Benoît Cœuré: The euro as a trusted means of payment

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the joint European Central Bank-Magyar Nemzeti Bank (the central bank of Hungary) conference on "Cost and efficiency of retail payments: Evidence, policy actions and role of central banks", Budapest, 15 November 2012.

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I wish to thank Thomas Lammer, Heiko Schmiedel and Wiebe Ruttenberg for their contributions to this speech. I remain solely responsible for the opinions contained herein.

Ladies and gentlemen,

It is a great pleasure to be here in Budapest and to open this joint conference entitled "Cost and efficiency of retail payments" organised by the Magyar Nemzeti Bank (MNB) and the European Central Bank (ECB). Let me start by thanking Governor Simor and our co-organisers from the MNB for the excellent cooperation during the preparation of this conference and for their warm welcome in Budapest.

The causes and effects of the financial crisis as well as the way ahead remain important issues for the ECB. Today, however, I would like to focus on some underlying fundamental elements of trust in the currency, namely payment services systems, and especially retail payments. This is not unrelated to the crisis, quite the contrary.

Since the introduction of the euro, the ECB has been responsible for maintaining the trust of 330 million Europeans in their currency. What is "trust in a currency"? Currencies have to be trusted to perform their three classical functions, first defined by Aristotle:[1] namely, to be a store of value, a unit of account (or standard of value), and a medium of exchange (we would say today: means of payment). Let me address them in turn.

- Trust in the euro as a *store of value* rests on the ECB fulfilling its primary mandate of medium-term price stability. It has done so in the past and will continue to do so. Euro area inflation has on average been very close to 2% since 1999; medium-term inflation expectations are very firmly anchored; and the ECB can be trusted to act decisively whenever risks to price stability materialise.
- Let me be frank: in some places, trust in the euro as a *standard of value* has been undermined by (unjustified) fears of a euro break-up, also known as "redenomination risk". This risk has been compounded by interbank market fragmentation along national borders, and by the fear that, say, one euro of commercial money might not be worth the same everywhere in the euro area. Responses are now in place or taking shape: the ECB's Outright Monetary Transactions will ease concerns of a euro area break-up, provided countries make the necessary adjustments; and the single supervisory mechanism should be promptly implemented to restore the singleness of euro area banks' liabilities, then complemented by a unified mechanism to wind down failed banks.
- Trust in the euro as a *means of payment* rests on well-designed and resilient infrastructures, both at the wholesale and retail levels. I would like here to convey two messages. First, properly functioning large-value *and* retail payment systems are essential, and therefore public authorities and central banks have both an interest and an obligation to ensure their resilience. Second, given the social and private costs of retail payments, authorities should not only focus on the smooth functioning of payment systems but also keep a close eye on their efficiency. An

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[1] Aristotle: Nicomachean Ethics, Book V, and Politics, Book I.

increased level of harmonisation and integration in the retail payments market could be a catalyst for greater efficiency.

Let me now elaborate.

The importance of well-functioning large-value payment systems for Economic and Monetary Union

The development of an integrated infrastructure for large-value payments was necessary in order to create a single money market and to allow for the transmission of a common monetary policy in the euro area. This macroeconomic relevance explains why central banks are typically much more involved in large-value payment systems (LVPS) than in retail payment systems.

The prominent role of central banks gives them a strong influence in the design and smooth functioning of LVPS. If central banks act as operators, they are even directly responsible. Poorly designed and operated financial market infrastructures can indeed exacerbate systemic crises by passing financial shocks from one participant and/or infrastructure to another. The effects of such a disruption could extend well beyond the infrastructures and their participants, threatening the stability of the entire financial market and the broader economy. Since the start of the financial crisis, financial market infrastructures in Europe have worked well and have not in themselves added to financial instability. In short, throughout the crisis, the ECB has complied with its Treaty mandate to "promote the smooth operation of payment systems".[2]

