

**“Euroland:
Our Single Payment Area!”**

White Paper

May 2002

Summary

1- Vision & Need for Industry Action

The political and economical goal of creating a single European market has been clearly established. This ambition extends to all aspects of life and business. On January 1, 1999, Economic and Monetary Union and the Euro were introduced. Politically, this was expected to eliminate most of the barriers hampering the freedom of movement of trade and goods across the EU. This step was expected to simplify the process and costs associated with commercial activities.

A particular objective was to create a single homogeneous market where currency would move as freely and cheaply in the new Eurozone as it had within previous national borders. From a policy maker point of view, the foundation stone to the Single Euro Payment Area (SEPA) had been laid. The vision foresees a Europe that will gradually develop into a market of 500 million Single Euro Payment Area citizens and consumers making and receiving over 100 billion non-cash payments transactions each year. These transactions will all be made within a domestic Eurozone market – with the cross-border transactions of today becoming a relic of the past. The expectation is that everybody will be able to make any payment within the Single Payment Area as easily and inexpensively as in his or her hometown.

Three and a half years into the Euro, however, with the transition period at its end, political and regulatory bodies are questioning why the original objectives have yet to be completed. True, in the retail world the Euro became a reality on January 1, 2002. While payment flows have not yet changed, they are likely to do so as barriers to free movement of trade and services are progressively removed. The changeover of the financial markets to the Euro also proceeded smoothly following years of careful preparation – and the collective investment of an estimated EUR 25 billion. Banks successfully switched their systems to the new currency and took part in the introduction of commercial and high-value cross-border payment systems (i.e., EURO1 and TARGET) in order to offer clients a choice of Euro banking services. Price convergence however has not happened for basic Eurozone money transmission products, available to consumers and small to medium sized enterprises (SMEs).

European banks have argued that without the necessary pan-European payment infrastructure in place, the cost of moving money nationally will always be lower than between countries. Although cross-border card transactions are increasingly efficient and significantly increasing investments are made in initiatives like the adoption of International Bank Account Numbers (IBANs) and the implementation of the MT103+ (albeit more slowly than expected), the reality of EMU and of the Euro demonstrates that more radical changes are required in the European commercial payments market.

Reaching this objective will imply a fair amount of change over time for every stakeholder in the transaction chain. Customers will need incentives to sometimes give up well-known instruments and move to new proposals, which will at times integrate novel technologies. Merchants and other trade intermediaries need incentives to proactively assist in reaching critical mass for innovative solutions. Banks will have to redefine their own business models but will also be looking to share the cost of developing highly efficient domestic infrastructures with other stakeholders. Policy makers and regulators will have to strike the right balance between legitimate pursuit of public good and ensuring the sustained stability and competitiveness of the financial system.

Because the Internal Market is built upon free market economy principles in the context of the European social model, introducing and managing change should as far as possible be based

on these same principles. This requires an active dialogue between all stakeholders in order to develop and maintain the necessary conditions for a harmonious migration. Only through collective action can the issues be truly resolved. European banks and credit sector associations will have to work with the various regulatory authorities, the European Commission, European Parliament and the European Central Bank (ECB). Only through the cooperation of all parties will the European Union be transformed into a Single Euro Payment Area, the most attractive place for investing and doing business.

Together, banks can take the right steps to create the required payments architecture and ensure that the regulatory process can be used positively to achieve the objective of a Single Euro Payment Area.

This white paper forms the basis of a new mindset and the start of a new momentum to make this happen. It is based on the conclusions of a two-day workshop in Brussels on March 25 and 26, 2002, with 40 representative¹ banks participating. A broad consensus² was reached on a large number of recommendations which are summarized in this paper.

But besides the consensus on the recommendations, perhaps the greatest indication of the resolve of the participating banks is the following declaration, which was issued at the close of the workshop:

“We, the European banks and credit sector associations,

- Share the common vision that Euroland payments are domestic payments*
- Join forces to implement this vision for the benefit of European consumers, industry and banks*

And accordingly,

- Launch the initiative ‘Euroland – Our Single Payment Area!’”*

¹ Representing all geographic regions of the EU, covering all types of institutions (commercial banks, savings banks, cooperative banks) and consisting of both larger and smaller players.

² In this document, we use the term ‘Almost unanimity’ (respectively ‘Broad consensus’, ‘Majority of participants’, ‘No consensus’) when more than 90% (respectively more than 70%, more than 50% and less than 50%) of the workshop participants agreed on the recommendation

2- Summary of Framework, Issues, Recommendations and Next steps

In order to develop a roadmap to make the Single Euro Payment Area a reality, one needs to (1) start from a good understanding of the current situation; (2) have a clear vision on the key trends going forward and the goals to be reached; (3) develop actionable recommendations that will move the industry from where it is today towards the long term vision; and (4) agree on some practical next steps to make the process move forward.

