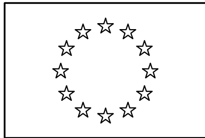


COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 1.12.2005
SEC(2005) 1535

COMMISSION STAFF WORKING DOCUMENT

Annex to the

proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market

IMPACT ASSESSMENT

{COM(2005) 603 final}

Disclaimer

This impact assessment report commits only the Commission's services involved in its preparation and the text is prepared as a basis for comment and does not prejudge the final form of any decision to be taken by the Commission.

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY 5
2. PROCEDURAL ISSUES AND CONSULTATION OF STAKEHOLDERS 12
2.1. Consultation methods, collection and use of expertise 12
2.2. Consultation of stakeholders, main sectors targeted 12
2.3. Results of the consultation and how they have been taken into account 13
3. PROBLEM DEFINITION 17
3.1. High cost of the payment system due to inefficient use of payment services 17
3.2. Fragmentation of EU payment infrastructures and services 19
3.3. Large differences in the efficiency of payment services in the Single Market 21
3.4. Lack of efficient competition and a level playing field in the payments market 23
3.5. Fragmented legal framework for payment services 23
4. RELEVANCE FOR THE EU 25
5. COMMISSION´S OBJECTIVES 26
6. MAIN POLICY OPTIONS TO REACH THE OBJECTIVES 29
6.1. Type of policy intervention at EU level to create a Single Payment Market 29
6.2. Type of legal instrument 31
6.3. Scope of the regulatory intervention 31
7. EXPECTED IMPACTS FROM THE DIFFERENT OPTIONS IDENTIFIED 33
7.1. Impacts of the alternative types of policy intervention 33
7.2. Impacts of the choice of legal instrument 36
7.3. Impact of the potential scope of the regulatory intervention 38
7.3.1. Market access requirements for payment service providers 39
7.3.2. Transparency of conditions and customer information requirements 44
7.3.3. Rights and obligations of users and providers 47
8. COMPARISON OF THE OPTIONS IDENTIFIED 51
8.1. Reasons for the proposed intervention 51
8.1.1. Type of policy intervention 51
8.1.2. Type of legal instrument and level of harmonisation 53
8.1.3. Scope of the regulatory intervention 54

8.2. Cost, Benefit and Risk analysis of the proposed regulatory intervention 58
9. MONITORING AND EVALUATION OF RESULTS 60
ANNEX 1: PROBLEM DEFINITION 63
ANNEX 2: RISKS AND COST ANALYSIS OF THE PROBLEMS IDENTIFIED.............. 78
ANNEX 3: THE SEPA PROJECT 81
ANNEX 4: ISSUES OUTSIDE THE SCOPE OF THE REGULATORY INTERVENTION 85
ANNEX 5: PRUDENTIAL REQUIREMENTS.. 88
ANNEX 6: CORE RIGHTS AND OBLIGATIONS OF PROVIDERS AND USERS......... 100
ANNEX 7: DISTRIBUTION OF IMPACTS AMONG STAKEHOLDERS AND COST-BENEFIT ANALYSIS 110

1. EXECUTIVE SUMMARY

This impact assessment has been conducted by the Commission's services in order to prepare the proposal for a Directive on Payment Services. It formed the basis for discussion and input from a wide range of external stakeholders and deepened the analysis of likely social and economic impacts. It is aimed at meeting the specific commitments of the Commission under the Lisbon and Sustainable Development Strategies by keeping EU intervention as simple as possible. Finally, it explains why a particular action has been chosen and why the proposed response is an appropriate choice. This impact assessment report does not prejudge the final form of any decision to be taken by the Commission.

Commission's consultation with stakeholders, analysis and fact finding studies revealed five core problem areas in the EU payment services market:

1. High cost of the payment system to the economy due to inefficient use

The payment system allows for the successful conclusion of 231 billion payments per year in the EU representing a total value of EUR 52 trillion[1]. Studies estimate the cost impact of the payment system to society to as much as 2–3 % of GDP. Cash is the main cost driver and accounts for as much as 60–70 % of the total cost of the payment system. Instead of efficient electronic payment services, for which the costs range between a few euro cents the cost per transaction when paid for in cash ranges between EUR 0.30 to EUR 0.55. The sectors most affected by the high cost of cash usage are the payments industry and merchants e.g. the payments industry is often cross-subsidising cash operations with revenues form electronic payments and account management fees.

2. Deficiencies in EU payment infrastructures and services

The infrastructure for payments in the EU is predominantly national, based on national markets, user habits and national currencies. These national payment systems have not yet adapted to fit the Single Market. They are not geared to handle cross-border payments as efficiently as national ones.

The few existing cross-border payment systems suffer from a lack of critical mass and operate with much higher unit costs than their national equivalents. Cross-border payments amount to only 3 % of total transactions.

Common technical standards and business rules are missing to allow for competition between national payments systems and cross-border payment systems. The lack of standards also prevents consolidation of payment systems and the redundancy of systems creates higher costs for providers, users and the economy.

3. Large differences in the efficiency of payment services in the Single Market

Despite the fact that the Single Market exists since 1992, the Internal Market for payment services is hugely fragmented. The introduction of euro in 1999 has provided for a market for euro cash payments but the integration of the market for electronic payments has only started.

[1] McKinsey & Company (2005).

This is evident in the huge differences in efficiency and prices for electronic payments between Member States.

Whilst it is difficult to compare efficiencies of national markets, the figures that do exist show substantial differences. The price of providing basic payment services related to a bank account varies between Member States by a factor of 1:8[2], e.g. from EUR 34 a year for the average customer in the Netherlands to EUR 252 in Italy. It is not only on price that large differences are seen between Member States. For example in some Member States payments are executed in real time or same day, but in others three days or even longer is the rule.

4. Lack of efficient competition and a level playing field in the payments market

The payment industry is a network industry and a certain degree of co-operation between competitors is necessary (e.g. to establish common standards) in order for the system to function efficiently. This cooperation should be limited to clear tasks and go no further than is absolutely necessary.

However, the Commission received many complaints from new market entrants from the non-bank sector, about substantial barriers to entry to the payments market and an unlevel playing field. New players are often faced with difficulties when trying to join existing national payment systems and infrastructures, which are a prerequisite in order to be able to compete.

The payments sector has been subject to several industry wide reports and investigations about uncompetitive governance structures and anti-competitive market practices by competition authorities not only in the EU, but also in other jurisdictions. Finally, this has led the Commission to open a sectoral enquiry of competition in the payment sector in 2005.

5. Fragmented legal framework for payment services

Very often efficient national payment services and systems are not available on a cross-border basis due to legal and technical barriers. For instance direct debits which are a common and cost-efficient service to pay for utilities are not available for payments in different countries. Similarly most of the popular and cheap national direct debit cards are not operating across borders.

As illustrated by this fundamental problems the current state of the EU payments market is unsatisfactory. Without an efficient, well-functioning and integrated payments market the full potential of the Internal Market remains unexploited.

---

[2] CapGemini, EFMA, ING "World Banking Report", 2005.

Therefore the Commission's established the following objectives for its policy intervention:

The Commission's ultimate objective is to integrate national payment markets and to create a Single Payment Market where improved economies of scale and competition would help to make it more efficient and reduce the total cost of the payment system to society.

The Commissions' initiative focuses on electronic payments as an alternative to expensive cash, as electronic payments are recognised to be more cost-efficient and stimulate consumer spending and economic growth. Modern economies are based on an intricate web of payments. Payments allow economic actors (business, households and governments) to complete a commercial transaction face to face or at distance. Payment systems are based on professionally managed infrastructures. Efficient electronic payment systems for remote transactions are particularly important in order to exploit the maximum potential of the Internal Market for goods and services.

The intermediate objectives to reach the overall objective of the Commission's policy intervention are:

(1) Enhanced competition between national payment markets by opening up markets and ensuring a level playing field,

(2) Increased market transparency for both providers and users, and

(3) Standardised rights and obligations of providers and users of payment service in the EU, with strong emphasis on a high level of consumer protection.

How will the proposed policy intervention address the identified problem areas and contribute to achieving the set objectives:

The Commission held several rounds of public consultations which helped to identify problem areas and policy options to address those barriers that could potentially create an obstacle for a Single Payments Market and might therefore be covered by the Commission's initiative.

(1) Reasons for and impacts of the type of policy intervention and choice of legal instrument

Based on the results of the consultation the Commission concluded that out of the five problem areas identified, areas (1), (2), and (3) are best addressed by market-led initiatives, while regulatory intervention would mainly be needed in area (4) and (5) in order to reach the ultimate objective of a Single Payment Market.

- *Role of the public sector*

Consequently the Commission's proposal will focus on the removal of legal and technical barriers and provide the market with a legal framework for consolidation of the historically fragmented European payments landscape. The proposed scope, legal instrument and full harmonisation approach are aimed at responding to the needs for subsidiarity and proportionality.

Harmonisation of the legal framework can better be effected by EU legislation than by national legislation. EU legislation will rationalise and simplify the current 'patchwork' of national rules for payments and provide the market with a single set of consistent and coherent legal rules. At this moment the legal landscape is fragmented. Each Member State has its own set of national rules governing various and different aspects of payments; prudential conditions for providers to enter the market; transparency conditions for users; rights and obligations of users and providers of payment services. Studies conducted by the Commission and consultations with industry, users and experts showed that the differences in national legal frameworks were an important impediment to the development of a Single Payment Market.

- *Role of the industry and self-regulation*

The Commissions' regulatory intervention is based on a strong role for self-regulation. The current proposal will only together with the successful completion of the Single Euro Payments Area (SEPA)[3] achieve the desired objectives of a Single Payment Market resulting in economic savings to payments industry and users.

Banking industry made a commitment to develop these common technical and commercial standards in the SEPA roadmap. In 2002 the European banking industry has set up the European Payment Council in order to create SEPA consisting of the delivery of common standards and services for euro payments by 2010.

Based on the free provision of services and common EU standards for technical and commercial interoperability of payment schemes and infrastructures, providers will have the chance to compete in a Single Payment Market. Over the long term, common European payment standards would provide the basis for consolidation and rationalisation, eliminating the duplication of investments for maintaining different systems[4], reducing operational costs for providers and businesses.

SEPA is certainly the most important integration initiative of payment markets and infrastructures in the near future and will focus on euro payments, where the expected economic gains are most substantial. However, it is expected to serve as role model and benchmark also for non-euro payment systems and will inevitably, through the enlargement of the euro zone, cover most of the Internal Market. The proposed legal framework will facilitate this initiative and provide the framework for the integration of the whole EU market.

(2) Reasons for and impacts of the chosen scope of policy intervention

Against the above background the Commission undertook to deliver the current proposal for a Directive, focussing on three key areas for EU legislation which were identified during stakeholder consultation:

---

[3] See EPC, "Euroland: Our Single Payment Area!", May 2002, at: http://www.europeanpaymentscouncil.org.

[4] Currently banks would invest in and maintain at least three different payment systems, one for national payments, one for euro cross-border payments and one for international payments in other currencies.

- *Market access and prudential rules*

The first building block of the Directive for a new legal framework is the harmonisation of market access requirements for non-credit institution payment service providers and introduction of a specific license for payment institutions.

An assessment of the potential social and economic impacts of keeping the differentiation of market access conditions between Member States found that the unlevel playing field is detrimental to the functioning of the Single Market and creates substantial barriers to market entry. The Single Market principle of the free provision of services, including payment services is currently insufficiently realised in the EU. Fragmented market access requirements distort competition and lead to higher prices for users and high profits for dominating providers in national markets and lower levels of innovation.

- *Transparency and information requirements*

The second building block of the new legal framework is aimed at overcoming the fragmentation effect of divergent national and EU rules on information requirements which constitute currently an impediment to cross-border service provision a high level of consumer information and an efficient EU payment services market.

The proposed package of transparency and information requirements should enhance transparency and thereby improve user confidence, facilitate user choice of the most appropriate payment service and eliminate the fragmentary effect of divergent national rules permitting the reaping of significant economic benefits of market integration for both users and providers. It is also essential to achieve this transparency and better information if another of the fundamental objectives of the policy intervention is to be fulfilled – improving competition by giving users transparency and choice.

- *Rights and obligations of users and providers*

The third building block of the new legal framework will be formed by harmonised core rights and obligations of users and providers in the interests of certainty and efficiency. In the identified areas the impact analysis showed that EU legislation would be more effective than self regulation or national legislations to achieve the objectives and bring about the desired efficiency gains.

The starting point for the assessment of social and economic impacts of these alternatives was the need to enhance the trust of users in remote or electronic payments in order to push back the use of cash in particular removal of obstacles (caused by mistrust) to the further use of cheap and efficient means of payments. Another important criterion was to give legal certainty to providers so that they could set up cost-efficient, fully automated straight-through processing of payment services without fear that efficient operation would be hampered by legal disputes.

However it was particularly for these rules that input from stakeholders showed that it would be disproportionate to apply them universally to all payments or all users. Therefore in order to avoid unwarranted costs for a limited number of rules, adjustments were made where a foreign currency was involved, for corporate users or where one of the payment service providers was located outside the EU. These adjustments were kept to a minimum in order to

preserve the level playing field. At the same time the underlying objectives were preserved and the regulatory burden kept to a minimum.

The estimates of the potential costs and benefits of the establishment of a Single Payment Market yield a positive result:

- The overall social cost of payment services could be reduced if the share of electronic payments would be increased and the use of expensive cash reduced. Best practice shows that modernisation of payment systems and increased use of the most cost-effective services[5] can half the average cost of producing payments over a period shorter than ten years. If all countries would reduce the use of cash, for example by using debit cards up to the level of the three countries with the lowest share of cash payments, this would increase banks profits by EUR 5.3 billion[6].

- Integration of the European payments market and infrastructures will strengthen competitiveness of the financial sector and offers a unique opportunity for banks to reduce their operational costs. Cost Income Ratio of the banks for payments stands at an unfavourable 90 % – a ratio that worsens the overall Cost Income Ratios of the banks from 55 to 64 %. Payments on average represent 24 % of banking revenues and 34 % of the operating costs of the European banks. Improved efficiency and consolidation of redundant payment infrastructures could positively impact the competitiveness of the banks.

- Through further product standardization and consolidation in the processing of payment transactions economies of scale can be maximised and efficiency of payment systems improved. For example if unit cost levels were to decrease to 20 percent above the best practice level in Europe, this would generate EUR 10 billion additional profits overall. Or if the costs of producing payment service could be reduced to the levels of the most efficient countries huge savings could be made, e.g. the cost per transfer in Belgium are around 20 cent while the cost in Germany are as much as 60 cent.

- Tangible benefits for businesses and their competitive position at large could be created by integrating electronic payments into the electronic business processes (e.g. e-invoicing) of enterprises. If banks would offer EU-wide, standardised, faster and more economic end-to-end automatable payments, conservative estimates project savings of EUR 50–100 billion per year for businesses.

- Free provision of services in a Single Payment Market and increased competition would allow retailers to use the services of the most competitive providers and benefit from real cross-border card acquiring, e.g. merchants would pay 20 times less for debit card acquiring and 9 times less for credit card acquiring (equivalent to savings of 4–5 % of sales value of each transaction)[7].

---

5 As illustrated by best practice of countries such as Finland, Island and Norway.

6 McKinsey&Company (2005).

7 Figures as reported by Eurocommerce.

- A Single Payment Market facilitates the removal of current differences between national payment infrastructures and convergence of price levels, creating the potential for enormous savings and a seamless payment experience for consumers and businesses. If the current price differences, of a factor 1:8[8] in Member States converged around the present European average, users in more expensive countries would gain substantially, e.g. Italian and Spanish users would see savings of respectively EUR 5.4 billion and EUR 1.3 billion[9].

8 Capgemini, EFMA, ING "World Banking Report", 2005.
9 McKinsey&Company (2005).

2. PROCEDURAL ISSUES AND CONSULTATION OF STAKEHOLDERS

Gathering opinions and information from interested parties is an essential part of the Commissions' policy-development process.

2.1. Consultation methods, collection and use of expertise

From 2000–2002 the Commission prepared[10] a Communication and two working documents[11] and seven surveys for a public consultation on a possible legal framework for payments and to assess the current state of the market in Member States. In 2003 the Commission prepared a Communication[12] for wide public consultation on the possible scope and content of a new legal framework. The final proposal was prepared in 2004–2005 in intensive collaboration with the two permanent expert groups and consultation with stakeholders and based on six working documents of the Commission services containing the possible draft provisions. Stakeholders and experts have also been involved in the preparation of the impact assessment report and have been consulted on a draft prepared in February 2005.

2.2. Consultation of stakeholders, main sectors targeted

The Commission has consulted stakeholders from a broad variety of sectors and professions and covering the geographical scope of the EU–25, throughout the regulatory process in line with its commitments under the EC Treaty[13]. The Commission drew upon the expertise of two permanent expert groups[14] and numerous bilateral meetings. From 2002–2005 the Commission has consulted stakeholders, in particular the payments industry, on all working documents for the preparation of this Directive. The Commission has benefited significantly from the input given by stakeholders. The responses and how they have been taken into account are presented below.

The sectors consulted are basically the following: payments industry (banks, infrastructure providers e.g. network, processing, clearing and settlement providers etc), banking associations (EU level as well as nationally) and the European Payments Council, payment cards organisations, e-money providers, mobile payment and telecom providers, associations (Eurocommerce), industry general, corporate treasurers (EACT, TWIST), SME organisation (UAPME) and national and European consumer associations (BEUC, FIN-USE), payments experts, consulting firms, lawyer firms, universities.

---

[10] All European Commission consultative documents on a possible legal framework for payment in the Internal Market are available online together with the Report on the application of Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers (COM (2002) 663 final) and the Study on the implementation of Recommendation 97/489/EC. See: http://europa.eu.int/comm/internal_market/payments/framework/index_en.htm.

[11] MARKT/208/2001 and MARKT/4007/2002.

[12] COM (2003) 718 final.

[13] See Protocol on the application of the principles of subsidiarity and proportionality.

[14] Since 2002 the Payment Systems Government Expert Group has conducted more than 16 meetings; representing the interests of Member States, the Eurosystem/central banks. Similarly the Payment Systems Market Expert Group held almost 16 meetings, with a large number of experts (a standard composition of 60 experts) representing all industries, businesses, retailers and consumer associations, as well as selected experts from central banks and the ECB.

2.3. Results of the consultation and how they have been taken into account

In spring 2002, the Commission started work on a common legal framework for payment services by taking stock of all the problems with regard to the EU payments legislation[15] and invited for comments from all interested parties. This working document aimed at launching a wide and open discussion on what should be done to further enhance the functioning of the Single Payment Market.

All respondents[16] saw a need to encompass possible industry self-regulation by regulatory measures on EU level in order to achieve a Single Payment Market. Views varied, however, on the scope and degree of the legal measures required. As a general rule it was deemed that new legislative provisions should be limited to those necessary to ensure a well-functioning use of payment services throughout the European Union.

As policy objectives for the Single Payment Market the following ones were suggested: Security; reliability; efficiency; transparency; strengthening the position of the customer; and competition.

All respondents considered the objectives of rationalisation and consolidation of existing EU instruments to be desirable. The current legislation was regarded as fragmented, overlapping and even in some case contradictory. A future legal framework should update and draw together the various pieces of EU law into a coherent legal instrument. Consequently the Commission prepared an inventory of national legislation and practises on several of the issues raised[17].

In order to prepare structured analysis of market obstacles and legal barriers and to gather views and comments on adequate solutions the Commission published a Communication[18] in 2003. The subsequent consultation[19] clearly confirmed 21 obstacles and commented on weather they were best addressed by self-regulation or EU legislation.

---

15 Working Document "A Possible Legal Framework for the Single Payment Market in the Single Market" (MARKT/208/2001 rev. 1) available at: http://europa.eu.int/comm/internal_market/en/finances/payment/.

16 The result of this consultation was presented in a Summary Document (MARKT/4007/2002 final) available at: http://europa.eu.int/comm/internal_market/en/finances/payment/area/consultation.htm.

17 The differences in national legislation on payment services, in central Single Market areas have been examined to identify obstacles to a Single Market for payments, in preparation of the present proposal. The answers to questionnaires on national rules by competent authorities can be found at: http://europa.eu.int/comm/internal_market/payments/framework/comparison_en.htm.

18 The COM (2003) 718 final is available on the EU Commission, Single Market homepage at: http://europa.eu.int/comm/internal_market/payments/framework/index_en.htm.

19 The results of the consultation conducted from 2 December 2003 to 15 February 2004 on COM (2003) 718 final have been published on the EU Commission, Single Market homepage at: http://europa.eu.int/comm/internal_market/payments/framework/index_en.htm.

Table 1: The Barriers identified in the communication
Barriers to a Single Payment Market
1.Right to provide payment services to the public
2. Information requirements
3.Non-resident accounts
4.Value dates
5.Portability of bank account numbers
6.Customer mobility
7.Evaluation of security of payment instruments and components
8.Information on the originator of a payment (SRVII of FATF)
9.Alternative dispute resolution
10.Revocability of a payment order
11.Right of refund in case of disputes in distance commerce
12.Non-execution or defective execution
13.Obligations of contractual parties related to unauthorised transactions
14.The use of "OUR", "BEN", "SHARE"
15.Execution times for credit transfers
16.Direct debiting
17.Removing barriers to cash circulation
18.Data protection issues
19.Digital signatures
20.Security of the networks
21.Breakdown of a payment network

The early consultations were taken into account when formulating the general approach and the objectives for the project for a new legal framework for payments. From 2004–2005 the Commission consulted Member States experts and stakeholders on the legal and technical details of the proposal[20]. Commentators have generally been very supportive of all the major objectives of the project and have helped to fit the rules to the needs of industry and users:

Payments industry regards harmonisation of legal barriers in Member States legislation as being equally important with the development of common payment standards and services for the creation of a Single Payments Market. Legislative intervention should focus on issues concerning the relationship between provider and user and should leave it to self-regulation of industry to define the rules governing the relationship between providers. The scope of the regulatory intervention should be limited to removing the identified legal obstacles. Full harmonisation of these obstacles is of major importance to payments industry to prevent future fragmentation and provide them with the much needed legal certainty over the legal framework of the Single Payments Market. Industry would also prefer directly binding rules to a long transposition process.

[20] The Commission published five working documents, each of which was open to public consultation through the two expert groups and an industry mailing list.

During consultation on the detailed rules of the proposal industry provided valuable input to ensure that the rules fit to business practices and do not intervene in the well-functioning of existing systems. Industry fully supports the objectives and has approved of the technical quality of the rules of the proposal. However, some controversy exists on rules which are regarded as being too consumer protective, for example, the strict liability of providers for the correct execution of payments or the limit of EUR 150 for the loss of a payment card where the user has not acted fraudulently. Furthermore providers from the banking sector would prefer competition from non-bank competitors restricted and subjected to bank capital requirements, whereas hybrid and non-bank providers, which have been operating legally in some Member States, such as Telecom operators providing mobile payments, are concerned about overregulation in particular if capital charges are applied.

Consumers: Support the Commission's initiative which is responding to the request for more transparency of payment services and which codifies core rights of users and providers concerning the key characteristics of efficient payment services. It also establishes the same high level of consumer protection without difference to the country of origin – objectives, which users did not find sufficiently realised by the self-regulatory initiatives of industry. Users would also be the main beneficiaries of efficient cross-border payment services and convergence of prices for payment services in the Internal Market. Though the proposal provides for some explicit exceptions to full harmonisation for national provisions which guarantee a higher level of efficiency and protection for users some reservations remain, concerning the disappearance of national consumer protection rules in favour of a harmonised framework.

Corporates/retailers: In general businesses have been very much in favour of the Commission initiative not only because they believe that the proposed legislation will create a Single Market for Payments also because it defines a benchmark for efficiency and opens the perspective for interoperable EU-wide payment services which businesses have been asking banks for a long time, without tangible results. Businesses expect huge savings from integration of payment systems and improved efficiency (estimated of savings from the implementation of a common standard for electronic invoicing and payment are in the area of EUR 50 billion. Currently businesses have huge costs (EUR 35–60/invoice) for processing an invoice manually. Full automation could reduce this cost by 70–90 % representing savings of EUR 25–50 per invoice). Corporates and retailers also expect a highly positive impact on competition through increased transparency, opening up of markets for new providers from the non-bank sector and more competitive services offers. Merchants, who have particularly complained about the low levels of competition in card acquiring expect to benefit from real cross-border acquiring and lower prices through increased competition.

The ECB and national central banks welcome the Commission's initiative for a Single Payment Market also as a necessary step to facilitate effectiveness of self-regulation and the creation of SEPA by industry. The Eurosystem supports the harmonisation of core rights of providers and users but had reservations on EU-wide market access for non-bank providers even though this reflects the current market situation in a large number of MS. In particular the ECB criticises the proposed level of prudential requirements for payment institutions and the lack of capital requirements.

The Economic and Social Committee generally endorsed Commission's initiative[21]. Views follow the positions of consumers and the payment industry in the Commission working groups which are reflected in the proposal.

Member States: All MS unanimously support the main objectives of creating a Single Payment Market and the means of establishing a new legal framework as formulated by the Commission. MS favoured a Directive over a directly binding legal instrument in order to harmonise existing legal obstacles in national legislation. MS support industry self-regulation to address problems in the 'interbank[22]' space such as the lack of EU-wide payment services and infrastructures. Regulation was deemed to be the appropriate means to overcome legal obstacles and necessary in areas where market failure seemed to have led to a mismatch between supply and demand side requirements and the lack of common standards leads to fragmentation and low levels of competition. A few Member States expressed reservations on full harmonisation of prudential rules for payment service providers[23] and certain liability rules (e.g. strict liability) which might interfere with existing civil law provisions in MS.

