, we – the ECB – have delivered on our primary objective to maintain price stability and the euro has fared well even in the current crisis. We can, therefore, say that the euro has been a success.

I strongly believe that the same will be true for SEPA. Once the many advantages of SEPA become fully realized and acknowledged. SEPA will be a great success.