

AN ANALYSIS OF THE SEPA CARDS FRAMEWORK (SINGLE EURO PAYMENTS AREA) ADOPTION IN ROMANIA

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Abstract: The study examines the actual status and the future application of Single Euro Payments Area SEPA Cards Framework, based on Romanian experience. The paper highlights the fact that there is no national card scheme in Romania and that the local cards market is still way behind its peers in the European Union advanced countries, aspects proved through the inconsiderable part of chip cards, the reduced numbers and small values of cards operations and through the cards terminals technologies non-EMV standard (ATM, EFTPOS). Our considerations focus on the achievements and the challenges Romania faces regarding the national implementation of SCF. We express our uneasiness regarding the need to finalize the regulatory national framework according to the PSD (Payment Services Directive - Directive 2007/64/EC of the EPC on payment services in the internal market) and SEPA.

Key Words: Single Euro Payments Area (SEPA) Cards Framework SCF, National card scheme, Challenges of the SCF implementation in Romania.

JEL Codes: G21, F36, F55.

1. Introduction

Single Euro Payments Area SEPA is a project backed and monitored by the Eurosystem and the European Central Bank for harmonizing and restructuring the national financial infrastructure and aimed at establishing a single market for payment services, efficient processing infrastructures and cheaper payments by standardization of procedures, information and payment processing technologies. SEPA Project consists of the following components: the SEPA credit transfers, the back to topSEPA direct debit, the SEPA Cards Framework and the Single Euro Cash Area.

The aim of this paper is to provide a global perspective of the Romanian banking card market from the perspective of the future implementation of SEPA Cards Framework. The SEPA for Cards started on 1st of January 2008 and we would describe the actual stage of the national banking card market development and plan for the SEPA implementation process.

After presenting the general frame of reference of our theme in the specialty literature and in the specific national and international legislation, the paper approaches the present stage of the SEPA Cards Framework implementation in Romania. Our personal contributions refer to the applicative description of the SEPA Cards Framework implementation, based on Romanian experience.

The information on our theme was realized by studying national and international specialty literature in this field and by consulting the available information from the institutions level which studies and researches on the banking card operations and on SEPA project, such as the European Commission, European Central Bank, European Payments Council, Bank of International Settlement, National Bank of Romania, Romanian Banking Association, TransFonD - the operator of the national retail payment infrastructure and National SEPA Committee from Romania.

2. Theoretical background

In the field of the theme we approached, the specialty literature holds theoretical analysis and empirical studies of the banking card operations. Studies prefer a descriptive or much too technical approach of banking card operations or infrastructures while recently more studies present the challenges of the SEPA application across the European countries.

Financial services in Europe have undergone dramatic changes in recent years. Much of this is due to development in information and communication technologies, the arrival of European Monetary Union and aging population. These will continue to be important drivers of change as the industry continues to progress³⁴⁵. An overview of the status of contemporary e-finance is offered by Shahrokhi³⁴⁶, who discusses related issues and challenges. His paper provides data about e-finance growth in the last decade and introduces advances and innovations in e-finance and challenges regarding the financial services and IT industries.

Studies on application of SEPA are relatively limited and were elaborated over the last few years. This subject did not arise only the interest of the international banking community directly interested in the future application of SEPA, but also that of the scientific communities. Bolt and Humphrey³⁴⁷ present the goal of SEPA, which facilitates the emergence of a competitive, intra-European market by making cross-border payments as easy as domestic transactions. With cross-border inter-operability for electronic payments, card transactions will increasingly replace cash and checks for all types of payments. Using different methods, they estimate card and other payment network scale economies for Europe. This indicates substantial cost efficiency gains if processing is consolidated across borders rather than “piggy-backed” onto existing national operations. Schaefer³⁴⁸ develops answers to the question regarding the advantageous conditions for countries to form a single payments area. This question is analyzed in a model of spatial bank competition for a better understanding of the economic foundations of the SEPA. An economic perspective research on the mostly informal policy debates about SEPA being developed. The analysis suggests that expectations about the positive effects of SEPA may be exaggerated as most channels for enhancing public welfare seem rather weak. Using a spatial competition model of retail payment networks, Kempainen³⁴⁹ approaches economic consequences associated with formation of the SEPA. The model considers an expansion of positive network externalities on the demand side and adjustment cost on the supply side and reveals that the introduction of SEPA may not lead to a fully competitive and integrated retail payment markets.

