

DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS

Sergio Gorjón

Sr. Expert on Payment and Securities Settlement Systems

FINANCIAL INFRASTRUCTURE WEEK 2011

Rio de Janeiro

March 14 – 17

PAYMENT SYSTEMS DEPARTMENT

DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS



AGENDA

- Opening remarks
- Main reasons for adoption
- Underpinning customer's confidence
- Some policy lessons

DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS



Setting up the stage

A monolithic concept?

Direct Debit : “A payment instrument for the debiting of a payer’s payment account whereby a payment transaction is initiated by the payee on the basis of authorization given by the payer.”

Source: Glossary of terms related to payment, clearing and settlement systems, ECB (2009)

What should the content of such authorization look like?

Where should the payer’s consent be stored?

...



How is the scheme governed?

What safeguards could be envisaged to protect the payer’s interest?

...

DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS



Setting up the stage

Some introductory figures: the European scenario

**Fig. 1 : Cashless payment instruments in the EU:
Cumulative market share**

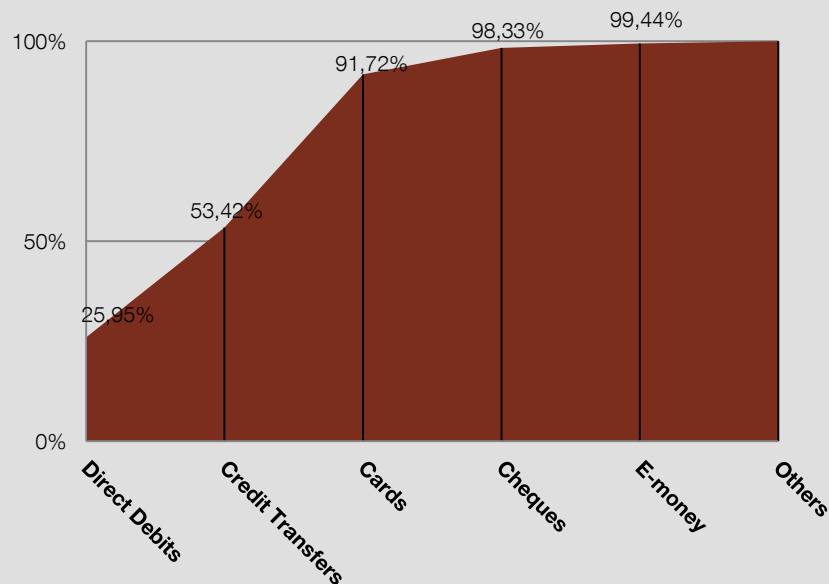
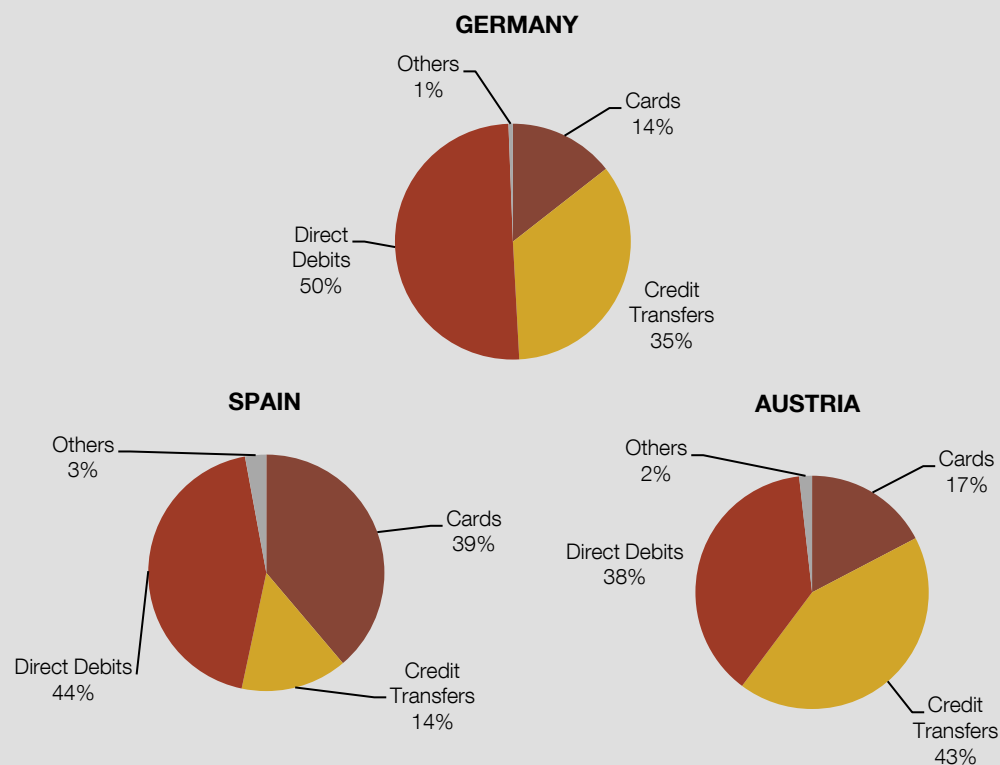


Fig. 2 : Relative importance of payment instruments in selected countries (% of total number of transactions)



Source: ECB's Statistical Data Warehouse (2009)



Switching to direct debits: a fairy-tale love story?

