The Cash Management Companies Association

The relevance and efficiency of cash

The views of the cash management industry

A response to the EPC New SECA Framework

October 2016

In May 2016, the European Payment Council (EPC) adopted its new "Single European Cash Area Framework" document.[1] The objective of this document is to "*develop a common set of rules and best practices for the distribution and recirculation of wholesale and retail euro cash in the Eurozone*". It proposes to do so through two main routes: "*harmonising National Central Banks operational conditions (thereby developing a virtual cash infrastructure at European level) and enhancing the processing efficiency in the cash chain".*

The document acknowledges that "cash is the most popular payment instrument", however states that it is the "most expensive". It follows by considering that the cost of cash is "imperfectly externalised to actual users, the usage of cash may thus be cross-subsidised by other bank revenues, contributing to burdening the pricing of other bank services".

ESTA feels compelled to respond to the "new SECA framework".

[1] "Single Euro Cash Area (« SECA ») Framework"; European Council Payment, 10 May 2016

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The SECA Framework document explicitly presents the issue from a "*banking perspective*". ESTA would like to take the opportunity of responding to this paper by addressing the issue of cash from a broader horizon. The key driver to the new SECA framework approach is "efficiency" from the point of view of the banking industry. Other aspects, such as security of payments instruments, the social role of cash (particularly with regard to financial inclusion) or the potential for efficiency of cash from a global perspective, not just from banks, are not considered, although they are of paramount importance from a public policy perspective.

Contrary to what is often stated, the number of payments in cash in the Eurozone continues to grow. As it is however growing at a lesser pace than the total growth of all payments including with electronic money, its share within the overall number of payments is decreasing. Therefore, when the EPC document refers to the "*declining use of cash*"[2], it refers in reality to a declining use of cash in *relative terms*. The different growth rates of cash and electronic payments may also be influenced by the fact that new payment instruments also lead consumers to overspend and be more prone to impulsive purchases than they would do with cash, as has been highlighted with contactless payments in the UK.[3]

Cash is attractive to consumers. As the EPC stresses strongly in its document, it costs banks which cannot pass on these costs to their customers. In this context, ESTA's views are that:

- Banks are not forced to offer cash services to their customers and could leave them to other stakeholders, and particularly the cash management industry whose core business is to deal with cash;
- If they do offer cash services, it is because cash is attractive to consumers and appears to be a condition *sine qua none* for customers opening bank accounts, which is the key to offering other services (payment cards, loans, saving and investments services etc.);
- A substantial part of the cost of cash results from the banks themselves, and substantial efficiency could be achieved via increased standardisation and deeper cooperation with /outsourcing to other stakeholders.

[2] Cf Section 1.3.1, page 11

[3] Cf for example http://www.themoneypages.com/latest-news/move-to-a-cashless-society-is-causing-brits-to-overspend/

Executive Summary

ESTA acknowledges that the EPC SECA framework takes only into consideration a "*banking perspective*" as is explicitly stated. Our vision seeks to address the issue of cash from a broader perspective.

The structure of our document consists in first looking at the issue of the social cost of cash, then restoring some facts on cash such as the myth of cash being free to users and then review the recommendations proposed by the EPC: for a number of them, ESTA can support them, although we disagree with the underlying analysis.

Looking at different and more comprehensive sources of relevance to assess the social cost of cash, ESTA recalls that <u>cash has the lowest unit social cost</u> of all payment instruments. We understand the concerns of the banking sector which supports half of the social cost of all payment instruments (not just cash), however we consider that this is hardly surprising for payment services providers. ESTA recalls that important social costs are not considered in the current calculation of non-cash payment instruments, such as the cost for society of financial stabilisation post the financial crisis and the cost of fraud. By opposition, the existence of seigniorage significantly reduces the actual social cost of cash.

Cash is a public good in competition with a number of types of private money. As for most things, competition is necessary for payment instruments: our document recalls that card payments instruments have been subject to serious competition enquiries. What matters most is that consumers keep the choice of payments instruments and the choice must be theirs, not that imposed by providers of non-cash payments services. The fact that cash is made available to consumers primarily through providers of alternative payment services – in other words: competitors - is however a matter of concern.

