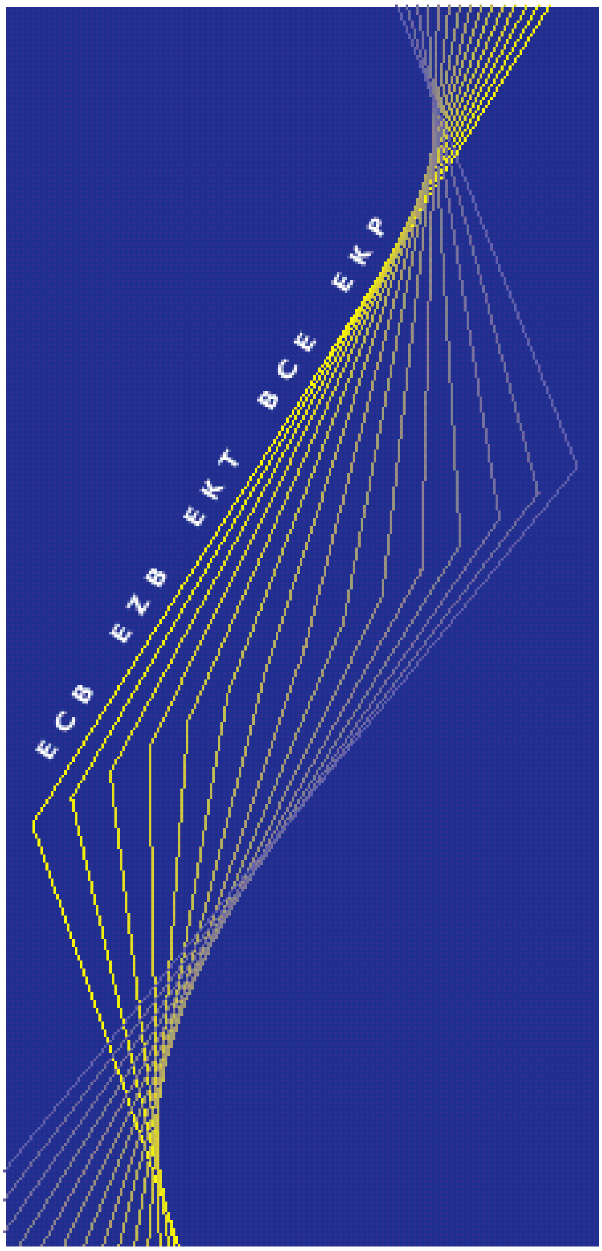
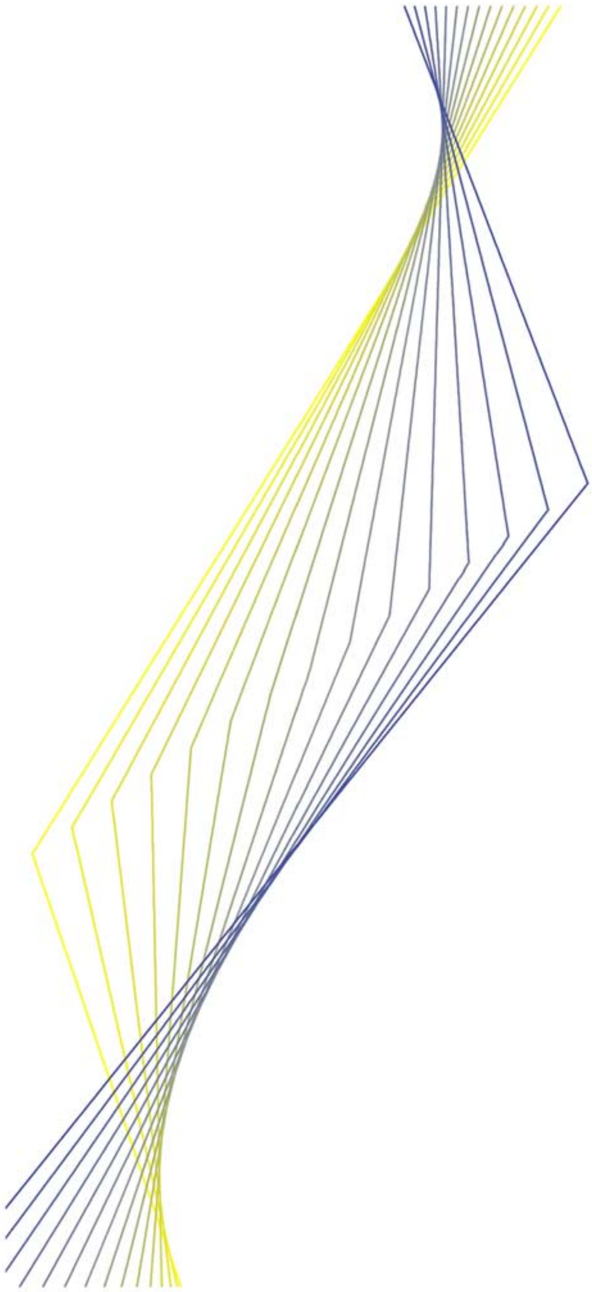
EUROPEAN CENTRAL BANK



TOWARDS AN INTEGRATED INFRASTRUCTURE FOR CREDIT TRANSFERS IN EURO

November 2001

EUROPEAN CENTRAL BANK



TOWARDS AN INTEGRATED INFRASTRUCTURE FOR CREDIT TRANSFERS IN EURO

November 2001

Address	**Kaiserstrasse 29**
	D-60311 Frankfurt am Main
	Germany
Postal address	**Postfach 16 03 19**
	D-60066 Frankfurt am Main
	Germany
Telephone	**+49 69 1344 0**
Internet	**http://www.ecb.int**
Fax	**+49 69 1344 6000**
Telex	**411 144 ecb d**

ISBN 92-9181-260-9

Contents

Executive summary

In any modern economy, the monetary system is based on the principle of "indifference" between the use of various types of money: banknotes and balances on sight accounts. With the exception of very small amounts, the customers' choice does not depend on costs, because the cost of transferring money domestically is so low in general that it is considered negligible. After the introduction of the euro banknotes and coins, European citizens will rightly expect the principle of indifference to apply across the euro area. This means that domestic and cross-border payments should be priced at the same level. This is far from being the case today.

For several years, public authorities (the European Commission, the European Parliament and the European Central Bank in particular) have been urging banks to lower the price of their cross-border payment services within the euro area. However, banks have consistently considered this line of business as a marginal one, with high production costs. As a result, no substantial improvement has been noted on the fee side since the average customer fee for cross-border retail payments has remained consistent at around EUR 20, even for very small amounts. Clearly, banks have disregarded the political importance of the problem. The lack of *competition* among banks also explains the lack of progress with regard to the price level of cross-border credit transfers, whereas a lack of *co-operation* on standards and infrastructures explains the lack of progress in reducing the cost of processing cross-border transfers.

