

ASSOCIAZIONE BANCARIA ITALIANA

Italian banks ready for SEPA
Green light for the single euro payments area

Benefits of SEPA for the Italian and European economies

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1. The changes under way

I am grateful to the Italian Banking Association for choosing to give such prominence, in this year's Convention, to the problems of SEPA, the single euro payments area. On the eve of its launch, the public is not yet sufficiently aware of the importance of the event, which can by all rights be described as a milestone in the process of European integration.

In 2002 European citizens were offered the possibility of making cash payments in a single currency. It was an historic innovation, whose benefits in terms of lower transaction costs have not been fully realized because the procedures, technical standards and legal framework for cashless payments continue to differ from one country to another. A single currency has been created, but not an integrated system for its circulation. SEPA now aims to achieve this. Breaking down the barriers to electronic payments between countries could greatly reduce the transaction costs of cross-border operations and enhance competition and innovation, to the benefit of consumption, production and investment.

The project will enable consumers and businesses to make non-cash payments within Europe¹ from a single account and under the same basic conditions, regardless of place of residence. More than 300 million European citizens will be able to use harmonized payment instruments as easily and safely as in their domestic markets today.

In little more than a month, on 28 January 2008, it will be possible to make credit transfers according to the new European standards, and the new requirements for credit and debit card payments will come into force. It will be possible, too, with no additional cost or formalities, to

¹ For the purposes of the SEPA project, the banking industry defines "Europe" as the 27 member states of the European Union plus Iceland, Norway, Liechtenstein and Switzerland.

receive payment for exports directly on Italian accounts or to have an Italian pension credited to an account abroad, or again to transfer funds to children studying at a university in Europe.

It will not be compulsory to use the standard pan-European instruments and the project will be market-driven. However, in addition to the commitment of the authorities and the banking industry there must be firm adherence to the project on the part of businesses, consumers and public bodies. These must be properly informed of the opportunities offered by the single payments area, as well as of the risks of remaining on the fringe.

The creation of SEPA, offering European citizens modern, efficient and reliable payment services, can contribute substantially to the realization of the Lisbon agenda for making the European Union “the most competitive and dynamic knowledge-driven economy by 2010”.

2. Pathway to integration

SEPA is a step in the integration of financial services markets, a process that began in 1999 in the field of large-value payments with the creation of TARGET. The system encouraged rapid integration between national money markets, which is essential for the conduct of an effective single monetary policy. TARGET2, successfully launched on 19 November, will contribute to closer financial integration in Europe; the new system is already used to settle more than 220,000 payments a day, for a value of over one trillion euros.

TARGET2 offers countries a fully harmonized gross settlement service, in terms of techniques and functions, and a single set of prices for domestic and cross-border transactions. The banking industry can now count on a larger set of functions and better quality of service at lower cost. TARGET2 also contributes to financial stability through its innovative architecture and organization, which can guarantee business continuity even in the event of severe malfunction or region-wide disaster.

The contribution of gross settlement systems to financial stability in the euro area has become tangible in recent months during the financial turbulence triggered by the sub-prime mortgage crisis. The credibility of the single monetary policy and the robustness of Europe's market infrastructure and payment systems have proved to be crucial to the orderly functioning of the markets.

The new TARGET2 system guarantees the technical and functional conditions for realizing the Eurosystem's other projects, such as TARGET2-Securities, which should reduce financial market segmentation even further and assist the management of securities posted as collateral for market operations in the euro area.

In the field of retail payments, standardization has been entrusted to the market. Pan-European clearing and settlement infrastructures will be realized through complementary initiatives by the Eurosystem, individual central banks and the banking community. The interoperability, access and reachability requirements have been drawn up for these infrastructures, with the technical aspects of interoperability established jointly; singly, each will determine its business strategies and necessary alliances.

