

Single Payment Area in the EU

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Introduction

One of the main economic pillars of the EU – **the single internal market** – came into being in 1993 upon The Single European Act. However, in a number of areas it has not been put through; obstacles preventing the **free movement of persons, goods, services or capital** still exist in certain areas. One of these, despite recent progress, is the provision of credit transfers.

Though the general principle of a single internal market applies, **the system of payment differs considerably on the national and European levels**. Payments on national levels are provided quickly, safely and with low expenses whereas the same is not true for payments among individual Member States. This involves, in particular small clients or small or medium-sized businesses who cannot get cross-border payments in the EU under the same terms as national payments. For certain payment instruments there are huge price **differences between the European and the national levels**; some instruments cannot even be applied as a cross-border payment. Moreover, each Member State has its own and often **different legal requirements** imposed on the payment service providers, which prevents new players from other Member States from accessing the market and decreases competition. Differences became more pronounced following the adoption of the single European currency, which in fact enabled the introduction of the single cash payment market. Non-cash payments, the volume of which is considerably more significant, however remain rather fragmented throughout Europe.

Figuratively speaking, payments are the oil that enables the wheels of economy to move smoothly. Without a proper and efficient single market of payments it is impossible to make satisfactory use of all the positive effects of the free movement of goods or services in the EU. The problem is not minor: each EU citizen realizes **138 credit transfers per year** on average. The total number of all payment transactions (cash and non-cash) in the EU is 231 billion per year corresponding to approximately 52 billion euros. Expert studies estimate that the payment system expenses amount up to 2 – 3% of the GDP and a **considerable part thereof is covered by the banks**. The main expenses are related to the cash payment system; the expenses are 0.30 to 0.55 euro per transaction. However, the non-cash payment system expenses amount only to several eurocents. The wider application of credit transfers, particularly in the cross-border payment system would **introduce considerable savings**.

Therefore, it is important to establish a **single payment area in the entire EU**, within which citizens, businesses and other institutions could realize payments in an easy and cheap manner as they do on national level.

According to the current opinion of the European Commission, the creation of a single payment market in the EU will be based on two pillars:

- **regulation** – regulative intervention of EU institutions that must provide the necessary legal basis for the process of unification of the payment system in the EU;
- **self-regulation** – self-regulating activities of the payment system providers intended to put through the standardization and integration of national fragmented payment infrastructures and services.

Existing legislation regulating payment services in the EU

The key European bodies took the first steps toward establishing the Single Payment Area in the EU in 1997, when **Directive 97/5/EC** and **Recommendation 97/489/EC** were approved. More considerable progress was not reached until the approval of **Regulation 2560/2001/EC** in 2001.

Directive 97/5/EC on cross-border credit transfers

The directive aims at **introducing the minimum information and quality requirements for a cross-border payment system** so that the funds are transferred among Member States in a timely and reliable manner and with reasonable expenses.

The Directive is a **binding legal instrument** that shall be **implemented in national legislation** in order to become valid. For the Czech Republic, it is the Payment System Act.

Main points of the Directive's arrangement:

- It applies to any cross-border credit transfer **of an amount of less than 50,000 euros** denominated in euros or in other Member State currencies.
- The Directive **defines precise information** which the institutions (i.e. "institution whose business is to receive repayable funds from the public and other comparable securities and to grant credits for their own account") or any natural person or legal entity other than a credit institution which makes cross-border transfers within its operation) must make available to their clients in relation to cross-border credit transfers. **Prior information on cross-border credit transfers** include, for instance the time necessary for the funds to be credited to the beneficiary, the manner of calculation of any commission charges (fees) or the reference exchange rate used. **Following the credit transfer**, the institution shall provide to the client, for instance a reference enabling identification of the transfer, information on the original amount of the cross-border credit transfer, the amount of all payable charges etc.
- The customer's institution shall execute the payment within the agreed time limit. If the agreed time limit is not complied with or if there is no agreed limit and the funds are not credited to the account of the beneficiary's institution **within five days following the date of acceptance of the order**, the institution shall compensate the customer.
- The customer's institution shall execute the payment within the agreed time limit. If the agreed time limit is not complied with or if there is no agreed limit and the funds are not credited to the account of the beneficiary's institution **on the day following the day upon which the funds were credited** to the account of the beneficiary's bank, the institution shall compensate the customer. If the beneficiary's institution can prove that the delay is attributable to the customer or the beneficiary, no compensation shall be payable.
- If, after a cross-border credit transfer order has been accepted by the customer's institution, **the relevant amount is not credited** to the account of the beneficiary's institution, the customer's institution shall credit the customer with the relevant amount (up to 12,500 euros) plus interests and paid charges.
- Institutions participating in the execution of cross-border transfer orders shall be released from their obligations if they can evidence that the non-performance is attributable to circumstances beyond their control.