In October 2001, under the threat of an EC regulation, the European Banking Federation made a significant move in agreeing on the definition of maximum levels for cross-border credit transfers which would bring them down to the level of domestic ones by the end of 2005. This should be considered as a very positive step since it was the first time that the banking sector had officially shown that it adhered to the principle of indifference.

It is clear that banks will be forced by regulation, by political and public pressure or by competition, even from non-banks, to lower the fees they charge to customers for cross-border credit transfers far faster than they anticipated. However, in all cases, the substantial lowering of bank fees will be sustainable in the long run only if bank costs also decrease substantially. This report focuses on the main technical improvements which would be required in order to allow banks to lower their costs and therefore to eliminate the "payment borders" which still exist within the euro area. As such, it can be seen as a technical contribution the Eurosystem wishes to offer to the banking community in order to improve the present situation.

The Eurosystem, acting as a catalyst, has already assisted banks in removing some of the obstacles at the origin of the high costs of cross-border retail credit transfers. Standards for the fully automated processing of such transfers have been defined, reporting requirements for balance of payments statistics have been eliminated (below EUR 12,500), and an arrangement has been proposed to allow banks to share customer fees between the sending side and the receiving side.

Three major sources of costs still need to be further addressed: internal costs within banks; the insufficient use of European standards; and the lack of an appropriate interbank infrastructure.

The most significant source of costs can be found *within the banks*. The substantial reduction in fee income on cross-border payments can be expected to push banks to adjust their procedures, including their IT software and their relations with their customers, within the next two years.

A prerequisite for the efficient interbank processing of payments is the implementation of *a common set of standards*. Experience gained in the national context shows that the creation of an interbank body supervising the definition of standards and co-ordinating their implementation is very useful. While the European Committee for Banking Standards has been successful in designing technical standards, its mandate did not enable it to be very active in defining strategic views concerning the implementation of standards and the definition of the related interbank practices.

As far as *infrastructures* are concerned, a multiplicity of initiatives have been proposed or developed, but so far none of them has attracted a critical mass of banks committed to funding the project and to providing the necessary traffic in the future. It is up to the banking industry to decide what kind of infrastructure would be most suitable for it. The report reviews four types of solutions that have been envisaged so far, and concludes that only two of them could serve the whole of the euro area banking sector and be implemented within a reasonably short time span (about two years after the decision). One of these models consists in the creation of a new automated clearing house, which would offer a valuable solution for cross-border transfers and which might also attract domestic payment flows stemming from some countries. The other model consists in linking existing domestic clearing houses in order to create a cross-border infrastructure. TARGET, the payment system managed by the Eurosystem, could possibly be used as the linking mechanism.

In order to foster price transparency and competition, certain accompanying measures seem indispensable. One earlier proposal of the Eurosystem, which has been taken up recently by the banking associations, is to invite all banks to offer the same basic service. This would facilitate price comparisons. An "observatory" could also be set up in order to increase price transparency. In addition, banks will need to educate their customers to enable them to determine under which conditions they could obtain the cheapest offer.

In the view of the Eurosystem, it would be feasible to achieve significant improvements in banks' costs in a reasonable time frame. Banks should take decisions setting the framework for an efficient infrastructure very soon, i.e. during the course of 2002. By the end of 2004, they should be able to process cross-border credit transfers at a cost level which should allow for the principle of indifference to apply. The Eurosystem stands ready to assist banks in achieving this goal.

Introduction

By definition, Monetary Union in Europe requires that the single currency be able to circulate throughout the area as freely, safely and efficiently as in any domestic monetary area. Although this third stage of Economic and Monetary Union (EMU) began almost three years ago, it will not be fully visible to the citizens of Europe until the euro banknotes and coins are introduced. This will change in a few weeks' time.

As underlined often in reports produced by the European Central Bank (ECB), despite the introduction of a single set of banknotes, banks will not simultaneously lower the costs of cross-border retail payments down to domestic levels. In particular, the price level for cross-border credit transfers is likely to remain very high in general.

In any modern economy, the monetary system is based on the principle of indifference between the use of various types of money: central bank money in the form of banknotes and bank money in the form of balances on sight accounts. Economic agents are free to use either form of money depending on their needs and the circumstances. With the exception of very small amounts, however, the choice does not depend on costs, because the cost of transferring money domestically is so low in general that it is considered negligible by users.

After the introduction of the euro banknotes and coins, European citizens will rightly expect the principle of indifference to be achieved in the euro area. They expect to be able to transfer bank money (e.g. using credit transfers) as safely and efficiently throughout the euro area as central bank money (e.g. using banknotes).

In July 2001, the European Commission proposed a drastic remedy to the problem. Under the terms of the draft Regulation now being examined by the Council and the Parliament, banks will be obliged to reduce prices for cross-border payments up to EUR 50,000 to the level of domestic payments.[1]

On 26 October 2001, the ECB issued its Opinion on the draft Regulation in which it clearly stated that the Eurosystem shared the general objective of the Regulation. However, the Eurosystem expressed reservations about the chosen method because the proposed Regulation interfered with the price regulation mechanism and gave too little time to the banking industry to adjust in a rational way. In addition, the Eurosystem warned about the adverse consequences that the inclusion of cheques would have. For the convenience of the reader, the ECB Opinion is annexed to the present report (Annex 1).

In the context of the discussion of the draft Regulation, on 22 September 2001 the ECOFIN Council invited the ECB to issue a report "on a realistic and concrete agenda of the implementation of modern payment systems infrastructures for credit transfers that lead to real lower charges". The ECOFIN

---

1 Fees for electronic payment transactions are to be reduced by 1 January 2002; those for cross-border credit transfers and cross-border cheques are to be reduced by 1 January 2003.

Council suggested that such a report should be prepared in co-operation with the national central banks and representatives of the private sector.

The ECB has produced this report within the framework of the Eurosystem and has therefore involved the national central banks in its preparation. Although the very short time frame did not allow for a formal discussion with the private sector on the contents of this report, the Eurosystem has drawn on contacts it has maintained with the banking industry on this issue over the past three years.

Chapter 1 of the report recalls the fact that, despite efforts on the part of the European public institutions, the banking sector has failed to address in a serious manner the issue of cross-border retail payments in euro and the situation remains highly unsatisfactory. Chapter 2 summarises the efforts already made to improve some features of cross-border retail payments in euro. Chapter 3 summarises the current state of thinking about the future payment system infrastructure for retail payments. Chapter 4 highlights the measures which should accompany the reform of the infrastructures. Chapter 5 presents a road map for the reform of the infrastructures, as requested by the ECOFIN Council, and Chapter 6 provides a conclusion.

