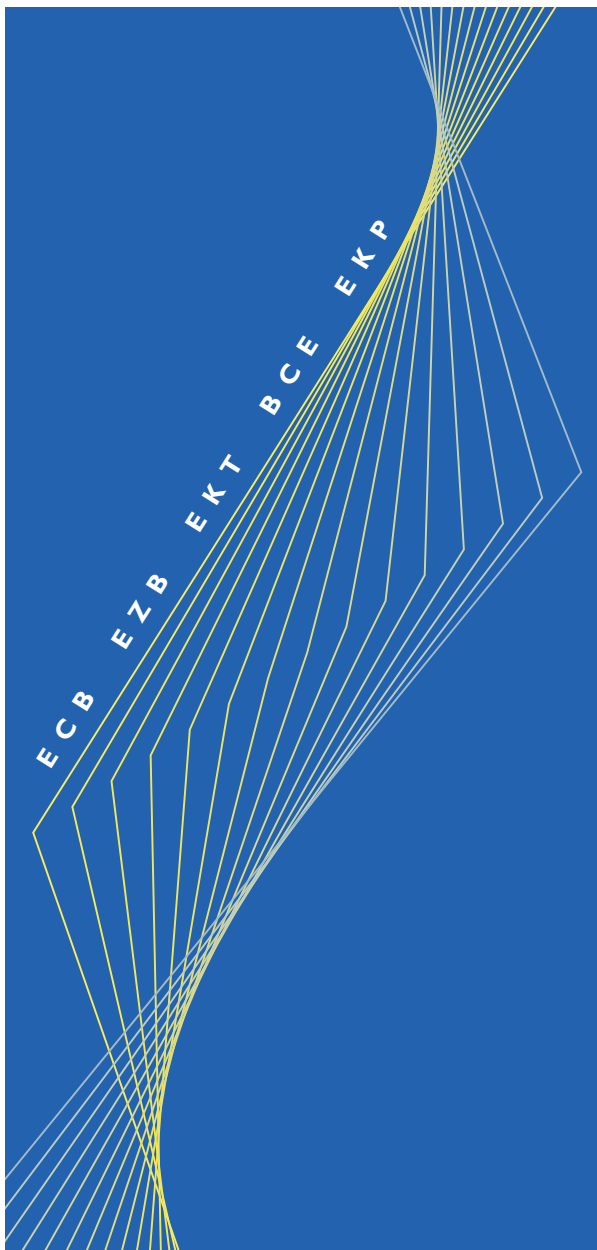




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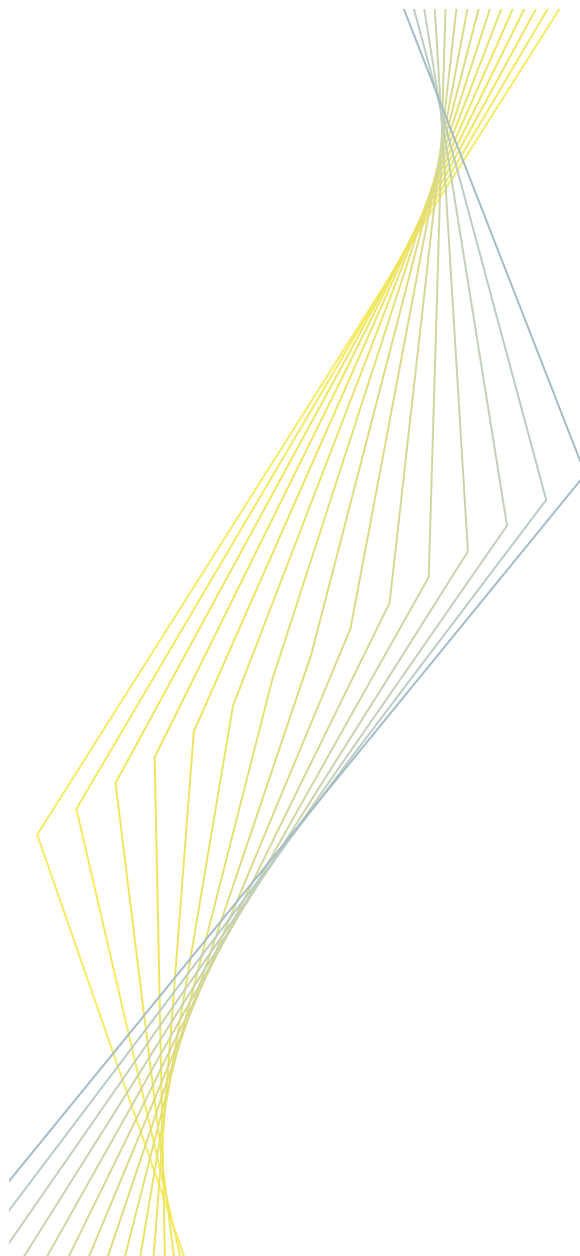


TOWARDS A SINGLE EURO PAYMENTS AREA – PROGRESS REPORT

June 2003



EUROPEAN CENTRAL BANK



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List of abbreviations

ACH	automated clearing house
ATM	automated teller machine
BBAN	Basic Bank Account Number
BIC	Bank Identifier Code
COGEPS	Contact Group on Euro Payments Strategy
EBA	Euro Banking Association
ECB	European Central Bank
ECBS	European Committee for Banking Standards
EPC	European Payments Council
EMU	Economic and Monetary Union
EMV	Europay International, MasterCard International, Visa International
ESCB	European System of Central Banks
IBAN	International Bank Account Number
IPI	International Payment Instruction
MT 103+	SWIFT message format 103+
NCB	national central bank
PE-ACH	pan-European automated clearing house
PIN	personal identification number
SEPA	Single Euro Payments Area
STP	straight-through processing
TARGET	Trans-European Automated Real-time Gross settlement Express Transfer system

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- “Improving cross-border retail payment services in the euro area – the Eurosystem’s view”, ECB, September 1999
- “Role of the Eurosystem in the field of payment systems oversight”, ECB, June 2000
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Towards a Single Euro Payments Area

Executive summary

The ECB has in the past published several reports that highlighted the significantly lower level of service for cross-border retail payments in the euro area than for national retail payments and formulated objectives and suggestions as to how this situation might be remedied¹. In this report, it assesses banks' endeavours and explains the Eurosystem's policy stance in this matter.

Until 2001, banks had largely failed to make substantial progress in the provision of cross-border retail euro payment services to end-customers. In December of that year, however, the environment banks operate in changed drastically when the European Parliament and the EU Council adopted the Regulation on cross-border payments in euro.² The Regulation obliges banks to charge equal prices for national and cross-border euro retail payments. In this new environment, the Eurosystem – which has acted as a catalyst for change since its inception – wishes to continue helping banks to bring their operating costs for cross-border payments into line with the fees they are permitted to charge according to the Regulation. The continuation of this policy, however, depends on the banks' ability and willingness to deliver tangible results.

Banks have recently stepped up their efforts to create an efficient Single Euro Payments Area (SEPA) and adopted a general strategy to achieve this by 2010. They have also agreed on a governance structure, with the European Payments Council (EPC) as their central decision-making body and several working groups providing the EPC with input on strategic issues. The Eurosystem invites the banking industry to integrate banks from acceding countries into the SEPA process so that the business needs of these banking communities can sufficiently be taken into account and so that these countries are in a position to consider requirements of the SEPA when redesigning their payment systems.

