

SIA - SSB

**DO YOU SEPA?**

Landing on the PSD Planet.  
4th International Payments Summit

**The integration of retail payment services in Europe:  
the PSD's contribution and the impulse of the market**

Franco Passacantando  
Banca d'Italia

Milan, 26 October 2009

Let me thank the SIA-SSB group for organizing this meeting on the eve of the crucial deadline of 1 November for the transposition of the Payment Services Directive in EU Member States and the launch of the new pan-European SEPA direct debit. The market's expectations are high indeed. Consumers and businesses expect access to innovative payment instruments and greater protection in their use of traditional ones. New operators are preparing to enter the market in retail payment services in competition with the banks. More generally, the hope is that the new instruments will finally supplant cash, with its extremely high social costs, in consumers' preferences. If these expectations were to be disappointed, it might jeopardize the entire process of European payments integration, which is crucial to our continent's competitiveness and growth.

### **Obstacles to SEPA and legislative initiatives to remove them**

We know that the benefits expected from the Single Euro Payments Area have not yet materialized. We must analyse the factors impeding migration to SEPA and judge whether the PSD and the other reforms under way can overcome them.

Three aspects in particular are of concern. The first is the still limited use of the SEPA credit transfer virtually throughout the euro area. Nearly two years after its launch, it is used on average in no more than 4 or 5 per cent of all credit transfers. We are far from the initial projection of 20 per cent by October 2010. The reason is that the SEPA credit transfer is mainly used for cross-border transactions and has replaced the domestic transfer only to a minimal extent. This prevents the economies of scale that are essential to yield significant benefits for final users.

The second concern is that cooperation among infrastructures is still insufficient, making it difficult at reasonable cost, to reach all European banks regardless of size and nationality.

Third is the slowness with which public entities are moving to SEPA instruments. As a recent survey by the Commission found, with a few virtuous exceptions the public sector is still relatively insensitive to the advantages of integration of the European payments industry.

An essential impulse for the success of SEPA is expected to come from the implementation of the Payment Services Directive, flanked by amendments to other important European legislation, first of all that on cross-border payments. The new rules governing payment services provide a uniform, pan-European definition of the rights and obligations of providers and users of payment services. The Directive also lays the premises for profound changes to the structure of the market by

instituting a new category of operator, payment institutions, which are authorized to combine payment service provision with commercial business.

Among the many innovations, some are of more immediate impact. For instance, the Directive establishes that the value date shall coincide with the date on which the funds transferred become available and that execution time be no more than one day from receipt of the order, with the possibility of agreeing, until 1 January 2012, a longer deadline, but still no more than three days. It requires the use of the unique identifier, namely the IBAN for SEPA products. The responsibilities of payment service providers as regards the whole transfer cycle are spelled out. Users are subjected to due diligence requirements, such as the retention of payment instrument security codes (PIN and password) and the entry of the correct unique identifier in payment orders. There are incentives for the use of the more innovative instruments, with an easing of the parties' obligations and responsibilities for small-value payments using electronic money and prepaid cards.

The PSD leaves a number of options open to the Member States, which obviously entails the risk of disparities in transposing the Directive into national law. However, for the most part these risks do not bear on SEPA instruments, and to deal with them the Commission has formed a Payments Committee to attenuate divergences by issuing guidelines. One of the options left to Member States is to treat micro-enterprises in the same way as consumers, i.e. with stronger protections in the area of transparency and time limits for contesting a debit. In Italy, the orientation that is emerging is to treat micro-enterprises like consumers with a few exceptions, such as the reimbursement of direct debits so as not to deprive these businesses of the highly regarded instrument that is Italy's rapid direct debit.

In many countries the transposition of the PSD is behind schedule, and it is to be hoped that the delays are quickly recouped. In Italy a draft decree underwent public consultation during the summer as regards the aspects with the most direct bearing on the operation of payment service instruments and services. Once approved by the Council of Ministers and by the competent Parliamentary committees the new rules will go into effect, hopefully by the end of this year.

Meanwhile, a Community rule has been passed that requires any institution offering domestic direct debits also to accept SEPA direct debits from any other operators located in the European Union. As of 1 November 2010 reachability will be a legal obligation.

As I noted, the public sector can contribute significantly to the success of the SEPA project by adapting the great volume of public payments to SEPA standards. As the provider of treasury services to the Italian government, the Bank of Italy is working with the Ministry of the Economy to adapt public payments to European standards. The first initiatives to adapt to SEPA schemes were

taken in January 2008. Within the next year the payment of State sector salaries – some 20 million credit transfers – will be made SEPA-compatible.

## **Market initiatives**

The slowness of the migration has reinforced many people in their belief that SEPA, which arose as a market initiative, cannot be fully realized unless it is made compulsory by government action. The most important measure now under discussion is the imposition of a mandatory end-date terminating the permission for payment operators to offer their customers traditional instruments that have a SEPA equivalent. The Commission recently held a public consultation on the matter; the results will be discussed at an upcoming Ecofin meeting.

Theoretically, the setting of a final deadline for the migration to SEPA instruments is reasonable: dual circulation of traditional and SEPA instruments, in fact, is not compatible with the drastic reduction in transaction costs that motivates the entire project. The end-date would eliminate not only the costs implicit in the coexistence of multiple procedures but also those that would become necessary to adapt the procedures to the final users' multiple, changeable needs.

