

Cross-Border Credit Transfers, SEPA Project Implementation and their Effect on SME's

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Abstract

In Czech Republic we noticed the term “cross-border payments” for the first time more than 20 years ago. Then Czech Republic was not a member of the European Union yet (it became an EU member in 2005) nevertheless as early as in 1990 the EU had shown its interest in starting regulating a banking area not regulated until then, i.e. the payments.

SEPA project emerged more than ten years later. It looked into issues which had been adopted by EU during gradual implementation of cross-border credit transfers. Why was it actually created? And has it contributed to satisfaction of the needs of mainly small clients, represented particularly by consumers and small and medium-sized enterprises, related to transfers of funds of EU countries?

The presented text deals with issues of cross-border credit transfers implementation in relation to SEPA project results, it answers the question whether at the moment SEPA project coincides with cross-border credit transfers or not and in the conclusion it evaluates the possible effect of cross-border credit transfers implementation on small and medium-sized enterprises.

Keywords: cross-border credit transfer, directive, ecb, European Commission, price, regulation, SEPA project, SME - small and medium-sized enterprise

JEL: F31, F36, G28

1. Introduction

Payments represent a financial relationship between the payer and the payee affected in certain forms via agreed payment instruments either directly between them or via entities designated for this purpose, particularly banks or savings and credit cooperatives (Schlossberger, 2012, p.11).

This legal relationship contains a complex of rights and obligations connected with execution of those operations in the course of which a bank or another entity providing payment services by their client's order performs payment transaction operations via a payment instrument selected by the client. Payments are above all a matter of the payer and the payee but if a bank or another entity enters into this legal relationship it takes the role of an intermediary. There may be various forms of payments. The basic classification is described in *Table 1 below*.

Out of the summary above, the following text addresses particularly the cross-border payments in their cashless form. This study does not consider other classifications as those aspects are not important in order to explain the essence of the problem.

With regard to the fact that we examine the effect of SEPA project on small and medium-sized enterprises (SME's) it is necessary to give their definition. In all EU countries SME's represent crucial economic entities and in terms of the number of employees they make up 99% of all business entities generating 70% of GDP in EU and 37% of GDP in the Czech Republic. SME's are subject to a uniform EU definition based on the number of employees and financial turnover:

- Microenterprise (micro company) - less than 10 employees, annual turnover and/or annual balance-sheet total does not

exceed EUR 2 million.

- Small enterprise - less than 50 employees, annual turnover and/or annual balance-sheet total does not exceed EUR 10 million.

- Medium-sized enterprise - fewer than 250 employees, annual turnover does not exceed EUR 50 million and/or annual balance-sheet total does not exceed EUR 43 million (Kašík & Havlíček, 2012).

2. Historical Bases

According to an estimate of the European Commission (hereinafter referred to as “EC”) payments represented by funds transfers among EEA countries¹ comprised more than 400 million operations in 1990, more than a half being payments not exceeding the amount of the then ECU 2,500. The conversion coefficient of ECU 1 to EUR 1 was determined in a ratio 1:1, i.e. this was an amount of EUR 2,500 (Tomášek, 1997). The European Commission (EC) also anticipated a substantial rise of both the volume and the number of payments thanks to the development of national economies of EEA countries and the interconnection of their mutual trading. The demand for the so-called cross-border payments would grow, leading the banks or other entities providing these services to continuous evaluation and improvement of individual products in this field. EC analyses resulted in the conclusion that the most frequently used payment instrument for **national payments** were credit cards while **cheques** were most frequently used for **cross-border**² payments. In cross-border payments **the lead role should be**

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¹ EEA countries are all EU member states + Norway, Lichtenstein and Iceland.

Table 1 (Schlossberger, Soldánová, 2007)

Aspect	Forms of payments
Payment method	<ul style="list-style-type: none"> • <i>Cash payments</i> – cash money is transferred between the payee and the payer in cash (treasury notes/banknotes and coins). The bank has only a limited role when money is delivered from an account and subsequently deposited to an account. • <i>Cashless payments</i> – credit transfer/direct debit is effected only via a cashless credit transfer on the payers' and payees' bank accounts, i.e. without using any cash. • <i>Electronic payments</i> – payment transactions effected through a payment instrument on which funds are deposited in the electronic form as electronic money.
Territory	<ul style="list-style-type: none"> • <i>National (domestic) payments</i> – between entities within a national economy. • <i>Foreign payments</i> – between domestic and foreign entities, i.e. they represent payments to and from abroad including those made by domestic entities abroad. • <i>Cross-border payments</i> – between domestic entities in relation to foreign entities from countries of the European Economic Area (hereinafter referred to as "EEA") in currencies of EEA countries.
Execution periods	<ul style="list-style-type: none"> • Preferential (express) payments – they ensure preferential (immediate) or expedited debiting of funds from the client's account (on behalf of the account owner) compared to the common standards laid down in the bank's commercial terms. • Standard payments – a form of payment which ensures fulfillment of the client's order (payment operation) according to standard terms agreed in advance.
Provider's relation to the credit transfer	<ul style="list-style-type: none"> • Obligation payments – the bank acts only as an intermediary and has no obligation relationship to the payment (e.g. clean payments, documentary collection). • Non-obligation payments – the bank enters the obligation in addition to or instead of the client when executing the concerned payment instrument (e.g. documentary letter of credit, bank guarantee).

