EBA CLEARING Services: The Changing European Payments Landscape

Sibos Special Interest Session

Toronto, 20th September 2011
EURO1 Reform Program Update: Improvements to liquidity management and risk control

Alan Taylor
Director, EURO1/STEP1 Services
EURO1/STEP1 daily average volume 2009-2011
EURO1/STEP1 transaction value evolution

EURO1/STEP1 daily average value 2009-2011

![Graph showing the daily average value of EURO1/STEP1 transactions from 2009 to 2011. The graph depicts the value evolution over the months of each year with three lines representing different years: 2009 (light blue), 2010 (dark blue), and 2011 (green).]
The press still reads the same:

* Bank “crisis”
* Country “crisis”
* Currency “crisis”
EURO1 finds itself in the middle of three important industry discussions:

- Liquidity discussions
- Risk discussions
- SEPA migration & end-date
Sequencing of issues

1. Review of risk sharing scheme
2. Algorithm and liquidity efficiency of scheme
3. Review of Participation rules
4. SEPA migration & end-date
5. Review of governance model
Future Development Group

Established with 12 members equally from OTC (Payments) and TLG (Liquidity)

Barclays  Intesa Sanpaolo
BNP Paribas  J.P. Morgan
Citibank  Royal Bank of Scotland
Commerzbank  Société Générale
Deutsche Bank  UBS
ING  UniCredit

• Largest users of system
• Systemically important banking groups
• Meetings and conference calls
• Also information exchange with CHIPS
LIQUIDITY MANAGEMENT
In order to ensure the maximum recycling of euro liquidity:

1) Two new distribution windows introduced at 11:00 and 12:00

2) Algorithm for eligibility to receive a distribution changed from position being at 60% of credit cap to 40% of credit cap
EURO1 – Optimisation of liquidity

Prefunding and liquidity distribution cycles

TARGET start-up

Window 1

Window 2

Window 3

Window 4

Window 5

Window 6

Distribution of liquidity from EURO1

Receipt of funds on PSA from EURO1 Participants

Pre-funding cut-off

EURO1 cut-off

End of day settlement

D 07:00

D 11:00

D 12:00

D 13:00

D 14:00

D 15:00

D 15:30

D 16:00
# Liquidity Bridge

## Pre-funding

<table>
<thead>
<tr>
<th></th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total volume</td>
<td>491</td>
<td>436</td>
<td>506</td>
<td>450</td>
<td>492</td>
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<tr>
<td>Daily average volume</td>
<td>21</td>
<td>22</td>
<td>23</td>
<td>20</td>
<td>23</td>
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<tr>
<td>Total value (billions)</td>
<td>396</td>
<td>352</td>
<td>406</td>
<td>366</td>
<td>390</td>
</tr>
<tr>
<td>Daily average value (billions)</td>
<td>17</td>
<td>18</td>
<td>18</td>
<td>17</td>
<td>18</td>
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## Liquidity distribution

<table>
<thead>
<tr>
<th></th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
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</thead>
<tbody>
<tr>
<td>Total volume</td>
<td>734</td>
<td>653</td>
<td>1,475</td>
<td>1,514</td>
<td>1,488</td>
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<tr>
<td>Daily average volume</td>
<td>32</td>
<td>33</td>
<td>67</td>
<td>69</td>
<td>71</td>
</tr>
<tr>
<td>Total value (billions)</td>
<td>344</td>
<td>312</td>
<td>398</td>
<td>359</td>
<td>378</td>
</tr>
<tr>
<td>Daily average value (billions)</td>
<td>15</td>
<td>16</td>
<td>18</td>
<td>16</td>
<td>18</td>
</tr>
<tr>
<td>(banks taking liquidity)</td>
<td>(47)</td>
<td>(45)</td>
<td>(48)</td>
<td>(48)</td>
<td>(49)</td>
</tr>
<tr>
<td>Percentage distributed</td>
<td>87</td>
<td>88</td>
<td>98</td>
<td>98</td>
<td>97</td>
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</tbody>
</table>
RISK CONTROL
LEVELS OF EXPOSURE
EURO1 – bilateral limits

