

Mr. Hartmann reviews the standardisation in cross-border payments in the light of European economic and monetary union Speech by Mr. Wendelin Hartmann, a member of the Directorate of the Deutsche Bundesbank, on the occasion of the EMI Seminar on Standardisation - The case of cross-border transfers, held in Frankfurt/Main on 30/1/98.

The European Monetary Institute has organised a seminar on a topic with which I have become very closely associated during the many years that I have been working at the Deutsche Bundesbank and my time as Chairman of the Working Group on EU Payment Systems. The focal point of my work has always been in the field of organisation and in what is generally called "controlling" these days. Success in organising and managing means running operations quickly, safely and cost-effectively: in short, efficiently. To do this one requires standard frameworks within which those participating in the system in their respective enterprises can interact, standard procedural components, standard specifications and basic technical conditions: in short, standards on whose application the participants are in agreement or which they are committed to use. This statement will have taken on a special meaning at the European level, too, by the beginning of stage 3 of economic and monetary union. I am therefore pleased to have the opportunity to speak to you today about my view of the issues concerning the standardisation of payments in Europe and of the role of the European System of Central Banks (ESCB) in this area.

From January 1, 1999 the EU central banks will be required to use the euro as a unit of account. TARGET, the large-value payment system, will support the reliable implementation of the monetary policy of the European Central Bank and will process payments in euros. The national RTGS systems of the central banks will be linked internationally through an Interlinking component called the "Interlinking system". The SWIFT network will be used at first as a communications network. All countries within the euro area will be able to participate in TARGET. EU member countries outside the euro area will likewise be able to participate in TARGET provided their national RTGS systems are able to handle the euro as a foreign currency in addition to handling their respective national currency. The credit institutions and their customers will convert to the euro successively at a date chosen by themselves. The credit institutions and the central banks will therefore incorporate conversion procedures into their accounting and payment systems. These will make it possible to convert transactions automatically prior to booking or before they are fed into a payment system, thus enabling the parallel use of two currency units. The means of achieving this vary from one European country to another. You can well imagine that all of these plans would be impossible without intensive consultation at national and international level, and consultation here means agreeing on standards.

Using TARGET for settling payment transactions has also given rise to new quality requirements with respect to securities settlement systems. Monetary policy operations and the collateralisation of intra-day credit with the purpose of fostering the smooth functioning of the payment system require the final and unconditional transfer of collateral prior to the granting of the credit concerned if the central banks are to be protected against credit risks. As the settlement of the cash leg of these transactions is done via TARGET, correspondingly tight time schedules have also to be applied to the settlement of securities transactions. A development similar to the RTGS systems at the national level and TARGET at the international level would therefore be extremely desirable to support the European money and capital markets. The national and international central securities depositories are currently cooperating on the preparation of a model to link their respective systems. Whether an EU-wide network of central securities depositories can be set up by the beginning of stage 3 of EMU is still uncertain. The central banks will carry correspondent safe custody accounts on a mutual basis for a limited

period so that the cross-border use of collateral will be possible. However, market solutions will have to be sought in the long term. I am confident that the central securities depositories will be successful in achieving that in cooperation with ourselves.

With this in mind the European Monetary Institute submitted, at the beginning of the month, a list of requirements which it had worked out in cooperation with the EU central banks and which contains standards for the use of EU securities settlement systems in ESCB credit operations in stage 3 of monetary union.¹ These new standards have to be met by all securities settlement systems which are to be used for the respective transactions with the ESCB. At this juncture I would, of course, also like to draw your attention to the previous EMI publications on the operational framework for the single monetary policy,² the general documentation on monetary policy instruments and procedures³ and, naturally, especially those on TARGET.⁴

The EU central banks are only marginally involved, if at all, in cross-border retail payment transactions, another field which also includes electronic money. It is generally agreed that these payments should continue to be primarily commercial transactions and are therefore not subject to the general technical preparations for monetary union. This means that the European commercial banks will be all the more dependent on an early agreement on the technical standards which are probably indispensable for competitive cross-border retail payment systems. There is no doubt that as a result of these standards cross-border retail payments in the single market will be more efficient and cheaper.

