

‘The development strategy of the payment system and non-cash circulation in Poland’

This address opens the second part of today’s session at the Congress of e-Economy, devoted to the topic of ‘The influence of financial institutions on the development of e-economy.’ It appears that my topic and the topic of my distinguished co-lecturers, the payment system, is a perfect example of how banks and other financial institutions, operating within the financial system, may impact the development of the e-economy in Poland, and vice-versa: how the e-economy may impact a national payment system.

In his address today, Mr Krzysztof Rybiński, Deputy President of the NBP, has touched upon the issues concerning, among other things, relations and interdependence between the two fields: the payment system and the e-economy. Let me repeat the thesis that Mr Rybinski put forward this morning: there is a close relation between the development of the payment system and that of the e-economy. Later in my speech I will point to the common area of the two fields, and how the development of one may influence the growth of the other.

Although many of the addressees of this lecture are well familiar with the topic of a payment system, let me begin my speech by providing an answer to the following question: what is the payment system? Many people think that the Polish payment system is, e.g. the ELIXIR system, operated by the National Clearing House, or the SORBNET system operated by the National Bank of Poland. They are partially right; however, they confuse the term ‘payment system’ as a domestic system with the particular funds transfer systems (payment systems). SORBNET and ELIXIR systems are payment systems in the second meaning (funds transfer systems), which indeed are the pillars of the Polish payment system per se. However, a national payment system is much more than the sum of particular payment systems.

According to the definition of a payment system adopted, *inter alia*, by the Bank for International Settlements, the European Central Bank and central banks of EU countries, a payment system is “a set of instruments, banking procedures, and, typically, interbank funds transfer systems that ensure the circulation of money,” typically within a given country (i.e. a ‘national payment system’).

The fundamental components of the payment system are:

- a) participants in the system;
- b) payments cleared in the system;
- c) money subject to transfer within the system;
- d) payment instruments used to effect payments;
- e) communication channels, via which payments are cleared;
- f) contractual relations among the interested parties.

All these components are to be found directly or indirectly in the appended diagram — a pyramid, which — in a simplified manner — depicts the most important persons (legal and physical) and institutions participating in the payment system, as well as the most important channels for effecting payments.

For the purposes of further analysis, it is important to isolate two parts of the payment system: the lower part of the pyramid, which includes either payment mechanisms that do not use the intermediation of banks (i.e. usual cash payments) or customer-bank relations (which constitute the first stage of banking non-cash payments), and the upper part of the pyramid, which includes interbank clearing and settlement and funds transfer systems, also called payment systems, that form the basic infrastructure of the payment system in every country.

In order to analyse properly the relations between the payment system in Poland and the e-economy, a breakdown of payments, into the most important categories: the fact of intermediation or non-intermediation of banks in executing payments (bank and non-bank payments), the type of money subject to transfer (non-cash and cash payments) and the type of the payment instrument by means of which a payment is effected (paper-based and electronic instruments), will be of use. It should be noted here that non-cash circulation is related solely to payments effected with the use of bank money, i.e. with the use of one of the forms of banking intermediation in executing payments, and that the most effective type of payments are non-cash bank electronic payments (in terms of time and low payment cost as well as the possibility of full automation of the payment handling service at every stage of the payment cycle). In fact, they constitute the common element joining the two fields discussed here, i.e. the payment system and the e-economy, and their development is of the greatest concern to the National Bank of Poland and Polish banks.

We may adopt a simplified assumption that money payments effected with the intermediation of banks consist basically of three stages:

- 1) stage one — placement of the payment order by the payer with their bank,
- 2) stage two — transfer of funds resulting from the payment order between the payer's bank and the bank of the beneficiary, typically via the central bank, with the possible use of clearing intermediaries, of whom the clearing house serves as the best example,
- 3) stage three — crediting of the beneficiary's account by their bank with the funds received from the payer's bank, and subsequent notification of the beneficiary.

From this perspective, depending on the form of transfer of payment order used at each of the stages, three primary periods of the development of the payment system may be distinguished:

- period one, which may be called the 'paper period' — at each of the stages payment orders and information are transmitted almost exclusively on paper media,
- period two (intermediate) — at the first and third stage, payment orders and information are generally transmitted on paper but the stage of interbank transfer of payment orders is partly or fully electronic,
- period three, which I would have called the 'developed or electronic period' — mainly the electronic form of placement and transfer of payment orders as well as transfer of information is used at all the three stages.

