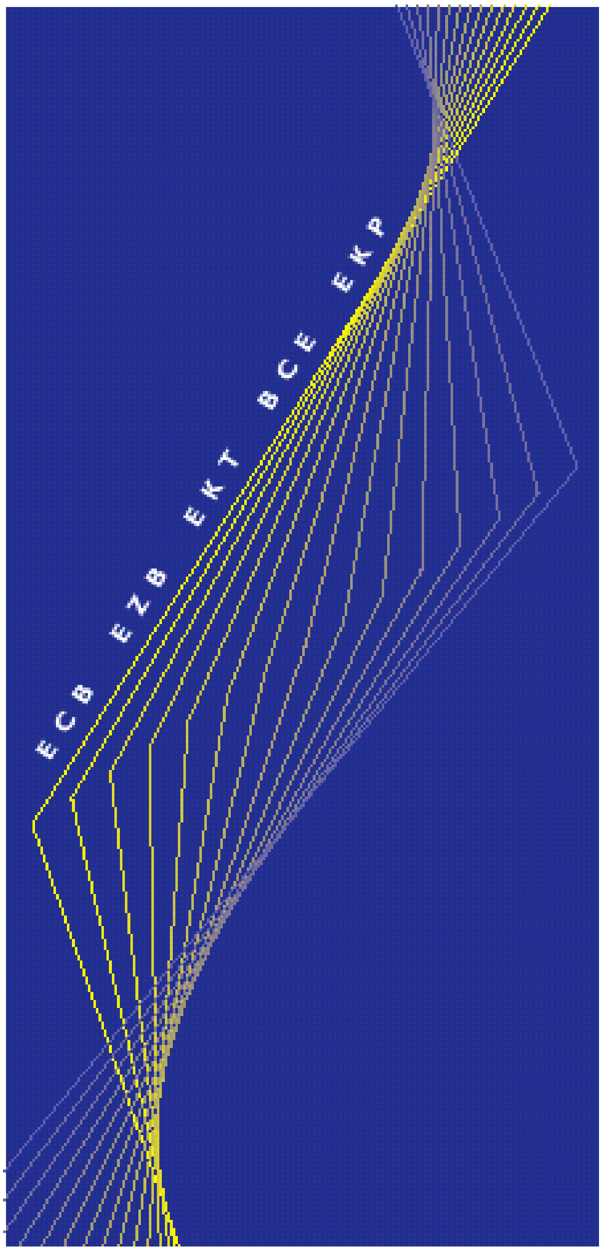
EUROPEAN CENTRAL BANK



IMPROVING CROSS-BORDER RETAIL PAYMENT SERVICES

PROGRESS REPORT

September 2000

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Executive summary

In September 1999 the Eurosystem published a report entitled "Improving Cross-Border Retail Payment Services – the Eurosystem's view" (the "1999 Report"). The 1999 Report recognised that the service level for cross-border credit transfers within the euro area is far removed from the service level for domestic credit transfers, although a single currency environment would require a single payment area in which people are able to transfer money as rapidly, reliably and cheaply from one part of the euro area to another as they can within each Member State. To launch the discussion and give a clear signal to the banking and payment systems industry, the Eurosystem defined seven objectives for the industry to fulfil by 1 January 2002.

This progress report identifies the achievements of the banking and payment systems industry since the publication of the 1999 Report, provides an interim assessment as of August 2000 against the objectives and identifies the outstanding issues.

In general, the banking and payment systems industry has clearly committed itself to the fulfilment of the Eurosystem's objectives and has focused on cross-border credit transfers, as called for in Objective 2. The other objectives are at present unfulfilled to varying degrees. The banking sector, however, has undertaken substantial preparatory work, especially in the areas of implementation of standards (Objective 7) as all components for a straight-through processing (STP) mode are now ready for implementation. Banks and payment infrastructure providers should subscribe publicly before the end of 2000 to the implementation of STP standards. Furthermore, the deadlines for the implementation of standards as proposed by the European Credit Sector Associations are set at the end of 2001, which is very late if the implementation is to affect customer prices in time. The banking sector is also urged to implement the paper-based International Payment Instruction (IPI), as well as to develop its electronic counterpart as soon as possible.

There are also indications, although based on a rather limited survey, that the end-to-end execution time for cross-border credit transfers (Objective 4) in most cases no longer constitutes a major problem.

In order to increase efficiency, retail cross-border systems should be accessible to a wide range of institutions (Objective 6). The EBA STEP1 system can be considered to meet this objective provided that clearing banks offer settlement services at reasonable prices. The payment networks based on enhanced correspondent banking could also qualify as such if they were to be more open to banks outside their traditional constituency. The

Eurosystem invites them also to consider co-operative arrangements among themselves in order to obtain economies of scale and to lower the costs, to the benefit of customers.

