Mr Hartmann reflects on recent developments in international payment systems

Speech delivered by Mr Wendelin Hartmann, Member of the Directorate of the Deutsche Bundesbank and Chairman of the Committee on Payment and Settlement Systems of the G10 central banks, at the Conference of the Belgian Financial Forum celebrating 25 years of the Belgian Automated Clearing House - CEC (Concluding session), held at the National Bank of Belgium, Brussels, on 23 November 1999.

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Ladies and gentlemen,

The Belgium Clearing House CEC (Centre for Exchange and Clearing) is celebrating its 25th anniversary this year, and today's speeches have shown that it can justifiably be called a success story. The early standardisation and centralisation of retail payments in Belgium offers many advantages from the point of view of cost and efficiency and might well act as a model for solving the many different problems in cross-border payments in Europe. As the representative of a central bank of a country with a much less centralised payment settlement, albeit with a high degree of standardisation, I am, of course, able to envisage other solutions as well.

It is probably no exaggeration to say that today's conference has fully met its objective. It has given all those involved in European retail payments - the financial industry as the service provider as well as the users and regulators - the opportunity of presenting their different standpoints, thus offering a platform for a very interesting and constructive exchange of views.

Considering the current developments in international payments highlighted by preceding speakers I would like to conclude that cross-border retail payments - including those in the euro area, in particular - are still in need of considerable improvement in terms of quality, efficiency and prices. The aim must be a dramatic reduction of the existing marked differences between domestic and cross-border payment services and their complete elimination in the longer term, so that the motto of this conference, "one eurozone for retail payments", can become a reality.

EU directive on cross-border payments

The fact that the European Parliament and Council directive on cross-border payments has now been implemented in almost all the EU member states means that a major step towards greater transparency and a better service level has already been taken. However, this measure alone will not be sufficient to meet the requirements of an efficient single market and the expectations of European consumers. Given a single currency and the use of electronic transmission media, the general public naturally does not understand why a credit transfer from Brussels to Frankfurt should be several times more expensive and take longer than a transfer from Brussels to Antwerp. It was not without reason that the EU Commission and the European Central Bank (ECB), independently of each other, have once again stressed the need for improvements. As far as I can see, there has already been distinct progress in the time it takes for a transfer between euro countries. But little has happened in terms of pricing. What are affected members of the public to think if - as in a recent case - they have to pay a fee of EUR25 for a transfer of EUR75 from Germany to Austria? However, I personally obtained some weeks ago the double amount of cash in Austria by drawing on my domestic account - which, of course, also involved a non-cash transaction - and this "only" cost EUR4 owing to the high degree of standardisation. The free negotiation of prices between the customer and the bank certainly represents one of the key areas of free competition, but if the result is out of proportion to the service provided, then - as past experience has shown - new operators or procedures tend to emerge - in Europe possibly in the form of cross-border cash transports or the increasing use of credit cards - which is unlikely to be in the interest of either the banking industry or of consumers. There are important reasons for adjusting the prices of cross-border transfers very rapidly to those of the efficient domestic procedures.

What is required in this connection is to work towards further improvements on the technical side.

Standardisation

The major importance of standardisation in Europe has therefore, in my view, been rightly highlighted in the report published by the ECB in September of this year. A Europe-wide linking of the national payment systems has not yet been reached. So far, national standards are only compatible for the provision of cash through automatic teller machines using the ec-card, but not for credit transfers. Owing to the differing standards, foreign payments are mostly still transferred in systems which are separate from domestic payment systems and are levied with special charges, in some cases without the consent of the originator. A complete conversion towards unseparated processing in each domestic payment system is not always possible and also quite expensive owing to the many possible combinations. A harmonisation in terms of cost, however, requires a very close Europe-wide cooperation. Here, the solution is to be found not so much in the development of new (additional) standards as in the general implementation and application of standards such as those already developed by the "European Committee for Banking Standards (ECBS)" (the International Bank Account Number (IBAN) and the International Payment Instruction (IPI), for example).