Of course, some intermediate periods may also appear, which are insignificant for the major topic of the analysis. The above determination of the periods of the payment system development brings us closer both to the explanation of relations between the payment system development and the development of the e-economy, as well as to a review of the development of the Polish payment system in recent years.

In my opinion, the payment system can only partially develop in an underdeveloped e-economy. In the abovementioned period two, only interbank transfers are effected electronically, due to the fact that the framework for the e-economy is limited at present:

limited access to and relatively high prices for electronic services, somewhat unfavourable legal regulations (the banking transfers are regulated mainly by civil legal agreements, and not by statutory law). This framework restricts the use of electronics to communication between banks and financial institutions. Without the general access of natural persons and business entities to various services and products based on electronic media and electronic processing, we cannot speak of the transition of a given national payment system to period three, i.e. a fully mature and effective payment system.

However, since the title of the present set of lectures is: ‘The development strategy of the payment system and non-cash circulation in Poland’, let me move on from the above, slightly theoretical part of the address, to the abovementioned strategic aspects of the issue.

I would like to point out a limitation here - there does not in fact exist any document called the ‘Development strategy of the payment system in Poland’. Considering the broad understanding of the term ‘payment system’ assumed above, and the active participation of both public and private entities in this field, every one of which has or may have its own vision and development strategy, there is no single strategy for the development of the payment system in Poland. No authority should replace the authorities of those entities and unilaterally determine or impose strategic directions of activities of those entities in this area. The National Bank of Poland does not endeavour to do so either, although it is aware of its statutory function within the scope of organisation of payments and settlement and supervision of payment systems. Neither can such examples be found in other countries, perhaps with few exceptions.

Presenting the above reservation, however, I wish to announce that the Payment System Department of the National Bank of Poland, in co-operation with experts from the Polish Banks Association and the Polish National Clearing House Co, i.e. entities the most involved in the analysis of the payment system in Poland, in 2005 developed a document entitled ‘Evolution of the Polish payment system against the background of developments in the payment and settlement system in the EU’, which is partly a programme and strategic document. That document was discussed at the session held by the Payment System Council, which is an advisory body to the NBP Management Board, in December 2005, and obtained its approval. Since the document was intended to be a programme document of the NBP for the area of the payment system, we assume its adoption by the Management Board of the NBP, and subsequent publication, which we are still awaiting due to the editing work that has still to be done. Nevertheless, taking into account the still draft version of the document, let me present — as proposals of the NBP Payment Systems Department — some of its elements, significant for the presentation of the strategic problems that the payment system and non-cash circulation face in Poland.

Although the document is not a real strategy development document, like every properly-constructed strategy, it includes: a diagnosis of the current scheme and a reminder of the basic trends in the development of the payment system in Poland and in the European Union in the past dozen or so years; a forecast of the trends in the development of the environment, i.e. the payment systems in the EU; a brief statement of the most important challenges for Poland in this respect; a suggestion of the strategic objective for the payment system in Poland; and a desirable course of action for its implementation in the forthcoming years.

Let me begin the discussion on the above elements by presenting the main stages in the development of the Polish payment system over the past 13-14 years. Until 1994 r., i.e. before the ELIXIR system was established, the Polish payment system was fully based on paper-based exchange of payment orders, both with reference to customer and interbank payments. Since interbank payment orders, routed generally to the SORBNET system in the NBP, were easier to electronise due to a smaller number of both payment orders and participants (banks' head offices) than customer orders, routed mainly to the systems of the Polish National Clearing House Co. (where participants are generally bank branches), as of 1998 we can speak of full electronisation of the SORBNET system, which in the case of the Polish National Clearing House Co did not happen until July 2004. I do not mean to say "only in 2004," since it was a great success of the Polish banks and the Clearing House to convert a typically paper-based clearing house 12-13 years ago into a fully electronic clearing house handling all cleared payment instruments electronically. As of July 2004 both primary payment systems in Poland perform clearing exclusively in the electronic format.