The European Parliament has indicated its strong support for the creation of a Single Payment Market for consumers and businesses. The European Parliament endorsed[24] the Commission's Communication concerning a new legal framework for payments.

---

21 European Economic and Social Committee Opinion INT/227 on the Communication concerning a New Legal Framework for Payments in the Internal Market adopted on 9 June 2004.

22 Inter-bank arrangements usually characterise bilateral or multilateral agreements between participating banks/providers in a payment system.

23 Member States having concerns regarding the level of prudential requirements for payment institutions and the waiver clause had often previously had a prudential regime that requires a credit institution license including capital charges for payment service providers.

24 European Parliament Resolution 2003/2101(INI) on a legal framework for a single payment area adopted on 19 April 2004.

3. PROBLEM DEFINITION

This section provides the reader with a brief outline of the five main problem areas affecting the efficient function of the Single Payment Market. A more detailed discussion and background material on all five problem areas can be found in Annex 1: *Problem definition*.

3.1. High cost of the payment system due to inefficient use of payment services

The payment systems intrinsic value is to provide an economical and effective way for society to settle obligations for the purchase of goods and services.

Therefore the most relevant indicator to assess if the payment system fulfils its function properly is the macroeconomic cost of the payment system and efficiency of various payment services. Though, it is difficult to obtain comprehensive figures on the aggregated cost for the EU payment system estimates[25] range from 2–3 % of GDP. A poor result, compared with the best in class, e.g. Belgium, the Netherlands and Sweden, who are clear cost leaders with a payment system that costs society between 0.3–0.5 % of GDP or countries such as Norway which show the way to half the total cost of the payment system in a period not much longer than 10 years in a joint effort of regulators and industry.

The key question for policy makers is therefore how to provide a market framework that fosters efficiency of the payment system. For that it is important to understand the factors which influence the costs of the payment system.

A more detailed breakdown reveals that cash, above all, is the main cost driver and accounts for as much as 60–70 % of the total cost of the payment system, or in other words 2 % of GDP while use of cost-efficient self-service channels and fully electronic payments which have been widely adopted in particular in Nordic countries operate at much lower cost levels. The higher cost of cash is mainly due to the expensive infrastructure needed to distribute and recycle cash, though there are certainly ways to lower these costs, savings are limited by the need for manual handling. In contrast to this, electronic payments can pass trough the system with almost no manual intervention and the cost depends primarily on the level of development of such STP-payments[26], consolidation and efficiency of the particular electronic payment system.

If the total cost of the payment system is an aggregate of the cost of cash and electronic payment channels the question arises which factors determine the usage patterns for different payment services and could potentially reinforce the transitional process away from expensive cash to electronic payment services.

---

[25] Humphrey and Pulley estimate the cost as being as high as 3 % of the GDP. A Belgian Study of Paul de Grauwe, “Cost of cash in Belgium”, estimates the cost of cash alone as being 2 % of the GDP. Further studies providing figures are Dutch National Bank – "Betalen Kost Geld" and T. ten Raa, Journal of Banking & Finance. The European Payment Council estimates the cost of cash handling in the euro zone amounts to EUR 50 billion.

[26] STP = straight-trough processing and refers to the fully automated handling of electronic payments.

The two main factors found and well documented in studies[27] are:

(1) the price of payment services for users

(2) the ease of use of different services.

These studies show that cost-based pricing of payment services triggers customer behaviour and the right price signals can drive customers to select more efficient payment services rather than less efficient ones. When prices paid by users reflect the real cost value of the service, they provide an incentive for users to select services that meet their needs at the lowest possible private and social cost. This promotes the efficiency of the payment system.

Unfortunately, today awareness of users of the real costs of different payment services is limited. But sectors which are aware and bear an important share of the costs of cash, namely the banking industry and retailers are highly supportive of the efforts to reduce the percentage of cash and also stress the need to raise awareness of users of the real cost of cash and the more cost-efficient use of electronic payment services[28].

However, at present the EU market framework does not provide enough price transparency for users and a 'level playing field' for the efficient competition of payment services, several factors (legislation, public opposition to changes in the global price structure, cross-subsidisation and non-cost-based pricing) distort the economic selection process. Several studies[29] illustrate that price distortions in the payments market are leading to a situation where inefficient payment services (e.g., cash, cheques) are chosen by users at the expense of more efficient ones.

Substantial costs savings could be achieved from increasing the level of fully electronic payments and payments related processes (integrated electronic invoicing). Studies[30] show that 70 percent of the costs in the payments value chain can be addressed by a reduction of costs at the front end, i.e. the providers interface with the customer because the use of cash or paper-based payment services demands several steps of manual intervention.

The savings come from fully automated sending and receiving of invoices and payments. These and much higher cost savings for corporate customers and the public sector have been confirmed[31] and are stemming mainly from the fully automated handling of payments, reduced software, risk and interest costs and better cash flow position. Average costs for manual manipulation to invoice senders are about EUR 2–8 for each sent invoice and about EUR 25–50 for received invoices. In Nordic countries there are 1.2 billion business to consumers (b2c) invoices and 1 billion business to business (b2b) invoices sent every year, amounting to savings from automation of EUR 15 billion/year. In Europe there are roughly about 20 billion invoices. Estimates of corporate users on the savings which could be obtained from fully integrated electronic payments are in excess of EUR 50 billion/year.

---

[27] Sveriges Riksbank, "Do prices reflect costs? – A study of the price and cost structure of payment services in the Swedish banking sector 2002", October 2004. Norges Bank, "Cost and Income in the Norwegian payment system 2001", September 2003.

[28] Along this line the European Payment Council has adopted specific recommendations and resolutions to create a framework for a Single European Cash Area.

[29] Studies of Sveriges Riksbank and Norges Bank.

[30] According to studies of McKinsey, "Ergebnis im Girokonto Österreich", 1999 und 2001.

[31] Estimates of the European Association of Corporate Treasures and practical experience by Nordea Bank in the Nordic countries in 2005.

3.2. Fragmentation of EU payment infrastructures and services

- *Cause and effect of the current fragmentation of payment systems in the EU*

Payment systems in the EU were originally created with the aim of meeting national requirements and based on national currencies. As payment systems evolved within national borders, most systems chose to operate on proprietary standards for the processing, clearing and settlement of credit transfers, direct debits and card payments. At a domestic level 97 % of the total payments volume is processed. In the past it was therefore sufficient to maintain a limited number of correspondent banking relationships or become a member in one cross-border payment system in order to deal with the low percentage of cross-border payments (currently 3 %). The current infrastructure for cross-border payments is mainly based on international payment schemes for cards or the EBA STEP2 clearing system for credit transfers. Taking this as a starting point, existing systems had no incentives/business case to invest in technical interoperability with other systems for these few cross-border transactions and consolidation on an infrastructure level between national and cross-border payment infrastructures has not made much progress.

Certainly it is a difficult task to eliminate the national differences in the information technology and commercial arrangements used by payment systems via an EU wide technical standard and respective scheme for technical and commercial interoperability. But the EU payments infrastructure remains highly fragmented as long as such standards are not put in place. Fragmentation complicates significantly the processing of cross-border payments relative to domestic transactions and creates barriers to the efficient delivery of payment services. Common standards are seen to facilitate consolidation of the historically fragmented European payments landscape, allow rationalisation of systems and infrastructures with the associated cost saving for industry and users.

Also the lack of common standards is a key barrier to competition between different national payment markets. Fragmentation of technical standards and proprietary non-interoperable systems prevent providers from competing on the service level of products offered to users and are not consistent with a Single Payment Market.

The current fragmentation of payment systems across Europe has also negative consequences for users such as limited availability of cross-border payment services, high costs, unreliability and lock-in in proprietary technological solutions and markets.

The establishment of the European Monetary Union and the introduction of euro have created the potential for huge savings. Development of an efficient EU payment market could help to overcome the current fragmentation. An efficient payment infrastructure which enables the quick and smooth flow of payments at a low cost in the whole EU is also key for trade in the Single Market and the competitiveness of the EU economy.

The business case for an integrated payment market lays in common standards and consolidation of infrastructures. Because payments in a single currency area could be processed without regard to their country of origin, economies of scale would drive down processing costs and new pan-European processing solutions would become possible and if the price and service levels of the best operating national payment systems would be met a critical mass of banks currently operating under the national schemes will be willing to migrate to the new systems. This is reinforced by the fact that banks today face huge costs for

processing payments. For the processing of 231 billion transactions/year banks in Europe spend on average 33 % of their operating costs.

Also infrastructure providers would be able to develop payment services for and compete in a much wider market based on a common technological platform and standard. The use of state-of-the-art technology and wide take up would allow enormous economies of scale. Software development and IT hardware costs will be limited for providers and should decrease over time, because mainstream technology will be freely available and IT vendors will take up given technical standards.

Common open EU payment standards are also the precondition for adding value to services in the payments value chain for users. Stakeholder would be able to take advantage of the best services offered in the Single Market, without difference to the origin of the provider or location of the payment system. For this to be realised users demand[32] interoperable payment systems in Europe, which allow for the same user experience across Europe and enable users to chose the most competitive provider.

- *Barriers to integration of national and cross-border payment systems*

There are a number of barriers for consolidation of payment infrastructures in the EU. Barriers include the current lack of common open payment standards, the lack of commercial and technical interoperability between schemes and infrastructures, the investments that need to be made to change systems, vested commercial interests, market power and governance structures.

Firstly, before consolidation of infrastructures would make sense, common technical standards need to be developed and business models to be aligned. In such a situation, greater economies of scale, lower costs per unit and savings from shared software development would form clear incentives for any individual provider to enter a Single European Payment Market.

Secondly, any change from existing to new pan-European payment schemes means banks are faced with sunk costs for existing systems and new investments for the migration to pan-European schemes (including customer migration). Banks are ‘locked into’ their national legacies and proprietary standards, which may have been improved over time to reach higher levels of efficiency representing some kind of local optimum. Banks have also educated their customers to connect to their system in a specific way. Commercial users (enterprises and governments) usually have huge IT applications which need to be adapted as a consequence of changes in the bank’s system. The available software solutions for this communication and processing channel differ widely in each country and across Europe.

Thirdly, savings are rather difficult to be realised for a provider on a stand-alone basis. Not only risk providers who adopt new standards first, to be faced with first mover disadvantages (e.g. if the mass of providers do not follow). The process of integrating and consolidating national payment systems is also likely to produce losers and winners. This creates a situation of huge potential gains depending on collective action and substantial risks for the individual provider on the other hand, making a “deadlock” the likely outcome. If all players involved

---

[32] Views expressed by stakeholders during the Commission’s public consultations on this legislative proposal.

adopt a wait-and-see attitude, the switch to EU-wide payment systems will not take place and all providers will be trapped in a deadlock: nobody is keen to be the first to change, unless a coordinated migration is organised, the first-mover is uncertain whether others will follow.

However, once a critical mass of players migrates, the process becomes self-reinforcing: the more providers make the switch, the more interesting it becomes for other providers to do the same, leading to more migration, etc. Therefore only binding industry commitments and legal certainty deliver a reliable basis for migration and investment decisions of individual providers and national payment communities.

Fourthly, achieve EU-wide acceptance of new payment services. For example a new pan-European direct debit scheme will mean that some banks with a strong commercial customer base will have an interest in developing this scheme while other banks with a large number of private customers will be more reluctant to grant access to their customer base. Therefore, some banks will make the new service available to their customers while some might decide not to do so. But this is exactly the crux: pan-European reach can only be achieved if all providers participate and make themselves available as intermediaries for paying others. This is a clear hurdle pan-European schemes need to overcome.

Finally, commercial protectionism is another major problem. Currently national payment markets do not compete and providers in national markets with high-margin do not need to be afraid of competitors as fragmentation of technical standards and the local governance makes it a very costly undertaking for new competitors to enter the market. A Single Payment Market, common standards and interoperability will take away these barriers and will so potentially increase competition.

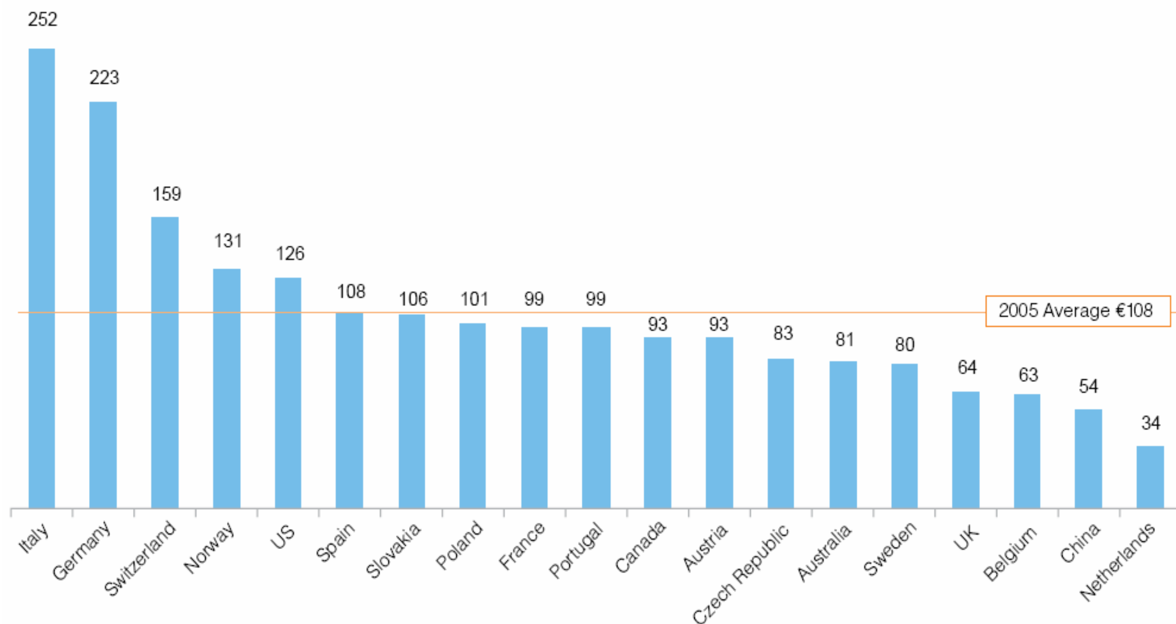
3.3. Large differences in the efficiency of payment services in the Single Market

Price levels are the most obvious indicators for the efficiency of payment services in different markets. Though it is difficult to compare prices in different countries taking into account national peculiarities, the huge price differences for payment services, of a factor 1 to 8[33], between EU Member States are negative evidence for the lack of integration of the EU payments market[34].

---

[33] Cap Gemini & Ernst and Young, EFMA and ING, “World Banking Report”, 2005.

[34] Ibidem.



According to studies[35] the competitive and regulatory environment has the most important impact on price convergence in national markets. Opening up national markets through the removal of legal, technical and commercial barriers and enforcing competition leads to a decrease in price levels and drives innovation.

Another indicator for the efficiency of payment services are service levels. One of the most obvious is the execution time of a payment. While in some countries the standard execution time for payments is the same day or next day providers in other countries the settlement of payment transactions (e.g. credit transfers) takes 3 days[36] and sometimes weeks for private customers (e.g. cheques).

Critics[37] could argue that there is a lack of incentives for banks to innovate and improve efficiency as long as their earnings are partly driven by the inefficiencies of the system (e.g. income on float that is earned for the time the payment order is placed, but not executed and the final crediting of funds on the account).

For businesses, this delay can have a substantial impact on cash flow, working capital and processing costs causing serious problems and this situation has been widely criticised by corporate customers and SMEs. Additionally, systemic delays in final settlement create significant counter party risk, the underwriting of which creates additional revenues for banks.

As the technical ability to settle payment transactions instantaneously is already available users require that payments are made faster and cheaper by banks[38] to allow companies and individuals to transfer funds from A to B in an efficient manner. It is an inefficient drag on the rest of the economy if "artificial" delays in the availability of funds negatively affect the cash flow of companies and individuals, finally impacting on the efficient allocation of capital.

---

[35] Cap Gemini (2005), McKinsey (2005).

[36] Extract of report for the European Commission prepared by Banking Research London, 2001.

[37] See "Frictionless Money - The Future of Money & Payments in an Electronic World", report by Logica plc and Capital Economics, 2000.

[38] A request also repeated in the Commissions' public consultations.

3.4. Lack of efficient competition and a level playing field in the payments market

The extent to which market forces and competition determine levels of efficiency and prices in payment markets is unsatisfactory. Competition between existing players and levels of market entry of new providers are very low.

Numerous complaints[39] and several national and European cases[40] of insufficient competition and anti-competitive behaviour of incumbents in the payments market have led the European competition authority to start a sectoral inquiry in payment services. The concerns relate to 1) competition between banks' as the traditional providers of payment services and 2) the market access and level playing field for new payment service providers entering the market.

The current regulatory situation seems to create a lack of competition in many payment services. Banks often enjoy a privileged competitive position in payment markets and the sometimes existing bank monopoly in payments excludes many innovative new players from providing payment services who want to enter the market. For example merchants pay in markets where there is only one bank providing card payment services fees which are 600 times higher than in other more competitive and less strictly regulated national markets.

Concerning legal requirements for market access, studies undertaken in this context have shown that limiting provision of payment services to fully-fledged credit institutions (i.e. banks) has a negative impact on competition and restricts access more than is necessary for the financial integrity of the payment system. In order to make outside competition work and achieve improved levels of service, in particular in markets with low efficiency and high prices, the often substantial technical and other commercial market entry barriers (e.g. scheme rules) need to be removed. Furthermore specific measures might be needed to allow new entrants to enter the market and be able to compete on a level playing field with banks.

Also the current market framework and the way payment services are provided hardly allow customers to make an informed choice and benefit from the most efficient offer in the Single Market. Users, in particular merchants and businesses complain about the lack of transparency and comparability of payment services. Furthermore, the multilateral fixing of fees between banks and other business and rules have led to vocal complaints of users that these practices inhibits free competition and created a barrier to the well-functioning of the Single Market.

3.5. Fragmented legal framework for payment services

The regulatory framework for electronic payments consists of rules and legislation partly set at the European level, and partly (and in a more detailed fashion) at national level. Although there is an "acquis communautaire" on EU payments legislation, which allows the Single Market to be considered as one single jurisdiction, the present legal framework is regarded as

---

[39] The Commission received numerous complaints from enterprises and citizens on high charges of payment services and a lack of certain products and services.

[40] See various cases of the EU competition authorities (VISA, Mastercard), national competition authorities (BE, DK, IT, NL, UK) and international cases (AU, US) concerning payment service providers in particular in the card payments market. See also various publications by the Reserve Bank of Australia, Reform of Card Schemes in Australia, 1998-2004.

fragmented, overlapping and in some cases contradictory, generating an unsatisfactory situation for all stakeholders[41].

The existing legal framework for payments is to a large extent based on national rules. All Member States have their national "rulebook" governing payment business and services. Its codification differs with regard to the content, level of details or degree of consolidation in one act. This has developed independently in each country and will continue to do so. New legislative developments will notably deal with the appearance of new payment means and methods which may give rise to new legal risks and problems. It is likely that the resulting national legal provisions in Member States will not necessarily converge but further fragment the Single Market, and thereby create conflict of law situations for the Single Market.

The Commission has undertaken studies that have confirmed divergence in national rules[42]. Such national diversity creates obstacles to an efficient Single Payment Market in the Single Market and hinders the integration of the payment infrastructure and further consolidation with a view to lowering the costs of transactions. For instance, the rules relating to the revocation of a payment order differ depending on where the order was placed within the Single Market.

---

41 See also the conclusions of the Financial Services Action Plan, "Financial Services: Implementing the framework for financial markets: Action Plan", COM (1999) 232 of 11 May 1999.

42 Report on cross-border credit transfers (COM (2002) 663 final), the Study on the implementation of Recommendation 97/489/EC and questionnaires on divergent national rules are available at: http://europa.eu.int/comm/internal_market/payments/.

4. RELEVANCE FOR THE EU

Having identified the problem and its underlying causes, it is necessary to verify if it is appropriate to intervene at EU level and whether the EU it is better placed than the Member States to tackle the problem.

The conditions for which are discussed in more detail below.

Firstly, the problem falls under the powers given to the Union[43] to ensure the proper functioning of the Single Market for goods and services which also requires a Single Market for Payments. European citizens and businesses are unable to obtain the full benefits of the Single Market, because of deficiencies in the integration of cross-border and national payment infrastructures and services, limited availability of pan-European payment services (e.g. recurring payments) and lack of interoperable standards allowing different national payment systems and providers to compete and users to use payment instrument without difference to their location in the EU.

The smooth functioning of payment and settlement systems is also a crucial aspect of a sound currency and is essential to the conduct of monetary policy[44]. Payment and settlement systems are a transmission channel for monetary policy and have a significant bearing on the functioning of financial markets. Payments systems are significant contributors to the broader effectiveness and stability of the financial system, in particular to consumer confidence and to the functioning of commerce. These systems are also crucial to the maintenance of banking and financial stability.

Secondly, the problems affecting the Single Payment Market cannot be sufficiently solved by the Member States. The necessary harmonisation of legal rules which provides the basis for the development of efficient EU/euro-zonewide payment services could not be effected by one Member State alone. Co-ordinated action and a common legal framework are necessary to address the deficiencies in the payment market.

To ensure a level playing field and fair competition between providers and also between different payment channels (e.g. cash vs. electronic payments) non-discriminatory legal treatment in the Internal Market should guaranteed. There should not be a difference in the legal treatment of a provider or payment service in country A and country B otherwise there is a risk that this could undermine the free provision of services and the freedom of establishment. Similarly users should enjoy the same high level of protection wherever they are in the Union and without difference to the country of origin of the provider or the payment service.

The creation of a Single European Payment Market is in the interest of Member States as they would benefit from increased efficiency of the payment system and improved competitiveness of enterprises and the economy. A lack of EU action might risk restricting the potential consolidation and integration of payment systems across the EU. To establish a balanced set of norms for the Single Payment Market can be can be better achieved by the Union.

---

[43] EU action is justified where there are barriers to the Single Market and is covered by Article 95(1) of the EC Treaty.

[44] Committee of Payment and Settlement Systems, "Policy issues for central banks in payments", March 2003, Bank for International Settlement.

5. COMMISSION´S OBJECTIVES

On the basis of the problem analysis the following **overall objectives** for the Commission's policy initiative have been defined:

To **create a Single Payments Market** based on Article 95 (1) of the EU Treaty and **increase efficiency** of payment services in the EU.

Modern payment infrastructures contribute to the competitiveness of the EU economy. Only if citizens and businesses are able to transfer money as rapidly, reliably and cheaply from one part of the European Union to another as is now the case within each Member State they can fully benefit from the fundamental principles of the free movement of goods, services, capital and labour.

Reducing the costs of payments and transaction costs for economic actors will improve competitiveness of the EU economy and efficiency of payment services in the EU. The economy needs efficient, consumer-friendly, low-cost and safe payment and billing solutions to foster trade and growth. This is of particular importance for goods and services that are delivered via new technologies such as services and digital content delivered via modern communication technologies.

In order to achieve these ultimate objectives, **three strategic intermediate objective**s have been defined:

1. **Enhanced competition between national markets by opening up markets and ensuring a** level **playing field**

Opening up currently national payment markets for existing and new providers from other EU Member States will increase competition and foster market entry. Increased competition is aimed to provide a healthy framework for a future Single Payments Market. It should promote consolidation of redundant payment infrastructures, improve efficiency through better economies of scale and stimulate innovation.

The operational objectives **in this area are:**

- Operational objective 1 = Removal of legal barriers to market access and a level playing field of prudential requirements for payment service providers
- Operational objective 2 = Increased number of providers and payment services in national payment markets
- Operational objective 3 = Increased cross-border provision of services of existing and new providers
- Operational objective 4 = Reduced number of payment infrastructures due to consolidation

2. **Increased market transparency for both providers and users**

Increased transparency between offers from payment service providers and conditions for payment services will improve consumer protection and facilitate an informed choice. Standardised information requirements make it also easier for providers to offer standardised and fully-automated services across borders. This is expected to contribute to greater variety of services, more competition and improved efficiency.

The operational objectives **in this area are:**

- Operational objective 1 = Consumers will receive standardised conditions for the payment services offered in the market.

- Operational objective 2 = Consumers will be able to compare the key elements of different service offers and benefit from greater transparency on prices and fee calculation methods.

- Operational objective 3 = Providers are able to offer payment services across borders under the same standardised conditions with regard to information requirements.

3. **Standardised** rights **and obligations of providers and users of payment service in the EU, with strong emphasis on a high level of consumer protection**

Standardised rights and obligations of payment service providers and users will help to overcome the current barriers for a unified payment services market. The current legal framework of national rules leads to national fragmentation of markets, a lack of availability of cross-border payment services and standards. The currently fragmented framework also protects national markets from outside competition and is an impediment for cross-border service provision. A uniform basis of core rights and obligations will allow providers to develop EU-wide service propositions. Users will be able to transfer money under the same conditions and with the same ease from one part of the European Union to another.