National retail payment systems will be called upon to play a crucial role in implementing SEPA. The Bank of Italy's contribution to the project, as manager of the Italian retail payment system BI-COMP, is to ensure that the system is adapted – together with the Italian clearing service providers – to handle pan-European instruments and to be interoperable with similar European systems from January 2008. Moreover, in order to broaden the range of alternative channels available for settling SEPA instruments, and thus the list of reachable intermediaries, the Bank of Italy will also offer BI-COMP participants a linking service to the STEP2 system run by EBA Clearing, guaranteeing full reachability of all banks and all Italian customers.

3. Benefits of SEPA

The advantages of retail payment market integration will be immediately apparent to those users, mainly businesses, that require regular cross-border payment services. The benefits will spread gradually to all firms and citizens as domestic instruments are replaced by European ones for the settlement of transactions. Some 16 billion credit transfers will be involved each year, about 30 per cent of all cashless payments in euros, and over 15 billion credit and debit card settlements.

The benefits for Europe's economy will be enormous. A forthcoming study conducted at the request of the European Commission puts them at around €20 billion a year for the next six years, assuming that migration to the new instruments is rapid and that advantage is taken of SEPA to continue to automate the entire payment cycle. The advantages will be even greater if superseding national market segmentation and making innovative payment instruments easier to use leads to greater competition and lower unit costs of banking services for both consumers and firms.

Corporate users

The special features of SEPA are still little known. In a Eurosystem survey of the state of readiness of businesses for SEPA conducted last summer, almost half of the respondents said they were not well informed about the project; those that are informed have already taken the first steps to adapt their internal procedures and plan to use the advanced payment products. The main source of information for businesses seems to be the press. The banking industry could do more: given its thorough knowledge of customers' operating and financial needs, it could be more active in promoting the radical changes under way in the payments system.

The premises exist for Italian banks to expand their cross-border and high-tech services considerably.

The Bank of Italy's survey of industrial and service firms has revealed that between 2000 and 2006 their level of internationalization, measured in terms of actual presence abroad

(production, design and marketing) and collaboration agreements (commercial, technical and production, research and development), has practically doubled. However, this trend has not been matched by an equivalent increase in flows of cross-border payments by Italian banks.

Moreover, the number of industrial firms using high-tech payment services is still small, even though the unit cost of electronic invoices is three times lower than that of paper invoices. The proportion of firms buying and selling online is also small: 16 per cent in industry and 30 per cent in services.

Italy's banking industry is developing innovative services for firms in the field of financial reporting and electronic reconciliation of payments; during discussions with end users additional products have been identified that will integrate administration and accounting even more closely with financial processes. Dialogue with businesses needs to be intensified if SEPA is to provide efficient and high-quality services that can support a significant improvement in competitiveness.

For firms to begin to use the new pan-European instruments with confidence it is also essential that nothing arouse fears of unwarranted increases in prices of domestic payments and that there be no deterioration in the quality of the bank services already available. In principle, there is no reason why prices of SEPA-compliant services should be higher than those of equivalent services previously offered to domestic customers.

The banking industry can finance the investments it will nevertheless have to make by developing high value added services, that is Additional Optional Services, and extending its business area to firms operating in other national systems.

Consumers

The benefits for European consumers will stem from easier comparison of the quality and price of services offered by domestic and foreign banks; choice among different intermediaries;

exact knowledge of the timing and cost of payments; and clear information about the difference between basic and optional services.

The expectation is, first, that there will be a marked narrowing of price differences around Europe for the same services, which the European Commission estimates in a range of 1 to 8. Eventually, the time needed to execute payments with pan-European instruments will be cut to just one day and the flow of information about the whole cycle of monetary transactions will improve.

Lower prices and greater transparency will increasingly lead consumers to try high-tech payment instruments and come to appreciate their availability and efficiency as opposed to paper.

Greater use of electronic payment instruments will help to lower their unit costs and reduce the cost to banks of handling cash and processing cheques. If these advantages are promptly reflected in the fees to customers, they could set in motion a virtuous circle that will deliver benefits to individual economic agent and to the economy as a whole.