Recommendation 97/489/EC concerning transactions using electronic payment instruments

The main aim of the Recommendation is to contribute to the development of an information society by promoting **customer confidence in electronic payment instruments**. This includes payment cards (debit and credit) and phone-banking and home-banking applications.

The recommendation **is not a legally binding act**; the European Commission only declares the intended final state. If it is unsatisfactory, an appropriate legally binding act may be adopted in the form of a directive or regulation.

Main points of the Recommendation's arrangement:

- The Recommendation stipulates **minimum information requirements** which should be contained in the conditions applied to transactions made by electronic payment instruments and the minimum obligations and liabilities of the clients and providers of the payment system.
- The minimum information contained in the **conditions governing the issuance and use of an electronic payment instrument** shall include a description of the electronic payment instrument, of the holder's and issuer's mutual obligations and liabilities, the normal period within which the transactions will be made, the types and amount of any charges related to the service etc.
- The holder (client) is obliged to notify the issuer **immediately of the loss or theft** of the electronic instrument and until the time of notification the holder is liable for any loss related thereto, which may not exceed 150 euros. As soon as the holder notifies the issuer – except when he/she has acted fraudulently – he/she is not liable thereafter for any incurred loss.
- The issuer of an electronic payment instrument **notifies the holder only of his/her personal identification number** and keeps, for a sufficient period of time internal records to enable transactions to be traced. The issuer is also liable for the non-execution or defective execution of the holder's transactions or for transactions not authorized by the holder.

Regulation 2560/2001/EC on cross-border payments in euros

The main aim of the Regulation is to **equalize various charges in the payment systems** of internal payments and cross-border payments. Unlike Directive 97/5/EC on cross-border credit transfers, the Regulation applies more generally to all transactions up to 50,000 euros inclusive of payment card transactions.

The Regulation is a **binding legal document and is directly applicable**.

Main points of the Regulation's arrangement:

- **The charges for cross-border payments** in euros within the single EU market must be **the same as charges for payments** in euros **within a Member State**. The Regulation will not apply to cross-border payments made between institutions for their own accounts.
- **With effect as of 1 July 2002**, the Regulation applies to charges for payment card transactions and ATM withdrawals **up to 12,500 euros**. With effect as of 1 July 2003 the charges applied for national and cross-border credit transfers (in the EU) for normal transfers up to 12,500 euros shall be the same. **With effect as of 1 January 2006**, the limit for payment card payments, ATM withdrawals and normal transfers shall be raised to **50,000 euros at maximum**.
- Clients (customers) will be **informed properly and sufficiently in advance on the charges** of cross-border payments.
- The Regulation stipulates the institutions' duty to inform clients of their **IBAN account number and institution BIC** in account statements (with effect as of 1 July 2003). It stipulates that the client is obliged to state the beneficiary's IBAN and his/her bank's BIC in payment orders. If the client does not notify the bank of the above data, additional charges may be charged to the client.
- The Directive may also apply to payments **in currencies other than the euro** upon the decision of the relevant Member State. So far only Sweden has joined in; therefore it applies **to the Swedish crown**.

Regulation 2560/2001 is further extended by **two conventions of the European Payment Committee** created in order to facilitate the implementation of the Regulation into practice; at the same time they are another step in establishing the Single Euro Payment Area (SEPA). Both conventions became effective on 1 July 2003, and are not obligatory for banks.