So far, it seems that customer prices have not decreased since the introduction of the euro (Objective 3 requires a substantial reduction) and in too many cases the payee has been charged some costs even though the payer has requested to bear all costs (Objective 5). However, the European Credit Sector Associations' initiative to agree on a multilateral interbank exchange fee (MIF) and to develop a "basic" service offer, if successful, has the potential to contribute substantially to the achievement of these objectives, although they need to be developed further. In particular, the "basic" service offer should include a payment execution time of no more than three working days (Objective 4). Furthermore, in order for the "basic" service offer to contribute significantly to greater price transparency and hence to enhanced competition, the Eurosystem invites banks to turn it unambiguously into a standard cross-border payment product with a common name, to be provided by most banks.

Regarding the balance of payments reporting burden on banks, an important breakthrough has been achieved. As from 2002, cross-border payments below EUR 12,500 will no longer need to be reported and hence reporting will no longer constitute a justification for high customer fees.

It should also be recognised that the achievement of the objectives depends not only on banks but also on companies and customers, who should include adequate information in invoices and payment orders so as to facilitate STP. In order to achieve this, there would need to be an information campaign, on which the industry should provide practical proposals by the end of 2000.

In view of the substantial progress achieved by the banking sector towards establishing the necessary conditions for the objectives to be achieved by 2002, the Eurosystem is maintaining its current policy of not becoming operationally active at present. It will continue to facilitate and foster discussions aimed at the timely fulfilment of the objectives.

Moreover, the Eurosystem will monitor closely whether the progress on technical preparations for improved cross-border services ultimately translates into an adequate service for the citizen. The Eurosystem has retained all options, including its own operational involvement, in case this is not achieved. The Eurosystem will provide a new assessment against the objectives at the beginning of 2002.

In order to facilitate the successful fulfilment of the Eurosystem's objectives, the banking sector should maintain and reinforce its efforts and, in particular, adopt the following action points:

1. The payment infrastructure providers and the banks should publicly commit by the end of 2000 to the implementation of STP standards and have these standards implemented by mid-2001.
2. The banking sector should cease, with immediate effect, the unlawful practice of "double charging" and find a practical solution to the underlying problem. If the MIF is adopted by the banking sector for this purpose, it should be implemented by mid-2001.
3. The banking sector should define a standard cross-border credit transfer product with a common name, which would contain the "basic" cross-border payment service offer, fulfil the Eurosystem's requirements and which most of the banks would provide. This product should be implemented by mid-2001 at the latest and its roll-out should be accompanied by a marketing campaign.
4. The banking sector should launch information campaigns targeting private and corporate customers in order to inform them about the standards and the information which should be included in invoices and payment orders. The banking sector should elaborate a practical proposal for this campaign by the end of 2000.

Introduction

In September 1999 the Eurosystem published a report entitled “Improving Cross-Border Retail Payment Services – the Eurosystem’s view” (the “1999 Report”). The 1999 Report underlined that a single currency environment requires a single payment area in which people are able to transfer money as rapidly, reliably and cheaply from one part of the euro area to another, as is now the case within each Member State. Only then will citizens and businesses alike be able to benefit fully from the principles of free movement of goods, services, capital and people.

The evidence to date indicates that substantial improvements are needed with regard to retail cross-border credit transfers within the euro area since their service level is far removed from the service level for domestic payments.

Indeed, the fees for retail cross-border payments remain substantially higher than for domestic payments, although the introduction of the euro has removed the cost of currency conversion within the euro area. In addition, the service level for such payments needs to be further improved and, the unlawful double-charging practices need to be eliminated as required by the Cross-border Credit Transfer Directive.[1]

An important deadline for the achievement of substantial improvements in this sphere is the start of the year 2002, by which time the introduction of the single currency will have been completed and all retail transactions within the euro area will be denominated in one currency only. By then, the benefits of the single currency should also be tangible with regard to cross-border retail payment services.

In the 1999 Report, inefficiencies in the field of retail cross-border payments were partially linked to low traffic, the still predominant recourse to correspondent banking and to the lack of adequate interbank infrastructures. However, the major cause of these inefficiencies was attributed to the internal organisation within banks and to the communication interface with the customer. The banking industry therefore was invited to make these segments of the cross-border payment processing more efficient.

In this context, after having considered several alternatives, and because the banking sector had started to address the issue, the Eurosystem took the view that its operational involvement would not, at that point in time, be justified. Instead, the Eurosystem intended to become a “catalyst for change” by initiating regular discussions with the banking and payment services industry in order to facilitate the achievement of

[1] Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997.

euro area agreements which would improve the environment for retail cross-border payments, in particular in the field of standardisation.

To launch the discussion, and to give a clear signal to the banking industry and the public, the Eurosystem defined the following objectives, which it encouraged the banking industry to fulfil:

Objective 1: Enhanced system(s)/services should be ready by 1 January 2002.

Objective 2: Priority should be given to cross-border credit transfers.

Objective 3: The price of cross-border credit transfers should decrease substantially.

Objective 4: Settlement time should be comparable for domestic and cross-border payments.

Objective 5: For cross-border credit transfers, as a default rule, fees are to be borne by the originator of the payment only.

Objective 6: Access to cross-border retail payment systems should be open.

Objective 7: Existing standards should be implemented as soon as possible.

