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Session [1B] ELECTRONIC PAYMENTS, AN UNDERUSED OPPORTUNITY : Actual cost of cash and related subsidiaries - Macro Advantages of electronic payments.

The Panel

Moderator: **Elemer Tertak**, Director, Financial Institutions, DG Internal Market and Services, European Commission

Panellists: **Fabrice Denèle**, Head of Interbank Relations, Caisse Nationale des Caisses d'Épargne (CNCE)

Jean-Paul Gauzès, MEP, Committee on Economic and Monetary Affairs, European Parliament

Jean-Michel Godeffroy, Director General, Payment Systems and Market Infrastructure, European Central Bank (ECB)

Leo Van Hove, Associate Professor of Economics, Vrij Universiteit Brussels

The Debate

Introducing the first session of the morning, a breakfast meeting, Elemer Tertak, Director, Financial Institutions, DG Internal Market and Services, European Commission, highlighted the cost of cash and related subsidies as an issue in any discussion about the attractions of alternative electronic methods of payment. The implementation of SEPA, the Single European Electronics Payment Area, had started, he said, and logically, this should reduce the use of cash.

Jean-Paul Gauzès, MEP, Committee on Economic and Monetary Affairs, European Parliament, and rapporteur for the European Payments Directive, said, the Directive was important for both the banking profession and for consumers.

Only the previous day, he said, French banks had published a press release highlighting the complexities of SEPA and an ongoing discussion about inter-bank commissions. When the first SEPA direct debits were implemented in January, Mr Gauzès said, he had stated his conviction that the payments market was a commercial one, not a public service. So it was up to the participants to find profits. The real question, he said, was to identify where the 'cursor' of charges should be placed so as not to disadvantage consumers. "If we squeeze out the producers, we will finish-up without consumers," he said. There needed to be a balance. "We have to get out of the dogma that is competition at any price".

Leo Van Hove, Associate Professor of Economics, Vrij Universiteit Brussel, made the impact he desired by unfolding a banner with the simple message: "Cash is too Cheap". It should be made more expensive, he said. "If I had my way, next time you go to an ATM (Automated Teller Machine) there would be a message appearing on the screen stating: 'This withdrawal will cost you 25 Euro Cents, or One Euro, depending on the amount'.... there would be no free cash anymore.

"Why? I am convinced that in the end, we would all be better off," he said. The problem with cash was that the labour and capital required to provide and use it were 'very substantial'. Studies by central banks put the cost of cash at 0.4 per cent to 0.6 per cent of GDP (Gross Domestic Product). The 'social cost' of cash in the Netherlands would amount to some €300 per family per year. And that 'social cost of cash' is paid by consumers, he said. Society would benefit from a switch to payments by an 'electronic purse' for low-value payments and debit cards for medium and high-value payments. "Cash is labour intensive. Electronic payments are simply more efficient."

Yet because consumers withdrawing cash faced no charges, it was perceived as being free, he said. That made it hard to charge appropriate prices for contact-less or mobile payments, because cash was effectively subsidised. "Imagine what would happen if merchants were to start surcharging for card payments once we have interchange fees all over the SEPA region." Users had no incentive to optimise their payment behaviour, so the efficiency of our payments was sub-optimal.

In his view, the solution was to introduce cost-based pricing for all payments, including those made by cash. There would be explicit, direct fees per transaction, proportionate to the underlying resource cost. It was the hierarchy of fees that was important, he said, making clear that cash is the most expensive transaction tool.

Selling this to consumers would be hard. But clearly, by providing consumers with any-time, anywhere access to their money, banks were providing value-added, for which they should be rewarded. No bank would want to be first mover, though, and concerted action would be seen as collusive: political courage and a different legal environment would be needed to drive such a change.

Fabrice Denèle, Head of Interbank Relations, Caisse Nationale des Caisses d'Épargne (CNCE), said the 'show-stopper' put down by the French banks was a reason to return to discussions, especially with competition authorities, to find a way to solve the problem. Although SEPA was a political project, the investment had to be recovered by the banks that were making it: "We need a return on the investment, and fair remuneration for the service each player on the value-chain provides to the others". He hoped the problem would be solved, but meantime, he favoured freezing the migration to SEPA payments.

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SEPA was a revolutionary project, but banks were used to continuous change. Switching to SEPA raised three challenges: for Information Technology Systems, the removal of legal barriers, and the problem of cash. Mr Denèle said he 'very much' supported the proposition that cash was too cheap. Any debate over charging for cash was likely to last for years. Free cash was 'a distortion for electronic payments' but one that the public sector and governments must think about. "I am not sure that banks, alone, can do more than they have already done," he said. "It's a social problem."

Jean-Michel Godeffroy, Director General, Payment Systems and Market Infrastructure, European Central Bank (ECB) had six points to make. There should be no doubt that the ECB and the Eurosystem were committed to making electronic payments as efficient as possible. Producing banknotes did have a cost for society. "We are committed to SEPA...not just transforming national instruments into European instruments, but also preparing the future," he said. Europe must seize the payment opportunities offered by the internet and the mobile phone, or find itself left behind by the rest of the world.

Confidence was key, he said. There must be technical security, and in that respect the European system was a global leader. Any technical failure would lose the system customers "and they will not come back". Data confidentiality was also an issue, particularly compared to cash. Law enforcement agencies could make use of electronic payment data: "Sooner or later, this will be a major issue." Customers would be concerned that a 'Big Brother' was checking what they were doing.