1. CredEuro

This convention regulates the standard design of payment services in order to ensure **efficient and cheap processing of retail cross-border payments in euros**, provided the client's and the beneficiary's banks are both located in an EU Member State. The convention provides low costs of processing and a fixed overall period for the transfer from the client to the beneficiary, i.e. three business days following the date when the payment order was accepted by the client's bank. A voluntary convention of the European Payment Council is being prepared for coming years – the **Prieuro**. This should require banks to provide even more demanding services; one of the proposed obligations is to transfer funds on the same date an order is made.

2. ICP (Interbank Convention on Payments)

Payments within this convention **must comply with STP requirements** (straight through processing): the order shall state the beneficiary's IBAN, the beneficiary's bank BIC; the maximum amount is 50,000 euros; the order shall not state any further instructions and shall be regulated by the SHA payment disposition (the client and the beneficiary bear the costs of their respective banks).

5 ICP principles:

1. the client and the beneficiary bear the costs of their respective banks,
2. the amount shall be transferred in full (the banks may not charge any fees),
3. the payment complies with the STP criteria (if not complied with, the beneficiary's bank may charge an additional commission fee for NON-STP processing),
4. rules for refusal/return of transfers,
5. rules for charging any fees (e.g. once a month).

The current legal framework for payment services in the EU has **a number of shortcomings**. The legal acts **overlap**, in some cases even **contradict each other** and in general they are **too complicated**.

Recommendation 97/489/EC is not binding and some Member States have not implemented it fully in their national legislation. Moreover, following the adoption of Regulation 2560/2001/EC, some rules required by the Directive and the Recommendation seem **obsolete; they do not correspond to the present market development**.

Generally, they are insufficient. The regulation of cross-border payments in euros brought the charges for cross-border transactions closer to the equivalent domestic payments, but it **does not imply the establishment of a single payment area**. Clients cannot choose one account and one payment card for the entire European Union. **The standards and business practices vary in each country**. The products, forms and services still vary and are limited mostly by the national borders. Certain payment service instruments such as collections cannot be made internationally at all. This means that the cross-border payments are only 3% of all payment transactions.

New legal framework – the European Commission's proposal

As stated above, Regulation 2560/2001/EC in particular has brought certain progress in establishing the **Single Payment Area in the EU**. The adoption of the European currency euro in 1999 (in cash in 2002) and the creation of the pan-European settlement system **TARGET** (Trans-European Automated Real-Time Gross Settlement Express Transfer) by the European Central Bank has also proved to be beneficial.

The progress reached so far **is, however insufficient** since a number of legal and technical barriers still prevent consumers, businesses and payment service providers to use all the positive effects of the single market of non-cash payments.

The existing legal framework for payment services based on a **combination of various national rules and incomplete legislation in Europe** is confusing, it leads to fragmentation of the internal market and prevents any possible volume savings to be realized. This discourages banks and other providers of payment services from creating the required pan-European payment infrastructure. The elimination of technical and legal obstacles should provide efficient payment services, competition among providers under the same conditions, adequate protection of clients, payment safety and a guarantee for the legal security of all participating subjects.

Therefore, the European Commission presented **consultation material to the New Legal Framework (NLF) for payments in the internal market** in 2003. Following an assessment of the consultation process during which all interested parties could comment on the proposals, it presented a specific legislative document in 2005 – a proposal of the **Directive on payment services in the internal market**. This creates the required legal basis for the establishment of the Single Euro Payments Area (SEPA) proposed by the European Payments Council (EPC). An alternate solution consisting of adoption of the NLF in the form of a Regulation with only specifically limited contents was rejected.

The newly proposed Directive on payment services in the internal market presents an overall change of the payment system regulation philosophy in the EU. While the previous legal arrangements applied the rule that what is not forbidden is allowed, the **NLF** applies the opposite principle: **what is not allowed is forbidden**.

Proposal for a Directive on payment services in the internal market

The proposed Directive will provide an **easier and fully harmonized legal framework** since it will supersede Directive 97/5/EC on cross-border credit transfers, Recommendation No. 87/598/EC on European Rules of Conduct for electronic payment, No. 88/590/EC on payment systems and relations between the payment card holders and issuers, and No. 97/789/EC on transactions performed via electronic means of payment, Article 8 of Directive 97/7/EC on consumer protection in respect to distance contracts and Article 8 of Directive 2002/65/EC on the distant marketing of consumer financial services.