Contrary to what is often stated, cash is not free to consumers: withdrawing cash from one's banking account is a 'basic' bank account service, as defined by EU law, already subject to (a series of) fees. This leads ESTA to consider that the request for the possibility of charging additional fees on cash services by banks, which are already remunerated for the basic bank account services they provide to their customers, would de facto amount to cross-subsidising other banking services in a time of low bank profitability. Key however is that no one should be forced to provide cash services to consumers and if banks find it too costly, then they should leave it to other stakeholders. What ESTA cannot accept is that cash availability is reduced only to promote those alternative means of payment that banks offer for substantial fees: this has led some countries to consider, and in the case of Norway to adopt, legislation forcing banks to offer a minimum level of cash services.

Looking at the recommendations proposed by the EPC, ESTA agrees that the cost of cash can and should be reduced. Yet, the EPC suggestion that this should be done through a "*reduction in cash handling*" would not be the solution if this means, in fact, reducing the volume of cash in circulation. In looking at this issue, one should distinguish between the inflows of cash, where much remains to be done, from the outflow of cash which is already very efficient.

A different approach to the cash cycle, leading to shorter cycles, local recirculation and a stronger cooperation between the cash management industry and the banking sector in dealing with cash, offers a significant potential for cost reduction. This implies as well, as suggested in the ‘new SECA framework’, a clear view on how NCBs wish to deal with cash and the role they wish to play in the cash cycle.

ESTA further agrees that standardisation would be an effective route to achieve it and we support the recommendation for a higher level of standardisation. However, ESTA considers that most of the standardisation potential remains in the hands of the banking sector itself. Standardisation would require some investment and the question is whether the banking industry is prepared to undertake them to be able to deal with cash efficiently.

Little however will be achieved through cross-border CIT services. First because transport is a decreasing part in the CMC business, second because the potential for improvement is not so much in transport but in the potential to allow for a more flexible cash handling by CMCs, which leads precisely to the reduction of transport. Third, there is very little demand for cross-border CIT services, so that in effect the potential for economies of scale from cross-border is very limited.

ESTA would nevertheless agree, provided the level playing field is secured, to a partial harmonisation of CIT licences, for example allowing domestic and cross-border CIT services under one single licence.

I) The societal cost of cash

The ‘new SECA Framework’ claims that cash is the “*most expensive payment instrument to operate, as illustrated by the societal cost it involves*”, without giving any details on how it defines “societal cost”.

The main difficulty in this debate is that there is no comprehensive, recurrent, study on the cost of cash allowing for a robust analysis: existing research has often been sponsored by stakeholders with a vested interest in the issue. The only comprehensive and recent work known to ESTA is the study conducted by the ECB in 2012.[4]

The relative reduction in the number of cash payments in a context where cash in circulation continues to increase probably explains that the social cost of cash increases. As will be discussed later, banks have a direct impact in the distribution of cash to consumers and the resistance that has been noted in making cash available to them contributes to the increase of the social cost of cash. For this reason, ESTA thinks that the unit social cost is a better indicator.

[4] “*The Social and Private Cost of Retail Payment Instruments: A European Perspective*”, ECB Occasional paper 137, September 2012. The document is not cited by the EPC.

From that perspective, the ECB work contradicts the EPC which concludes that "*on average the results show that cash has the lowest unit social cost*" of all payment instruments.[5]

What the ECB work shows is that the societal cost of retail payments – not just cash – is 0.96% of GDP. Most probably, the issue is that, as is acknowledged by the ECB, banks are bearing 51% of the social cost of all retail payments (again, not just of cash): this is hardly surprising considering that for most bank customers, receiving and making payments is the primary purpose of their bank account.