1 The present situation

Since the early 1990s, deficiencies in cross-border payment services have repeatedly been highlighted in several communications and made obvious in various pricing studies. Since little progress had been made and public discontent was on the increase, Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers was adopted, making the transparency of charges, a maximum execution time and information on redress procedures mandatory. Although the cross-border credit transfer directive led to a decrease in execution times,[2] it did not achieve a decrease in bank charges. Prices continued to be set at unacceptably high levels. Recent studies have revealed that the charges for a EUR 100 cross-border credit transfer have remained unchanged for almost a decade on average between EUR 17 and EUR 24. In a context where cross-border credit transfers represent less than 2% of the total number of transactions, competition has apparently been very limited.

The Eurosystem has attributed major importance to the lack of efficiency in cross-border retail payments. It issued a report entitled "Improving cross-border retail payment services – the Eurosystem's view" in 1999 and identified the causes of the problem. It concluded that the main reasons for the deficiencies were: i) low volumes compared with domestic volumes; ii) the lack of an adequate interbank infrastructure and the predominant use of correspondent banking arrangements; and iii) the lack of the use of agreed standards and the low level of automation at the interbank and intrabank level. In addition, the Eurosystem formulated seven objectives for more efficient cross-border payment services to be achieved by 1 January 2002. The Eurosystem urged banks in particular to give priority to improving the efficiency of cross-border credit transfers.

In September 2000, the ECB issued a progress report on cross-border retail payment services, acknowledging that work had progressed in some fields (as illustrated in Section 2), but stressing that further efforts would urgently be needed in order to achieve substantial progress before 2002. Emphasis was placed on the fact that some issues (e.g. the implementation of standards, the definition of a standard cross-border credit transfer product, the launch of an information campaign) required immediate action.

These points, which were calling for co-operative action by the banks, got only a partial response. Banks' difficulty in organising co-operation to develop common solutions to process cross-border euro payments more efficiently and their persistent underestimation of the political importance of the issue have prevented them from putting more emphasis on improvements. Efforts were only stepped up significantly after the Commission issued a draft Regulation. While it should be acknowledged that present infrastructures and, most importantly, the communication procedures with customers and

---

2 Execution times have come down to three days, thus converging towards domestic levels. However, the situation remains that payments might never reach their destination.

intrabank processes, do not allow banks to provide cross-border services at a cost which is comparable with the costs incurred domestically, it is clear that banks will be forced by regulation, by political and public pressure or by competition from non-banks to lower their fees.

A positive sign that banks had started to acknowledge the above-mentioned need was a recent proposal from the European Banking Federation for a digressive regime on the maximum cross-border charges which banks will be allowed to impose on top of domestic fees. More details on this proposal can be found in Annex 2.

It is now in banks' interest to reduce their cost base as quickly as possible in order to minimise these losses. In the remainder of the report, following the request of the ECOFIN Council, an overview of the measures deemed useful to improve the payment infrastructures in the euro area is presented. It covers not only the interbank infrastructures such as funds transfer systems, but also the standards without which the former would not be able to operate. The analysis is made from a technical viewpoint.

2 What has already been done

Up to now, three concrete results have been achieved, each of which is making a positive contribution to the establishment of efficient STP[3] procedures and infrastructures in the euro area.

2.1 The definition of Straight Through Processing (STP) Standards

The banking sector realised long ago that there was a need for an international communication network and standardisation in order to make payment processing more efficient in a cross-border context. In particular, banks from all over the world established the Society for Worldwide Interbank Financial Telecommunication (SWIFT) in 1973. Today SWIFT is the major international system for transmitting payment and other financial instructions. A similar focus on standardisation can also be found in the debit/credit card area. Mastercard and Visa, the two international service and network providers, have co-operated to establish the standards for card payments. In addition, the three European credit sector associations created the European Committee for Banking Standards (ECBS) in December 1992. Whereas SWIFT mainly concentrated on the enhancement of communication between banks and worldwide standards, the ECBS worked mostly on their implementation in the European context.

SWIFT has defined and is in charge of updating the list of ISO Bank Identification Codes (BIC), which is a world standard allowing banks to be identified in a codified way. The ECBS has reviewed the specifications of the ISO IBAN standard (International Bank Account Number), which allows for the transformation of (non-harmonised) domestic account numbers into an international one, thus ensuring that it can be implemented in Europe.

Many banks in the euro area now provide BICs and IBANs to their customers. The use of both is a prerequisite for the STP processing of cross-border payments.

The ECBS has also designed the IPI (International Payment Instruction), which is a standard form to be completed by customers wishing to make cross-border credit transfers. The IPI will help banks to transform customer payment instructions into electronic data likely to be processed in a STP mode. An electronic version of the IPI is currently under preparation which would allow customers to capture STP information directly.

Finally, the Eurosystem has fostered discussions with SWIFT and the banking sector which have lead to the development of new standards based on the SWIFT message formats used for transmitting customer information between banks in a cross-border context. The new standards (called MT102+ and MT103+) allow for the STP of payments between banks.

---

[3] Straight Through Processing (STP): the automated end-to-end processing of payments transfers, including the automated completion of confirmation, generation, clearing and the settlement of instructions.

As a result, the basic set of technical standards which are needed for banks to process cross-border credit transfers in a STP mode is now available. Time is now needed for banks to implement these standards within their own applications and to develop or adopt funds transfer systems which can handle them in the most efficient way. Banks claimed that they could not devote too many resources to these new software developments because they had to deal successively with the introduction of the euro in financial markets, the Year 2000 problem and now with the final changeover to the euro.

If pressure continues to be exerted on banks, it can be expected that the implementation of STP standards will become a high priority in the list of tasks to be performed by their IT departments. A realistic estimate is that banks should be able to complete the introduction of the STP standards in their applications possibly before the end of 2002, but at the very latest by the end of 2003.

2.2 Reduction of the scope of balance of payments reporting

Banks have indicated in the past that balance of payments reporting was a significant cost factor preventing them from processing cross-border payments in an STP mode. The Eurosystem therefore sponsored discussions between the banking sector and the statistical authorities that led to a common minimum exemption threshold of EUR 12,500 as from 2002, together with a harmonised list of economic codes[4], as defined by the Committee for Monetary, Financial and Balance of Payments Statistics (CMFB)[5].