The Directive is a **binding legal document** that needs to be implemented in national legislation so that it becomes valid after its approval. The Directive is to be approved in the **co-decision procedure** in which the EU Council and the European Parliament have to agree on it. It is projected for approval **by the end of 2006**.

Main points of the proposed Directive's arrangements as proposed by the European Commission:

1. Subject matter, scope and definitions

- Four categories of institutions entitled to provide payment services are distinguished: (i) credit institutions (banks, savings and credit cooperatives, central banks, post offices), (ii) electronic money institutions, (iii) post office banks, (iv) other natural persons or legal entities who have been granted authorization to provide payment services, so-called payment institutions.
- The Directive applies to payment system services (stipulated in the Annex) where the provider is located in the EU: depositing and withdrawing funds from a bank account, payment orders, collection orders, payment card or other electronic money transactions, transactions of internet banking, home banking or phone banking and others. Transactions consisting solely of a transfer of cash or cheque payments are not regulated in the Directive.
- The Directive applies to payments in all EU currencies and the majority of requirements involves transfers of less than 50,000 euros or its equivalent in another currency.

2. Right to provide payment services to the public

- This chapter defines the requirements to be submitted by the payment service providers in order to obtain an authorization, e.g.: type of payment services foreseen, a business plan including a budget, description of administrative and accounting procedures, risk management procedures etc.
- If the application of a payment service provider complies with all the requirements, an authorization will be granted. The authorization will be valid automatically in all Member States with no further procedure (the principle of a single European passport). The EU Member States shall ensure that the authorization is recognized in other Member States.
- Authorization to provide a payment system without application may also be granted to small payment service providers if it is in the public interest e.g. for the implementation of money laundering rules or mechanisms to prevent terrorist financing. Here, Recommendation VI of the international organization against money laundering and terrorist financing, FATF (Financial Action Task Force) are applied aiming at enabling certain illegal providers to move from the grey economy to the official sector. The single European passport principle does not apply to such providers.
- The Directive requires that the Member States maintain a register of payment institutions, maintain stipulated terms when receiving an application, require that payment institutions keep records of all services and transactions for a reasonable time, but not more than 5 years, etc.

3. Transparency and information requirements

- The Directive regulates individual payment transactions as well as payment system framework contracts. For each category it requires sufficient information to be provided.
- This part of the Directive stipulates the particulars to be included in the communicated terms of the payment system: description of the obligations and liabilities of the payment service provider and the payment service user, specification of the information or identifier that must be provided by the payment service user in order for a transaction to be executed, the execution time for the transaction, the availability of appropriate funds on the user's account, a reference to the point in time of acceptance of a payment order, all charges, an indication of the applicable law and the competent court for the settlement of potential disputes etc. It also stipulates a list of information to be provided to the user and beneficiary following the acceptance of the order or the funds.
- Certain other conditions apply for the payment system framework contracts, e.g.: the technical requirements with respect to the provider's and user's communication, the user's right to initial contracts on the provision of payment transactions, exchange rates and tariffs to be applied to transactions etc. The Directive also stipulates methods for altering or cancelling the payment system framework contract. The simplified mode applies to micro payments not exceeding 50 euros.
- The Directive also stipulates information to be provided to the payee after the acceptance of an order (a reference enabling the identification of each payment or information relating to the payee, the amount of the payment transaction and charges for the transaction or the exchange rate) or to the beneficiary after the acceptance of funds from the payee (a reference enabling the identification of each transaction and beneficiary, the full amount transferred under the order, transaction charges or the exchange rate).

