Recent developments in German and European retail payments

Europe is on the road to a single market in cashless payments. The EU Directive on Payment Services in the internal market must be transposed into national legislation by all member states by 1 November 2009. This will establish a harmonised legal basis for payments in Europe. The Directive puts in place the legal framework for a European direct debit scheme. Payment institutions will create a new category of payment service providers which is subject to less regulation than banks and is designed to improve competition in European payments. Furthermore, work is also being undertaken on the creation of a Single Euro Payments Area (SEPA). SEPA credit transfers were introduced in the market as early as January 2008. From the beginning of November 2009, the European banking industry will also offer the SEPA direct debit. The aim is that SEPA products will replace all national payment procedures. Product innovations are likely to bring about further major changes in the European retail payment market. These initiatives discussed under the heading of "eSEPA" could, among other things, considerably improve the efficiency of payments via the internet and at traditional retail outlets.

Harmonised legal framework in Europe

The European Commission has been focusing on European retail payments for several years

Harmonised legal framework as a condition for a single market

now. The payments processed in the retail payments segment have a low priority and usually involve small amounts. Until the beginning of this decade, the European Commission's regulatory concerns in this sector concentrated mainly on improving cross-border payments in Europe, which were characterised by low transparency and high prices. Since then, the emphasis has been on creating a smoothly functioning internal market for payment services with the aim of overcoming the prevailing national segmentation by means of further harmonisation.[1] The key to tackling this is a uniform legal framework, which was established by the Payment Services Directive (2007/64/EC). The Payment Services Directive (PSD) contains both regulatory provisions and other civil law regulations for the various payment service providers (such as credit institutions, e-money institutions, payment institutions) and the payment services they provide (for example, credit transfers, direct debits, card payments). In Germany, the transposition of the European Directive into national law, which, according to EU provisions, must be completed by 1 November 2009, has led to a significant expansion of existing provisions regarding payments. The regulatory aspects of the Directive are implemented in the Payment Services Oversight Act (*Zahlungsdiensteaufsichtsgesetz* or ZAG), while the civil law provisions have been incorporated into the Civil Code (*Bürgerliches Gesetzbuch*) and its Introductory Act (*Einführungsgesetz zum Bürgerlichen Gesetzbuch* or EGBGB).[2]

New cashless payment providers

At present, payment services can be provided in the German market only by credit institutions which are permitted to conduct giro business pursuant to section 1 (1) No 9 of the German Banking Act (*Gesetz über das Kreditwesen* or KWG). This means that there are – amongst others – strict requirements governing the capital resources of these institutions. When the Payment Services Oversight Act comes into force on 1 November 2009, a new category of providers, known as "payment institutions", will be able to provide payment services. In Germany, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) is responsible for granting a licence to conduct such business, which is also regulated in the Payment Services Oversight Act. Payment institutions are subject to lower capital requirements than credit institutions; their business operations are, however, subject to certain restrictions. They may, for example, hold payment accounts for their customers, but are allowed to use them exclusively for payment transactions, while the funds on these accounts shall not constitute deposits. The funds on payment accounts must also be collateralised as a matter of principle, for ex-

1 The Bundesbank gives a detailed account of the process of change in retail payments in the following articles published in its Monthly Reports: "The Road to the Single Euro Payments Area", December 2005, pp 29-42; "Recent developments in payment cards and innovative electronic payment procedures", December 2006, pp 89-100; "Cashless payments in Germany and the role of the Deutsche Bundesbank", March 2009, pp 49-64.

2 The Payment Services Implementation Act (*Zahlungsdiensteumsetzungsgesetz*) implements the regulatory provisions of the Payment Services Directive (Title II of the Directive) as a new Payment Services Oversight Act and amendments to other laws affected thereby (including the German Banking Act (*Kreditwesengesetz*)). The civil law regulations consist of information requirements (Title III of the Directive, to be implemented in Article 248 of the Introductory Act of the Civil Code) and in business practice provisions (Title IV of the Directive, to be implemented in sections 675 and 676 of the Civil Code).

ample, through insurance or an escrow account investment at banks. Furthermore, such institutions are not allowed to pay interest on customer funds on payment accounts. Moreover, they may only grant credits from their own funds and only in conjunction with payment services such as card payments. The maximum duration of these credits is 12 months.