The Eurosystem very much welcomes the decisions taken and general commitments made by the EPC. The entire banking community must now properly implement these decisions. The role of national and sectoral banking associations could be considered in this context. They could foster the implementation of the EPC's decisions in the same way that they promote adherence to established national practices. The Eurosystem will closely monitor the implementation of the EPC's decisions.

In addition, the Eurosystem expects the banking industry to publicly state all intermediary steps and major milestones in its SEPA strategy more precisely than in the past. In particular, it encourages the EPC to ensure the widespread implementation of bank-to-bank and bank-to-customer straight-through processing (STP) standards. The Eurosystem has repeatedly called for the swift implementation of STP standards but some banks have not followed this request. Shortcomings seem to exist with respect to the implementation of the International Payment Instruction (IPI) and more particularly to the development of the electronic Payment Initiator (ePI). This standard has an important bearing on the fully automated end-to-end processing of cross-border retail payments and banks should attach sufficient importance to it.

The Eurosystem welcomes the fact that the banking industry has reached a decision on its preferred infrastructure for intra-EU payments in euro (a pan-European automated clearing house (PE-ACH)) and that a provider is already operational. Compared with the previous situation, this infrastructure puts banks in a better position to efficiently transfer payments throughout the euro area

¹ "Improving cross-border retail payment services in the euro area – the Eurosystem's view", September 1999; "Improving cross-border retail payment services – progress report", September 2000; "Towards an integrated infrastructure for credit transfers in euro", November 2001.

² Regulation (EC) No 2560/2001 of the European Parliament and of the Council of 19 December 2001.

and thus reduce their interbank costs. The Eurosystem expects all banks to be able to receive payments via the PE-ACH shortly and to increase the volumes they process via the PE-ACH in order for it to reach critical mass soon. In the near future, banks could also grasp the opportunity to increase the efficiency of the PE-ACH by transferring national payments to it. Thus they may induce a consolidation of the currently fragmented euro retail infrastructure, provided that such a move does not lead to a deterioration in the level of service for national payments. In order to fully reap the benefits of STP, banks should also automate their intrabank processes. The link between banks and their customers is a significant source of cost and offers significant savings potential if adequate procedures are implemented.

In promoting the smooth operation of payment systems, the Eurosystem has three policy tools at hand: action as a catalyst for change, conduct of oversight and involvement as an operator and provider of payment services. In its pursuit of a SEPA, the Eurosystem has played a role as a catalyst for change. It plans to continue playing that role by closely co-operating with the EPC and with all other stakeholders, stepping up its analysis of developments to provide enhanced market information and data, offering assistance for security enhancements and monitoring the progress made. The Eurosystem will report on progress in these matters as it appears necessary. Should banks, however, not be able to deliver the promised results within the committed timeframe, the Eurosystem might step up its involvement, using its regulatory tools more actively.

Introduction

Article 105(2) of the Treaty establishing the European Community and Article 3 of the Statute of the European System of Central Banks and of the European Central Bank give the Eurosystem a mandate to promote the smooth operation of payment systems. The promotion of a "Single Euro Payments Area" (SEPA) follows directly from this statutory task. The SEPA should enable individuals and enterprises to transfer the single currency swiftly, cheaply and safely throughout the euro area, thus reaping the full benefits of Economic and Monetary Union (EMU) and of the Single Market in general.

Since the start of the third stage of EMU in 1999, systems such as TARGET, operated by the Eurosystem or EURO 1, operated by the Euro Banking Association (EBA), have made it possible to make large-value cross-border payments in euro as safely and efficiently as national euro payments.

In 2002, the SEPA also became a reality for retail cash payments with the introduction by the Eurosystem of euro banknotes and coins. The last step is to extend the SEPA to cover retail cash-less payments (i.e. payments made using balances on sight accounts at commercial banks). For several years, public authorities (the European Commission, the European Parliament and in particular the Eurosystem) have urged banks to bring their cross-border payment services in euro up to the same level of service available in their national environment. With the aim of helping the banking sector to meet this objective, the Eurosystem, in the pursuit of its mandate, has worked intensively with banks to help them lower the cost of their cross-border payment services.

However, confronted with the difficulties banks have experienced in transforming that work into substantial progress in cross-border retail payment services to end-customers, the European Parliament and the EU Council adopted in December 2001 the "Regulation on cross-border payments in euro" (see Chapter 1.2). The Regulation obliges banks to charge equal fees for national and cross-border payments. Banks are now facing the necessity of actually lowering their costs rapidly to minimise their losses on cross-border services. To address this challenge they agreed last year on a new strategy with regard to SEPA and on a "road map" for its delivery.

Against this background, the ECB has produced this report to describe recent developments in the field of cash-less retail payments (Chapter 1), to assess in that context the banks' endeavours to achieve a SEPA (Chapter 2) and to explain what policies the Eurosystem intends to develop in this environment (Chapter 3).

The Eurosystem being the central banking system of the euro area, this report primarily addresses developments in the euro area. However, the Eurosystem aims to align its policies with those pursued for the further development of the Single Market for payments in the EU. It therefore works closely with the European Commission. Emphasis should be placed on the integration of acceding countries in the SEPA initiative. Since these countries are about to join the EU and are committed to adopting the euro at a later stage, they should participate to the SEPA work and adapt their payment systems accordingly.

I Recent developments in the field of retail payments in the euro area

I.1 Removal of obstacles to lower costs for cross-border payment services

Until 2002 banks were reluctant to create a SEPA

Payment systems and their infrastructures have traditionally been developed for currency areas delineated by national borderlines. As a result, there exist in the euro area very efficient national retail payment systems. The start of the third stage of EMU has brought a dissociation between the currency area – the euro area – and national boundaries. In order to ensure safe and efficient processing of retail payments throughout the entire euro area, payment systems need to be adapted to the new environment.

Until 2002, the European banking industry had been reluctant to take the steps necessary to create an efficient infrastructure for cross-border retail payments. Individual banks did not want to make sizeable investments without being certain that other banks would be willing to make similar investments so that the entire banking community could reap the benefits. Due to network effects, individual investments can only be successful if other banks join in investing in the same infrastructure and provide critical mass so that economies of scale can develop. Thus the benefits for an individual bank increase with the number of participants in such infrastructures. Since the industry remained inactive for years, a catalyst was needed to co-ordinate efforts and to put pressure on banks that blocked improvements or were not prepared to progress in an adequate manner. The most urgent task of this catalyst was to help co-ordinate the efforts of the industry to set up a pan-European retail payment infrastructure and to establish an appropriate governance structure for the banking industry. Both a pan-European infrastructure and effective governance are needed to realise the SEPA.

The Eurosystem's catalyst role

The Eurosystem addressed this issue immediately after its inception. The level of service for cross-border retail payments differed significantly from that available for national payments. The European general public clearly expected payments throughout the euro area to be provided at a level of service similarly efficient to that it was used to in the national context. The fees banks applied to cross-border retail payments in euro amounted on average to roughly 100 times those for national payments. Typically, cross-border euro retail payments were executed much more slowly than comparable national payments.