4. Rights and obligations of users and providers

- The Directive stipulates the conditions for the authorization of payment transactions by the payee via a payment verification instrument: the payee must use it in accordance with the instructions and notify the provider immediately of the loss thereof; the provider shall ensure that the security features of the payee are not accessible to any third parties and refrain from sending any unsolicited payment verification instruments etc. The Directive also provides the settlement of disputes on the authorization of any payment transaction made.
- In the event of unauthorized payment the payment service provider is obliged to refund the payee the amount of the unauthorized payment immediately. A certain financial compensation may be agreed. The client will bear the loss up to the amount of 150 euros (which may be reduced by the Member States) from the use of a lost or stolen verification instrument occurring before he/she has fulfilled his/her obligation to notify the provider thereof. This will not apply if he/she has acted fraudulently or with gross negligence. This client protection does not apply to enterprises exceeding the size of a micro enterprise (i.e. more than 10 employees and annual revenue exceeding 2 million of euros or a balance sum exceeding 2 million of euros) since they have sufficient capacity to assess the risk of unauthorized payments.
- The user and the payment service provider may agree on maximum spending ceilings for payment services and the payment service provider may block the payment if there is suspicion of fraudulent use. If the payment order is refused, the reasons for the refusal shall be notified to the user without undue delay and no later than within three days. Internal records on payment services shall be kept for at least one year.

- If the payment transactions are carried out in the currency of a Member State and the payment service providers are located in the EU, the Member State shall require that the transaction fees are charged to the user and the payee (SHA disposition). The payee may vary this requirement by mutual agreement with his/her provider.
- If the payment service providers are located in the EU, the Member State shall require that for transactions initiated by the user (payment order – credit transfer) the funds are credited to the payee's account no later than at the end of the first business day following the acceptance of the order (D+1). Until the end of 2009, the user and the payment service provider may agree on a period of no longer than three days (D+3). This does not apply to currency conversion or micro payments (up to 50 euros). For payment transactions initiated by the payee (collection order – direct collection) a general period of one day is also stipulated unless the payee and the provider agree otherwise. In the case of deposit of funds to the client's account, the payment services provider shall ensure that the funds are credited no later than the following business day (D+1). The Member State may require an even shorter period than that stipulated in the Directive with respect to domestic payment transactions (applies to fund deposits and transfers).
- The payee's payment service provider shall ensure that the funds accepted from the user are received by the payee immediately after the acceptance and no additional fees shall be charged in relation to their release.

5. Amendment and Payment Committee

- In order to take account of the technological and market developments in payment services and to ensure the uniform application of the Directive in the Member States, the European Commission may amend the list of activities covered by the Directive and adopt certain other provisions. The Commission shall be assisted by the Payments Committee composed of representatives of the Member States.

6. Final provisions

- No later than two years after the application of the Directive to the national legislation of the Member States, the European Commission will prepare a report on the implementation of the Directive.
- The Member States shall allow persons who have commenced the activities before the Directive came into force to continue the activities of payment institutions for 18 months after the date of the Directive's application into national legislation.
- The Member States shall apply the Directive into their national legislations within 12 months after the date of adoption of the Directive.

Current Status of the Directive

The European Commission proposed the Directive in early December of last year. At present it is **discussed at meetings of the Committee of Permanent Representatives of the Member States (COREPER)** and soon it will be discussed in the **relevant committees of the European Parliament**. The initial negotiations however indicate that the coming approval process will not be easy.

The opening paragraphs are subject to significant dispute. According to the European Commission's proposal backed by the United Kingdom and the Scandinavian countries, **newly established payment institutions** should be subject to lower regulation compared to banks that compete with them in payment services. For example, the rules of capital adequacy or minimum amount of the registered capital should not apply to them. Furthermore, they may also pursue other business activities (e.g. telecommunications services). Austria, as the presiding state (supported by Germany), ECB and the majority of the European Parliament are of the opposite opinion. They require that **natural persons should not be allowed to become payment institutions**, they should be subject to capital adequacy, may not pursue any other activity than payment services and funds from clients would have to be strictly separate from their own funds.

The Directive is also criticized for other problems. Its scope is, in some points focused on payments where **one party is not located in the European Union**. After its application it will be difficult to make e.g. American banks to comply with obligations stipulated in European legislation.

With respect to the stipulated rights and obligations **the Directive is unbalanced**, since it exceedingly emphasizes the protection of clients and **a large part of the obligations is placed on the payment service providers**. This is clear, for example with respect to the limited liability of the electronic payment instrument holder (e.g. payment card) where the holder bears liability only up to the amount of 150 euros before he/she notifies the provider of the loss and the remaining amount is at the liability of the provider. Making the payments prompt as stipulated in standard rule D+1 is certainly a positive step for the future. The question is whether the deadline for the rule is not too murderous.