Since the publication of the 1999 Report, the Eurosystem has continued to liaise closely with the banking sector on these issues. Several multilateral and bilateral meetings were held in order to identify, together with the banking sector, the specific impediments to fulfilling the objectives, and to investigate and, where possible, agree on effective solutions.

The purpose of this report is to describe the developments since the publication of the 1999 Report (see Section 1), to provide an interim assessment of these developments vis-à-vis the Eurosystem's objectives (see Section 2) and to identify remaining issues (see Section 3). Section 4 draws some conclusions and proposes some follow-up work.

1. Developments since the 1999 Report

1.1 Infrastructure and market

The 1999 Report stated that correspondent banking was the method commonly used for processing cross-border credit transfers. This has led to a fragmentation of payment channels and to very costly interbank processing of cross-border payments. The 1999 Report therefore recommended that further consolidation of the payment systems infrastructure would be desirable.

Since the publication of the 1999 Report, more customer payments[2] have been processed via payment systems such as EBA Euro1 and TARGET, which were in principle established for large-value payments. In EBA Euro1 the average volume of payments processed per month rose from 1,305,164 in the first half of 1999 to 2,010,864 in the first half of 2000, of which, on average, 66% relate to payments below EUR 50,000. In TARGET the average monthly volume of cross-border payments grew from 566,611 in the first half of 1999 to 829,554 in the first half of 2000 and the share of customer payments in the cross-border volume increased from 19% to 33%. Nevertheless, the average value of a cross-border customer payment in TARGET still amounts to EUR 1.1 million, indicating that the system is used more for commercial than for retail payments.

These results show that the market increasingly considers traditional correspondent banking as inadequate for the processing of large-value and corporate payments. Nevertheless, the lack of efficient mass payment processing facilities and integration with domestic retail payment procedures indicates that systems such as EBA Euro1 and TARGET are not entirely appropriate for retail cross-border payments.

Payment networks which are based on enhanced correspondent banking, such as TIPA, Eurogiro, S-Interpay, have also substantially increased their business, with growth figures of 30% or above, attaining a volume comparable to that of EBA Euro1 and TARGET combined. Most networks already use straight-through processing (STP), i.e. no manual intervention is needed for payment processing, and the message formats used are in most cases compatible with S.W.I.F.T. standards (MT100/102[3]). Some networks are also planning to implement the MT103+[4], the International Bank Account Number (IBAN) and the International Payment Instruction (IPI).

The Euro Banking Association (EBA) has announced the development of a payment system specifically designed for cross-border low-value payments. This initiative consists of a short-term and a medium-term plan.

In the short term, i.e. by November 2000, a cross-border low-value credit transfer system (called "STEP1") will become operational. STEP1 will use the existing infrastructure of the EBA Euro1 system for large-value payments, without being subject to the strict risk management requirements of the large-value segment, and will allow

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2 In this context "customer payments" also refers to payments to and between corporations.

3 The MT100 and MT102 are the customer payment message formats currently used; the MT100 is a single payment message and the MT102 can contain several payment instructions.

4 The MT103+ is the STP (straight-through processing) version of the new customer payment message MT103; see also Section 1.4.

access to a greater number of banks. In fact, STEP1 will have a two-tiered membership made up of, first, the clearing members of Euro1 and, second, any other bank which is not a member of Euro1 but which acquires the status of a STEP1 bank and uses a Euro1 clearing bank as a "settlement bank" for its low-value payments.

The positive effects expected from the establishment of STEP1 can be referred to as threefold: STEP1 is intended to shorten transfer times (payments are settled the day after they are sent), it should encourage the use of industry standards and it may set a precedent for the development of Europe-wide business practices. By basing STEP1 on the Euro1 infrastructure, the EBA has explained that STEP1 will be able to go live earlier than would have otherwise been the case, i.e. if the banking sector were to have initiated a "fully fledged" automated clearing house (ACH) project.

However, STEP1 will not process batch files (other than the MT102 messages) and will not provide the central sorting function traditionally included in ACH-type solutions. This means that the originating bank itself must group payment instructions according to the bank of the beneficiary, which limits the potential to cut costs and reduces the benefits of scale.

In the medium term, the EBA envisages the development of a true ACH-type arrangement. This second constituent of its initiative has not yet been further elaborated.

1.2 Pricing of the cross-border credit transfers

A report on "Bank Charges in Europe"[5] provides a survey-based description of the situation as at November 1999 regarding charges for cross-border transactions within the euro area.

The average fee paid by the originating customer for an "OUR"[6] credit transfer of EUR 100 was found to be EUR 15.51, the range being from EUR 8.15 to EUR 25.61. Furthermore, when taking into account the additional fee of between EUR 3.0 and EUR 10.8 being charged to the receiver in 25% of cases, the average total cost for cross-border credit transfers increased to EUR 17.10. Moreover, when comparing a transfer from country A to country B with the same transfer from country B to country A, fee differences exceeding 300% were sometimes noticed.

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5 "Bank Charges in Europe", a report for the European Commission (Directorate-General Sanco), B5-1000-99/074610, IEIC, April 2000. The results of this report are based on a relatively small survey of 352 cross-border transfers.

