

Benoît Coeuré: SEPA migration, innovation and change

Speech by Mr Benoît Coeuré, Member of the Executive Board of the European Central Bank, at the European Payments Council off-site meeting, La Hulpe, 21 November 2012.

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Ladies and gentlemen,

Thank you very much for your invitation to speak at this year's off-site meeting of the European Payments Council¹. My remarks today uphold the tradition established by Ms Tumpel-Gugerell over the past eight years. It indicates the importance we attach to the role and work of the EPC and is a sign of the good cooperation between the ECB and the EPC.

Let me start right away by conveying the three main messages that I have for you. Of course, I will be more than willing to take your questions afterwards.

First of all, the most prominent example of European financial integration currently is the establishment of the "Single Euro Payments Area"— in short, SEPA. The SEPA project, as well as other integration projects in payment systems, pre-dated the current financial crisis. Payment systems were not disrupted by the financial crisis and certainly did not cause this crisis, thanks to solid operations, regulations and central bank oversight. In fact, payments and, in particular, retail payments turned out to be one of the few stable business lines left for banks. It is no surprise that many banks are rediscovering retail payments. The provision of payment services to companies and households is one of the core functions of retail banking, and also a key public service. Therefore, the work on the SEPA project remains a crucial part of European integration in the area of financial services. The ECB is committed to accompanying this work under its Treaty mandate to promote the smooth operation of payment systems, as a contribution to the efficiency of euro area economy, and as a way to support continued trust in the euro.

My second message, or perhaps a word of warning, is that the status quo in retail payment services cannot be expected to remain stable. New players are entering the market and offering attractive propositions to end-users. Especially with regard to "innovative" payments, such as mobile payments and internet payments, all the creativity seems to be coming from outside the traditional banking sector. The ECB welcomes new payment systems and services, regardless of who is offering them, provided that they are efficient, safe and reliable. For banks, this poses various strategic questions which the EPC might also wish to reflect upon during its strategic retreat today.

My third message deals with the future role of the EPC itself, in light of the ongoing review of SEPA governance. It is not only in the EPC's own interest that it stays at the centre of European retail payment integration and innovation; it is also in the interest of the market. The EPC is well positioned to continue contributing to the work of the SEPA Council, representing the European banking sector for retail payments. Therefore, I expect the EPC to continue taking a pro-active approach and to continue working on developing efficient retail payment instruments and services.

SEPA Credit Transfer, SEPA Direct Debit and the migration end-date

SEPA is an initiative aimed at achieving a fully integrated market for retail payment services in euro, with no distinction between cross-border and national payments. The Eurosystem

¹ I wish to thank Iddo de Jong for his contribution to this speech. I remain solely responsible for the opinions contained herein.

continues to monitor and support the work in this field. Special attention is being paid to the migration to the new SEPA instruments. According to the SEPA indicators, the migration in the euro area from domestic credit transfers to SCT reached 30.3% in September 2012. As regards SEPA direct debits, the migration amounted to only 1.9% in September 2012, which is lower than hoped for.

An end-date regulation to support the migration to the SCT and SDD schemes was adopted in March 2012. It lays down rules for the initiation and processing of credit transfer and direct debit transactions denominated in euro within the European Union. It also defines a clear timeline by when these rules need to be implemented. For the euro area, the final deadline is 1 February 2014². As of this date, existing national credit transfer and direct debit schemes will have to be phased out and replaced by the pan-European SEPA alternatives as developed by the EPC. Although not always appreciated, the migration end-date regulation is an example of a close and fruitful cooperation between a self-regulatory initiative, the European institutions and – ultimately – the European legislator.

Based on our monitoring of the migration, we know that there are examples of countries that have already achieved “mass migration”. For credit transfers, Finland, Luxembourg and Slovenia accomplished migration by the first half of 2012. Public authorities, as large “users” of payment services, have taken the lead in these countries. Spain and France, with 40% and 30% respectively, show that it is not just “small” countries that can make it work. For direct debits, similar national divergences occur, with Greece and Luxembourg leading the way, but also Belgium managed to reach double digits in the first half of 2012. Unfortunately, for direct debits, public authorities cannot take the role of “launching customer”, as not all citizens will like the idea of tax authorities collecting tax payments by means of a direct debit. However, efforts are under way at national level to facilitate migration, for instance, by communication campaigns, and I welcome the strong involvement of national central banks in coordinating these efforts.