Single Euro Payment Area (SEPA)

The second pillar regulating the consolidation of payment system markets in the EU is the initiative of the payment service providers where **the banking industry is crucial**. The payment service providers will have to find **the most efficient pan-European business model** for payment systems or the most convenient method of integrating the fragmented payment infrastructure and various payment service products with the aim to make a profit from potential savings and offer new, technologically developed and efficient payment technology.

Thus far, this opinion is also held by the European Commission. The freedom of the banking industry representatives will, however not be unlimited; the European Commission as well as other key European organizations (the Council, Parliament, ECB) will for certainly **reserve the right to influence and/or dismiss the rules** proposed by the banks. This has also been confirmed by Charlie McCreevy, the Commissioner responsible for the Internal Market. He presented consultation material on the stimuli for the SEPA establishment in February, in which he stated his vision on how this should work. He warned the banks that if they fail to progress sufficiently in SEPA establishment, the Commission may adopt **its own legislative solution**.

The proposed Directive on payment services in the internal market is a **necessary legal framework for the establishment of the Single Euro Payment Area (SEPA)**. The main role, however remains with banks and other payment service providers who, for this purpose established **the European Payments Council (EPC)**.

The European Payments Council

The European Payments Council **is the decision-making and coordination body of the European banking industry in relation to payments** with the purpose to create SEPA. The Council was established upon the initiative of the European Association of Cooperative Banks (EACB), the European Savings Banks Group (ESBG), the European Banking Federation (EBF), the Euro Banking Federation (EBA) and 42 European banks in June 2002 in response to the single euro currency and to Regulation 2560/2001/EC on cross-border payments in euros.

The European Payment Council aims at creating system solutions enabling Euro zone citizens and gradually all of "Europe" (perceived by EPC as the EU plus Iceland, Norway, Liechtenstein and Switzerland) to make the essential payment transactions in a single currency "**with one account and one payment card in any country under the same fees and terms as in their home country.**" The intention to establish SEPA was specified in the White Book: "Euroland – our single payment area" and in the EPC Charter in 2002 in the following declaration: "We, the European banks and European Credit Sector Associations:

- "Share the common vision that Euroland payments are domestic payments,
- "Join forces to implement this vision for the benefit of European customers, industry and banks and accordingly,
- "Launch our Single Payments Area."

SEPA is an area where citizens, companies and other economic actors are able to make and receive payments in euros within Europe – whether between or within national boundaries – under the same basic conditions, rights and obligations **regardless of their location**. This applies to credit transfers, direct debit and debit card transactions.

While the definition refers to Europe in general, the establishment of **SEPA will be the priority of the Euro zone**. In Europe – except the Euro zone – it will be possible to participate in payment systems in euros and adopt standards and procedures of the Single Euro Payment Area (SEPA), thus contributing to the establishment of a single internal market in payments. This will, however not be obligatory.

Cash – the single European currency, euro – has already become pan-European currency within the Euro zone. In order to achieve SEPA, non-cash transfers such as **credit transfers, direct debit and payment card transactions** also must become pan-European.

The European Commission's attitude should also be mentioned. In its documents, the abbreviation SEPA means the Single **European** Payment Area, which indicates the applicability of SEPA within the EU as a whole, not only in the Euro zone. It would, however, be rather inefficient to include non-euro payments in the pan-European payment schemes and instruments (see below) since the costs would be considerably higher than the benefits, regardless of the fact that 10 out of 13 states of the Euro zone (except the United Kingdom, Denmark and in part, Sweden) anticipate adopting the euro soon.

SEPA Roadmap 2004-2010

Since its establishment the European Payments Council, together with the banking industry has contributed significantly to the creation of SEPA through its adoption of several resolutions and recommendations. During the first nine months of its operation the Council introduced **CredEuro** – the first pan-European automated clearing for cross-border credit transfers up to 12,500 euros required to be credited to the payee's account **within three days** D+3. A new standard, **Prieuro** is under preparation, aimed at making payments within the same time as national payments; by 2007 the transfer should be made within the same day (D+0), and an Inter-bank convention on payments (**ICP**) enabling the crediting of the whole amount to the payee's account (see above). The first Pan-European Automated Clearing House (PE-ACH) started operation in July 2003, i.e. the STP2 system operated by the European Banking Federation.