When the EPC states, wrongly as the ECB shows, that the societal cost of cash is the highest, it remains silent on the societal cost of other means of payment. ESTA considers that the definition of the societal cost of alternatives - electronic - means of payment should take into consideration two major costs:

- The cost of card fraud: the cost to society – card operators, merchants and card holders – of card fraud needs to be put into the equation as the amounts are substantial and the risk is multi-faceted (card fraud, piracy, hacking, identity thefts etc.). The ECB produces regular reports on card fraud which provide information gathered from 23 card payment schemes. More than the aggregate level of card fraud reported in the ECB's fourth report (€1.44 bn in the Single Euro Payment Area in 2013, which represents an increase of 8% compared to 2012), [6] the major issue is the direct impact on each individual card holder of the fraud they suffer and the perception they have of the risk of being exposed to fraud. The impact of such risk is not just on costs, but on trust which is a core element of any economic activity;

- The societal cost of financial stability: further to the 2008-10 financial crisis, the societal cost of bailing out the financial sector was globally estimated by the IMF at no less than 10 trillion dollars.[7] For the UK alone, the estimated cost of how much the UK Government spent buying shares at the height of the financial crisis was £65.8 billion. This led for example the then UK deputy prime Minister Nick Clegg to suggest that "*Every adult in Britain would receive free shares in the nationalised banks under plans to reward the public for helping bail out the City during the financial crisis*".[8] Because a number of financial institutions were "too big to fail", stabilisation of the financial system required that their rotten assets in their balance sheets were transferred to the State, with a substantial impact on public deficits which tax payers ultimately support.

As is highlighted by RBR is that the growth of card fraud is stronger than that of card payments: whilst card payments increased by 15% in 2015, card fraud increased by 19%.[9]
If taken into account, the two elements above would increase the societal cost of non-cash means of payment. If a "*perfect externalisation of the cost of cash*" should be proposed, then in all fairness, the costs related to these two elements should also be considered for non-

[5] €0.42, i.e. less than half the unit social cost of cards (0.99, with debit cards being much cheaper than credit cards).
[6] https://www.ecb.europa.eu/pub/pdf/other/4th_card_fraud_report.en.pdf
[7] The Telegraph, 23 June 2011
[8] ibid
[9] "*A research-based view on physical and logical ATM threats*"; RBR presentation at the 2016 ATM Security conference, 12 October 2016, by Alan Burt

cash payment instruments. Any "*education of the consumers*", as proposed by the EPC,[10] should then extend to these aspects of direct relevance to them.

Further, the societal cost of cash should also take into consideration the amounts related to "seigniorage" inherent to cash. In actual fact, the societal cost of cash may be less than the cost of cash that the EPC suggests, in so far as cash generates public revenue which would otherwise be levied on consumers/citizens through taxes. The EPC even suggests that it amounts to "substantial incomes"[11].

Banks, however, do not benefit from seigniorage – the EPC framework document actually suggests that "seigniorage may be used to cover part of the cost of the banking sector by providing these cash services free of charge to customers"[12]. ESTA would be happy to support the EPC in its claim for a share of seigniorage.

Any statement on the high level of social cost of cash therefore needs to be put into perspective and formulated differently: what the EPC is primarily concerned with in its document is the direct cost to their members, i.e. the "*private*", not the "*societal*" cost of cash.

Therefore, the recommendations of the EPC on the "*need to reduce the volume of cash handling*" might help the banking sector. It would not, however, necessarily benefit to the economy and society at large, as is inferred in its recommendations.

II) Restoring the truth on cash

i) Competition is necessary between means of payment.

ESTA considers that competition is, in payment instruments as for most other economic areas, indispensable to ensure plurality of choice, availability and affordability of means of payments.

Cash is in essence public money which generates public revenue (seigniorage). It is a public means of payment which is competing with other, private, means of payment (electronic payments) which generate revenue for the banks, card operators or other companies (e.g. mobile). Electronic money is a fast moving environment: some electronic means of payment developed a decade ago to substitute for cash no longer exist anymore and new devices, non-card based such as mobile payment, are in fast development.

Electronic money is, as said, private money that generates private revenue for its promoters. In a recent past, a number of major competition cases were launched, both at EU and national levels, against card operators. The issue was to assess whether the system of multilateral interchange fee (MIF) was compatible with EU competition policy. The European Commission took the view that MIF was an association of undertakings that had the object

page [10] Cf section 4.7, p. 27
[11] Cf page 21
[12] Cf page 21

and the effect to reduce competition between acquiring banks, with an impact on the price of goods and services paid by consumers. It led to decisions against them and, to avoid any future risk, an EU Regulation on interchange fees setting maximum rates that can be charged on the use of these cards was also adopted.