The operational objectives **in this area are:**

- Operational objective 1 = Users are able to rely on the same conditions wherever they use payment services in the EU

- Operational objective 2 = Providers are able to develop and roll-out payment services for the entire EU market under the same legal conditions

The necessary instrument to help in achieving these intermediate objectives is the creation of a new legal framework for payments in the EU.

The Commission's initiative for an integrated and efficient EU payments market is one of the key actions of the Community Lisbon programme[45] and makes an essential contribution to the Lisbon partnership for growth and employment[46], and is in line with recent EU financial market policy objectives[47].

---

45 COM (2005) 330 and SEC (2005) 981 of 20.7.2005.

46 COM (2005) 24 of 2.2.2005.

47 The proposal for a New Legal Framework for payments in the Single Market is part of the Commission's Financial Services Action Plan (FSAP). See the 6th Progress Report of the FSAP, available at: http://europa.eu.int/comm/internal_market/en/finances/actionplan/.

6. MAIN POLICY OPTIONS TO REACH THE OBJECTIVES

This section is aimed at assessing the different policy options suited to achieve the set objectives. It should also help to assess in the following sections if regulatory intervention is needed, what the impacts are and if the proposed intervention proportionate.

6.1. Type of policy intervention at EU level to create a Single Payment Market

Alternatives

1.	No action at EU level
2.	EU-regulatory policy approach
3.	Market self-regulation
4.	Combination of a new EU legal framework and market self-regulation

(1) No action at EU level

The no-action option means keeping the current fragmented legal framework in the EU which has been one of the main triggers for the confinement of payment services to national borders. It also means not to address the shortcomings identified but leave it to national authorities and market self-regulation by payments industry to achieve a Single Payment Market.

The main benefit of such an option is that there is no need for adaptation of national payments legislation and the costs of change of national payment systems to common EU standards are zero. In most cases national legislation has shaped payment habits and national payment systems have catered to the particular needs of their home markets.

However, this situation has not solved the huge differences in efficiency between national payment markets and has acted as a barrier to competition and for integrating financial markets and is lacking efficient solutions for payments for goods and services in the Single Market. This solution also means keeping the legacy of national legislation making it difficult for providers to overcome and cater for a wider Single Market. The evolution of national legal provisions will not necessarily drive to a convergence, maintaining the legal obstacles to achieve an efficient Single Payment Market and resulting in inefficiencies.

Furthermore market self-regulation and national regimes are not likely to tackle the inexistence of a level playing field across the EU and the lack of a consistent legal framework for an integrated EU payments market. This approach would not provide the necessary trust and legal certainty for market participants.

(2) EU-regulatory policy approach

This option is to solely entrust it to legislation to create a Single Payment Market. Legislation could create a harmonised market framework for payment services in the EU. It could establish the essential rules for the provision of payment services for both the relationship user and provider and between providers.

Regulation could regulate the main rights and obligations of the involved parties, minimum standards for efficiency and security of the payment system. It could also define the necessary

common standards and business rules for the exchange of payments between different systems and across borders. By that it would offer a very cost-effective approach to provide both providers and users with the necessary legal certainty and protection of their rights to contract without difference of their origin.

However, this option does not leave room for self-regulation of industry. It also might be difficult to take into account the complexity and network character of payment systems. It is not enough for the development of comprehensive pan-European payment market that a single provider or user is willing to operate in a single market framework. It takes a large number of market participants to co-ordinate and to agree on terms for acceptance and standards for the operation of pan-European payment system.

(3) Market self-regulation

This option would mean to encourage industry to take appropriate measures for the creation of a Single Payment Market which would result in the removal of technical and commercial barriers including adoption of common standards, development of viable business models for EU-wide payment services and interoperability and consolidation of infrastructures.

The adoption of Regulation (EC) No 2560/2001 has potentially created the necessary incentive[48] for the payment industry to modernise cross-border payment infrastructures. However, there are clear limitations for self-regulation in mastering the challenges of creating a Single Market. A self-regulatory initiative will not be able to overcome existing differences in the legal framework and address the problems of a level playing field for providers and different payment service. It is also unlikely that it will fully remove the barriers to efficient competition in national markets.

Furthermore, the development of common standards and alignment of payment service schemes takes a considerable amount of co-operation between competitors. This makes it rather difficult for self-regulation – without involvement of regulators and the commitment of users – to solve the issue of (binding) adoption of standards and schemes, which is necessary for reaping the benefits of consolidation and improved economies of scale.

(4) Combination of EU legislation and market self-regulation

This option combines the advantages of the previous two options of EU regulation and self-regulation and mostly off-sets their drawbacks if they were to be pursued on a stand-alone basis.

In this scenario EU legislation could establish a coherent and comprehensive EU legal framework for payments, achieving a high degree of consolidation, legal certainty and simplification of legislation. But the regulatory intervention would be much more limited leaving it to industry to solve the issues of standardisation and product harmonisation and establishing rules concerning the relationship between providers.

---

[48] Regulation (EC) No 2560/2001 considerably reduced prices for cross-border payments and obliged payment industry to charge the same prices for cross-border payments in euro as they charge for much more efficient national payments. Until then, market self-regulation was not successful to put the necessary infrastructures in place to allow equally efficient processing of national and cross-border payments.

On the other hand self-regulation could focus on the issues where market-driven solutions are clearly superior such as the definition of specific services targeted to customer needs. In the Single Euro Payments Area project (see detailed description in Annex 3: *The SEPA Project*) the European banking community has committed itself to build efficient infrastructures (pan-European clearing and settlement systems) for the main payment services in the euro currency (credit transfers, direct debits, credit and debit card payments) that could cater to the European market instead of national markets. The EPC adopted a roadmap – subscribing to the vision that all payments in euro should become domestic by end 2010.

This option would allow taking account of the advantages and flexibility of self-regulation to adapt to a fast-moving market and specific needs. It would draw on industries initiative for an SEPA while EU regulation would complement industry's project by taking away legal obstacles for the SEPA project and providing a harmonised framework for an even wider market, the Single Market.

6.2. Type of legal instrument

Alternatives

1. Regulation 2. Directive

(1) Regulation

An EU regulation could contribute considerably to solving problems of legal clarity and simplicity because – since there would be no transposition into 25 national legislations – the risk of diverging national legal texts would be eliminated. Also it seems that payment service providers and users would prefer a directly legally binding instrument.

(2) Directive

A Directive could be a more sensible solution as it would harmonise the main legal rules and remove existing legal barriers but could be transposed into national law taking into account the huge differences in national payments legislation. Member States have expressed a strong preference for this solution.

6.3. Scope of the regulatory intervention

Alternatives

1. General scope of the regulatory intervention: geographical, currency 2. Specific scope of the regulatory intervention: which of the legal barriers identified during the stakeholder consultation should be addressed?

(1) General scope of the regulatory intervention

The choice for the general scope is whether the regulatory intervention should cover all payment services provided in the EU, national and cross-border and in all currencies.

The logic of the Internal Market would suggest that all payment services regardless of the country of origin or currency should be covered by the regulation. Such scope would be justified in order to address the problems identified in both national and cross-border payment systems and markets (see part 3) and to achieve the economies of scale and efficiency gains expected from a consolidation of national (97 % of payments) and cross-border payment systems (3 % of payments). However, the differences between currency areas (e.g. settlement of e.g. dollar payments outside the EU) and level of development of payment infrastructures (e.g. for payments arriving or destined to third countries) would have to be taken into account.

industries SEPA project. This step by step approach would allow focusing first on the efficiency of payments in euro as there progress can be achieved easier and more quickly and maybe at a later stage assess further regulatory steps. However, it would leave potential efficiency gains of consolidated national and cross-border payment systems and an integrated Single Payment Market untouched.

(2) Specific scope of the regulatory intervention

The extensive stakeholder and expert consultations carried out by the Commission highlighted 21 concrete legal obstacles which could potentially be addressed by the regulatory intervention (see list under 2.3.).

On the question which of these 21 obstacles affecting the Single Market for Payments should be tackled in the current proposal a specific impact assessment was made by the Commission with the input of stakeholder consultations which is summarised in the following chapter.

However, for reasons of principle the question of cash and cheques, bank accounts and security of payment systems are considered outside the scope of the regulatory intervention. For detailed discussion of the reasons on the issues which have not been included in the regulatory proposal consult Annex 4: *Issues outside the scope of the regulatory intervention*.

7. EXPECTED IMPACTS FROM THE DIFFERENT OPTIONS IDENTIFIED

This section deals with the expected economic and social impacts of the different policy options and considers the risks and uncertainties in the policy choices. A detailed discussion of the impact on stakeholders can be found in Annex 7: *Distribution of impacts among stakeholders and cost-benefit analysis*.

7.1. Impacts of the alternative types of policy intervention

Based on an in-depth analysis of the current barriers for a Single Market (see part Problem definition) five problem areas are clearly identifiable affecting 1) the relationship between users and providers and 2) the relations between providers:

(1) Inefficient use of payment services caused by distortions in the price and legal framework

(2) Deficiencies in pan-European payment infrastructures and services

(3) Large differences in the efficiency of payment services in the Single Market

(4) Lack of efficient competition and a level playing field in the payments market

(5) Lack of a coherent legal framework for payments

Which of the five problem areas are best addressed by market self-regulation and which should be in the scope of the regulatory intervention, if any action is taken at all?

The matrix on the different policy options below summarises the advantages and drawbacks of each of the options.

	Advantages	Drawbacks
No action	• No change cost for national and cross-border payment systems but high opportunity costs • No change in the legal framework, therefore no compliance and adaptation cost • Maintains 'competitive' advantage for some players in protected markets • No risk of change for market participants	• Maintains inefficiency of national markets and national and cross-border payment systems and is unlikely to create a Single Market • Complicates trade in the EU through the lack of efficient EU-wide payment systems • The legal framework and the market for payment services remain complex and non-transparent • Delays restructuring and improved competitiveness of the financial sector • Maintains distortions in competition • Users in high-margin low efficiency markets will pay the price for the fragmentation • Corporate/merchants suffer from not integrated, non-standardised and uncompetitive payments

EU regulatory approach	• Simplifies and provides EU-market with a consistent and harmonised legal framework • Facilitates restructuring and improved competitiveness of the financial sector and economy. • Sets the framework for the development of pan-European payment services including efficient cross-border payments by setting standards, harmonising rights amongst providers and between providers and users, defining the business rules of schemes and infrastructures • Eliminates distortions in competition reduces inequalities between providers creating a level playing field • Improves market transparency	• To rely solely on regulation to solve the problems of the Single Payment Market might entail the risk of overregulation, stifling innovation and resulting in not market conform solutions • Cost for legal compliance of providers would potentially be higher if a Single Market should be established solely by regulation • Cost of possible accompanying measures for restructuring payment service contracts, service propositions and payment systems
Market self-regulation	• Market self-regulation (consolidation, streamlining payment services and adopting common standards) would improve competitiveness of the financial sector • Integration of national and cross-border payment systems would facilitate trade and greatly benefit users of payment services • Cross-border payment service provision would have beneficial effects on less efficient national markets • Consolidation of redundant infrastructures and improved efficiency of services reduces total cost of the payment system • Common standards and streamlining of payment services leads to improved economies of scale and more efficiency	• Legal barriers for Single Market and uncertainty over legal framework would remain • Risk of self-regulatory initiative to fail due to strong vested national interests opposing change and opening up the market • Investment cost of measures for restructuring of payment systems for providers and corporate users • Common standards and streamlining of payment services might lead to disappearance of some national well established services in exchange for common services with lower service levels • Price convergence might not point downwards after integration which will disappoint users and would not be e beneficial outcome for the Single Market • In a Single Market (some) national systems might no longer be competitive which poses a threat to their providers • Profitability of some non-competitive traditional providers is threatened by market consolidation and increased competition

EU regulation + self-regulation	• Competitiveness of the financial sector and the economy is improved in the long term at the potentially lowest regulatory cost. • Provides legal certainty through a consistent legal framework for the whole EU market and greatly simplifies the single market • Reduces in the midterm legal compliance costs for provider and users • Common standards and streamlining of payment services leads to improved economies of scale and more efficiency • Facilitates the development of pan-European payment services including efficient cross-border payments and the consolidation of infrastructures through self-regulation • Distortions in the selection process of payment services are reduced. • Eliminates distortions in competition, reduces inequalities between providers creating a level playing field • Might foster market entry of new and alternative providers • Improves market transparency • Integration of national and cross-border payment systems would facilitate trade and greatly benefit users of payment services	• The drawbacks of the specific options can be very much limited and counterbalanced through the combination of EU-regulation and self-regulation • Cost for legal compliance of providers and users very limited because only a core set of harmonised rules • Investment cost of measures for restructuring of payment systems for providers and corporate users are off-set in the long-term through high potential for improved efficiency • Risk of 'lower service levels' limited due to minimum standards for efficiency, liability etc. are defined in the regulatory framework and a benchmark set for industry self-regulation • Price convergence in the long-term should point downwards if regulation ensures that the market follows fair competition • (Some) national systems might no longer be competitive and profitability of some non-competitive providers is threatened by market consolidation and increased competition

According to the above analysis and the advantages of the different policy options it seems that for problem areas (1), (2), and (3) a strong role of market self-regulation is clearly desirable to create modern, cheap and efficient pan-European payment services and infrastructures. Industry's proposal for the creation of SEPA is focussing on solving the market co-ordination problems in area (1), (2), and (3) as far as relations amongst providers are concerned. It will address in particular the need for common technical standards for payments, service agreements between providers and infrastructure requirements.

What industries proposal will not address in problem area (1)–(3) are rights and obligations in the relationship between providers and users, including adequate protection of users and minimum standards for efficiency of all payments in the EU. Therefore, as a complement to industry's initiative, the regulator should set out the necessary incentives for the development of competitive, time and cost efficient EU payment services and provide a coherent legal framework, which guarantees legal certainty for market participants and adequate protection for users.

Based on the scope and depending on the success of industry delivering on its roadmap for SEPA, the Commission believe that for the moment regulation can be restricted to the definition of general principles, applicable to all payment services in a non-discriminatory way, based on which there should be no barriers to make payments as easily, safely, efficiently and inexpensively as within national borders.

In the problem areas (4) and (5) the role of the regulator is clearly predominant. The assumption that market forces will create the necessary infrastructure can only work if market forces function efficiently. That means that e.g. conditions for market access in the Single Market are the same, providers can compete on a level playing field, good governance and

non-discriminatory access are respected in payment infrastructures, technical market entry barriers are removed, conditions for payment services are transparent to the user so he can make an informed choice and preferences are shaped by economic rationality.

The Commission considers that for the moment it is not necessary to intervene directly in the relationship between providers and relevant arrangements on technical standards and infrastructures. There is certainly a market co-ordination problem but industry will address this problem in its SEPA program. Therefore, at the current point in time, the Commission considers it not necessary to mandate a specific standard or rules for payment schemes and the setup of the payment system. As long as there is no obvious market failure, market forces shall determine the design and success of schemes and the consolidation of infrastructures.

Following the limitation of regulation to aspects of the relationship between provider and user, leaving aside the relationships between providers the current proposal does not solve problems of competition in the infrastructure area and problems based on the lack of interoperable standards – which industry has taken on responsibility to solve. The regulatory intervention in this case would only have an indirect impact on the relationship between providers. Incentives for competition are reflected in price signals and customer behaviour in the immediate market but not in the rest of the value chain. Therefore the functioning of market forces and price signals are of crucial importance. That means interference in transmission mechanisms such as distortion of real costs and prices of payment services or a lack of transparency have an important impact on the efficient functioning of the market.

In this scenario strong monitoring of results of the interplay of regulation and self-regulation and to what extent it benefits EU citizens and businesses is necessary. While the Commission is convinced of the advantages of self-regulation it will continue to study the efficient functioning of incentives for market forces to govern pricing, for providers to innovate and reduce the macroeconomic costs of the payment system and for technical and organisational barriers to market access to be removed. If monitoring should confirm market failures in these respects the Commission will not hesitate to propose binding legislation.

7.2. Impacts of the choice of legal instrument

The analysis of impacts of the choice of legal instrument is trying to assess the likely consequences of each option.

	Legal certainty	Timeliness	Impact on stakeholders	Subsidiarity, proportionality	Financial cost
Regulation	√√√	√√√√	√√√√	√	√
Directive	√√	√√	√√√	√√√√	√

A Regulation could contribute considerably to solve the problems of legal clarity and simplicity since there would be no transposition into 25 national legislations consequently the risk of diverging national legal rules would be eliminated. Also it would be the swiftest solution as there is no transposition necessary. Also a regulation was requested by part of the market. Notably payment service providers have a strong interest in knowing conclusively the comprehensive list of essential, necessary and sufficient legal requirements in order to comply and act under conditions of legal certainty. A Regulation would certainly be suited to ensure the elimination of legal barriers to the development of pan-European payment services.

However such an instrument could not take into account the differences in Member States legal systems. The interaction of a Regulation with the host of national rules that were to be left untouched could create problems.

A Directive could be a more sensible solution as it would harmonise the main legal rules and remove existing legal barriers but could be transposed into national law taking into account the huge differences in national payments legislation. This seems to be a very important point given the great differences between payment markets, infrastructures and payment habits in Member States which are largely due to the legacy of national legislation. Often there exist different legal acts for the regulation of different types of payment services and payment service providers. For this background, most Member States argued that a directly applicable EU legal instrument such as a regulation could pose problems when interfacing with the trunk of national rules.

Alternatives: Full harmonisation versus minimum harmonisation

According to stakeholder consultations legal certainty and subsidiarity are the two most important aspects concerning the choice of legal instrument. Therefore a key question is if the issues identified for regulation should be fully harmonised or if minimum harmonisation is better to meet stakeholder requirements.

Today, diverging national rules prevent the economic rollout of pan-European payment services, as providers might have to adapt important aspects of their statute and their services to national rules, potentially the interrupting provision and full automation of services. Payment service providers would clearly benefit from the legal certainty that full harmonised EU legislation could provide, as they do not have the uncertainty that host Member States may evaluate the level of protection of their statute or services and find them not to be equivalent to their own or they may simply have contradictory legal requirements than the home Member State. In the same way users would enjoy the same familiar level of protection when using payment services from other Member States as they do in their own State. Even if mutual recognition, based on a high level of harmonised rules, would protect users and providers from some of the detrimental effects, it would not allow to reap the benefits of market consolidation and competition which potentially take place in an Single Market with the same rules and a level playing field for providers and users. Full harmonisation would certainly be an efficient means for achieving a well-functioning Single Market because it creates a simple, coherent framework to the benefit of the industry and consumers.

On the other hand, minimum harmonisation based on the home country principle combined with mutual recognition of legislative provisions can facilitate the offer of greater choice of services to the benefit of consumers but does not alleviate the problems of fragmentation of markets and legal environment.

7.3. Impact of the potential scope of the regulatory intervention

Identifying the most important impacts of the general scope for the regulatory intervention can be done very quickly and an overview can be found below:

Covering all payment services provided in the EU, national and cross-border	Pro: The economies of a Single Payment Market lay in the consolidation of national payment systems, touching not only the 3 % of cross-border payments but improving efficiency of all 56 000 million/year payments in EU including 97 % of national payments. To restrict the scope to cross-border or intra-EU payments only would jeopardise the smooth functioning of the Single Market as a whole and would further fragment the market along national borders. The EU is the biggest trading block in the world and has huge numbers of payments flowing in and out of the EU. For the part of these payment services, which are provided by EU service providers to EU citizens and businesses, users need legal certainty when making or receiving a payment to or from a party outside the EU. Also EU citizens travel extensively outside the EU and expect to be protected by the same rules governing their contract with the payment service provider in the EU, even when they use their e.g. credit cards outside the EU. Contra: The disadvantages from such a wide scope are that all payment services and system will have to adapt to the new EU rules, even if they only cater for a purely national payment clientele.
Scope excluding payment services in non-EU currencies	Pro: Payment systems in the EU are currently fragmented along former and existing currency areas. Former national payment systems, dealing with payments in the Member State's currency should migrate into pan-euro payment systems – processing national and cross-border payments. Consequently a new legal framework for a Single Payment Market should provide for all payments no matter which currency and if they are national or cross-border. Contra: Payment industry but will focus in their SEPA project on euro payments only. Its view is that economies of scale and technical complexities currently do not merit the development of separate infrastructures for cross-border payments in non-euro currencies. But it is expected that following the enlargement of the euro area these non-euro payments would migrate into the soon to be created euro infrastructures. The payment industry also voiced concern about a second point: that the proposal could cover all currencies and all transactions including those in non-EU currencies and where only either the payer or the payee are located in the EU. In such cases where for instance the payment service provider is strictly liable for the execution of a payment transaction they are concerned about potentially higher costs which have ultimately to be borne by the user. Therefore the industry would like to see the scope of regulation restricted to EU currency payments carried out inside the Single Market.

Specific scope of the regulatory intervention:

This section is dedicated to the question which of the legal barriers identified during stakeholder consultation should be addressed in the scope of the regulatory intervention and in what way. The Communication of December 2003 concerning a New Legal Framework for Payments in the Single Market identified 21 concrete legal obstacles and possible solutions out of which 7 where discarded as being outside of the scope of the regulatory intervention (see Annex 4: *Issues outside the scope of the regulatory intervention*). An assessment of the

other 14 legal barriers and the ways in which they could potentially be addressed in the regulatory intervention sometimes has significant impacts and therefore a more detailed discussion and analysis of each of the policy elements and potential impacts was carried out and can be found summarised in three chapters in Annex 5: *Prudential requirements* and in Annex 6: *Core rights and obligations of providers and users*. An overview of the impacts of the different policy options in the three mean areas of regulatory intervention can be found below.

7.3.1. Market access requirements for payment service providers

Alternatives

1. Keep status quo of nationally fragmented market access requirements
2. Harmonisation of market access requirements for non-credit institution payment service providers and introduction of a specific license for payment institutions

(1) Keep status quo

At present it is very difficult for payment service providers who operate legally in countries without a licensing requirement to gain access to the markets of Member States which insist, for prudential reasons, on a licence. Undertakings, which are not credit institutions but provide payment services are subject to very different legal requirements from one Member State to another. The same activity undertaken by such a payment service provider may need a licence as a credit institution in country A, an e-money licence in country B, a special license in country C and is considered as an unregulated activity in country D. In more than half of the Member States the payment services that have been included in the draft Directive for the scope of business of the new license for payment institutions, have not been regulated in the past or the providers would need only simple registration to provide these services.

The second reason for reassessing the status quo is the lack of competition in payments markets. Several payments market are currently characterised by substantial barriers to market entry. Fragmented market access requirements distort competition leading to high prices for consumers and high profits for dominating providers in national markets and lower levels of innovation. To foster competition deregulation of the market and improved access to the provision of payment services and participation in payment systems (former “banks only” infrastructures) are needed.

Under the new Special Recommendation VI of the OECD Financial Action Task Force (FATF), in order to combat terrorist financing and money laundering, each payment service provider must in future be registered or licensed. Several such money transmitters and other newcomers (e.g. telecommunication operators) have complained that meeting the requirements under a banking licence – designed for the full range of banking activities – is too expensive and burdensome for simple payment service providers and is disproportionate given the reduced risks of such an activity.

This situation would potentially be further severed by a different transposition by Member States of Special Recommendation VI on the establishment of a registration or licensing regime for money remitters. In case the Commission takes no initiative for the licensing of money remittance, each Member State will keep or create its own regime: State A considers that this activity needs a banking license, State B only a simple registration. Although a

company registered in State B may benefit theoretically from the EC Treaty right to provide this service[49] also in State A, it is practically faced with huge difficulties to legally provide payment services in State A. The Commission has received several complaints about this situation from money remitters and other potentially affected payment service providers.

The differentiation of market access conditions between Member States is detrimental to the functioning of the Single Market. The regulatory status quo produces a situation that results in overregulation in some areas and problems of unregulated activities in others and a missing level playing field. The Single Market principle of the free provision of services, including payment services is currently insufficiently realised in the EU as there is no clarity on the freedom to provide payment service, except for those undertakings which provide these services with a credit institution or an electronic money institution license[50].

According to the EC Treaty rules (Article 49) on the freedom to provide services in the Single Market, a legally exercised activity in one Member State can ipso facto be legally exercised in other Member States, except if the general interest justifies the contrary. However, to apply the mutual recognition principle on the basis of the general provisions of the Treaty without establishing harmonised minimum requirements for payment services might bear the risk of disputes before the European Court of Justice. Mutual recognition might be easier to achieve by establishing an EU-passport regime based on harmonised licensing or registration requirements, for payment service providers.

(2) Harmonisation of market access requirements for non-credit institution payment service providers and introduction of a specific license for payment institutions

The EU could harmonise the licensing requirements for payment service providers. For this purpose it would create, in addition to the credit institution and the e-money institution license, a specific license for all other non-bank payment service providers. This specific license for payment institutions would create the basis for more competition in national markets based on a passport regime within the Single Market. It would also transpose OECD Special Recommendation SR VI and address the issues related to money laundering and terrorist financing.

The European licensing regime for payment service providers would be based on a hierarchy of the level of risk of the payment service provided.

According to this methodology in the future, there would exist four different types of providers who can all offer payment services but are subject different levels of prudential requirements proportionate to the level of risk they pose: (i) providers who use deposits to fund payment transactions will continue to be subject to the existing prudential requirements for credit institutions (ii) providers who use e-money to fund payment transactions will continue to be subject to the existing prudential requirements for electronic money institutions (iii) providers for all other payment services that do not involve deposits or issuance of electronic money would be subject to the new low risk category of payment institutions (iv)

---

[49] And a proportionality test may result in establishing that – under the Single Market principles – a payment service provider who wishes to undertake cross-border money transmission would be able to do so.