Recently, a further increase in the exemption threshold was envisaged in the proposal for a regulation on cross-border payments in euro. The ECB Opinion of 26 October 2001 expresses very strong reservations about such a measure in the present context. For payments above EUR 12,500, the payment fee represents only a small fraction of the funds transferred, while the loss of information entailed in a substantial increase in the threshold would have a strong negative impact on the quality of balance of payments statistics. Therefore, a further increase in the reporting threshold should be postponed in order to allow statistical authorities to adjust their procedures over time.

2.3 Multilateral interchange fee (MIF)

Payment fees can be charged to the payer and/or to the payee. However, in line with prevailing domestic practice, the 1997 Directive 97/5/EC on cross-border credit transfers introduced as the default convention in the cross-border context the fact that the originator pays a fee to its bank and that the beneficiary is not charged. However, the costs of payment processing are borne by the two banks (although, if processing is carried out in an STP mode, the higher costs are on the sender's side, which has often to transform data presented in paper form into electronic data). In the domestic context,

---

4 Economic codes permit the standardised classification of cross-border payments by reflecting the nature of the underlying transaction.

5 The CMFB consists of senior statisticians from national statistical institutes, national central banks, the European Commission and the ECB.

banks generally assume that there is a balance between being on the senders' and on the receivers' side. In other cases, they have agreed on an interchange fee – typically paid by the sending bank to the receiving bank - to ensure a fairer distribution of the payment fees among senders and receivers.

In the cross-border context, in the absence of such an agreement between banks, customers were very often charged both on the sending side and on the receiving side. This situation is not appreciated by customers, in particular when the beneficiary is not credited with the full amount which the originator has agreed to pay. As a result, double charging was, in general, made unlawful in the EU by means of the Cross-Border Credit Transfer Directive.

However, in the euro area, the flow of cross-border credit transfers is not evenly distributed. Banks present in the north are typically on the sending side, while those in the south are more on the beneficiary side (this is caused in particular by payment flows related to tourism).

In order to solve the issue of double charging and the fair distribution of fees, the banking sector produced a proposal for a default multilateral interchange fee (MIF) which will apply in the absence of a bilateral agreement between the banks concerned. In practice the amount of the MIF is added to the original amount of the transfer and taken out by the receiving bank. The MIF is a very useful mechanism to allow the receiving bank to be paid and to minimise the administration costs of the scheme (e.g. reconciliation). It might therefore be a very important complement to STP in order to lower costs between banks.

The European banks have put forward a proposal to the European Commission, acting as competition authority, that the MIF be set at EUR 3. The proposed fee is too high to be compatible with the objective of bringing cross-border fees down to the low domestic level. It may reflect banks' costs as they are perceived at present, but once STP processing is achieved in the euro area, the costs to the beneficiary banks should be very low in line with the "best practice" case. As a result, should the proposed level of the MIF be considered acceptable by the EU competition authorities at present, the banking sector should agree on a future reduction of this level in the coming years.

3 New payment infrastructures

3.1 The general context

Cross-border retail payments are currently processed in different ways. The majority are processed through traditional correspondent banking arrangements between the main banks in each country acting as a correspondent and clearing bank on behalf of other banks. There are also specific arrangements with limited membership among closely related banking groups. Some banks also use TARGET (the real-time payment service provided by central banks for gross settlement) or the Euro 1 system (a net settlement system provided by the EBA, the Euro Banking Association), although both systems were primarily designed for large-value payments. None of these methods is consistent with solutions retained domestically for the processing of retail payments. Therefore, once the banking sector was convinced that it would have to lower the costs of cross-border retail payments, it started to discuss the possibility of using new arrangements. However, banks have experienced difficulties in agreeing on the future strategy.

The Eurosystem has often been invited by public authorities to step in and develop its own infrastructure. However, interbank processing costs are not the main factor behind the very high fees charged to customers. Some of the existing arrangements already offer interbank processing charges of around EUR 0.50. This represents only 2-3% of the average cost currently charged to customers. As a result, it is clear that the creation of a new interbank infrastructure would not in itself provide substantial improvements if it were not accompanied by measures to improve the processing within banks and the interface with their customers in particular. Moreover, investing in new systems would represent a waste of resources if the new infrastructure were not used by the banks because the new arrangements do not fulfil their requirements. As a result, the shape of the future infrastructure in Europe has to be decided by the banks and the possible operational involvement of the Eurosystem can only be the result of their request.

Drawing on national experience, it appears that a few criteria could be set in order to evaluate whether or not a payment arrangement is likely to be viable.

First, the project has to be well constructed, with reasonable deadlines and financial implications, and with very strong governance.

Second, the project has to be backed by a critical mass of banks which agree to commit themselves to bringing in the necessary funding and, later, the necessary traffic.

Third, the projected system should provide for fair and open access to all banks (although not every bank would need to be a direct member).

Fourth, the future infrastructure should be structured in such a way that it facilitates the progressive integration of domestic and cross-border payments into an infrastructure that can efficiently handle both domestic and cross-border payments.

In this context, this chapter does not aim to reach conclusions as to what would be the best choice for the euro area. It simply mentions the main models to be considered, evaluates whether they could constitute a solution to facilitate the general improvement in the processing of retail payments in the euro area, and estimate the time which would be needed to implement them. Each of the models presented below has a number of variants and combinations which cannot be presented in a short report. In addition to these models, there may be a number of complementary solutions for specific purposes, such as person-to-person transfers for single micro payments, e-payments or other specific niches. Normally these kinds of initiatives do not focus specifically on the euro and the euro area, however, if successful person-to-person payments were to develop, they could also make a positive contribution to enhancing efficiency in the euro area.

All the models could be elaborated and implemented either without any involvement of the Eurosystem (pure market initiative) or with the Eurosystem playing the role of catalyst, fostering co-operation, in line with its current approach. Moreover, if deemed useful, the Eurosystem could play the role of settlement agent in most of the models.

3.2 The main models to be considered

A single Automated Clearing House (ACH) for the euro

In this model, all transactions (national and cross-border payments) would be routed to a single ACH, which would replace all existing national structures. Banks would access the single ACH using a common set of standards, regardless of their location (see Figure 1).

By definition, this model completely removes cost differentiation between domestic and cross-border transactions. To some extent, it could be considered as the ultimate achievement of consolidation in terms of retail payment systems. The very high level of traffic would guarantee that interbank costs would be very low (possibly less than EUR 0.01). In the present context, where interbank procedures and the use of payment instruments are so different across countries, this model remains rather theoretical because the cost of change would be high if this model were to be implemented rapidly, as common standards would have to be implemented in the internal systems of all banks. Moreover, the implementation time would be very long (several years) and it is not certain that it would be the most appropriate one from the point of view of competition.

