THE IMPLICATIONS OF SINGLE EURO PAYMENTS AREA (SEPA) ON BANKING EFFICIENCY

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Abstract: *With the creation of the euro by the Maastricht Treaty in 1992, European integration has deepened. Even with this step done the financial market is fragmented. In order to eliminate this disadvantage, the European Union has taken a number of measures. The first step is the Financial Services Action Plan in 2000, through the Lisbon Strategy. Second is the European Commission Regulation 2560/2001 to harmonise fees for cross border and domestic euro transactions. Third is the first pan-European Automated Clearing House in 2003. Last great step made is the Single Euro Payments Area (SEPA) in 2008. In this paper, we want to research the degree of implementation of SEPA by using quantitative indicators: credit transfers, direct debits and payment cards, and the effects of this system on bank efficiency.*

Keywords: SEPA; banking; efficiency
JEL Classification: F15; F36; G29

INTRODUCTION

The creation of the euro, by Maastricht Treaty in 1992, is the first step towards a true single banking market. A single currency allows to all players to know the price of products and services in different countries and facilitates comparisons. Currency conversion is no longer necessary to know the price of a product and service from a foreign country and currency risk is eliminated. The European banking system remains fragmented and banking institutions charge different fees in countries member of European Union, especially for cross-border transactions. To eliminate disparities between fees charged in different countries, the European Union has made several steps.

In 2000, through the Lisbon Strategy, the European Union introduced the Financial Services Action Plan, which is a key component to create a single market for financial services. The European Commission Regulation 2560/2001 harmonises fees for cross-border and domestic euro transactions. EC Regulation 2560/2001 "lays down rules on cross-border payments in euro in order to ensure that charges for those payments are the same as those for payments in euro within a Member State" (EC Regulation 2560/2001, p. 2). In 2002, the European Central Bank introduce euro banknotes and coins into circulation. In 2003 first pan-European Automated Clearing House (PE-ACH) goes live. On the 28th January of 2008, the Single Euro Payments Area become operational, parallel to domestic instruments. In 2010, SEPA payments become dominant form of electronic payments.

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SEPA allow standardization of payments in euro across Europe. Besides the 28 Member States of the European Union, there are other six states in the SEPA: Iceland, Lichtenstein, Monaco, Norway, San Marino and Switzerland (EPC List of SEPA Scheme Countries, 2014).

SEPA is a payment system that allows cross border euro transactions to operate as if it are national transactions, effectively removes borders. It can be a tool to reduce costs through economies of scale (Single Euro Payments Area, Seventh Progress Report: Beyond Theory into Practice, 2010). Researchers have shown that a doubling in the volume of payments generates an increase in operational costs by a third (Retail payments: integration and innovation, 2009). The SEPA system consists of three components: credit transfers, direct debits and payment cards.

"A credit transfer is a payment initiated by the payer. The payer sends a payment instruction to his/her payment service provider (PSP). The payer's PSP moves the funds to the payee's PSP. This can be carried out via several intermediaries. A direct debit is a transfer initiated by the payee that is the recipient of a payment, via his/her payment service provider (PSP). Direct debits are often used for recurring payments, such as utility bills. They require a pre-authorisation ("mandate") from the payer. Direct debits are also used for one-off payments. In this case, the payer authorises an individual payment. Debit cards allow the cardholder to charge purchases directly and individually to an account. Credit cards allow purchases within a certain credit limit. The balance is settled in full by the end of a specified period. Alternatively, it is partly settled. The remaining balance is taken as extended credit on which the cardholder must pay interest." (Understanding payments - Types of payment (ECB: Types of payment))

1.THE EVOLUTION OF SEPA

In order to monitor the evolution of SEPA, the Euro system publishes a series of quantitative indicators: migration of credit transfers, migration of direct debits and migration of card payments.
First indicator examined is SEPA credit transfers (SCT). Table 1 show the percentage of all credit transfer (CT) transactions per country in the euro zone between January 2014 and March 2014. Once the deadline approach, February 2014, countries have intensified the pace of transition to SEPA. The European Commission has adopted a proposal to introduce an additional transition period of six months to ensure minimal disruption for consumers and businesses (Business - SEPA - The Single Euro Payments Area (Ready for SEPA)).

A group of small countries (Cyprus, Latvia, Slovakia, and Finland) passed completely to SEPA system, all transactions using the new system. Estonia has made a quantum leap, from 2.65%

in January 2014 to 99.7% in February 2014. Except for a small group of countries, Germany, Greece and Austria, all euro area countries made over 90% of transactions in SEPA.