As regard the role of banks in the migration, communication with their customers, as well as close cooperation with their larger business customers, “big billers”, is of the essence. The EPC has a very important role to ensure that the banks’ customers are ready. In fact, this could be its top priority for 2013. Nevertheless, in 2013 the EPC could also turn its attention to the adaptation and deployment of these two schemes for use in new channels, such as with internet and mobile payments.

SEPA for cards

Beyond credit transfers and direct debits, further progress is still needed in the field of SEPA for cards. The Eurosystem is studying the merits of a SEPA Cards Processing Framework which would connect card processors. The objective is to process card transactions across intra-European borders more efficiently. It would be a strong boost to competition between card schemes, domestic and international, as well as between card processors.

Recently, the European Commission announced new legal proposals on multilateral interchange fees. Banks will have to be more mindful of the processing costs, as well as the card scheme fees and the bank-internal costs of card transactions. At the same time, it will also be a good moment to seize the vast growth potential for card transactions that still exists in many countries. Whereas a cashless society continues to be utopian, a “cash-light” society is certainly within reach.

² Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009. The deadline for euro-denominated payments in non-euro area EU countries will be 31 October 2016.

Furthermore, in July 2012 the Eurosystem organised a third meeting of the Forum on the SEPA Certification Framework. The Eurosystem thereby expressed its support for the continued joint efforts being made by the stakeholders. In this case: card schemes, certification authorities, evaluation laboratories, terminal manufacturers and the banking industry. Together, they are developing a thorough methodology for the security evaluation and certification of new payment terminals for physical card acceptance. The goal of this multi-stakeholder cooperation is to allow retailers and terminal manufacturers to buy and sell card payment terminals which function securely with all card schemes all across Europe.

When thinking of card payments and the internet, several things come to mind, such as cumbersome keying-in card numbers and sometimes excessive surcharging. However, my main thought is card fraud. Regrettably, even though banks have a great interest in reducing card fraud, and the EPC could in theory play a major role, so far it has not engaged thoroughly with this important task. Some card schemes and some national card associations have been more ambitious when it comes to addressing card transaction security. Fraud is about criminals financing themselves and their activities; decisions on fraud-prevention should therefore not only be based on a bank's short-term business case, the need to fight fraud is also justified from the perspective of keeping trust in the payment system, and from society's perspective in general.

It all shows that, in respect of user convenience and of security, cards were not designed for use on the internet. Although measures could be taken to improve this experience, banks should not pin all their hopes on cards when it comes to delivering payment services for the internet.

Study into costs of retail payments – importance of retail payments

In October 2012, the ECB published the results of its study into the costs of making retail payments, conducted in cooperation with 13 NCBs³. For the euro area, these costs amount to around €45 billion, or almost 1% of GDP. If extrapolated to cover all the 27 EU countries, they would be around €130 billion. The results underline the importance of retail payment services to the people of Europe and its economy as a whole. The study offers valuable guidance on how overall cost efficiency can be improved even further.

Retail payments are an economic factor on their own, representing a market segment dominated by banks – at the moment. Research shows that the performance of banks in EU countries with more developed retail payment markets is better; an effective payment service market is found to be associated with higher bank stability⁴.

According to AT Kearney⁵, Europe's retail banks are continuing to recover after bottoming out in 2009. Despite the crisis, income remained remarkably stable and is just slightly below 2007 levels. Not only are traditional retail banks re-discovering the advantages of the more traditional transaction services, prominent investment and corporate banks are doing so too. Payment services have a low risk profile and therefore do not worsen the solvency ratio; they allow for stable profits and are close to the customer, offering cross-selling and customer retention possibilities⁶.

³ For more details, see Schmiedel, H., Kostova, G. and Ruttenberg, W., "The social and private costs of retail payment instruments: a European perspective", Occasional Paper Series, No 137, ECB, October 2012.

⁴ Hasan, I.; Schmiedel, H.; Song, L. (2009): Return to Retail Banking and Payments. ECB Working Paper Series No 1135, Dec. 2009. <http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1135.pdf>

⁵ AT Kearney (2012): 2012 Retail Banking Radar: Change Looms in Europe, 2012.

⁶ Lubig, D.; Wandhöfer, O. (2011): Margenstark, risikoarm und kundennah: Die Renaissance des Transaction Bankings (in German). Bain & Company, 2011.