Debit cap: formed by bilateral limits received

Mandatory + discretionary limits

Bank A
- 5m
- 0 to 25m

Debit Cap = Sum of limits received

1bn max

Receiving Bank
EURO1 – bilateral limits

Credit cap: formed by bilateral limits granted

Credit Cap = Sum of limits granted

1bn max

Grantee Bank

Mandatory + discretionary limits

Bank A
5m
0 to 25m

Bank B
5m
0 to 25m

Bank C
5m
0 to 25m

Banks set limits according to their risk assessment
Reduction of risk in system

*Mandatory bilateral limit needs to be adjusted downwards not least in view of individual bank and country concerns.*

- Change the mandatory amount from EUR 5 million to EUR 2 million
- Reduces residual exposure by more than 50%
- Total removal of the mandatory limit would have impact on the liquidity within the system and on the loss sharing procedures
Flexibility of risk allocation within the system

Ensure sufficient liquidity remains available within the system as a result of any adjustment to the bilateral limit structure.

- If the mandatory limit is reduced then the discretionary limit is to be increased to a new maximum to enable banks to maintain the required levels of their respective debit and credit caps.
- New maximum discretionary limit to be EUR 50 million (doubled from existing amount). Larger users could then allocate their discretionary limits to ensure sufficient (sending and) receiving capacity.
- The EURO1 simulator is now operational and allowing EBA CLEARING to model “What if” scenarios based on different limit allocations.
Debit cap: formed by bilateral limits received

Mandatory + discretionary limits

Bank A
2m
0 to 50m

Bank B
2m
0 to 50m

Bank C
2m
0 to 50m

Debit Cap = Sum of limits received

1bn max

Receiving Bank
EURO1 – bilateral limits – new amounts

Credit cap: formed by bilateral limits granted

Credit Cap = Sum of limits granted

1bn max

Mandatory + discretionary limits

<table>
<thead>
<tr>
<th>Granting Bank</th>
<th>2m</th>
<th>0 to 50m</th>
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<tbody>
<tr>
<td>Bank A</td>
<td>2m</td>
<td>0 to 50m</td>
</tr>
<tr>
<td>Bank B</td>
<td>2m</td>
<td>0 to 50m</td>
</tr>
<tr>
<td>Bank C</td>
<td>2m</td>
<td>0 to 50m</td>
</tr>
</tbody>
</table>

Banks set limits according to their risk assessment
RISK CONTROL – TIMING
Bank driven risk management

Credit & debit caps result from bilateral limits
- Banks grant bilateral limits according to own risk assessment
- Bilateral limits can be changed up to 18:00 on day D-1 for effect on day D:
  - Discretionary element – no restriction
  - Mandatory element – 51% or more of participants must do the same

Foreseen from mid-October

- Discretionary element can be changed up to 07:00 on D for effect on day D:
  - Can react to deteriorating circumstances
    - Over bank holiday
    - Over week-end
    - Overnight
Benefits for banks

Risk sharing substantially reduced

Implementation will be at the same time as the introduction of the change to the amounts of the mandatory and discretionary bilateral limits.

_This means that banks can now bring their exposures down to virtually nothing same day._

Banks can now react to adverse situations without having to wait effectively another business day.
Impact on banks

**Risk management being further improved**

Should a bank be subject to its mandatory limits being set to zero by the requisite number of banks, the stricken bank would be currently exited from the system that day.

Work is underway to develop a soft landing for a stricken bank, so that it may continue to send and receive payments within the system, but at no risk to the participants.
Impact on banks

Payment processing being further improved

- The circles processing algorithm is now activated at regular intervals on an ongoing basis throughout the day
- This process will be automated

- The liquidity benefits of the multilateral netting effect for payments in EURO1 ensure banks are not adversely affected by the new legislation on capital and liquidity requirements

This puts EURO1 in a leading competitive position against gross systems.
Positioning EURO1

- EURO1 is an RTGS-equivalent net system: finality of payments is achieved at the moment of processing

- EURO1 operates on a net basis, but is not a netting system

- It is acknowledged that the limited queuing of payments is acceptable in order to benefit in full from the multilateral netting effect

- EURO1 is seen as a system for urgent payments

- ACHs are not the vehicle through which high value payments should be processed

- Single payments will remain
STEP2: Update and Outlook

John Broxis
Director, STEP2 Services
STEP2 KEY POINTS
• STEP2 is Europe’s first and only Pan-European ACH:
  – Based on a country neutral governance model
  – Enabling full reach to all SEPA banks
STEP2 Key Points