No such risk of collusion between economic operators exists with cash. ESTA's views are that cash, as the only alternative and infrastructure-free means of payment in competition with electronic payments, fulfils a general public interest for consumers and citizen who should keep the possibility of choosing the payment instrument the most adapted to their situation and the circumstances under which they wish to make payments.

ESTA agrees fully with the EPC when it writes that "maximum society and economic efficiency can only be achieved when payment instruments compete against each other for customer acceptance on the basis of their own merits". From what precedes, it does not seem however that any issue with regards to fair competition in payment instruments have ever arisen from cash. Yet, the fact that cash is mainly made available to the public through competitors having alternatives to offer is a circumstance that requires some vigilance, as will be discussed below.

ii) Cash is not free to consumers and the cost of making cash available to customers is covered by existing EU legislation

The SECA Framework document calls for their customers to pay for their personal use of cash. Its rationale is straightforward: "*Resources used in the cash chain are a synonym for cost for banks since there are often no <u>direct</u> revenues from the provision of the cash services*".[13]

EU regulation on bank charges to their customers

The fees that banks may charge to their customers have been the subject of an EU Directive, on the fees related to payment accounts (Directive 2014/92 of 23 July 2014), the purpose of which was to improve the transparency and the comparability of banking fees charged to their customers. The reality that the Commission wished to address when it initiated the Directive, and after a self-regulatory approach failed, was the following:

"The wording used by account providers when describing their fees was complex and varied greatly between the different institutions. Information was difficult to read or ambiguous. The lack of accurate information – including omission of free-of-charge services, incomplete fee information, information that was insufficiently detailed and even different tariffs quoted for the same service – added to this difficulty ."[14]

[13] Cf section 4.1 page 24 (ESTA underlines).
[14] http://ec.europa.eu/finance/finservices-retail/docs/inclusion/20130506-factsheet-1_en.pdf

Concerning possible fees on cash, the EU Directive provides that withdrawing of cash from one's payment account is a basic service that banks have to offer to consumers[15] without limitation in the number of operations. Except in the case of payment transactions through a credit card, credit institutions cannot *"charge any fees beyond the reasonable fees, if any, irrespective of the number of operations executed on the payment account".*

EU consumers already pay for the cash services they receive

The SECA Framework's claim in section 1.3.2.3 that "consumers and their representatives (e.g. consumer organisations) should accept a fair share of the cost of cash related to the personal use of that commodity"[16] is therefore already a fact.

Moreover, as the EPC puts it, "*banks move over from teller transactions to self-serve cash transaction at cash machines*" so that increasingly the only way to obtain cash is through an ATM.

Withdrawing cash from an ATM suggests at least two necessary conditions:

i) having a bank account, on which banks levy a general fee as well as specific operation fees; and
ii) having a card for using the ATM: banks charge additional fees on cards (a yearly fee to the holder irrespective of specific charges that can be levied when using the card). In some cases, withdrawals at ATMs can also be subject to a fee.

Therefore, access to cash from one's account is all but free and banks already charge their customers, albeit indirectly, for the service they provide to them. Putting it differently, access to cash, when it is limited to withdrawal at ATMs, might well be a service offered by a bank to its customers when selling the services of a card. Additional charging for cash, as part of a service already sold, may then not be complying with existing EU law.

iii) Banks have something else to sell to substitute for cash

The reality is that banks may not like cash, as they have their own, alternative means of payment to offer, on which they cash revenue. Their opposition to cash, and their gradual withdrawal from the cash chain, is a means to improve their profitability, not just by reducing 'costs', but essentially by generating additional fees on their customers.

When it is suggested that "the usage of cash may thus be cross-subsidized by other bank revenues, contributing to burdening the pricing of other banking services"[17], the reality may be different. The world economy is going through a lasting period of very low/negative interest rates which has a direct impact on banks' profitability. Charging additional and direct fees for cash would be a way for banks to compensate for their lack of profitability resulting from low interest rates. In other words: the question may be whether the call for additional fees on cash might be tantamount to cross-subsidizing other low profit banking activities

[15] Cf. Article 17.1.(c) : services enabling cash withdrawals within the Union from a payment account at the counter or at automated teller machines during or outside the credit institution's opening hours
[16] Cf section 1.3.2 page 12
[17] Cf page 7 of the EPC document

through two main routes: charging more for cash and incentivising bank's customers to use other payment instruments on which banks can charge fees directly.