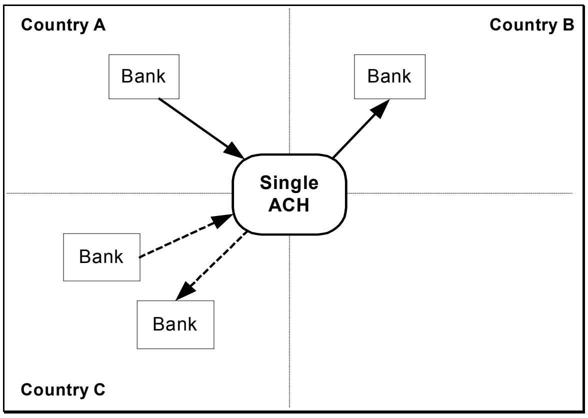


Figure 1: A single ACH for the euro.

A pan-European ACH

In this model, a new ACH would be created primarily to process cross-border traffic (see Figure 2). At the beginning, domestic payments would continue to be processed at existing domestic ACHs. However, it can be expected that, over time, banks individually or national banking communities would bring their domestic traffic to the system, thus ensuring that it would progressively achieve a high level of economies of scale and, therefore, low processing costs between banks. Such a model could be implemented within a more reasonable time frame (1 to 2 years, once the promoters have agreed on the specifications of the model). Even if it does not fully eliminate cost differentiation, it is at least an intermediary solution which could form the basis for further consolidation. It could also contribute substantially to the generalisation of euro area standards and business practices.

The Euro Banking Association, which already manages the Euro 1 system for large-value payments and is operating STEP 1, a low-value cross-border credit transfer system for individual payments, has a project of this kind which is called STEP 2. This project is considered by several banking communities as the most concrete answer to the lack of a European infrastructure for retail payments.

The main uncertainty is linked to the potential "club-type" organisation of such a model, which could possibly lead to discrimination between banks.

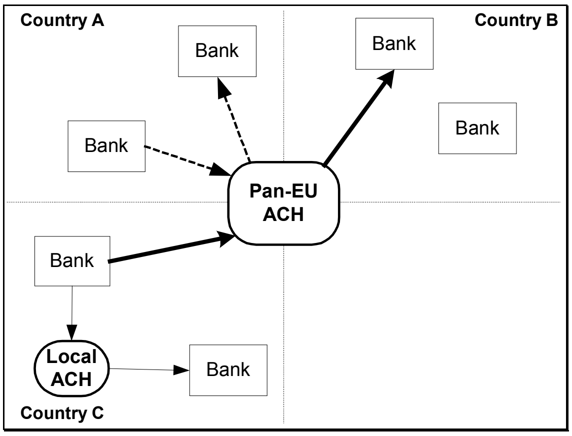


Figure 2: Pan-European ACH.

ACH linkages

In the most simple variant of this model, banks send all payment instructions (domestic and cross-border) to their domestic ACH. Domestic transactions continue to be processed locally in accordance with existing procedures and formats. Cross-border instructions, which comply with international standards, are routed to another ACH handling the settlement account of the beneficiary bank (see Figure 3).

The concept of ACH linkages was sponsored by the European Commission in the mid-1990s. It failed because most banks (at least the bigger ones) did not consider this model to be suitable for them. However, this model could be reconsidered in the context of the existence of the euro.

TARGET could be used as the linkage infrastructure because TARGET would not only provide a routing mechanism, but also a very simple way in which to settle credit transfers, which are processed in a batch[6] mode. The main advantage of the model is that it could be implemented in a rather short time frame (1 to 2 years, once the specification of the model is agreed).

The main drawback of the system is that it does not allow domestic and cross-border payments to be processed in the same way and therefore at the same cost (although the cost difference for the banks is likely to be very small). Moreover, solutions would have to be found to cover countries where there is currently no ACH (Austria, Finland and Ireland) or no single national ACH (Germany). In the long run, ACH linkages could hamper the consolidation of the existing ACHs and might therefore be an obstacle to a further reduction in processing costs in the euro area in the medium term.

6 Batch processing means the transmission or processing of a group of payment orders in batches at discrete time intervals.

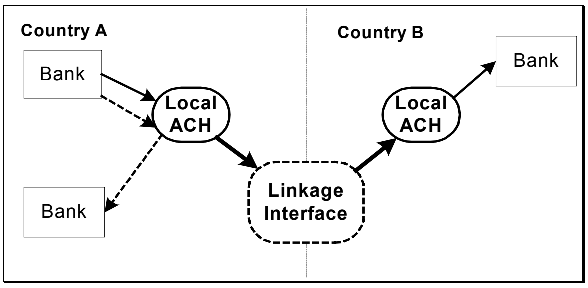


Figure 3: ACH linkage.

Bilateral exchange

This model is inspired by the situation in countries where no ACH is in operation and where, as a result, retail transactions are exchanged and settled in the framework of bilateral agreements (e.g. Austria). This model is also followed by several banks in Germany (see Figure 4). By definition, bilateral exchanges reduce the number of intermediaries in payment processing, which could be a cause of costs and delays. However, even if in the future technological changes may make this model more attractive, it is difficult to imagine that it would provide a general solution for the euro area and its thousands of banks. However, it can be expected that this model will be used by some banks (e.g. between banks belonging to the same group, or between very large banks), in parallel with other more centralised solutions.

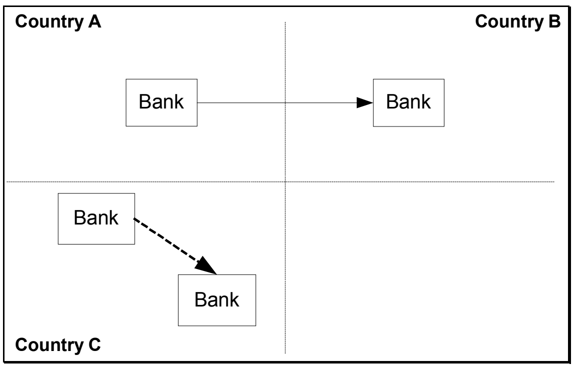


Figure 4: Bilateral exchanges.

4 Co-operation and competition

Irrespective of the infrastructure banks find most suitable, some accompanying measures seem to be indispensable for the realisation of a single payment area. These measures aim at increasing co-operation at an interbank level in the field of infrastructure. They also aim at fostering competition between banks in their relations with customers.

4.1 Organising a new framework for interbank co-operation

The successful implementation of standards and of interbank systems largely depends on the existence of interbank organisations providing strategic orientations, acting as a binding force committing the banks and reviewing progress in the various projects related to the payment systems infrastructure. This is, for example, the case in the field of standardisation for *Zentraler Kreditausschuss (ZKA)* in Germany, the *Comité français de normalisation bancaire (CFONB)* in France or the *Convenzione Interbancaria per i Problemi dell' Automazione (CIPA)* in Italy.