STEP2: the PE-ACH

- Full reach
- Full compliance and high resilience
- Advanced functionality
- Capable of processing high volumes
- Cost-efficient
- Flexible and extendable to meet specific domestic processing needs
STEP2 SCT Growth

STEP2 SCT – Daily Average Volume

- 2010-01: 100,000
- 2010-02: 300,000
- 2010-03: 500,000
- 2010-04: 700,000
- 2010-05: 900,000
- 2010-06: 1,100,000
- 2010-07: 1,300,000
- 2010-08: 1,500,000
- 2010-09: 1,700,000
- 2010-10: 1,500,000
- 2010-11: 1,600,000
- 2010-12: 1,700,000
- 2011-01: 1,400,000
- 2011-02: 1,500,000
- 2011-03: 1,700,000
- 2011-04: 1,600,000
- 2011-05: 1,500,000
- 2011-06: 1,600,000
- 2011-07: 1,709,376

EBA CLEARING

sibos 2011 Toronto
STEP2 – Interoperability

Status: September 2011
STEP2 SCT – Reach

123 of which are Direct Participants

Status: September 2011
CHANGES FOR 2011/2012
Irish Domestic Service

• In October 2011, the STEP2 Irish Service will go into operation with the following benefits for the Irish community:
  – Automation of settlement
  – Compliance with D+1 end-to-end processing requirement (PSD)
  – Provision of a migration path to SEPA

• The Irish Banks will process 1 million payments per day.

• STEP2 will facilitate a bilateral file exchange transfer, with centralised settlement allowing extremely cost-efficient processing.
STEP2 Settlement Cycles

- Two new settlement cycles will be added.
- The cut-off for same day payments will be extended by one hour.
- A new (optional) settlement window will be introduced in the evening to allow delivery of tomorrow's payments during the evening.
• STEP2 performs a lot of validation, transaction by transaction:
  – In 2010, there was one technical rejection for every 10,000 payments.
  – In 2011, there was one technical rejection for every 30,000 payments.

• High-volume domestic users are sending millions of transactions in a day with 0 rejections.

• Finnish Domestic traffic in one month:
  20 million payments – 80 rejections
Prices Decrease

- Half the cost of STEP2 processing goes on validating transactions.
- For 2012, we will introduce a new high-volume processing service for domestic payments on a closed user group basis.
- By halving the processing requirement, we will halve the price.
- Transaction cost of STEP2 falls by 50% for domestic volumes.
POST-MIGRATION REQUIREMENTS
Looking Beyond SEPA Migration

• The SEPA Migration End Date legislation is in the process of being finalised.

• The migration end-dates could be applied in a very short time frame (possible end-date for Credit Transfers: Q1 2013).

• Eventually, all Credit Transfers and Direct Debits will migrate to SEPA.

• What will be the requirements for the post-migration world?
Post-Migration CSM Requirements

- Very high processing capacity
- Extraordinary resilience
- Flexibility in price and processing options
- Value-added functionality
• 2009 External (IBM Certified) Benchmarking exercise proved that STEP2 is already able to process high volumes (i.e. over 10 million transactions per day) without further modification.

• Since the Benchmarking, the following developments took place:
  – Processing performance has been upgraded.
  – New more efficient service level options have been introduced.
  – End-Date Legislation has been announced.

• EBA CLEARING will run a second benchmarking exercise to prove that STEP2 can smoothly process 100 million transactions per day, end to end.
STEP2 Resilience

- SIA processes 15bn transactions per year (Payments, cheques, cards, ATM, POS)

- The resilience of the infrastructure is equal to or better than that of any other CSM in Europe

- EBA CLEARING will run a consultation exercise to determine whether the current infrastructure configuration is sufficient or should be improved.
Flexibility in Pricing and Processing Options

• There is no ‘one size fits all model’

• A single pipe for all SEPA payments but supporting domestic AOS

• Payment processing service levels:
  – Payments handled at transaction level
  – Payments handled at the batch level
  – Bilateral file exchange solutions
Value-Added Functionality

- The End-Date Regulation will impose standards on the customer-to-bank space.

