

Yves Mersch: Efficient retail payments – key in strengthening the competitiveness and growth potential of the EU

Speech by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, at the ECB/Bank of Italy Workshop on “Interchange Fees”, Rome, 24 March 2014.

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Ladies and Gentlemen,

It is a great pleasure for me to be here today to contribute to this discussion on retail payments in the euro area and in Europe more broadly. But first of all, I would like to thank the Banca d'Italia for organising this workshop jointly with the ECB, and for hosting it in this beautiful setting. I am also grateful to Fabio Panetta for opening this event in the morning.

Payment systems and payment schemes, like this city, don't get built in a day. Good things take time. Payments are a network industry, and they rely on cooperation between banks and other payment service providers – cooperation that calls for resolve and stamina.

Today, I would like to talk about retail payments and the ECB's and the Eurosystem's role in those payments, and to touch on current developments and future challenges. I'd also like to say a few words on interchange fees, the issue of this workshop.

Why are retail payments important?

Payments oil the wheels of the single market. They facilitate the “four freedoms” – the free movement of people, goods, services and capital. Without an efficient electronic payment system, the Union would not have been able to develop and grow over the years. And neither should we forget the contribution made by the large-value and retail payment systems to Europe's economy at the height of the crisis and in its aftermath. They helped Europe's economy to run smoothly.

Some of you may still remember the times when wages were paid in cash, or the inconvenience of obtaining foreign currencies for trips abroad, the complexities of cross-border payments, not to mention the plans disrupted by unforeseen exchange rate movements. You may even remember how interbank positions were cleared and settled at a physical meeting at the central bank at the end of the business day.

Efficient, robust, standardised and integrated retail payments and payment systems are essential to make trade easier, to increase competition and innovation, to foster financial integration and to complete the single currency project. They play a key part in strengthening the competitiveness and growth potential of the European Union.

In 2012 the ECB published a study, conducted with 13 EU central banks, on the social and private costs of different retail payment instruments.¹ The study showed that the social costs of retail payment instruments are substantial and amount to €45 billion, i.e. 0.96% of GDP for the participating EU countries.² So, in terms of costs, retail payments certainly matter.

An ECB study from 2009 shows that in countries with more developed retail payment services banks perform better – both in terms of their accounting ratios and their profit and

¹ 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, Frankfurt am Main, September 2012. The paper is available at <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp137.pdf>.

² Denmark, Estonia, Finland, Greece, Hungary, Ireland, Italy, Latvia, Netherlands, Portugal, Romania, Spain and Sweden.

cost efficiency.³ Retail payment transaction technology itself can also improve bank performance, and evidence shows that heterogeneity in retail payment instruments is associated with enhanced bank performance. Similarly, a higher usage of electronic retail payment instruments seems to stimulate banking business. There is also evidence showing that retail payment services generate more stable revenues for banks and decrease their risk. So, also in terms of bank performance, retail payments matter.

In this context, the discussions on “ring-fencing” retail banking activities are relevant. Retail banking is about taking deposits, offering credit to the real economy and providing payment services to firms and households. These three functions are key public services.

To sum up, retail payments are important, and maybe more important than people often think. I am convinced that even greater efficiency in payment systems would further advance the development of the internal market.

Let me now turn to the role of the ECB and the respective national central banks.

The central banks' role

One of the basic tasks of the European System of Central Banks is to promote the smooth operation of payment systems. The integration and harmonisation of retail payment systems within the euro area is therefore of vital concern to us.

Progress in this field has only been achieved gradually. It takes time and is sometimes difficult to recognise. However, looking back to when the euro was introduced, we can see that we have made some considerable progress.

Back in 2000 most cross-border credit transfers were processed via correspondent banking arrangements, which were based on bilateral relationships between financial institutions. To provide adequate geographical coverage, many bilateral arrangements were needed. It was a system which was considerably less efficient than the fully automated interbank funds transfer systems that were used for national payments in most Member States.

These arrangements might also explain the high charges for cross-border payments at that time. The European Commission's report “Bank charges in Europe”,⁴ published in April 2000, stated that the average total cost of a cross-border credit transfer was €17.10 for a €100 transfer. Moreover, a cross-border credit transfer took on average nearly 3½ days.

Since the introduction of the euro, the ECB and the other Eurosystem central banks have worked in close cooperation with the Commission and the payments industry to establish the Single Euro Payments Area (SEPA).

The ECB has acted as a catalyst here, providing analytical work and producing progress reports, together with the national central banks, as well as organising conferences and other events to bring market participants together. It has also worked closely with EU legislators, supporting a harmonised legal framework for retail payments. It has resulted in some concrete achievements:

- Pan-European schemes for basic retail payments, i.e. the SEPA credit transfer and direct debit, were introduced by the payments industry in January 2008 and November 2009 respectively.
- Costs for cross-border payments are the same as for national payments, and

³ See Hasan I., Schmiedel H. and Liang S., “Return to retail banking and payments”, Working Paper Series, No 1135, ECB, Frankfurt am Main, December 2009. The paper is available at <http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1135.pdf>.

⁴ See http://ec.europa.eu/dgs/health_consumer/library/surveys/sur14_en.pdf.