6 In an "OUR" credit transfer, all costs are to be borne by the ordering customer.

If these findings are compared with the European Commission's similar study of 1994, progress can be seen clearly as the fees have decreased by more than 40% in most countries.

When compared with the Eurosystem's survey of spring 1999, however, where customer fees ranged from EUR 3.5 to EUR 26.0, no progress can be detected. In this respect, it should be noted that the methodology used in the two studies was different, which makes comparisons difficult: real payments were made in the European Commission's study, whereas the Eurosystem's study was based on public information on the banks' fees.

The report entitled "Bank Charges in Europe" revealed further that even where the OUR option is specifically requested by the originating customer, some costs were charged to the beneficiary in 25% of cases. This so-called double-charging is in breach of the Directive on Cross-border Credit Transfers.

The underlying problem in this respect is that when a customer initiates an OUR order, the receiving bank does not necessarily receive a share of the customer fee charged by the sending bank to cover its costs. This drawback has become more pronounced with the emergence of new payment systems, i.e. EBA Euro1 and, in particular, TARGET, through which banks can reach a large number of other banks with which they do not have well-established business relationships. There are several ways to address these problems, such as billing the originating bank or establishing a database containing information on charges levied by all banks in the euro area. However, the billing would create costs for both the originating and the receiving bank, and the originating bank could not be entirely sure of the level of the receiving bank's fee before the bill arrives. This uncertainty could lead to a situation where the originating bank sets its own fee at an unnecessarily high level. The database solution would lead to practical problems, not only in its creation and in the establishment of access to the database for all banks, but especially in keeping the data up-to-date, as the database should contain all prices of all banks providing these services in the euro area. In order to overcome these problems the banking sector has started to define a default multilateral interbank exchange fee (MIF), which would serve to cover the costs of the receiving bank. This fee would be included in the payment message sent by the originating bank to the receiving bank. This would remove the need for the receiving bank to bill the originating bank (see Section 3.1).

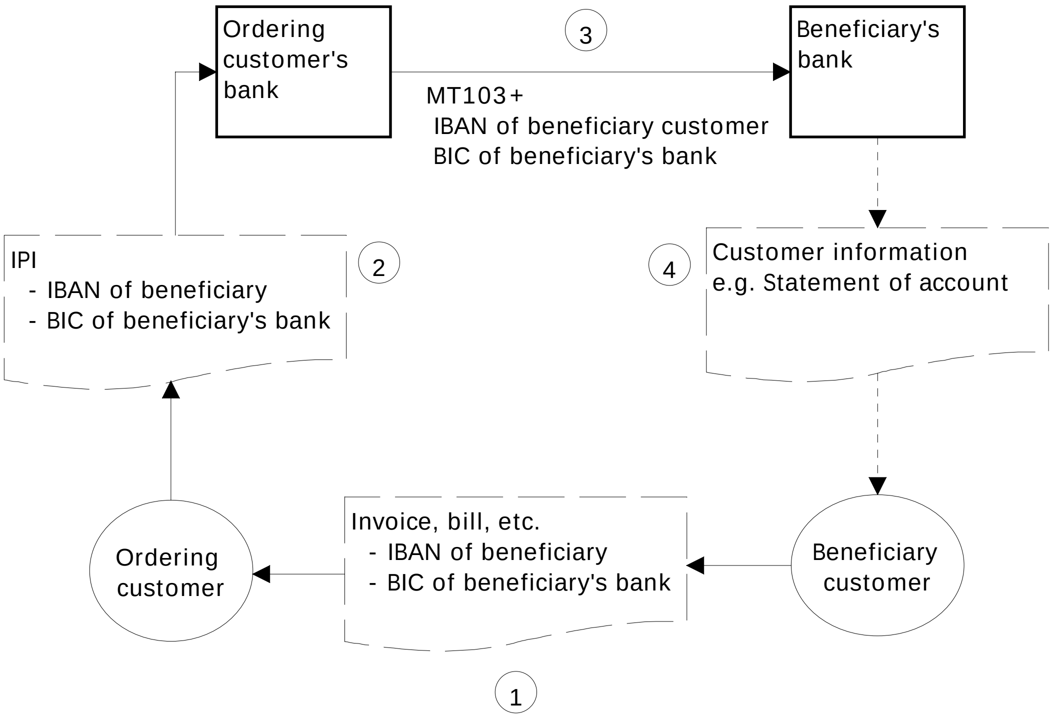
1.3 Payment execution time

From the report “Bank Charges in Europe” (based on a limited survey), it appears that the average execution time of a cross-border credit transfer was 3.41 working days. However, 5.14% of credit transfer orders required 7 or more working days to be executed, thereby not even fulfilling the Cross-border Credit Transfer Directive’s default execution time of 6 working days.

1.4 Definition of STP standards

The definition of a cross-border credit transfer standard has now reached a stage where the building blocks for a Eurosystem-wide straight-through processing (STP) mode have been defined. This can be considered as a major achievement in terms of co-operation between banks and the Eurosystem over the past year.