SEPA is based on the interaction between an initiative of the authorities and banks' self-regulation. It follows a long series of legislative measures adopted by the Community to ensure more extensive protection of end users, in terms of transparency of contractual conditions and efficiency and security of services. There were three fundamental steps in the process: i) the 1997 directive on cross-border credit transfers, which for the first time established obligations concerning not only transparency but also the maximum times for executing funds transfers; ii) the 2001 regulation on cross-border payments, which required the same contractual conditions to be applied to cross-border payments within Europe as to domestic payments; and iii) the directive on payment services (2007/64), which was published last week in the Official Journal of the European Union and completes the process by increasing the role and responsibility of payment service providers and creating the conditions for the development of innovative, efficient and secure services.

The participation of consumer associations in the Forum of SEPA stakeholders under the European rules governing the project will involve new forms of dialogue among stakeholders. It can be expected that the associations will fully publicize the innovations and practical implications of the reform (such as the general introduction in credit transfers of international bank account numbers, IBANs), monitor the latter's correct application and propose any necessary adjustments.

4. Role of the public administration

Public payments account for a large proportion of the total: in Italy in the last three years the state treasury alone has made about 45 million retail credit transfers per year, 13 per cent of the total. The involvement of the public administration is thus essential to the practical implementation of SEPA and the rapid replacement of domestic instruments with pan-European instruments.

In October 2006 the ECOFIN Council called on the public administrations of the various countries to guide the transition to the new standards.

The Italian central government, flanked by the Bank of Italy as its treasurer, is one of the few in Europe to have chosen to begin the shift towards the new SEPA instruments as early as next January. The approach adopted is a gradual transition that, starting from the procedures having a smaller quantitative impact, such as electronic payment orders, can go on to extend techniques and methodologies to the bulk procedures. The most important step will be taken between 2008 and 2009 with the adoption of the European standards for the crediting on bank accounts of about 40 million salary and pension transactions per year involving nearly 12 million people.

An additional boost to the automation of payment cycles and the progressive switch to IT of government departments, as well as to the modernization of commercial practices and the transparency of accounting processes, will come from the measures introduced in the finance bill prohibiting public entities from accepting paper-based invoices.

While the central government has shown it fully understands the modernization opportunities and efficiency gains connected with SEPA, involving local government appears more difficult, since it is marked by a plurality of profoundly different entities with a high degree of autonomy not only in expenditure decisions but also in the choice of payment procedures. About two and a half million payments per year are still made by local government bodies using paper-based procedures carried out manually by their treasury sections, including about one and a half million by means of credit transfers.

The absence of a single forum for all local government bodies hinders the task of providing information and heightening awareness. In this regard, a firm commitment by the central government and the banking system is indispensable. The Bank of Italy, in cooperation with the Italian Banking Association, has planned a series of initiatives to disseminate information on the innovations concerning the systems for collecting local expenditure data and the influence of SEPA on the future management of payments.

5. Directions of change

The final objectives of SEPA – to increase the fluidity of commercial and financial transactions and enhance competition in the market for retail payments – place the project within a broader programme of economic policy interventions at European level, in accordance with the Financial Services Action Plan drawn up by the European Commission.

Promote the use of innovative payment instruments

A key aspect of the project is the drive for innovation in payment services. This is why the new SEPA framework is not concerned with paper-based instruments but concentrates instead on instruments with a higher technological content.

The total circulation of euro notes and coins is growing relatively fast and the growth is above all in the larger denominations.

Using cash entails substantial costs for users and the economy, however. Recent studies of some European countries show that payments with electronic instruments are less costly than those in cash, even for very small amounts of about 10 euros.

The large-scale use of cash is partly due to the fact that European consumers do not see the costs of its handling properly, not least because the price structure of banking services does not make them explicit.

Factors contributing to the use of cash in Italy include the fragmentation of the retail sector, practices intended to avoid or evade tax and labour rules, and diffidence towards instruments that are more advanced but exposed to fraud, such as cards.