In the euro area, it has proven to be difficult to progress quickly in the field of infrastructure because the interests of the different market participants have been very heterogeneous and none of the existing interbank organisations could play a steering role in this field. This is partly linked to the fact that infrastructure issues are strongly related to the currency and, so far, no single interbank organisation has covered the interests of the euro area-based banks. Banks have generally pointed out the lack of sufficient volumes and commercial interest in developing cross-border retail payment systems. There were clearly incentives to develop large-value payment systems because the euro-based financial market consolidated rapidly. Changes in customer behaviour in retail banking and payments are slower and the present barriers are slowing down change. In order to speed up developments the incentives for development should be increased.

Drawing on the experience gained in the domestic context, it could be useful for the banks to envisage creating two co-ordination bodies at the euro area level. One could play a steering role to give guidance to the existing standardisation bodies (e.g. choice of new standards to be developed, planning for the implementation of the standards, definition of business practices which need to complement the technical standards). It would, however, not be necessary for this body to be in charge of technical discussions, because the ECBS (see Chapter 2) could continue to be entrusted with the practical work of standardisation. The other body would monitor the development of new payment arrangements (e.g. choice of the type of arrangement, approbation of the user requirements and of the specifications, monitoring implementation). Alternatively, a single body could be in charge of both functions.

It is quite unlikely that the move to STP could progress rapidly in the absence of such bodies. It is also clear that the setting-up of such organisations would not be easy because the number of banks to be represented is very high, because the domestic environments are very different and because their experience of working together has been relatively limited. The Eurosystem could, inside or outside such a body, continue to play its role of catalyst, facilitating the decision-making process on infrastructures and monitoring implementation.

4.2 Enhancing transparency and competition

It is clear that, so far, competition between banks has not been sufficient to ensure a decrease in the fees charged for cross-border payments. As a result, banks would show their willingness to progress swiftly towards the equalisation of domestic and cross-border payments in the euro area if they agreed to implement measures which would allow customers to compare prices.

The Eurosystem has already encouraged the banking industry to develop a product with a common name that would encompass a "generic" service for cross-border credit transfers. This service should be based on the assumptions that 1) customers provide all the information which is necessary for fully automated (STP) processing and 2) the amount of the transfer is below EUR 12,500, so that no balance of payments reporting is necessary. There should, however, be at least two service variants available: clerk-assisted service and self-service. Especially corporate, but also private customers are increasingly making use of internet-based self-service possibilities. The European banking community has committed itself to proposing to its customers a common credit transfer scheme called "Eurocred" as early as 2002 (see Annex 2 for more details).

In addition to this "generic" product, banks would, of course, be free to offer different cross-border products that are priced differently and that might suit the particular needs of their customers. The Eurosystem is aware that the banking sector is working along these lines and wishes to encourage it to progress quickly.

For this generic product to be successful, the Eurosystem has already indicated that its existence should be made known to customers through an information campaign. Moreover, banks should be encouraged to indicate on their websites at which level they price this standard service. The setting-up of an observatory could also be envisaged for bank charges for cross-border payments in order to facilitate comparisons between banks and to evaluate the progress achieved by the banking sector in general. Consumer organisations could possibly be involved in such a framework.

4.3 Customer education

Efficient payment processing also relies on co-operation on the part of the customer. It is obvious that the banks' efforts towards STP processing will not be fruitful if customers are not able to provide the necessary data. In the field of credit transfers, it means that the senders should be able to provide the IBAN of the beneficiary and the BIC of the beneficiary's bank. It is fair to assume that banks will be able to lower their charges only for those customers who are able to provide the necessary information. It is clearly the duty of the banks to educate their customers so that most of them can benefit from the new infrastructure. This education process could be more effective through joint campaigns by the whole of the banking sector, possibly with the support of public authorities.

5 A suggested road map

Drawing on the previous chapters, it is now possible to indicate what is feasible in order progressively to create an environment in which banks incur costs for cross-border payments which would be broadly comparable with the costs they incur for domestic payments. This would allow them to offer cross-border payment services to their customers in euro under the same conditions as for domestic ones. This calendar would assume a very strong commitment on the part of the banking sector. It should be further refined after consultation with the banking sector.

In order to keep the calendar reasonably tight, a number of measures should be envisaged in the very short term, i.e. as early as 2002:

- implementation of the MIF;
- a critical mass of banks implementing the generic credit transfer product and making their prices available on their websites;
- promotion campaign for the generic credit transfer;
- an agreement between banks to set up bodies in charge of creating and implementing new standards and for developing a new payments infrastructure;
- a calendar for the widespread implementation of the STP standards;
- definition of the main features and the user requirements of the new payments infrastructure; choice of the model deemed appropriate by the European banking community;
- setting up of an observatory for bank charges for cross-border payments.

Some measures may require longer lead times:

- the implementation of STP standards by all banks;
- the setting-up of new infrastructures;
- definition of best practices for STP processing;
- customer education.

The Eurosystem intends to carry out a close follow-up on the implementation of the road map and to publish a second progress report on "Improving cross-border retail payment services" in the second half of 2002. The most demanding element in terms of time is related to the adaptation and automation of internal procedures at banks, although, depending on the model, the setting-up of new infrastructures may also be time-consuming. It would be reasonable to expect that those banks which are most advanced in their preparations could offer cross-border payments at the price of domestic payments on a sound economic basis by the end of 2004. The others should bear the consequences of their late preparations.

6 Conclusion

Within Economic and Monetary Union, one major policy objective of the Eurosystem has been the creation of a single payment area for the euro. In such area, there is to be no difference for banks' customers – in terms of pricing and execution time – whether a payment crosses the border of a Member State within the euro area or not.

By comparison with the domestic context, the banking sector, at the same time, has been exposed to insufficient competition (in setting customer charges) and has suffered from a lack of co-operation (in the field of infrastructures).

To remedy shortcomings for cross-border retail credit transfers, it will be indispensable for the banking industry to set up and implement a common set of standards and a code of business practices enabling the fully automated straight-through processing of credit transfers throughout the euro area. A common set of standards and codes is, however, not a sufficient condition for optimal solutions to emerge. There has to be an adequate payment systems infrastructure and a common understanding of how standards and infrastructure will meet. In this respect, the banking industry should choose an infrastructure from among the models described in this report (or a combination thereof) that it considers optimal for its business needs. When making that choice, a balance will have to be struck between co-operation and competition. Systems have to be highly competitive, in terms of prices and in terms of service more generally, but a proliferation of the number of initiatives should be avoided in order to overcome the problem of critical mass.