These building blocks are the S.W.I.F.T. message MT103+, the International Bank Account Number (IBAN), the Bank Identification Code (BIC) and the International Payment Instruction (IPI). These standards cover different parts of the payment processing chain, as can be seen from the following diagram.



The *MT103+* must be used in accordance with very strict rules in order to guarantee automatic processing by any bank in a payment chain. It also provides the means to meet specific requirements such as transparency of charges and, when needed, transmission of balance of payments reporting information. The MT103+ will be introduced into S.W.I.F.T.'s network in November 2000[7], such that as from this date banks will be obliged to accept MT103+ as an incoming message format, although they are not required to use it for outgoing payments. Some payment systems (TARGET, EBA Euro1 and STEP1) have committed themselves to implementing the standard. The industry recommends that the European banking community should start to use these message formats in preference to the MT100 format at the earliest opportunity, and certainly by the end of 2001.

The *IBAN* (International Bank Account Number) is an international standard for presenting bank account numbers, which includes a checksum, thereby allowing for an off-line integrity control. The banks do not have a harmonised schedule for the distribution of IBANs to customers, and some banks are planning to do this only by the end of 2001. Furthermore, the banks would only be required to be able to process IBANs on incoming cross-border payments by the end of 2001.

BICs (Bank Identifier Codes) are a world-wide standard providing a unique identification of banks and their branches. These are needed for routing payments, at least during the transitional phase until the banks' systems are able to route the payments on the basis of the IBAN only.

The *IPI* (International Payment Instruction) is a harmonised paper form designed for the submission of cross-border transfers by customers. There is, however, no common agreement within the banking sector on either the implementation of the IPI or a possible electronic version, which would be useful for STP purposes.

The European Credit Sector Associations[8] have informed the ECB that the European banking community will move to a common message framework to enable transfers to be processed STP end-to-end by the end of 2001.

1.5 Balance-of-payments (b.o.p.) reporting requirements

When banks were invited by the Eurosystem to reduce their fees for cross-border retail payments, they claimed that b.o.p. reporting was a major obstacle, first, because it is a

[7] S.W.I.F.T. has also defined an STP-capable MT102+ (multiple MT103+). The MT102+ would enable multiple credit transfers to be sent in one message, using the same STP rules, and thus provide the same benefits as the MT103+. S.W.I.F.T. will include this update in its Service Release 2001.

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

burden which is specific to cross-border payments only and, second, because quite often it requires a manual intervention, which breaks the STP chain.

Banks also claimed that b.o.p. reporting introduced a competitive disadvantage between them, as Member States do not have a common approach (e.g. with regard to data collection through banks or survey-based systems, exemption thresholds or simplification thresholds). In addition to this lack of harmonisation, the banking sector criticised the inefficiency of the reporting schemes in force, which obliged them to report the same information twice, both on the originating side and on the receiving side.

Discussions were initiated, therefore, between the banking sector and statistical authorities on the following subjects, in order to improve the efficiency of b.o.p. reporting:

- ***Harmonisation of the economic codes***[9]

  A list of harmonised economic codes was finalised, subject to refinements by January 2001, in June 2000 by the Committee for Monetary, Financial and Balance of Payment Statistics (CMFB).[10] By January 2001 Member States will have provided national timetables for its implementation. This enhancement should facilitate the automation of the reporting.

- ***Definition of the threshold***

  In June 2000 a common minimum *exemption* reporting threshold of EUR 12,500, with effect from 1 January 2002, was agreed by the CMFB. In other fora, banks asked for an exemption threshold of EUR 50,000 (the maximum amount for payments subject to the Directive on Cross-border Credit Transfers). However, this would have resulted in too great a loss of statistical information (notably for some items on services, where 40% of the information would be lost above EUR 12,500).

The implementation of a uniform exemption threshold constitutes a major breakthrough in diminishing an administrative burden that is specific to cross-border payments. Thus reporting requirements will no longer be a justification for high customer fees for cross-border payments under EUR 12,500.

The implementation date of 1 January 2002 for the exemption is just timely enough to allow for a more satisfactory achievement of the Eurosystem's objectives. Concerning

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

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

the implementation of harmonised economic codes, where no implementation date has yet been agreed upon by the CMFB, the Eurosystem will seek as early an implementation as possible.

2. Interim assessment against the Eurosystem's objectives

The Eurosystem invited the banking and payments systems industry to fulfil its objectives by 1 January 2002. This section evaluates the achievements of the industry as at August 2000; it should therefore be considered as an interim assessment.

Objective 1: Enhanced system(s)/services should be ready by 1 January 2002

As this is an overall objective, its fulfilment depends on the fulfilment of the other objectives; it will be addressed in the conclusions accordingly (see Section 4).

Objective 2: Priority should be given to cross-border credit transfers

As can be seen from the developments described above, the banking sector is clearly focusing on credit transfers. Within this category of payments, it may be easier to solve the problem of a poor service level for small-value euro-denominated payments (i.e. below EUR 12,500) as these payments will no longer be subject to any b.o.p. requirements. It would, of course, be useful to be able to apply the same procedures and systems to the widest possible range of commercial payments. However, this should not delay achieving improvements for the small-value segment of the market, in which the problem is most pronounced and the sensitivity of the public is understandably the greatest.

