THE IMPACT OF EUROPEAN INTEGRATION ON THE PAYMENT SYSTEM

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The introduction of euro in 2002 led to the creation of a single "domestic" market for cash retail payments in euro. In order to create a single market for cashless payments as well, the European banking community, ahead by European Council Payments, has launched the Single European Payments Area project (SEPA) in 2002. The project designed new payment schemes for credit transfer and direct debit, as well as a card payments framework. SEPA credit transfer scheme was officially launched on 28 January 2008. The whole project is expected to be implemented by the end of 2010. In this paper we refer to the necessity of introduction of this ambitious project, to the essential features of its components and to its overall economic impact. We also discus the challenges of Romanian payment system generated by the implementation of SEPA.

Keywords: payment system, Single European Payments Area, Romanian payment system

Introduction

Over the last two decades payment and settlement system have gained an increasing importance in the most countries as a result of a growth in the volume and the value of transactions resulted from money and foreign exchange markets, in particular, and from financial markets in general.

Generally, a payments system is made of three major components:

- RTGS system settles large-value payments on one to one basis.
- Clearing House settles low-value payments through clearing system on net basis.
- Securities settlement system – settles transaction with securities.

Given the fact that payment system represents the main channel through which central bank implements monetary policy, it has a vital importance to the economy, especially in what concerns well functioning of financial system and assurance of financial stability.

1. Payment System in Euro zone

Since the payment system plays a vital role both in terms of financial stability and facilitation of transactions among customers, European Central Bank and the Eurosystem give an important attention to the smooth functioning of the payment system in the euro area.

1.1. Components of Payment System in Euro zone

The payments in euro area are settled through the following components:

- TARGET (Trans-European Automated Real-time Gross settlement Express Transfer system) settles large-value euro payments. It was created by interconnecting national RTGS systems and the ECB payment mechanism in January 1999. Today TARGET is the largest payment system in the world (Godeffroy J. M., p.1).
- The Correspondent Central Banking Model allows Eurosystem counterparties to use their eligible marketable assets issued in other euro area countries as collateral in order to get a credit from their home central bank.

- EBA (Euro Banking Association) Clearing is a private provider of both high-value and low-value clearing and settlement services to banking community in the European Union through three systems: EURO 1, STEP 1 and STEP 2 (the only retail payment system).

1.2. Payment instruments in euro area

The most used cashless payment instruments within euro area are credit transfer, direct debit and cards (www.ecb.int).

Credit transfer is a payment instruction initiated by the payer, being sent to the payer's bank, which moves the funds to the beneficiary's bank, possibly through some intermediaries. Credit transfers are the most used instrument, representing around one-third of cashless payments.

Direct debit is a payment initiated by the payee through its bank, after the agreement between the payee and the payer. Direct debits are used both for returning payments with a pre-authorised agreement and for one-off payments where the payer authorises the individual payments. The payments through direct debits represent around one-quarter for all cashless euro payments.

Cards are issued by a credit institutions or card company. They can be debit cards or credit cards. Debit card allows the cardholder to charge purchases directly and individually to an account. Credit card allows the cardholder to make purchases within a certain credit limit. Card payments represent less than one-third of cashless payments.

2. SEPA – Single European Payments Area

2.1. Creating of SEPA

In spite of the introduction of euro in 2002, the payment systems of member countries adopters of single currency were not equipped to handle it as differences between national and cross-border payments continue to exist. Since then a "domestic" market for cash retail payments in euro was created, but not for cashless. Although large-value payments, procedures, instruments and services have been harmonized until today, this performance was not achieved in the case of retail payments. To pass these deficiencies, the European Payment Council (EPC), the decision-making and coordination body of the European banking industry in the domain of payment, launched the SEPA project in 2002. It represents a programme which aims to create a single domestic payments market in euro, where, the costumers could make cashless payments in euro zone as easily, efficiently and safely as in their domestic countries, from a single account anywhere in the euro zone using a single set of payments instruments (Schmiedel H., p. 5).

European banking community is now implementing common standards and procedures for credit transfers, direct debits and payment cards to eliminate the differences between domestic and cross-border payments in euro. Creation of SEPA between 2008 and 2010 may be compared to the transition process from national currency to a single common currency (Schaefer G. K., p. 3).

SEPA is implementing in three stages (ECB 2006, p.14):

1. The design stage began in 2004, engaging the plan of the new credit transfer and direct debit scheme and the framework for cards, clearing and settlement infrastructure.
2. The implementation stage last between the mid-2006 and end-2007, consisting in preparation for the adoption of the new SEPA instruments, standards and infrastructure.
3. The migration stage started in January 2008, being characterised by the coexistence of the national payment schemes with the new SEPA schemes.