This is especially true for LVPS, which have had to cope with major challenges. TARGET2 and Euro1 as euro-denominated LVPS faced a sharp decrease in their activities from 2008 onwards as a direct consequence of the financial crisis. Since 2010 they have been growing again but at slower pace. The same phenomenon has been observed elsewhere – consider the Fedwire Funds (the Real-Time Gross Settlement system operated by the Federal Reserve System). In addition, the systems have had to cope with higher traffic volatility and even the default of some of their participants. The launch of TARGET2 was completed in May 2008, just before the Lehman episode. Since then it has proved to be extremely robust and has greatly helped banks to properly manage their euro liquidity in these difficult times. It continues to lead by example, with an availability of 100% in 2012. Almost 1,000 banks in Europe use TARGET2 to initiate payments on their own behalf or on their customers' behalf. Taking into account branches and subsidiaries, almost 60,000 banks worldwide (and thus all of the customers of these banks) can be reached via TARGET2. The system is settling on average around €2.4 trillion every day, with peak days over €3.5 trillion, which represents more than a third of the whole euro-area GDP settled in just one day.

But what are the reasons for this strong performance in such difficult times? The answer is that the necessary infrastructural decisions have been taken and implemented with the euro introduction and they have been steadily developed since then.

The Eurosystem is also actively pursuing more efficient and safer arrangements for the management of liquidity, collateral and securities. For example, the implementation of cross-border tri-party collateral management services within the Eurosystem's collateral framework. Today, these services are only available to a limited number of Eurosystem counterparties in a small number of countries (France, Germany, Luxembourg and, very recently, Italy). In 2014 however, the Eurosystem will go live with the support of cross-border use of tri-party collateral management services via the Correspondent Central Banking Model (CCBM), thereby making them equally available to all euro area counterparties. While tri-party services do not increase the availability of collateral as such, they allow for a considerably

[2] Treaty on the Functioning of the European Union, Article 127.2.

more efficient delivery of collateral to the Eurosystem, in turn allowing counterparties to optimise the use of their collateral assets with central banks and in the market. To enhance this process even further, the Eurosystem is also cooperating with the market to achieve interoperability between the different tri-party offerings.

Another very important initiative in this respect is TARGET2-Securities or T2S, which is a single platform for the settlement in central bank money of potentially all securities transactions in Europe. The idea of consolidating numerous systems into a single platform managed by the Eurosystem was triggered – on the cash side – by TARGET2, which brought about an upheaval in terms of banks' ability to manage their liquidity in central bank money throughout the euro area. Furthermore, TARGET2 made it even more apparent that a fragmented securities settlement landscape, such as the one we have in Europe, can give rise to serious inefficiencies and risks. As of 2015, T2S will complement the integration already in place at the payment system level, and contribute to creating a true single market for post-trade services. It will increase competition in the provision of those services and thus reduce fees for end users and investors. T2S will foster financial stability by allowing seamless cross-border as well as domestic securities settlement in central bank money across all participating markets. It will reduce the complexity and fragmentation that characterise the current infrastructure. Moreover, T2S will support the Eurosystem collateral management framework by simplifying the cross-border exchange of securities eligible as Eurosystem collateral, meeting the increasing need for high-quality collateral that we are witnessing in the market today. T2S is the proof that, in spite of the current crisis, there is still an integration momentum. We are striving to build a stronger euro area and in particular stronger euro area markets.

One final point on the subject of LVPS: given the importance of sound payment systems and market infrastructures for the effective implementation of monetary policy and financial stability, robust oversight arrangements with adequate central bank involvement are critical. We have recently seen decisive progress in this area. The April 2012 CPSS-IOSCO principles, agreed by central banks and securities regulators worldwide, have strengthened respective international requirements. Similarly, at EU level, the new European Market Infrastructure Regulation (EMIR) provides for the close involvement of central banks of issue, such as the ECB, and central bank overseers in the ongoing oversight of central counterparties (CCPs). Enhanced cooperation arrangements are also being developed in the context of the Central Securities Depository Regulation (CSDR).

Responsibility to ensure an integrated retail payments market

Let me now turn to retail payments.