Payment institutions as additional competitors

Initially, the new competition from payment institutions is unlikely to make much of an impact on the banking industry in Germany. Although market entry for payment institutions will be simplified owing to less stringent regulatory conditions, the range of products they can provide is strictly limited to payment products. In particular, payment institutions cannot offer their customers the usual combination of payments and the safekeeping of money at a low rate of interest, as is possible with giro accounts. With this in mind, it is likely that the companies registering as payment institutions in Germany will be mainly those whose current services will, in future, be classified as payment services. This includes, for example, companies which, in card business, are responsible for the clearing and collection of payments for the retailer (acquiring) or which carry out money transmission services. In the medium term, however, it is possible that non-banks with a broad customer base and/or advanced technological capability – possibly in cooperation with banks – will also enter the market for payment services. It should be noted in this context that payment institutions approved in one EU country can also offer their services in all other EU countries.

New regulations for relationship between banks and customers…

The PSD also necessitates changes to business practice in payments. These include additional information requirements for providers of payment services, which are obligatory in the private customer segment, but can be waived in the business customer segment. The regulations concerning execution times, charges, value dating, availability and liability will also be revised.

…affect not only the execution of payments…

For example, the maximum execution time (between receipt at the instructed bank and crediting to the account of the payee) for non-paper-based payments will be reduced from up to three business days at present to one business day in the future. For a transitional period until 1 January 2012, payment providers can still agree with their customers a period of no longer than three business days. Moreover, the execution of payment transactions using solely the customer identification (eg IBAN – International Bank Account Number) will be possible in the future. It will be left to the discretion of the relevant credit institutions whether they continue to cross-check the account numbers and names of their customers. With regard to the calculation of charges, payment amounts must, without exception, be passed on without deduction in future.

…and value date…

The legal provisions for value dating and availability have also led to the further tightening of the regulations for the processing of transactions. Accordingly, credit transfers have to be placed at the payee's disposal immediately. In future, the value date for credit transfers will therefore be the day on which the amount is credited to the payee's payment service provider. By contrast, the debit value date may not be earlier than the date on which the payer's account is debited. Overall, the possibility of banks' making profits on interest or floats is dramatically reduced.

... but also liability issues

Furthermore, the customer is now, within a period of eight weeks from the date on which the funds were debited, being given a statutory entitlement to a refund for authorised direct debits provided certain conditions are met.[3] For non-authorised payments, the period in which the payer can raise an objection is limited to 13 months after the debit date. Another new aspect is the introduction of strict liability of the payer in the event of theft or loss, for example, of his/her payment card. This liability is limited to €150, however. It ceases to apply as soon as the loss has been reported to the credit institution. This will encourage the customer to treat the payment card carefully and responsibly.

Effects on credit institutions

The civil law provisions of the PSD impose stricter obligations on credit institutions, for example, through stricter liability regulations. The implementation of these provisions also incurs greater expense. The shortening of execution periods and the considerable cutback in float profits will have a negative effect on income. This means that credit institutions will have to review their existing business models and turn to other options in order to reduce handling costs. This could result in greater efforts in cooperation between banks in payments.

Provision of new payment instruments

New European payment instruments

Since 2004, the European banking industry has been working on harmonised European payment instruments and technical standards as part of the initiative to create a Single Euro Payments Area (SEPA). First results are already available in the form of the SEPA credit transfer and the SEPA direct debit. The European banking industry also agreed on basic rules regarding SEPA for cards.

SEPA credit transfers

Restrained use of SEPA credits transfers to date

The SEPA credit transfer, which was developed by the European Payments Council (EPC) and largely corresponds to national procedures, has been offered by almost 4,500 credit institutions in Europe since 28 January 2008. So far, it has not proved particularly popular, however. In May 2009, SEPA transfers accounted for just 3.9% of all credit transfers processed via clearing houses in the euro area. The SEPA credit transfer is currently being used primarily for cross-border payments. This also explains the somewhat higher percentage of SEPA credit transfers in other – mainly smaller – European countries. Since many corporates and public administrations in Germany have announced a single-step changeover in their payments together with the SEPA direct debit, a significant increase may be expected only from 2010 onwards.

3 This rule will not affect the German collection authorisation procedure, however, as, in this case, the customer subsequently approves the direct debit within six weeks of the statement of his/her account.