National experience has shown that agreements on a common set of standards and codes, their implementation and discussions on infrastructural problems require the existence of at least one banking industry body with the required competence as well as the power to credibly engage all the parties involved. The lack of such a body in the euro area has dramatically hampered progress in that respect so far. The Eurosystem could, within or outside such a body, continue to play its role as catalyst, facilitating the decision-making process on infrastructures and monitoring implementation.

The Eurosystem is prepared to discuss with market participants the use of TARGET in the area of retail payments either by offering to process multiple credit transfer message types and/or by also allowing ACHs to forward and receive messages through TARGET, thereby constituting a communication and settlement bridge between different ACHs. The Eurosystem would also be ready to play its role as a catalyst for change if the banking sector were to opt for another solution.

The current report illustrates a road map to achieve the objective of a single retail payment area for credit transfers in a phased agenda. The report highlights some milestones to which the banking and payment systems industry will have to agree and be committed. It leaves sufficient room for the market to find the optimal path and solution towards a single retail payment area. The Eurosystem holds the view that this agenda could be acted upon by the end of 2004 if the banking sector were fully committed to achieving this goal.

Reaching the stage of "indifference" between domestic and cross-border payments should, however, not be conditional upon progress in technical and operational preparations. Since banks had been inactive for too long, some of the more inefficient institutions will, at some point, have to accept losses stemming from starting their preparations late. Progress towards a single payment area should be monitored carefully through an independent observatory and shortcomings deviating from the agreed road map should be highlighted appropriately. Ultimately reaching the stage of indifference for credit transfers would, however, not sufficiently satisfy the criterion of indifference in a wider sense. In a true single payment area, all payment instruments would need to fulfil the criterion of indifference, thus requiring additional efforts on the part of other instruments as well (card payments, direct debits and cash withdrawals in particular).

Annex 1

OPINION OF THE EUROPEAN CENTRAL BANK

of 26 October 2001

at the request of the Council of the European Union on a proposal for a regulation of the European Parliament and of the Council on cross-border payments in euro

(CON/2001/34)

1. On 26 September 2001, the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a regulation of the European Parliament and of the Council on cross-border payments in euro (hereinafter referred to as the 'draft regulation'). Its main intention is the establishment of the principle that charges levied by an institution in respect of cross-border payments in euro will be the same as the charges levied by the same institution for corresponding domestic payments.
2. The ECB's competence to deliver an opinion is based on the first indent of Article 105(4) of the Treaty establishing the European Community (hereinafter referred to as the 'Treaty'), and Article 3.1, Article 4(a) and Article 5 of the Statute of the European System of Central Banks and of the European Central Bank, as the draft regulation contains provisions concerning the smooth operation of payment systems and the collection of balance-of-payment statistics. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, this opinion has been adopted by the Governing Council of the ECB.
3. The draft regulation provides that charges levied by an institution in respect of cross-border payments in euro up to EUR 50 000 shall be the same as the charges applied by the same institution in respect of corresponding payments within the Member State in which the establishment of that institution executing the cross-border payment is located. The draft regulation is envisaged to apply from 1 January 2002 to cross-border electronic payment transactions, that is in principle to card payments and cash withdrawals at cash dispensing machines, and from 1 January 2003 to cross-border credit transfers and cross-border cheques. The draft regulation also contains provisions obliging institutions to provide their customers with prior information on charges in the interests of transparency. In addition, it contains measures facilitating automated straight-through-processing of cross-border payments by imposing a mutual obligation on institutions and customers to communicate to each other the relevant International Bank Account Number (IBAN) and the Bank Identifier Code (BIC) upon request. The draft

regulation also establishes a reporting threshold for balance-of-payment statistics of EUR 12 500 from 1 January 2002, and increases it to EUR 50 000 as from 1 January 2004.

4. The draft regulation is based on Article 95(1) of the Treaty, according to which the Council shall 'adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market'. With regard to the choice of legal basis, the ECB would welcome an assessment by the Council of compatibility of the draft regulation with the principle of an open market economy with free competition as laid down by Article 4(1) of the Treaty, with the right of property and with the principle of proportionality.

5. Articles 1 to 3 of the draft regulation provide for the alignment of charges for cross-border and domestic payments in order to establish a single payment area for the euro. In that sense, the objective of the draft regulation is fully in line with the policy pursued by the Eurosystem since the publication of its 1999 report on *Improving cross-border retail payment services: the Eurosystem's view*, i.e. the creation of a single payment area for the euro. In this respect, the ECB shares the view that the notion of 'border' should not be in itself a factor that justifies differences between payments in the euro area. The ECB has always promoted an integrated payment area for the euro where the differences in cost and convenience of making domestic and cross-border payments should reduce substantially and eventually disappear. Furthermore, in line with the tasks entrusted to it by the Treaty, the ECB also shares the view stated in the explanatory memorandum according to which the creation of a single payment area for the euro is desirable to enhance the confidence of the public in the single currency. The ECB remains therefore firmly committed to the ultimate purpose of a fully integrated single payment area for the euro. However, while sharing the objective of the draft regulation, the ECB would like to emphasise its reservations against a regulation influencing prices for services which risks disruption of the working of the market economy. Whilst understanding the underlying considerations for the draft regulation, the ECB would favour addressing the economic issue by allowing banks a longer, albeit definite, time limit to adjust their prices progressively in line with the progressive decrease of their cost base. Indeed, the proposed pricing laid down in the draft regulation will not remedy the existing fragmentation of payment channels and costly interbank processing of cross-border payments – which are some of the main reasons for the high charges. In this perspective, the draft regulation addresses only the consequences of the underlying inefficiencies and not their causes.

6. In this respect, the following general comment addresses the timing of entry into force of the draft regulation. The ECB has been working intensively with the banking sector since 1999 as a catalyst for change. Since then, progress has been made and obstacles that were identified as hampering cross-border payments have been removed. Therefore, the ECB expects that – as a result of implementation of measures – a substantial fee reduction for cross-border payments should already take place from 1 January 2002. A fully integrated single payment area, necessary for full equalisation of prices on a sound cost and production basis, should follow in a second step within a timeframe as short as realistically possible allowing for necessary structural adjustments.

However, at least for credit transfers, banks need additional time, for example until 2005, to put in place the necessary infrastructure and logistics to allow for an economically viable equalisation of prices between domestic and cross-border transfers. It should be considered that while consolidation of the payment systems infrastructure following the introduction of the euro has already occurred for the large-value transfer systems, a pan-European infrastructure for retail payments is not yet in place. Consolidation in this field is expected to start after the final changeover to the euro.