Even so, it is not an open-and-shut argument. It is not so easy for a country like Germany, which considers the cost of duality to be sustainable. Nor is it any easier for one like Italy, whose domestic products are superior in quality to their SEPA equivalents. I believe that in general the setting of the deadline, reasonable enough in principle, should be the finishing touch to the process of adapting SEPA instruments to the needs of firms and households, not a means for making their use mandatory.

This means that regulatory measures cannot simply and completely supplant the impulse that the market must in any case provide. And for the market to work, the incentives, competitive conditions and governance that oversee the process must all be strengthened.

*Incentives.* Patently, no market initiative can be successful unless the service providers and final users perceive some advantage: higher profits, lower costs, or better service. For this to happen, pan-European initiatives must be allowed some flexibility, but without permitting segmentation. We are convinced that it is possible to provide additional optional services (AOS) to supplement the SEPA schemas without reintroducing national segmentation. Indeed, AOS could be the means for extending national best practices and procedures throughout Europe. And they could

give banks an incentive to invest in a sector where standardization will inevitably reduce profit margins.

*Competition.* What spurs to competition may derive from Community harmonization measures and technological innovation? Above all the drive will be for new products such as mobile payments, and will come from new operators, chiefly payment institutions, including “hybrid” ones, such as telecommunications and mass retailing corporations. Plainly, there is a risk that innovation may not come within the SEPA framework. This must be averted in order to prevent the development of purely national products that would clash with the integration of the European payments market.

The Bank of Italy has conducted a survey of the innovative payment services industry whose findings will soon be made public. Right now I can say that we have found strong interest among Italian non-bank operators in moving into this market not only with alternative channels of access to the services already provided by traditional intermediaries but also with new services of their own supplementing commercial products. Although the process will be gradual, especially given the present economic uncertainty, most operators are taking every possible precaution not to be caught unprepared by competition, which could also come from abroad.

*Governance.* The SEPA project, until now almost exclusively appertaining to the banking industry, requires governance more open to two other categories: non-bank payment service providers and final users. The European Payments Council’s public consultations with the main stakeholders, asking for proposals to improve the pan-European instruments, are not sufficient. Italy’s national committee for SEPA migration, headed jointly by the Bank of Italy and the Italian Banking Association, has been active for years now. The committee deserves praise for providing a forum for frank and thorough discussion with all the stakeholders affected by the project and producing sound solutions to optimize SEPA. It was within the committee that firms’ proposal for an AOS to complement the SEPA direct debit with some of the most highly appreciated functions of Italy’s existing direct debit product was finalized.

One final, crucial factor for fostering the use of SEPA instruments is communication; this is essential to get non-specialists to appreciate the advantages of the new services, which are still not being used because they are wrongly considered too complicated or risky.

## **Stimulating clearing and settlement infrastructures**

It is essential, in order to spread the new pan-European instrument, that clearing and settlement infrastructure managers act on two fronts: to adapt their procedures to the new SEPA instruments on schedule; and to achieve the reachability of all banks by means that guarantee a level playing field between infrastructures. To this end, the European market is developing two models for dialogue among banks: direct participation in a central system (at present, STEP2) and the European Automated Clearing House Association model of interlinking among systems, i.e. “interoperability agreements”, which to date has produced nine interlinks between different structures.

The Eurosystem has laid down some requirements for infrastructures that intend to handle SEPA instruments to ensure efficiency and competitive parity. In addition, the infrastructures have been called on to inform the market of their self-assessment of compliance with the SEPA requirements, in order to heighten transparency and so stimulate competition between providers.

As operator of the BI-COMP clearing and settlement system, the Bank of Italy, together with nine other European infrastructures, has promoted the preferential use of SEPA direct debits by government bodies and firms. With a view to the forthcoming European obligations on direct debit reachability, BI-COMP has been adapted to handle the SEPA direct debit and enable the banking industry to use it under EPC rules.

More than 150 banks have already agreed to participate in the initiative, and starting on 2 November they can settle SEPA direct debits with one another and with the banks belonging to foreign infrastructures that are interoperable with the Bank of Italy system for these instruments. The actions so far have been patterned on those taken last year to launch SEPA, thanks to which BI-COMP members can now reach over 60 per cent of all the European intermediaries that have joined the SEPA credit transfer scheme.

The Bank of Italy also participates in the SEPA direct debit services offered by the EBA-Clearing STEP2 system. In this way it can provide its linking service, already available for SEPA credit transfers, ensuring reachability of BI-COMP participants within the single retail payments area.

As provider of retail payment services the Bank seeks to offer the market the broadest possible opportunities for using the new pan-European payment instruments, under the obligation of full cost recovery laid down by the regulations and underscored by the Eurosystem policy statement.

## **Conclusion**

I am sure that today the migration towards SEPA is no longer reversible, but we must not underestimate the risk that the whole process may be much longer and more costly than was originally imagined. It is too early to tell whether the new Directive and the other legislative and regulatory initiatives will speed up the project. But I am convinced that in addition to the regulatory and self-regulatory measures covered in this session of the Summit, the impulse that the new legislation imparts to competition will be crucial. Hopefully, these initiatives will not be restricted to local areas but will contribute, together with the providers of banking services, to the integration of the European payments system.