Progress is insufficient; there are differences between domestic and cross-border payment transactions within one country and among domestic payment systems in various countries.

A new impulse to progress with the SEPA establishment was the **SEPA Roadmap 2004-2010**, adopted in December 2004 and updated last year.

Payment service instruments

The Roadmap focuses on establishing the Single Euro Payment Area through the introduction of three key payment schemes for:

- a) SEPA **Credit Transfers**,
- b) SEPA **Direct Debits**,
- c) SEPA **Debit Cards**.

These schemes will create a **set of core payment instruments in SEPA** to be implemented by the banks and provided to their clients. A decision was adopted under which the schemes (frameworks) will be separated from the payment infrastructures. The SEPA payment schemes (frameworks) are defined as a **common set of rules and practices** for the provision and operation of a SEPA payment instrument agreed at an interbank level. The payment schemes will be managed by a non-profit special bank institution that is yet to be established (Scheme Management Entity).

to a) SEPA Credit Transfers

The Credit Transfers will be regulated in the document titled "SEPA Credit Transfer Scheme Rulebook", the first version of which was adopted by the European Payments Council in March 2006 (the final version may vary according to further negotiations). Credit transfers in accordance with the SEPA credit transfers shall comply with the following:

- payments in euros without limitations,
- payments will state the BIC bank code, the IBAN account number and the payee's bank will be accessible within SEPA,
- payments will be made without deductions; the user and the payee will bear the charges of their respective payment service providers/banks,
- minimum requirements on transfers are within three business days of the date of acceptance of the order (D+3); the period of D+1 is anticipated in future (to be in accordance with the NLF); the optional standard Prieuro anticipates the fund credit on the same day (D+0),
- transfers are processed through STP (= automated direct processing)
- additional data of the sender, up to 140 symbols will be sent to the payee complete, without alterations.

to b) SEPA Direct Debits

The Direct Debits will be regulated in the document titled "**SEPA Credit Transfer Scheme Rulebook**", the first version of which was adopted by the European Payments Council in March 2006 (the final version may vary according to further negotiations). Some particulars are similar as for SEPA Credit Transfers (BIC bank code, IBAN account number, STP processing, unlimited payments in euro, unless a limit is decided by the end of this year).

There are, however even more significant disputes as for which model will be adopted as SEPA. The key factor is the mandate = a contract between the payer and the payee for the clearance of liabilities in the form of collections. In the majority of West European countries the contract must be delivered to the payee's bank; the bank keeps a database of such contracts and checks the payee's identification numbers. There is a different system applied in the Czech Republic: the mandate database is managed by the payer's bank and it decides whether to enable collection from the payer's account subject to whether the payee's requirements are in accordance with the data in the database. The form of cross-border SEPA direct debits has not yet been finally decided.

to c) SEPA Debit Cards

The Debit Cards will be regulated in the document titled “**SEPA Card Framework**”, the first version of which was adopted by the European Payments Council in March 2006 (the final version may vary according to further negotiations).

Cards compatible with the SEPA principle should be based on the EMV standard, with chip technology. Though it is more expensive than magnetic strips, it is safer. Users will use SEPA debit cards in every shop and withdraw cash from ATM machines throughout the EMU under the same conditions as in their home countries.

This will apply solely to debit cards. It is not yet planned to include also credit cards, but this may happen in the future.

Generally speaking, the pan-European SEPA card will be issued by EuroCard or Visa associations, which would mean the end of national debit schemes with considerable market shares in some states (this does not apply to the Czech Republic). An alternate and less probable scenario anticipates that various national schemes mutually agree to use the same standards and interconnect so that they become “SEPA compliant”.

