Mr. Weiner:

First question. Yes, Cathy?

Ms. Cathy Allen, Chief Executive Officer, Santa Fe Group:

A question on TelCos – their natural entrance into the payments arena because of their transaction processing, billing, customer relationship, and environment: I know the Payments Directive does take them into consideration in Europe. In the United States, I think there is maybe a naiveté about their interests or their strategies and, in particular, around the use of cell phones or PDAs, because they will have the device in the customer’s hand. What did you all learn about or what can you say about TelCo entrance into the payments arena?

Mr. Weiner:

You are absolutely right that it is a major movement in both Europe and the United States. My view is that it is a payments
mechanism that could very well take off in the near future. I would also agree that the United States is a little behind the curve in thinking through what the implications are. The Payments Service Directive explicitly recognizes it. Simonetta?

Ms. Rosati:

Perhaps I can give an example to give an idea of how much we expect this to facilitate payments by the users. You see in Europe Internet connection penetration on average in the various countries is between 50 and 60 percent. Mobile telephone penetration in some countries is over 100 percent. It is very close to 100 percent in most European countries, which means that basically almost everyone has a mobile telephone in their hands and some people even have two – one for private purposes and one for business purposes. It is like having most of the time a wallet in your hands. To make a payment on the Internet, you need to go on the Internet. But now with a mobile telephone, you can also surf the Internet. The potential of this tool as an access to payment products is clearly very high in Europe. With the recent regulatory opening, telephone companies would be able to set up payment institutions to provide payment services.

Mr. Weiner:
In the United States, as well, we have seen surveys that show that a large segment of the population, especially younger people, are more likely to leave their house with a cell phone than with a wallet.

Another question? Yes.

Mr. Peter Burns, Vice President, Federal Reserve Bank of Philadelphia:

Incidentally, thank you very much for the great paper. I apologize for not having had an opportunity to get through it, but I did spend a little bit of time reading about the section on private rule making, I guess I would call it. I know this was a paper about central bank oversight and regulation in Europe and the United States, but I was curious as to whether either of you had any particular opinion about the ability of private rulemaking to, in fact, maybe operate more effectively and efficiently than government bureaucracy or government regulatory efforts in this area? I am staying with the consumer side, but you have to look at the way Visa and MasterCard smooth out the differences in Regulations E and Z with the liability issues. You mentioned PCI, an industry-oriented standard, NACHA, and then we have the private networks with PayPal and AmEx. Cathy mentioned her involvement with BITS. BITS was involved with a very interesting project which they dubbed The Partner Group, which was again an industry attempt to look for harmonization around some security issues. I find that stuff kind of appealing. So my
question is, Having studied this, do you have a view on that? Second, I do understand this sort of phenomenon is more prevalent at least at this stage in the United States versus Europe, but I am wondering what the advent or development of SEPA, if we won’t see more private-sector collaboration and ruling-making? Is that maybe too many questions? I apologize.

Ms. Rosati:

The one on SEPA: One can say this is a far-reaching project and it is driven by the European banking sector, so it is a self-regulatory effort by the market. Of course, it is supported by the public authorities, which have a strong interest in its realization. It has various dimensions; it is led by the banking sector, but there are also other entities. There are other slices of the project. Let’s say there is a SEPA for infrastructures, with an attempt, for instance, of the existing European ACHs to interconnect with each other to make sure they can serve all the European market. There are developments on SEPA payment instruments. So the private sector is very active on various fronts. Of course, the authorities monitor the progress that is being made and the ECB publishes a progress report regularly to make the point and try to give indications on its preferences. The European Commission is also very active on this. Of course, we have to see what then the market is delivering, but so far it is really taking action.
Mr. Weiner:

I would underscore that. On the U.S. side, we have found the SEPA issue to be very interesting as we have studied it. Clearly, it is industry-led. In the United States, as Peter noted, certainly there are initiatives here as well in a number of areas. From an economic standpoint, one always prefers a market solution to a regulatory solution, if there is an efficient market solution. So I think we would all encourage private-sector efforts to come to common standards, common practices, and so on, absolutely.

Yes, Ken?

Mr. Kenneth Posner, Managing Director, Morgan Stanley:

In the United States, there would appear to be some controversy or some limitations to nonbanks acquiring bank charters. Bank charters seem to be necessary for some parts of the payments landscape. So there has been controversy recently with certain retailers trying to acquire industrial loan bank charters. My question is, In Europe, are there similar limitations that prevent nonbanks from acquiring bank charters, or are the rules more flexible? In other words, in Europe, could a retailer or grocery store acquire a bank charter, take deposits, and therefore move further into the payments system, or are there regulatory barriers to that?
Ms. Rosati:

You mean by acquiring a bank? Well, for instance, in the current setting in France – I can give this example because it was an example I saw during the survey – there is a very large supermarket chain called Auchan. In order to be able to issue payment cards for their customers, in the current regulatory setting they had to set up a bank, which is then subject to banking regulation. Once you set up a bank, all the bank risk is covered by the appropriate regulations. This is a concrete example we already have in front. What is an interesting point for development in Europe is the introduction of a new payment institution category. I asked myself, Would it be possible then that even banks may decide to set up a payment institution to spin off their payment business? Or maybe a large retailer would not need to set up a bank, they might just need to set up a payment institution to provide payment services. Of course, the payment institutions would not be allowed to take deposits in a banking sense. But they might be allowed under certain conditions to extend credit. This is really the new dimension we are in in Europe. So far, the only way for them was to set up a bank. Now, new opportunities are put in place by the regulatory innovation.