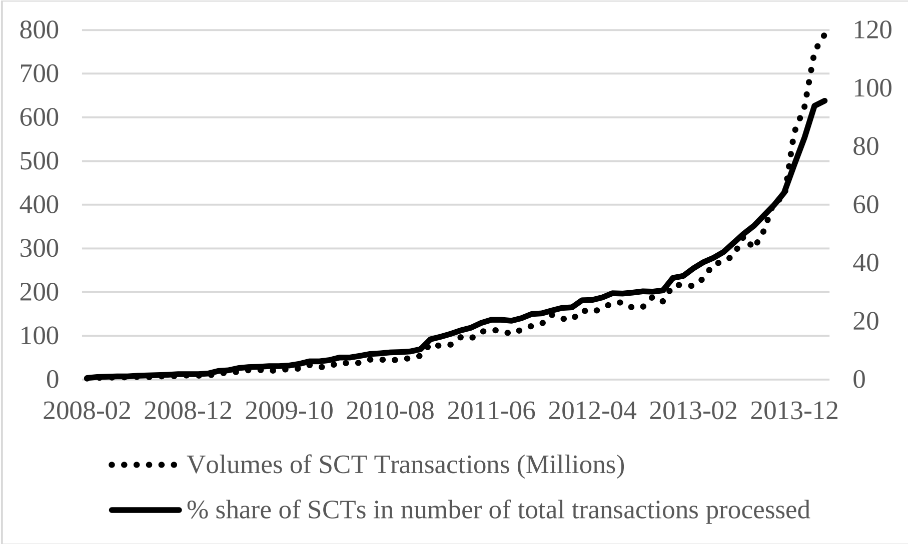
Table 1 - Usage of SCT as a percentage of all CT transactions per country (euro area countries) between January 2014 and March 2014

	2014 -01	2014-02	2014-03
BE	86.79	95.64	99.72
DE	58.51	77.85	80.34
IE	60.89	90.61	96.83
GR	81.53	83.12	82.85
ES	82.71	90.5	96.64
FR	84	91.7	93.47
IT	61.49	89.86	93.77
CY	100	100	100
LU	96.3	96.3	96.41
LV	100	100	100
MT	68.72	80.16	93.96
NL	86.38	91.75	95.27
AT	66.2	74.95	82.9
PT	89.16	92.32	93.47
SI	99.3	99.36	99.3
SK	100	100	100
FI	100	100	100
EE	2.65	99.7	100

Source: European Central Bank Database

The transition to SEPA has implications on banking efficiency. All transactions in the euro area will be processed in SEPA and transaction costs will be similar in all member states.

Figure 1 - Volume and share of SCT transactions in euro zone between February 2008 and March 2014



Source: European Central Bank Database

In Figure 1 is the volume and percentage of SCT transaction in euro between February 2008 and March 2014. The transition to SEPA system accelerates in the last year.

Table 2 - SEPA direct debits – transaction shares per country (euro zone countries)

	2014-01	2014-02	2014-03
BE	64.09	89.89	93.44
DE	29.4	53.4	52.83
IE	61.35	89.65	96.14
GR	70.1	69.53	83.34
ES	15.34	48.82	62.1
FR	72.51	87.02	90.62
IT	34.3	53.28	63.48
CY	0	0	-
LU	49.09	74.37	-
LV	0	0	0
MT	23.35	47.79	38.51
NL	73.62	84.38	85.13
AT	73.95	87.89	99.47
PT	26.68	53.14	67.81
SI	100	100	100
SK	0.01	100	100
FI	0	0	0
EE	0	0	0

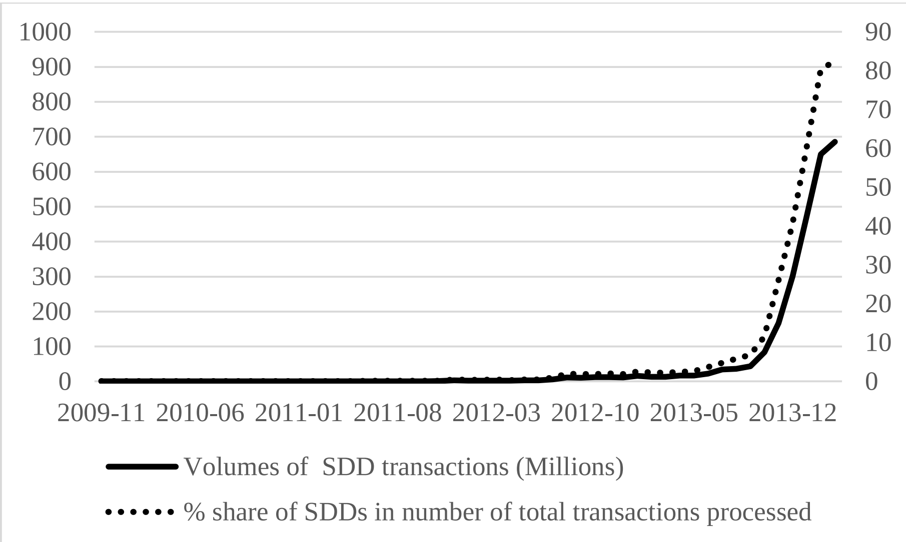
Source: European Central Bank Database

In Table 2, we can see transaction shares per country in the euro zone of SEPA direct debits (SDD) between January 2014 and March 2014. The evolution of direct debits is much lower than credit transfers it is. Only a third of countries, 6 of 18, have achieved over 90% of direct debits transactions in SEPA.