Single Euro Payments Area (SEPA)

SEPA participating countries	
31 European countries	– 27 European Union countries – Norway, Iceland, Liechtenstein and Switzerland
Parties involved in SEPA	
European Payments Council (EPC)	– Decision-making and coordination body of the European banking industry – Develops standards and rules for SEPA procedures – Coordinates the practical implementation of SEPA
European Commission and Eurosystem	– Promotes the development of SEPA
End users Enterprises Public administrations Consumers	– Use of SEPA instruments
SEPA instruments	
SEPA credit transfers	– No maximum limit for use within European countries participating in SEPA – Use of IBAN (International Bank Account Number) and BIC (Bank Identifier Code) – Europe-wide crediting within one bank working day (until 2012, special agreements of up to three bank working days possible)
SEPA direct debits	– No maximum limit for use within European countries participating in SEPA – Use of IBAN and BIC – Unambiguous identification of the creditor – Debiting on fixed due date – Precise objection periods
SEPA card payments	– Creation of a single European card market in which the technical prerequisites for using cards at every terminal are met by 2011 – Card systems and card products to conform with SEPA from the end of 2010

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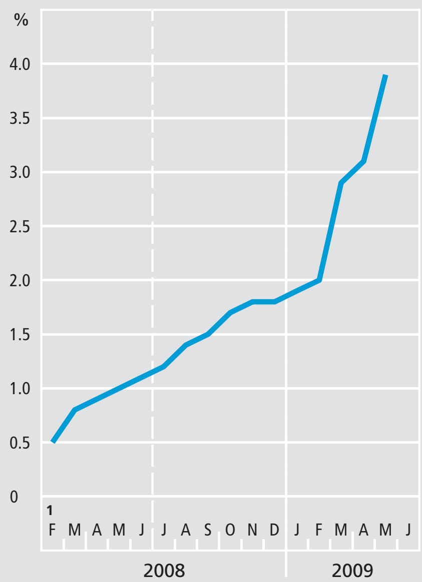
SEPA credit transfers as a percentage of all credit transfers in the euro area



1 Including 28 to 31 January 2008.

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SEPA direct debits

Introduction of SEPA direct debit possible only with uniform legal framework

With the SEPA direct debit, it is now possible for the first time to use a direct debit comprehensively for cross-border payments in 31 European countries. This requires a uniform legal framework. Until now, direct debits have usually been possible only within a single country, since the relevant national procedures have a differing legal basis. This is due to the liability and refund issues associated with the direct debit procedure, which are regulated under civil law in many countries. The introduction of the SEPA direct debit therefore requires a harmonised legal framework to enter into force and is thus dependent on the transposition of the PSD into national law in each of the member states.

Reachability – a key to success

The EPC started the adherence process for the new SEPA direct debit in May 2009. The relevant banks must participate in the procedure to be able to offer the SEPA direct debit. The only way to ensure the success of the SEPA direct debit, however, is to ensure access to this payment method for as many bank customers as possible, ie if the SEPA direct debit is supported by the banks which hold their accounts. If creditors (eg insurance companies, utilities companies) expect that SEPA direct debits cannot be processed for a large number of their customers, they will initially avoid using them. All providers of payment services in the euro area which are currently able to receive national direct debits will therefore be obliged to accept SEPA direct debits from November 2010. This is set forth in the revised Regulation of the European Parliament and Council on Cross-Border Payments in the Community, which is scheduled to enter into force on 1 November 2009.

Two new procedures for private and business customers

Two different direct debit procedures are offered in SEPA: a "core direct debit" and a procedure intended solely for business customer transactions ("business-to-business direct debit" (B2B)). Both versions differ from the national procedures used in Germany in that they use the international codes to identify accounts (IBAN) and the relevant payment service providers (BIC: Bank Identifier Code). The SEPA direct debit is based on a mandate issued by the debtor to the creditor. The mandate includes an unambiguous reference and the data it contains – unlike for the existing collection authorisation – are forwarded to the debtor's bank. On this basis, payment service providers can offer additional services,

Comparison of SEPA direct debit (core) and the collection authorisation procedure

SEPA direct debit (core)	Collection authorisation procedure
Use within SEPA (31 European countries)	National use only
Mandate information is supplied in the data record when a direct debit is collected	Only reference to the collection authorisation when a direct debit is collected
Mandate expires after 36 months of inactivity	Collection authorisation valid until revoked
Specified due dates	Due upon presentation
Fixed lead times – First and one-off direct debits: due date – 5 days – Recurrent direct debits: due date – 2 days	–
Creditor identifier must be used	No equivalent element
IBAN and BIC must be used	Account number and bank sort code must be used

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such as automated mandate handling for the payer. In future, creditors will be assigned a unique creditor identifier, which will be issued in Germany by the Bundesbank.