Like the large-value payment systems, retail payment infrastructures have also worked well during the crisis. Admittedly, they have no direct major impact on the overall stability of the financial system. But they are essential for the proper functioning of a market economy and people's trust in the currency as a means of exchange. Europeans' trust in the euro can be inferred from their support of Economic and Monetary Union with the euro as the single currency: in the euro area, almost two-thirds of citizens support the single currency (63%).[3] Therefore, besides their function as an overseer for retail payments, central banks also need to build trust, facilitate integration and improve efficiency in this field too.

The most prominent integration example in Europe is the establishment of the "Single Euro Payments Area" – in short, SEPA.[4] This project aims to harmonise and integrate former

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3 European Commission (2012): Standard Eurobarometer 77, Spring 2012. Public Opinion in the European Union – First Results. http://ec.europa.eu/public_opinion/archives/eb/eb77/eb77_first_en.pdf

4 For more information on SEPA see: www.sepa.eu.

purely domestic retail payment markets. It is should lead to lower fees, speed up payment execution and foster competition across Europe. SEPA is one of the most far-reaching transformations in the field of European financial integration. Having started as a self-regulatory initiative by the payments industry, the final push had to be provided by the legislator. In this way, concrete end dates for full migration towards SEPA credit transfer and SEPA direct debit were defined and put forward. Currently, the euro area indicators for migration to SEPA credit transfers show that about one out of three transfers in euro are already processed in the new SEPA format. However, there are still big country-specific differences. In respect of the figures for migration to SEPA direct debits, progress is far less promising: less than two out of 100 direct debits are currently processed in the new SEPA formats. Today SEPA is a reality and as I speak, it is harmonising the way thousands of banks, hundreds of thousands of companies and tens of millions of people are processing and making their day-to-day payments.

Soon, in February 2014, all corresponding national legacy instruments for euro retail payments will be fully replaced by the two SEPA instruments in the countries of the euro area. By that time, the key foundations of SEPA will have been laid. With the successful completion of SEPA, we not only have the euro as our single currency, but we will also have one domestic market for cashless payments – extending well beyond the euro area. Throughout 32 SEPA countries,[5] payments in euro will be as fast, safe and efficient as national payments are today.

In addition to SEPA credit transfers and direct debits, payment cards and other innovative, mobile and online payment instruments are becoming increasingly important. Therefore, further efforts, going beyond SEPA, are needed. These will require political support to create a fully integrated and competitive European market for retail payments. However, we must be careful to avoid creating a “fortress Europe” by disregarding international developments. Precisely for this reason, SEPA has been built according to international technical standards[6] which can be used globally – not only within Europe and not only for retail payment infrastructures but also for large-value payment systems and security settlement systems. It is encouraging to see that countries in the Asia-Pacific region, Africa and the Americas are paying close attention to SEPA, maybe with a view to adopting it in their national context. Such harmonisation and integration initiatives beyond Europe are certainly welcome.

Let me now address the issue of SEPA governance. The SEPA Council, established in 2010 and currently under review by the European Commission and the ECB, brings together high-level representatives from the demand side (corporates, SMEs, retailers, consumers) and from the supply side (banks, payment service providers) and facilitates a dialogue on retail payments at European level.

To achieve a fully integrated European payments market, there are two distinct concepts that would need to be reflected upon when re-defining the mandate of the SEPA Council. One option would be that the SEPA Council becomes an advisory body for public authorities in the exercise of regulation. Another option, which is the preferred alternative in my view, is to accept a body that is empowered with a self-regulatory focus.

These two concepts are not mutually exclusive; one may fit best in respect of some issues, while the other may do so on other issues. Any self-regulatory nature of the SEPA Council shall be complemented by regulation and/or competition to find out the most efficient solutions to integrate the market. In any case, the notion of self-regulation versus regulation shall be seen as a dynamic phenomenon which may change over time. I admit that finding the right combination of self-regulation and regulation always represents a challenge, but the

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5 In addition to the EU27, SEPA comprises Iceland, Liechtenstein, Monaco, Norway, and Switzerland.

6 SEPA makes use of ISO standards, such as IBAN and ISO20022. ISO20022 is the standard used for T2S and plays an important role for the future developments in TARGET2.

benefits of market-driven solutions for retail payments in Europe are apparent. In addition, it is important that self-regulation is guided by the search for Europe-wide solutions, thereby preventing any recourse to national and fragmented market structures.