Seignorage – the right to issue money – was also an issue, he said. One experiment that had failed was E-money (except, perhaps, in Belgium) because the banks were too keen to keep the seignorage for themselves rather than giving the best service to consumers. Having tried E-money himself in Germany, he found it was not efficient enough to be worthwhile. Of course, banks were keen to capture a larger part of the transaction market now serviced by cash. But a key concern for bankers should be whether the instruments they were making available to customers were efficient enough to attract users.

Mr Godeffroy concurred that cash was too cheap to customers. A charge at ATMs was the only way to make customers 'feel the cost of cash'. But this would be a major cultural problem. People feel their normal money is cash, even though in the modern world most is 'crypto-money' in electronic form. "It is when you want to go out of this circuit that you should pay a price, because there is a cost attached to that, but I don't know who will have the courage to explain that to the customers."

Finally, he cautioned against speed in moving to new instruments. Extreme care was needed in progressing the E-money directive, and 'excessive'

deregulation with the risk of a failure that would trigger a definitive rejection by customers.

Pulling together the threads of the debate, the session chairman, Elemer Tertak, reminded the audience that share certificates, which, like banknotes, were once pieces of beautiful printed paper, have been completely 'de-materialised'. The stock exchange did not collapse, however. He believed printed money would also ultimately disappear, but "this takes a long time".

However, in his capacity as Director, Financial Institutions, DG Internal Market and Services, at the European Commission, Mr Tertak said he also wanted to respond to the issues raised by Mr Denèle and the French Banking Federation. There was no dispute between the ECB and the industry that the objective was to achieve cheap payments for everyone. This was as essential for the economy as utilities were for daily life. A European sectoral inquiry had shown huge differences in the cost of the same services across Europe. That showed fees weren't necessarily linked to costs. In the debate over SEPA, there were "mis-interpretations on both sides" he said. He hoped they could be resolved by 1 November 2009, when direct debits should be in place. "Direct debit payments will escape from national boundaries and become effective across the whole of Europe for the benefit of all."

Mr Denèle responded that for many consumers today, cash seems to be "the last space of freedom". Cash was the only way to pay without traceability. "From a social and cultural point of view, we feel more free whilst using cash." Of course, that left space for the underground economy. But it was a problem that banks could not solve alone. Charges for ATM withdrawals were common in the US, but were very sensitive. Society should not leave the banks alone to face the issues. A lot of stakeholders would say banks were simply trying to make more profits.

Mr Godeffroy argued that if banks wanted to introduce fees for ATM withdrawals, they would have to cut other charges.

From the floor, **Gerard Hartsink**, chairman of the European Payments Council, said the Council had worked with the European Central Bank and Eurosystem to draw up a 'road-map' for cash conversion to increase efficiency in the cash cycle. Simultaneously, the 'repositioning' agenda to change attitudes to cash had faced consumer resistance, notably in Belgium where attempts at charging led to a Parliamentary outcry. By number, not value, six out of seven payments were still made by cash, he said. He asked for the panel to comment on several issues. He called for the publication of 'national cash plans', and for the lessons learned from success in some countries to be shared. And he suggested part of the seignorage should be used for education about cash cost issues.

Mr Godeffroy said he did not believe central banks were legally able to share seignorage. "I think it is up to the banks to offer good service to

their customers," he said. Personally, he believed fees should be introduced for ATMs, even when users were 'within the network' of their own bank, but banks must be "ready to explain what they are prepared to give in exchange", otherwise it would be seen as banks fooling their customers.

Mr Gauzès said the original text of the Payment Services Directive, for example, was very favourable to consumers and very difficult for banks. During the Parliamentary process he had sought to ensure there were gains for consumers, and that the banking industry should not be at a disadvantage. In the end, it was adopted almost unanimously. "When you take the time to explain and to reflect you can achieve a text that takes into account the interests of all." But very few MEPs were interested in such technical work that attracted so little media attention.

However, he added: "The integrated European payment system is essential for the proper functioning of the single market. But we have very different situations in different countries. Finns do everything by telephone, Italians don't."

Confidentiality issues should not be underestimated, said Mr Van Hove. He had undertaken a study that demonstrated that Belgian consumers did not understand the confidentiality of transactions using the Proton electronic purse, but "if you explain it to them, they understand." He said it was an "excellent idea" that banks should buy television airtime to explain the cost of cash and "what happens behind the scenes". Fortis, a Belgian bank, had faced a backlash after trying to introduce charges at ATM machines.

Consumers needed to know the usage cycle of a €50 banknote. Such a note, obtained from an ATM, was spent once, then returned by the merchant to his or her bank, because it was too large to be used in change. Mr Van Hove

suggested the public sector should lead. "There are a lot of places where there is still no way to pay electronically," he said. The issue was cultural: "Even small changes, in a choice context, can make a huge difference". So making only small withdrawals an option on the first screen of an ATM machine could discourage larger withdrawals. "Do merchants even try to promote payment instruments? They don't. That's something that could help."

Mr Denèle said it was "most important" to optimise the use of cash. This was a global problem. The public sector should play a key role as 'early adopter' of electronic payments, yet "the public sector has its own agenda, for very good budget and other reasons, and it is difficult for them".

A member of the audience observed that one reason cash remained so popular among consumers was because "cash is used for tax avoidance reasons mainly" and people would continue to use it even if it were more expensive. Maybe transferring money from mobile phone to mobile phone could solve the problem, he suggested.

Another listener said that too often, when there was a big problem the European Commission tried to solve it by competition instead of working deeply on the subject to find the right solution. If, in the payment area, there were no incentives for producers to collaborate, competitors might not take the risk of investing in infrastructure. Consumers belong to one bank, merchants to another. "Both sides must have an incentive to sell the service." It was the only way for the industry to progress. It was vital not to be "too ideological on the way we address this issue".

Closing the session, Mr Tertak said continued dialogue was crucial.

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