

## **Nonbanks in the Payments System: Innovation, Competition, and Risk**

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Session 6: Central Bank Perspectives

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Speaker: Philip Klopper, Executive Director, De Nederlandsche Bank

### **Mr. Hoenig:**

We are now getting down to the end, and to the many who have resisted the temptation to get out into that sunshine early, I am very appreciative.

We are the last session, and we are going to talk about the central bankers' perspective. We have, besides myself, Philip Klopper and Philip Lowe. We will begin with Philip Klopper, then Philip Lowe, and I'll close. We'll take questions and end on lunch and hopefully a very successful program. So, let me turn it over to Philip and we'll get started.

### **Mr. Klopper: [remarks correspond with handout]**

Thank you very much, Tom. Let me also thank you and the staff of the Kansas City Federal Reserve Bank for hosting this event, for organizing it, and for inviting me to speak here. It has been an inspiring experience so far.

Later on in my presentation I am going to refer to a number of sheets that are in your file. They look like this. Of course, you always

come to these events prepared with a prewritten speech, but having heard what has been said over the last few days, there is so much overlap that I have decided to rearrange it. So, I will carve out a number of remarks and observations and then zoom in on the situation in the Netherlands.

I come from the Dutch Central Bank, De Nederlandsche Bank, and the Dutch Central Bank has the traditional central bank functions: monetary policy in a framework of the ESCB. We do research, we give economic advice, we produce statistics, and we fulfill a number of roles with regard to payments.

But we are also a supervisor. In the Netherlands, the field of supervision has been divided into prudential supervision and market conduct supervision. The Central Bank is the prudential supervisor of banks, insurance companies, pension funds, and a number of other institutions.

If you look at the regulatory field, there are a number of active agencies. I have mentioned the Central Bank. There is also this Market Conduct Supervisor, there is the Competition Authority, and there is the Consumer Protection Agency that has recently become more active with regard to payments.

Each of these agencies has its own mandate, and that means we do not always come to an agreement when it comes to developments in the markets. That is our problem—"our" as in the agencies. It is

always a challenge to make sure that you do not end up passing the problem to the institutions in the society, which then might be given orders to turn left and right at the same time. I assume that is universal to each jurisdiction that is present in this room.

This session is about central bank perspective. To zoom in a bit on the element perspective, I want to tell you a story of something that happened to me a couple of weeks ago.

I had a meeting scheduled, with a very aggressive, young, greedy lawyer. He came to my office and he parked his car in the street. When he was getting out, he was not very careful, so he opened his door, another car came by and ripped away the door of his car. He came into my office quite upset, complaining about his beautiful new BMW and did I know what it had cost? He whined on and on. I was a bit surprised because he obviously had not noticed that, not only had his door been ripped out, but also his left arm had been ripped off.

So, I said to him, “It is fine about your car, but how about yourself?”

And he looked at the stump at his shoulder and said, “Oh no, that was a new Rolex!”

This story is to illustrate that what you see depends on where you sit—perspective. This is the first observation I would like to make. Central banks have always seen the payments system, the payments ecosystem it has also been named, dominated by banks—pure banks

and other companies controlled by banks. Suddenly this landscape is starting to change and new players have come in, real nonbanks.

It would be easy to think from the central bank perspective that these nonbanks are the agents changing the payments landscape. That is not the case. It has been more or less implicit in a number of presentations that were given yesterday the nonbanks are not driving the change. I think other things are driving the change, and the change is much more universal.

In my opinion, fundamental to the change is the development of technology. This development of technology has brought transparency, and transparency has brought unbundling. That is universal to society, whether you are in manufacturing, you are in services, or you are in government.

This development is highly autonomous. The implications are that you should not have the ambition as a regulator to really change that autonomous development, either stop it or make it different, because it will happen. Public policy agencies sometimes suffer under the so-called god complex, that they can create the new world by law. That would be a grave misunderstanding to project on the payments field. It is a great misunderstanding in general, but it could be very harmful for the payments field. If we were to take that attitude, the development would still happen, but we would cause great costs to

society by getting the regulation wrong, and we would seriously negatively impact the competitive position of our jurisdiction.