- The execution time for a credit transfer does not take more than one banking day (D+1) and the trend is clearly towards same day – or even real-time – settlement of retail payment transactions.

The ECB has also been a strong advocate of the SEPA end date regulation and it specified 1 February 2014 as the end date for migration to SEPA credit transfer and direct debit. Despite the Commission's late amendment allowing banks to process old payment formats until 1 August this year, most Member States succeeded in migrating before the original deadline of 1 February 2014. The most recent migration figures from February 2014 shows that 93.9% of all euro area credit transfers, and 80.3% of all euro area direct debits were processed in SEPA format.

Current developments, future challenges

As I said earlier, good things take time. That applies to the European Union and to the creation of an integrated market for retail payments. The successful migration to SEPA credit transfer and direct debit does not mark the end of our efforts in retail payments, but lays the foundation for new and innovative payments, and further integration.

I wish to take this opportunity to mention some areas in which we would like to see further integration and harmonisation.

First of all, cards. Cards are the alternative to cash at the point of sale. 12 years after the introduction of euro banknotes and coins, we still don't have an integrated European market for card payments. That is why the Eurosystem is currently preparing a report entitled "Card payments in Europe – a renewed focus on 'SEPA for cards'". It will emphasise the need to harmonise principles, business practices and rules, as well as technical standards relating to card payments.

We would also like to see payments become faster. Although the D+1 requirement for credit transfers – part of the Payment Services Directive – came into effect in 2012, an increasing number of merchants want to have a payment confirmation before providing the goods or services, and person-to-person payments via mobile phones seem to have great potential. It is becoming clearer by the day that the market wants increasingly faster retail payment execution. Such services are already available in some Member States, but they need to be widely available across Europe.

Even if we are focusing on the euro area and the rest of Europe, we should however also aim for integration in a broader context, by bringing forward SEPA standards to a global level as an input for others. SEPA is based on the ISO standard for financial services messaging and on clear business rules.⁵ The use of this global standard and these rules for retail payments worldwide would further facilitate the interlinking of payment systems and increase efficiency for all involved. Think about its potential for remittances by migrant workers.

Security, unsurprisingly, continues to be a critical topic. Advances in technology mean that the safety and security of retail payments remain of vital interest to market participants and authorities alike. The SecuRe Pay Forum published its recommendations for improving the security of internet payments in January 2013, and it recently published its "public note on security of payment account access services".⁶

The creation of the Euro Retail Payments Board (ERPB) by the ECB's Governing Council is another step taken by the Eurosystem to foster an integrated, innovative and competitive market for retail payments in euro in the EU. The ERPB will bring together representatives from both the supply and demand sides to identify strategic issues and work priorities,

⁵ See "ISO 20022 Financial Services – Universal financial industry message scheme".

⁶ See <http://www.ecb.europa.eu/pub/pdf/other/pubnote201403securitypaymentaccountaccessservicesen.pdf>.

including business practices, requirements and standards, and ensure they are addressed. The Commission will participate as an observer. Similar “social dialogue” bodies have already been set up and are successfully operating in several Member States. The move to establish the ERPB was very well received and its first meeting is scheduled for 16 May.

Finally, I would like to say a few words on virtual currency schemes. Bitcoin is perhaps the most notable and topical of these, but certainly no longer the only one. Many media commentators have been wondering what impact these currencies will have on retail payments and even on central banks. I agree that virtual currency schemes are an interesting phenomenon and should not be ignored or dismissed. The ECB was one of the first public authorities to see their potential and their risks and published a detailed analysis in 2012.⁷ Despite the overall rise in the value of bitcoin since the publication of the report and the media attention it is getting, our conclusions still seem to be valid, namely, that such currencies are not (at least yet) economically important. In Europe, virtual currencies do not pose a risk to price stability or financial stability, but do pose a risk for users. However, this user risk is more related to speculative investments and consumer protection, and not necessarily to payments. Nevertheless, we are closely following developments and keeping in touch with other authorities.

All in all, we are living in a time of rapid change. It may well hold in store some novel and even unconventional challenges as we create the building blocks for further financial integration.

Interchange fees

Let me conclude by touching on interchange fees, the topic of today’s workshop. The fees have turned out to be a rather controversial issue, not only in Europe but also worldwide. The Eurosystem’s position is neutral on interchange fees. But clarity is needed so that banks and other payment service providers can decide on future investments. That clarity has now been provided in the Commission’s proposal for an interchange fee regulation, which we very much welcome.

Even with a cap on interchange fees, banks should seize the opportunities that a “SEPA for cards” offers. The growth potential for cards at the point of sale is still substantial in Europe, especially in some countries. The favourable outlook for card transactions is a business case in itself, even for a scheme that operates with a low interchange fee.

Building the European Union is a slow and laborious but ultimately rewarding process. The migration to SEPA credit transfer and direct debit marks the completion of another element in that construction, and there are more to come. I am sure that today’s workshop will give us new insights and help pave the way for further design and construction work, which is of such value to the people of this continent.

Finally, a word of thanks to the colleagues of the Banca d’Italia for their warm welcome and hospitality. And, of course, thank you all for attending this workshop today. Unfortunately, I soon have to leave for Frankfurt, so let me wish you “buon appetito” and a fruitful afternoon session.

⁷ See <http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf>.