During the crisis, the non-cash retail payments market continued to show growth rates well above GDP growth. This can serve as a proof of the resilience of payment services and their attractiveness as a market in which to invest.^{7, 8} Alongside the lending and the taking of deposits, the provision of payment services to companies and households is one of the three core functions of retail banking, which are also key public services. Retail payments therefore not only have an economic relevance for the supply side, but also have an overall social relevance. The involvement of the demand side is therefore critical to any change process in retail payments. This all shows the importance of payment systems and the SEPA project in particular for European financial integration and the benefits this brings to society.

Innovative payments

Whereas SEPA has already contributed to the objectives of the European single market, it will also need to be expanded towards new sectors of the economy, such as e-commerce⁹. In the European Commission's recent proposals on the completion of the single market, one key objective is to facilitate e-commerce in the EU by making payment services easier to use, more trustworthy and competitive¹⁰.

The prospects of full migration to the SEPA credit transfer and direct debit schemes form the foundation for innovative payment services offered on a pan-European scale. This is proven by the fact that, upon closer inspection, innovations are often related to the way the payment is initiated, such as via a mobile phone or the internet. The underlying payment instrument used is often a card payment, sometimes a credit transfer and occasionally a direct debit.

For m-payments, smaller pilots have been organised in several European countries, sometimes followed by actual deployments, but no EU-wide solutions exist. In fact, the Eurosystem is concerned that too little attention is being paid to technical standardisation and/or business interoperability. This might create for m-payments the same well-known problems which SEPA has been trying to solve.

As for internet payments, their development, rollout and usage has not kept pace with the rapid development of e-commerce. Certainly there are some success stories at national level. But even 43 years after the forerunner of today's internet first linked two computer networks in the US, solutions are absent in many countries. Of course, when we look beyond the traditional banking sector, solutions do exist, even offering a global reach to e-commerce merchants. Other new players are entering the market and offer appealing propositions to end-users. The ECB welcomes efficient, safe and reliable payment systems and services, regardless of who is offering them. The status quo in retail payment services cannot be expected to remain stable. For banks, this poses various strategic questions which the EPC might also wish to reflect upon during its strategic retreat today.

In view of the limited progress achieved by the market so far, the SEPA Council¹¹ has identified a number of key challenges to be examined in order to ensure the provision of

⁷ Capgemini (2012): World Payments Report 2012.

⁸ Recently published figures of Capgemini show an annual growth rate in non-cash payments volume of 3.4% for the U.S., of 4.9% for Europe and of more than 30% for emerging markets like Russia or China. These increases in volume were mainly fuelled by card payments and especially by debit card payments.

⁹ Monti, M. (2010): A new strategy for the Single Market – At the service of Europe's economy and society, Report to the President of the European Commission, José Manuel Barroso, 9 May 2010.

¹⁰ European Commission (2012): Single Market Act II, Together for new growth, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 3 October 2012.

¹¹ The stakeholders' forum, co-chaired by the ECB and the European Commission, aims to promote an integrated euro retail payments market by ensuring the proper involvement of all parties and by fostering consensus on the next steps towards the realisation of SEPA. The banking industry, public administrations

EU-wide internet payment services for e-commerce. Among those challenges: ensuring sufficient choice to meet user requirements, delivering user-friendly, privacy-compliant and highly secure payment services, as well as fair and open market access while creating a level playing field for incumbent and new players.

At the request of the EPC, a stakeholder meeting on internet payments was organised on 8 November. The meeting, which was co-chaired by the ECB and the European Commission, provided new impetus for the discussion, especially on payment initiation services. These services make use of the banks' online banking systems and are often offered by non-financial institutions which are not always regulated, supervised or overseen. During the meeting, it became clear that the various providers of payment initiation services have very different operational models. Some have chosen to rely on contractual agreements with the account-servicing banks. Without such cooperation, the technical part of the payment service is more difficult to maintain, sensitive data of the account owner is not protected, and the payment service is less reliable overall. The SEPA Council will follow up on these issues at its next meeting.

Competition rules and work on integration

I am aware that there is a debate on "competition versus integration", which sometimes tries to frame the current status of the SEPA project as being blocked by competition law. However, the issue for the competition authorities has been the anti-competitive way in which some market participants have behaved in recent years. The authorities are also concerned that work, such as that on standardisation, is being done in an exclusive manner.