played by classic clean payments, especially at the level of payment orders. The direction of further development in the field of payments should focus on gradual removal of technical differences and priorities between national payments and cross-border payments, particularly after introduction of the common currency – euro.

Cross-border payments always concern legal orders of at least two states. But those might have differed under the conditions of the EU single internal market because EC bank law was not sufficiently harmonized twenty years ago. It was not possible as before the third stage of the European Monetary Union started each member state had pursued its autonomous currency and bank policy and therefore its own supervision over the financial market too. However the diversity of member states' legal orders keeps placing obstacles to free movement of capital within EU which has been shown in countries outside the Eurozone by still high prices of cross-border payments compared to the prices of national ones (Tomášek, 1997).

Therefore EC set to a groundbreaking step and in February 1990 it adopted EC Commission Recommendation on transparency of banking conditions relating to cross-border financial transactions No. 90/109/EEC. This legal document, even though on the basis of a recommendation, may be considered a very substantial one as it laid down six principles for execu-

tion of cross-border credit transfers. These principles were set for the sake of greater transparency of conditions of providing cross-border credit transfers to serve in particular consumers and SMEs. These principles may be described as follows:

1) Clients must receive advance information on the conditions under which cross-border financial transactions are effected.

2) Clients must receive follow-up information on the charges for effected transactions as well as on the supplementary charge for foreign currency exchange.

3) When apportioning the transaction-related costs between the transferor and the transferee the transferee must have a guarantee of receiving the payment exactly in the amount specified in the payment order.

4) Unless determined otherwise banks must deal with payment orders within two business days from the date of receipt of the funds and in the event of any delay they must refund at least a portion of the operation costs.

5) Unless determined otherwise the transferee's bank must fulfill its obligations arising from a payment order no later than on the business day following receipt of the funds.

6) Banks participating in cross-border payments must be capable of dealing flexibly with complaints lodged by clients and in case of legal disputes they must make sure that clients

² In this place it is necessary to understand the "cross-border payments" as a transfer of funds among EEA countries in their currencies. Definition of this term developed differently in the course of time.

may exercise their right to refer their complaints to competent national bodies established for this purpose.

In the course of time practical application of this Recommendation has shown which of its items have proved to be the most important ones and which need to be further advanced. In 1992 consumer associations, associations of small and medium-sized entrepreneurs as well as credit institutions came to an agreement with EC in the fact that the most important principles are the principle of clients' knowledgeability, the principle of timely execution of payment operations and the principle of elimination of double imposition of charge on the concerned operation. Nevertheless as it was only a recommendation for commercial entities these principles were not put into life and different prices of national credit transfers persisted, double imposition of charge on a single operation was still applied etc.