The main reasons for these deficiencies were highlighted in a report published by the ECB in September 1999 entitled "Improving cross-border retail payment services in the euro area – the Eurosystem's view". These reasons were i) different processing chains for national and cross-border payments and the low volumes of the latter ii) lack of use of agreed standards and low level of automation at the interbank and intrabank levels and iii) lack of an adequate interbank infrastructure and a predominant use of correspondent banking arrangements.

The Eurosystem then assisted the banks in removing some of the obstacles at the root of the high costs of cross-border retail credit transfers, identified in the 1999 report. The set of technical standards needed for banks to process such transfers in a STP mode were defined in co-operation with the industry. The Eurosystem sponsored discussions between the banking sector and the statistical authorities that led to a common exemption threshold of €12,500 for balance of payments reporting, together with a harmonised list of economic codes. Banks were also encouraged to agree on an arrangement that allowed them to share customer fees between the sending side and the receiving side. These

achievements were outlined in the progress report published by the ECB in September 2000 and in an article which appeared in the ECB's Monthly Bulletin in February 2001.

In addition, the ECB, at the invitation of the ECOFIN Council (the EU Council in the composition of the economics and finance ministers), issued in November 2001 a report "on a realistic and concrete agenda for the implementation of modern payment systems infrastructures for credit transfers that lead to real lower charges". In this report, entitled "Towards an integrated infrastructure for credit transfers in euro", the Eurosystem provided an additional contribution with regard to three major sources of costs that still needed to be addressed by banks in order to eliminate "the payment borders" which still exist within the euro area for credit transfers: internal costs within banks, the insufficient use of Eurosystem standards, and the lack of an appropriate infrastructure. It outlined a "road map" to which the banking sector should commit in order to achieve substantial improvements in the provision of cross-border retail payment services by the end of 2004. In particular, the Eurosystem requested banks to set up a governance body in charge of creating and implementing new standards and to decide on a new payments infrastructure, and invited them to offer a basic cross-border credit transfer service available to all banks to foster price transparency and competition.

1.2 The Regulation on cross-border payments in euro

Background

Although the work undertaken by the Eurosystem together with banks should have allowed a significant reduction of prices charged for cross-border payment services, during the summer of 2001 two price studies sponsored by the European Commission revealed that no substantial improvement had been made. According to these studies, average charges for a €100 cross-border

credit transfer ranged between €17 and €24, a level that was clearly unsatisfactory.

The European Commission and the European Parliament felt that this lack of progress with respect to cross-border retail charges necessitated a drastic political solution. As a consequence, the European Commission proposed a "Regulation on cross-border payments in euro". On the basis of this proposal, the Regulation (EC) No 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro was adopted.

Content of the Regulation

The Regulation requires that, with effect from 1 July 2002, charges levied for cross-border electronic payment transactions (i.e. card payments and withdrawals from ATMs) in euro up to €12,500 be the same as for national payments. With effect of 1 July 2003, the same regime also applies for cross-border credit transfers in euro (up to the same amount). With effect from 1 January 2006, the threshold of €12,500 will be raised to €50,000. Institutions must make transparent to their customers the charges that will apply. In addition, in order to facilitate the processing of cross-border transfers, credit institutions should indicate a customer's International Bank Account Number (IBAN) and the institution's Bank Identifier Code (BIC) on the customer's account statements. Bank customers are obliged to communicate their IBANs and BICs to each other. Should a customer not communicate the beneficiary's BIC and IBAN to the sending bank, the bank would be entitled to charge higher fees. To reduce the reporting requirements for banks, national balance of payments reporting obligations for cross-border payments up to €12,500 had to be removed by 1 July 2002. The Regulation is to be reviewed not later than 1 July 2004, particularly to decide whether it would be advisable to increase the balance of payments reporting threshold to €50,000. Finally, Member States that have not adopted the euro may extend the

application of the Regulation to their currency if they notify the European Commission accordingly.

At the request of the EU Council, the ECB on 26 October 2001 delivered an opinion on the draft Regulation (CON/2001/34) sharing its general objective but also expressing reservations given the Regulation's interference with the price formation mechanism. Upon the contribution of the ECB, cheques were excluded from the Regulation's principle of uniform charges as this payment instrument is difficult to process electronically and thus has an efficiency disadvantage compared with other payment instruments.

Economic consequences of the Regulation

The Regulation has provided a drastic solution to the price discrepancy between national and cross-border retail payments in euro. It has introduced a significant constraint on banks' pricing policies. Efficient payment systems and operating procedures are generally available only at a national level. Banks currently incur significantly higher costs for making cross-border retail credit transfers but will now be prohibited by the Regulation from passing on these higher costs (including a certain profit margin) to their customers. It is also noted that there are structural differences in the pricing policies and price levels for payments in the different countries where the Regulation is applicable. Banks therefore urgently need to reduce their costs for cross-border retail payments to achieve an economically viable rate of return in that line of business. Indeed, the expected substantial lowering of bank fees for cross-border payment services will be sustainable in the long run only if bank costs also decrease substantially.

As a result of the Regulation, banks, particularly in countries with highly competitive and efficient national systems with low profit margins, have for the time being the option of either incurring

temporary losses until cross-border and national payments can be processed at a similar level of efficiency or seeking compensation through an increase in fees. There is anecdotal evidence that when the Regulation came into effect for card payments as of 1 July 2002, some banks increased their prices for these (or other) services in order to cover deficits incurred by their cross-border transactions with local payment services. In individual cases, such increases have amounted to more than 50%.

Impact on Eurosystem policy

The adoption of the Regulation also had an impact on the Eurosystem's policy towards the SEPA. The Eurosystem's first step was to help banks find ways to reduce their charges and improve their service levels. The capacity of banks to adapt to this new environment is of considerable interest to the Eurosystem. In the event of a large-scale failure to adapt, there is a risk of undesirable side effects (for example, increases in national fees or a withdrawal of cross-border transfers from the range of services offered) that would jeopardise the establishment of an efficient and safe single payments area for cash-less retail payments. The Eurosystem therefore has a strong interest in helping banks reduce their cost base, as this will put them in a position to maintain and improve the quality of their payment systems services. In addition, customers will ultimately also benefit from these reduced costs, as a competitive environment will encourage banks to reduce fees for payment system services and thus pass on their cost savings to their customers.

The Eurosystem takes the view that the banks' SEPA initiative should not only aim to make cross-border retail payments more efficient than they are today. Its goal should also be to make processing such payments more efficient than processing national payments today, so that national payments could be made more efficient by integrating them into a pan-European infrastructure.

1.3 The banking sector's strategy to create a Single Euro Payments Area

Strategy of the European Payments Council and governance

The European banking industry agreed in May 2002 on a strategy for achieving a true Single Euro Payments Area with no differences in services for national and cross-border payments. In a White Paper³ entitled "Euroland, Our Single Payment Area", the European banking industry has clearly committed itself to achieving this aim. It has agreed to create an efficient retail payments infrastructure and established a "road map" with general milestones to be reached.

In summer 2002, the European banking industry also agreed on a governance structure and on the key areas on which it intended to focus to achieve the SEPA. The main co-ordination and decision-making body of the European banking industry in payments matters is the European Payments Council (EPC). It is composed of a General Assembly with 52 delegates representing all types of European banks (major as well as smaller market participants). The three European credit sector associations⁴ and the EBA are associated to the EPC and also administer its secretariat and its working groups. The EPC Assembly decides on policy issues developed by five working groups. The Eurosystem has been invited to attend the meetings of the EPC and most of its working groups as an observer in order to provide its own perspective on the banks' strategy at an early stage. The Co-ordination Group supports the process and consists of 15 representatives, selected by the EPC. It synchronises the work of the EPC and its working groups and acts as an interlocutor with the Eurosystem and other public authorities. The EPC created the following working groups to address the issues it feels are most pressing for the achievement of the SEPA project:

- **The Business and Customer Requirements Working Group** is to

regularly monitor and manage the evolution of payment instruments along their lifecycles.

