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Payments in Europe: A round table discussion to establish a baseline view of European payments world with Charlie Nunn (McKinsey), Pedro Deserrano (VISA) and Paul Smee (APACS) held on Thursday 22nd January 2009 at City Marketing Suite, Basinghall Street, London, EC2P 2EJ

Visa/CSFI Fellowship Programme

At the heart of the payments issue is the differing pace of change in financial and technological innovation. The chair kicked off the discussion with a little history. Back in the 18th century Abraham and Benjamin Goldsmid made a fortune borrowing short and lending long to provide primary financial support to British military campaigns against France during the French Revolutionary Wars. The strategy eventually backfired just as it did for Northern Rock except the personal consequences were much graver – Benjamin hanged himself and Abraham shot himself. Why is the progress in finance so limited? As Roger Bootle said some years ago, payments are “too slow, too expensive and too opaque”.

The first speaker laid out the figures. Revenue from payments – fee income and net interest income on cash, card, cheque and electronic payment transactions – was €180bn in 2006, larger than airlines, and provided a quarter of banking revenues. If anything it will be more important as the credit crunch hits other revenue streams. It provides €40bn or a sixth of bank profits. While the costs of handling, transactions and processing amounted to €50bn, revenues were €90bn, so there was clearly extensive cross-subsidisation. The cost of handling and processing cash was €20-25bn so there was opportunities for efficiency gains especially for countries less attached to cash.

As much as three-quarters of the growth potential would come from liquidity i.e. balances held on account. In terms of transaction costs, regulatory initiatives such as the Single Euro Payments Area and the Payment Services Directive could put as much as €20bn at risk. On the liquidity side the credit crisis may led to fewer loans and running down of bank balances. A 1% increase in loan losses would wipe out credit card profitability while a 0.5% decline in net interest income would cut €15-20bn of income for current account businesses.

What are the solutions? One is a war on cash. Many banks are looking to drive efficiency to the next level. However this may not the right time to try to change people’s behaviour or start discriminating on price. No bank will go it alone and charge for using ATMs. The second is a battle for liquidity if banks focus on high-quality, fast, embedded services to attract consumers. Lastly there could be new revenue models such as charging an annual fee for using a bank account – something that would provoke a political reaction.
The second speaker had some good news. VISA Europe saw spending on its cards at point of sale increase 10.3% during 2008. E-commerce in December Christmas was up 24% on last year. Use of VISA debit cards at point of sale is up by almost 11% in Europe,

and over 70% of spend is now on debit. However the credit crunch was having an impact as annual spending growth has fallen from 8.8% in the second quarter to 5% in the fourth. The growth in debit gave banks, which own VISA, an opportunity to displace cash and cheques. Debit has been resilient. Risk-adjusted return on capital fell 1% for debit but 11% for credit. Is debit the future? The third speaker said it was more varied than that, as people would still prefer to take advantage of delayed repayment on major purchases. The second speaker said Carrefour's launch of credit and debit cards showed there was room for competition. The chair said Nellie Kroes, the EU competition commission, has voiced hostility towards the duopoly of VISA and MasterCard. It is possible Western Union or PayPal could provide competition on processing.

A big issue is interchange fees, the fee paid by retailers to the issuer of a credit or debit card for transaction-related costs. The Commission is putting downward pressure even through the Australian experience shows that retailers simply keep all the benefit of a cut. In December 2007, the Commission ruled that MasterCard should withdraw its cross-border fee. The second speaker conceded some fees were too high and said VISA was working with the Commission on an agreement by the end of this year.

The third speaker said the key aspect of payments was the reliability of delivery. If a cheque takes time to clear we grumble, if an ATM is shut we curse, but if our salaries fail to land in our bank accounts on time, we riot. The system has stood up to pressure during the crisis and a new Faster Payments Service with real-time online transfers between accounts is working. The Payments Council, an independent body, has produced a detailed 10-year plan that seeks to search for improvements in collaboration with users.

Abolition of cheques is a key issue. No single bank CEO would be able to scrap them although collectively they would all like to migrate away from them. Will the Government block that? The speaker felt it was a case of nihil obstat – they would not put obstacles in the way if the process were transparent. But one member said many in the Southern-based finance industry underestimated the affection for cheques especially in the North as a way of being able to keep a record of transactions. The chair said that surely the mobile phone was the perfect complement to a debit card as it allowed instant access to one's balance in the way a chequebook stub didn't.

The third speaker said the aim was not to stop people doing something but to open up their options. He doubted there was a great sentimental attachment to cheques. The issue of cash is overshadowed by the informal economy, whether terrorist finance or simply paying one's cleaning lady off the books. There are some transactions where only cash will do and the sentimental attachment is much greater. What is the future for SEPA? The speaker said it was a political initiative designed top-down which might explain the low take-up. There was no sign of mass migration from national systems to SEPA. He forecast a "son of SEPA". The end result will be consolidation in processing to maybe five, six or seven large processors in Europe. The first speaker said it could be as few as three.