In the field of card payments, the EPC's reaction to the latter concern has been to establish a true stakeholder involvement process, i.e. the Cards Stakeholders Group. For SCT and SDD, a Customer Stakeholder Forum has already existed for many years. More recently, a forum was established with the clearing and settlement infrastructures processing the transactions. In the field of internet payments, the preliminary reaction of the EPC has been less fruitful. The EPC decided to stop all its work on its E-payments Framework without addressing the issues at stake and without trying to seek the involvement of all stakeholders.

The challenge will be to address the issues of today and tomorrow, for SCT and SDD, for card payments, but also for m-payments and internet payments, in a way that includes all stakeholders.

Review of SEPA governance and future role of EPC

In 2012, the SEPA Council has conducted in-depth discussions regarding the review of SEPA governance – in other words, on the way the SEPA project is being managed. At the core of these discussions is the future role of the SEPA Council itself in shaping the future of retail payment services in euro. In this context, SEPA should be understood as the European payments area, and not the time-bound project – so why not call it the European Retail Payments 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 preferable in my view, is to accept a body that is empowered with a self-regulatory mandate. As regards the latter, the ECB would be willing to continue co-chairing the SEPA Council, as far as it is without prejudice to the statutory tasks of the ECB.

and end users (such as consumers and corporate entities, including small and medium-sized enterprises and retailers) are represented. Four Eurosystem central banks also participate on a rotating basis.

Work at different levels is envisaged. At the strategic level, the SEPA Council would discuss and agree on the key topics and would set priorities. At a more pragmatic level, concrete requirements would be developed in a multi-stakeholder environment. For certain issues, existing standardisation bodies or new organisations would develop technical specifications.

The debate is ongoing, but should hopefully come to a conclusion by the end of this year or in early 2013, as there are many topics to discuss.

As regards the role of the EPC in the new SEPA governance, it is not only in the EPC's own interests that it stays at the centre of European retail payments integration and innovation; it is also in the interests of the market. It is clear that the EPC should continue contributing to SEPA Council work, as a representative of the European banking sector for retail payments. The involvement would be at the strategic level and often also at the requirements level.

In addition, as scheme owner of SCT and SDD, the EPC has a continued responsibility for maintenance and improvements. It should do that in a transparent way, as is being done with the Customer Stakeholder Forum, the Clearing & Settlement Forum, and with the consultations on new releases.

Perhaps the EPC should review its involvement in cards, where it is not a scheme owner. The SEPA Cards Framework and its subsequent Q&As have not proved to be very effective in developing a European card payments market. The work of the Cards Stakeholders Group on the standardisation of functional requirements and the standardisation of the security requirements for cards and terminals should become the leading workstream. The EPC's role would then be to channel the positions of the European banking sector at the strategic level of the SEPA Council, as well as to provide technical expertise in the discussions of the Cards Stakeholders Group. It is a good example of how social dialogue and multi-stakeholder involvement can work.

For innovative payments, such as internet and m-payments, the EPC has a legitimate role to enable the use of the EPC's own schemes. It could do so by developing implementation guidelines for SCT and SDD for use in such payments. It is important that this is done in a way that involves other stakeholders, also those outside the traditional banking sector.

Conclusions

Let me conclude. The work on payment systems and on SEPA in particular remains a crucial part of European integration in the area of financial services. SEPA is delivering value to all European citizens. For banks, before and during the financial crisis, the provision of retail payments is one of their few stable business lines and an area on which many banks are focusing.

The internet, in an embryonic form, started 43 years ago today. Young people today are unaware how our economy, our society and the world functioned before the internet, and especially before the World Wide Web. How do you think they perceive the fact that the institutions to which they entrust most of their money and on which they rely to make most of their payments are still mostly absent when they want to make payments on the internet?

The ECB welcomes efficient, safe and reliable payment systems and services, regardless of who is offering them. But if banks want to play a role in the future of retail payments, they will need to act soon, as their position cannot be expected to remain stable. New players are entering the market and offer appealing propositions to end users, especially with regard to "innovative" payments, such as m-payments and internet payments.

The EPC's position will need to be adapted in the light of the ongoing review of SEPA governance. The EPC is certainly well positioned to continue contributing to the work of the SEPA Council, representing the European banking sector on retail payments. Therefore, I expect the EPC to continue taking a pro-active approach. Being the scheme owner of the

SEPA Credit Transfer and Direct Debit schemes, positioning these schemes more prominently as building blocks for internet and m-payments seems to be a logical next step.

Thank you very much for your attention.