There are conflicting signals with regard to the evolution of payment instruments in Italy. The growth in electronic transactions per capita is slowing and their value in absolute terms is still far below the Eurosystem average even though Italy's endowment of infrastructure is in line with that of the other countries. Debit cards are still used mainly to withdraw cash rather than to make payments directly.

On the other hand there is slow but steady progress in reducing the use of cheques; on-line credit transfers are increasing; the use of prepaid cards is growing rapidly, above all for transactions carried out over the Internet.

Banks will need to make a major effort in terms of adapting payment cards to the new and more secure technologies, switching to chip cards and adopting international standards, as required by the SEPA project. This is a necessary condition for strengthening economic agents' trust in the reliability of instruments that are the closest substitutes for cash.

The contribution of SEPA is supplemented by important legislative measures aimed at the twofold objective of countering the use of cash for illicit purposes and discouraging inefficient payment instruments. The decree transposing the 3rd Anti-Money-Laundering Directive, issued in the middle of November, introduces limits on the transferability of cheques and rules to make the use of electronic money products more flexible.

Increase competition

The Eurosystem shares the objective of promoting competition in the retail payments market set by the Commission and the European Parliament.

The directive on payment services, which the member states must transpose into national law by 1 November 2009, introduces a new category of institutions authorized to supply payment services, which can be coupled with business activities. A broad range of services is permitted: in addition to SEPA instruments, it includes the opening of lines of credit and keeping accounts for customers when this is for the purpose of executing payments. The entry of telephone companies and large-scale retailers into the market for payment services will heighten competition with traditional intermediaries in quality, price and innovation.

Further measures that will increase competition concern the transparency of the contractual conditions for users, graduated according to customers' real needs. The obligations regarding the provision of information concern both the contractual conditions and the effective execution of payment orders.

In addition, there are numerous initiatives under study at Community level to support SEPA's effective implementation: from the promotion of greater customer mobility to the extension to direct debits of the obligation to apply the same conditions to cross-border payments as to corresponding domestic transactions, and the revision of the rules on electronic money, which could be included in the directive on payment services.

A far-sighted approach is required. It is necessary to prevent the advance of innovation from leading to new forms of technical rather than regulatory fragmentation that could create additional obstacles to the integration of the European market. On the contrary, SEPA requires the adoption of open standards, shared not only at European level and capable of facilitating the access of new competitors to the market for payment cards and electronic funds transfer. Competition between the various providers of traditional and new payment services does not necessarily imply a “hostile” relationship. In accordance with the view of the payment system as a network economy, it is necessary to grasp the opportunities for cooperation between financial and non-financial institutions capable of fostering the evolution of basic payment systems towards more complex and innovative financial services, such as payment applications based on contactless technologies.

6. Conclusion

The implementation of SEPA is the necessary complement to the introduction of the single currency and the process of European financial integration. In the same way as for the changeover to the euro, the project is based on national coordination mechanisms linking authorities, banks and other interested parties and the drawing up of detailed plans regarding the manner and timing of the migration of national systems and instruments to the new European standards.

SEPA will bring significant benefits to the European and Italian economies, thanks to the reduction in transaction costs and the increase in innovation and competition in the market for payment services. New products and new participants, including some of a non-financial nature, will be able to capitalize on extensive commercial networks and particular technological solutions. As I mentioned earlier, the potential benefits for the European economy are of the order of €20 billion per year for the next six years.

The new directive on payment services is intended to produce a uniform regulatory framework. Here again it is desirable to proceed without delay to strengthen the mechanisms of

European discussion and coordination, to prevent the discretion allowed at national level from reintroducing the regulatory asymmetries that the directive is intended to overcome.

With SEPA on the horizon, these considerations suggest the desirability of broadening the range of pan-European products to include those developed most recently and redefining governance mechanisms, with the participation of non-bank institutions as well.

It is in this way that SEPA can also provide impetus in a phase following that of the introduction of the basic pan-European instruments and contribute fully to modernizing the European payment system and improving the area's prospects of economic growth.