- Banks will need help in migrating volumes of many services:
  - File handling and converting legacy or customer XML
  - Enrichment service (e.g. BIC/IBAN conversion services)

- EBA CLEARING is investigating how to help the banks in these areas through partnering with existing service providers.
The E-Services Initiative of EBA CLEARING
MARKET DEMAND
A Growing Trend

“eCommerce nets £28 billion in United Kingdom in 2011”
August 4, 2011

“Online Shopping keeps on beating records in Spain”
August 1, 2011

“Western European E-commerce Market Continues Strong Growth”
August 15, 2011

“Internet used more in Europe for online shopping than to browse social networks”
July 22, 2011

“Internet access among EU households has almost doubled over the past five years”
August 4, 2011
Key Barriers for Online Shopping

Security, privacy and trust are still the major barriers in consumers’ minds:

- I have no need
- I prefer to shop in person, like to see product, loyalty to shops, force of habit
- Payment security concerns
- Privacy concerns
- Trust concerns
- Lack of skills
- Relevant information about goods and services difficult to find on website
- Don’t have a payment card allowing to pay over the Internet
- Delivery of goods ordered over the internet is a problem
- Speed of the Internet connection is too slow
- Others

Source: Eurostat Eurostat - Community survey on ICT usage in Households and by Individuals
E-Payment Merchants Initiative

In June 2011: A position paper on online payments in Europe, including key requirements formulated by web merchants across the continent, was presented at the Euro Banking Association conference EBAday in Madrid.
10 recommendations:

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<thead>
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<th>A Improvement of existing products</th>
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<tbody>
<tr>
<td>Recommendation 1</td>
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<td>Recommendation 2</td>
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<tr>
<td>Recommendation 3</td>
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<td>Recommendation 7</td>
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Source: E-Merchants Position Paper
THE MYBANK RESPONSE
Online shopping paid through online banking all across Europe.

MyBank. Coming soon.
MyBank is a button to be displayed on the website of web merchants.

Consumers click on this button to complete their purchase in a secure manner via the online banking channel of their bank.
Starting Principles

• MyBank is multi-purpose
  – Guaranteed Payment
  – Payment on Delivery
  – E-mandate creation / modification / cancelation

• Focussing on EUR transactions but open to multi-currency

• Adaptable for smart phones and other web connected devices.
BENEFITS FOR BANKS
Short-term Benefits

• Generating revenue
• Reducing costs
• Improving customer satisfaction
• Meeting regulatory expectations
The Strategic Business Case

• What is the risk that if the banking industry does nothing, bank customers will find other ways to do the things that they want to do?

• Is there a threat that non-banking entrants, with smart technology, a wide customer base and a sufficient level of trust will take the customer front end?

• MyBank brings the banking industry back into the game and counters the risk of disintermediation.
The Strategic Business Case

• What is the value of putting the bank back into the heart of the e-commerce transaction?

• What is the value of getting somebody to go to their bank’s website every time they buy something?

• What unknown opportunities exist for the custodians of a customer account by linking the payments capability to real-time, internet and mobile capability?
CONSULTATION AND PILOT
Initiative Launched

• Q1 and Q2 2011 Blueprinting exercise

• The initiative was launched at the EBA CLEARING Annual Shareholders’ meeting on 14th June 2011.

• EBA CLEARING ran a consultation process with stakeholders from 14th July to 26th August 2011.
Positive Outcome of Consultation

- EBA CLEARING received results from organisations representing over 3,000 institutions.

- MyBank is welcomed by merchants and consumers, and is now seen as the banking industry’s initiative in e-commerce.

- Today, there are over 30 banks supporting us in all major European countries, with full coverage in many of them.
Roadmap

• Call for Pilot Banks and e-merchants.
  – Definition of the Pilot: scope aims and objectives
  – Further definition of the operational issues
  – Definition of the governance environment
  – Definition of the roll out objectives

• May 2012: Live Pilot Launch

• Then, observation, tuning, ramp up and launch
EBA CLEARING’s Success Factors

This initiative will be successful, because EBA CLEARING

• is a country-neutral, pan-European organisation
• has a reputation for building practical solutions that work
• has a spotless record of delivering collaborative payment projects on time

MyBank is a simple, secure solution that meets clear requirements and delivers value to Merchants, Consumers, Banks and Regulators.
EBA CLEARING’s Services and Initiatives

EURO1
STEP2
MyBank

Part of the changing face of the SEPA Environment
EBA CLEARING
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NEW:
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