New element: lead times

Another special feature of the new SEPA direct debit are the envisaged lead times in the settlement process. These increase processing security and, for example, enable the debtor to be informed in advance of an imminent direct debit. A SEPA direct debit should generally be sent to the debtor bank several days before the due date. For the core direct debit, this period is five days for first or one-off direct debits and two days for subsequent direct debits, whereas it is only one day for B2B direct debits. The system currently used in Germany, which involves the redemption of direct debits upon presentation and the associated faster payment of debits for the creditor could be incorporated into the SEPA direct debit, for example, by establishing an additional national service.

Problem scenario: mandate migration

To begin with, the SEPA direct debit will probably find only limited use in Germany. Unlike in many other European countries, the collection authorisations issued for the national procedure cannot be used as the law stands at present for the collection of SEPA direct debits. The existing direct debit mandate authorises only collection by the creditor and does not allow the debtor's payment service provider to debit the debtor's account. It therefore does not meet the legal requirements for a SEPA mandate. The initiation of SEPA direct debits in Germany would therefore necessitate the issuing of new SEPA mandates, which is complex for the user. This may diminish the acceptance of the new procedure considerably. To avoid this and increase the use of SEPA direct debits from the outset, the German banking industry and the Bundesbank have submitted a proposal for the migration of direct debit mandates to SEPA mandates. In line with this proposal, debtors are to be informed by the creditor that their direct debit authorisation mandate has been migrated to a SEPA direct debit mandate and to be granted a period of two months in which to raise any objections. This solution, however, requires the mandate migration to be legally supported, which is not yet the case. If such a solution for migration to SEPA mandates failed to be adopted in Germany, several hundred million mandates for national direct debits would have to be replaced in a laborious process. As a result, the SEPA migration in Germany, the country with the most direct debits in Europe, would thus be delayed for years. This, in turn, could have a negative impact on the entire SEPA project – which is also a political project – since, for reasons of efficiency, many companies are planning to migrate to SEPA credit transfers and SEPA direct debits in a single step. Germany's reputation as a financial centre could also suffer a setback. Not only might Germany be accused of cutting itself off internationally, German providers would scarcely be able to offer SEPA direct debits at competitive rates in Europe owing to the low uptake.

Support from public administrations desirable

Furthermore, the hesitance of public administrations is an impediment to the widespread use of the SEPA procedure in Germany. Public administrations are reluctant to convert their payments to SEPA and thus provide an example of migration to the new instruments. In Germany, government social and salary payments account for more than 30% of GDP. The migration of these payment flows could lead to a significant increase in SEPA payments in Germany. However, this would require a higher prioritisation of the SEPA project at all levels of public administration. Another impediment to SEPA migration in Germany is the high degree of flexibility of the German direct debit procedure, which is reflected in the development of pragmatic solutions for specific transactions (for example, mandates for collection authorisation are no longer required in written form). It should be noted, however, that these proceedings do not comply with regulations in the strict sense. The resulting risks are usually borne by the bank concerned (in most cases, the creditor's bank).

Ruling on interchange fees

Not least, the various business models for direct debits pose problems for the introduction of the SEPA direct debit. While, in many countries, the participating credit institutions have to cover the costs they incur themselves, transaction-related interchange fees are agreed multilaterally in some countries. In such cases, the creditor's bank has to pay a certain amount of money per transaction to the debtor's bank as a reimbursement of expenses. Germany therefore has a special status since interchange fee are incurred only in the case of return direct debits. The creditor's bank thus compensates the debtor's bank for the increased efforts incurred in processing return direct debits. The European Commission recently signalled that, on grounds of competition law and owing to a lack of immediate economic necessity, it will not permit multilateral transaction-related interchange fees in the direct debit procedure in the longer-term. It has, however, allowed a three-year transitional period in which the business models used for legacy direct debits in the country concerned can also be applied for national SEPA direct debits. For cross-border SEPA direct debits, interchange fees of a maximum of 8.8 cents per transaction can be charged during this period. This ruling aims to facilitate migration and prevent the SEPA direct debit from being placed at a disadvantage in comparison with legacy instruments. This should allay the fears of many users – in Germany, too – that the introduction of the SEPA direct debit could lead to an increase in the cost of payments.