At the national level, the majority of the scientific references to the SEPA implementation belong to some authors, who describe three major projects in respect to the European payment systems: Payment Service Directive PSD, TARGET 2 and SEPA³⁵⁰. They present the implications of these projects for the market participants, for the operators, for the National Bank of Romania.

At the level of the European Union, the importance given to the national banking payment systems is for now the biggest one. Arguments over this importance are offered by the Directive on Payment Services, adopted in 2007 - Directive 2007/64/EC of the European Parliament and of

345 May, G. (2004). The future of financial services in Europe, Foresight, vol. 6, issue 5, p. 271-280.

346 Shahrokhi, M. (2008). E-finance: status, innovations, resources and future challenges, Managerial Finance, vol. 34, issue 6, p. 365-398.

347 Bolt, W., Humphrey, D. (2007). Payment Network Scale Economies, SEPA, and Cash Replacement, Review of Network Economics, Concept Economics, vol. 6, issue 4, p. 453-473.

348 Schaefer, G.K. (2008). An economic analysis of the Single Euro Payments Area (SEPA), FIW Working Paper series, no. 11.

349 Kempainen, K. (2008). Integrating European retail payment systems: some economics of SEPA, Bank of Finland Research Discussion Papers, no. 22.

350 Dedu, V., Bratu, R. (2008). Romanian Payment System Perspectives in the context of the integration in EU, Studia Universitatis Babeş-Bolyai Oeconomica, no. 1, p. 92-101. Beju, D., Filip A. (2008). The impact of European Integration on the Payment System, Analele Universitatii din Oradea Stiinte Economice, no. XVII, p. 685-690.

the Council on payment services in the internal market are detached, which provide the legal foundation for the creation of an EU-wide single market for payments. After the formal adoption by the Council and the European Parliament and the publication, the provisions of this Directive will need to be implemented by all Member States by 1st of November 2009. The countries implied in SEPA projects have developed their own migration national plans and the success of SEPA depends on an adequate governance of the project.

3. A current approach and the challenges of SEPA for Cards in Romania

The results achieved in the field of business card development in Romania emphasize the fact that the number of issued cards has increased with as much as 2.86 million in the course of the last year only. Today there are over 8700 ATMs, 162000 POS and EFTPOS terminals in Romania. Almost 14 million transactions in Romania were performed via payment cards with the debit function in the third quarter of 2008 with a value of 2737.9 millions RON and 4 millions transactions in Romania were performed via payment cards with the credit function in the third quarter of 2008 with a value of 704.91 millions RON. Romanian customers rather use debit cards than credit cards, both in terms of transactions' value and volume. Card payments have grown rapidly, but the use of cards is still far behind that of other countries. We observe the dynamics in the number of transactions at POS located in the country with cards issued in the country amounted to over 16 millions in the third quarter in 2008, with value of 2551.13 millions RON³⁵¹. The Romanian banking cards market is still subject to deep changes and competitive pressures, on its way to maturity. But, all these mentioned above remarks show a considerable potential for growth.

In Romania there is no national card scheme and only VISA and MasterCard payment schemes are currently in use. The local card market³⁵², although on an upward trend, is still way behind its peers in the European Union advanced countries – the average per one thousand inhabitants is below the European Union - wide average (567 against 1508 in EU) and the average of operations per inhabitant (3.34 against 50.02) is also lower than the average in the European Union.

Starting with March 2007, the Romanian Banking Association - a body representing the national banking community within the European Payments Council - played a leading role in the unfolding and implementation of the SEPA project. The governance structure of SEPA project at national level includes the following boards: SEPA National Committee, SEPA Commission and SEPA project team. SEPA National Committee is a decision-making body having responsibilities in drafting the strategy of SEPA and coordinating its implementation across the entire local community. It was established in March 2008 with the participation of the Romanian Banking Association, the Ministry of Public Finances and Transfond - the operator of the national retail payment infrastructure. The committee is responsible among other things for the approval of the SEPA National Implementation and Migration Plan.