The shortcomings of cross-border payments in terms of efficiency and costs become particularly evident, of course, in the processing of credit transfers within the euro area. After all, the use of the single currency means that national boundaries in payment systems should no longer play any role. From 2002, when the national banknotes and coins will be replaced by the new currency, this discrepancy will become even more obvious. Even so, the problem also has a dimension which goes beyond Europe, since cross-border payments are on a rising tendency worldwide in the wake of globalisation. Therefore, at the end of this conference, allow me in my capacity as the chairman of the "Committee on Payment and Settlement Systems (CPSS)" of the G10 central banks to cast a glance beyond Europe's frontiers.

Activities of the CPSS

The CPSS is a platform of the G10 central banks for the monitoring and analysis of trends in domestic and cross-border payment and settlement systems and for coordinating their oversight function. The focus of the committee's activities has always been on large-value payment systems. As a result of the major transactions executed through these systems, the credit and liquidity risks associated with the payments and the settlement can potentially lead to cross-system problems which jeopardize the stability of the financial system as a whole. Moreover, efficient and secure large-value payment systems are indispensable for a functioning money market and hence ultimately also for an efficient implementation of monetary policy measures. The CPSS has therefore been advocating the reduction of risks in payment and settlement systems for years. Examples of this are the minimum standards for the design and operation of cross-border and multi-currency netting and settlement schemes, often called the Lamfalussy criteria, and studies on the settlement risk of foreign exchange transactions. Moreover, the committee is currently working on the formulation of "Core principles for systemically important payment systems" which are intended to contribute to a reduction of risk, not only at the G10 level but also worldwide.

Why now does the CPSS also concern itself with questions of retail payment systems where, owing to the lower transactions, considerations of risk are of minor importance? Well, the central banks perceive their responsibility in this area too and they do so within their general role as overseer in payments. For that reason, the CPSS has intensified its activities in the area of retail payments in recent years - and, not least in view of the rapid developments, particularly in the area of new electronic payment instruments, what is known as "electronic money".

Electronic money

"Electronic money" can normally be divided into card money and network money. In the case of card money, electronic value units are being stored on chip cards, which are known as prepaid-cards or electronic purses. It is a new electronic payment instrument which is mainly designed for retail payments and is intended to replace cash transactions when purchasing lower-priced goods and services, for example, from vending machines. Besides this, another form, which is known as network money, has developed. Here, the value units stored on chip cards or hard disks are used to make electronic payments via computer networks such as the Internet. Although the development of network money is currently still at an early stage, the increasing importance of the Internet and thus of electronic commerce will undoubtedly contribute to a rapid spread of those products in the future.

The central banks are affected in two ways by the development of electronic money. First, this new instrument has the potential to replace cash and may have an impact on the demand for money and its velocity of circulation. Implications for monetary policy and seignorage cannot therefore be ruled out. Second, the central banks have the task of maintaining the integrity of payments. They therefore have to examine the question of the technical security of these new instruments as critically as the reliability and financial integrity of the issuers of electronic units of value. The extensive analyses conducted by the G10 central banks were incorporated into two reports published in August and October 1996, respectively: "Security of electronic money" and "Implications for central banks of the development of electronic money". In contrast to the EMU, where the central banks issued the recommendation that the right of issuing electronic money should be restricted to credit institutions, the G10 central banks did not propose a binding regulatory framework for the time being. But they will - as at the EU level - continue to monitor developments in this area very closely in the future in order to be able to initiate any appropriate measures that are necessary.

In the EU, the directive on the taking-up, the pursuit and the prudential supervision of the business of electronic money institutions, which was drawn up some time ago, under which e-money institutions in principle become credit institutions, has unfortunately still not been adopted by the ECOFIN Council. At the urgent request of the Governing Council of the ECB, the draft forwarded by the Commission to the Council has not been approved, since it would mean that in line with the waiver in Article 7 issuers of e-money would not fall within the definition of "credit institution" under certain conditions and would therefore be exempted from banking supervision. This would result, for example, in these issuers of e-money not being subject to minimum reserve requirements or the redeemability requirement, which would, in turn, impede a level playing field among the issuers - in this instance at the expense of the credit institutions. Moreover, the draft directive does not contain a clear indication that the issuer of e-money has to guarantee the redemption of electronic money in all cases at par value. Owing to the enormous potential of this new form of money, the ECB has to ensure from the outset that its monetary policy responsibility will not be jeopardized by developments outside its sphere of influence. These factors have to be given at least equal weight in considering the promotion of e-commerce as intended by the EU Commission. In my view, this is also necessary, since correspondingly stricter regulations have already been legislated in a number of EU countries (such as Germany).