[50] Payment service providers with a credit institution or e-money license benefit from a European passport established by Directives 2000/12/EC and 2000/46/EC, based on minimum harmonisation and mutual recognition.

post giro institutions authorised in accordance with their statute and applicable legislation to provide payment services.

The new low-risk category of payment institutions should embrace in general non-credit institution providers, providing payment services, which is not connected to deposit taking or e-money issuing. The primarily intended services that could be provided by such institutions comprise: money remittance services, payment services based on a credit line such as debit, deferred debit or credit card payment services, issuing payment cards, acquiring services for payment transactions.

This new licensing regime would also reflect market developments in recent years, that were closely related to the boost in information technologies, triggering the development of innovative products and market entry of a new generation of providers very often from the non-bank sector such as telecom operators, money remitters, card issuers and acquirers, payment aggregators, electronic billing and payment providers, micro payment providers and alike.

This option has the positive effects of harmonising the regulatory regime for payment service providers in the EU and of creating a level playing field for all providers.

Discussion (for more detailed analysis consult the relevant chapter in Annex 5: Prudential requirements)

The new category of payment service providers apart from credit institutions and e-money institutions is not connected to deposit taking or e-money issuing activities. The services that can be provided by payment institutions comprise amongst other ancillary activities, money remittance services, payment services based on a credit line such as debit, deferred debit or credit payment services, issuing payment cards, acquiring services and issuing of guarantees for payment transactions. These are ordinary payment services which despite their importance for the provision of payment services are not ‘systemically important’: the failure of such a payment service provider does not trigger disruptions or transmit shocks across the financial system.

Member States that currently have a regulatory regime, with prudential requirements for payment service providers different from those for credit institutions following the abovementioned reasoning; have in fact not had any history of bankruptcy in the sector, have a higher number of non-credit institutions providers and new market entrants and have consequently experienced an increase stimulus for competition to the benefit of users.

Therefore it might be concluded that a new regulatory regime for payment institutions different from those for credit institutions does not pose a threat to financial stability. The risks involved in the provision of payment services outside of those accompanying deposit taking and the issuing of e-money could be reflected in a risk appropriate regulatory regime. Providing a level playing field means treating the same risks in the same way. Prudential requirements should be proportionate to risks and should not overburden smaller providers and new entrants to the market, which are not primary financial service providers. In particular quantitative solvency requirements, such as capital charges, similar to the ones applied to credit institutions seem to be disproportionate to the risk and are inappropriate for the services concerned.

After consideration and discussions with Member States and the payments industry, in particular with the providers concerned and following in-depth assessment of their business models a well calibrated regulatory regime seems to provide the most appropriate policy option to address the above discussed issues. The new regulatory regime should take into account the various risks of this new category of payment institutions and should promote competition and efficiency without compromising the safety of the payment system.

As a principle the new category of payment institutions should not be entitled to provide payment services that would involve the taking of deposits. Consequently the financial risks for the payment services in question are much lower than for payment and deposit facilities provided by regular credit institutions. The remaining risks concern the financial and non-financial risks of the activities of payment institutions such as money remittance services, issuing and acquiring services or mobile payment services.

The proposed regulatory regime should take account of the identified operational and financial risks of payment institutions and should oblige the provider to fulfil a well-calibrated set of qualitative prudential requirements. A payment institution should be subject to ongoing prudential supervision and should be obliged to fulfil qualitative prudential requirements: in particular the proof of sufficient and adequate resources to run sound business operations including the provision of a business plan, sound administrative, accounting and internal control procedures and segregation of accounts. Other qualitative prudential requirements relate for example to the quality of the management, security and quality of IT systems and full responsibility for tied agents or other outsourced parts of the payments undertaking. Also payment institutions should be subject to the full range of anti-money laundering and terrorist financing rules in place for financial institutions. These rules are similar those of credit institutions and in some cases more detailed to account of the specific circumstances of payment service providers.

Quantitative prudential rules should not be foreseen. For payment institutions qualitative requirements seem to be more appropriate. In evaluations and consultations the Commission has considered different designs and levels for the prudential requirements: Any request that a payment service provider should be subject to the same quantitative capital requirements as a credit institution is on its own very difficult to defend. This is not only because credit institutions' capital requirements are determined by a fundamentally different business model with often complex risks that arise in connection with deposit taking and engagement in various financial activities. Also the operational risk model used for BASEL II solvency requirements is not adequate for the particular risk profile of payment institutions. According to BASEL II the operational risk for credit institutions stemming from payment and settlement services merits an 18 % capital charge for credit institutions. This 18 % capital charge has been developed on the basis of a modelling exercise of the data collected by the BASEL Committee. The data collected are referring to the losses of average size credit institutions engaged in various kinds of payment and settlement systems and services. This loss record is of no relevance for the financial soundness and particular risk profile of payment institutions. Also there is no comparable history of bankruptcy in the non-credit institution payment sector, no evidence of high risks that are not effectively managed and no loss data of these providers available that would suggest the application of operational risk or credit risk charges.

Finally there are no depositors to protect and payment services users would in the future – following adoption of the EU proposal – enjoy the same high level of protection no matter if they have a contract with a credit or payment institution. According to the proposal users

would benefit from a clear liabilities regime of payment service providers for the successful and effective execution of payments but also enable the users to have a clear understanding of the financial risks they incurs through participation in a payment system.

Assessment of the cost-effectiveness of regulatory measures

The discussed regulatory measures aim at global objectives such as the fight against money laundering and terrorist financing or stimulation of competition and may create both advantages and disadvantages for various addressees. Such disadvantages may very well constitute additional 'costs' to some addressees. The below table presents the most typical types of cost that may result from the discussed policies containing spending as well as non-spending elements, both at the level of the body or bodies implementing the measure and its addressees.

Type of cost	Body or bodies involved in the implementation of the measure	Addressees
Budgetary cost	No direct financial outlays from the EU budget or other public funds.	Not applicable
Transaction cost	Member States will face costs associated with implementing monitoring and enforcing the regulation.	Costs might be incurred by the new category of payment service providers ('payment institutions) in identifying and selecting the most appropriate compliance route.
Compliance cost	Not applicable	Direct costs incurred by payment service providers who chose to apply for a payment institution license in order to comply with the regulation, including administrative cost and opportunity costs.
Adjustment cost	Not applicable	The costs for new payment service providers with a payment institution license for reallocating resources because of policy induced changes in behaviour (concerning compliance of the payment service provided and related questions concerning the system and procedures).

7.3.2. Transparency of conditions and customer information requirements

Alternatives

1.	Market self-regulation
2.	Keep divergent national regimes
3.	Standardised transparency and information requirements at EU level

(1) Self-regulation

According to some views from the banking industry, it would be difficult and not desirable to cover the diversity of payment services with one standard set of information requirements and concluded that the new information requirements should focus on general principles and more detailed information provision could be left to self-regulation, such as a code of conduct.

However, this view is not shared by the majority of banks represented in the European Payments Council. They would prefer EU legislation fully harmonising all national information requirements, so that there is only one set of rules which providers have to comply with because the legacy of national and EU information provisions would potentially fail any self-regulatory attempt.

The argument that transparency on conditions for payment services can only be achieved if information is provided in a maximal standardised and user-friendly way was also strongly advocated by user associations. Another problem with market self-regulation is the currently low levels of compliance with consumer information requirements. It is felt that self-regulation of industry would not yield the desired results in terms of improved transparency and better customer information.

(2) Keep divergent national regimes

The advantage of national rules is that they take into account country specific payment services and payment habits. National rules on transparency and information requirements served the payments market well as long as cross-border payments and the Single Market did not play an important role.

With the creation of the Single Market and furthermore with the introduction of the euro it becomes a necessity to harmonise the divergent ways in which Member States have sought to provide for consumer protection to ensure that customers benefit also from the increased competition of market integration. In the particular case of payment services, national rules which maintain national differences, hinder cross border payments and prevent the roll out of more efficient pan-European payment services and systems.

(3) Standardised requirements

Standardised requirements for the entire EU will allow consumers and providers to benefit from a single set of rules. To harmonise the essential information requirements at EU level would facilitate the supply of payment services across the Single Market and reduce compliance costs for payment services providers. Improved transparency for all payment services provided in the EU will also increase competition and create a level playing field.

Users will be able to rely on a standardised way throughout the EU of how conditions are presented and will be able to make an informed choice from a variety of offers.

Discussion

Awareness is a crucial element of consumer protection and transparency enhances competition in payment services. The payment service user needs to have clear information about the payment service which he wants to use, and/or which has been provided to him. Transparency is a prerequisite in order to be able to compare different offers on the market, to decide on the conclusion of the contract with full knowledge of its terms and conditions, and to be in a better position to understand the service provided. The payment service users should have the same high level of essential (necessary and sufficient) information wherever he buys or uses a payment service in the Single Market.

As far as consumer confidence is concerned, regulatory efforts can clearly help to improve the situation. Harmonisation of legal rules on customer information requirements concerning a payment service contract is believed to contribute to informed customer choice and to strengthen competition between different payment service offers.

Furthermore a single set of requirements allow providers to develop pan-European business models with a high level of standardisation that can be offered across borders under conditions of legal certainty. Keeping the current fragmentation of legal rules on customer information requirements would not allow reaping the significant economic benefits of market integration for both consumers and providers (e.g. greater choice of goods and services as a result of increased competition on merit rather than national origin; lower prices and improved quality of services). It is important that Single Payment Market policies are designed in such a way as to ensure that these benefits are realised in practise.

Assessment of the cost-effectiveness of regulatory measures

1. Basic cost-effectiveness of regulatory measures

The cost impacts of regulatory measures are mainly the adjustment costs for providers from national regimes to standardised EU requirements. However, the total compliance costs for providers will substantially decrease, instead of 25 regimes they will have to comply with only 1 set of rules in the future. Furthermore the adjustment cost for providers are spread out over a period of at least 2 years, in which in any case regular changes to the conditions and customer information provided are made. The standardised requirements also foresee that the full set of information has to be provided only once at the start of a contract.

2. Improved cost-effectiveness achieved by fine-tuning of regulatory measures

In order to further reduce the burden of information provision, different cases could be distinguished and the information needed by users could be adjusted to the particular situation:
a) Framework contracts: For example the customer wants to get a payment card and other payment services from his bank. In this case he should receive the necessary information about the conditions for using a payment service and should be informed about key rights and obligations. For later payment transactions, covered by the framework contract, providers only need to provide a minimal set of key information items on the particular transaction.
b) Contract for a single payment transactions: typically the case for money remittance transactions. In this case a limited set of information items such as key conditions, rights and obligations concerning that particular transaction need to be provided.

3. Further improved cost-effectiveness through proportionality test of rules

Case: Micropayments[1] are means for transferring money in situations where collecting money with the usual payment systems is impractical or very expensive because of the small amounts collected. Micropayments have to be suitable for the sale of non-tangible goods over the Internet such as digital content or information services. This imposes tough requirements on speed and cost of processing of payments as delivery of services occurs nearly instantaneously and often in arbitrarily small pieces. With the rising importance of intangible (e.g. information) goods in global economies "conventional" payment methods tend to be more expensive than the actual product. On the other hand, billing for small portions of a product or service reduces the need for security[1]. In this case a light-tough information regime which summarises the key information for the user but does not overburden these innovative systems which often rely on a fully automated environment (e.g. micro payments via mobile phone) does strike the right balance between information needs and cost-effectiveness.

7.3.3. Rights and obligations of users and providers

Alternatives

1. Market self-regulation
2. Keep divergent national regimes
3. Standardise core rights of providers and user and establish a minimum standard for efficiency in EU legislation

The starting point for the assessment of social and economic impacts of these alternatives was the need articulated by stakeholders to provide legal certainty to providers so that they could set up cost-efficient, fully automated straight-through processing of payment services without fear that efficient operation would be hampered by legal disputes. The also asked for the removal of obstacles (caused by mistrust) to the further use of cheap and efficient means of payments and in addition measures to enhance the trust of users in remote or electronic payments in order to push back the use of cash. Finally it was recognised that a common minimum standard of efficiency of the core features (e.g. execution time) of payments services which are essential for a well-functioning of modern economy should also be established by rules.

In order to fulfil these objectives and with the help of stakeholders the following areas were identified where rules were considered necessary:

– Certainty over the conditions for the authorisation of a payment transaction and responsibilities of the parties in case of unauthorised transactions e.g. as a consequence of fraud, loss or misappropriation of a payment verification instrument (e.g. card)

– Conditions for the revocability of payment orders and certainty about the point in time the provider has accepted an order

– Certainty about the execution of the full amount of a payment transaction and liability of the payments service provider for the correct execution of a payment transaction,

– Clarity about levying of fees for a payment transaction and certainty and clarity about the availability of funds and value dating

– Maximum execution times

– Rules on dispute settlement mechanisms

Following this, the question arose how to best address those issues and establish a set of transparent and common rules.

(1) Market self-regulation

Certainly market self-regulation can and must play a role in the definition of common rules. However, this will usually focus on the development of products and payment services and definition of rights and obligations of the parties involved, in particular in the interbank relationship. These rules are certainly driven by the market and commercial interests of the players setting the rules.

It is therefore rather unlikely that those rules can provide for the interests of all parties in the market and form a common, fair and transparent framework balancing the interests of all actors.

Also there are already legislative rules in place in several or all of the Member States in the areas identified during stakeholder consultations. In this case self-regulation is not a viable option for establishing common rules for the whole of the Internal Market and can only play a secondary role once such rules have been established.

Thus regulation does not necessarily need to be exclusive but could be complemented by self-regulation in particular where the market requests a product or service and industry develops a viable service proposition and defines the necessary standards and rules for that.

(2) Keep divergent national regimes

National legislation could certainly provide the legal framework for a purely local market or aspect that only concern local market practices which are of no relevance to the common market and do not form unproportionate barriers for market entry of foreign providers and services.

Historically, development of payment services aimed at local markets and extensive national legislation on payment services can be found in most Member States. However, it seems today that those rules are too fragmented or go too far with the result that national rules create substantial barriers for the establishment of a genuine Single Payment Market.

Subsidiarity and proportionality principles rule out a 'maximalist' approach in which all national rules are abolished in exchange for EU legislation. It is necessary to apply a subsidiarity and proportionality test in all areas.

Only areas which can be identified as having transnational character and where common rules create value-added they should be considered for EU action. The extensive consultation with Member States and stakeholders served the purpose of identifying issues which fit those criteria. In the consultation the above issues where identified by stakeholders for EU legislation.

(3) Standardise core rights of providers and user and establish a minimum standard for efficiency in EU legislation

The EU has the responsibility under the Treaty for the removal of barriers to and creation of a Single Market.

EU legislation is certainly one efficient way to achieve harmonisation of the legal framework for payment services in the Single Market. However, EU legislation should only address

issues which are in the common interest for the economy, citizens and enterprises, where there is a clear market failure or self-regulation seems not suitable and national legislation cannot or only insufficiently fulfil the same objectives.

Stakeholder consultation confirmed the need for EU action on the issues listed above. An in-depth impact assessment (see annexes) and consultation of industry, users, Member States, central banks and experts helped to define rules which are proportionate to the problems and leave room for market self-regulation and take into account existing national legislation.

Assessment of the cost-effectiveness of regulatory measures

The types of cost identified occur in the context of EU legislation, which is targeted towards clearly identified problem areas and aims at balancing the interests of the addressees realising the maximum benefit for society and the economy.

Certainly not always all addressees of a measure will necessarily ‘benefit’ from it. As legislation aims at global objectives (see chapter 5), and may create both advantages and disadvantages for various addressees. Such disadvantages may very well constitute additional ‘costs’ to some addressees.

The table below presents the aggregated cost and benefits that may result from legislation on EU level. The impact assessment for individual stakeholder groups and cost-benefit analysis on the detailed level of each proposed rules can be found in Annex 7: *Distribution of impacts among stakeholders and cost-benefit analysis*.

Addressees and bodies implementing the measure	**Cost and benefits of common rules in EU legislation**
Payment services providers at national scale:	Providers at national scale will have to bear with some implementation costs to adapt their systems to the new requirements of a new legal framework. These implementation costs will vary depending on the current regulation of the Member States where they are settled. Transparency and price comparability will give an opportunity for most efficient providers to improve their market position. The least efficient systems and providers will have to adapt their systems resulting in costs to upgrade their system to the efficiency benchmarks of this Directive. National providers will benefit from the increase in the number of transactions due to a higher confidence in payment systems, and the economies of scale due to infrastructure consolidation.
Pan-European Providers:	The existence of a new legal framework common for the whole EU will help in the creation of SEPA and allow providers to operate in a true pan-European market. Providers will benefit from a lower regulatory burden and more legal certainty. They will only have to comply with a single set of rules instead of 25, reducing dramatically their compliance costs. They will benefit from the possibility to provide payment services within the European Union. The consolidation of infrastructures will help in achieving a critical mass to take advantage of the large economies of scale presented in this market.

Payment service users	Businesses, commerce and final consumers are the greatest beneficiaries of the proposal. Users in general will benefit from more competition in the provision of payment services, improved transparency and legal certainty due to the existence of a common legal framework in the EU. They will have access to a wider choice of cheap, efficient and reliable pan-European payment services. They will benefit from the same level of protection wherever they use a payment service all around the EU. Some of the risks that in the past were borne by the user will be made transparent and shifted to providers. This implies that users can not only make a more rational choice on the real costs of a transaction, but that these costs will be reduced through increased competition, economies of scales and reduction in compliance costs. A higher number of transactions due to a consolidation of payment systems and an increase in the confidence of consumers in payment systems will potentially reduce prices. Instead of having to bear the non-transparent risk cost for the unreliability of the payment system in the future payees can choose providers in a rational way, taking into account the risk cost of certain payments.
Member States/Administrations	The establishment of common rules for the provision and use of payment services will improve overall efficiency of the payment system and foster competition in a market that has been suffering from a lack of competition in the past. The expected increase in cost for Member States will be limited to costs for transposition of rules and monitoring compliance of providers and users. There is no directly budget relevant cost for Member States.
Society at large:	Society at large will not be faced with any increase in costs but will benefit from the huge potential for cost reduction in the payment system over the next years. The current costs of the payment system range between 2–3 % and could be substantially lowered by consolidation of national and cross-border payment infrastructures, better economies of scale and more competition on a European level.

8. COMPARISON OF THE OPTIONS IDENTIFIED

8.1. Reasons for the proposed intervention

8.1.1. Type of policy intervention

The Commission analysed what type of policy intervention is necessary and appropriate to achieve the stated objectives:

	Effectiveness	Efficiency	Consistency
No action	No achievement of policy objectives	No resources needed (though high opportunity costs through not realised efficiency gains)	Negative social and economic impact
EU regulation	Achievement of specific objectives (1)–(3). However, ultimate objective of a more efficiency and a Single Payment Market can only be facilitated.	Regulatory and administrative resources needed to achieve impact level. Legal compliance costs for stakeholders.	Positive economic and social impacts through the streamlining of the legal framework. Potentially unintended impacts in areas where regulation intervenes strongly in innovation and market developments
Self-regulation	Achievement of ultimate policy objective only partially. Specific policy objectives (1)–(3) are either impossible or are unlikely to be met	Resources/Investments needed for the integration of payment systems and migration to achieve efficiency gains.	Positive economic impacts though limited by fragmented legal and market framework.
EU-regulation + self-regulation	Highest potential to achieve ultimate and all specific policy objectives.	Regulatory and administrative resources as well as investments needed to achieve maximum efficiency gains.	Good balance of economic and social impacts

Discussion and chosen alternative

The Commission believes that most benefits, at the least (regulatory) cost, could be achieved by combining market self-regulation and where necessary regulatory measures for achieving a Single Payment Market. Taking into account both the potential abilities and limitations of government and market action this also seems the option with the highest potential to achieve

the objectives (chapter 5) and least risk of failure. However, only careful evaluation of progress will finally allow determining the success of this strategy.

No action at EU level must be dismissed because it would leave the current unsatisfactory state of the Single Market for payments untouched. It would leave the potential economic gains unrealised or more difficult to achieve. Industry would still be faced with a highly fragmented legal framework which would hinder its task.

An EU-regulatory led approach also seems the have limited potential to achieve an effective integration of national payment infrastructures which is necessary for a true Single Market. The complexity and network character of payment services imply the involvement of a large number of market participants to drive forward the project of consolidation and integration if it is to be a success.

The evaluation and given state of the EU payments market would suggest a co-ordinated public and private initiative which seems to be the most promising route to deliver a Single Payment Market. This option provides the benefits of a market framework facilitating market-driven solutions, when at the same time ensuring trust and legal certainty for market participants in this change process and minimising the costs of migration.

According to this option industry self-regulation would be responsible for overcoming the problems related to a) inefficient use of payment services caused by distortions in the price; b) deficiencies in pan-European infrastructures and services; and c) large differences in the efficiency of payment services between Member States. In general industry will be responsible for the co-ordination of the payments industry including the establishment of the necessary standards and agreements between payment providers that are especially important in a network industry.

The EU regulator on the other hand would be responsible for a) creating a coherent legal framework for payments in the EU that facilitates industry's tasks as described above; and b) ensuring more efficient competition and creating a level playing field in the payments market. Principally the regulator will undertake the tasks that industry cannot carry out in particular the removal or harmonisation of legal barriers.

The proposal would define guiding principles rather than detailed technical rules and provide flexibility with regard to rapid changes and market developments. The proposal could also help simplify existing EU legislation since it could repeal previous EU texts (Directive 97/5/EC and Recommendation 97/489/EC) and harmonise in codified way core legislation on payment services in the Single Market.

Extensive consultation and close co-ordination with industry ensures that rules proposed are effective and cause the minimum burden for business. Only a very limited number of issues would be treated with regulation (and have been confirmed in stakeholder consultations) and would be proposed for full harmonisation as it is much easier for industry to have to comply with only one set of rules than having to come to conform to 25 different, and often conflicting national rules.

8.1.2. *Type of legal instrument and level of harmonisation*

In areas where EU intervention was considered justified, the Commission analysed whether to proceed with a Regulation or a Directive and whether full or minimum harmonisation was most appropriate.

(1) Directive versus Regulation

A Directive was considered the most appropriate way forward, in the light of subsidiarity, proportionality and to take account of national specificities. In order to avoid any risk of refragmentation of the desired common legal framework, the approach of a Directive combined with full harmonisation is proposed. Full harmonisation ensures a high level of protection for consumers as well as a level playing field for providers. Finally, it avoids refragmentation of the market that could occur if Member States were free to add additional national rules, which would be possible under minimum harmonisation. However, the Directive only covers issues, where it was found that their exclusion would compromise economic benefits sought and increase the risk of fragmentation of the market. A Directive also satisfies the principles of subsidiarity and proportionality impacting existing national legal frameworks supporting payments as little as possible and avoiding unintended consequences as might occur without the possibility of sensible transposition.

A Regulation does not allow taking into account the complexity of present payment legislation interwoven into (in particular consumer protection rules and contractual law) the national legal systems. Such national frameworks are the outcome of many years interaction between consumers, financial institutions, regulators, systems, etc and provide a working and fundamentally understood basis for domestic payment transactions. Furthermore, since payments form only a part of the business transaction, legislation on payments must not be considered in isolation. Some payments, particularly transfers, comprise a chain consisting of several different contracts subject in some cases to different national laws and global practices.

The aim of the proposed new legal framework is to provide the payments market with a harmonised, reliable and easy to understand framework for providers and users of payment services. This objective could certainly be achieved with a Regulation but for above mentioned reasons the Commission will propose a Directive. However, should a later review of this legal instrument indicate the need for a directly binding Regulation the Commission will reconsider this option.

(2) Full harmonisation versus minimum harmonisation

Article 95 of the Treaty provides the basis for establishing a true Single Payment Market. One means of achieving a well-functioning and efficient Single Market is full harmonisation of legislation, because it creates a simple, coherent framework to the benefit of the industry and consumers. On the other hand, minimum harmonisation based on the home country principle combined with mutual recognition of legislative provisions can facilitate the offer of greater choice of services to the benefit of consumers but does not alleviate the problems of fragmentation of markets and legal environment.

Today, diverging national rules prevent the economic rollout of pan-European payment services. A provider might have to adapt important aspects of its statute and its services to national rule which will in most cases disrupt the efficient cross-border provision and full-

automation of services. Payment service providers would clearly benefit from the legal certainty that full harmonised EU legislation would provides, as they do not have the uncertainty that host Member States may evaluate the level of protection of their statute or services and find them not to be equivalent to their own or they may simply have contradictory legal requirements than the home Member State. In the same way users would enjoy the same familiar level of protection when using payment services from other Member States as they do in their own State. Even if mutual recognition, based on a high level of harmonised rules, would protect users and providers from some of the detrimental effects, it would not allow to reap the benefits of market consolidation and competition which potentially take place in an Single Market with the same rules and a level playing field for providers and users.

However, full harmonisation should be limited to those issues where national provisions would hinder the establishment of fully integrated pan-European payment services and infrastructures, the Single European Payment Area and a Single Payment Market. Full harmonisation should focus on problems in the field of payments, which need to be treated in the same way all over Europe.