The EPC feels that the framework for different payment instruments has to be made compliant with customer requirements in a pan-European context. In November 2002 it adopted the concept of a basic pan-European credit transfer scheme, called Credeuro. The Credeuro convention establishes a standard for the execution of a "basic" pan-European credit transfer, requiring from bank customers a minimum set of information and guaranteeing a maximum execution time of three days (from the day when the order is accepted to the day when the beneficiary's account is credited). In February 2003, the EPC adopted an Interbank Convention on Payments that ensures that the instructed amount of a transfer is credited to the beneficiary customer in full. Furthermore, the EPC will define requirements for a pan-European direct debit scheme by end 2003, for implementation by July 2005. The use of cheques, especially cross-border cheques, is to be considerably reduced, and incentives are to be created to motivate customers to use other instruments.

- **The Infrastructure Working Group** is to foster the development of and convergence towards the preferred infrastructure model (i.e. a PE-ACH). The EPC favours a STP-capable PE-ACH infrastructure with fair and open access, owned and used by banks, to be available for credit transfers by mid-2003 and for direct debits by mid 2005. The PE-ACH is defined as "a business platform for the provision of euro retail payment instruments and basic related services, made up of governance rules and payments practices and supported by the necessary technical platform(s)". Central banks and ACHs might become facilitators providing

³ See www.europeanpaymentscouncil.org.

⁴ The European Banking Federation, the European Savings Banks Group and the European Association of Co-operative Banks.

technical access to banks, and central banks might also participate as users. According to the calculations of the EPC, in order to ensure the economic viability of a PE-ACH, a first critical mass of roughly 50% of the current cross-border credit transfer volume needs to be processed via the pan-European infrastructure. It is intended that this number of transactions be reached by mid-2004 by channelling transactions that are currently processed via correspondent banking relationships into the PE-ACH. However, the real critical mass will only be obtained when national retail payments from countries without ACH infrastructure are also processed in the PE-ACH. It is planned that by 2007 service levels will have improved in such a way as to ensure same-day settlement.

In some countries the banking industry has started discussing how to achieve the migration of national retail transactions to the PE-ACH – it is unlikely to take place via a “big bang”. On the contrary, the migration of national business will probably be progressive, perhaps through the “concentric model”⁵ which would enable STP to be gradually extended throughout the EU.

The EPC plenary of 28 January 2003 endorsed EBA STEP 2 as the first service provider of a PE-ACH and as the provider most likely to be able to process Regulation-compliant credit transfers by July 2003. STEP 2 became operational on 28 April 2003, and indicated that it would be able to support the concentric model. The EPC plenary of 4 June 2003 adopted a resolution requiring that every financial institution in the EU be reachable via STEP 2 by end-2003, and via any other potential PE-ACH in the future.

- It is the task of **the end-to-end STP Working Group** to promote end-to-end STP for each SEPA instrument. The EPC concluded that an STP standards and governance body should be agreed. A common set of pan-European standards, rules, conventions and legal requirements for basic payment instructions should allow

banks to achieve, across Europe, levels of service and automation at least equal to the best national performance today. A timetable for the implementation of such standards and rules is to be defined by the end of 2003. An additional set of standards, rules and conventions enabling the provision of value-added or local usage services offering STP is to be approved and a timetable for implementation defined by 31 December 2004. The EPC plenary of 4 June 2003 adopted a resolution calling for fully EU-harmonised requirements for the fight against money laundering in the area of payments, as different national rules would hinder STP.

- **The Cash Working Group** focuses on short-term objectives to improve the efficiency of cash handling in the euro area. In addition, the EPC intends to develop a strategy in order to significantly reduce the use of cash in the long term. Banks will formulate their national strategies in 2003 and implement them by 2007. The working group intends to prepare recommendations addressing legislative, regulatory or technological developments regarding the handling of cash to maintain banks' profitability in that business. It is the task of this working group to explore a new pan-European approach to cash handling policy and infrastructure, to establish a harmonised framework for cash services and to enhance the process efficiency for cash provision. The EPC has indicated timeframes for certain deliverables. For example, as of 2003 customers should be informed about the benefits of electronic payments and encouraged to increasingly use such means. By the end of 2003 banks are to have developed best practices for cash processing that are to be deployed in 2004.
- **The Cards Working Group** focuses its work on the payment products that

⁵ The concentric model would allow specific user groups to process payments above €12,500, for example, or use the Basic Bank Account Number (BBAN) instead of the IBAN during a transition phase without compromising the long-term objective of moving to pan-European standards.

currently represent the vast majority of transactions and need to be addressed with priority.

There are at present various price and interchange structure differences between national and cross-border card transactions at customer and merchant level as well as between credit and debit cards. In addition, most cross-border euro transactions are subject to conditions defined by global card schemes. Furthermore, fraud is a major concern for consumers, merchants and providers. In order to address these problems and combat fraud, banks intend to create an ultimate business model (e.g. convergence of debit/credit cards, generalised use of PIN numbers with debit cards, increased standardisation of debit cards, removal of magnetic stripes) as well as appropriate card infrastructures. They also intend to explore different options for network switching fees, for pan-European interchange structures for issuing and acquiring banks and a strategy vis-à-vis the

(national and international) card networks to enable the banks to regain/maintain significant control over cards issued. These investigations should lay the foundation for a concerted course of action over the next five to ten years. Innovative solutions will be monitored and debated in a second phase, also in relation to other non-card-based payment instruments. Issues arising from the use of card infrastructures for e-payments and m-payments will also be considered.

The EPC plenary of 4 June 2003 endorsed eight recommendations related to anti-fraud activities, consistent tariff schemes across the SEPA, the amendment of rules and conventions, the removal of regulatory obstacles, the improvement of technical standardisation by means of co-operation, the application of the SEPA vision by the banks as shareholders in card schemes and the improvement of data collection and distribution. It was agreed that the eight recommendations should be implemented at the latest by 1 January 2006.

2 Assessment of banks' endeavours towards the creation of the SEPA

The Eurosystem has already published its expectations for the issues the banking sector needs to address in order to achieve a SEPA (see section 1.1). The banking industry, for its part, has recently stepped up its endeavours to create a SEPA by adopting a collective strategy to implement its vision for organising payments. **The EPC White Paper of May 2002 was a first and encouraging step on the part of the banking community towards meeting the Eurosystem's objectives.** It underlines the banks' commitment to bringing about a SEPA and outlines their general strategy for achieving this goal by 2010. This general strategy does, however, need to be specified more clearly. In many cases, the EPC has articulated political intentions, **but concrete**

deadlines and milestones are still missing. The EPC needs to transform its objectives into a fully-fledged project with a sound plan and fixed deliverables. A convincing arrangement for the enforcement of EPC decisions needs to be developed and communicated to all banks and the general public.