Against the background of the three periods in the development of the payment system mentioned, the above stages suggest that the Polish payment system only reached period two of development from July 2004 on – i.e. the period when there is electronic exchange of payment orders between banks, however payment orders are still transferred mainly paper-based between bank customers and banks. Naturally many banks offer their customers e-banking services, providing online access to the bank account is available and the possibility exists of make payments online. The number of accounts with access via electronic channels has also been growing month after month. However, this is still a minority, which — according to the abovementioned classification of periods in the development of the payment system — locates the Polish payment system in second period of its development.

Let me move on to a review of the Polish payment system from the point of view of the NBP Payment Systems Department. The payment infrastructure in Poland should be assessed positively, both in relation to zloty and — since 2005 — euro payments settlement (after establishment of the SORBNET-EURO and EuroELIXIR systems and their connection to the pan-European TARGET and STEP2 systems), as well as solutions within the scope of standardisation (including in particular the common introduction of the IBAN (bank account number) and supervision of payment system elements (such as payments systems or authorization and settlement systems). Instead of speaking about the defects of the Polish payment system, let me speak of its weaknesses, since weaknesses are easier to overcome than defects – and I hope, we will sooner or later overcome them. Such weaknesses include first and foremost various aspects of the non-cash circulation in Poland, its scarce use being one and the most important of them, whilst within the framework of non-cash circulation — a relatively low use of electronic payment channels by bank customers. The use of non-cash circulation in Poland is characterised by very low indices, in particular as compared to other EU countries.

I would like to present five selected - and in my opinion the most important - categories that characterise non-cash circulation in individual EU countries. In compliance with the principles of comparison, the above categories have been reported per capita in a particular country. Data for these charts have been raised from the Blue Book, newly published two weeks ago by the European Central Bank, containing statistical data concerning payment systems and securities settlement systems in EU countries for 2004.

According to those data, Poland holds the last position in three of the five categories. The first two categories are an exception here: the number of accounts, where Poland holds the fourth from last position and its index is a half lower than the EU average, and the number of transfer orders, where Poland is ahead of 7 countries and its result is also about twice lower than the EU average. Considering the remaining three categories, i.e. the number of direct debits, the number of payment cards and the number of card payments respectively, Poland comes last, and its result is correspondingly about a hundredfold, over twofold and almost eightfold below the EU average.

It is not the right time or place for a detailed analysis of the reasons behind such developments; however, the above data support the previous judgment that, with a relatively good infrastructure of the payment system, at a level comparable to that of other EU countries, non-cash circulation and the use of all non-cash payment instruments by customers of Polish banks is underdeveloped. Without going into detail, I would like to stress that, the causes of this state of affairs (besides reasons of economic, legal and psychological nature) include the relatively restricted (both in physical and economic terms) access of population to the Internet, compared to other EU countries, which results in a lower use of e-banking as one of the least costly channels of access to the account and effecting payments.

Having presented a diagnosis of the current scheme of the payment system in Poland, let me point to the four basic challenges that the Polish payment system is to face in the forthcoming years:

- 1) deployment of the TARGET2 system,
- 2) implementing the directive on payment services in the internal market, which is currently being elaborated, into Polish law,
- 3) preparation of the Polish banks and infrastructure-providing entities for the SEPA standards,
- 4) Poland joining the euro zone.

As to domestic challenges, I will point to, among other things, the necessity of increasing the effectiveness and competitiveness of payment services in the Polish banks (compared to foreign banks and other domestic entities), which will entail, in my opinion, changes in the fees and commissions policy, as well as the need to meet the requirements of the increased use of non-cash circulation in Poland, projected by many research centres at the world top level.

Coming towards the end of this address I would like to present a proposal of the strategic objective of the Polish payment system, which, in the opinion of the NBP Payment Systems Department and the Payment System Council, may be adopted for the forthcoming years, and suggestions of activities aimed to achieve this objective.

The strategic objective has been put with the following wording:

The objective of the Polish payment system is to provide public payment services at the highest possible level, taking into account in particular cost-effective public access to various modern payment instruments as well as the effectiveness, competitiveness and security of clearing domestic payments systems, considering the necessary adjustment of the Polish payment infrastructure and principles of functioning of the payment system to the requirements of European co-operation and integration.

In my opinion, the achievement of the adopted strategic objective requires many activities in various areas connected with the functioning of the payment system in its broad terms.

One such basic activity should be the continuous enhancement of the effectiveness and security of the domestic payment infrastructure, including in particular payments systems, which should settle payments routed to them quickly and in a competitive manner as compared to pan-European systems, and facilitate the settlement of all types of pan-European payment instruments.