Even if we would keep on limiting the payments landscape to banks, the developments we see today would still happen. In that case, banks would do them or nonbanks would somehow get bank status. That is the first observation I would like to make.

The second one is as follows. Payments were born in the banking world, and the banking world is a regulated world. It therefore has always been felt logical that the rules that apply to banks also apply to payments. But I am not so sure that, if payments had developed outside the banking world, they would today be regulated in the same way.

The third remark I would like to make is bank regulation is fundamentally different from oversight. Central banks and supervisors have been known to use their powers from prudential supervision to influence the banks' behavior with regard to payments—moral suasion. Personally, I am not so sure about the morality of moral suasion, but it has been known to happen and we have been known to do it.

It is important to keep in mind when you look at the future of payments that prudential bank regulation is different in character and different in purpose. The purpose of bank regulation is to protect the depositor. The character is very rule-based. Oversight has a different

purpose. Oversight is focused on the integrity and the continuity and safety of the payments system. It is much more principle-based than bank supervision. It being principle-based means that this also gives us an opportunity to deal with the developments of the future. It can help us both maintain adequate oversight of new players and maintain a level playing field between banks and nonbanks.

Zooming in on the way we apply this principle in the Dutch environment, I would like to refer to sheet 6 in the set we have given you. As Gerard Hartsink has so eloquently explained to you yesterday, in Europe we tend toward a scheme-oriented approach of payments. That means we distinguish between the scheme, scheme ownership, processing, networks, distribution, etc., and we have chosen to apply our oversight to all payments on the scheme ownership.

In the studies that were distributed in preparation for this conference, you have seen the distinction between payment methods and payment activities. Within the scheme, you see both the payment activities adding up to the payment product. We have taken a functional approach, what we call the “role model approach,” toward the scheme. That means we do not look at what the individual players *are*, but what they *do*. That approach gives you flexibility if the landscape starts to change.

First of all, this approach focuses on the role of the scheme owner. The roles of issuer and acquirer are the most closely linked to that of the scheme owner. They, in turn, are connected with roles, such as issuing and acquiring processor, payments services provider, and the clearing institution. The remaining roles in the scheme, so far, are those of the clearing processor, settlement processor, settlement institution, and the network processor.

In the Netherlands, the role of payments services provider has recently been added as a new role within the scheme. This shows the rising importance of nonbanks in our payments system.

If you look at this scheme-oriented approach, the role model, we also have chosen to incorporate more self-assessment by the scheme owner. This choice, by the way, has been made independently from the choice for the role-based model because we feel that, generally speaking, when new risks arise in the payments market, a reaction from the players in the market themselves will be more proactive, earlier, and better focused than a reaction from us regulators because we are farther away from the system. It is often easier for them to make a quick assessment of the efficiency gains arising from innovations in the payments markets and the risks involved with them than it is for us.

Of course, this does not mean that we as regulators no longer have a role to play and we can go home and start looking for a new career.

But in the presence of a scheme-oriented organization, the more reactive control mechanism of the regulators on the payments systems can act as “the big stick.”

So, oversight by De Nederlandsche Bank is now primarily focused on the scheme owner and within the scheme on clearing and settlement. However, our overseers may at any time decide to take a closer look at other roles or players. If necessary, they can switch and change the intensity of their oversight as they feel required.

The scheme owner concentrates on issuing and acquiring roles on the network processor and on the payments services providers. So how should the assessment by the scheme owner work in general? The scheme owner first of all sets a structure with licenses, rules, and regulations for the participants of the scheme. Here, the licensing process and the monitoring role of the scheme owner is part of the control mechanism of the scheme.

The overseers of the Central Bank assess whether the structure proposed by the scheme owner is adequate. As long as the scheme owner does its job well, we will not step in. Otherwise, we will.

This is the model we currently employ in the Netherlands, and we are satisfied with it. Of course, the development of new techniques and the entry of new players always asks us to assess the risk and the change in the risk that brings us. But we feel this functional model,



this role-oriented model, in combination with the self-assessment by the scheme owner works well and will be future-proof.

Tom, I would like to stop here now and give it over to the other Philip.