As these examples show, the standards that are relevant to payment transactions consist of general legal norms regulating structures and procedures, thus forming a basis which ensures that business operations are at least of a minimum quality. National legislators and other legislating authorities are responsible for this type of standardisation. They themselves set, make possible or limit procedural standards from, for example, competitive aspects through legal norms and legal interpretation. I would now like to concentrate on payment system standards that are suitable for operational use and that have been developed - usually by private operators - on the basis of the procedural standards I have just mentioned.

The main objective of standardising operational procedures should always be to achieve the maximum degree of rationalisation for all participants while retaining competition

1. European Monetary Institute: Standards for the use of EU securities settlement systems in ESCB credit operations; January 1998

2. European Monetary Institute: The single monetary policy in stage three; Specification of the operational framework; January 1997

3. European Monetary Institute: The single monetary policy in stage three; General documentation on ESCB monetary policy instruments and procedures; September 1997

4. European Monetary Institute:

- Report to the council of the European Monetary Institute on the TARGET system by the Working Group on EU Payment Systems; May 1995
- First progress report on the TARGET project; August 1996
- Technical annexes to the first progress report on the TARGET project; August 1996
- Second progress report on the TARGET project; September 1997
- Technical annexes to the second progress report on the TARGET project; September 1997
- End of day procedures in TARGET; September 1997

with respect to terms and conditions. What this means in practice is the creation of efficient business processes through the use of standard components such as data records and, ultimately, the use of standard comprehensive procedures themselves. This makes it possible - especially in payment systems - to achieve economies of scale and straight-through-processing. In addition to that interface problems can be reduced and, as a result, the costly conversion into other standards can be avoided. Standard data formats (e.g. SWIFT and EDIFACT), address codes (e.g. bank code numbers, BIC and IBAN) and communication protocols (e.g. ISO/FTAM) as well as the standard general procedural arrangements and legal frameworks are examples of how such objectives can be achieved.

As far as procedures relating to applications are concerned, there is no doubt that the banking industry deserves credit for standardisation issues being tackled enthusiastically and successfully. This has often been done in close cooperation with the central banks and the European banking associations (e.g. the ECBS). I hope that the European Central Bank will also take part in this in future. Today's event suggests that it will.

I think it is important to refer here, too, to the industrial standards that support our business and that have become essential pillars of the systems we use: there is no doubt that SWIFT, which is probably *de facto* the only globally accepted payments standard, is the main one to mention here. No less effective, however, are the respective national standards in each country, for example, the DIN standards of the Deutsches Institut für Normung and, on a world basis, the international standards, for example, the internationally accepted ISO standards of the International Standardisation Organisation, which are being incorporated into national standards. I would like to draw your attention in particular to the internationally standardised data transfer via ISO/FTAM protocols and electronic mail by means of the ISO/OSI X.400 standard for message handling systems. These systems are also used in the German gross and net payment systems. When supplemented by the protocols of the TCP/IP family (Transmission Control Protocol/Internet Protocol), they will play a "translator" role between the business applications under the different IT conditions of the various central banks in the future communications network of the ESCB.

Thus, we already have an excellent set of instruments and suitable means of achieving standardisation. So what is still missing in practice in cross-border payments in Europe? What else can and should be done? There have been complaints about the time required to execute payments and about the transparency of procedures used in retail payment systems. Implementing the transparency directive of the EU Commission will possibly help here. In the standards relating to applications in this payment sector, however, we have a large number of procedures which still confuse the user and which, generally speaking, are relatively inefficient. If I now add electronic money on chip cards or network money to my list, I think the absence in many cases of internationally applicable standards is precisely what is hampering the spread of technical innovations and the speed of European integration. As far as the cross-border use of debit cards is concerned, a commendable start has been made here, and these efforts have been successful. Perhaps we are therefore justified in thinking that progress will soon be made in the other areas for which solutions have not yet been found such as the interoperability of e-money systems. Such progress would be desirable in achieving a standard European direct debits system as well. Different national legal frameworks, customs and experience naturally do not make it easy to achieve common standards. Even the security systems in payment transactions are still largely nationally oriented. In the end, the absence of common standards, and not just for retail payments, results in a *de facto* isolation of national payment systems. In the long run that certainly cannot be in Europe's interest because for the participating banks and their customers it

can only compound the problem of segmented markets with little transparency but with relatively high prices and a low degree of efficiency.