There is nothing wrong in banks having a competing product to offer to their customers in lieu of cash. However, it seems that the new SECA Framework's arguments related to the "societal cost" of cash may in reality be down to one main agenda: addressing their own (private) cost for cash.

iv) Banks have been disengaging already too much from cash

The reason for the relative reduction of cash payment should be analysed more precisely. Consumers like cash. In a number of countries, this reduction is in part the result of the limitation in the availability of cash imposed by the banking sector (reduction of ATMs, reduction of branches, unavailability of cash over the counter etc.). When cash is available and accessible, consumers use it.

A number of National Central Banks (NCBs) from Nordic countries have expressed strong concerns on the disengagement of banks from cash, and in some case even threatened to call for legislation. Norway recently passed a legislation to impose a minimum level of cash services by banks.

The major paradox of cash is that it is made available to consumers principally through banks, which have no interest in cash and even have an economic interest in the reduction of cash payments. Cash may cost banks while it often brings no "direct" revenue to them (but does earn *indirect* revenue as explained above). On the contrary, other payment instruments such as cards or bank transfers generate revenue for banks.[18] The incentive for banks to reduce the availability of cash and push their customers towards alternative means of payments is therefore obvious. It is perfectly legitimate, but is in no way in the "public" interest.[19]

By doing so, banks do not only increase their revenue, but reduce competition in payment instruments, up to a point where some NCBs have expressed concerns on the ability of consumers to obtain the cash they want.

ESTA views are that banks are free to disengage from cash, but should do so in a structured and organised manner with other stakeholders so as to ensure that cash remains accessible to consumers. What ESTA feels is not acceptable, is that banks might be - as some NCBs think is already the case – giving consumers no alternative, reducing cash offering and proposing their own payment instruments instead.

[18] Of note, the fees that can be charged for such payments has been the subject of EU legislation, be it the MIF regulation for cards or the 2012 SEPA regulation for credit transfer and direct debit transactions in Euros

[19] Cf the EPC comments that bank infrastructure should be rationalised "in conformity with public needs (accessibility in accordance with *less* cash usage…)" (ESTA underlines)

Cash needs to remain available to consumers. It does not have to be so exclusively through banks.

III) ESTA's views on the EPC recommendations in the SECA framework document

As part of its section on the purpose of its new SECA Framework, the EPC suggests defining "the way for efficiency in cash infrastructure and logistic through realising scale efficiencies for the industry (cross-border services; NCB regulations and standardisation)". It also calls for efficiency gains throughout the cash handling chain.

ESTA supports in principle these objectives, though our way of achieving them may be different if not contradictory to those proposed. ESTA disagrees with the background analysis of cash proposed by the EPC and, more fundamentally, considers that the analysis is flawed since the EPC is conflicted when it advocates for reduction of cash since it has an interest in it.

i) Nothing forces banks to offer cash services which may be offered more efficiently by other stakeholders

As said earlier cash is attractive to consumers and is a key service they expect from their banks when opening a bank account. Once consumers have opened an account in a bank, they usually concentrate their banking services with their bank.[20] If banks continue to offer cash services despite its alleged cost, it is because those who do not would probably lose numerous customers.

Banks therefore have full discretion to offer cash services or not. If not, it is however important that their customers keep access to cash and can continue withdrawing cash from their account. If banks continue to offer cash services, it is their own choice.

ESTA would suggest that banks could reduce the cost of their cash services by disengaging from it in a structured manner whereby they outsource these services, or continue to offer them in cooperation with the cash industry. This would allow for economies of scale to be fully exploited, for banks to reduce their costs related to cash, and consumers to continue keeping access to cash. Experiences of the cash management industry running multi-bank branches in remote areas are already being implemented successfully (notably in South America): efficient solutions exist.

[20] Hence the focus of the European Commission on the ability for consumers to be able to change bank account easily.

ii) Most of the potential for the reduction of the cost of cash is in the hands of the banking sector

Cash costs banks which cannot levy direct fees on the cash services they offer to their customers. For this reason, banks in some countries have invested relatively little in cash technologies and have not come up with innovative solutions for dealing with cash. This explains the cost of cash they bear, which could therefore be substantially reduced.

