MONETARY PANEL
Amsterdam - 9 November 2007
Minutes of the meeting

Present

Wim BOONSTRA, President of the Monetary Panel

Austria	Marianne KAGER
Belgium	Jean-Jacques REY
Czech Rep.	Kamil JANACEK
France	André ICARD
Germany	Rainer BODEN Ralph ODENDALL
Netherlands	Paul CAVELAARS Bouke de VRIES Maarten LEEN Ruben van LEEUWEN Fred von DEWALL
Spain	Rosa Maria GELPI
Un. Kingdom	Graham BISHOP

Speakers

Arnoud BOOT - Professor University of Amsterdam, Incoming chairman Dutch Royal Economic Soc.
Michiel GORIS- Managing Director and CFO, ING Direct
Michael SALMONY - Advisor to the Board of Directors, Equens

ELEC Secretariat

Jean-Claude KOEUNE, Secretary General

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Introduction

The *President* took the chair at 9:10 and welcomed participants from eight countries. He expressed the Panel's gratitude to the ING Group for hosting the meeting, which moreover was preceded, the evening before, by a working dinner enlivened with a discussion on the world economic, monetary and financial situation led by Maarten Leen, Senior Economist at ING.

1. Adoption of the agenda

The agenda was unanimously adopted.

2. Approval of the minutes of the last meting

The minutes of the meeting held in Rome on 30 March 07 were approved.

3. Developments in payment systems and impact of SEPA

The *President* introduced the first speaker, Dr *Michael G. Salmony*, who gave a presentation entitled "Developments in Payment Systems". He first presented facts and figures concerning Equens N.V., a European payment services company whose total yearly volume of transactions processed currently equaled 1.5 times the European GDP. Next he analyzed the European payments market: its size, main characteristics, variety of systems, growth rates of different payment instruments, and evolution of non-cash transactions in member countries. He focused further on the developments, challenges and likely impacts of a harmonized SEPA (Single Euro Payments Area): the radical changes it would bring about, their consequences for banks, companies, and consumers, and the strategic choices this implied for banks. Finally, he described the evolution of e-invoicing, e-payments and m-payments, which in his view were increasingly driving the dynamics of the market for payments and where non-bank service providers were more and more active, giving rise to new challenges for banks and regulators.

The *President* thanked Dr Salmony and suggested that the discussion on his thought-provoking speech be grouped with the one on the following presentation. He therefore introduced the second speaker and gave him the floor.

4. "Direct" retail banking

Mr *Michiel Goris* presented ING Direct, first giving a rapid overview of the ING Group, a "well-positioned global financial services company", with ING Direct being one of its 6 strategic business lines. ING Direct, he said, had started operating in 1999 and was now present in 6 European countries (plus Australia, Canada and USA), having been designed to offer banking services in mature markets without the support of physical branch offices. He next surveyed the results to date and the key principles and values that were driving such results, including the low cost (a cost advantage of around 120 bp vis-à-vis traditional banks) and the "fleet of companies" concept which allowed ING Direct to "think globally but act locally". He finally outlined its vision, strategy and sources of future growth, stressing that "at maturity, ING Direct will have a narrow range of simple products in each product category with substantial scale, efficiency and profitability".

The *President* thanked Mr. Goris and opened the floor for a **debate on the first two topics**. For the sake of brevity and clarity, the questions, comments and answers have been regrouped under three headings:

- on SEPA and payment systems:

- Mr. *de Vries* said that the motive behind SEPA was originally to obtain greater equality in the pricing of transactions across Europe, but that the system's real advantages now lay in its forcing to reform national payment systems according to European standards. Mr. *Boden* said that the move toward SEPA was at the beginning politically inspired before turning into a technical issue, and wondered whether it was not once again becoming political; Mr. *Salmony* agreed, saying that the effort to involve 7000 banks behind SEPA necessarily had a political dimension.
- Ms. *Gelpi* asked about the extra benefits provided by SEPA relative to what for instance VISA already offered. Mr. *Salmony* replied that SEPA could among others greatly facilitate the paying of salaries by European corporations. Moreover, as a European market for payments arose, competition would lead to downward price alignments. Finally, he said, the advent of SEPA would provide a payment infrastructure that could be useful for the development of new services at the European level. Mr. *von Dewall* asked whether the system would eventually allow for real-time payments. Mr. *Salmony* answered that this was indeed the final goal, but that no pan-European real-time payment system existed yet.
- Mr. *von Dewall* inquired further about payment security and safety issues connected with SEPA, and Mr. *Icard* asked if any constraints were to be imposed on it on account of anti-laundering or anti-terrorism measures. Mr. *Salmony* answered that the latter would continue under SEPA to be

handled by individual banks, and that the system's security question rose no new issues beyond those that already existed in national payment systems.

- Mr. *Rey* inquired about the difference between payment services offered by Equens and the Target II network. Mr. *Salmony* answered that Target II mostly existed for transferring funds between large banks, whereas the range of services offered by Equens was much broader.
- Mr. *de Vries* asked whether differential pricing could be used to discourage cash versus non-cash transactions. Mr. *Salmony* replied that this depended on local legislation, but that having customers pay for getting cash was never popular; the cost of cash transactions had already been reduced by ATM equipment, he said, and cash use would only be reduced further by the provision of alternatives such as payment with mobile phones.

