



## **European Commissioner sounds warning bell on Single European Payment Area (SEPA)**

### **Introduction**

Charlie McCreevy, the European Commissioner for Internal Market and Services has delivered a number of veiled warnings to financial institutions in relation to the implementation of the Single European Payments Area (SEPA). In his speech to the Institute for European Affairs of 30<sup>th</sup> June he warned that “protecting inefficiency, restrictive or protectionist practices never delivers welfare benefits to consumers, economies or businesses in the long term...in my view, the banking industry needs to focus on the macro benefits and the opportunities SEPA will bring as well as on the micro benefits in terms of taking out direct costs in their businesses”. This follows on from McCreevy’s speech of 7<sup>th</sup> June where he did not rule out the possibility of Commission intervention in the implementation of SEPA and stated that, although there has been progress in transposing financial services directives over the last year, the Commission will “continue to bang the drum, to name and shame and, if necessary, to go to the European Court”<sup>1</sup>.

Following the publication of the proposed Payment Services Directive, both the European Central Bank and the European Payment Council have published detailed responses to the proposed Directive calling for significant changes to the legislation before its implementation.

### **Benefits of SEPA**

The single market for payment services is expected to have substantial economic gains with some commentators predicting that it will lead to savings of €50-100 billion per year for the EU economy. The aims of SEPA are to contribute both to the Lisbon Agenda to make the EU the most competitive and dynamic knowledge-driven economy by 2010 and to complete the process of Economic and Monetary Union. For these benefits to be achieved, the European Commission, in its Consultation Paper on SEPA Incentives, has specified three basic criteria that must be met:

- there must be common standards which are set in an open, transparent and accountable process which can revise or adapt in the common standards as necessary;
- there must be an available infrastructure that is characterised by full technical and commercial interoperability, and
- there must be transparent cost-based pricing to encourage the use of efficient payment instruments to the detriment of expensive payment instruments (at present institutions are not permitted to offer differential pricing (called “surcharging”) dependent on the payment instrument preferred by the consumer).

In this bulletin, we have outlined the progress made in implementing the proposed Payment Services Directive and highlighted the views of the European Payments Council and the European Central Bank as to what steps need to be taken to ensure the proposed deadline of 1<sup>st</sup> January 2008 is met for implementation of SEPA.

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<sup>1</sup> McCreevy, C. ‘Improving decision-making and completing the single financial market’, Speech 7<sup>th</sup> June 2006, Brussels.



## **Proposed Payment Services Directive**

SEPA is to be implemented via the proposed Payment Services Directive (which was published by the European Commission on 1<sup>st</sup> December 2005). The proposed Payment Services Directive has three main objectives:-

- To create a level playing field with respect to the right to provide payment services to the public;
- To enhance competition, consumer choice and protection by implementing clear and consistent rules for information requirements and transparency for payment services; and
- To create clarity and certainty on core rights and obligations of users and providers of payment services.

The proposed Payment Services Directive permits four different categories of payment provider: (i) credit institutions; (ii) electronic money institutions; (iii) post office giro institutions; (iv) other natural or legal persons who have been granted authorisation to provide and execute payment services (“payment institutions”).

## **Payment Institutions**

In order to obtain authorisation as a payment institution<sup>2</sup>, a written application has to be submitted to the regulatory body in the provider’s home Member State containing various deliverables including: (i) a business plan including a tentative budget calculation for the first three financial years which would allow the presumption that the applicant is able to employ the appropriate and proportionate systems, resources and procedures to operate soundly; (ii) a description of the applicant’s administrative and accounting procedures, such as would allow the presumption that it conducts sound and adequate procedures and controls; (iii) a description of the applicant’s risk management system. The authorisation, once granted, is to be valid in all Member States and will allow the payment institution concerned to provide payment services throughout the European Community.

Payment institutions are to be entitled to engage in the following activities:-

- The provision of payment services;
- The provision of operational and related ancillary services such as guaranteeing execution of payment transactions, foreign exchange services, safekeeping activities and storage and processing of data; and
- Access and operation of payment systems for the purposes of transferring, clearing and settling funds.