Although full harmonisation entails that Member States can not deviate from the rules fully harmonised by this Directive, this does not mean that full harmonisation should be used in a “maximalist” way, as the highest possible level of protection, it means harmonisation at a high level, identical for all providers and users of payment services. Additionally the concept of mutual recognition might be used for aspects that for various reasons (e.g. national rules on execution times which established already a higher level of efficiency than the one targeted by the current proposal) have not been harmonised. This would allow Member States to adopt rules that go beyond the level of harmonisation but prevents any detrimental effect of such diverging rules on the Single Payment Market[51].

8.1.3. Scope of the regulatory intervention

The Commission analysed the scope of its intervention, namely the legal obstacles that need to be harmonised to create a Single Payments Market including the geographic scope and currencies covered.

The impact assessment carried out by the Commission confirmed the positive social and economic impacts of a unified payments market. The maximum of economic savings can be achieved by a coherent framework for the entire EU market providing the conditions for rationalisation of national payment systems, improved economies of scale and a seamless payments experience for users and businesses. However, it is expected that in the short-term the gains in the euro zone will be potentially higher than in non-euro countries, as the first wave of integration will take place in the euro zone where industry’s SEPA initiative is focussed.

The EU is the largest trading block in the world and citizens and business need efficient and secure payment services regardless of the currency in which they are trading. Therefore, the

[51] Member States should only take measures if they are necessary and proportionate and justified on grounds of public policy or public security. It is important that the notion of “public policy” has been construed narrowly by the European Court of Justice, and is limited to cases of “genuine and sufficiently serious threats affecting one of the fundamental interests of society”. See also Case 30/77 Bouchereau [1977] ECR 1999.

Commission's intervention should cover the whole EU (and not just the limited number of cross-border payments or the euro zone). Similarly, the proposal should include all currencies (not just payments made in euro or in other Member State currencies) and should focus only on efficient payment services that would realise significant cost savings and market share in the future. This meant excluding high cost cheques and cash[52].

Furthermore the analysis shows that in order to ensure a level playing field and improve efficiency, all payment services, users and providers should be subject to the same rules laid down in the proposal. Minor exceptions should only be made for certain rules where their application would be disproportionate, lead to disproportional higher costs or impracticalities. Consequently some rules could be adapted, e.g. a lower level of protection for corporate users, less stringent rules for payments in non-EU currency and where a payment transactions involves a provider outside the EU. Stakeholder consultation helped identify these exceptions and so avoid unnecessary costs without sacrificing the overall objectives of the proposal.

The future pan-European payment infrastructure currently developed by the payments industry[53]will focus on euro payments only while the EU has to ensure the smooth functioning of the whole Single Market. The proposal should therefore establish core rights and obligations of providers and users and apply to all payment services, national and cross-border. Only when citizens and businesses can make payments throughout the EU, as easily and safely as in the national context today, the objective of a real Single Payment Market is achieved. For users it should not make any difference where their payment service provider is located or in which currency the payment transaction is executed.

The impact assessment on best way to tackle the 21 issues identified during stakeholder consultation, taking into account both subsidiarity and proportionality concerns, led to the conclusion, that only 13 should be tackled in the proposed EU Directive and 1 issue ("Information on the originator of a payment (SRVII of FATF"[54]) in an EU Regulation. For the 7 remaining issues market-led solutions or Member States actions were deemed more appropriate.

- *Market access and prudential rules*

The first building block of the proposal for a new legal framework is the harmonisation of market access requirements for non-credit institution payment service providers and introduction of a specific license for payment institutions.

An assessment of the potential social and economic impacts of keeping the differentiation of market access conditions between Member States found that the unlevel playing field is detrimental to the functioning of the Single Market and creates substantial barriers to market entry. The Single Market principle of the free provision of services, including payment

---

52 Cash has its own legal framework and the use of cheques is declining and only to be found to a significant extent in a few Member States and their cross-border usage all but eliminated.

53 See the project of the European Payments Council for a "Single Euro Payments Area".

54 The implementation of OECD Special Recommendation VII of the Financial Action Task Force on Money Laundering will be treated separately from the NLF and will be proposed for an EU regulation. A regulation would ensure a single set of rules directly applicable, reducing the implementation costs for industry of the adaptation of IT systems. Given that this information regime would also be required in dealings with other payment services providers from third countries, a common EU rule would strengthen EU's position with regard to the multilateral negotiations with third countries.

services is currently insufficiently realised in the EU. Fragmented market access requirements distort competition and lead to higher prices for users and high profits for dominating providers in national markets and lower levels of innovation.

The Commission believes that the new legal framework could harmonise the legal requirements for payment service providers and that the proposal for a new license for payment institutions will fill a regulatory gap. It will increase the overall level of security and enhance competition in payment services where currently there is a lack. The new license will increase the overall stability of the payment system, because it will bring formerly unregulated providers into a sound regulatory system and subjects them to the due diligence of prior authorisation and prudential supervision.

In view of the significant differences in risks between fully-fledged credit institutions and other payment service providers, it was decided that a prudential regime based on capital requirements is disproportionate and therefore unjustified and would fail to solve the problem of insufficient competition in the tradition payments market. A prudential regime based on appropriate qualitative prudential requirements for the initial and ongoing supervision is proposed which addresses all of the identified risks. It is considered that this would also provide for a level playing field between providers under this new regime and existing bank providers. The stricter solvency requirements for banks are balanced with the risk arising from their privileged and important economic position to accept deposits[55].

In order to achieve a maximum effect in the area of fighting money laundering and terrorist financing the new prudential regime should encompass all payment service providers which are not credit institutions. However, the analysis showed there was a risk that small money remitters, which often provide services for *"unbanked"* and disadvantaged social groups such as immigrants, could be driven into the underground sector if the full set of rules designed for all service providers was applied. If driven underground there would be less protection for their vulnerable users, and money laundering and terrorist financing rules would be more difficult to enforce. Member States were therefore given an option to waive some of the prudential requirements for such small providers to avoid this risk.

- *Transparency and customer information requirements*

The second building block of the proposal for a new legal framework is transparent conditions and customer information requirements.

The proposed package of transparency and information requirements should enhance transparency and thereby improve user confidence, facilitate user choice of the most appropriate payment service, and eliminate the fragmentary effect of divergent national rules so permitting the reaping of significant economic benefits of market integration for both users and providers.

The rules on transparency were assessed by stakeholders in order to ensure that they are well balanced with regard to informing users adequately but avoiding information overload and minimising cost to providers.

[55] These deposits allow banks also to finance their payment activities on more advantageous terms than other providers.

A light information regime is also regarded the most appropriate for micro payments (i.e. payments for amounts less than 50 €). Such payments are for small ticket items and are deemed one of the key enablers for e-commerce and effective distribution of digital content. In order not to stifle innovation in a sector where margins are very small due to the low value of the goods or services purchased, the analysis showed that a simplified information regime would be more cost effective and still provide for sufficient consumer protection.

The cost of compliance with these harmonised set of information requirements was evaluated positively by payment service providers. The requirement to communicate the conditions to the customer (in contrast to making information only available) was counterbalanced by reducing this obligation to the conclusion of a framework agreement or payment service contract. This means that the full set of information has to be provided only once, at the beginning of the contract. This conforms to the current business practice and should not increase compliance costs for providers. Further simplification will be achieved for providers acting across borders by replacing 25 existing regimes with one set of fully harmonised information requirements. The costs for providers for adaptation from national to the new EU rules will be one-time costs and spread out over a minimum of 2 years (through transposition) in which in any case regular changes to conditions and customer information are made.

- *Rights and obligations of users and providers*

The third building block of the proposal for a new legal framework is to harmonise core rights and obligations of users and providers in the interests of certainty and efficiency in a Single Payment Market.

Stakeholder consultation and in-depth impact assessment helped to identify the areas where common rules are needed and where EU action could better achieve this objective than self regulation or national legislation.

In further rounds of consultations on the detailed content of the rules and their impacts the balance of interests and proportionality was tested. Concluding that, even though the rules should be applicable without exception to all payment services provided in the EU, that it certain differences should be made between different payment services or different groups of users Therefore, in order to avoid unwarranted costs adjustments for a limited number of rules were made, for example where a foreign currency was involved, for corporate users or where one of the payment service providers was located outside the EU. These adjustments were kept to a minimum in order to preserve the level playing field. At the same time the underlying objectives were preserved and the regulatory burden kept to a minimum.

8.2. Cost, Benefit and Risk analysis of the proposed regulatory intervention

Options	Costs	Benefits	Risks
1. Main policy options			
A: Status quo	• Current situation: fragmentation, inefficiency. • Uncertain results. • Slow advance. • Lack of common legal framework.	• Market-based solutions are possible but not particularly likely as was experienced also in the past	• High risk that a Single Payment Market will not be achieved.
B: Strong EU regulation	• Increased regulatory costs • Inadequate consideration of market self-regulatory abilities	• Ensuring a tight common framework. • Ensuring necessary steps for the integration of fragmented payment infrastructures and services are taking place	• Overregulation.
C: Market self regulation	• Inadequate market intervention in order to achieve real savings. • Unproductive investments and sunk costs due to lack of binding rules which could provide sufficient legal certainty for investments • Cost of legal uncertainty due to the lack of a common framework.	• Market driven solutions (however, currently existing distortions would not be eliminated)	• Risk of adverse effects on competition due to the lack of a common framework ensuring fair competition • Legal and probably a large number of technical and commercial market entry barriers would remain due to strong vested interests
D: Proposal for a new legal framework combined with self-regulation for technical aspects	• Monitoring. • Legal compliance cost for new rules which are different from MS	• Increased likelihood of achieving objectives at the least regulatory cost. • Marked driven solutions are facilitated and encouraged	• Reducing uncertainty and risk in the changeover to SEPA and the Single Market

Options	Costs	Benefits	Risks
2. Regulatory approach			
Legal instrument			
A: Regulation	• Impossible to adapt the instrument to the big differences between payments markets, infrastructures and habits.	• Clarity and simplicity, no divergence in transposition. • Speedier legislative process.	• High risk of problems when interfacing with the rest of national rules.
B: Directive	• Greater divergences. • Slower process.	• Greater adaptation to particularities.	
Level of harmonisation			
A: Full harmonisation	• Less flexibility for national specificities.	• Ensure a level playing field. • Promote cross-border shopping.	
B: Minimum harmonisation	• More difficult to provide pan-European services, needing to adapt to several national rules.	• Combined with mutual recognition it might facilitate the offer of greater choice of services.	
3. Scope of regulation			
A: All payment services provided in the EU.	• Cost of adjustment to some payment systems in some MS.	• Ensures the smooth functioning of the Internal Market as a whole.	
B: Exclude some payment services, like non-EU currency ones.	• Discrimination. • Not a level playing field.	• Potentially lower adjustment costs.	

9. MONITORING AND EVALUATION OF RESULTS

Given the magnitude and complexity of the undertaking to create a Single Payment Market it is vital that all measures implemented by both EU regulation and market self-regulation are monitored and followed up by an in-depth review.

There should be ongoing monitoring from now onwards of the effectiveness of market self-regulation in order to early detect failures and devise where necessary correcting measures. In particular it should be assessed:

- the progress on the integration of the European payment services market and the accomplishment of a Single Euro Payment Area (SEPA) including the necessary standards and infrastructure for the processing of standard payment services such as credit transfers, direct debits and card payments;
- the development of technologically advanced and competitive payment services that would increase users' acceptance and convenience and thereby further increase the rate of electronic straight-trough processing of payments;
- the scope of application of standards and conventions for national and cross-border payments, the level of standardisation and interoperability of payment systems and services and the removal of technical barriers (e.g. interoperability of terminals and payment cards, national account structures) and business practices that prevent the user to use payment services European-wide regardless of his country of origin;
- the progress on time and cost efficiency of standard payments;
- the conditions for market entry and the competitive structure of the European payment services market and its impact on prices for payment service users;

The results of the monitoring process should be measured against the forecast economic gains as the current proposal is based on the success of this industry initiative and would not achieve its full potential if the aspect to be delivered by industry were missing.

The review of this proposal should be conducted not later than two years after the end of the transposition period referred to in the proposal. The Commission shall submit to the European Parliament, the Council and the Economic and Social Committee a report on the implementation of the proposal, accompanied, where necessary, by proposals for adapting it to legal, technical and economic developments in the field of payment services, in particular with respect to the proper functioning of the Single Market.

This review should assess the progress made towards the ultimate objective of a Single Payment Market and should evaluate in more detail the level of achievement with regard to the strategic intermediate objectives and operational objectives established for this initiative:

1. **Enhanced competition between national markets by opening up markets and ensuring a level playing field should be measured against the operational objectives of:**

- Operational objective 1 = Removal of legal barriers to market access and a level playing field of prudential requirements for payment service providers
- Operational objective 2 = Increased number of providers and payment services in national payment markets
- Operational objective 3 = Increased cross-border provision of services of existing and new providers
- Operational objective 4 = Reduced number of payment infrastructures due to consolidation

2. **Increased market transparency for both providers and users should be measured against the operational objectives of:**

- Operational objective 1 = Consumers will receive standardised conditions for the payment services offered in the market.
- Operational objective 2 = Consumers will be able to compare the key elements of different service offers and benefit from greater transparency on prices and fee calculation methods.
- Operational objective 3 = Providers are able to offer payment services across borders under the same standardised conditions with regard to information requirements.

3. **Standardised rights and obligations of providers and users of payment service in the EU, with strong emphasis on a high level of consumer protection should be measured against the operational objectives of:**

- Operational objective 1 = Users are able to rely on the same conditions wherever they use payment services in the EU
- Operational objective 2 = Providers are able to develop and rollout payment services for the entire EU market under the same legal conditions

The proposal is expected to follow normal implementation procedures, i.e. transposition in Member States within 12 months. As in other financial services fields, implementation may be facilitated through cooperation between Member States ministries' and supervisory authorities and with the Commission help and assistance[56].

[56] The Commission indicated in its 2002 Communication on better monitoring of EU law (COM (2002) 725 final) of 11 December 2002 how it can and does assist Member States with transposition of Directive into national law.

In addition to normal monitoring of implementation by Commission, the newly created Payments Committee should provide the Commission with input on the well-functioning of this proposal and need for adjustments. The Payments Committee should provide the Commission with the expertise and know-how and input on market developments and help to assess the functioning and impact of certain rules. It should in particular assist the Commission in the proper implementation of this proposal.

ANNEX 1: PROBLEM DEFINITION

1. Background on the use of payment services and the macroeconomic cost of the system

Use of payment services in the EU

Usage of payment services and customs vary substantially from one EU country to another. Usage patterns are often the result of a historic evolution and are slow-moving trends, but over time similar payment services become popular in the whole of Europe[57]. As a particular payment service gains global acceptance, a country's lower level of development and efficiency can sometimes explain its lower frequency of use of that product.

For instance, cheque usage is influenced by such local factors as legal obligations to use cheques for certain transactions and restrictions on cost-based pricing, local habits, the cost of transfers as an alternative, and the investments that banks have made to reduce cheque processing costs (which lessen their incentive to reduce cheque usage). However, the usage of cheques, after cash the most expensive payment service, is generally on the decline. In the latest surveys the main cheque users come from France, Portugal and the United Kingdom. In other European countries surveyed, customers used fewer than ten cheques per year.

The cheque as a purely paper-based instrument has lost significant market share against those payment services that can work electronically. In terms of transaction volumes, credit transfers have only recently lost the leading position of payment services share to payment card transactions in Europe. This trend is also followed by the wide use of credit transfers, direct debits, and standing orders (instead of cheques) in Germany, Austria, Poland, Slovakia, and the Czech Republic.

The use of cost-efficient self-service channels and fully electronic payments initiation through the internet, online or telephone banking has been adopted in particular in Nordic countries such as Finland and Eastern Europe, e.g. Estonia, Latvia, Lithuania, Slovakia and the Czech Republic, which use more online banking than most other European countries. Banks in these countries were apparently adopting these new technologies, avoiding the cost of infrastructure build-up, and "leapfrogging" the Western European countries that have large branch networks.

Percentage of total volume of electronic payment transactions for the EU–15[58]

[57] See trend development in the ECB Bluebook, Payment and securities settlement systems in the European Union and the "World Banking Report", a annual study of CapGemini, EFMA and ING.

[58] Payment and securities settlement systems in the European Union, Addendum incorporating 2002 figures (Blue Book, April 2004), (data for the period 1997-2002).

Table 13

Relative importance of cashless payment instruments

(percentage of total volume of cashless transactions)

	Cheques (%)					Payments by credit/debit cards (%)					Credit transfers (%)					Direct debits (%)					Card-based e-money (%)				
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
Belgium	7.0	5.8	5.0	3.8	1.7	27.3	28.9	32.8	33.3	34.6	54.0	51.9	46.7	47.8	46.9	9.4	10.2	11.8	11.2	9.8	2.3	3.3	3.6	3.8	7.0
Denmark	9.6	7.8	6.7	5.5	4.5	48.4	50.1	51.1	53.7	54.5	25.9	25.7	25.7	24.1	24.5	15.2	15.5	15.6	15.8	15.7	1.0	1.0	1.0	0.9	0.8
Germany [1), 2)]	4.2	3.8	3.3	2.6	1.2	9.2	10.7	13.4	14.7	16.6	47.7	47.0	45.0	44.7	45.0	38.8	38.4	38.1	37.8	36.9	0.1	0.2	0.2	0.2	0.3
Greece [3), 4)]	nav	nav	22.1	22.5	19.2	nav	nav	64.5	62.5	56.1	nav	nav	9.1	6.8	10.8	nav	nav	4.3	8.2	12.5	nap	nap	nap	nap	nap
Spain [5)]	12.9	10.7	8.9	7.3	6.0	23.5	24.3	22.9	26.3	36.4	14.7	14.5	15.2	15.6	14.7	48.9	50.5	52.9	50.7	42.8	0.1	0.1	0.1	0.0	0.04
France	44.1	40.1	37.9	35.4	34.2	23.6	26.1	27.8	30.0	30.6	17.8	18.4	17.7	17.8	18.7	14.4	15.5	16.6	16.8	16.3	nap	nap	nav	0.02	0.1
Ireland	56.6	49.2	41.3	30.1	26.3	7.8	22.6	28.0	39.7	47.4	16.9	12.9	13.7	13.0	13.3	18.7	15.4	17.1	17.1	13.0	neg	neg	nap	nap	nap
Italy	28.2	25.2	21.7	19.3	17.2	15.1	18.0	21.2	24.7	29.1	42.3	38.0	36.6	34.8	31.8	14.4	18.8	20.5	21.1	22.0	neg	neg	neg	neg	neg
Luxembourg	2.7	2.1	1.6	1.2	0.7	62.7	61.7	61.5	60.9	61.2	29.7	29.9	28.1	27.2	24.9	5.0	5.7	6.5	8.1	7.9	nap	0.7	2.3	2.7	5.3
Netherlands [4)]	1.8	1.0	0.5	0.2	neg	25.1	27.8	29.3	31.9	32.8	44.0	41.2	40.4	39.1	37.0	28.4	29.3	28.9	27.9	27.6	0.7	0.8	0.9	1.0	2.6
Austria [6)]	2.8	2.1	1.4	1.0	0.6	8.1	10.5	12.2	14.6	17.3	61.3	57.8	56.0	55.5	46.6	27.7	29.3	30.1	28.4	33.7	0.1	0.3	0.3	0.5	1.7
Portugal [7)]	39.8	34.1	29.0	27.1	24.1	44.0	47.2	50.6	56.4	58.2	6.3	6.3	7.7	4.4	6.3	9.2	11.9	12.1	11.8	11.3	0.7	0.6	0.5	0.3	0.1
Finland [4)]	0.3	0.1	0.1	0.1	0.1	37.4	38.4	40.5	42.5	45.5	58.5	56.8	54.6	52.3	49.3	3.9	4.6	4.7	5.0	5.0	0.02	0.06	0.06	0.1	0.1
Sweden	0.4	0.3	0.2	0.2	0.1	20.9	22.3	26.7	31.6	50.6	71.2	69.6	65.4	60.4	38.8	7.3	7.4	7.5	7.7	10.4	0.2	0.4	0.2	0.1	0.1
United Kingdom	31.7	28.8	26.1	23.5	21.0	31.5	34.3	36.6	39.0	41.2	18.3	18.1	17.8	17.7	17.7	18.5	18.8	19.4	19.7	20.1	nav	nav	nav	nav	nav
EU [8)]	21.3	19.0	17.2	15.5	14.5	21.0	23.3	26.6	29.0	32.2	32.91	31.71	30.0	29.34	28.27	24.6	25.8	25.9	25.9	25.1	0.3	0.4	0.5	0.4	0.7
Euro area [8), 9)]	20.1	17.8	16.0	14.6	13.8	18.4	20.7	22.7	26.6	29.6	34.8	33.4	32.3	30.8	30.1	26.5	27.9	29.0	27.7	26.7	0.3	0.4	0.5	0.5	0.7

1) Payments by credit cards: from 2000 onwards, the figure includes retailer card transactions.

2) Direct debits: debit card transactions are not included under this item but are shown under "Payments by debit cards".

3) All cheques for which the acquiring bank is different from the issuing bank.

4) The figures for payments by credit/debit cards include payments by cards with a delayed debit function.

5) This table does not include data relating to bills of exchange, traveller's cheques and other documents.

6) Credit cards does not include delayed debit cards (charge cards); credit transfers and direct debits do not include items initiated by banks; these data are not available.

7) This table does not include data related to bills of exchange.

8) Total excluding countries for which data are not available.

9) Following its entry to the euro area, the figures for 2001 onwards include Greece.

Percentage of total volume of electronic payment transactions for the new EU Member States + Bulgaria and Romania[59].

Table 13

Relative importance of cashless payment instruments

(percentage of total volume of cashless transactions)

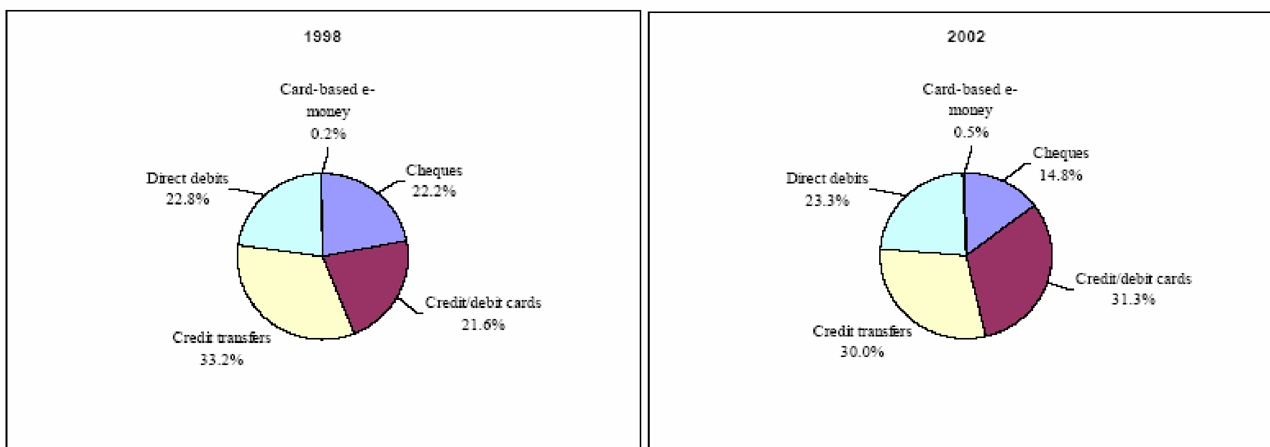
	Cheques (%)					Payments by credit/debit cards (%)					Credit transfers (%)					Direct debits (%)					Card-based e-money (%)				
	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003
Bulgaria	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav	nav
Cyprus	61	57	52	49	47	19	22	26	27	31	7	7	7	9	8	14	15	15	14	14	nap	nap	nap	nap	nap
Czech Republic	0.54	0.44	0.22	0.04	0.09	1	3	3	5	8	83	75	75	67	54	16	22	22	28	37	nav	nav	nav	nav	nav
Estonia	0.04	0.04	0.04	0.03	0.03	24.5	29.15	34.83	40.18	44.8	73.1	65.0	57.8	52.1	47.1	2.36	5.79	7.36	7.68	8.07	nap	nap	nap	nap	nap
Hungary	0.03	0.06	0.0	neg	neg	14	16	18	22	26	62	63	61	56	53	23	21	21	22	21	nap	nap	nap	nap	nap
Latvia	0.2	0.2	0.1	0.1	0.1	9	12	16	20	25	91	88	84	80	74	0.0	0.0	0.1	0.2	0.4	nap	nap	nap	nap	nap
Lithuania	nav	nav	nav	0.04	0.02	14	17	20	31	38	79	78	76	65	58	4.9	3.2	1.8	1.5	2.7	2.0	2.4	2.2	3.3	1.8
Malta	nav	nav	68	65	57	nav	nav	19	18	29	nav	nav	13	15	11	nav	nav	neg	2	3	nap	nap	nap	nap	nap
Poland	1.9	1.6	0.8	0.4	0.2	7.2	11.1	14.8	19.0	19.9	90.9	87.2	84.3	80.2	79.3	neg	neg	0.2	0.4	0.6	nap	nap	nap	nap	nap
Romania	15	17	21	17	9	0.5	0.6	1.1	5.7	7.7	84	82	77	77	81	0.3	0.3	0.3	0.3	2.8	nap	nap	nap	nap	nap
Slovakia[1)]	0.11	0.13	0.09	0.08	0.04	2	4	7	9	26	95	93	91	89	71	3	3	3	3	3	nap	nap	nap	nap	nap
Slovenia	nav	nav	nav	2.2	1.2	nav	nav	nav	41.6	39.3	nav	nav	nav	47.1	51.1	nav	nav	nav	9.2	8.4	nap	nap	nap	nap	nap

1) Since 2003 a different methodology has been used for credit transfers and direct debits, which has also had an impact on the figures for other items.