Mr. Posner:
Would you agree that is the difference between Europe and the United States?

**Mr. Weiner:**

Yes, it certainly sounds like it. My guess is it also varies within countries. So, while France may have this kind of situation, I am guessing other countries do not. The SEPA and Payments Services Directive will, in a sense, harmonize it to some extent.

**Ms. Rosati:**

Yes, so far France is an example where the national legal system up to now reserved payment instruments activity only to the banks. When the directive is implemented, nonbank payment institutions will be allowed to provide payment services and there will be the same set of rules across all Europe.

**Mr. Weiner:**

That is ironic. What I am hearing is that today in France, if you want to do payments, you have to be a bank, so you are more than willing to become a bank or to acquire a bank. In the United States, of course, we have not had that attitude.

**Ms. Rosati:**
Unless you are an e-money institution, of course, because for that there is a special legal and regulatory regime.

Mr. Weiner:

I think Avivah had a question.

Ms. Avivah Litan, Vice President and Distinguished Analyst, Gartner, Inc.:

It is just a short question. As you were surveying this entire landscape so thoroughly and methodically, what did you perceive to be the biggest risks? What are the regulatory requirements? I don’t need to jump to the solution, but you must have seen some risks. Can you summarize what you saw?

Mr. Weiner:

It is a short question but it could require a long answer. Of course, there are any number of risks. We highlight some in the last part of our paper. Rising nonbank presence certainly introduces some new risks or, if not new risks, more importance of certain risks, like operational risk, data-fraud issues, and so on. However, we also are quick to point out the nonbank presence in some cases mitigates risk as well. Some of the nonbanks have been at the forefront of fraud detection and so on. It cuts both ways. But, as far as taking your question—What does this change mean for risk?—there are profound
implications and we can only start to get at them at this conference. Fortunately, we do have an entire session devoted to the topic tomorrow, which of course you are moderating, so you have a chance to answer your own question!

**Mr. Jamie McAndrews, Vice President, Federal Reserve Bank of New York:**

Maybe it would be worthwhile to spend a little bit more time on defining what is a bank and what is a nonbank. In the United States (I am not a lawyer), but as I understand it reading the Glass-Steagall Act, any deposit-taker in the United States has to be regulated either as a bank or as a money transmitter. My question is, How can you tell the difference between a bank and a nonbank – PayPal, for example? Because, in the Glass-Steagall Act, this fundamental thing of deposit-taking, they did not define how you determine whether the deposit-taker becomes a bank or a money transmitter. So, is it the ability to issue credit cards or is it access to the safety net or what in your mind distinguishes …? I understand you just took the definitions as given in your paper, but how meaningful are the distinctions between bank and nonbank?

**Mr. Weiner:**

That is a great question, Jamie. We had to draw the line somewhere and have some kind of definition, so we decided to go with
the standard definition. Clearly, the lines are blurred, which is one of the fascinating things about this topic. When does a nonbank really become a bank? Does it really matter? The point is, they are engaging in payments activities that carry some risk with it. We could debate definitions a long time – and we have internally. It was interesting; it was instructive on the U.S. side to compare what we have here with what is going on in Europe.

**Ms. Rosati:**

Can I say something? In Europe, basically a bank is an institution allowed to take deposits and provide credit in parallel, let’s say. So, in the case of an e-money institution, though this enters into the definition of a credit institution, this is not a bank because an e-money institution (as PayPal is in Europe) can take funds from the users in exchange of e-money but it absolutely cannot provide credit. This is a distinction. In the case of the payments institutions that have been recently introduced, there has been in Europe a very big debate on what the difference is between the payments institution and a bank. They can hold payments accounts, they can take funds from the public to make these payments, and some of them can provide credit for these payments. The regulatory coverage makes sure these institutions will not really take deposits in the sense of a bank because there are safeguard measures to make sure the funds they take to make the
payments cannot be commingled, they can only be used for the purpose of making the payments for which they were collected, and they must be separated from their old funds, and so on. Even when they are allowed to provide credit, this is done only under certain, specific conditions and must be done out of their own funds. They cannot use the funds they received to make payments in order to provide credit. So, this ensures the separation between these two activities and, therefore, they are not considered banks. Of course, when it comes to the payment risks, a risk analysis is needed.