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<sup>2</sup> There are certain exceptions to these requirements where, for example, the total business activities if the entity concerned generates a total amount of funds outstanding which does not exceed 5 million Euros on average over a month and 6 million Euros at any given point in time (Article 21 proposed Payment Services Directive).



The definition of payment services under the proposed Payment Services Directive is extremely wide and includes (i) cash deposits and cash withdrawals on a payment account held either by the user's payment service provider or by another payment service provider as well as the operations required for operating a payment account; (ii) execution of payment transactions where the funds are held on deposit in a payment account or covered by a credit line for a payment service user; (iii) issuing of payment cards which allow the payment service user to transfer funds; (iv) money remittance services where the funds are accepted by the payment service provider for the sole purpose of making a payment transaction and transferring the funds to the payee; (v) executing payment transactions by distance communication (e.g. mobile phone or other IT device).<sup>3</sup>

### **ECB expresses concern over activities to be provided by payment institutions**

The European Central Bank has expressed concern over the scope of payment services which payment institutions are permitted to provide. In its official opinion on the proposed Payment Services Directive (published in the Official Journal on 9<sup>th</sup> May), the ECB expressed the opinion that payment services should preferably be restricted to credit institutions or e-money institutions or that the payment service activities of payment institutions should be restricted to (i) money remittance services where the funds are accepted for the sole purpose of making a payment transaction and transferring the funds to a payee; and (ii) card issuing (provided the underlying account is held by a credit institution).

The source of the ECB's concern has arisen due to the unclear scope of the proposed Payment Services Directive and whether, for example, payment institutions may hold funds having similar economic and legal characteristics to deposits or e-money. The conclusion drawn by the ECB is that, despite statements to the contrary within Recitals 8 and 9 of the proposed Payment Services Directive, payment institutions will in fact receive deposits from their customers and may also grant credit financed by money received from the public. As a consequence, the ECB believes there is a mismatch between the permitted activities of payment institutions and the proposed prudential and supervisory approach suggested by the proposed Payment Services Directive with credit institutions being placed at a regulatory disadvantage as they will be subject to capital adequacy safeguards and supervision on a consolidated basis for operational risks on their activities whether they perform their payments activities directly or via a subsidiary qualifying as a payment institution).

### **Guidelines on access to and operation of Payment Systems**

Article 23 of the proposed Payment Services Directive provides that Member States are to ensure that rules on access to and operation of payment systems must be objective and proportionate and may not inhibit access more than is necessary to safeguard against specific risks and to protect the financial safety of the payment system. In addition, Article 23 contains a list of requirements which Member States are not permitted to impose in respect of payment providers: (i) a ban on participation in other payment systems; (ii) a rule which discriminates between authorised payment service providers in relation to the rights, obligations and entitlements of participants; (iii) any restriction on the basis of institutional status.

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<sup>3</sup> The full list of payment services is contained in the Annex to the proposed Payment Services Directive.



The ECB argues that payment system operators should be entitled to differentiate between different types of payment service providers regarding the conditions to be fulfilled before payment service providers can gain access to payment systems (provided this is done on objective grounds).

### **European Payments Council**

The design, specification and monitoring of the implementation of SEPA is the responsibility of the European Payments Council (EPC), which was created by the banking industry in 2002 following the enactment of the Cross-Border Payments Regulation in 2001 (this Regulation obliges banks to charge equal payments for cross-border and domestic payments). Work by the EPC covers three fundamental areas of European payment products: payment schemes for Credit Transfer, Direct Debit, and a framework for card payments.

Three phases for the implementation of SEPA were identified by the EPC: (i) a system design phase (this has now come to an end); (ii) the implementation phase during which the schemes, frameworks and standards proposed by the EPC are expected to be implemented by banks and other institutions and products developed on the basis of these schemes, frameworks and standards (the deadline for which is 1<sup>st</sup> January 2008); and (iii) the migration phase with the adoption of SEPA products leading to an irreversible uptake of new SEPA products reaching critical mass by the end of 2010.