2.2. Components of SEPA

SEPA takes into consideration the following aspect (ECB 2006, p.19-26):

1. SEPA instruments

SEPA introduced two new payment schemes for credit transfer and direct debit as well as a card payments framework. These instruments will gradually replace the current national instruments.

a) SEPA credit transfer is an interbank payment scheme which defines a universal set of regulations and procedures for credit transfer denominated in euro. In this scheme any customer can be reached. The whole amount is credited to the payee's account, without a limit on the value of the payment. The duration of settlement is maxim three business days.

b) SEPA direct debit is an interbank payment scheme which defines a universal set of regulations and procedures for direct debits denominated in euro. Under the SEPA there are two different models for direct debits: 1) debtor gives the mandate directly to the creditor and 2) debtor gives the mandate directly to its bank. In this scheme direct debits can be made to any receiver. The duration of settlement is maxim five business days for the first payment and two business days for returning payments. SEPA also develops a business-to-business direct debit scheme.

c) SEPA card framework sets out a set of high-level principles regarding of card payments, developed by EPC. Under this framework cardholders will be able to pay with a single card all over the euro area, being limited only by brand acceptance by merchants. Card payments will be made in a common and reliable way. Payment card processors can complete with each other and provide their services within euro zone, building a more competitive, consistent and cost-efficient card market.

2. SEPA infrastructures

The SEPA clearing and settlement framework refers to the principles according which infrastructure providers will sustain the SEPA instrument schemes. This framework also ensures the separation of scheme and structure. SEPA aims to build an infrastructure which allows all euro payments to be made, received, and settled directly or indirectly and to assure full transparency in terms of infrastructure providers' services and prices.

3. Standardization

In order to permit automated processing of all payments denominated in euro, the EPC has adopted a common approach of standards regarding business requirements, logical data elements and payment messages. These standards are obligatory in the bank-to-bank field and suggested in the customer-to-bank field.

4. Legal framework

The legal framework for SEPA instruments was set up taking into account three main issues:

- The right to provide payment services to the public
- Transparency and information requirements
- The rights and obligations of users and providers of payment services.

2.3. The impact of SEPA

The SEPA project is comparable to the switch to the euro from the point of view of its aspiration, dimension and complexity. Thus it represents the rational main further step towards faster European integration. The implementation of SEPA will get several positive economic effects and opportunities, but also challenges (Schmiedel H., p. 5):

- Costumers, both citizens and companies will benefit by the ease, safety and simplification of making payments in euro using a single bank account. Also, SEPA will stimulate the competition among banks in order to provide innovative services and new, added value products to their costumers.
- Within SEPA, the payment cards will became the favourite instrument, replacing the cheques and cash payments. The costumers will be able to use a single card for all euro payments, which will led to an increase in usage of cards. Moreover, the increasing competition among acquirers and card scheme should drive down costs and fees.
- The overall impact of SEPA on banking community differs depending on its stages. Over time the benefits and challenges of SEPA are influenced by two contradictory effects: first, the increasing in banking industry competition due to the elimination of the barriers across national countries and, second, the assurance of cost savings in payment processing and growth of business opportunities.

In the short term, the coexistence of SEPA and national retail payment schemes is supposed to generate higher cost and a limited impact on the banks' income. The industry and consultancy studies focused on the impact of SEPA show that the initial investment costs of banks at European aggregate average level are range between 5.2 bullion euro and 7.7 bullion of euro, as it is presented in table below (Schmiedel H., p. 9).

Study	Estimated SEPA investments in EUR billion	
	Low	High
Accenture/PSE Consulting (2006)	3	>8
Boston Consulting Group (2006)	0.5	5
Eurogroup/FBF (2007)	9.1	12
Iflex-solutions/Financial Insights (2006)	5.4	5.4
TowerGroup (2005)	8	8
Average	5.2	>7.7

Table 1 Overview of selected SEPA impact studies

In the longer run, when SEPA schemes will replace national schemes, the banks' costs are expected to diminish due to automation, possible economies of scale and scope and innovations (e.g. electronic invoicing). The banks' income will also be influenced by the increasing of competition. Furthermore, the banks' approach will have a significantly impact on costs and incomes. Banks that introduce supplementary automated services will be able to produce new business opportunities (Schmiedel H., p. 20).

The cost of the new system could be significantly diminished by extending the implementation stage because SEPA could be better fit into the technological innovation cycles of national payment systems. Thus, SEPA will have the possibility to become a welfare enhancing project, through the cost reduction for cross-border transactions and higher efficiency due to the increased cross-border competition in banking industry (Schaefer G. K., p. 25).