The issues that need to be addressed in detail fall into two broad categories: (i) cost-efficiency of end-to-end customer and interbank processes and (ii) effectiveness of the market set-up. The following section of the report examines whether the banks' endeavours match the Eurosystem's expectations.

2.1 Cost-efficiency of interbank and end-to-end customer processes

The importance of efficient STP processes

In its 1999 report, the Eurosystem highlighted the importance of appropriate infrastructures and operating procedures for the efficient processing of cross-border credit transfers. In its analysis of the causes of high costs, the Eurosystem specifically referred to the need to consider the whole processing chain end-to-end. In fact, the interbank leg of a cross-border credit transfer might only reflect 5-10% of its total cost, the major part stemming from the intrabank and client-bank relationship side.

Since 1999, some banks have improved their intrabank processes so as to be able to provide their customers with full STP for both incoming and outgoing payments. They have also automated the link to their customers and achieved a highly significant proportion of STP payments in a relatively short period of time⁶. In individual cases, the share of STP payments has increased to 50% of all cross-border euro payments within half a year. The remarkable increase can easily be explained by the mutual benefit that bank and customer enjoyed from STP processing. The banks incurred significantly lower costs with STP and passed the cost advantages on to their customers in the form of considerably lower charges. Unfortunately, there is some evidence that intrabank and bank-to-customer STP procedures may not be the norm in many institutions.

An important prerequisite for efficient interbank infrastructures are standardised message formats and bank and customer identification codes that allow fully automated STP of all payments. Therefore the Eurosystem has repeatedly urged the banking industry in earlier reports to implement STP standards for credit transfers (e.g. MT 103+, IPI, BIC, and IBAN)⁷. The focus in that respect has been on the BIC and IBAN, and the provision of these two standards to the customer has become mandatory with the

Regulation⁸. In its progress report of September 2000 the Eurosystem invited the banking sector to promote the use of the IPI and to develop the ePI.

The Eurosystem is disappointed with the progress on STP standard adoption and it is particularly in this area that deficiencies in EPC governance will need to be addressed urgently. The Eurosystem had asked banks to implement these standards by 2001, but although they have been readily available, the banks seem not to have implemented them yet on a widespread scale. A number of banks have implemented at least some of the STP standards but others have still been reluctant to do so. In particular, the EPC and the banking associations in the relevant countries have not yet taken sufficient initiatives to promote the use of the IPI. The Eurosystem therefore again emphasises that this standard form, which is already available, should be implemented as soon as possible. In addition, **banks are strongly encouraged to finalise the ePI** so that all relevant information can be captured by the beneficiary in an electronic data container which can be used by the ordering customer to transmit all relevant data to the ordering bank electronically.

Since STP standards in a payment system only unfold their benefits once they are being used by a critical mass of participating parties, **widespread implementation of STP standards is indispensable** for an efficient, fully automated processing of cross-border payments. The Eurosystem regrets the insufficient implementation of (customer-to-bank and bank-to-bank) STP standards. This dissatisfaction is shared by the banks that have begun to use the standards but can still not reap the benefits of full STP processing of cross-border credit transfers since many beneficiary banks are unable to process them.

⁶ In that respect, it is noted that corporate clients increasingly use automatic links whereas occasional consumers still often use paper-based solutions.

⁷ See list of abbreviations at the beginning of this report.

⁸ The Regulation does not make the use of BIC and IBAN mandatory in payment systems.

Therefore, the EPC is invited to confirm to the public that:

- all banks have now acquired a BIC;
- IBANs have now been distributed to all customers;
- the entire banking industry complies with the Regulation on cross-border payments in euro;
- banks have implemented the paper version of the IPI and are stepping up their efforts to develop and implement the ePI.

If the above-mentioned measures have not been fully implemented yet, the **EPC should clearly commit to a strict and very short timeframe** to achieve this. Once the EPC has defined its strategy on technical standards it needs to ensure that banks implement the standards developed and agreed, with the required quorum, by the European Committee for Banking Standards and SWIFT. National banking associations need to support and monitor the implementation of the standards. The EPC should report on a quarterly basis on the active and passive **implementation of the IBAN, BIC, MT 103+ and IPI**. It should also provide an estimate of the percentage of the total payment volume processed in STP mode.

The Eurosystem also expects banks to formulate a precise, long-term strategy for removing differences between national and euro area/international standards at the customer-to-bank and bank-to-bank levels. In this respect, the Eurosystem observes that the relationship between the EPC and existing standard-setting bodies (such as the European Committee for Banking Standards and SWIFT) seems to need clarification and strong co-operative links.

Of course, the endeavours of the EPC to spread the use of STP standards need to be supported by bank customers. This means that a payee needs to mention its IBAN and its bank's BIC on its invoice in order to

facilitate the use of these standards by the payer initiating the credit transfer. It is the obligation of **banks** to create awareness on this issue among their corporate customers and the respective customer associations. They **should** therefore **properly inform their customers and the customers' associations and stress the importance of widespread dissemination and use of STP standards**.

PE-ACH – the banks' preferred infrastructure

The Eurosystem extensively discussed the interbank infrastructure aspect of cross-border retail payments in its report to the ECOFIN Council and suggested a road map to the banking industry outlining measures that should be taken in order to reduce the cost to banks of processing cross-border retail payments in euro. It seems that, in general, banks have integrated the Eurosystem's suggestions into their strategy. They have voiced their preference for the concept of a PE-ACH as the future infrastructure for settling cross-border retail payments. The banking industry has indicated that the EBA STEP 2 system complies with its preferred concept, and the system started "ramp-up" operations in April 2003. The international credit card companies have also started developing retail transfer schemes for person-to-person and person-to-business payments with a particular focus on cross-border transfers. Visa has launched pilot operations of its new service "Visa Direct" and MasterCard is developing a similar service.

The Eurosystem welcomes the fact that the banking industry has reached a decision on its preferred infrastructure concept as well as on its first service provider. It encourages the EPC to consider all possible contributions from the industry (e.g. from the card sector) in order to select the most efficient PE-ACH solution(s). The Eurosystem reiterates that appropriate infrastructures can significantly contribute to the improvement of cross-

border retail payment services in the euro area. Generally, payment infrastructures benefit from scale economies. Hence, a need for wide acceptance, open access and open governance should be taken into account in the design of new infrastructures so as to enable them to benefit from positive network externalities. The chosen infrastructure must have sufficient capacity to process a quickly increasing number of payments. The banking sector should accept its **responsibility to process cross-border transactions more efficiently** and should **process such transactions via the PE-ACH as soon as possible. National payment traffic should also be transferred to the PE-ACH over time if the PE-ACH offers more efficient solutions than national procedures. In addition, the EPC should ensure that, by the end of 2003, all EU banks are reachable via the PE-ACH.** By the end of 2004 all acceding countries banks should be reachable. For transparency reasons, i.e. to document whether banks are fulfilling their commitment to process 50% of cross-border credit transfers via the PE-ACH by mid-2004, the EPC should report the penetration rates of the PE-ACH on a quarterly basis.

The national central banks (NCBs) of Germany, Italy and Austria have declared their intention to participate in EBA STEP 2, the PE-ACH solution that is currently preferred by the EPC. They intend to settle cross-border credit transfers via EBA STEP 2 and thus offer efficient cross-border services to their customers and respective national banking communities.