7. Furthermore, the ECB is of the opinion that aligning charges for domestic and cross-border payments at a premature point in time may eventually trigger some counterproductive reactions from institutions, such as a decreasing supply of cross-border payment services or an increase of domestic fees or of the fees charged for other services. Moreover, in some countries domestic credit transfers are free of charge or at low charges, while in others charges are quite high. An undesirable effect of the draft regulation could be a prolongation of the current disparities between countries and persistence of price differences for cross-border payments across different euro area countries.

8. In addition, the ECB notes that at present, practices concerning who is actually charged for domestic credit transfers – sender, beneficiary or both – may differ amongst Member States. Therefore, transposition of this domestic practice to cross-border payments between countries with a different practice is not straightforward. It is also not clear whether the draft regulation leaves any freedom to agree between sender and receiver on who bears the cost of the transfer. Moreover, further consideration should be paid to the relationship between the draft regulation and Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers[7] in this respect. More generally, a standardisation of practices regarding charges could prove to be appropriate and should be investigated.

9. The ECB agrees that the creation of a single euro payment area calls for improved procedures for cash withdrawal, card payments and credit transfers. However, Article 3 includes also cheques in the scope of the draft regulation. Whilst the ECB recognises that cheques still play an important role in a few national markets, it is of the view that any measures which could foster the cross-border use of this payment instrument should be avoided. In view of its statutory mandate to ensure the smooth functioning of payment systems, the ECB would instead discourage the cross-border and domestic use of cheques in favour of more secure and efficient means of payment, one reason being that cheques are paper-based and cannot be processed as efficiently as electronic payment instruments. Also, introducing cheques in the scope of the draft regulation would force banks to invest in infrastructure to handle cross-border cheques, while the banks must at the same time invest heavily in improving the processing of cross-border credit transfers.

---

[7] OJ L 43, 14.2.1997, p. 25.

10. The ECB welcomes the initiative in Article 4 of the draft regulation to foster the transparency of fees levied on cross-border payments and payments effected within the Member State in which an institution is established. This Article will enhance competition, contribute to the establishment of a single payment area and improve the advantages for consumers in the internal market.

11. Article 5 of the draft regulation imposes a mutual obligation on institutions and customers to communicate their International Bank Account Number (IBAN) and the Bank Identifier Code (BIC) to each other upon request. The ECB has always promoted standards as a means of facilitating the execution of cross-border payments. It has initiated discussions and worked intensively with the banking sector in order to introduce standards such as the IBAN. Therefore, the ECB shares the objective of Article 5 of the draft regulation to accelerate and facilitate the implementation of defined standards. However, the ECB suggests that sufficient flexibility should be provided for future developments of technical standards to ensure the efficiency of payment systems in the long-term. Finally, it is noted that the draft regulation does not allow time for the institutions and their customers to comply with Articles 4 and 5. The Council may wish to consider whether this will be feasible in practice.

12. According to Article 6(1) of the draft regulation, Member States shall by 1 January 2002 remove any national reporting obligations for cross-border payments up to EUR 12 500 for balance-of-payment statistics. The threshold will be increased to EUR 50 000 from 1 January 2004. The Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) agreed in June 2000 on a common exemption threshold of EUR 12 500 from 1 January 2002 for those Member States making use of settlement-based reporting by banks on behalf of their customers. The amount was chosen to relieve almost all retail cross-border and around two-thirds of all transactions from balance-of-payments statistical reporting. With the EUR 12 500 threshold, consumer cross-border payments are in practice exempt from any reporting burden. The ECB is of the opinion that a premature increase of the threshold to EUR 50 000 would not increase substantially the proportion of cross-border transactions exempted but would have a severe impact on the quality of statistics through the loss of information concerning some balance of payments items, mainly services, income and transfers. Accurate balance-of-payments data are required for decision-making. In addition, a deterioration in national balance-of-payments data would reduce the quality of national account aggregates, notably gross domestic product and gross national income. A radical reform of the data collection systems in some Member States to maintain data quality would take time and probably add directly to the reporting burden on small and medium-sized enterprises in particular. A two-threshold system, with separate thresholds for payments within and outside the EU – an approach which could limit the impact on balance-of-payments statistics of the euro area as a whole – might be cumbersome and add to banks' reporting costs. For these reasons, the ECB strongly recommends postponing the increase in the threshold to EUR 50 000 to 2006 to allow sufficient time for the development of alternative sources. The draft regulation should also make clear that the threshold applies to reporting by banks of cross-border payments initiated by their customers, and is without prejudice to the obligation to meet the

statistical requirements set out in the ESA95 Regulation. The ECB also suggests postponing until 2004 the removal of obligations as to the minimum information concerning the data of the beneficiary which prevent automation of payment execution contained in Article 6(2) of the draft regulation, as this may in particular entail consultation of various parties at the national level.

13. Regarding the application of the draft regulation in the three countries not participating in economic and monetary union, there appears to be a need for further clarification. As the euro will remain a foreign currency in these countries, it might be difficult to determine the adequate reference to an equivalent domestic payment, i.e. whether, for instance, the comparator would be either a transfer in the domestic currency or a transfer in euro within the same non-participating country. Similarly, it is unclear what will be the reference charge for a cash withdrawal in one of these countries.

14. This opinion shall be published in the *Official Journal of the European Communities*.

Done at Frankfurt am Main on 26 October 2001.

The President of the ECB

[SIGNED]

Willem F. DUISENBERG

Proposal of the European banking community for a common cross-border credit transfer scheme (Eurocred) with digressive fees

The European banking industry, represented by the European Credit Sector Associations (ECSAs), agreed on a new “Eurocred” standard for cross-border transfers in the EU with a maximum price for consumers (originator of transfers). This maximum price will be in line with whatever is agreed between the European banking industry and the EU authorities. According to the proposal of the Board of the European Banking Federation, maximum prices for cross-border transfers will gradually be reduced until they reach, by the end of 2005, the domestic levels in each Member State. The proposal suggests maximum additional charges for the cross-border element of the transaction as follows:

from 1 July 2002	€ 12
from 1 January 2004	€ 8
from 1 January 2005	€ 4
from 1 January 2006	€ 0

This proposal is made under the condition that the Commission authorises the MIF as an essential element of the price moderation. Thus, the banks are prepared to commit to price reduction for cross-border payments until the point of indifference with domestic prices is reached. In a first step Eurocred will be offered by a certain number of banks from 1 January 2002. In a second step, the ECSAs will endeavour to have Eurocred extended by the endorsement of all their members by 31 March 2002 so that it can be adhered to by all banks by 30 June 2002 at the latest.