### **Tension between European Payment Council and the European Commission**

Following the publication of the proposed Payment Services Directive, the European Commission published a Consultation Paper on SEPA Incentives. The European Payment Council's subsequent response to the Consultation Paper indicates that there are several substantive issues upon which the two parties have not reached agreement: (i) whether e-invoicing should be part of the SEPA programme; (ii) the level of involvement of non-bank payment service providers; (iii) whether there should be any amendments to the SEPA schemes which were finalised in March 2006; and (iv) the level of priority to be given to legislative harmonisation efforts required to facilitate the implementation of the SEPA Credit Transfer and Direct Debit Schemes and to measures supporting the repositioning of cash.

### **E-Invoicing**

E-invoicing is an issue on which the Commission and the EPC are clearly divided. In the Consultation Paper the Commission views SEPA as a 'spring-board' on which to launch e-invoicing (which will, in the Commission's view, lead to huge potential savings for the EU economy) in the belief that an increase in competition will lead to increased creativity in product offerings. The EPC, on the other hand, does not view e-invoicing as a payments matter per se and believes that it should therefore be excluded from the current SEPA programme (a view that is shared by the European Association of Corporate Treasurers (EACT)). The EPC goes on to highlight that the issue of e-invoicing is going to be covered as a top priority of the EACT's Corporate Action on Standards (CAST) project and that related work is currently being undertaken by the European Committee for Standards/Information Society Standardisation System (CEN/ISSS).as requested by the European Commission.



### **Involvement of Non-Bank Payment Service Providers**

The issue of governance of the EPC was highlighted in the SEPA Consultation Paper and is one that Charlie McCreevy mentioned in his speech on 7<sup>th</sup> June. The Commission is concerned that non-bank payment service providers have not been adequately consulted in the design of SEPA schemes and frameworks and that, as a result, the objectives of the proposed Payment Services Directive are unlikely to be achieved. Another criticism levelled by the European Commission is that there has been a lack of involvement of infrastructure providers and processors with the likely result being a system which favours bank-owned processors over independent service providers.

The EPC states in its response that consultation has been undertaken with a variety of user groups and with payment infrastructure providers and this consultation exercise has been reflected in the plans for the schemes and frameworks. In addition, the EPC states that the schemes do not limit access to credit institutions only but include all participants active in the business of providing banking and /or payment services.

The Commission also criticises the schemes proposed by the EPC for credit transfer and direct debit on the basis that they are not ambitious enough and rather than being forward looking are defined on the basis of existing national services. The Commission raises concerns that the credit transfer and direct debit products will not be 'best of breed' and will therefore put the success of SEPA at risk on the basis that the products will be used for cross-border payments only as the relevant products do not significantly improve on those available in national markets.

### **Finalisation of the current SEPA schemes**

The Commission has also expressed concerns over the SEPA Card Framework on the basis that it will have a negative impact on competition, integrating and removing barriers at the cost of moving to a highly concentrated market. Second, the Commission states that the SEPA Card Framework does not address conditions for effective competition in the European market for card processing in relation to either (i) the standards defined for card payments; or (ii) the separation between schemes and infrastructure (this is also an issue that was raised by the European Commission in its interim report into payment cards).

In response to this, the EPC's view is that the standards set do not describe the product offers that individual banks will deliver and additional services can be developed based on the schemes. The EPC believes that SEPA schemes will enhance the scope of customer propositions and that these will evolve according to competition. Further to this, the products themselves should have an advantage over existing national payment products as they will be usable throughout Europe as compared to the more limited reach of existing payment instruments.

The failure to agree upon the content of the SEPA Credit Transfer and Direct Debit schemes and the SEPA Card Framework is likely to lead to significant delay beyond 1<sup>st</sup> January 2008 (i.e. the date by which consumers should be offered the possibility to use pan-European payment instruments) in the implementation of SEPA as customers and providers will not be willing to commit the substantial capital needed to change their existing processes unless there is certainty as to the content of the SEPA Card Framework and the Credit Transfer and Direct Debit schemes.



### **Finalising European legislation in time for the launch of SEPA in 2008**

In order to achieve the proposed deadline of making SEPA products available by 1<sup>st</sup> January 2008, EPC believes that the legislative programme needs to be finalised as soon as possible (a view which is shared by the European Central Bank). However, given the divergent views on the scope of payment services, whether the ability to provide payment services should be restricted to credit institutions and e-money providers and the issues that need to be agreed prior to agreeing the card scheme rules there remains a risk that these deadlines will not be met without Commission intervention.

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