With regard to the fact that the self-regulatory function within the banking sector did not work then as envisaged by EC, EC proposed and the European Parliament passed Directive 97/5/EC of the European Parliament and of the Council on cross-border credit transfers in 1997. Despite being plain and relatively poor in content, this Directive may be considered a turning point in the field of the payment instrument of cross-border payment order. It is the first generally binding legal document in the field of interbank cross-border payments which is binding on EU countries. When applied a uniform process of execution of cross-border payments in the field of clean payments is integrated into legal orders of individual states (Schlossberger, 2007). In order to support cross-border payments clearing the European Central Bank (hereinafter referred to as "ECB") instituted an interbank payment system TARGET in 1990 (Schlossberger, 2012). Direct regulation of cross-border payments started thereby. Another rule of law which considerably affected regulation of the price policy of clean cross-border payments was Regulation (EC) No. 2560/2001 of the European Parliament and of the Council on cross-border payments in euro. As the European Commission (hereinafter referred to as "EC") had declared that it would keep following the path of payments regulation the EU banking sector decided that it would be suitable to react to this situation. Banks declared they even wished to take charge of this initiative and to proceed in accord with EC but in the form of self-regulation. Therefore in March 2002 representatives of 42 European banks met and set up a body called EPC – European Payments Council (Chuchvalcová, 2007). These banks made it their goal to create the Single Euro Payments Area (SEPA) by the end of 2010 at the latest. In 2004 the number of SEPA participating countries was increased by the newly acceding ones. It was also decided that EPC, until then rather an interest association, would be institutionalized. On 17 June 2004 EPC was transformed into a non-profit company according to the Belgian law whose members are banking sector representatives of all 25 EU countries. Banks from EEA and Switzerland were invited to join it (Schlossberger, 2012). Two alternatives of basically the same coexisted next to each other – the official interest of EU bodies in implementing cross-border credit transfers into the life of all banking entities and the private-law activity of large European banks called SEPA aimed at execution of credit transfers among project members. It is creditable however that both alternatives had similar or even **identical goals – to provide payments in the field of cross-border credit transfers under the same conditions as applied to national payments but only in relation to credit transfers in euro.**

3. Legal Regulation of Payments

The current legal regulation of cross-border credit transfers is based on two fundamental legal regulations – Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market (hereinafter referred to as the Directive) which had to be transposed into legal orders of all EU member states or EEA member states as the case may be. The other two important rules were published as Regulations which means their direct applicability in all member states. The first of them is Regulation (EC) No. 924/2009 of the European Parliament and of the Council on cross-border payments in the Community and repealing Regulation (EC) No. 2560/2001 (hereinafter referred to as "Regulation 924"); the other one, supplementing Regulation 924, was published as Regulation (EU) No. 260/2012 of the European Parliament and of the Council establishing technical requirements for credit transfers and direct debits in euro and amending Regulation (EC) No. 924/2009 (hereinafter referred to as "Regulation 260").

The above-mentioned Directive introduced several important changes in the field of payments which affected all users as well as providers. For one thing it administratively introduced the term "payment services" and for another it allowed entities other than banks to provide selected services connected with payments in the form of a payment service. On all providers it imposed an information obligation when negotiating about conclusion of a contract on provision of payment services, information obligations before as well as after making payment service transactions and last but not least it gave preferential treatment to consumers and SMEs meeting criteria laid down in the Directive. The Directive also introduced limit execution times for cross-border operation processing not to be exceeded.

Regulation 924 took effect in November 2009 and it directly supplements the Directive. This rule of law can be considered another basic source of European law for execution of credit transfers in euro or other currencies as the case may be. It defines certain basic terms for the field of payment services and it lays down obligations of member states in the field of price policy when carrying out credit transfers within domestic and cross-border payments. This Regulation also provides for the actions of member states when carrying out the so-called direct debit. For the time being the last community law regulation in force and effect in the field of payments, or more precisely payment services, is Regulation 260. This Regulation has a direct effect on implementation of cross-border credit transfers as SEPA transfers. It is a direct, union-wide support for SEPA project, specifying the schedule of migration to the project payment services. Some issues will be addressed hereinbelow.

4. Payment Services and Cross-Border Payments

The Directive defined a new category, a term to which both the professional and the general public have been gradually getting used to. What is the relationship between the payments and the payment service categories? And how do the cross-border payments and SEPA project payment transactions fit into this context?

It follows from the Directive that the following activities can be considered a payment service:

- placing cash on a payment account,
- withdrawing cash from a payment account,

- executing a funds transfer initiated by the payer (credit transfer), the payee (direct debit) or the payer via the payee (debit card operations) unless the granting of credit is concerned,
- executing a funds transfer initiated by the payer (credit transfer), the payee (direct debit) or the payer via the payee (credit card operations) by which a credit is granted,
- issuance and administration of payment instruments and devices for receipt of payment instruments,
- executing a funds transfer for which neither the payer nor the payee use a payment account – the so-called money remittance,
- executing a payment transaction by an electronic communication service provider as long as the payer's approval of the payment transaction execution is given via an electronic communication device,
- cashless foreign currency business.

In order to prevent different interpretation of what is and what is not considered a payment service, the Directive contains also the so-called negative definition of the payment service. Hence for the example the following shall not be considered a payment service:

- preparation, collection, processing and delivery of banknotes and coins,
- money exchange business,
- issuance of paper cheques, paper-based drafts or traveller's cheques,
- issuance of paper-based vouchers for goods or services,
- issuance of postal orders and some other services.