Fragmentation of retail payment markets can lead to inefficient market structures and higher costs to participants and society as a whole. Measuring the true underlying costs of retail payments is not trivial. Some pioneering national central banks have already looked into this issue at domestic level. European cross-country comparisons are so far uncharted territory. It is only recently that the ECB has shown in a study[7,8] that the social costs of retail payment instruments, including cash and non-cash payments, are substantial. They amount to almost 1% of GDP in Europe. The study also makes clear that considerable differences exist within Europe. In facilitating the debate among participants in the payment chain, the ECB study seeks to provide an important tool for further benchmarking and efficiency analysis.

Another important dimension is trust in the safety of retail payment instruments. In this sense, the protection of individuals' payments data becomes more and more sensitive and important. Data breaches can have effects as devastating as environmental disasters[9] and undermine overall confidence and faith in a currency and retail payment instruments. Therefore, payments data have to be handled with utmost care. It should be protected from misuse, while at the same time recognising the need for open and fair competition in the payments field.

Let me also point out the issue of financial inclusion. It is interesting to note that in the EU not everybody has a bank account. For example, one-quarter of Italians and one-third of Hungarians do not have a bank account. According to the European Commission, in Romania and Bulgaria almost three-quarters of inhabitants are unbanked.[10] Against this background, while striving for greater efficiency in retail payments, financial inclusion is another important pillar. In my view, it is essential to make sure that every European consumer can open and use a basic payment account with a set of basic payment services. Only then will people will be able to fully benefit from SEPA. As such, I fully agree with the European Commission, which has stated this objective in a recent EU Recommendation.[11]

Talking of retail payments let me say a final word on banknotes. Even if there are different views in society about the efficiency of cash as a means of payment, both its friends and foes agree that it will be used as a means of payment in the foreseeable future. And as it is the task of the Eurosystem to protect the integrity of the euro banknotes and stay ahead of counterfeiters, the ECB has recently announced the introduction of a new series of euro banknotes, called the Europa series. They will be introduced in ascending order over several years, starting with the €5 banknote in May 2013. The new €5 banknote will include enhanced security features and has been made more durable. It will be unveiled in full on 10 January 2013.

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7 The following 13 central banks have been actively participating in the study: Danmarks Nationalbank, Eesti Pank, Central Bank of Ireland, Bank of Greece, Banco de España, Banca d'Italia, Latvijas Banka, Magyar Nemzeti Bank, De Nederlandsche Bank, Banco de Portugal, Banca Naţională a României, Suomen Pankki and Sveriges Riksbank.

8 [9]Schmiedel, H.; Kostova, G.: Ruttenberg, W. (2012): The Social and Private Costs of Retail Payment Instruments. ECB Occasional Paper Series No 137, Sept. 2012. http://www.ecb.int/pub/pdf/scpops/ecbocp137.pdf

9 [10]Hughes, S.J. (2010): Payments Data Security Breaches and Oil Spills: What Lessons Can Payments Security Learn from the Laws Governing Remediation of the Exxon Valdez, Deepwater Horizon, and Other Oil Spills? Indiana University Maurer School of Law, Jan. 2010. http://www.repository.law.indiana.edu/facpub/499/

10 European Commission (2012): Special Eurobarometer 373, Retail Financial Services, 2012.

11 Recommendation 2011/442/EU on access to a basic payment account: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32011H0442:EN:NOT

Let me conclude by emphasising that large-value and retail payment systems play a vital role in the overall economy. We can be proud of the fact that payment systems have proven to be the rock in the troubled waters of the crisis. I do not want to imagine what would have happened if payment systems had got in trouble as well. Therefore, it is our duty to ensure the continued operational performance of payment systems, to strive for efficient cost structures while keeping a high level of security in retail payments.

This conference will for sure bring further insights, allowing us to take the right policy decisions. I look forward to a stimulating discussion, wish all of us a very successful conference and I thank you for your attention.