Migration of national transactions to the PE-ACH

Once national ACHs come close to the end of their investment cycle, banks could consider not investing in a redesign of their national ACH but instead aiming to **process national payments via the PE-ACH. In this way they could work towards consolidating the euro payment systems**

infrastructure and eliminating the currently fragmented national payment systems. However, the banking sector should ensure that current levels of service for national payments are, at a minimum, not reduced. It would therefore be useful if the **EPC** were to appropriately and publicly **confirm its commitment in respect of the chosen infrastructure and the ultimate goal (e.g. convergence into one or a limited number of infrastructures working at the euro area-wide level and based on the same set of bank-to-bank standards).** The chosen PE-ACH infrastructures should not process only one payment instrument but be able to support different payment instruments.

2.2 Effective market set-up

Effective governance

For the retail payments market to function properly, there must be sufficient co-operation among banks (e.g. to agree on interbank and customer-to-bank standards, infrastructures and a governance structure that can make commitments on behalf of the entire European banking industry). This creates network effects but still allows competition between banks with respect to relations with customers. The Eurosystem highlighted this need in its report to the ECOFIN Council.

The Eurosystem welcomes the fact that European banks have responded to its call for interbank co-operation by creating the EPC and its working groups. This is an encouraging step in the direction of sound and effective governance for the European banking industry. **The success of the EPC and its sub-structures will ultimately, however, be determined by the results it has committed to deliver.** In this respect, the Eurosystem encourages the EPC to ensure a high level of efficiency in the proceedings of its working groups by giving them clear mandates and thus avoiding frictional losses. A re-evaluation of the

mandates and a redistribution of tasks may at times increase the effectiveness of the EPC's work. The EPC currently reports regularly to the Eurosystem on short and medium-term deliverables and the progress of its working groups mainly through the Contact Group for Euro Payments Strategy⁹ (COGEPS). To further increase the transparency of its SEPA process, **the EPC should monitor, in particular, the short and medium-term timetables of its working groups and keep the Eurosystem informed, thus enabling close track to be kept of milestones.** The Eurosystem also encourages the **EPC to clarify its decision-making processes and the ways in which decisions will be implemented and adhered to.** It would be highly desirable to obtain clarity on these aspects very soon. **It is indispensable that decisions made by the EPC are properly implemented by all euro area banks.** The EPC needs to consider a formal and structured model for a harmonised implementation, including enforcement, that will take place in all national banking communities in parallel. In this respect it should be considered how national banking communities/associations could foster adherence to EPC decisions in a way similar to what has been the national practice.

Establishing best business practices

The EPC will also have to ensure that banks define best business practices for the processing of (cross-border) retail payments. The EPC has integrated the definition of best practices into its SEPA strategy and banks have made significant progress in some areas, but in others action urgently needs to be taken.

The different surveys carried out by the European Commission have shown that processing times for small-value cross-border credit transfers in euro have declined over time and have come closer to national execution times. The 2001 survey showed that the average execution time for cross-

border credit transfers was slightly less than three working days. This is largely in line with the objective the Eurosystem had defined in 1999. Banks are nevertheless encouraged to improve further on execution times so that any differences compared with national transfers vanish in the near future. Such improvements could also render an intended change of the 1997 Directive on cross-border credit transfers unnecessary. The European Commission plans to reduce the maximum execution times for cross-border credit transfers from six to three days, but in fact on average the banking community achieves this improved service already. The Eurosystem feels that legislative action might not be needed here, as it would be most effective if banks were to agree among themselves to make three business days the maximum permissible execution time. Legislative action in this respect might even paralyse the market's endeavours to improve on execution times even further. If the European Commission were to propose legislative measures nonetheless, it should take account of the integration into a SEPA. It should therefore define a maximum execution time not only for cross-border transactions but for all intra-EU payments.

Credeuro

A measure towards further improvements in execution times is the creation and promotion of a generic cross-border credit transfer product or service that should be provided by all banks. The Eurosystem has been asking for such a standard service for some time, and banks have finally taken up this suggestion and created the "Credeuro". The Credeuro is a convention for Regulation-compliant credit transfers that are processed via the PE-ACH. It establishes a standard for the execution of a "basic" pan-European bank-to-bank credit transfer which guarantees to a bank customer certain information and a maximum execution time of three days. Some

⁹ A group co-chaired by the Chairman of the Eurosystem's Payments and Settlement Systems Committee and the Chairman of the EPC.

banks have already implemented the Credeuro, and the EPC adopted it as of November 2002. It mandated the STP working group to prepare an implementation guideline and communication plan, which were made available to the public in April 2003. In order to increase transparency on Credeuro, the EPC should publish a quarterly list of banks in each country that have adopted it. In addition, the EPC should provide figures to the Eurosystem on Credeuro-compliant credit transfers processed by banks adhering to the Credeuro convention as a percentage of total payment volumes and values.

Interbank charging principles

Another important business practice that urgently needed to be determined was the distribution of charges for cross-border credit transfers amongst the parties involved. The 1997 Directive of the European Parliament and of the Council on cross-border credit transfers requests that the full amount of a cross-border credit transfer be credited to the recipient unless specified otherwise, thus requiring the bank of the originator to apply all charges to its customer. This charging option, called OUR, was considered to be the most transparent since the originator would be aware of the full cost. The Regulation on cross-border payments in euro requires charges to be the same for national and cross-border transactions, rendering the OUR option impracticable since many countries on a national level share the cost between the bank of the originator and the bank of the recipient (SHARE option). Therefore, banks have a strong preference for applying the SHARE option to cross-border transactions. In principle, banks could also agree that all charges should apply to the beneficiary bank (BEN option).

The Eurosystem takes the view that the respective parties should find the solution most suitable for them as long as the principle of transparency, which has always been the guiding objective, is fully respected. Banks

should agree on the most efficient common charging practice across the entire euro area that is legally permissible. Intermediary banks should not be allowed to deduct fees. For all transfers it must be ensured that the principal amount is always transferred in full. This is a basic expectation of customers using payment services. Otherwise they would find it difficult to fully satisfy their payment obligations. The **Eurosystem welcomes the fact** that these principles have been taken into account in the **Interbank Convention on Payments**, adopted by the EPC in April 2003, which makes SHARE the default option for basic euro credit transfers covered by the Regulation. This practice will, for STP payments, also put an end to the “beneficiary deduct” principle, whereby in the past intermediary banks deducted their own charges from the principal amount.

Observatory for bank charges

Irrespective of banks' chosen charging regime, the **Eurosystem reiterates the need for consumer organisations to establish an observatory to monitor banks' payment charges and charging principles**. It had proposed an observatory in its report to the ECOFIN Council but this has not been pursued so far. An observatory is important **to enhance transparency** and thus improve competition among banks. Although the Regulation on cross-border payments in euro requires equal prices for national and cross-border payments in euro, the need for an observatory remains. As various price studies by the European Commission have shown, bank charges and the principles used differ significantly between individual banks as well as between different countries. Such an observatory would greatly facilitate the comparison of bank services for customers. Consumer organisations are likely to be best suited to establish and manage such observatories. At a national level, they could compile relevant data that could be fed into a euro area wide database managed by a central consumer organisation following an agreed methodology.