Development of market shares between different electronic payment services within the EU–25 at a pan-European level based on total number of transactions60

59 ECB Bluebook, Payment and securities settlement systems in the accession countries, Addendum incorporating 2003 figures (Blue Book, February 2005), (data for the period 1999-2003).

60 ECB Bluebook, addenda incorporating 2002 figures (2004).



The current social cost of payment services: the impact of price distortions

The societal costs of the payment system, describing the infrastructure to distribute and recycle cash, transfer funds and make payments smoothly, safely and efficiently, are substantial. Depending on the level of development and efficiency of the particular payment system the estimates for running the payment system range from 2–3 % of GDP.

A more detailed breakdown[61] reveals that cash, above all, is the main cost driver and accounts for as much as 60–70 % of the total cost of the payment system, or in other words 2 % of GDP. These studies estimate the cost per economic transaction when paid for in cash between EUR 0.30 to EUR 0.55[62]. Congruent with these findings, other studies confirm the cost of cash at about 1.36 % of sale value or 2.3 % of transaction value (EUR 0.32 for transaction value of EUR 14)[63].

The overall social cost of using payment services could be reduced if consumers and business selected the means of payments in a more rational way. When prices paid by users reflect the real cost value of the service, they provide an incentive for users to select services that meet their needs at the lowest possible private and social cost. This promotes the efficiency of the payment system.

It is well documented in studies that cost-based pricing of payment services triggers customer behaviour[64] and the right price signals can drive customers to select more efficient payment services rather than less efficient ones. A good example is cheque usage, which is broadly on the decline. That decline was exceptionally strong in Belgium, where cheque use represented over 7 % of all transactions in 1998 and had dropped to below 1 % by 2005. Continuous increases in price, along

---

61 Though it is difficult to quantify the exact costs of cash, studies using a comprehensive methodology to cover direct and indirect costs, come to similar conclusions. These studies for example take into account all costs of cash to the economy, including cost of printing, security, handling, transportation (including intermediaries, commercial banks, merchants and central banks), cost of cash to merchants and users, including back office processing, transport, security, equipment costs, and opportunity costs. Though it is difficult to quantify the exact costs of cash, several studies, which use a comprehensive methodology to cover direct and indirect costs, come to the conclusion a similar conclusion.

62 Paul de Grauwe, "Cost of cash in Belgium" and Dutch National Bank – "Betalen Kost Geld".

63 PriceWaterhouseCoopers, "Cost to Businesses of Cash in Australia" and GfS, "Cost of cash study in Switzerland".

64 Sveriges Riksbank, "Do prices reflect costs? – A study of the price and cost structure of payment services in the Swedish banking sector 2002", October 2004. Norges Bank, "Cost and Income in the Norwegian payment system 2001", September 2003.

with the suppression of the Eurocheques warranty and the promotion of alternatives, are responsible for this decline.

Another example is increased charges for the use of cash. Banks in many countries were encouraging consumers to use ATMs, particularly their own. To promote their ATM systems, banks in France, Norway, Spain, Slovakia, the Czech Republic and Poland have progressively charged more for transactions at the cashier's window and for withdrawals from other banks' ATMs. Withdrawal frequency at other banks' ATMs usage was higher in countries where no charges were applied – for example, in Austria, Sweden, and the UK. However, a further decrease of cash payments and a move to electronic payment services could be achieved if cash withdrawal and cash usage would reflect the high costs of cash handling.

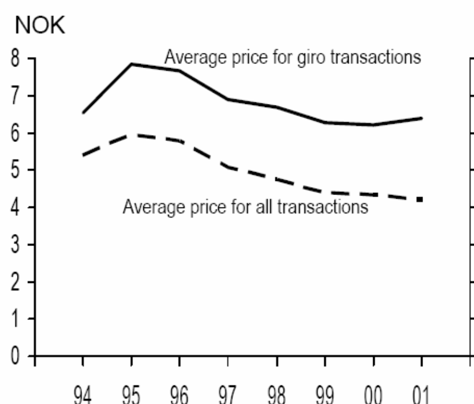
The argument of more cost-transparency in prices of the real economic cost is supported by studies on consumer habits, where pricing of payment services plays an important role in the selection of payment services. Experiences from Norway and Sweden show that the demand for payment services has reacted quite sensitively to changes in prices for payment services aimed at introducing more cost-transparency. Consumers have responded to price variation by increasing their usage of electronic payment services.

Box: Cost-based pricing and shift from paper-based to electronic payment services in the Norwegian payment system[65]

Financial services are among the sectors of the Norwegian economy that have made the strongest contribution to the rise in productivity in the past decade. Revised national accounts figures show that productivity for mainland Norway (non-oil sector) rose by 2.4 per cent annually in the 1990s. Financial services represent one of the sectors showing strongest productivity growth, with an annual average of 6.3 per cent in the same period. Payment services – an important part of financial services – have contributed to the increase in productivity. The rise in payment system productivity is attributable both to more rational production methods and increased use of the most cost-effective services. Due to their pricing policy for payment services, banks have brought about a shift in demand from paper-based to electronic services. The results presented in this working paper give further support to the analysis and statistics that show increased productivity.

Since 1994, the number of payment transactions has doubled to 968 million in 2001. The total number of employees in the banking industry has risen by 1 per cent, while the number of branches has been reduced by 13 per cent. The number of post offices halved from 1994 to 2001. Total costs for producing payment services fell from NOK 6.3 billion in 1994 to NOK 5.9 billion in 2001 (in 2001 NOK), a fall of 6 per cent. The reason for this is a shift from manual services to electronic payment services such as payment cards and electronic giros. The average cost of producing payment transactions[1] was halved in the period. At the same time, prices charged to customers have increasingly reflected the actual costs of producing the services. As from 1 July 2000, Norwegian banks were no longer allowed to earn float income. The gain achieved by increased productivity accrues both to customers and the banks. Chart 1 show that, on average, the customers paid less for a transaction in 2001 than in 1994 (in terms of 2001 NOK) both when the basis is all services and when we base the calculation on giro services only[2]. Since 1994, more transactions have been produced by banks by lesser recourses (measured in NOK).

[65] "Costs and Income in the Norwegian Payment System – An application of the Activity Based Costing framework", Working Paper, Financial Infrastructure and Payment Systems Department, Norges Bank, 2003.



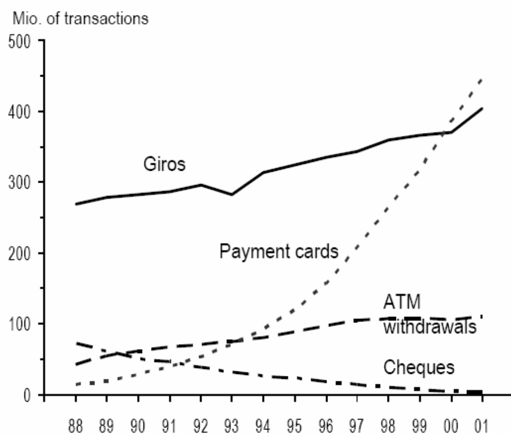


Chart 2 shows that the use of various payment services has changed substantially since the first survey. In 1988, payments at point of sale were usually made by cheque or in cash, whereas in 2001, payment cards were the most frequently used non-cash payment instrument. Bills are mainly paid by giro, and the number of giro payments has increased slightly over the whole period. Today, about half of all cashless transactions are executed by means of cards.

In 1994, 40 per cent of all cashless payments were electronic. This share increased to 83 per cent in 2001.

* The average cost is calculated by weighting unit costs for the individual services by national transaction figures. The figures in Table 1 are adjusted by the general consumer price index and express costs in 2001 NOK.
** Chart 1 is from the analysis in Norges Banks "Annual report on payment systems (2002)".

However, at present the EU market framework does not provide a 'level playing field' for the efficient competition of payment services, several factors (legislation, public opposition to changes in the global price structure, cross-subsidisation and non-cost-based pricing) distort an economic selection process. Several studies[66] illustrate that price distortions in the payments market are leading to a situation where inefficient payment services (e.g., cash, cheques) are chosen by users at the expense of more efficient ones. Studies on bank charges for payment services show that banks tend to use two-part tariffs and variable costs are poorly reflected in transaction fees actually paid by both consumers and corporate customers. In addition, there exist large cross subsidies between different payment services, foremost from acquiring card payments to issuing cards, cross-subsidisation of cash distribution to the public with the income from float and account balances. Such practices distort the price signal to the users of payment services. As a result, user of payment services do not chose the most efficient payment services.

"Electronic" payment services are more efficient and reduce the costs to the economy

The modern and most efficient payment services currently being used are electronically initiated fully automated payments such as payment cards, credit transfers and debit instruments, in particular where they are integrated in the electronic business processes of companies (e.g. e-invoicing) and supported by the electronic devices of users (e.g. mobile phone, Internet). Modern, electronic payment services produce much less costs to society because they can be processed in a fully automated way reducing the handling and operations costs for all parties involved in the value chain (banks, businesses, merchants and users).

---

66 Sveriges Riksbank, "Do prices reflect costs? – A study of the price and cost structure of payment services in the Swedish banking sector 2002", October 2004. Norges Bank, "Cost and Income in the Norwegian payment system 2001", September 2003.

Substantially costs savings could be achieved from moving to a fully electronic and automated processing of payments and payments related processes. Cost reductions are due to fully automated end-to-end payment processing (so called "straight-through processing" (STP) without manual intervention. Studies[67] show that 70 percent of the costs in the payments value chain can be addressed by a reduction of costs at the front end, i.e. the providers interface with the customer. Because the use of cash or paper-based payment services demands several steps of manual intervention (e.g. physical cash handling, counterfeiting checks, cash transport) it produces high costs.

Estimates of corporate users on the savings which could be obtained from fully integrated electronic payments are enormous[68]. If banks would adopt an open standard for electronic invoicing and payment the cost savings are in excess of EUR 50 billion[69]. According to the European Association of Corporate Treasurers, today the processing of an invoice in corporations with large paper-based processes costs between EUR 35 and 60. Full automation could reduce these costs by 70–90 % (representing savings of EUR 25–50 per invoice).

2. Fragmentation and lack of interoperability of EU payment infrastructures and services

Limited availability and efficiency of cross-border payment services and infrastructures

Payment systems in the EU were originally created with the aim of meeting national requirements. This has lead to the current fragmentation of payment systems across Europe with negative consequences for users such as limited availability of cross-border payments, high costs, unreliability and lock-in in proprietary technological solutions and markets. The current setup of the payment system is not suited to the needs of a Single Market and a single currency, where an infrastructure is needed which enables the quick and smooth flow of payments at a low cost in the whole area.

---

67 According to studies of McKinsey, "Ergebnis im Girokonto Österrreich", 1999 und 2001.

68 "E-Payments without frontiers - Issue Paper for the ECB Conference on 10 November", European Central Bank 2004.

69 According to estimates of Nordea Bank based on experiences in the Nordic countries, 2004.

Overview of payment services and potential cross-border use

Services	Concept	Importance and utility for the user	Advantage	Disadvantage
Credit transfers	A credit transfer is an instruction from the payer to his provider to debit his account and to credit the beneficiary's account. The payment is initiated on the payer's side.	A convenient way for effecting money transfers between accounts as well as between private persons. Credit transfers are one of the most widely used electronic payment service in the EU, with a share of 30 %.	Available on cross-border level	Costs are still high due to a lack of critical mass, only one pan-European clearinghouse (EBA STEP 2), limited services level, not competitive with national prices execution times and quality
Direct debits domiciliation (excluding cards)	Direct debits are preauthorised debits on the payer's account that are initiated by the beneficiary.	Direct debits are often used for recurring payments, such as utility payments, or for one-off payments in connection with remote transactions. Direct debits are the second most important payment service (25 % of electronic payments) in Europe.	–	Not available on cross-border basis in Europe.
Credit card payments	Credit cards lead to a debit on payer's account. Customers can make purchases and/or withdraw cash as credit. The credit granted is either settled by the end of a specified period (deferred debit cards), or extended as credit.	Credit cards were initially designed for payments at physical points of sale, but are also used for remote payments ("card not present" transactions, e.g. via the telephone or internet). Between 3–6 % of all non-cash transactions in the EU are credit card payments.	Available on cross-border level only through international card networks	Less than full acceptance and expensive in particular for merchants (1–5 % fee on purchased good)
Debit card payments	Debit card payments are debit instruments, i.e. they lead to debit transactions on the account of the payer. Debit cards are the most widely used instrument at points of sale. Around one-fifth of all payments are made using debit cards.	Debit cards provide a convenient way to present the cardholder information needed to initiate a debiting of the cardholders account. This information is embedded in the magnetic stripe (or chip) on the card. A dedicated terminal is required to read the information on the debit card, and possibly to verify whether the debit card is still valid and whether the transaction would exceed any usage limits set for the card.	Available on cross-border level only through international card networks: (VISA, Mastercard)	National debit card schemes (which are the majority) are not, working on a cross-border level because of a lack of interoperable infrastructures. Costs for cross-border transactions are higher in relation to national equivalents.
ATM transactions	ATM cash withdrawals are based on the card payment infrastructure (debit or credit card). An ATM cash withdrawal results in the debiting of the payer's account.	The availability of cash dispensers is a convenient way for users to get cash independent from bank opening hours. ATMs have reduced the cost of cash handling. The usage figures are incorporated in payment transactions with debit and credit cards.	Available through international card networks: (VISA, Mastercard)	High costs for banks compared to national payments
Electronic money (e.g. e-purses)	Based on prefunded claims that are used as generally accepted means of payment. Chip cards or other electronic devices are used to allow the transfer of the centrally stored anonymous claims.	E-money and in particular e-purses offer a convenient way to make remote, cashless and anonymous payments for small amounts without involving the operator of the system. Take-up in most European countries has been slow achieving only 0.5 % of total electronic payment transactions in the EU.	Usually not available on cross-border level	Slow market adoption and low penetration.

Stakeholders expect core payment services to be efficient, cheap and reliable

Stakeholders[70] expect core payment services to be efficient, cheap, reliable and interoperable, without difference between national and cross-border payments, in order to benefit from a Single Market. Stakeholder would like to take advantage of the best services offered in the Single Market, without difference to the origin of the provider or location of the payment system.

For this to be realised stakeholders demand interoperable payment systems in Europe, which allow for the same user experience across Europe and enable users to chose the most competitive provider: Citizens and businesses need certainty about the reliable functioning of the payment system, with clear and short execution times and guarantees for the correct transfer of the full amount to the beneficiary. Users want flexibility when choosing a provider and technological solutions that facilitate customer mobility. They want a single access point to the payment system, which does not require substantial investments every time they change providers. In particular corporates expect huge cost savings through the full integration of payments in their electronic business processes (e.g. e-invoicing) could come (from a standard interface to the banks payment system.

STAKEHOLDERS EXPECTATIONS concerning a single payment market	
Private customers: Across the European Union…	**Reach/Interconnectivity**: I can use the same payment instruments that I use today locally throughout Europe (e.g. possibility to use my chosen card in a maximum number (%) of shops/ATMs). **Prices** (a) are the same for cross-border and domestic transactions when using a payment instrument in the EU, (b) generally they go down through increased competition and (c) are in relation to costs. **Efficiency**: Certainty that my payments will arrive at the final recipient within the agreed period of time and for the agreed price and funds. **Security** best of breed. **Convenience**: I have the same user experience no matter where I use my payment instrument – locally or cross-border (e.g. I use my card in the same manner).
Merchants: Regardless of my customer's origin within the European Union…	**Reach**: The payment methods I offer enables the maximum percentage of customers to pay without regard to their country of origin. **Prices** I pay to my payment service provider are transparent fee and generally they go down through increased competition. **One offer:** I can choose the most competitive provider and/or a unique way to manage payments operationally across EU without facing technical or organisational barriers. I can make use of cross-border service provision (e.g. real cross-border acquiring) **Costs**: My own internal costs go down, thanks to features of the payment systems I use (e.g. reporting, transaction time, fraud prevention).

[70] Views expressed by stakeholders during the Commission's public consultations on this legislative Directive.

Corporates: operating local and global **(Governments)**	**Reach:** I can connect to any provider in the EU through one standard IT interface which allows me to maintain only one system to send and receive payments in locally and globally. **Price**: Transparency on prices in an environment driven by competitive forces (e.g. standard for statements for financial services used) **Efficiency:** I have full transparency over payment flows. Certainty about execution time, fees and effectiveness of payments. Payments are fully integrated in electronic business processes and allow the fully automated processing of invoices and payments. **One offer:** I can choose the best offer from the most competitive European providers and are not 'locked-in' through technical and other barriers. **Costs:** The payment solution allows me to fully automate sending and receiving payments in my internal IT achieving enormous cost savings.
Providers: providing payment services to mostly local customers yet within a SEPA	**Access:** I can offer my payment (processing) services wherever I choose to (ultimately/ideally) in a similar way across the EU on the basis of harmonised legal, technical and organisational framework. **Profitability/ Price:** Prices allow me to recuperate my costs and make a profit. **Cost:** My cost go down through better economies of scale (cost/unit) of SEPA schemes, one solution for cross-border and domestic payments based on common SEPA standard technology which helps to reduce IT costs. **Service level:** I will be able to maintain existing service level and can offer additional services based on common SEPA standard. **Transition costs:** Endgame and migration plans are clear to allow me to plan the roll out in such a way to best fit in my internal investment cycle, IT projects, etc.

3. Prices of payment services vary substantially between different markets

The price of core day-to-day payment services (electronic payments, cash handling and bank account management) varies to a surprising extent across countries. The average price a typical customer paid in 2005 for a year's payment and bank account management services was EUR 108. This figure fluctuated widely across countries, ranging from a low of only EUR 34 a year in the Netherlands to a high of EUR 252 in Italy[71]. Most countries ranged from EUR 0 to EUR 159 if we omit the extreme ends of the spectrum. At the high end, Italy and Germany's prices were above EUR 200, while on the lower end of the spectrum, the UK, Belgium, and the Netherlands had prices of EUR 64 and below.

Further steps are necessary such as opening up national payment markets for outside competition and a level playing field for payment services in the EU in order to foster the free provision of services and allow citizens and businesses to benefit from lower prices in a Single Payment Market.

Another concern to the Commission is the costs of cross-border payments, surveyed over a period of ten years. Regulation (EC) No 2560/2001 introduced the principle of equality of charges for national and cross-border payments, but the underlying costs for the system and banks remain the same. Integration of cross-border and national payment infrastructures could increase efficiency and reduce costs for cross-border payments for banks and users.

Cost results of transfer exercise on cross-border credit transfers in the EU–15:[72]

	Study 1993 (12 EU-MS) (1048 transfers of 100 Ecu)	**Study 1994** (12 EU-MS) (1048 transfers of 100 Ecu)	**Study 1999** (EUR-11) (352 transfers of 100 Euro)	**Study 2001** (EUR-11) (352 transfers of 100 Euro)	**Study 2001** (EU-15) (1480 transfers of 100 Euro)	**Study 2003** (EU-15) (provisional) (1480 transfers of 100 Euro)
Austria	-	-	10.61 (3)	17.40 (6)	22.27 (7)	11.19 (4)
Belgium	23.93 (8)	23.06 (6)	13.37 (4)	11.87 (3)	12.84 (3)	14.26 (5)
Denmark	19.89 (5)	21.19 (4)	-	-	21.23 (5)	17.21 (8)
Finland	-	-	20.11 (8)	14.36 (5)	21.26 (6)	18.71 (10)
France	34.79 (12)	33.01 (12)	16.88 (6)	18.06 (7)	25.41 (9)	22.62 (14)
Germany	19.57 (3)	26.16 (7)	13.78 (5)	11.93 (4)	14.73 (4)	10.56 (2)
Greece	27.23 (9)	32.78 (10)	-	-	47.33 (15)	31.09 (15)
Ireland	23.04 (7)	27.13 (9)	25.98 (10)	25.04 (10)	36.08 (14)	22.24 (13)
Italy	19.79 (4)	20.88 (3)	18.28 (7)	19.74 (8)	28.61 (13)	16.71 (7)
Luxembourg	16.84 (1)	15.75 (1)	8.91 (1)	9.58 (1)	9.79 (1)	9.89 (1)
Netherlands	17.69 (2)	18.84 (2)	10.00 (2)	11.45 (2)	12.11 (2)	11.11 (3)
Portugal	34.37 (11)	26.75 (8)	29.68 (11)	31.04 (11)	28.08 (11)	18.12 (9)
Spain	21.10 (6)	22.04 (5)	20.50 (9)	20.56 (9)	24.65 (8)	19.78 (11)
Sweden	-	-	-	-	27.20 (10)	14.62 (6)
UK	27.45 (10)	32.99 (11)	-	-	28.47 (12)	*22.03 (12)*
TOTAL	**23.93**	**25.41**	**17.10**	**17.37**	**24.09**	*17.60*

While prices vary enormously across countries and for cross-border payments, the Cap Gemini study shows that pricing differences within a given country are smaller due to a broadly consistent

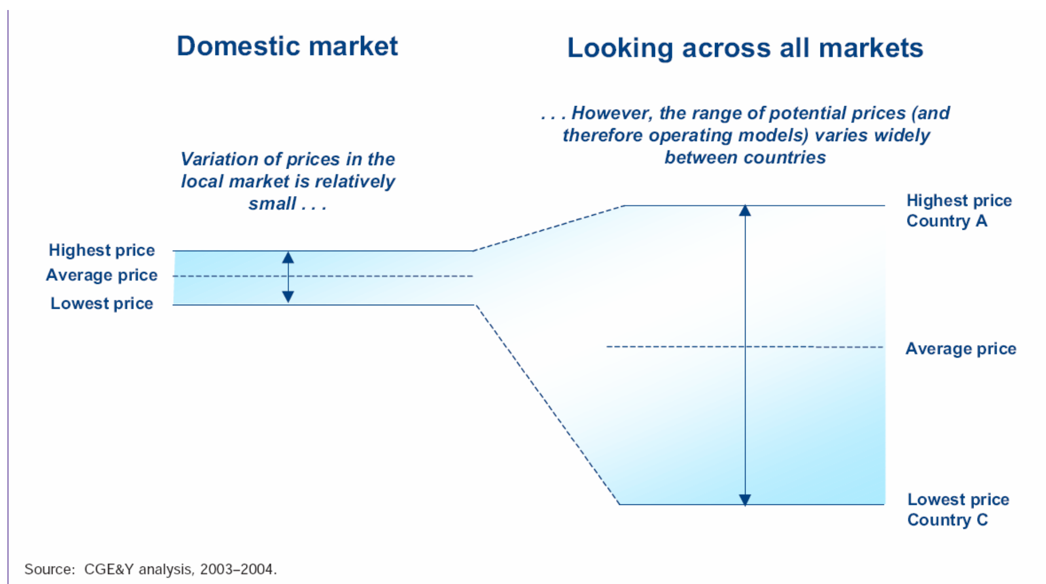
71 Cap Gemini & Ernst and Young, EFMA and ING, "World Banking Report", 2005.

72 Extract of studies prepared for the European Commission.

pricing model used by most institutions within a country. Figure 7 shows clearly the price range disparity between domestic and international markets.

The average price of a comparable set of core banking services across different countries varies by a factor 1 to 8, and other, non core banking charges outside the scope of our survey explain only part of this difference. Macroeconomic factors such as local income, labour costs, market size, and competitive environment would be expected to be major contributing factors to price, along with less quantifiable influences such as behavioural factors and the degree of regulation in a particular market. However, the Cap Gemini study found no evident link between pricing and country incomes or purchasing power parity.

Price range disparity between domestic and international markets:



But the study found that the competitive and regulatory environment have an important impact on pricing practices in national markets.

Opening up of national markets and enforcing competition (sometimes forced by competition authorities for example the split between payment schemes and infrastructure providers in the UK, NL) helped to reduce prices and drive innovation. Another model for success seem to be a combination of certain regulatory pressure exercised either by central banks or the competent regulator together with collective marked-led initiatives for the improvement of payment services (e.g. BE, SE).

Central initiatives, such as the Single Euro Payments Area (SEPA) led by the European Payments Council (EPC) have a great potential for consolidation of national payment markets and convergence of prices. The SEPA initiative aims to transform the euro zone into an area where customers can make payments, using a single set of payment instruments as easily and safely as in the national context today. For customers, it should not make any difference where or with which bank in the euro area the account is held.

4. Lack of efficient competition in the payments market

In most countries the payments system is run by the local banks. Access to and operation of infrastructure and payment schemes are controlled either by banking associations or co-operatives or by national banks. The fact that the owners of the system also determine prices, technical standards and access to the system and are at the same time largely identical with its users; seem to result sometimes in a conflict of interest. These market characteristics can become a concern if there are clear signs of low efficiency and high prices in combination with restrictions imposed by existing participants on entry to a market, as it happens to be the case in payment service markets.

Price structures and levels of efficiency within countries are determined by the technology in use and the existing legacies of national systems. Market entry for foreign and new providers is often difficult given the huge technical market entry barriers legacies and business practice in each country. For example, if a national credit transfer scheme established by the local banking associations does not provide for one-day execution time, the market usually has no alternative than to accept the proposed service levels. Consequently, the dominant national payment schemes and their inherent (in)efficiency dominate the local market, while new competitions are virtually non-existent. Innovation takes place either on a collective basis or not at all.