In the following chapters these four steps will be tackled from four different angles. First, the perspective of the customer – since the entire effort is driven by customer needs and requirements. Second, a vision on the necessary development of market infrastructures (ACHs). Third, standards, rules and conventions – the key drivers of end-to-end straight-through-processing (STP). Finally, cards, the dominant cross-border payment instruments today, which face specific issues which have less to do with standards and infrastructure. Some issues on cash handling are covered in the chapter on cards.

1. Clear divide between domestic and cross-border payments

Current situation

At a high level the current situation could be characterized as one with

- *Five main instruments fulfilling customer needs today, with cards dominating cross-border payments.* Customer requirements in terms of cost, quality and time are clearly met at a domestic level, but performance is poor for cross-border transactions.
- *Efficient national infrastructures, but very different from each other.* No real pan-European ACH infrastructure is in place today for mass low value payments³.
- *High STP-rates for each country, thanks to well developed standards and rules (as well as significant efforts to educate customers to their compliance), which again are very different from one country to another.* Although several international standards (IBAN, BIC, MT103+) are in place, cross-border STP rates remain low.
- *Standards and infrastructures for cards in place for seamless domestic and cross-border processing, but significant price differences between domestic and cross-border transactions.* Overall, globalization is most advanced in cards, both in terms of business dynamics as in terms of governance structure.

It is clear that a number of inhibitors, obstacles and constraints still stand in the way of creating a Single Euro Payment Area where domestic and cross-border payments would be equivalent for the customer. To reach full equivalence, initiatives will need to be taken to lift the existing barriers, harmonise domestic rules and establish a clear legal or regulatory framework.

³ It should however be mentioned that TARGET is working efficiently for cross-border payments but it does not target the mass low value transactions as performed by consumers or small SMEs.

2. Emergence of a common vision on the Single Euro Payment Area

Key trends

The current situation is clearly not satisfactory. Key trends point towards an emerging common vision for organizing payments in the Eurozone:

- *Customers need to have convenient access to payment services, with transparent pricing and minimum service levels (quality, security and execution time) equal for domestic and cross-border transactions.* This should not mean that customers across the EU should all have the same customer experience and price; on the contrary, there should be room for value-added services. Necessary enablers include common definitions, the development of a limited set of pan-European instruments, as well as mechanisms to monitor the development of these instruments over their lifecycles.
- *Banks should be able to decrease the overall cost of payments and have room to offer value-added services at a premium.* To reduce costs the use of cashless and electronic means of payment should be promoted in line with the European banking industry's ambition to reinforce its leadership in the area of payment services.
- *The optimal components of payment schemes (i.e., infrastructure elements, standards, rules, etc.) should be developed in a concerted way within the Eurozone.* A set of pan-European rules and standards facilitating efficient payment execution (STP) is therefore a must.

A number of actionable recommendations are needed to start putting this vision into practice.

3. An ambitious action plan going forward

Key recommendations

The following four chapters present recommendations on how to move forward from the four angles identified above.

- *Customers expect to be provided with a limited set of convenient, cheap, reliable and predictable instruments to cover their most important payment needs, i.e., face-to-face payments, one-off and recurring remote payments, and ATM cash withdrawals. In this context, banks should not only keep offering pan-European credit/debit cards, ATM cash withdrawals and credit transfers, but should also start developing an efficient cross-border direct debit instrument.*
- *The participating banks have expressed a clear preference for the development of a Pan-European Clearing House with fair and open access.* In the near term, multiple infrastructures will continue to exist. However, a vision is required for the long term architecture, and a smooth migration path from the current systems to this new infrastructure will be necessary.
- *A set of basic value added standards and rules for STP will need to be implemented to achieve the required cost savings and reliability.* Gradual

migration (as opposed to a ‘big bang’), supported by a strong governance, is the preferred way forward.

- *For cards, the banking industry should further explore options and develop platforms to put forward European interests in the context of global card networks, as well as launch specific initiatives regarding debit cards, ATM cash withdrawals and cash.* Despite the fact that cards are by far the most advanced cross-border payment instruments for mass low value transactions, several issues remain to be addressed – primarily, differences in price for cross-border and domestic payments. Moreover, the expected – mainly technology driven – evolution in the card industry will create additional challenges for the banking sector (e.g., breaking-up of national industry structures, co-residing applications on chip, etc.).

4. Creating the appropriate governance structure and roadmap

Practical next steps

To move forward on these different fronts, a strong governance structure is a pre-requisite. The appropriate working groups to prepare and implement decisions will also need to be created: one for Payment Instruments, one for Infrastructure, one for STP, one for Cards and a final one for Cash. These working groups should not overlap with existing forums and, in this context, some existing groups will have to be leveraged, refocused or rationalized. An overall roadmap with key milestones has been developed; if followed, this roadmap will lead to significant results by 2003 and will set the stage for the full realization of the benefits of the Single Euro Payment Area before 2010. Governance and roadmap are addressed in the final two chapters of this white paper.

Interested to read the full report?

An electronic copy of the full White Paper can be ordered by e-mail and against payment of EUR 400,00 (plus VAT 21% when applicable) from any of the following addresses:

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