Other activities include:

- 1) **increasing significantly the scope of non-cash circulation**, primarily through:
 - extending the base of entities using both banking services in general, and e-banking as the basic channel of effecting non-cash payments,
 - offering incentives to make mass payments via bank accounts,
 - removal of legal impediments to effect non-cash payments,
 - promotional and educational activities within the scope of non-cash circulation.
- 2) **facilitating access to a wide range of payment instruments and services, including cross-border trading**

This will require banks, among others, to offer pan-European payment instruments at prices identical to those in the case of similar domestic solutions, and also to prepare for handling cross-border payment orders (routed to and received from the STEP2 system), i.e. both credit orders and the pan-European direct debit (PDD), currently under development.

3) **activities related to the payment cards market**

Activities related to the payment card market should be considered in three respects: with respect to card issuers, clearing agents and holders of the payment instrument discussed.

With reference to card issuers, I observe the necessity to meet the following postulates:

- the immediate introduction of chip cards, which is primarily justified with the concerns about the security of payment card users as well as is in line with the solutions proposed within the framework of SEPA (the EMV standard);
- the further lowering of the interchange fee, which, on the one hand, may contribute to a temporary fall of bank earnings on this account; on the other hand, however, it may lead to an increase in non-cash circulation and in the interest of acceptants in this method of settlement, which may in turn entail an increase in revenue in the long term due to the scale of turnover.

With reference to clearing agents, I observe the necessity to adjust their activities to the requirements following from the directive on payment services in the internal market. Moreover, there is a possibility of foreign clearing agents emerging on the domestic market. There is nothing wrong with such entities undertaking business activities in the territory of Poland, since Poland is located within the borders of the single European market, where competitive activity, being not contradictory to the law of a given country, is a standard and should not be constrained. The most important issue here is ensuring the equality of entities in the face of the law, i.e. adherence to the principle of functioning of foreign entities within the uniform legal framework binding for domestic entities.

With reference to payment card holders, intensive promotional activities should be initiated to encourage consumers to change their behaviour patterns related to the use of payment cards (the majority of transactions effected at present are cash withdrawals, and not payments). The activities of card issuers alone will not suffice for obvious reasons if they are not followed by facilitating the use of payment cards in a scope much broader than today.

- 4) **continuing and streamlining oversight activities over various elements of the payment system, including the solution of the problem related to oversight of payment agents or intermediaries,**
- 5) **active involvement and ongoing monitoring of works on the directive on payment services in the internal market and implementing European legal provisions to Polish law,**
- 6) **efforts aimed at achieving SEPA standards by the Polish banking sector,**
- 7) **continuation of works related to the participation in the TARGET2 system.**

The above activities do not relate to a single entity, or to one type of business activity, e.g. banks. Achievement of the abovementioned strategic objective through the performance of the above activities requires co-operation among various entities involved in the payment system. The Payment System Council, which consists of representatives of managements of public institutions (the NBP, the Ministry of Finance, the Securities and Exchange Commission), commercial self-government (the Polish Banks Association), and of other institutions involved in the payment system (the National Clearing House, the National Depository for Securities, POLCARD S.A., Poczta Polska) seems to be an appropriate forum for such co-operation. However, for the performance of some activities other institutions and bodies will be necessary, including in particular government institutions in the case of legal activities or activities concerning public administration authorities.

To conclude this address, I would like to stress once again the interdependence between the development of the payment system and that of the e-economy. For the e-economy to develop, there must be a particular need for a given person or enterprise to have access to and use the Internet not only to search or exchange information, but also to effect transactions. In my opinion, a need of this type includes various electronic access channels to bank accounts and the possibility to effect payments. At the same time, if not accompanied by the development of e-economy, the system payment cannot achieve a fully mature stage of development (i.e. third period, according to the classification proposed above), which would entail the use of inexpensive, quick and secure electronic non-cash payment services both in the interbank and customer-bank relations.

I truly hope that in the forthcoming years the abovementioned challenges of the payment system will be met and the strategic objective achieved, and the development of the payment system will favour the ever more common and broader public access to the Internet, which in result should drive the development of e-economy, thus benefiting customers and users of both discussed fields.

Thank you for your attention.