At this stage, the industry action is in line with this objective.

Objective 3: The price of cross-border credit transfers should decrease substantially

If the results from the report "Bank Charges in Europe" can be generalised, it can be concluded that fees have decreased substantially, but that their present level is mostly still very high (albeit with some variations among countries) compared with the price of domestic credit transfers. Moreover, this development seems to have occurred before 1999 and it can therefore be concluded that the advent of the euro and the availability of well-established cross-border payment systems have not given rise to clearly visible price reductions for cross-border credit transfers. However, banks have made considerable progress in preparing the ground for a more efficient handling of cross-border credit transfers, especially in the area of standardisation. It is still expected that, by 1 January 2002 at the latest, a fair share of the efficiency gains – many of which have yet to materialise – will have been transferred to customers through lower prices.

At this stage, the industry has not yet fulfilled this objective.

Objective 4: Settlement time should be comparable for domestic and cross-border payments

In concrete terms, the objective requires the execution of a cross-border credit transfer to take no more than one day longer than the execution of a domestic credit transfer, i.e. no more than 3 working days. The study by the European Commission indicates an average execution time of 3.41 days, which, if these results can be generalised, indicates that the full achievement of the objective is within reach and should in fact occur before 2002.

At this stage, the industry is close to fulfilling this objective.

Objective 5: For cross-border credit transfers, as a default rule, fees are to be borne by the originator of the payment only ("OUR option")

Even where the OUR option is specifically requested by the originating customer, according to the report entitled "Bank Charges in Europe", some costs were charged to the beneficiary in 25% of cases. This so-called double-charging is a breach of the Directive on Cross-border Credit Transfers, and should cease immediately. In order to tackle this problem, the banking sector has started to define a default multilateral interbank exchange fee (MIF), which would cover the costs of the receiving bank. This fee would be included in the payment message sent by the originating bank to the receiving bank.

An agreement on the MIF initiative (see Section 3.1) would facilitate both the more widespread use of the OUR option and the elimination of unlawful double-charging practices.

At this stage, the industry has not yet fulfilled this objective.

Objective 6: Access to cross-border retail payment systems should be open

Any solution which increases the efficiency of retail cross-border payments should be accessible to a wide range of institutions. This is not yet always the case for cross-border arrangements, since access to payment networks is sometimes restricted to institutions from the same "family" or conditioned by reciprocity considerations. It would, however, be desirable for these networks to be more open to banks outside their traditional constituency, to implement common standards and to consider co-operating among themselves in order to obtain greater economies of scale. The EBA STEP1 system can be considered as meeting the objective of open access, provided that clearing banks offer their settlement services at a reasonable price.[11] TARGET is the only system, however, that is not only accessible to, but also accessed by, the overwhelming majority of banks. Even though it may not be the optimal solution for the processing of retail cross-border payments, TARGET prices nevertheless constitute a de facto ceiling for the fees levied by direct participants upon indirect participants in other arrangements.

At this stage, the industry has not entirely fulfilled this objective.

Objective 7: Existing standards should be implemented as soon as possible

The STP-capable cross-border credit transfer standard is now ready and awaiting implementation. Some payment systems (TARGET, EBA Euro1, STEP1) have committed themselves to implementing the standard and the European Credit Sector Associations have recommended that banks implement the standards, with the exception of the IPI, by the end of 2001 at the latest. This deadline for implementing standards is very late, therefore the Eurosystem would urge banks to implement the standards by mid-2001 at the latest. The banking sector should also consider implementing the paper-based IPI by this time and developing its electronic counterpart, as they can be seen to be valuable for STP purposes.

The negotiation and co-ordination process, which has lead to the above results in the field of standardisation, has proven to be demanding and complex. Considerable efforts should be made to streamline the decision-making and "commitment" process for the implementation of standards within the banking sector. In a single currency area, which covers several countries, interbank co-operation should, over time, be organised as efficiently as it is at the national level.

At this stage, the industry has not entirely fulfilled this objective.

3. Outstanding issues

Of the Eurosystem's seven objectives, objectives 3 to 7 have not yet been fully met, although substantial progress has been achieved on most of the issues. However,

[11] As STEP1 envisages settlement via the current Euro1 settlement banks, the STEP1 banks will be charged bilaterally by the settlement banks for settlement services. In order to avoid unnecessary barriers to entry, it is vital that these banks are willing to provide their services to prospective STEP1 banks at a reasonable price.

considerable effort is still required to meet all of the objectives by the year 2002 target. Thus the resolution of the outstanding issues is particularly urgent.