A significant aspect of this is the absence of standardisation in their processing of cash. A typical example is the issue of ATM cassettes, which the EPC refers to at the end of its document.[21] ATM cassettes often belong to banks and the question of their standardisation has been a subject of discussion for quite some time: simply, banks have not been able to agree on a standard which would imply that some banks would keep their cassettes and others would have to change them.

It is striking for example that in countries where banks have set up joint cash services (e.g. in the Netherlands with GSN), no such standardisation has taken place despite the fact that one single operator is contracting for the major banks of the country.

ESTA suggests therefore that the EPC looks in detail at the potential for cost reduction which could be achieved through a more optimal internal standardisation, rather than suggesting that the cost of (internal) inefficiencies of the sector is passed on to consumers.

iii) Processing efficiency in the cash chain

There are two aspects to the issue which ESTA thinks should be considered separately: the inflow and the outflow of cash. The outflow of cash is, in general, highly efficient and only limited improvements can be made. Local recirculation can be a factor, provided that all requirements of the ECB 2010 Decision are complied with: in that area, ESTA concurs with the EPC that no outflow of cash, whether through ATM or otherwise (e.g. cashback) should be allowed without having controlled the notes as per the requirement of the Decision.

Many more efficiency gains could however be achieved in the area of inflow of cash, with numerous counting and recounting and other duplications of tasks which could be reduced by a shortening of the cash chain. To a large extent, it is a question of the role that NCBs wish to play in the recirculation of cash. The issue has been addressed in a joint EPC and ESTA document on the different models of delegation/transfer of responsibility from NCBs to commercial operators which reviewed their potential to improve the cash cycle efficiency. However, the efficiency gains potential is not limited to just that.

According to the ECB, 60% of the cash in circulation in the Eurozone is recirculated via the Eurosystem and 40% through commercial operators (CMC companies and banks essentially). An evolution of the integration between the NCB and commercial players (not

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[21] Cf section 6.2.4 p. 34

only banks) should be envisaged more structurally, particularly in countries where there is a significant reduction of the NCB network of offices.

On this point, ESTA considers that the cash management companies have a core role to play in contributing effectively to the implementation of the EPC's wish that *"coins and notes not returning to the banks remain of such quality that confidence of the public is not affected, image of banks and other cash operators is preserved"* and ATMs continue to operate smoothly. More generally, a closer cooperation between the banks and the cash industry could help substantially in reducing the cost of cash.

Finally on this point, improvement can also be generated by a smoother logistic with regards to conditions of packaging and delivery of unfit notes to NCBs: changes imposed to packaging by NCBs, both for coins and notes, can generate costs and inefficiencies, particularly when the packaging/delivery requirements are different from the practice of market operators (forcing the industry to have different standards of packaging depending on whether the notes are delivered to the NCB or to commercial customers). Frequent and radical changes in the requirement of coin packaging, as well as restrictions as to where and when they can be delivered, is also an area where some visible improvements could be achieved.

iv) Cross-border services will only achieve limited efficiency gains

The EPC is adamant that there is something flawed in the way cross-border CIT services operate and is calling for major changes in the CIT Regulation. At the same time, the new SECA framework considers that economies of scale are one of the ways to improve efficiency.

If economies of scale are indeed a typical way of improving efficiency (not just for cash), ESTA thinks that there is some contradiction in suggesting that cross-border is the way to achieve them. There are a number of reasons for that:

- The cross-border Regulation only concerns the transport side of cash which is, in relative terms, a decreasing part of the activity whilst cash management is growing. Reading the EPC document, we tend to agree that the cash management side of the activity is where efficiency gains can be achieved, more than in transport which is already very lean with very low margins. Therefore, the cross-border argument, as viewed from the scope of the EU regulation, is not the most relevant;
- There is a very low demand for cross-border activities, and therefore a limited scope for economies of scale. ESTA has consistently stressed that the low cross-border activity (and subsequently of licences) is a reflection of low demand, not a consequence of flawed regulation;
- The key issue with cross-border CIT is in the implementation of the posted worker directive due to the very different social rules pertaining in relevant Member States. The political and economic aspects of the implementation of the current rules are being considered by the EU and this is something which goes way beyond the mere scope of payment instruments or CIT. For cross-border CIT as for any other labour

intensive activity, this is however critical as circumvention of social rules has a major impact on the level playing field;

- The regulatory environment and licensing schemes (where they exist) also varies significantly from one country to the next, with a risk of circumvention in the case of cross-border with, again, a likely major impact on the level playing field.