It is clear from the above-mentioned that payments are a broader term than payment services with regard to the fact that this term covers broader legal relations emerging between the entities – the client and his bank, due to the wider range of payment instruments used. This statement can be based on legal foundations laid down in the Directive. Payments and services connected therewith may be provided only by banks or cooperative savings banks according to special legal regulations.

A **payment service** is a category which contains only the selected payment instruments but which can be provided also by other entities, in particular by payment institutions or electronic money institutions. In general the entities offering payment services are called **payment service providers**.

The European legislation thus prepares the way for a more competitive environment for provision of payment services including cross-border credit transfers. This indirectly supports healthy competition among payment service providers, EC's objective being to provide greater support for business and subsequent financial settlement in particular in the sector of SMEs and consumers.

Only three payment services were determined as **SEPA project payment products**:

- SEPA Credit Transfer (hereinafter referred to as "SCT"),
- SEPA Direct Debit (hereinafter referred to as "SDD"),

- SEPA Cards³.

If we wanted to classify the category of "cross-border credit transfer" under the above-mentioned SEPA project instruments, we would restrict ourselves only to the first two – SCT and SDD. Nevertheless all three basic SEPA products are always provided in euro in contrast to cross-border credit transfers. Thereby we come to the current characteristic of the **cross-border credit transfer**. A cross-border credit transfer can be understood as each electronically processed payment transaction initiated by the payer or the payee or via the payee as long as the bank or another payment service provider of the payer and the one of the payee are located in different EEA member states and the payment transaction is executed in currencies of those countries⁴.

5. Current Form of SEPA Project

SEPA project has been based on the voluntariness principle. If a bank or another payment service provider as the case may be wished to join the project it must meet certain required criteria and sign the so-called Agreement of Accession. The project has gradually put into life all three basic instruments. SCT has been available to all members since January 2008, SDD since later – it was got to work in November 2009 and in 2010 another principle was accomplished – the principle of **reachability** (see below).

The set goals of SEPA project have been, despite a delay, quite successfully accomplished according to the set schedule adopted in the document "**SEPA Roadmap**" in December 2004. In order to support SEPA project the European Commission issued a new document in September 2009 called: "**Completing SEPA: a Roadmap for 2009-2012**".

The document identifies the actions to be completed by all stakeholders (EU and national authorities, industry and users) over the next three years, following six priorities:

- 1) foster migration,
- 2) increase awareness and support SEPA products,
- 3) design a sound legal environment and ensure compliance,
- 4) promote innovation,
- 5) achieve standardization and interoperability,
- 6) clarify and improve SEPA project governance.

This plan is focused particularly on entities from those member states which have adopted euro but it is expected that member states outside the Eurozone will be interested therein too despite the slower pace of SEPA migration. Main principles of the document were reflected in Regulation 924 and subsequently revised and supported by Regulation 260.

The **draft Resolution** stated in its explanatory report⁵ that despite strong support for SEPA from EC and ECB, SEPA had been originally approached as a project motivated by the market – i.e. private institutions, particularly banks of EU countries. Being a coordinating and decision-making body, ECP proposed and implemented schemes for credit transfers and direct debits executed within the whole EU or EEA as the case

³ Works on e-Payments and m-Payments have been under way since 2010 but in the author's opinion those are only other combinations and forms of the classic cross-border credit transfer.

⁴ I.e. as of 1 November 2009 the criterion of credit transfer value, the limit of up to EUR 50 thousand, was cancelled. In other respects see Regulation (EC) No. 924/2009 of the European Parliament and of the Council on cross-border payments in the Community and repealing Regulation (EC) No. 2560/2001.

⁵ Page 2 of the Czech version of the draft Regulation published under Interinstitutional file number 2010/0373 (COD) on 16 December 2010.

may be. But with regard to the **rather slow pace of migration**⁶ all stakeholders gradually admitted that in order to **complete** the project **successfully it would be necessary** to legally **establish** a binding **end-date**. This can be affected only by a generally binding legal regulation of EU, i.e. the Regulation. It was stated that even two years after initiation of SEPA payments scheme the number of those payments in the Eurozone had not reached 10% of the threshold value. The linear extrapolation of the current pace of SCT scheme migration indicates that it would take more than 30 years to complete the system which is unacceptable. As stated in the explanatory report even more optimistic scenarios do not expect a faster completion than in 15 to 20 years. Therefore EC decided to support acceleration of SEPA system implementation and it submitted a draft of the above-mentioned Regulation 260 which was adopted on 14 March 2012.