3.1 Multilateral interbank exchange fee

The banking sector is elaborating a proposal on the multilateral interbank exchange fee (MIF). The intention is to propose two MIFs, a lower level MIF for STP payments and a higher level MIF for non-STP payments. There is a consensus emerging within the banking sector that the MIF would be a default interbank exchange fee aimed at providing remuneration for the provision of services when receiving a cross-border credit transfer, applying only to OUR payments denominated in euro and covering only cross-border payments processed through euro-interbank payment systems. Furthermore, the implementation of the MIF assumes that there are no b.o.p. statistical reporting requirements, i.e. that it would apply only for payments up to EUR 12,500. The banking sector expects its internal negotiations to be finalised by the end of 2000, followed by a formal notification to the European Commission. The MIF is intended to enter into force on 1 January 2002.

In principle, a multilateral fee could be seen as a restriction of competition in the form of a multilateral price agreement and should therefore be considered in the light of the relevant Community (and national) competition legislation.[12] However, the competition legislation provides certain criteria for such agreements to be granted an exemption, including the criterion that customers must receive their fair share of the benefits and that there should not be a direct link between customer prices and the MIF, as customer prices should be determined by free competition. Provided that these criteria are fulfilled, the MIF might be acceptable to the European Commission, which is the authority competent to decide whether an exemption from Community competition legislation would be needed and could be granted.

The MIF initiative should facilitate the avoidance of double-charging and contribute to meeting the ex ante information requirements of the Cross-border Credit Transfer Directive. Furthermore, the MIF must contribute to the overall objective of substantially reducing customer prices. Moreover, interbank exchange fees should be as low as possible and should cover the smallest possible part of the processing chain, given that they could be seen as a restriction on competition. In this respect, the Eurosystem has

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12 See in particular paragraphs 1 and 3 of Article 77 (ex Article 81) of the Treaty establishing the European Community and the Notice on the application of the EC competition rules to cross-border credit transfers (95/C 251/03).

expressed the following concerns (which, of course, are without prejudice to any evaluation of the matter by the competent authorities).

First, the range of services to be covered by the MIF should be as small as possible in order to provide maximum scope for competition. In particular, it is clear that charges for cross-border retail payments will only decrease substantially if most of the payments are processed without using correspondent banks as intermediaries. Thus there does not appear to be any justification for including remuneration for such intermediaries in the MIF, as their services will not, in most cases, be needed.

Second, if intermediaries are used, the Eurosystem would prefer the first intermediary bank in the country of destination of the payment, rather than the beneficiary's bank, to be the recipient of the MIF. Indeed, the processing of the cross-border payment in the destination country should be considered identical to the processing of a "real" domestic payment, and hence the processing should be undertaken according to the domestic clearing and settlement rules.[13] Therefore, the most straightforward solution would be for the intermediary bank to receive the MIF and forward it in full or in part to the beneficiary's bank according to the domestic clearing and settlement rules or bilateral contracts.

Third, in relation to calculation methods for cost recovery, it should be taken into account that, by using STP, the operational costs to the beneficiary banks will be minimal, that is to say very similar to those which they incur for domestic payments. Admittedly, investment costs related to the adaptation of internal systems to the new STP methods are probably substantial. However, it would be rational to spread their recovery over a large number of years, instead of over three years as foreseen by the banking sector, since part of this investment will be made once and only once. Furthermore, the MIF should contain only remuneration of actual costs and investments necessary for the reception of cross-border payments.

Fourth, the need for an MIF, as well as its level, should be revised from time to time. Given increasing cross-border payment volumes and technological improvements, the MIF should decrease over time.

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[13] Similarly, the MIF for cross-border payments should not be applied where the sending credit institution is making the conversion to the domestic payment standard of the beneficiary by directly accessing the domestic payment system (ACH) in the receiving country.

3.2 The implementation and use of STP standards

The Eurosystem welcomes the common understanding which has been reached on the standard (MT103+, IBAN, BIC and IPI) allowing the end-to-end STP of cross-border credit transfers. The timetable proposed by the banking federations could, however, be considered somewhat unsatisfactory.

For the *MT103+* format, the banking federations recommended that the European banking community should start to use the format (sending and receiving) by the end of 2001. The Eurosystem shares the view of the banking federations, but invites and encourages banks to use the MT103+ instead of the MT100 format for the bulk of their outgoing payments by mid-2001. As not all banks have BICs yet, the Eurosystem urges them to apply for one at their earliest convenience, and by mid-2001 at the latest.

Furthermore, the Eurosystem understands that banks do not have a harmonised schedule for the distribution of *IBANs* to customers, and that some banks are planning to do this only by the end of 2001. In addition, banks would only be required to be able to process IBANs on incoming cross-border payments by the end of 2001. The Eurosystem considers these deadlines to be very late, as customers and companies also need time to accustom themselves to using IBANs. It is therefore urging the banking sector to distribute IBANs to customers in the first half of 2001 and to be able to process them by mid-2001 at the very latest.

Finally, the Eurosystem takes note that the banking sector has no common agreement on the implementation of the paper-based *IPI*. The Eurosystem considers the paper-based IPI as a first step, which should be followed by an electronic version of the IPI in order to allow automatic processing from customer to customer, e.g. via the internet. However, when electronic customer interfaces are used for customer account management and payment purposes, adequate attention should be paid to security in order to guarantee the authenticity, integrity, confidentiality and non-repudiability of messages. As the IPI, and in particular its electronic version, is useful for STP purposes, the Eurosystem urges the banking sector to implement the paper-based IPI by mid-2001 and to prepare the electronic version as soon as possible.