• on the <u>ING Direct business model</u>:

- Mr. *Icard* inquired about the asset side of ING Direct balance-sheet and about its policy of risk management. Mr. *Goris* replied that assets consisted mostly of AAA-investments and mortgages, and that each "company" in the "fleet" of ING Direct had its own local ALM, with risk being thus managed at three levels: the local one, ING Direct and the Group. Ms. *Kager* remarked that in all big banks the treasury department had a tendency to become a bank within the bank. Mr. *Goris* agreed that this could indeed become dangerous when Treasury became a monopoly within the bank.
- Mr. *Bishop* asked about the potential use of SEPA by ING Direct and the impact of different deposit guarantee schemes across Europe. Mr. *Goris* answered that ING Direct normally joined local payment platforms in countries where it operated and saw no competitive advantage in being a front-runner in SEPA-use, while its customers usually paid scant attention to deposit guarantees, out of a belief that a big bank would never be allowed to fail. Mr. *Salmony* pointed out that cross-border traffic in payments was bound to increase, particularly at the wholesale level, making SEPA-use a requirement for most banks.
- Mr. *Salmony* referred further to Citigroup's view that Europe was not large enough for a bank with worldwide ambitions, and wondered about ING Direct's strong insistence on being locally-based; Mr. *Boonstra* inquired about the impact the integration of payment systems in Europe might have on ING Direct's business model. Mr. *Goris* reiterated his view that retail banking would remain a local game for 20 more years, given that most customers found it convenient to have an account in their own country and a bank manager speaking their own language. Mr. *Salmony* said that ING Direct, with 20 million accounts now, was certainly the most successful direct bank so far, but that only big banks could afford such systems (he remarked further that a non-bank like PayPal had 160 million accounts).

• on the <u>European retail banking market</u>:

- Mr. *Rey* asked whether, from the views expressed by Mr. Goris, one should not draw the conclusion that efforts by the European Commission to integrate the retail banking market had been a waste of time. Mr. *Goris* replied that ING had been able to apply its business model in various countries because the Commission had successfully fought against local restrictions (for instance in France or Spain) that otherwise might have prevented it. However, he observed, there still existed many types of local protection that were slowly eroded by the European Commission's persistent action.
- Mr. *Boden* commented on remaining obstacles to a European market in retail banking, and singled out differing standards of consumer protection. Ms. *Gelpi* remarked that since total harmonization of consumer protection was unattainable and even mutual recognition was not accepted for consumer protection, one could think of agreeing on at least a few important principles: however, she said, one could in practice only agree on general abstract principles, and thus, their application being left to the member states, the obstacles remained.
- Mr. *Goris* argued that there was little incentive for banks to develop retail services on a European scale, given that economies of scale in the field were in his view non-existent, and that language remained a stronger barrier than local requirements for consumer protection. Mr. *Boonstra* expressed the view that SEPA, once in operation, would create strong market forces that would speed up progress toward a European market in retail banking. Mr. *Salmony* concurred, pointing out to the dramatic effects increased competition among telecom companies had had, following the liberalization of the market.

- Mr. *Boden* and Ms. *Kager* inquired about the coexistence in some countries of traditional and "direct" retail banking and about their market shares in deposits. Mr. *Goris* answered that every big bank now provided internet banking services; Mr. *Boonstra* remarked that in the Netherlands direct banking was now completely integrated in retail banks and that ING Direct was present only in countries where it had no traditional branches or subsidiaries, making it difficult to answer Ms. Kager's question.

5. Private equity

The *President* introduced *Professor Arnoud Boot*, who gave a presentation entitled "Private equity, exchange-listed companies and financial market turmoil" Stability in the shareholder base, he argued, was crucially important for entrepreneurship to the extent that it allowed managers to develop long-term strategies. For public companies on the other hand, greater liquidity lowered the cost of capital but could result in a more volatile shareholder base: this, which he dubbed "the dark side of liquidity", had created opportunities for private equity, whose development could partly be seen as a response to the Sarbanes-Oxley Act (SOX) and other requirements for exchange-listed companies.

The speaker analyzed further the key benefits to a company of being private, noting in particular the opportunities this offered for better alignment between management and investors as well as between corporate governance and firm characteristics. One problem that remained to be solved, however, was the lack of protection for minority shareholders, since private equity players had an obvious advantage when communicating with the firm's management. Professor Boot concluded with a few remarks on the current credit crisis, stressing that academic research in corporate finance, while praising securitization for the better speading of risks it afforded, had never advocated the kind of liquidity creation it could permit by transforming long term liabilities into short-term assets.

Mr. *Bishop* wondered about other stakeholders' (such as workers and local councils) interests when a public company became private. Further, he asked why private equity players could consistently outbid other players and commented on the Heathrow disaster that was blamed on private equity. Professor *Boot* replied that, for private players, the liquidity penalty (higher cost of funds) was more than made up by the capacity to control management.

6. Future work of the Monetary Panel

Given the venue foreseen for the next meeting (Warsaw), the *President* said that he would consult by e-mail with the Panel on topics that might be relevant for new member states.

7. A.O.B.

Mr *Bishop* reported that the draft of the *Cahier Comte Boël* n° 13 on retail banking was nearly complete and included comments from discussions held in the Rome and Vienna meetings of the Panel, but needed some slight updating on the consumer credit directive and on SEPA, taking today's discussion into account. He foresaw a finalization of the *Cahier* for January 2008.

8. Date, time and place of the next meeting

In Warsaw, on a date in March 2008 to be fixed in agreement with the Polish section, which was willing to host the meeting.

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