The objective of Regulation 260 establishing technical requirements for credit transfers and direct debits is

- to determine end-dates for SEPA payment instruments migration, in particular credit transfers and direct debits, by introduction of a complex of standards and general technical prerequisites,
- to ensure reachness of payment service providers in case of credit transfers in accordance with reachness set for direct debit transactions contained in Regulation 924 and interoperability of payment systems.

Reachability is characterized as a situation when the payment service provider providing services in the form of national credit transfers as well as direct debits must be, in accordance with the rules of a payment scheme, ready to process a credit transfer or a direct debit initiated by a payment service provider located in any EEA state.

Another term which has to be accepted within SEPA project is interoperability.

Interoperability is a situation when payment service providers carry out credit transfers and direct debits within a payment scheme complying with following conditions:

- same rules apply to national and cross-border credit transfer transactions and to national and cross-border direct debit transactions between EEA member states,
- the participants in the scheme represent a majority of payment service providers within a majority of member states,
- processing of credit transfers and direct debits must not be prevented by technical obstacles.

Regulation 260 contains **the following end-date for reachability and interoperability** (End-dates)⁷ :

- **1 February 2014 for SCT and SDD**⁸ for countries within the Eurozone,
- **reachness for SCT and SDD**, including non-euro countries, with effect from 1 February 2016
- **interoperability for SCT and SDD, including non-euro countries, with effect from 31 October 2016.**

These days as the community law regulations supporting SEPA project have been implemented in legal orders of EEA member states, **the difference between a cross-border payment and a SEPA payment has been in fact removed. But certain minor differences persist.** They concern particularly the following fields:

- SEPA payments are executed **only in euro**, a **cross-border credit transfer** is a transfer of funds **in euro and other currencies of EEA countries** (e.g. in CZK or CHF),
- within **cross-border credit transfers different conditions for consumers and small entrepreneurs on one side and legal persons** on the other side may exist which is not true about SEPA payments, with a few exceptions (e.g. SDD – core system and B2B system).
- **difference in certain payment requirements** (Schlossberger, 2012).

Until Regulation 260 took effect, i.e. until 14 March 2012, it had been possible to impose other charges on cross-border credit transfers than on national credit transfers in euro as long as the credit transfer had exceeded the limit of EUR 50 thousand. This difference between SEPA credit transfers and cross-border credit transfers was administratively removed by Regulation 260⁹.

Implementation of the community law (in particular Directive on payment services in the internal market) removed differences in particular in charges for payments and deadlines for processing. **Regulation 260 turned SCT and SCD into products** to be provided by providers as **“mandatory”** ones as long as they provide them within national payments.

6. Importance of Payment Products for SMEs

We can say that **SEPA** is an area where consumers, small and medium-sized enterprises and other economic entities may make and receive payments in euro within individual countries as well as between them under the same basic conditions, rights and obligations regardless of their geographic location.

The objective of SEPA is to strengthen European integration by creating a single market of payment services for small payments. The existence of a single market for all payments in euro will strengthen competition and innovations and thereby bring better services for customers.

SEPA elements are:

- single currency,
- single set of tools for payments in euro – cashless credit transfers, direct debit and payments made via credit cards,
- effective infrastructure for processing payments in euro,
- uniform technical standards,
- uniform operating procedures,
- harmonized legal basis,
- continuous development of new services for custom-

⁶ SCT – the share of SCT transactions to all transactions within EEA amounted only to 29.6% as of September 2012, the share of SDD to all DD amounted only to 1% as of the same date - source: www.ecb.de/paym/sepa/

⁷ Regulation of the European Parliament and of the Council establishing technical requirements for credit transfers and direct debits in euro and amending Regulation No. 924/2009, Article 6 – End-dates

⁸ Article 6 – End-dates contains also other deadlines which however represent rather exceptions from the basic end-date.

⁹ In relation thereto Article 3(1) of Regulation 924 was amended.

ers (Schlossberger, 2012).

7. Conclusion

We can conclude from the above-mentioned that cross-border payments will be advantageous for entrepreneurs as well as consumers. For one thing binding periods are set for execution of cross-border payments or for execution of SEPA products as the case may be, e.g. SEPA credit transfer or SEPA direct debit. And for another, the price regulation of cross-border payments in euro guarantees that payments in euro to be made within cross-border payments must not be burdened with charges higher than those charged for national payments in euro.

Nevertheless if a SME client's bank participates in SEPA project, for the time being on the basis of the principle of joining this project voluntarily, the quality execution of cross-border credit transfers in euro is even strengthened. Once the above-mentioned end-dates for **reachness** and **interoperability** take effect, the national and the cross-border payments will be actually provided under absolutely equal conditions even outside Euro zone countries.

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