The investment required to implement the standards may be considerable and the return on the investment will typically depend on the adoption of the same standards by other market participants. In order to prevent banks waiting for others to announce their intentions first, it is desirable that, before the end of 2000, banks and payment infrastructure providers should publicly confirm their commitment to the implementation of STP standards.

3.3 Transparency

The envisaged enhancements in the processing of cross-border payments will reduce banks' costs and increase the speed of payment execution. It is important for the reputation of the banking sector, and for the acceptance of the euro, that the availability of a better service is made known to the public and that the customer knows that the submission of payment orders in the correct format will be beneficial in terms of price and speed of execution.

At present, the cost of cross-border credit transfers does not normally constitute a decisive factor in a customer's choice of bank and is therefore not a strong element of competition. This is also related to the fact that a prospective customer faces difficulties in comparing the services and prices of different banks with regard to cross-border retail payments and hence in selecting the service provider that best fulfils its needs.

Partly in response to these concerns, the banking federations have defined the prerequisites for STP in combination with which they intend to offer at least a "basic" service level. This "basic" service level would apply to retail cross-border credit transfers:

- between banks located in the EU or the EEA;
- denominated in euro;
- with an OUR option; and
- not exceeding the exemption threshold for b.o.p. reporting, i.e. EUR 12,500.

The "basic" service level would be provided only where the customer provided a payment order containing full bank and account details of the beneficiary, i.e. the IBAN and BIC of the beneficiary bank.

If these conditions are met, the following will apply:

(i) the sending bank will charge the originator a fee for the cross-border credit transfer in accordance with its published and widely available set of charges;

(ii) the sending bank will undertake to pay the receiving bank an agreed interbank exchange fee;

(iii) the receiving bank (whether this is the beneficiary's bank or an intermediary) will make the full amount of the cross-border credit transfer available to the beneficiary; and

(iv) upon receipt of a cross-border credit transfer the receiving bank will ensure that the beneficiary receives funds in its account within the same time scale as that which would apply to the same beneficiary in respect of a similar domestic transfer.

The Eurosystem welcomes the idea of defining a “basic” service level, but notes that this should fulfil not only the requirements of the Cross-border Credit Transfer Directive but also the Eurosystem’s objectives, especially the maximum payment execution time of three working days (Objective 4).

Furthermore, this initiative does not fully contribute to price comparability, as banks may still provide a more advanced cross-border payment product without necessarily providing the “basic” service itself. It is difficult to understand, particularly for smaller value cross-border payments, why there has been no proposal to agree on a *standard* service.

The Eurosystem therefore strongly recommends that the banking sector should define a standard cross-border payment product with a common name, which would be in line with the Eurosystem’s objectives, and which would be supported by a marketing campaign by the banking sector. Keeping in mind the basic objectives of the Eurosystem, the product should be defined and implemented as soon as possible and certainly by June 2001 at the latest, in order to allow time for competition to affect customer prices before 1 January 2002.

3.4 Information campaigns

The public at large has to be informed about the standards and how they should be used when ordering cross-border payment transfers. The corporate sector involved in cross-border business should also be targeted in a specific information campaign, since it could promote the use of the International Payment Instruction (IPI), and it should be encouraged to mention on its invoices its bank and account details in line with the agreed STP standards (i.e. the BIC and IBAN).

Such an information campaign is considered vital if customers and the banking sector are to benefit fully from STP processing. Without such a campaign, the corporate sector cannot be expected to provide its banking details and customers the appropriate information in payment orders. This would lead to a break in the STP chain because of the need for manual corrections of, and extra data to be included in, the payment messages.

To promote transparency the banking sector should also undertake a marketing campaign for the standard service level for cross-border payments as discussed in Section 3.3. This campaign should take place in mid-2001.

The Eurosystem desires the banking sector to elaborate practical proposals for such information campaigns by the end of 2000.

4. Conclusions and follow-up

The banking and payment systems industry has committed itself to fulfilling the Eurosystem's objectives and has achieved significant progress, especially in the area of standardisation. The Eurosystem is therefore retaining its current policy of not becoming operationally active at present, but is continuing to work as a catalyst for change.

However, the successful and timely fulfilment of all the objectives is still uncertain and will depend on the resolution of the pending issues. The Eurosystem will follow developments closely and will provide a further assessment against the objectives at the beginning of 2002. In the event of failure to fulfil the objectives, the Eurosystem would need to reconsider its policy of not becoming operationally active.

The fulfilment of the objectives would considerably diminish the gap between the service levels for domestic and cross-border credit transfers within the euro area. Further work after 2002 will, however, be needed in order to achieve a single payment area in which cross-border credit transfers are executed as efficiently as domestic credit transfers are today, this being the Eurosystem's ultimate goal in this respect.