Fair and open access

Another important Eurosystem objective, already voiced in the 1999 report, is fair and open access to cross-border retail payment systems. Most of the cross-border arrangements currently operating are tailored and accessible to members belonging to a particular group of banks (e.g. savings banks, co-operative banks). The Eurosystem does, however, expect efficient cross-border payment systems to be accessible to a wide range of institutions, as this is a prerequisite for competitive prices for end-users. The EBA STEP 2 system can be considered to be sufficiently open provided that EBA continues to pursue its plans to offer direct access to all potentially interested banks irrespective of their membership in other EBA systems. In addition, direct participants in STEP 2 need to offer their services to second-tier banks at reasonable terms.

Pan-European direct debit scheme

Regarding a pan-European direct debit scheme, the EPC is working intensively on a new scheme to be set up from scratch with no overlaps with existing national schemes. This would mean a single legal framework, a single scheme and a single instrument or set of instruments. In the development of the new scheme, particular emphasis should be placed on analysing the benefits of full automation and electronification of the entire direct debit process. Designing a completely new scheme creates an opportunity to make use of state-of-the art electronic procedures to achieve safety and efficiency. In parallel the European Commission is investigating the need for legal harmonisation in this field to facilitate the process. **The Eurosystem appreciates the EPC's work on direct debits and encourages it to devote significant attention to this payment instrument which may play an important role in future European payment systems.** The EPC is requested to provide the Eurosystem with information on the milestones that are planned for the

launch of the pan-European direct debit scheme and the results achieved in that respect. Existing national direct debit schemes should seriously consider adopting the standards of the new pan-European scheme or transferring the volumes of existing schemes to the new infrastructure.

Replacement of cheques by more efficient and innovative payment instruments and methods

A cheque task force has been set up by the EPC to develop a strategy for reducing and finally eliminating the cross-border use of cheques. The Eurosystem supports the long-term elimination of the cross-border use of cheques. Since there is no efficient infrastructure in place to process cheques at a cross-border level, this payment instrument is more costly to process than others. The Eurosystem **encourages the banking sector to set incentives for the use of efficient and innovative payment instruments.**

The banking industry has long been disinclined to pursue a launch of e-payment and m-payment initiatives as a priority for the near future. Many of these initiatives failed in the past and banks are reluctant to devote additional resources to such projects. The EPC established only recently a task force to investigate relevant issues in depth. The Eurosystem is of the opinion that **the banking community should pay close attention to innovative payment instruments and methods based on pan-European standards** (e.g. secure use of card payments over the internet, e-payments and m-payments). These payments offer significant efficiency potential which should be exploited. An important reason why customers have been reluctant to use e-payments and m-payment methods in the past was a perceived lack of security. Banks therefore must provide adequate security features and properly inform their customers of the benefits of such instruments and the level of security that can be assured.

Information campaign

Finally, it is extremely important that banks properly inform their customers and customer associations about the standards, procedures and requirements for processing of cross-border retail payments. In this respect, a **large-scale promotion campaign**, which the Eurosystem already asked for in 1999, is urgently **needed** to educate bank customers and customer organisations in such a way that they can

make the most efficient choices when instructing their banks to process cross-border retail payments. The EPC clearly realises the importance of this measure, but it is emphasised that an information campaign involving the entire banking community is needed to achieve the desired results. Individual measures seem no more than a second-best solution for this purpose. In this respect, it is noted that the EPC has started a dialogue with several European customer organisations.

3 Eurosystem policies to support the payment industry's work on the Single Euro Payments Area

3.1 Overview of the Eurosystem's policy framework and tools

The task of the Eurosystem, as defined in the Treaty and in the Statute of the ESCB, is to promote the smooth, i.e. safe and efficient, operation of payment systems. This basic task is broadly defined: notably, it encompasses not only large-value payment systems but also retail systems and instruments. To fulfil this task, the Eurosystem has several tools at hand: it can act as a catalyst for change, as an overseer and as a regulator, and it can also offer facilities as an operator of payment systems. These modes of intervention and possible motivations to engage in them are also described in the G10 report on policy issues for central banks in retail payments.¹⁰

In a phase when payment markets are in a process of development, and new initiatives, instruments and infrastructures are emerging, the Eurosystem prefers to let the market forces work and restrict its involvement to facilitating market developments and setting the framework of principles for efficiency and safety. Market participants are usually best placed to determine on their own what is the most efficient and most practical solution to serve the needs of customers and the economy. Following this policy, the Eurosystem has helped to trigger and speed up the development of a SEPA for cross-border retail payments by acting as a catalyst

for market evolution. It has raised awareness in the banking industry of the need to eliminate efficiency differences between national and cross-border payments and to create a SEPA. It has urged banks to reduce charges and to improve the level of service for cross-border euro retail payments.

The Eurosystem also performs the role of an overseer of payment systems. In this function, it ensures that established systems and systems that are in a design phase which fall under its oversight competence operate safely and efficiently. In addition, it tries to influence markets which have not been able to develop on their own, by using appropriate oversight tools to ensure they achieve the necessary and desired results. For established systems, the Eurosystem collects and analyses appropriate information to assess compliance with its oversight standards. Regulatory measures will be taken if appropriate and necessary to ensure the smooth operation of payment systems. This will be the case if the market fails to deliver basic services in an efficient and safe manner and in particular if:

- acting as a catalyst has not produced appropriate market outcomes,
- moral suasion does not achieve the desired results, or

¹⁰ "Policy issues for central banks in retail payments", Bank for International Settlements, March 2003.

- a harmonised set of standards are necessary to ensure that efficient and safe payment services are provided in the euro area on a level playing field.

A third option to ensure the smooth functioning of payment systems is for the Eurosystem to take a direct operational involvement in such systems. In the field of retail payments it may do so, thus complementing its involvement as a catalyst or overseer.

3.2 Actions to be taken under the Eurosystem's catalyst role

As indicated earlier, the Eurosystem, in general, prefers market solutions for the provision of services. If the market fails to provide adequate solutions, the Eurosystem has to intervene in an appropriate manner. With respect to the establishment of the SEPA, it has therefore acted as a catalyst for change, co-operating intensively with the banking industry and contributing to the remedying of several deficiencies. In order that the Eurosystem can continue with this preferred function, it is indispensable that banks commit to delivering measurable results.

Monitoring of progress of and co-operation with the banking industry and the EPC in particular

Besides monitoring general trends in retail markets, the Eurosystem will scrutinise closely the activities of the European banking sector. In this regard, the dialogue with the EPC and its working groups is of particular importance.

The European banking community has acknowledged the responsibility of the Eurosystem for retail payment system issues and the benefit of developing policies in a co-operative way with mutual understanding of the respective positions. It has therefore invited the Eurosystem to participate in the

meetings of the EPC and most of its working groups as an observer. The first experience of the Eurosystem's participation in these fora is positive. Discussions at EPC level have been productive and co-operative. Participants focus on the common goal, although they may see different limitations with regard to one aspect or another. Most EPC working groups have shown a similarly constructive spirit.

The **Eurosystem clearly supports the banking sector's endeavours with regard to the SEPA project**, as outlined in the May 2002 White Paper of the EPC. **The EPC will have to specify the targeted milestones and prove the credibility of its approach by providing measurable results**, in line with the strategy outlined. It is thus indispensable that it reports regularly and extensively to the Eurosystem. The Eurosystem observers in the EPC and its working groups will accompany the work of the respective groups with constructive criticism, where needed. They will **stand ready to assist wherever Eurosystem support and advice is useful and feasible**, but they will also point out deviations from the envisaged timeline and highlight any shortcomings.