The SEPA National Implementation and Migration Plan includes the strategy adopted by the local community for the implementation of SEPA and the migration towards the use of the new payment instruments (the organization of SEPA project at national level, the components related to project planning, organization and management, as well as the commitments and cut-off dates assumed by all stakeholders in order to complete the migration). SEPA Commission, established at the level of the Romanian Banking Association in March 2007, is in charge of organizing debates on the issues pertaining to the manner of implementing SEPA at national level. SEPA project team was founded under the patronage of the Romanian Banking Association, having a

351 National Bank of Romania, Statistics report – Cards and numbers of terminals Indicators, 2009.

352 Pascu, C. (2008). Romanian Banking Overview, <http://rbd.doingbusiness.ro/en/2008/september/overview-of-economic-sectors/2/90-romanian-banking-market-overview.html>.

structure similar to that of the European Payments Council, responsible for the roll-out of SEPA project at national level and, most notably, for drafting the SEPA National Implementation and Migration Plan. Moreover, the Romanian Banking Association has begun setting-up SEPA National Forum, i.e. an advisory body comprising representative associations of all SEPA stakeholders (companies, small- and medium-sized enterprises, large merchants, utility providers, consumers, etc.).

As for SEPA, the NBR National Bank of Romania assumed the following tasks: to guide and foster the expectations of Romanian stakeholders regarding SEPA, to co-operate with the public administration which is expected to be among the frontrunners in using SEPA products in Romania, to co-operate with consumers in general so that their expectations would be known to SEPA National Committee, to contribute to the co-ordination of communication efforts at national level and to monitor the progress in implementing SEPA at national level.

In March 2009 Romania adopted the SEPA National Implementation and Migration Plan (second version), which defines and draws up the national strategy for implementation and migration to SEPA payment instruments for credit institutions, payment systems and users of payment services in Romania.

In order to draw up the National SEPA Implementation and Migration Plan, the Romanian Banking Association and TransFonD, the operator of the national retail payment infrastructure, have elaborated a questionnaire which was sent to the credit institutions in order to be filled in. The questionnaire regards the credit institutions' plans to implement SEPA standards, the settlement channels which will be employed in order to send/receive SEPA instruments, the plans for migrating to SEPA Credit Transfer scheme starting with 28 January 2008, the plans for implementing SEPA Direct Debit, the phase of the EMV standard adoption process for card systems, data regarding the volume of Euro payments, the critical mass, as well as information on communication strategy with their customers³⁵³. EMV represents a Standard initiated by Europay, MasterCard and VISA in order to provide interoperability for IC cards (Chip Card), and IC capable ATM & POS terminals, in order to authenticate card payments.

From the data provided by the 39 credit institutions, members of the RBA Romanian Banking Association, which were operating in Romania on 30 June 2008, the following are worth mentioning that the branches of EU credit institutions have adhered or intend to adhere through their parent banks and:

- 19 credit institutions - that process an average monthly volume of about 259.000 Euro payment orders (initiated and received), accounting for about 98% of the total monthly volume of Euro payments – have migrated to SEPA credit transfer scheme SCT;
- 9 credit institutions have responded that they are in the phase of drawing up their own plans for SEPA implementation and migration;
- one credit institution has not expressed its option concerning SEPA implementation;
- 3 credit institutions have stated that currently they do not make or plan to make Euro payments before the Euro adoption in Romania (given the particularity of their business, such activities are not currently required);

4. Conclusions

The actual Romanian banks stage of development reveals that in order to be SEPA-compliant with regards cards transactions, banks:

1. Offered the new SCF-compliant schemes and cards from 1st of January 2008.

353 National SEPA Committee from Romania (2009). SEPA National Implementation and Migration Plan, <http://arb.ro/sepa.php?id=28&c=SEPA-National-Implementation-and-Migration-Plan-V2.01-March-2009-Edition>, p. 7-8.