What conclusion are we to draw from all of this? The status quo of standardisation in Europe's cross-border payment systems is hardly satisfactory. There is no doubt that what we require is a simple, that is to say, a standardised, form of access to the national systems within the EU from other countries. The European central banks, and the banking industry, have shown that it is possible to build bridges in the first instance to link national systems to each other. Bridging standards reduce the national conversion cost to the cost of using this standard instead of a large number of national ones. I am thinking here of the Interlinking system in TARGET and, with respect to retail payments, of, for example, TIPANET of the cooperative bank sector or S-Interpay of the savings bank sector. Further progress could then be achieved, for example, by stepping up the consistent use of international standards and the ECBS norms, which are not dependent on specific formats, for the national side of settling cross-border payments, that is to say, by using them in the country in which the principal is domiciled and in the country of the ultimate beneficiary. In my opinion, there is an urgent need for action in the field of retail payments. I very much prefer a market-oriented approach. As far as possible, the banking industry and the central banks should reach voluntary agreements on efficient cross-border payments. These agreements can be amended more easily and more efficiently to meet the momentous developments in payment systems than, for example, payments legislation could. The work on European integration in payments, however, must be accompanied by a harmonisation of the legal frameworks, which in some cases still contain enormous differences. This work must be done by the legislating bodies. The Directive on settlement finality which the EU Commission is in the process of passing legislation on and which is designed to remove the possibility of national bankruptcy law having an effect on payments and settlement systems is a very important step here. However, there are still a number of other obstacles to be cleared away, for example, those adversely affecting progress in establishing a standard European direct debit system. However, the central banks could take over an active role as coordinator provided the European banking industry were in agreement.

Criticism is sometimes heard to the effect that standardisation and the formation of cartels in payments are undermining competition. I do not think this is true as long as the technical standards do not adversely affect competition with respect to terms and conditions. It is true that standardisation leads to restrictions in operational freedom. A bank can no longer act exactly as it wishes. In the end, however, standardisation tends to foster competition on a transparent platform which is technically uniform.

EDIFACT is possibly an example of a system in which efforts at standardisation may also be limited. This standard, which in my opinion is splendid, broadly-based and applicable in various sectors of the economy, has only had moderate success in being applied in payment transactions. The credit institutions in Germany have agreed to admit the EDIFACT format as a standard in addition to the national DTA format and the SWIFT formats in interbank credit transfers. I think that the pressure from the large enterprises to find as many applications for this effective standard as possible has created problems with respect to its acceptability and implementation among those concerned. The payment systems component directly affecting us is only a small part of the entire application spectrum. Only time will tell whether there has been success in establishing this very consistent standard for process control. It could be argued in the first instance that in any case different individual, national and international needs call for a corresponding plurality of systems even in payment transactions. In my opinion, however, it would be better in the long term to strive for a maximum degree of standardisation with the aim of creating uniform effective payment standards at least throughout Europe. The resultant

rational and efficient systems could strengthen the position of Europe in the growing global competition.

Standardisation in payment transactions remain an important topic for the ESCB - and not just for the ECB. The implementation of monetary policy and a satisfactorily functioning economy require efficient payment systems. According to Article 3 of the ESCB's Statute, one of the functions of the ESCB is therefore to promote the smooth functioning of the payment systems. Article 22 of the ESCB's Statute actually gives the future ECB the right to make regulations to ensure efficient and sound clearing and payment systems within the Community and with other countries. To that extent there may be a fairly reasonable distribution of functions within the ESCB in line with the subsidiarity principle laid down in the Maastricht Treaty.

The ECB and the national central banks could be asked to act as intermediaries or coordinators for the banking industry in standardisation matters concerning payments. The fact that central banks may also be seen by the banking industry to be competitors in some cases, namely in large-value payment systems, has not proved to be a problem so far. Providing a service of a neutral nature in relation to the various banking groups has always been a function of the central banks. The banking industry and the national central banks have cooperated successfully for years to devise and implement rules and systems for executing payments. I am therefore optimistic that the industry will continue to do this in cooperation with the ECB in future. The way the preparatory work for payment systems in stage 3 of monetary union has gone so far confirms my opinion. Let us therefore meet the challenges that lie before us with enthusiasm and confidence.

Ladies and gentlemen, I expect that this seminar will provide important insights into the possibilities of improved cooperation in the field of standardisation between the EU Commission, the European banking associations and the central depositories, on the one hand, and the future ESCB, on the other. I am convinced that the undisputed objective of an efficient European financial market cannot be achieved without successful standardisation.