Should banks compromise on the promised deadlines, the Eurosystem would have to consider whether regulatory measures should complement its catalyst role. Of particular importance will be the successful launch of the PE-ACH and the Credeuro, the wide-scale implementation of STP standards and, ultimately, accomplishing the SEPA for all payment instruments. **The Eurosystem will pay particular attention to the safety of payment instruments and payment systems, operational risks as well as fraud issues.** In this respect it will continue to emphasise that adequate security measures have to be taken, particularly in relation to market innovations.

In recent discussions, safety and efficiency differentials between different settlement assets have repeatedly been highlighted. In

the SEPA discussion, efficiency problems in the cross-border use of commercial bank money for retail payments have played a prominent role. In addition, the EPC is concerned about potential disadvantages of central bank money, in the form of (physical) cash, compared with other (in particular electronic) payment instruments. It therefore aims to develop ways to reduce the use of cash. The **Eurosystem** takes account of this discussion and will carefully **analyse the use of central bank money in the retail economy**.

Eurosystem offers assistance in developing cross-border services for payment instruments

In continuing its catalyst role, the Eurosystem is prepared to assist the banking industry with, among other things, the creation of a pan-European **direct debit scheme**. The direct debit is one of the fastest growing payment instruments in the euro area and the benefits of this instrument should be made available not only on a national but also a cross-border basis. **The Eurosystem stands ready to offer its legal analysis and technical support** in addressing relevant issues.

The Eurosystem also co-operates with the EPC in its work on other payment instruments, e.g. cards, including innovative payment solutions. It could contribute to the analysis of the clearing and settlement process for card payments and help to monitor the modalities and implementation of security standards such as the EMV standards. Furthermore, the Eurosystem could assist banks in trying to achieve interoperability of payment instruments in the euro area. Thus, **the Eurosystem could play a role in facilitating standardisation of payment instruments and fostering transparency on relevant issues**. The ultimate objective, shared by the banking community and the ECB, is to realise a SEPA for all payment instruments.

Increase of transparency and analysis on retail issues

With a view to deepening its assessment of the latest developments, **the Eurosystem plans to improve the quality and quantity of its retail statistics** on payment systems and payment instruments in order to facilitate a comparison of respective data for national and cross-border payments in different countries. A better quality and quantity of retail statistics will also permit a more in-depth analysis of underlying trends in retail markets. In order to increase the transparency of such developments, the Eurosystem intends to make these statistics available to the public (e.g. in its “Blue Book”) in the course of 2004.

As part of its work to promote the smooth functioning of payment systems, the ECB has decided to continue the operation of the **electronic Payment Systems Observatory (ePSO)** initially run by the European Commission. ePSO is an open, information-sharing infrastructure for electronic payments. Its website (www.e-pso.info) contains an electronic discussion forum, an inventory database of e-payment initiatives and documents related to e-payments prepared by European authorities. The ECB will also regularly organise conferences, seminars and workshops to facilitate the exchange of information between the stakeholders.

Co-operation with the European Commission

The Eurosystem has co-operated with the European Commission since the start of the SEPA discussion. Both institutions have tried to induce improvements and the European Commission ultimately initiated the Regulation obliging banks to remove price differentials between national and cross-border retail payments. Due to the increased dynamics in the SEPA discussion, the Eurosystem has also intensified co-operation with the European Commission and will continue to do so. The Eurosystem will

support the European Commission in removing impediments in the legal environment, i.e. offering views and advice on possible legislative issues (e.g. the legal framework for direct debits). Similarly, the Eurosystem, in its area of competence, i.e. its role as catalyst and overseer of payment systems, will seek the views of the European Commission.

The European Commission is currently preparing a public consultation on a “New Legal Framework for Payments in the Internal Market”. The aim is to consider ways to adopt a coherent and modern legal framework for retail payments in the Internal Market by codifying the various legal instruments adopted by the European Parliament, the EU Council and the European Commission in this field into one comprehensive, coherent legal framework. The ECB is of the opinion that this work could be helpful in removing some legal barriers to the SEPA e.g. by addressing the legal obstacles to pan-European direct debits. At the same time the ECB has cautioned the European Commission not to over-regulate but to first allow market alternatives to be fully exploited. Therefore, banks’ progress on the level of service for cross-border retail payments should be a decisive factor for the European Commission when reviewing Directive 97/5/EC of the European Parliament and of the Council on cross-border credit transfers. The Eurosystem has taken the view that market-induced improvements of execution times seem to lead to the desired outcome, i.e. that execution times could fall well below three business days, so that legislative action might not be needed in this respect. In addition it is also recalled that banks’ progress towards a SEPA will also be a determining factor for the European Commission when it reviews the Regulation on cross-border payments in euro, which it is due to do by July 2004.

3.3 The Eurosystem’s oversight and regulatory function

Oversight standards for retail payment systems

In July 2002 the Eurosystem issued for public consultation a set of oversight standards for retail payment systems. Simultaneously with this report, it will publish the final set of standards and explain the changes made. The Eurosystem issued these standards to ensure the smooth operation of retail payment systems that are of prominent importance to the economy, to ensure efficiency and safety in a level playing field among the participants of different systems and ultimately to foster the public confidence in the euro.

Regulatory activity of the Eurosystem with respect to a SEPA driven by banks’ progress

Notwithstanding its preference for solutions found through market forces and its policy to act accordingly as a catalyst for change, the Eurosystem has also to carry out its oversight tasks. Regulatory measures are taken if the safe and efficient operation of payment systems is not achieved by the market on its own. The Eurosystem therefore takes the view that if banks cannot deliver efficient cross-border retail services, and if the Eurosystem acting as a catalyst was not sufficient to induce them to do so, it may need to become more closely involved and finally might apply regulatory measures to achieve tangible results.

As described earlier in this report **banks seem to have significant deficits in the implementation of STP standards** (e.g. BIC, IBAN, MT 103+). There is no disagreement in principle among European banks on the technical standards to be used for STP. But some banks do not seem to be willing to authorise the necessary investments to implement these standards. As the catalyst involvement of the Eurosystem has not induced the entire banking sector to strive for a widespread implementation of STP

standards so far, the **Eurosystem may have to consider whether the adoption of more formal measures might be better suited to achieve its objectives in this field.** At a national level, NCBs will approach their respective banking communities to discuss how STP standards can be spread more widely in the national context.

The Eurosystem attributes major importance to the security of payment instruments, as this is an integral part of its mandate to ensure a smooth operation of payment systems. It has therefore formulated high-level security objectives for e-money systems. After market consultation in March 2002, the objectives were published in May 2003 and detail the Eurosystem's expectations in this field.

3.4 Operational involvement

Some NCBs have a long tradition of providing clearing services for national retail payment systems and all NCBs currently provide settlement services for national retail systems. The operational involvement of NCBs sometimes has historical roots; sometimes it is designed to overcome structural market inefficiencies by granting fair and open direct access to all banks or is a consequence of a market failure to provide safe and efficient services. The operational involvement of NCBs may complement their oversight function. Given this degree of operational involvement, the Eurosystem does not exclude per se that it might become more actively involved in the provision of cross-border retail payment services, should its catalyst approach produce insufficient results and should banks fail to deliver efficient services on their own.