- **Convenience:** it's simple, it's fast, it's secure.
- **Control:** swift and straightforward reconciliation of debits on account statements as well as payments received.
- **Cost-savings:** automation drives workload down. Reduced working capital costs for creditors. Additional money-saver opportunities for debtors.
- **Credit risk management:** reliable cash flow based on a predetermined due date for collections (withdrawal date).

... but certain risks cannot be ruled out: overdrafts, wrong debits due to mistakes and/or fraud, etc.

DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS

Building up user's trust

Curbing access rights to your account: **the Mandate**

© European Payments Council

- **Twofold authorization:** collection of payments (creditor) + disbursement of funds (debtor's bank).
- **Issuance:** paper-based, electronically or by other means.
- **Structure and content:** mandatory fields (IDs) vs. optional information.
- **Storage and circulation:** creditor-mandate flow (CMF) vs. debtor-mandate flow (DMF).
- **Dormancy period:** as an additional precaution, a long period of inactivity (no collections) triggers expiration.

DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS

Building up user's trust

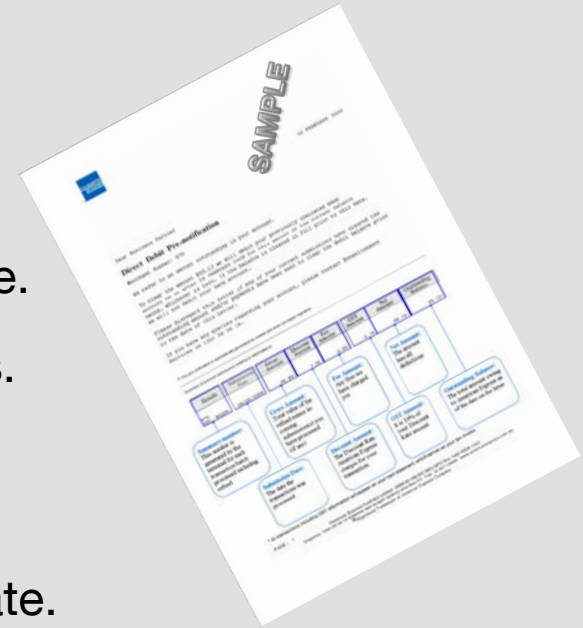
Anticipating crucial information:

Advance Notice to Debtors

- Customary practice though not necessarily regulated.
- Allows for the planning of balances prior to the due date.
- Further helps enhance legal security of account holders.

Advance Mandate Information

- Prompts debtor bank access to the terms of the mandate.
- Empowers debtors to take corrective actions early on.
- Provides creditors with swift certainty about the status of the debtor's account.



Ensuring a money back guarantee: **Refund Rights**

- Claims by the debtor for reimbursement of a direct debit.
- Either a self-regulated right or enshrined in legislation.
- Applicable to both authorized and non-authorized collections.
- Timelines usually apply.
- May require the provision of factual elements sustaining the claim or operate on a no-questions-asked basis.
- Debtor banks preserve their right to receive a compensation.



DIRECT DEBITS: A CORNERSTONE OF RETAIL PAYMENTS

Balancing costs and benefits

Displaying tangible **economic advantages**

- Monetary benefits aren't necessarily allocated in an even manner among the various user groups.
- Charging practices -and the underlying cost recovery mechanisms- are crucial for optimizing acceptance rates.
- Competition law and tradition have a strong influence in the resulting long-term business models (end-user fees, MIF, discounts, etc.)





What have we learnt?

- An off-the-shelf, uniform approach will do little to promote direct debits:
International experience provides a good starting point for discussion, but each country needs to factor in its own circumstances.
- Safety is a major source of concern for debtors:
Engaging end-users in the design phase proves essential to address their reservations as well as to encourage swift adoption.
- An appropriate pricing structure is further critical:
An overall pricing strategy is of chief importance to address economic imbalances and generate adequate incentives for all the parties involved.



SERGIO GORJON

THANKS

BANCO DE **ESPAÑA**
Eurosistema

PAYMENT SYSTEMS DEPARTMENT