Also the current market framework and the way payment services are provided hardly allow customers to make an informed choice and benefit from the most efficient offer in the Single Market. On the one hand, there is very limited choice in product offerings (usually there is one dominant national payment scheme per payment method) and on the other hand, customers are not in a position to compare the actual fees and service offers they receive from their providers with the price level of other markets. Additionally, customer mobility is made difficult through a lack of standards e.g. common customer interface and business practices for the bank account mobility such as penalties for closing an account or fees for the transfer of standing payment orders and direct debits.

The particular example of card payments shows this limited negotiation power towards banks and the low impact of customer pressure. For years merchants[73] have been complaining that they have very limited possibilities to actively compare different providers as merchant service charges are often not transparent to merchants and do not allow for such comparison. More substantially, they cannot benefit from the Single Market by choosing the most efficient providers as main price and service elements (multilateral exchange fee (MIF), non discrimination rule) for national markets are already preset on an international scheme level (e.g. Mastercard, VISA). This makes prices and service elements de facto non-negotiable for the merchant. Merchants complain about the level of fees and the way they are fixed, in particular as they are currently not able to process all their transactions in the country with the provider of the lowest fees.

---

[73] Eurocommerce as the representative industry association for wholesale and international trade filed several complaints with national and European competition authorities. Also national interest groups have been constantly complaining about the situation in the card payments market.

Fees for debit and credit card operations (February 2003[74]):

Country	Credit Card Fee	Debit card Fee*	Debit card fee equivalent**
Austria	2.5 %	1% + 0.14 ct	34 ct
Denmark	0.75%	2.5- 5.75%	50-115 ct
Finland	0.9-1.25 %	5 ct	5 ct
Belgium	1-2%	6 ct	6ct
France	0.55 - 2 %	0.55 - 2 %	11-40 ct
Germany	1.5 - 3.8 %	0.5 – 1 %	10-20 ct
Netherlands		27 ct	15-30 ct
Portugal	3 – 5 %	3-5%	60-100 ct
Spain	0.52 – 5.77		
UK	1.2 – 2.5 %		9-75 ct

* Debit card transactions are often split in a percentage + flat rates figure in eurocents;
** on a purchase of EUR 20.

5. Lack of a level playing field in the payments market

Several competition cases in the EU and other countries (Australia, US) suggest a new regulatory approach for payment services including deregulation to instil more competition in payment markets.

The most important measure in this respect is the removal of legal and technical market entry barriers for new providers in order to make true cross-border provision of services possible.

The current regulatory situation creates a lack of competition in many payment services.75 Banks enjoy a privileged competitive position in payment markets and the sometimes existing bank monopoly in payments excludes many innovative new players from providing payment services who want to enter the market.

Concerning legal requirements for market access, studies undertaken in this context[76] have shown that limiting provision of payment services to fully-fledged credit institutions (i.e. banks) has a negative impact on competition and restricts access more than is necessary for the financial integrity of the payment system. Furthermore specific measures might be needed to allow new entrants to enter the market and be able to compete on a level playing field with banks. Banks benefit from competitive advantages due to their regulatory status. Banks control the majority of consumer deposits[77], and any payment system will at least initially have to debit funds from consumers' accounts with the banking sector if it does not provide the payment service against a credit line.

---

[74] As reported by Eurocommerce.

[75] Retailers complain about the high costs they must pay to banks for the use of credit cards e.g. on average merchants pay 3% of their turnover for credit cards payments; in markets where there is only one bank providing these services the fees are 600% higher than in other more competitive and less strictly regulated national markets. Several DG Competition cases and a sectoral study in the card payments market highlight the lack of competition.

[76] See various publications by the Reserve Bank of Australia, Reform of Card Schemes in Australia, 1998-2004.

[77] Deriving from the exclusive status of credit-institutions with respect to deposit taking, defined in the Codified Banking Directive 2000/12/EC.

Banks have a privileged relationship with their customers, allied with information about their banking and expenditure habits, which they can use to target customers.

In order to make outside competition work and achieve improved levels of service, in particular in markets with low efficiency and high prices, the often substantial technical and other commercial market entry barriers (e.g. scheme rules) need to be removed. Leaving aside the harmonisation of anti-competitive commercial practices the main difficulties are technical barriers and rules on access to national payment schemes. Banks are the organisations with immediate and unmediated access to the clearing and settlement system. This gives them several advantages. Direct members (banks) earn on indirect members (non-banks) fees for processing their payments and issuing guarantees on these payments. Direct members also set the fees to be paid for the exchange of payments in the respective network, which are then imposed on new entrants to the system. Members enjoy a competitive advantage over non-members when developing the payment system, as they develop technical and commercial agreements amongst them which make it difficult for new players to access the market. The costs for a foreign competitor for connecting to proprietary local systems without interoperable standards are extraordinarily high. Additionally initial costs will be high as customers may move slowly to new service providers.

6. Insufficient codification of core legal rules for payment services in EU legislation

Payment legislation at EU level (including EMI and ECB rules) is rather recent. The first legally binding act, Directive 97/5/EC[78], was adopted in 1997 and contained a small number of provisions dealing with cross-border credit transfers. In the same year Recommendation 97/489/EC[79] was published, providing for the protection of customers using electronic payment services, such as payment cards.

Further progress has been made since then, culminating in the adoption of Regulation (EC) No 2560/2001[80]. The Regulation on cross-border payments introduced the idea of a “domestic market” for all intra-EU payments in euro that applies to credit transfers, cash withdrawals at cash dispensers and payments by means of debit and credit cards.

The current legal framework presents some shortcomings. The three key EU legal acts show have some overlaps[81]. Certain rules of the Directive have become obsolete after the adoption of the Regulation. A recent Commission Report[82] on the Directive demonstrated shortcomings. A Study[83] on the Recommendation 97/489/EC revealed insufficient transposition into national legislation.

---

78 OJ L 43 of 14.2.1997, p. 25.

79 OJ L 208 of 2.8.1997, p. 52.

80 OJ L 344 of 28.12.2001, p. 13-16.

81 E.g. all three legal acts contain measures with regard to the information to be provided. This is confusing for both the payment industry and the consumers: the payment services users have no easily understandable set of requirements. The payment service providers are equally in a situation where they have to refer to various legal texts with similar requirements but expressed in different terms, without knowing whether the information they provide is sufficient under EU and national law.

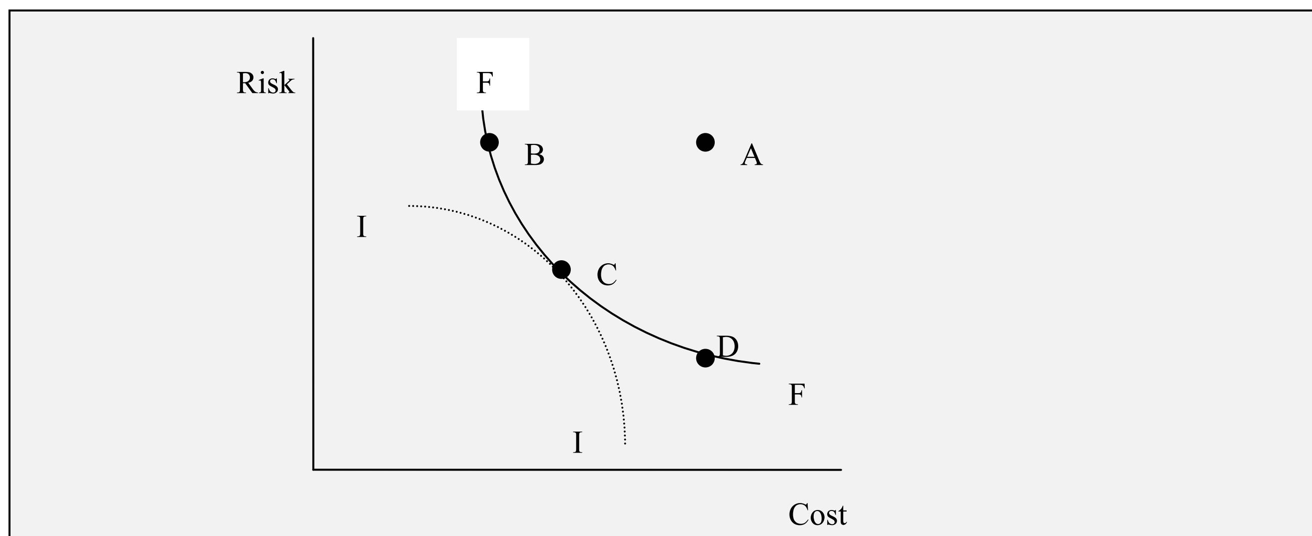
82 Report from the Commission to the European Parliament and to the Council on the application of Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers (COM (2002) 663 final).

83 The Study on the implementation of Recommendation 97/489/EC concerning transactions carried out by electronic payment services and in particular the relationship between holder and issuer (May 2001) is available at: http://europa.eu.int/comm/internal_market/payments/.

It is therefore desirable to reconsider the new needs for legislative proposals in the context of deficiencies in EU and national legislation to achieve an improvement in proposing a comprehensive coherent legal framework.

ANNEX 2: RISKS AND COST ANALYSIS OF THE PROBLEMS IDENTIFIED

This model gives as simple graphic idea of the different economic problems and inefficiencies presented above[84]. The vertical axis can be considered as a weighted sum of the risks functions of all the parties bearing payment risks. Similarly, the horizontal axis measures the weighted sum of costs borne by all the parties.



The FF curve is the social best-practice efficient frontier for the payments system, in the sense that risks cannot be reduced without increasing the costs and vice versa. The position of the curve depends upon the technology used to process and settle payments, financial techniques for monitoring and controlling risk, and the regulatory environment, all of which may be altered by innovations. The convex shape of the frontier reflects a usual assumption: as risks get lower, the marginal cost of further reductions in risks increases.

All of the points in the areas above and to the right of the efficient frontier FF are feasible outcomes, as well as those on the frontier, but the points to the right and above FF reflect inefficient choices from a social viewpoint.

Curve II reflects the social utility function. Since greater risk and greater cost reduce social welfare, shifting curve II to the left increases social welfare (lower cost for given risk). Given the frontier curve FF, the point of highest social welfare is represented by point C, where the II and FF curves are tangent.

Point A represents an inefficient situation, as risks can be reduced without increasing the costs (point D) and costs could be reduced, without increasing risks (point B). However, as the frontier represents the risks and costs borne by all members of the society, some market players may prefer to be at point A if substantial risks and costs are imposed on others while their own costs and risks are smaller.

---

84 "A framework for analyzing efficiency, risks, costs and innovations in the Payment System". Allen N. Berger; Diana Hancock; Jeffrey C. Marquardy. Journal of Money, Credit and Banking, Vol. 28, Nov 1996.

Point B would be an efficient situation in the sense that risks cannot be reduced without increasing costs and vice versa, but from a social-utility point of view, the stakeholders as a whole would prefer a situation where risks would be lower even if that means that costs are higher.[85]

So, the effects of the previously explained shortcomings of the current situation in Europe are the following:

Inefficient use of payment instruments

The inexistence of a cost-based pricing for payment services make consumers choose inefficient payment instruments. This productive inefficiency places the European economy in a point like A where cheaper payment instruments could be used without increasing risks, or safer instruments without increasing costs. If consumer demand for payment services is price elastic (and the Norwegian experience suggests so), fostering cost-based pricing for payment services will change consumer behaviours, moving payments production towards the efficient frontier.

Even though the choice of the consumer was a technically efficient instrument (in the FF frontier), if risk is mispriced, because the party creating the risk is not fully charged for it or is overcharged, then either too much or too little risk relative to the social optimum may be created, even if costs and risks are on the efficient frontier. That would be a problem of allocation efficiency.

Furthermore, a broad application of new technologies to payment services could improve technical efficiency, shifting the risk-cost efficiency frontier to reach a higher level of social utility. However, this kind of efficiency improvements do not necessarily imply improvement of overall efficiency, if payment production is far from the efficient frontier, a movement of the frontier may not affect the situation insofar as productive efficiency is not improved.

Lack of pan-European payment infrastructures and services

The slow progress on consolidation of banks´ payment services, infrastructures and standards, limits the possibilities of achieving the expected economies of scale derived of a stronger consolidation. Important savings of costs could be achieved moving the efficient frontier to a situation down and to the left and improving the social utility derived of payment systems production.

Low efficiency of payment systems and services in the Single Market

The technical solutions to reduce the time to process a payment already exist but they have not yet been totally exploited by service providers. This excess in processing time increases not only the costs for the consumers but also the risks. The upgrading of payment systems would improve technical efficiency, shifting the risk-cost efficiency frontier in payment systems to the left and down, being able to reach a point where lower risks for a given cost or lower costs for a given risk are borne by the society.

---

[85] Innovations can affect risk and cost outcomes for payments. There are three main ways that these innovations can improve the payment systems. 1) Innovations can affect the location of the risk-cost frontier. There are three types of innovations that can move the frontier: technological, financial or regulatory. 2) Innovations can help to move payments production to the efficient frontier by increasing productive efficiency. 3) Innovations can improve the payments system by adjusting the relative prices faced by payments system participants to improve the choices made between risks and costs. That way we improve allocative efficiency.

Lack of efficient competition and a level playing field in the payments market

A higher degree of competition and a level playing field in the payments market will: foster innovation by allowing new payment providers to enter the market, and reduce costs by helping more efficient competitors to improve their market position. Innovations may move the FF frontier to a more efficient situation and the improvement of the situation of the most efficient payment providers may move payment services production towards the efficient frontier.

Fragmented legal framework for payment services

The existence of a fragmented regulation in the EU is not only an obstacle to a higher consolidation of infrastructures and the creation of pan-European payment services, to a higher degree of competition between payment services providers and to the existence of a level playing field. Furthermore, this fragmented regulation, in itself, creates legal uncertainty in the market players, adding unnecessary risks and costs to payment processes. So, regulatory innovations might reduce the risks transmitted through the payments system and push the FF frontier downward.

ANNEX 3: THE SEPA PROJECT

1. European banking industry's initiative for an integrated Single Euro Payments Area

Until the Commission proposed Regulation (EC) No 2560/2001, several self-regulatory initiatives had failed to deliver the necessary payment infrastructure and services to make payments in the Single Market more efficient, user-friendly and reliable.

In retrospect this regulatory intervention is deemed to have 'kickstarted' industries' initiative for a Single Euro Payment Area. The adoption of Regulation (EC) No 2560/2001 had two effects, it considerably reduced prices for cross-border payments because it obliged payment industry to charge the same prices for cross-border payments in euro as for national payments and it provided an incentive for the payment industry to modernise EU-wide payment infrastructures. When Regulation (EC) No 2560/2001 was adopted the necessary infrastructures were not in place to allow equally efficient processing of national and cross-border payments.

Industry, in order to achieve an acceptable and economically viable unit cost level in the payments market, is faced with the challenge to build efficient infrastructures (pan-European clearing and settlement systems) for the main payment services (credit transfers, direct debits, credit and debit card payments) that could cater to the European market instead of national markets. In order to respond to this challenge, banks' decided in 2002 to setup the European Payment Council (EPC)[86], as its main co-ordination and decision-making body. The EPC was put in charge of the creation of a Single Euro Payment Area (SEPA), consisting of the delivery of common infrastructures and services for euro payments for all banks by 2010. The EPC adopted in 2002 the following roadmap – subscribing to the vision that all payments in euro should become domestic by end 2010.

SEPA OBJECTIVES – ROADMAP 2002–2010[87]

"Over the last 5–10 years Europe has achieved a major step forward by agreeing to the introduction of a single currency – the euro – and by converting accounts, notes and coins to this currency. Time has come now to launch the next wave that will ensure that the economic benefits of this conversion accrue to all actors: consumers, SMEs, corporates, retailers and banks. In the previous chapters, the key recommendations for achieving these benefits were laid out. This chapter combines the proposed actions and milestones into an overall roadmap:

By December 31, 2002: *a substantiated, syndicated and detailed roadmap* achieved by: (1) launching a strong governance structure and the five working groups by July 1, 2002; (2) reviewing and substantiating the choice for a pan-European ACH (e.g., review of existing options, business rationale, business requirements); (3) systematically analyzing standards, rules, business practices and conventions required for STP; (4) conducting a detailed investigation of the specific networks and switching fees for cards and proposing options to allow efficient cash handling within the euro zone (the last three actions by the end of 2002). These efforts will lay the foundation for a concerted course of action over the next 5–10 years.

86 The founding members of the EPC are 42 European banks, the 3 Credit Sector Associations EACB, ESBG, FBE and EBA. Today the EPC represents banks from all geographic regions of the EU, covering all types of institutions (savings banks, cooperative banks, commercial banks) and consisting of both smaller and larger players.

87 According to the EPC's White Paper on SEPA adopted in May 2002:

By July 1, 2003: *the first tangible results* achieved by: (1) having an operational pan-European ACH; (2) defining a pan-European direct debit product (e.g., value proposition, requirements, migration timetable); and (3) agreeing to the basic standards, rules and conventions for credit transfers and cards, leveraging the existing standards (e.g., IBAN, BIC, MT103+). These targets are ambitious, but necessary to create the right momentum and make efforts credible to the other stakeholders.

By December 31, 2004: *ramp up activity* by: (1) having 50 % of cross-border payments volumes on the pan-European ACH infrastructure; and (2) agreeing to the value added services standards and their implementation plan (including incentive measures and cut-off point). By this time the industry should be in the acceleration phase, provided there is a real will to move forward.

By July 1, 2005: *the next wave of innovations*, starting with the processing of the first transaction of the new pan-European direct debit instrument. By this time the governance structure should be able to demonstrate that it can respond to the continuing changes in the environment by launching new initiatives.

By December 31, 2007: *achieve target service levels* for the pan-European infrastructure, so that banks will be able to reap the full benefits from the migration in their own back offices.

By December 31, 2010: *achieve a full migration for banks and their customers to the Single Euro Payment Area*, with realization of all economic benefits and a clear shift in mindset from "Migration towards SEPA" to "Managing SEPA on a going concern basis". Although this time horizon might seem long, it is actually quite ambitious given the changes that will have to take place in legislation, in the activities of thousands of banks and in the habits of millions of customers."

The Commission fully endorses industry's objectives for SEPA and appreciates the complexity of this important project. The Commission proposal would facilitate industry's work by removing legal obstacles to the SEPA project and harmonising the legal framework for payment services in the EU.

2. Progress made for the creation of SEPA

The banking industry's programme as outlined above includes the development and adoption of necessary scheme rules including commercial and technical standards for the three main payment services, credit transfer, direct debit and cards. The milestones defined foresee for instance that in 2003 the first pan-European clearing house is operational, with 50 % of all cross-border payments processed in this new clearing house by 2004. By 2005 industry wanted the new pan-European direct debit scheme operational and 2007 the full benefits from the new pan-European infrastructure should be effective for banks, allowing a full migration of national payment systems, banks and customers to SEPA payment services and infrastructures by 2010, for both national and cross-border payments.

Until 2004 the progress of the banking industry was slow for realising SEPA. Much time was spent to set up the European Payments Council (EPC) governance structure but little was achieved in terms of delivering the promised milestones, e.g. until start of 2005 none of the SEPA payment

instruments has been delivered. End-2004 industry acknowledged[88] that there has been slippage against the milestones as defined in 2002.

If SEPA is to be completed by 2010 the major part of work for SEPA needs to be done during the remaining five years between now and 2010. Presently there were clear signs for a "recovery" of industry's initiative. Beginning of 2005 industry updated its roadmap for SEPA and passed the following declaration[89]:

- We will deliver the two new Pan-Euro Payment Schemes for electronic credit transfer and for direct debits. We will also design a Cards Framework to define a single market for cards. The scheme rulebooks and the cards framework definition will be delivered by end 2005, and the services will be operational by January 2008.
- We know from feedback from our community in the euro zone that by the beginning of 2008 the vast majority of banks will offer these new pan-European services to their customers.
- We are also convinced that a critical mass of transactions will naturally migrate to these payment instruments by 2010 such that SEPA will be irreversible through the operation of market forces and network effects.
- SEPA will be delivered by the banking industry in close conjunction with all stakeholder communities (consumers, SMEs, merchants, corporates and government bodies) and supportive public authorities. The community of European banks is strongly committed to this ambitious programme of action, based on self-regulation and a full recognition of the role of market forces and competition.

However, banks new declaration and commitments seem to differ from the original promises and full migration to SEPA in 2010[90] (which is where the real benefits could be reaped). In its new declaration payments industry expresses commitment to the objective of a full migration of national payment systems to SEPA payment schemes but does not guarantee this migration. It is left to market forces, if such migration takes place. Therefore the choice rests with the national payment service providers to migrate, what is 98 % of payments volume into SEPA payment schemes, or not.

The industrywide debate illustrates that there are many obstacles which could potentially delay the project and negative incentives that could potentially hamper adoption by national payment service providers. Sunk costs for past investments in proprietary infrastructures create a "lock-in" situation in existing national systems and pose a major obstacle to overcome. It is already rather difficult to make a large number of market participants agree on a common standard but to get individual banks to make substantial investments and to implement a proposed standard and adopt a new payment scheme as long as they do not have a clear business case and certainty that all other providers will also adopt the same standard/scheme is a real challenge. Self-regulation can only provide to a

---

[88] In its progress report 2004, ECB criticised the EPC for the slow progress. In its updated roadmap 2004, industry admitted delays in the first two years, also reacting to the critical ECB progress report.

[89] EPC Crown Plaza Declaration adopted on 17 March 2005.

[90] This concern is confirmed by interviews with individual banks and national banking communities.

limited extent the certainty that all providers (approx. 8000 banks) and users (several million corporates and 450 million private users) will adopt a particular standard/scheme[91].

However, SEPA offers a unique window of opportunity to develop and implement common schemes including the necessary interoperable standards in order to prevent irreparable fragmentation of payment markets. There is a risk that without the development and adoption of open interoperable standards supporting end-to-end automation, the whole SEPA project will fall short of its objective and there will be no real integration of cross-border and national payments infrastructures.

[91] SEPA standards and schemes can not be mandated by the EPC for banks or users. Therefore banks that are first to adopt these new standards and products will be faced with first mover disadvantages. Banks which will migrate to SEPA standards and schemes have high initial investment costs which will deliver no obvious benefit unless other banks migrate to theses new standards and the new schemes gain critical mass. Only in this situation, the "old" systems will "tip over". To overcome this "first mover disadvantage", banks need legal certainty and a clear political signal.

ANNEX 4: ISSUES OUTSIDE THE SCOPE OF THE REGULATORY INTERVENTION

Out of the 21 legal obstacles identified in COM (2003)°718 final the following three were regarded to be outside the scope of a regulatory intervention aimed at recasting the regulatory framework for electronic payments in the EU.

- Cash and cheques are considered to fall outside the scope

It was commonly accepted by all stakeholders that the new legal framework for payments in the Single Market should focus on future-oriented means of payment which entail a potential for cost-efficient cross-border use. Therefore the project focuses exclusively on electronic payment services, which provide a clear low cost and efficient alternative to cheques and cash (see discussion in part 3.1).

The issue of "*removing barriers to cash circulation*" was not taken up.

The Commission is of the opinion that as a first step industry together with the Eurosystem should try to tackle this issued together with strategies for the reduction of the use of cash and migration to electronic payment services with the aim to ultimately reduce the high costs to society and the economy. At a later stage and if this is necessary in order to remove obstacles and reduce the high costs of cash the Commission might consider a framework for cash payments and related services in the EU.

- Bank accounts are considered to be outside the scope

The regulatory intervention focuses on payment services which might rely on the use of bank accounts but does not enter in the detailed arrangements and rules governing the access, pricing and technical features of bank accounts. at a later stage dedicated measures might be necessary to address problems related to bank accounts.

The issue of "*Non resident accounts*" was not taken up.

The Commission's stock taking found that some Member States provide for a different legal regime for resident and non-resident bank accounts. The reasons for this different treatment are various e.g. balance of payments reporting, money laundering and tax issues. Not all of these problems can be solved within the scope of this regulatory intervention, which will have to concentrate on payment-related issues. The Commission might at a later stage address this issue by a Recommendation or in the context of the broader scope of financial services policy.

It was decided that legal requirements for the "*portability of bank account numbers*" should not be taken up

The benefit of the introduction of a mandatory rule ensuring the portability of bank account numbers is to facilitate mobility of customers. Currently the cost for changing from one bank to another is very high. Bank account portability is expected to facilitate competition. However, studies carried out in some Member States (UK, NL) regarding this question of portability have shown that the recently introduced EU-wide IBAN-BIC[92] numbering system is not compatible with

[92] Regulation (EC) No 2560/2001.

the portability of account numbers without incurring in disproportionate costs and provoking problems for efficient straight through processing.

The Commission believes that after the considerable investments in the development of the IBAN-BIC numbering systems, time is needed for this system to prove its effectiveness. It would not be appropriate at this stage to impose a modification of the system. Nevertheless, the IBAN-BIC system appears to be a very complicated system and may need to be simplified in the long run. Therefore the Commission advises the banking industry to launch studies in order to create, in the long run, a more simplified numbering system for payments in the Internal Market.

- Security are considered to be outside the scope

The relationship between providers including the security of payment processing and clearing infrastructures and network operators was considered outside the scope of the regulatory intervention. It was deemed appropriate by stakeholders to focus solely on the relationship of provider and user and matters which are of relevance in this sphere and were strictly payments related.

