Cross-Border Retail Payments

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Today's Picture

- Customers expect a set of convenient, cheap, reliable and predictable instruments to cover their most important payments needs:
  - face-to-face-payments, one-off and recurring remote payments, ATM cash withdrawals
- While customer requirements are generally met in many countries at a domestic level, performance in most areas is poor for cross-border transactions
  - As recent as late 2002, the average fee applicable to retail cross-border transfers in the Euro zone was 100 times higher than that applicable to comparable domestic transfers

Today's Inefficiency

- A "natural" explanation
  - with few exceptions (e.g. payment cards), payment infrastructures already in place are only domestic in terms of their scope, this is, they were developed for a monetary zone delimitated by national boundaries.

- Additional issues:
  - Payment instruments being used
  - Involvement of a Foreign Exchange Transaction
  - "Different" risks
  - Supply factors (diversity of service providers)
  - Regulation (including customer protection) and Oversight

Payment Instruments

- All over the world, cash continues to be the most relevant instrument for cross-border payments in terms of volume

- As for cashless transactions, payment cards are the most relevant instrument in terms of volume
  - In the EU, cards account for 83 percent of total cashless transactions. In many cases, however, cards are not used as payment instruments but rather for ATM cash withdrawals
  - Using cards for remote payments?

Payment Instruments

- Cheques still relevant for remote payments, especially in less “bancarized” countries
- With the payment system technology currently available, electronic credit transfers and direct debits would appear to be the natural instrument for remote payments
  - Until recently, only available through cumbersome and costly correspondent arrangements
  - Only in recent years, with the spreading of processing and messaging technologies, they are starting to become accessible to the average individual

Involvement of a FX transaction

- Not necessarily the case
  - Cross-border payments in the Euro area, or payments between a dollarized country (e.g. Ecuador) and the US
- In some cases, more than one FX transaction, meaning more intermediaries
- Usually, large exchange rate spreads
- Interestingly, however, at present cross-border transactions between countries that use the same currency are not very different in terms of overall inefficiency from transactions involving two or more currencies

“Different” Risks

- The risks are actually the same than for domestic transactions, although the mix can be quite different
- Increased legal risk
- Increased operational risk due to intensive manual procedures (i.e. lack of interoperability)
- However, fraud and other security concerns (e.g. identity theft) are regarded as the main risks
  - In the case of cards, cross-border fraud is approximately 20 times higher than domestic fraud.

Supply Factors

- Increasing demand for cross-border payment services with enhanced flexibility, speed and geographical outreach
- Banks have not been able to cope with this
  - Banks strong in urban areas, where they have generally well-developed infrastructures and where payments involve “bancarized” sectors
- Thus, non-banking (or even non-financial) institutions have gained an important market share
  - Proprietary messaging systems
  - Large distribution networks covering remote locations

Regulation and Customer Protection

- Transparency standards are particularly low for cross-border payments
  - Several implicit charges that are not disclosed to customers (e.g., exchange rate spreads, charges applicable to the receiver, etc.)
  - Minimum service levels, which, for example, give certainty on the time of accreditation of funds to the beneficiary, are practically non-existent
  - It is still costly for customers to foster competition through customer research and comparisons

Oversight

- Still no consensus that retail systems should fall under the direct control of the overseer
- Additional problems in the case of retail cross-border payments:
  - Overseeing non-financial payment services providers
  - Overseeing the full flow of a transaction would necessarily involve two or more national authorities

A broader and more activist agenda in the particular area of retail cross-border payments?

What can be done?

- Improvements through:
  - The “natural” or inertial evolution of cross-border payment systems as a result of increased economic and political integration
  - The systematic and conscious effort to improve/reform retail cross-border payment systems

A look at the SEPA

- In theory, with the adoption of the Euro domestic payments and payments between the countries of the Euro zone ought to be identical
- Up to 2002, however, this was not the case:
  - High costs when compared to domestic transactions
  - Relatively low STP rates
  - Lack of transparency
  - Poor performance for customers (cost, quality and time)
  - For cards, seamless domestic and cross-border processing, but significant price differences between domestic and cross-border

A look at the SEPA

- The European Commission decided that a drastic political solution was necessary. In December 2001 the European Parliament adopted the “Regulation on cross-border payments in euros”

- Main features:
  - All fees applicable to card and ATM cross-border transactions in euros, up to Euro 12,500, must be identical to those being applied to domestic transactions
  - This same regime would apply to credit transfers starting on July 1, 2003

A look at the SEPA

- To comply with this Regulation, the European Payments Council approved two key market conventions:
- The CREDEURO Convention
  - Establishes a basic bank-to-bank pan-European credit transfer that allows banks to give guarantees to their customers as regards information requirements, execution time and remittance information transmitted
- The Interbank Charging Principles Convention
  - A standard procedure for achieving end-to-end certainty in charging methods, and allowing for the instructed amount to be credit to the beneficiary in full

A look at the SEPA

- Commercial banks have decided on a pan-European architecture, the Pan-European Clearing House (PE-ACH) as the preferred model for credit and debit transfers.
- In a first stage, the PE-ACH will process credit transfers in combination with existing clearing and settlement systems

Summit of the Americas Commitment to Reduce Remittance Costs by at least half by 2008

– An upcoming Pan-American Payments Clearinghouse?