SEPA for card payments

European card market highly fragmented

The market for payment cards in Europe (credit and debit cards) has been highly fragmented until now. Credit cards are normally issued by banks in return for a fee on behalf of the major international card companies (such as MasterCard or VISA). By contrast, the debit card segment is dominated by national schemes. Debit cards – as in the girocard system developed by the German banking industry[4] – are usually issued in conjunction with a giro account by the bank which holds the account. These national debit cards can, for example, be used for cashless payments and to withdraw money from ATMs, but are basically restricted to domestic use. In order to enable cross-border usage of national debit cards in the context of co-badging, the infrastructures of international schemes are generally used to process cross-border transactions. The national debit card schemes in most European countries are based on different business models and technical standards, which has led to the strong fragmentation of the European cards market.

EPC guidelines for SEPA card payments

The aim established in the EPC's 2006 SEPA Cards Framework (SCF) is that no card scheme intended exclusively for national use will be in operation from 2011. With SEPA for cards, the fundamental preconditions should be realised in order to use any card at any terminal. This is intended to put in place a single market for card payments in Europe. A key component of this is the creation of effective competition at all levels of a card transaction: issuing, acquiring, acceptance, and processing. Besides eliminating national legal and business policy practices, this necessitates the creation of a single technical standard (interoperability). As a common security standard, for example, the SCF requires all payment cards, card terminals and ATMs in SEPA to be equipped with EMV standard chip technology. This standard has already largely been adopted for payment cards and ATMs in Germany, whereas only a very small percentage of retail card terminals are equipped with EMV technology. Moreover, although the EPC approved a framework for standardisation of card payments in December 2008, this cannot be implemented as a standard owing to a

4 Since 2008, girocard has been the superordinate framework for both German debit card payment systems: the electronic cash system used in retail and the German ATM system. Girocard is also the name of the German debit card (previously ec card).

lack of technical and functional specifications.

Generally, the rules for SEPA card payments in the SCF are not as clearly defined as the very detailed procedural descriptions for SEPA credit transfers and SEPA direct debits. Further efforts will therefore be required on the part of the European banking industry – especially with regard to the development and implementation of standards, for example, for the authorisation and processing of card payments – if the SEPA compliance of payment systems is not to become a mere matter of form.

Options for a single card market…

The SCF provides for a number of options in achieving a single European area for card payments. These include replacing national card schemes with existing international schemes, cooperating with international card schemes, and interconnecting or expanding national schemes on a Europe-wide basis. The development of at least one additional European card scheme would, in any case, be a desirable way of improving competition and efficiency in the card market. Otherwise, there is either the risk of the two international card schemes, which promote their strong brand, worldwide acceptance and, supposedly, greater profitability, dominating the market or a continuation of the *status quo* with many exclusively national schemes.

…and the resulting market initiatives

In the meantime, some market initiatives in this area have emerged. The Euro Alliance of Payment Schemes (EAPS), for example, is working on interlinking existing national debit card schemes. Thus far, schemes from Germany (girocard), Italy, Spain, Portugal and the United Kingdom as well as the European ATM network EUFISERV have been interlinked. However, since major markets such as France are not yet connected, this initiative currently lacks reach.

Furthermore, a number of large German and French credit institutions plan to establish a European alternative in the card market with their "MONNET" initiative. Their aim is to create a new card payment scheme based on an attractive, future-oriented business model. This approach is still in the planning stage, however. A third initiative, called "PayFair", involves the development of a card scheme which enables account-related payment cards to be issued by both credit institutions and retailers. This project is currently in the pilot phase and is scheduled to be launched in Belgium in autumn this year. Although the design and structure of European alternatives is essentially to be left to the market, it remains crucial that full use is made of the efficiency level of European integration and a sufficiently high level of acceptance is achieved in the euro area as a whole.

Future business models must be secure

In order to further develop the European card market, costing certainty has to be ensured with regard to the long-term business model and, in particular, the application of multilateral interchange fees. In this regard, the European Commission has generally approved an interchange fee for cross-border MasterCard transactions, but only in conjunction with a considerable reduction – compared with previous rates – to 0.2% (for debit cards) and 0.3% (for credit cards). Even if the European

Commission takes a case-by-case approach and demands proof of the benefits of an interchange fee using an economic model, this decision is likely to be taken as a signal for other card schemes. In the longer term, it could also become a yardstick for the relevant national competition authorities.