"In Estonia and Finland, the legacy direct debits will, primarily, be replaced by SCT-based e-invoicing solutions. Latvia joined the Euro Area on 1 January 2014. As a new euro area country, Latvia officially has one year to complete the migration to SCTs and SDDs (migration deadline is 1 January 2015)." (Understanding payments - Types of payment (ECB: Types of payment))

In Figure 2, we can see the volume and share of SDD transactions in the Euro Zone between November 2009 and March 2014. Until the end of 2013, the volume and share of SDD transactions were insignificant. Unlike SEPA credit transfer transactions, SEPA direct debit transactions increased strongly in the end of 2013 and beginning of 2014. The volume of the direct debit transactions is higher than credit transfer transactions, but the share is much lower, almost 60% comparative with over 90%.

Figure 2 - Volume and share of SDD transactions in the euro zone between November 2009 and March 2014

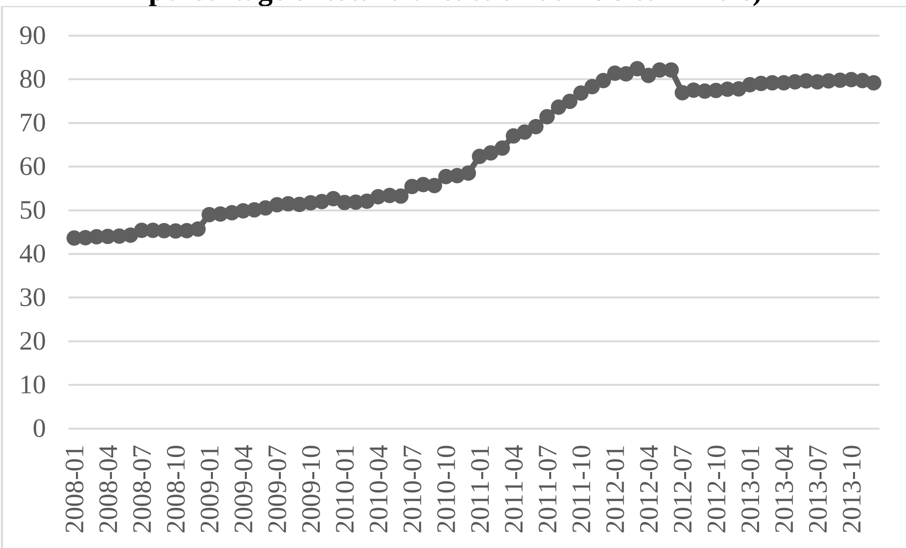


Source: European Central Bank Database

For a card to be used in SEPA it must apply the EMV specifications and must require the use of PIN codes (Another step forward for the SEPA, 2007). Even if the EMV specifications appeared before SEPA, EMV migration can be seen as an indicator for SEPA adoption, in the sense that non-EMV card, POS terminals and ATMs are, by definition, not SEPA-compliant (A secret weapon for the SEPA battleground, 2007).

“In September 2005, the SEPA Card Framework (SCF), which defines the principles for all card transactions within the euro-zone, was introduced, and in March 2006, version 2.0 of the SCF was approved.” (European unity, 2006)

Figure 3 - EMV transactions in the euro area between January 2008 and December 2013 (as a percentage of total transaction at POS terminals)



Source: European Central Bank Database

In Figure 3, we can see the EMV transactions in the euro area between January 2008 and December 2013, as a percentage of total transaction at POS terminals. Unlike credit transactions and direct debit transactions, cards have implemented in a higher proportion EMV specifications; from over 40% in 2008 at the end of 2013, the percentage reached 80% of card transactions.

CONCLUSIONS

The appearance of Euro was an important step toward deepening EU integration. The currency risk has been removed and consumers can easily find the price of banking products and services and can make comparisons without the need to perform currency conversions. The banking market remained fragmented and the price of cross border transactions vary between Member States. To eliminate this disadvantage the SEPA system was created.

From the analysis of the three components, credit transactions, debit transactions and card transactions, we see that important steps are required to be implemented in the banking system. The component credit transactions has the highest percentage of implementation, over 90% of total transactions in the Euro Zone. On the second place there are the card transactions, with approximately 80% of total card transactions, and in the last place the direct debit transactions. As SEPA implementation is put into practice, banking efficiency improves by harmonized fees. However, the transactions made in SEPA are not feeless, but are harmonized at EU level and states that have adopted it.

SEPA adoption process is not completed, especially in direct debits transactions and a new postponement of the deadline is possible. SEPA have positive effects on banking efficiency, through a fees relief for cross border transactions. The harmonization of fees on cross-border transactions will mean a reduction of the profit of banks in this segment and they will find new ways to increase revenues, sometimes using less legal practices.

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