Comparative study on retail payments

To gain a better understanding of the most recent general developments and trends beyond issues of electronic money, the CPSS commissioned a working group to study retail payments. The first step was a comparative study on retail payments in the G10 countries and Australia, which was published in September 1999.[1] The report contains a description and analysis of various payment instruments, especially from the point of view of the end-users. Furthermore, a cross-country comparison was made

[1] Committee on Payment and Settlement Systems: "Retail payments in selected countries: a comparative study"; Bank for International Settlements, Basel, September 1999.

on the use of the individual instruments and the relevant expected trends. Finally, it included a description of technical innovations in electronic retail payments. The outcome of the study shows that cash transactions continue to play a significant role in all countries studied, but that the use of the individual payment instruments in non-cash payments varies greatly from one country to another. In many European countries and in Japan, the credit transfer is still the most frequently used instrument, whereas Australia, the United States, Canada and a few European countries tend to be "cheque countries".

A survey on the clearing and settlement systems for retail payments is planned as a follow-up. Both analyses are ultimately to form the basis for a debate on possible policy objectives of the G10 central banks in retail payment systems.

Potential forms of participation by the central banks

As already mentioned, the described activities concern the central banks' role in their oversight of private systems in which they exert an influence on an efficient and secure design of retail payments. This function is normally exercised either in cooperation with the banking industry or as a sovereign function based on a legal mandate.

The fundamental issues which are examined by the G10 central banks include, first and foremost, the degree of the central banks' participation in retail payment systems. This currently varies very widely among the central banks of the individual countries. All central banks perform the oversight function, but, beyond this, a number of other, more active forms of participation, are theoretically feasible.

For example, central banks can influence the standardisation of retail payments processing at the national or international level by actively participating in the banking industry's standardisation committees, without setting unilateral standards on their part. The analysis of the situation in Europe shows that in the long run, competition with differing standards is detrimental to all the parties involved, since the interoperability and straight-through processing are impeded, thus giving rise to high and avoidable costs. Here, central banks regard themselves as mediators promoting and accelerating the process of standardisation. The Eurosystem's central banks have positioned themselves precisely in this way. They wish to be seen, above all, as a catalyst for improvements in cross-border retail payments; it is only if the market participants were not to perform their role that they would have to think about a broader operational involvement.

A major contribution which the central banks are already making is that of taking on settlement for private clearing facilities of the banking industry. At the G10 level, all central banks provide such settlement facilities; in other words, the balances derived from the interbank settlement of retail payments are offset via the respective RTGS systems and/or accounts with the central banks. This helps to minimise risks, since private settlement agents always bear a default risk. Nevertheless, this only requires a low degree of operational commitment on the part of the central banks, since the settlement of files containing retail payments may be executed as a sum total in large-value payment transactions.

Necessity of private initiatives

I hope that I have been able to give you an insight into the intentions and various activities of the European and G10 central banks in the field of national and cross-border retail payments. However, we should keep in mind that it is primarily the task of the private sector to eliminate the current shortcomings in cross-border retail payments, which are rightly criticised in my view. Essentially, what the central banks can do is to draw attention to undesirable developments, urge improvements and offer their assistance for this. Torn between the consumers' expectations of convenient and low-cost payment facilities and the banking industry's interests, the central banks should, in my view, continue to assume mainly a role as mediator and catalyst. Why should the central banks and the banking industry not be able to master this agenda 2000 together to the benefit of all those involved? At all events, initial successful efforts, such as those in standardisation, are under way. However, they must be implemented at the national level as soon as possible and be reflected very soon and lastingly in adequate prices for cross-border transfers.