2. Have to ensure that after the end of 2010 all general purpose payment cards in circulation and issued in SEPA will be SCF-compliant.

3. Have to complete the implementation of EMV. Also, banks have to realize the compatible infrastructure EMV-equipped terminal networks ATM and POS. As concerns the ATM terminals, the Romanian credit institutions committed to finalize the conversion to the EMV standard in 2008, with only one exception whose deadline was set to December 2009. At the end of Quarter Q2, 2008, 85.16% of the ATM terminals were EMV-compatible. Out of 25 credit institutions having ATMs, 20 were involved in the conversion process, and 18 had even managed to achieve the full conversion of their ATMs to the EMV standard. Regarding the POS networks of acquiring credit institutions, from the hosts' point of view, these will be totally EMV-compatible by 2008. Acquiring credit institutions, with 2 exceptions, have reported the migration of POS terminals to EMV in 2008. Nevertheless, only 37.67% of the terminals were converted at the end of Q2, 2008. In fact, out of 18 credit institutions having POSs, 10 have already initiated the migration process, while 7 have 100% the terminals they manage. In what regards card issuance, out of 24 active credit institutions, only 3 were actually issuing international EMV cards at the end of Q2, 2008. Other 5 credit institutions started projects for EMV certification.

Undoubtedly, SEPA will mean the cross-border efficient payment transactions and the decisive advantages lie in the fact that the many different instruments, formats and rules for Romanian payments will be harmonized with European payments. We remark the advantages of SEPA at the level of financial institutions (which will be able to operate in a common pan-European environment) and advantages for banking customers (which will be able to make their Euro payments throughout the SEPA from a single bank account for credit transfers, direct debits and card payments). For all its positive aspects, SEPA presents a disputable item regarding to omission of cheques and bills of exchange, which are discouraged as much as possible.

We studied the stages of SEPA adoption in Romania and found the following:

- a) There is a governance structure of SEPA project at national level, which contains the following boards: SEPA National Committee, SEPA Commission and SEPA project team.
- b) SEPA National Committee is a decision-making body having responsibilities in drafting the strategy of SEPA and coordinating its implementation across the entire local community.
- c) Romania had established its national migration plan (In March 2009 Romania adopted the SEPA National Implementation and Migration Plan, second version).
- d) Consistent communication has taken place between the national banking authority (National Bank of Romania), Romanian Banking Association, other financial institutions (e.g. TransFonD, the operator of the national retail payment infrastructure) and banking companies. The Romanian Banking Association has begun setting-up SEPA National Forum, an advisory body comprising representative associations of all SEPA stakeholders -companies, small- and medium-sized enterprises, large merchants, utility providers, consumers, etc.
- e) The need to finalize the regulatory national framework according to the PSD (Payment Services Directive - Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market) and SEPA.

Examination of the SEPA implementation in Romania reveals numerous challenges and uncertainties related to the national interpretations of European legislation on payment services, particularly PSD. The connection between this European Directive and the future creation of SEPA is obvious. We consider that the Payment Services Directive PSD is a complicated directive and its adoption in Romania implies imminent national interpretations. The difficulty of PSD application results from its complexity and length and from the possibility of each country to choose certain options in PSD transposition. In order to adapt their conditions to the PSD and SEPA, banking companies will need to invest in their infrastructure. Romanian banks have to adopt the European policy regarding cards. EPC recommends banks to have specific functional and security requirements. SEPA SCF supports the introduction of CHIP and PIN throughout the

region, thereby facilitating secure and transaction authorizations. Our research reveals that Romanian banks are still focusing on compliance and reachability of SEPA SCF. We consider that it is important for banks to invest in the new card SCF-compliant technologies in the near future. The main challenges and objectives for the Romanian card market in respect to adopting SEPA Cards Framework will be the establishment of a deadline for the migration to SEPA cards and the compulsory requirements regarding the cards, which must have a chip and comply with the EMV standard in order to be SCF compliant. We believe that the national migration to SEPA Cards Framework compliant standards concerns the entire banking community, customers, mergers and the banks' attitude and national regulators will be defining.

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