For these reasons, ESTA has expressed its position in favour of minimal harmonisation which would allow for CIT operators to perform domestic and cross-border services under one single licence. This should contribute, albeit modestly in our view, to more efficiency. This seems in line with the recommendation under section 6.2.3 of the framework document.

ESTA disagrees strongly, however, with the EPC statement that cross-border may be the "*only way to survive in the long term for the CIT industry*". Not only because there is only low demand for cross-border services – not a good perspective if this should be the "*only way to survive*" - but essentially because the industry is moving from a 'CIT' to a 'CMC' industry.

The issue can be viewed however in a more positive way: more processing and cash management by CMCs should mean less transport for the very reasons that are mentioned in the SECA Framework document. The banking sector can contribute to this process by externalising their cash function to CMCs in order to exploit economies of scale and ensuring an efficient and sustainable cash service to their customers.

v) EPC's considerations of the CIT industry's market structure

The new SECA Framework reviews the role and requirements for third parties in its section 5 and states, somewhat inaccurately, that "*based on CIT regulation 1214/2011, CIT companies are allowed to provide professional transport of euro cash by a CIT vehicle by road*". It should be specified that the Regulation only concerns the cross-border licensing scheme, while the ability to perform CIT operation is a matter for domestic authorities, some requiring a licence and others not.

The document raises concerns on the concentration of the CIT industry "*giving rise to possibly business continuity issue and prices increases*".

The EPC can be reassured on both accounts. The reasons for the high level of concentration are well-known: they lie in the low level of margin, the importance of economies of scale and a high level of maturation/saturation of the market.

These concerns should be mitigated by the fact that there are limited barriers to entry on the market: regulatory barriers are low and in some case non-existent (e.g. some countries do not require any license for operating). In any case barriers to entry are not of such a level that they could account in any way for the level of concentration.

Of major importance, however, is that despite the level of concentration of the market, it remains fiercely competitive. This can be explained by a number of reasons:

- First, it is very easy for any customer - a bank for example - to 'sponsor' a new entrant on any market by granting it a market of sufficient size: should any large customer be unhappy with the market situation, it can therefore call in a new operator at relatively short notice. It should be said that in such cases, the entry into the market of a new operator sponsored by a customer would mean a loss of business to an 'incumbent' which may well find its position on that market untenable;

- Second, there have been, in a number of cases, customer-led initiatives such as the creation of consortia by banks, as the ECB report on the CIT survey of 2015 recalls,[22] which have contributed to further concentration. When the EPC criticizes the concentration in its sector and the impact this might have on the market, it ignores experiences in countries such as the Netherlands, Denmark or Portugal where banks have joined forced to substitute for the CIT/CMC operators, in some case leading incumbent operators to stop their operations on those markets;

- Third, procurement of CIT/CMC operators by banks and other customers is often based on mere price competition, leading to very low margins. To some extent, the market structure is also a consequence of such procurement practices, leading to competition being just on price and margin squeezing.

Therefore, the concentration of the industry is largely offset by the fact that market power remains very much with customers. There are virtually no obstacles for a customer to change operator and large customers are usually keen to use more than just one operator. However concentrated the market might appear, customers keep the market power and can influence the market very effectively by their own decisions.

The market power of customers is such that there is some (cor)relation between the concentration of the banking sector and the concentration of the CMC industry on a specific market: when the banking sector is highly concentrated, so is the CMC sector on that market.

ESTA would like to take this opportunity to call on EPC members to revisit the approach to procurement of CIT/CMC contracts where the key criteria should no longer be prices but to define a new tendering framework that would focus on clearly defined operational output. This could be part of the follow-up to the EPC document's suggestion made in section 5.2 calling for best practices as a basis of "*determining the relationship of financial institutions with CIT*" (or, to be more accurate, the '*CMC'* industry).

vi) The absence of internal market for cash handling

ESTA can only underline the accuracy of the EPC when its states that there is no internal market for cash handling in the EU or in the Eurozone. Existing legislation, such as the Payment Services Directive, is not suitable for the industry and the registration of CMC companies as PSP under the directive is a long and uncertain process resulting from tense negotiations with supervisory authorities. As these negotiations would not provide the CMC

[22] ECB report, page 10

with a European Passport, the process would need to be repeated in each country where a PSP status is sought.