Development of demand: payment behaviour

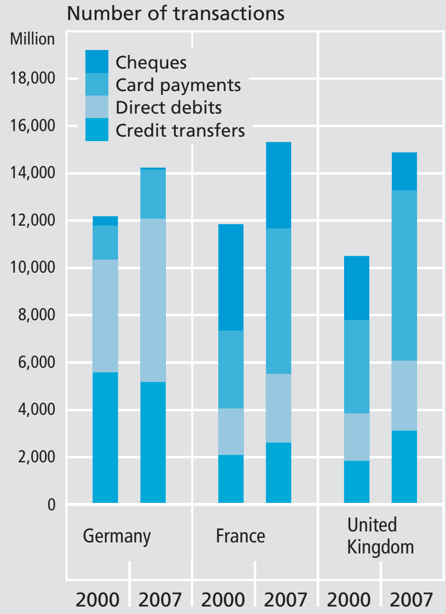
National differences in the use of payment instruments

Card payments increased sharply in EU countries between 2000 (12 billion transactions) and 2007 (27 billion transactions).[5] Nonetheless, payment behaviour in Europe still varies greatly owing to the diverse historical developments. For example, in Germany the direct debit is the most used cashless payment instrument (48%). Basically, the direct debit offers payment recipients the major advantage of being able to manage their own liquidity, while payers benefit from its great convenience. Moreover, the German direct debit procedure is simple and flexible; one-off payments, in particular, can be dealt with quickly and smoothly. By contrast, card payments play a major role for example in Scandinavian countries and the United Kingdom, while, in contrast with most other European countries, cheques are still very popular in France and Ireland.

Debit card payments in Germany

Around 30% of the German retail sales are transacted using debit cards. On the one hand, these are "genuine" debit card payments based on the German "electronic cash" system which are made using a PIN and constitute a guarantee for the retailer. On the other hand, electronic direct debit

Use of cashless payment instruments in Germany, France and the United Kingdom



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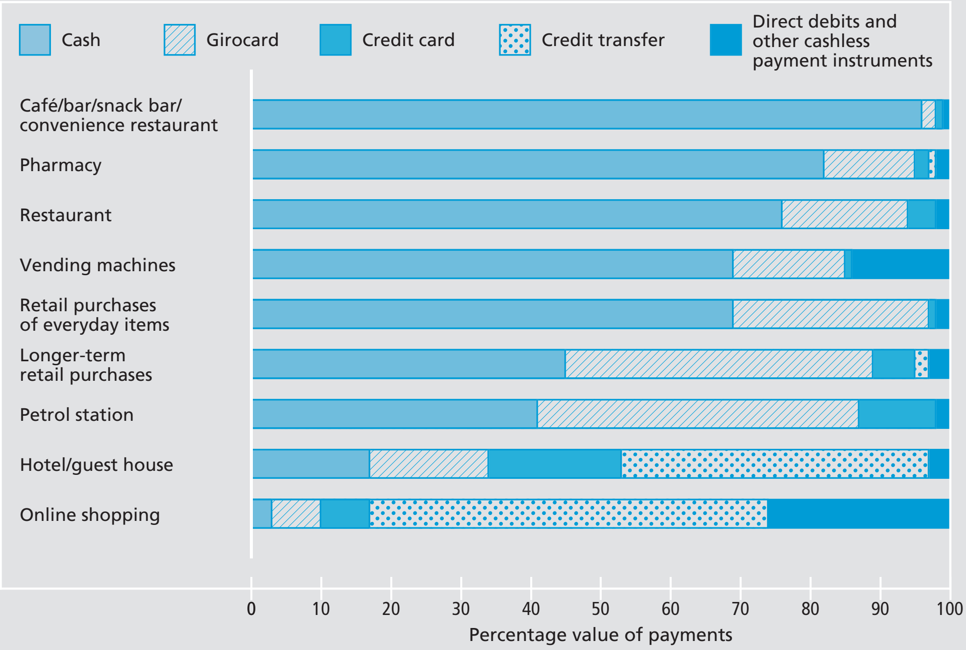
transactions (ELV) are also included in this figure. Here, a collection authorisation order (without payment guarantee) to be signed by the customer is generated based on the data stored on the debit card. The ratio between these two types of transactions has shifted significantly in favour of electronic cash in recent years. In addition to the higher level of security, the fact that the banking industry has made the use of this procedure more attractive, especially for retailers accepting a large number of card payments, plays a key role in this respect.

5 Owing to a methodological change in the collection of payment statistics, there was a decline in debit card transactions (including electronic direct debit transactions) in Germany in the reporting year 2007.