2.4. Implementation of SEPA

SEPA includes all the member countries of euro zone, together with the other members of European Union, and Island, Liechtenstein, Norway and Switzerland.

On 28 January 2008 the European banking community formally launched SEPA credit transfer. This represented the first step in a migration process during which costumers will move from existing national electronic payment systems to the new SEPA instruments. During the migration period customers will be able to use SEPA schemes parallel with the national instruments. Since the initial points are different across euro zone, most of the migration work will take place at the national level.

The next important step will be the introduction of SEPA direct debit by the end of 2009, whose implementation was delayed for juridical and technical reasons. This scheme will require to be improved by further options in order to offer appropriate solutions for diverse consumer requests.

This will be followed by implementation of SEPA card framework, which came into effect on 1 January. This will generate wide changes on European card markets. The objective of SEPA project with regard to card is to support the expansion of this instrument from both supply (banks) and demand (cardholders, merchants) points of view, with no difference between national and cross-border card payments. A new European card scheme is expected to emerge, harmonizing card payments in euro area (Tumpel-Gugerell G., p.2).

By the end of 2010 all infrastructures should be able to process SEPA payment instruments and public administrations, companies and citizens will use exclusively the SEPA instruments.

3. Romanian Payment System

3.1. Introduction of Electronic Payment System

Romania's joining of European Union required the implementation of an electronic payment system, similar with the systems used by the member countries. In this purpose, a large project was lunched in 2001, co-financed by the EU (through PHARE) funds in amount of EUR 8.04 million and by domestic banking system (through TRANSFOND) in amount of EUR 8.4 million (NBR, Annual Report 2005, p. 63). The implementation of the new Electronic Payment System (EPS) was the widest project coordinated by the National Bank of Romania (NBR). The EPS is compatible with the payment systems in the EU regarding the functionality and conformity with international standards and practices in the field. The EPS, gradually implemented in 2005, is managed by the NBR and services related to technical operation are provided by TRANSFOND (National Society for Funds Transfer and Settlement), which was set up in 2001, being a joint-stock company, held by NBR (33.3%) and 25 credit institutions (66.67%).

3.2. Components of Electronic Payment System

Romanian EPS comprises three components (BNR, Annual Report 2005, p. 65-73):

1) ReGIS system (the Romanian electronic Gross Interbank Settlement system)

ReGIS, launched on 8 April 2005, represents the real-time gross settlement system, ensuring the settlement of large-value (above 50,000 RON) and urgent payments in domestic currency realised by credit institutions, on its own behalf and account or on customers' account as well as of payments in domestic currency arising directly from or made for the settlement of net positions initiated by the net settlement systems and the settlement of operations performed with financial instruments. ReGIS ensures the connection to the TARGET.

2) SENT system (the System for Electronic Net Settlement run by TRANSFOND)

SENT, launched on 13 May 2005, represents the automated clearing house, ensuring the clearing of low-value payments (for instance, credit transfer and direct debit smaller than 50,000 RON) among credit institutions and between them and State Treasury and the computation and transmission of multilateral net positions of the participants for final settlement in ReGIS. Presently, the clearing sessions take place three times on day. The clearing of order payments accepted by SENT requires the insurance by collateral under the form of funds and/or government securities deposited in the ReGIS or SaFIR systems.

3) SaFIR system (Settlement and Financial Instruments Registration)

SaFIR, launched on 3 October 2005, represents the depository and settlement system of operations with government securities and certificates of deposit issued by NBR. SaFIR is a real-time gross settlement system, which organizes and manages the registration and transfer of property rights on these financial instruments, and settles the transactions related to them.

In the architecture of the Romanian payment system there still functions a system of paper-base clearing of payments related to debit payment instruments (cheques, bills of exchange and promissory notes), which will be replaced in the future by an electronic system operates through SENT. EPS also includes a back-up and recovery system, whose aim is to assure the permanent operation of the payment system in the situation of unforeseen events.

3.3. Impact of SEPA on the Romanian payment system

Conclusions

The adoption of euro as single European currency will be finished only when the SEPA will entirely become a reality, allowing the customers to make cashless payments across euro area, using a single bank account and a single set of instruments, as easily, efficiently and safety as in their national payment systems today. The implementation of SEPA will get several economic benefits and opportunities for customers and merchants, but also challenges. From the view of banks, initial stages of SEPA requires substantial changes and the positive effects can appear mainly for those banks that launch new technological products and provide innovative services. The implementation of SEPA in Romania needs for the support of the regulating local authorities and also for massive investments in the banking system.

Fifteen Romanian banks have already joined SEPA and have engaged to respect the SEPA standards as far as credit transfer operations in Euro are concerned. Other Romanian financial institutions must fulfil the adhering process by the end of December 2010.

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