What matters most is the different appreciation by Member States' authorities of how CMC companies can manage clients' funds. This aspect is key to the business environment that the industry is facing in various Member States and reflects directly on the type of business model that can be put in place.

ESTA agrees with the EPC when it calls for "*enhanced cash processing efficiency*" and refers to the 2013 joint ESTA/EPC document on "*improving the efficiency of the handling on cash – cash cycles models*", as substantial efficiency gains in cash processing can be achieved through i) a more consistent business environment, ii) common understanding as to how the CMC industry is allowed to manage customers' funds, and iii) a clearer long term view on the cash cycle model to be put in place with each NCB.[23]

vii) Concerning the EPC requests for standardisation

Section 6 of the EPC document calls for specific standardization requirements. It is ESTA's view that banks could do much more themselves as we have highlighted in various part of our response.

ESTA would like to make the following additional points:

- Banknotes degraded by protection devices: ESTA supports the ECB/BNB work currently underway concerning the common detection criteria for stained notes and clear criteria for how stained notes should be processed.
- The use of IBNS homologated in Member states should be allowed in cross-border transport based on the mutual recognition principle. There is no need to agree on new (European) standards. ESTA would not support any harmonisation of standards for IBNS systems, which could risk freezing technological developments. There is a plurality of protection systems which need to be used in adequate circumstances and in accordance with the customers' needs and contractual arrangements. Of concern to ESTA is the relative frequent occurrence of false activations of IBNS.
- ESTA would not support that stained note losing their legal tender as this would risk undermining the confidence of the public towards cash. However the ability to exchange stained notes should be limited, exclusively done by NCBs with a record of the identity of the holder and of the circumstances of the staining.
- ESTA supports the tracing of inks or degradation system, however this should be considered reasonably: too stringent or restrictive tracing (e.g. imposing unique tracers for each transport/box) would probably be excessive and unnecessarily costly.

[23] In this context, the ECB suggestion in its CIT Report of 2015 for a "harmonised implementation of the Payment Services Directive in all Member States" might be an interesting route to explore.

IV) Conclusions

ESTA hopes that this document will provide a useful and complementary input to the considerations that the EPC has made from its “banking perspective” to the way the efficiency of cash handling can be improved.

Key to ESTA is that cash is, contrary to other means of payments, a public good to which the public is entitled, particularly as it is the sole means of payment that requires no infrastructure for its use.

We understand the concerns in relation to reducing the costs of its members when their profitability is sharply reduced due to the monetary policies implemented worldwide. However, the reduction of cash handling – which we understand to be a proxy for the reduction of cash in circulation – as suggested in the new SECA Framework is not a solution that meets the general interest.

With regards to the request from banks to be paid for the cash services they deliver to their customers, ESTA’s views is that banks already charge for these services at “reasonable level”, as provided by the existing EU basic account directive. A substantial potential of reduction of the cost of cash lies in the hands of the banking industry, through increased standardisation and closer cooperation with the cash industry.

ESTA is wary that competition between means of payment should not be reduced, particularly in a situation where one stakeholder has primary responsibility for the availability to the public of a competing product. This is a very peculiar situation and some NCBs have already expressed serious concerns at the pace of disengagement of banks from cash. Banks should not stay in the cash business if they don’t want to, however they should not do that by excessively restricting access to cash.

The efficiency of the cash cycle is a matter which involves a relatively large number of different but complementary stakeholders. ESTA considers that, with regards to our industry, the potential for economies of scale resulting from cross-border is limited and is unlikely to lead to much cost saving.

Ultimately, the potential for cash processing efficiency gains is much stronger if sought from an evolution of the entire cash cycle. Beyond the necessary evolution of the relationship between NCBs and the banking sector that ESTA supports, much more can also be achieved by a closer cooperation between the EPC members and the cash management industry, as argued throughout our response.

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