Use of payment instruments by place/purpose of payment



Source: Bundesbank study on payment behaviour in Germany, 2009.

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The popularity of the electronic cash procedure is revealed by its wide market coverage. There are currently 95 million debit cards in circulation in Germany. According to a Bundesbank study,[6] around 90% of those surveyed possess at least one debit card. One major factor in determining its use in the retail trade is the amount to be paid. The majority of payments made using debit cards are between €50 and €100. Furthermore, there are considerable differences in the place and purpose of payment. Overall, there continues to be considerable potential for expansion in debit card payments in Germany. This is suggested by the fact that less than half of the debit card holders interviewed used their card at least once a week on average. Additionally, given an annual average of around 25 card payments *per capita*, the available figures indicate that Germany is well below the European average (around 55 card payments *per capita*).

Credit cards less relevant in Germany

With a share of around 5% in retail sales, credit cards play only a secondary role in Germany. Owing to the wide availability of overdraft facilities in Germany, credit cards in the true sense (ie with an actual credit function) have not managed to penetrate the market. Credit card ownership in Germany – around 14 million in 2007 – is highly dependent on gender, age, educational background and household income. Moreover, retailers and restaurants are somewhat reluctant to accept credit cards owing to the high fees charged in some cases. It remains to be seen how far the

6 See Deutsche Bundesbank, Payment behaviour in Germany, July 2009.

recent European Commission decisions on card business, which led to a reduction in interchange fees, will lead to greater acceptance and, thus, greater use of credit cards.

Expectations regarding the *Geldkarte* have not been fulfilled. The chip embedded in the card, which is used for this purpose can, for instance, be loaded at ATMs and used at vending machines to buy cigarettes, parking tickets and tickets for public transport. The amendments to the Law for the Protection of Children and Youth (*Jugendschutzgesetz*), and the proof of age, which is a function also stored on the chip, were expected to increase the use of the *Geldkarte*. Nonetheless, only 50 million payments or thereabouts were transacted in this way in 2008. As well as limited opportunities for use, this may be due to the lack of awareness about the existence of this function on the chip: although the *Geldkarte* chip can be found on around 80% of all girocards, only one-fifth of those interviewed for the Bundesbank study claimed to have one.

Innovative payment procedures

Innovative payment procedures

The term "innovative payment procedures" encompasses payments which, with the support of modern information and communication technology, initiate payments which are then processed mostly on the basis of established bank procedures (credit transfer, direct debit, card payment).[7]

Internet-based procedures

More than anything, the sharp rise in internet trading in Europe, particularly in Germany, could lead to perceptible changes in cashless payments. Although traditional payment procedures still predominate in this area, the Bundesbank study showed that 10% of online purchases were settled using special internet payment procedures. These include collection procedures (eg Click & Buy), server-based e-money systems, for example PayPal, as well as the German giropay procedure. The latter is an online credit transfer procedure in which the customer is directed straight from the pay window of the internet retailer to its bank's online portal. The retailer receives payment confirmation immediately after the payment has been executed. The immense growth potential of such procedures is illustrated by their growth elsewhere in Europe where, for example, the Dutch iDEAL system has attracted a market share of 40% of online retailing within just a few years.

Contactless payment procedures

Expectations are also high with regard to contactless payment procedures based on NFC technology (NFC: Near Field Communication). Here, payment is initiated using either a card equipped for the purpose or with a chip integrated into a mobile phone. The payment itself is then processed using prepaid credit or as a debit or credit card transaction or as a direct debit. This technology is particularly attractive for public transport as it also allows the ticket to be stored (paperless ticket). In Germany, for example, Deutsche Bahn (Touch & Travel) and the public transport network Rhein-Main-Verkehrsverbund are in the process of introducing contactless payment procedures. International card companies are

7 See Deutsche Bundesbank, Recent developments in payment cards and innovative electronic payment procedures, op cit.

also trying to use this technology to penetrate the low-value payment segment, which, to date, has been dominated by cash. According to the Bundesbank study, almost 95% of all payments of up to €20 are still made in cash in Germany.

Influencing user behaviour

Users are relatively hesitant to change their payment behaviour. It is therefore essential that innovative payment procedures meet customer needs, such as comfort and safety, to the largest possible extent. Moreover, potential users must be familiarised quickly with the handling of innovative products and their associated instruments. Particular attention should be paid to safeguarding privacy and protecting data from unauthorised use.