Payment infrastructure – clearing settlement houses

Logically, completely new pan-European payment instruments will have to be settled by clearing houses able to process them. The houses will have to be able to settle any SEPA credit transfer or SEPA direct debit from any EMU Member State under the same conditions, with no discrimination according to locality. Exclusively national clearing houses will cease to exist or transform according to SEPA principles in pan-European clearing houses (**PE-ACH**).

Each payment service provider in SEPA will, therefore have to be connected to the PE-ACHs either directly or via another provider/bank. Of the current dozens of clearing houses in the EU only few of the PE-ACH type are expected to survive. The first such house is the STEP 2 system operated by the European Banking Federation.

Schedule:

According to the schedule, the EPC plans to effect all three pan-European payment schemes (credit transfers, direct debit, debit cards) **by January 2008** and expects the majority of clients to use them **by 2010**. Generally, there will be two stages of the SEPA introduction.

Stage I as of 01/01/2008 – payment service providers should have the first SEPA compliant instruments ready for clients (such as credit transfers, direct debits, debit cards) to use in the cross-border and national payment transactions. In a two-year transitional period the national payment instruments and clearing systems will coexist with the SEPA instruments and systems, provided an increasing number of clients switch to SEPA. The first initiators of SEPA payments should be public institutions and multinational corporations for whom the benefits should be particularly distinct. Gradually, other clients will join in and SEPA will gradually become important.

Stage II as of 01/01/2010 – SEPA payment instruments settled by PE-ACH will be used by the majority of clients; exclusively national payments will terminate gradually and cease to exist.

SEPA Impact on the Czech Banking Industry

Payment services are expected to undergo **serious changes** in the near future. As a result, cross-border payment transactions (within the EU) will cease to exist and the EU single internal market concept will supersede national markets, also in the payment transactions.

Although pan-European payment service instruments will be implemented first in the Euro zone according to SEPA, the Czech Republic will be approaching the stage of adoption of the euro at the time of their implementation (the official policy of the Government and the Czech National Bank anticipates accession to the Euro zone in 2010). Therefore, it is highly advisable to participate in the SEPA and payment instruments from the very beginning. We are pleased to state that this is already happening. **Czech banks** participate in the activities of bodies and working groups of the EPC through their **representatives**. Karel Vítkovský, the Vice-Manager of the Payment Service Department of Česká spořitelna, is a member of the Cash Working Group.

The SEPA project is a **logical supplement to the Economic and Monetary Union (EMU) and the single internal market**, as the basic economic pillars of the EU. Although we strongly believe that the consolidation of payment services within the EU is generally beneficial in the long-term perspective, an open discussion on the costs of adopting new systems is encouraged. The European Commission estimates the annual “operational” savings from the standardization and consolidation of payment transactions in the EU as a whole to be 50-100 billion euros. No studies exist yet on the

single costs of the transfer from national payment systems and instruments to SEPA. It is, however clear that the main part of the costs will be paid by the payment service providers, in particular banks.

The following three types of costs related to the adoption of SEPA in the banking industry may be identified in the manner of simplification:

1. **Investment costs** on the single change of information systems.
2. **Operational costs** for the implementation of new instruments that, due to their pan-European solution may be more expensive than purely national schemes.
3. **Financial losses** – for example, for the decrease of fees for cross-border payment transactions that are higher than domestic.

In addition to costs, banks may **expect benefits**. The single passport principle within the provision of payment services will allow efficient entities to access the as-yet less accessible foreign markets and expand their business. Increased competition will not only result in decreased income; it will also result in pressure to reduce costs. Higher standardization and expansion of markets (instead of 25 national markets there will be one pan-European market) will **allow sharing the costs** of development and acquisition of information systems.

Czech banks are privileged in this respect. The SEPA project corresponds to the euro adoption project. If they enter the Euro zone in 2010 when the new SEPA rules become applicable, the costs of adjustment and acquisition of new information systems or an information campaign for their clients and other similar costs **may be covered at the same time**.

It will be up to each bank to decide how to approach the revolutionary project of SEPA adoption. If the banks remain in the national framework, they cannot expect good results. If they manage to agree on cooperation with cross-border partners or use synergy within a multinational bank group, their **adoption costs may decrease significantly** and they may **profit** from the overall change **in the long-term perspective**.