Cooperation as a key factor for success

Preferences for using payment instruments depend heavily on their acceptance. An innovative instrument is not received well by consumers if it is accepted only by a relatively small number of (internet) retailers or restricted to regional use. It is therefore also necessary for retailers to benefit from the new procedures through fast as well as, compared with cash, cheaper payment processing and, where possible, through better customer retention. Since the coexistence of various technologies can hamper market penetration, interoperability between various providers plays a major role.

Furthermore, open models based on cooperation between various market partners are far superior to smaller, insular solutions which, for instance, require the use of a certain mobile telephone network or particular handset. In France, for example, the “Payez Mobile” project, which is currently in the pilot phase, is a cooperative venture between banks, mobile telephone providers, international card schemes and terminal manufacturers. It is scheduled to be introduced throughout France in 2010.

eSEPA

In the eyes of the European Commission and the Eurosystem, innovative forms of payment also play a major role with regard to SEPA. The Eurosystem sums these up under the term eSEPA. As shown by a European Commission study in 2008, comprehensive use of electronic billing, for example, would give a further significant boost to the efficiency gains of a single market in cashless payments.[8] In order to speed up this development, the European Commission and the Eurosystem are supporting the EPC in the development of new initiatives for eSEPA.

Initiatives by the European banking industry

The EPC is itself currently working on developing frameworks for the initiation of SEPA payments in electronic form or via mobile channels. The linking-up of existing, national internet payment procedures is intended to make them usable throughout Europe. In addition, by the end of 2010, guidelines are to be drafted regarding the initiation and receipt of SEPA credit transfers and SEPA card payments by mobile phone. These are designed to serve as a basis for further cooperation and standardisation in Europe. A general framework, such as that applicable in the card sector, would be of little use here. Instead, a precise set of rules defining com-

8 http://ec.europa.eu/internal_market/payments/sepa/ec_en.htm.

mon procedures and standards for all the parties involved will be essential.

Outlook

SEPA and PSD will intensify competition

SEPA and the implementation of the PSD will make it easier for payment services providers to enter the national markets of other European countries. Competition in the European market for payment services will therefore intensify. In the medium term, the prices of payment services can thus be expected to converge at a low level throughout Europe as a result of greater transparency and a larger selection of providers. Individual providers may also try to differ from each other by offering customer-specific value-added services. However, this would require all providers to gear their strategies comprehensively to SEPA. Minimum investments which only allow a small volume of transactions to be processed in the SEPA segment would not be helpful in achieving the overall aim. Equally unsustainable is a proposal which has been reintroduced into the discussion by some users; this focuses on retaining the German payment procedures whilst incorporating the technical SEPA standards, but not the other SEPA standards. Moreover, it would be necessary for the banking industry to offer the SEPA direct debit as soon as possible, ie by November this year.

Concept of critical mass fails to withstand practical test

A single European payments market ultimately requires the general use of SEPA instruments. This would also form the basis for further innovations in European payments. When the SEPA process was conceived, the banking industry assumed that increasing market demand for the new products would, for business management reasons, lead more or less automatically to the phasing out of existing national instruments. However, this is unlikely to be the case. Although business customers have shown some interest in SEPA owing to the new quality of its cross-border aspect, the necessary investment will not be made on a sufficient scale until the development path is certain. Furthermore, short-term adjustment costs often play a bigger role in the relevant decisions than long-term economic advantages. Another factor is that the concept of SEPA is not yet anchored on a broader base. The national procedure is offered as standard both at the counter and online by almost all credit institutions in Germany. The IBAN and BIC are quoted on the bills of only a small number of public administrations and private firms. These international codes are only reluctantly printed on bank customer cards and payment forms, too. Bank statements are the only documents to contain the IBAN and BIC, as prescribed.

An end-date must be set

If SEPA is actually to overcome the fragmentation of the European payment services market, an end-date for the SEPA migration has to be set. Owing to the differing interests within the European banking industry, however, there are doubts as to whether the market alone can agree on a deadline for phasing out the national legacy instruments. Regulatory measures, such as an ECB or EU regulation, must therefore be considered.

In order to increase acceptance of the SEPA instruments among users, it is equally import-

European discussion forum

ant to ensure an adequate involvement of stakeholders other than the banking industry in the further SEPA process. To guarantee that all participants are involved in an appropriate and timely manner, a forum to discuss strategic topics relating to European retail payments might be found to be helpful. This forum should be based on the European organisational structures of the banking industry which were created with SEPA and have proven successful notwithstanding some difficulties.