The issue of "*digital signatures*" was not taken up.

The Commission's assessment found that the existing legal framework provided by Directive 1999/93/EC on Electronic Signatures, establishing the general legal framework for electronic signatures in the EU by ensuring their legal recognition and free circulation within the Single Market is sufficient to ensure legal certainty and no further regulation is necessary.

The issue of "*security of payment networks*" was not taken up.

Due to the comprehensive legislation on the subject (Art. 17 of the Data Protection Directive and similar provisions in Directive 2002/58/EC) the Commission decided to refrain from further legislation. Instead the Commission intends to follow up on the subject together with the newly created European Network and Information Security Agency in the framework of the EU Fraud Prevention Action Plan.

The issue of "*breakdown of a payment network*" was not taken up.

Usually the user is not in a position to influence the technical performance of the system operated by the service provider; in that sense it is arguable to impose a liability rule for the possible damages suffered by the user or the merchant in case of the breakdown of a payment network making it impossible to access the payment facilities.

However, there are circumstances, beyond the providers´ control that may cause a temporary interruption of a system. There is no reason why a payment service provider should be held liable for unlimited consequential losses due to system breakdown while other service providers (telecoms, electricity…) do not face a similar liability. Furthermore, the existence of a multiplicity of means of payment at the disposal of the consumer makes it even more difficult to defend an unlimited liability. Furthermore the additional costs will be passed on to consumers.

The Commission Services believe that legal responsibility in case of a breakdown of a payment network is a matter subject to contractual law. Furthermore, the difficulty in proving the impossibility to use another mean of payments and in quantifying the damages makes it hard to establish general legal provisions.

The issue of "*security of payment instruments and components*" was not taken up.

The Commission's consultation confirmed the problems affecting the EU-wide/international recognition of security standards and the resulting problems for the parties involved (e.g. high cost for duplication of certification process, diverging requirements, lack of transparency of information received by the party requesting a security evaluation and the lack of standards of security requirements used for payment products).

However, the issues identified are going certainly beyond the scope of payment services and the Commission believes it should therefore better be tackled in a separate project. For this purpose the Commission has started a detailed investigation and assessment together with a market expert group in the framework of the EU Fraud Prevention Action Plan.

ANNEX 5: PRUDENTIAL REQUIREMENTS

This section discusses the potential impacts of different prudential requirements for payment institutions from a competition and financial stability perspective under the condition that requirements must be proportionate to the factual evident risks associated with the business lines pursued by payment service providers.

1. Existing regulatory status of payment service providers

The provision of payment services has been regulated very differently in Member States. However, the provision of payment services has never been restricted to credit institutions only. Money remitters have always been different from banks – their activity is distinctively different from deposit taking and associated risk – a fact that has been acknowledged in applicable EU legislation ('Banking Directive'). However, this fact has been transposed very differently in Member States legislation.

Payment card issuers and acquirers have – in the majority of cases – been unregulated entities in Member States. The low number of non-credit institution card issuers and acquirers is to a lesser extent consequence of the legal treatment in Member States but more a result of market entry barriers imposed by credit institutions through the particular card payment schemes. In the documented cases[93] dominant national banking association running the local debit card scheme or the international credit card schemes would restrict access of non-bank competitors to the system, e.g. by obliging them to become a credit institution, agreeing on discriminatory entrance fees and charges for the use of the system or technical entry barriers such as the standards for cards and terminals.

Mobile payment services and post-paid billing and payment services have in most Member States been unregulated activities. However, overlaps and uncertainty about the interpretation of the e-money Directive 2000/46/EC have in some case led to the result that e.g. Member States required telecom operators to become e-money institutions for the prepaid aspects of their payment business and where at the same time enforcing a prohibition of the respective Directive to provide post-paid payment services.

All types of non-credit institution providers have in common that there have been few or no reports of problems. Member States which had either no regulation or only registration of these providers did not encounter problems. There has been no concern for financial stability or costumer protection.

[93] Cases documented by national and European competition authorities.

2. Prudential requirements from a financial stability perspective – risk profile of 'main types' of payment institutions compared to credit institutions

Business activity	OF CREDIT INSTITUTIONS: DEPOSIT TAKING + PAYMENT SERVICE PROVISION
Systemically importance in payments market (size, number of providers)	Credit institutions as deposit taking institutions undertake a wide range of financial activities, of which the provision of payment services may be only a small part, and have commensurate range of skills and infrastructure. They also pursue comprehensive risk management policies designed to ensure fundamentally, that depositors can be confident of withdrawing their funds in full on demand. In contrast payment institutions provide more specialised activities and generate risks that are much narrower and easier to monitor and control than those across the spectrum of activities of a deposit-taking institution. The systemic importance of credit institutions payment operations for the payment system is illustrated by the enormous number of transactions running through banks payment systems and balances held by banks. Banks handle 231 billion transactions per year with a total value of EUR 52 trillion. The funds held by banks on customer bank/payment accounts amount to a total of EUR 3 165 billion.
Deposit taking and related risks	The nature of deposit taking as an activity, where banks take depositors' money offering a promise of repayment on demand and subsequently invest this money in assets less liquid than this promise to repay (for example making loans to consumers and businesses), and the systemic importance of banks to the wider economy is reflected in the regulatory regime applied to them.
Credit risk Operational risk (technical failure, fraud, etc.)	Capital requirements have been introduced for credit institutions to protect depositors of the credit and operation risk credit institutions run. Capital charges shall ensure the stability of the single institution and ultimately the financial system whereby the capital charges reflect the risk exposure of the credit institution and shall prevent them from failure.
Financial soundness/Risk of bankruptcy	The operational risk model used for the revised (BASEL II) solvency requirements for credit institutions, for example the 18 % capital charge for payment and settlement services reflects the operational risk run by credit institutions. According to BASEL II, the losses incurred by credit institutions from payment and settlement services merits an 18 % capital charge. This 18 % capital charge has been developed on the basis of a modelling exercise of the loss data of banks collected by the BASEL Committee. Therefore this ratio is only relevant to the particular risk profile of credit institutions and only where the 'standardised approach' is applied. It describes the substantial risk banks face in payments, clearing and settlement of payments and securities.
Money laundering and terrorist financing	Credit institutions like other financial or payment service providers handle the flow of funds and are therefore exposed to the risk of money laundering and terrorist financing.

Business activity	MONEY REMITTANCE
Systemically importance in payments market (size, number of providers)	Money remittance systems are classified as systemically not important payment systems[94]. A two tear structure of the money remittance sector can generally be found in most Member States: consisting of officially registered larger internationally operating remitters and a majority of small remitters operating without license. These small remitters operate in most cases in a limited network of friends and families (often immigrants or socially underprivileged groups with no access to the banking system) and provide remittance services as a non-for-profit or low profit activity associated with other businesses (e.g. related activities such as *bureaux de change*, travel agencies and import-export businesses, or unrelated activities such as shops or taxi companies). The number of officially operating money remitters in Member States (a range of 5 in some MS to 1,435 in the UK) depends largely on the type of prudential regime adopted. Member States with a registration regime, focussing mainly on prevention of money laundering have a higher number of registered providers than countries which generally demand a banking license. At European level, the total number of money remitters seems to be represented by 2000 of actors (most of them small remitters). A Commission study[95] based on Member States records shows some EUR 17 billion flowing from the EU to non-EU countries. This figure highlights the core role money remitter's play in facilitating cross-border payments in particular to developing countries (remittance flows are the second largest financial flow to developing countries after foreign direct investment, more than double the size of net official finance) – a market segment only insufficiently served by banks.
Deposit taking and related risks (covered by minimum and ongoing capital requirements, deposit insurance)	In contrast to deposit taking or issuing e-money, money remitters offer a straight remittance service that involves taking in money to pay out to a named beneficiary usually within 24 hours. The threat of a 'bank run' – deposit makers requesting their funds back at the same time and the bank having inadequate capital reserves to comply – is not applicable to money remitters. The remitter does not invest the remittance in between receiving it and paying it out, and usually makes the funds available for collection within approximately 20 minutes of being entered onto the accounting system. The average transactions going through money remittance systems are of relatively low value (average EUR 200–400 depending on country[96]). If an individual money remitter were to become insolvent and unable to pay out remittances, consumers would stand to loose comparatively small amounts of money. In contrast to an insolvent bank which might undermine the stability and integrity of the wider economy and the financial system, an insolvent money remitter would not have any comparable impact. An insolvent money remitter would not have the capacity to damage the wider financial system.

94 Based on the G10 standards entitled "Core Principles for Systemically Important Payment Systems (Core Principles)", which were adopted by the Governing Council of the ECB in January 2001.

95 EU survey on workers remittance from the EU to third countries (ECFIN/235/04-EN (rev 1) published on 28 April 2004 by the Commission, DG ECFIN.

96 Based on an independent study commissioned by the UK's Department for International Development (DFID). These figures have also been confirmed by an EU survey on workers remittance from the EU to third countries (ECFIN/235/04-EN (rev 1) published on 28 April 2004 by the Commission, Economical and Financial Affairs DG.

Credit risk/ counterparty risk/settlement liabilities	Money remitters do not face a credit risk, as the customer will make the funds available before the transfer takes place. Customers face a short-term credit risk during the time they have handed over funds and until the transfer is completed, which is almost instantaneously. This credit risk is in no ways different from the credit risk present everyday in the economy where all transactions which are not settled in a payment versus delivery mode are subject to a short-term credit risk. It is deemed inappropriate to impose on all economic actors therefore solvency requirements. The same rationale should apply to the business of money remitters where first payment takes place and shortly afterwards delivery. Settlement risks are very short-termed as most of the transactions are settled immediately. Settlement obligations to others regularly do not exist as money remittance systems are usually closed systems. Where they do exist it is only as intra-system credit (credit towards agents) or exceptionally as a participant in a clearing and settlement system, which usually should be addressed by system-internal and adequate risk management procedures.
Operational risk (technical failure, fraud, etc.)	Money remitters face like other payment service providers operational risks depending on the size of their operations due to technical failure of systems (own IT systems are mostly used by large but not by small remitters), legal compliance, fraud, etc. Money remitter's operational risk is however, very narrow as the systems are usually closed systems (no other parties involved) and it therefore does not create counterparty risks or chain effects. This is in stark contrast to the banks payment system, which is embedded in a multilateral network, and creates substantial counterparty risk and chain effects which could potentially destabilise the financial system.
Financial soundness/Risk of bankruptcy	Available evidence and reports from money remitters suggest that money remitter employ sufficient capital to provide payment services with an adequate level of reliability and financial soundness and to cover both their risk towards customers and their operational risk. Different examples show that in a comparison with the revised banking capital requirements money remitters' actual capital stands far above 100 %. It implies that money remitters devote to payment services a capital higher than banks under the banking capital requirements. Insolvency records of Member States show that so far there were no cases of bankruptcy of money remitters reported including any negative consequences for the stability of the financial system.
Money laundering and terrorist financing	Money remitters are dealing with the transfers of funds and risk therefore to be used for money laundering or terrorist financing purposes.

Business activity	PAYMENT CARD ISSUING
Systemically importance in payments market (size, number of providers)	Payment card *issuers* in each scheme assess the creditworthiness of, and issue cards to, cardholders; authorise cardholders' transactions; settle with acquirers for transactions accepted by merchants; collect payments from cardholders; deal with disputed and fraudulent transactions; and contribute as necessary to the scheme's loss-sharing arrangements. Currently the sector of credit card issuers is dominated by banks due to scheme rules of national and international card organisations and only a few non-bank issuers have yet entered the market.
Deposit taking	Card issuers do not accept deposits from the public.

Credit risk/ counterparty risk/settlement liabilities	The liquidity and credit risk for debit card issuers is very limited as the cardholders account is debited immediately before or right after settlement with the merchant acquirer. For credit card issuers liquidity risks arise because issuers must settle with acquirers within a day or so of transactions taking place, while repayments by cardholders for credit cards may be spread out over several days or months. In this case also credit risks arise because cardholders may fail to pay their outstanding credit card accounts. Issuers must be able to manage both of these risks if they are to settle their obligations to acquirers; their ability to assess the creditworthiness of cardholders is critical. However, risks to issuers need to be kept in perspective. While their settlement obligations have to be met daily, their demand for liquidity should be reasonably predictable, given normal seasonal spending patterns and established billing cycles. For credit card issuers, there is no obvious counterpart to a run on liquidity where depositors have concerns about the soundness of a financial institution; cardholders are most unlikely to run up new debts suddenly if the solvency of their credit card issuer were in doubt. Furthermore according to figures about the current market structure: 97 % of cards used are debit or deferred debit cards only 3 % of cards issued are real credit cards. Consequently the credit risk for debit cards would be marginal and the duration on average for the credit risk of credit cards not more than 1 month. It is important to stress that the credit risk is only to the issuer, cardholders do not face any risk in these transactions. In contrast to depositors with banks who might loose their money, cardholders benefit form a credit line which they only have to pay back subsequently (e.g. delivery first and payment later). The business of issuing debit or credit cards is mainly about proper management of credit risk, though of a very simple type compared to the complex credit risks managed by banks: Example: A large retailer such as Tesco or Carrefour issues a debit card to its customers. The financial information provided by the customer together with the customer databases (which allows them to link a particular customer with each single item of his everyday purchases) puts them in a good to monitor their customers' creditworthiness (e.g. it would be easy to establish a daily spending limit). The risk is even further reduced if the card issued is linked to the customers bank account and the amount is debited directly and instantaneously to the account. Customers on the other hand might like the service of an additional credit line or in case of direct debit, there might be value added services (such as loyalty schemes).In France cards issued by retailers are so successful that retailers issue already as much cards(50 Mio. cards) as banks.
Operational risk (technical failure, fraud, etc.)	Operational risks resulting from the management of a complex payment system are not predominant in card issuing. However, like other payment service providers the operational risks of card issuers depend on the size of their operations and other risk stemming from legal compliance, fraud, etc. However, there is no apparent risk to the cardholder.

Financial soundness/Risk of bankruptcy	Financial soundness of non-bank credit card issuers is difficult to assess because of the limited number of non-bank providers. However, Member States competent authorities did not report problems of undercapitalised payment card issuers. Furthermore, the companies which have so far shown an interest in issuing payment cards are mainly large retailers with superior financial standing and credit rating. Other providers are often subsidiaries of banks or otherwise outsourced entities which are included in the consolidated supervision of banks. Should an average card issuer go bankrupt, only the daily number of transactions would be affected – for clearing and settlement systems with one settlement cycle, even less for systems with more than one settlement cycle a day. Normally transactions are settled once or several times a day. Given the wide range of alternative payment mechanisms there is almost no risk that the transactions will not be completed. Therefore a failure of a card issuer would not induce systemic effects for the entire financial system.
Money laundering and terrorist financing	Card issuers are dealing with the transfers of funds and risk therefore to be used for money laundering or terrorist financing purposes.
Business activity	PAYMENT CARD ACQUIRING
Systemically importance in payments market (size, number of providers)	Credit card acquirers in each scheme assess the ability of merchants to deliver goods and services paid for by payment cards, and sign them up to accept the scheme's payment cards; capture merchants' card transactions and seek their authorisation from issuers; guarantee payment to merchants for the value of payment card transactions acquired; settle with issuers for transactions acquired as well as for disputed and "charged back" transactions.
Deposit taking and related risks	Card acquirers do not accept deposits from the public.
Credit risk/ counterparty risk/settlement liabilities	In the normal course, acquirers are net receivers of funds from issuers at daily settlement. In some cases there might be a delay of a day or so between their payments to merchants and receipt of settlement funds from issuers, in these exceptional cases acquirers may face liquidity risks, although these should be readily manageable. Acquirers may also face liquidity and credit risks arising out of refund claims from credit cardholders. However, most card transactions do not generate refund obligations for acquirers. Example: A restaurant meal or groceries paid for by payment card. The meal has been consumed or the groceries purchased, the card is present and the merchant has a record of the cardholder's signature. The transaction has been completed on a "delivery versus payment" basis and the scope for the customer to initiate a refund to its payment card account (known as a "chargeback") is virtually nil. Therefore, each acquirer has an interest in ensuring to assess price and bear the risks associated with card transactions at the merchants they sign up. The risks of merchant default for an acquirer, argue for a diversified merchant base.
Operational risk (technical failure, fraud, etc.)	Financial consequences of an operational disruption of technical systems (e.g. terminal or ATM) or a fraud may lead to losses for the company.

Financial soundness/Risk of bankruptcy	As stated earlier the business of acquiring is not so much a financial service but a technical one. Typically, from the non-bank sector technical infrastructure providers and network processors engage in acquiring activities or large retailers might have an interest in self-acquiring. Factual evidence available suggests that non-bank card acquirer have so far employed sufficient resources to run sound technical and financial operations and have actually often been more efficient than banks in doing so. In case an average card acquirer fails, only the fraction of not executed payment transactions on this day would be affected. Such a failure is unlikely to cause any systemic effects for the entire financial system.
Money laundering /terrorist financing	Card acquirers are dealing with the transfers of funds and risk therefore to be used for money laundering or terrorist financing purposes.
Business activity	MOBILE PAYMENT SERVICES
Systemically importance in payments market (size, number of providers)	Telecom operators "core" business is the provision of mobile voice and digital content/data services (90 % of total services). Over the past couple of years, digital content, such as information services, ring tones, screensavers and games for mobile phones, have increased in popularity. This will continue to be the case with the launching of 3G networks around Europe and is fundamental to the success of the Information Society. Payment services are usually offered as a value added service for their mobile phone clients in order to a) pay for core communication services provided by the operator b) purchase low value digital goods or services such as a ring tone, music, a digital newspaper c) buy low value physical goods or services such as a cinema ticket or pay a taxi. In case of a) existing core communications business of their telecom operator such as voice and data/digital content services, which customers may pay for on a pre or post-pay basis there is clearly no question of a payment service. However, in the case of b) low value digital content/ data services where the basic elements of the content are produced by third parties, the situation is more complex. Because in most case, the mobile operators purchase the content for resale to their customers or, more often, enter into bilateral revenue-sharing contracts with the third party content suppliers (or merchant acquirers) concerned. Mobile operators add intrinsic value to such services, in the form of access and distribution as well as search facilities, even when the services themselves originate from third parties. Mobile operators also take full payment responsibility for their customers to remunerate the 3rd party merchant for the content element of the service via normal invoicing methods. Therefore the service cannot be delivered in absence of the telecom operator and there exists no alternative to remunerate such services. These services should not be classified as payment service in the sense of the proposed Directive. In contrast, type c) payment for physical goods or services which are ordered and paid through the mobile phone are considered as payment services.
Deposit taking and related risks (covered by minimum and ongoing capital requirements, deposit insurance)	Telecom operators are not entitled to take deposits. Under the current scope of an e-money license as defined in Directive 2000/46/EC authorised telecoms might accept prepaid funds from their customers in exchange for e-money which can be used for payments. Comprehensive prudential rules are laid down for this case. Telecoms might offer remittance services which are not connected to deposit taking. In this case telecom operators would be faced with a risk similar to money remitters.

Credit risk/ counterparty risk/settlement liabilities	Telecoms might offer post-paid payment services, allowing customers to purchase products and service via mobile phone and e.g. invoice the amount to the customers via their regular phone bill. In this case mobile operators would be faced with a credit risk. However, there is no risk for the user of mobile payment services to lose money. Given the low amounts per transaction the credit risk for providers is marginal, in particular compared to the credit risks already managed today by telecom operators for their millions of customers without being subjected to solvency (capital) requirements.
Operational risk (technical failure, fraud, etc.)	Telecoms run operational risks for the well-functioning of their systems, internal controls, administrative procedures (e.g. billing, fraud) etc. Telecoms are already today dealing with all these risk and are subject to the relevant legislation for telecommunication operators.
Financial soundness/Risk of bankruptcy	Due to the marginal size of payment operations run by telecoms operators is seems inappropriate to require particular financial soundness provisions. However, in most cases where telecom operators have started to offer payment services they were fully compliant with either the e-Money Directive or the Banking Directive.
Money laundering, terrorist financing	The risks of money laundering and terrorist financing are only relevant for the payments activities of an operator not for his other activities.

3. Prudential requirements and the need for quantitative solvency requirements

The main arguments for and against quantitative solvency requirements for payment institutions are summarised in the next tables.

Arguments in favour of quantitative solvency requirements for payment institutions:

– It avoids distortions between credit institutions providing payment services alongside other financial services and pure payment service providers ("payment institutions").

– Regulatory requirements, in particular the handling of operational and financial risk, should be the same for banks and payment institutions in order to provide a level playing field.

– There are various risks associated with payment institution activity, such as bankruptcy risk, counterparty risk, technical and operational risks, fraud, etc. Prudential rules and requirements regarding financial capacity or guarantees will be necessary to cover these risks.

– Concern that payment institutions could pose a threat to financial stability in case of insolvency or destabilise trust of users in the payment system if there are no quantitative prudential requirements such as capital.

Arguments against quantitative solvency requirements for payment institutions:

– The risks of payment institutions are hugely different from those of credit institutions. Credit institutions' prudential capital requirements are determined by the fact that their other activities pose a high risk to customers deposits held in the institution.

– Payment institutions on the contrary, provide more specialised activities and generate risks that are much narrower and easier to monitor and control than those across the spectrum of activities of a deposit-taking institution. In particular payment institutions are prohibited to accept deposits and are only permitted to use funds accepted from users for rendering payment service so that customer funds will not be mixed with own means for other business activities.

– There is no empirical evidence that the providers – which in the future would become subject to such a regime – would run undue financial or operational risks, nor is there empirical evidence of problems in the non-credit institution part of the payment sector or any history of bankruptcy even in the absence of statutory capital requirements.

– The specific conditions that justify the solvency rules for credit institutions are not present for these non-credit institution providers: no depositor protection, no systemic or prominent importance of the systems concerned and no threat to the integrity and stability of the financial system. Compare for examples a Telcom operator, which is only interested to provide payment services as ancillary service and bills small payment transactions (e.g. the purchase of a ringtone) on the customers invoice and the operations of a bank with huge payments operations based on millions of customer deposits and complicated long-term investment and lending operations.

– Also, solvency requirements (incl. quantitative requirement such as capital requirements) are disproportionate to the risk associated with the activities and nature of payment institutions and would potential overburden smaller providers and new entrants to the market which are not primary financial service providers.

4. Prudential requirements from a competition perspective

Payment markets are currently characterised by substantial barriers to market entry. Fragmented market access requirements distort competition leading to high prices for consumers and high profits for dominating providers in national markets and lower levels of innovation.

The national payment systems and infrastructures are usually run by a consortium of national banks, which operate these for "banks only" infrastructures on a non-for-profit or cost-sharing basis. This setup has in some markets led to alarming results where competition authorities[97] found that market forces only insufficiently govern the pricing of such consortia and that they have little incentives to innovate and reduce the macroeconomic cost of the payment system, and they can protect markets by restricting access for other providers.

To foster competition regulators in some markets have chosen to deregulate the access to the provision of payment services and participation in payment systems (former "banks only" infrastructures) and provide for a level playing field between payment service providers[98]. In particular they introduced a very simple prudential regime for payment services with the effect that those markets saw an increase in the number of providers. Part of this successful policy was to remove technical market entry barriers such as non-discriminatory access to processing, clearing and settlement systems to ensure that the level status of providers was also respected in industry arrangements.

[97] See for example recent cases/investigations of the competition authorities in AU, IT, NL, ES, UK and US and the EU.

[98] For example UK was one of the few markets where there recently was an increase in the number of card acquirers and other innovative payment service providers following a deregulation in 2000 of the payment system. Another example is Australia, where a special prudential regime for "credit card institutions" was created in order to bust open the highly concentrated card acquiring and issuing market. Since the reform in 1998 and prices for card payment services have gone down and the number of providers again has increased.

At a European level similar questions need to be addressed in course of designing a prudential regime and level playing field for payment service providers. Prudential restrictions should only go as far in limiting competition as this is necessary for the stability and integrity of the financial system. In this respect the current prudential regime is unsatisfactory, as it is incomplete and incoherent, leaving certain activities and providers unregulated while others are subject to prudential supervision, and it uneven as it only grants banks unlimited access to markets and special privileges (such as deposit taking).

A regulatory level paying field should follow the principle of same activity, same risks, same rules. Therefore, a new prudential regime for payment service providers needs to analyse the activities and related risks of the different providers (see above) and propose appropriate prudential rules which should be applicable to all providers operating in this business.

A regulatory level playing field should not be confused with different kinds of institutions, i.e. credit institutions and payment institutions. Credit institutions take deposits and any payment service that is attached to any payment/bank account is different from payment services offered by non-deposit taking institutions. The basic fact that credit institutions hold deposits for the general public on which they launch payment services puts them in a substantially different risk category and assigns them a specific role in the financial system for which the Banking Directive foresees special prudential risk remedies. But the fact that credit institutions take deposits does not only make them different from a purely prudential perspective it also gives them fundamental competitive advantages. Credit institutions earn substantial revenues from the interest rate margin on deposits and float of payments.

Example[99]: The average aggregated holding on transaction accounts in Sweden in 2002 was approximately SEK 650 billion. The average interest on these accounts was 2.15 % and the average repo interest rate was 4.07*. The interest margin is thus 1.92 % and multiplied with SEK 650 billion results in revenues of approximately SEK 12.5 billion (approx. EUR 1.4 billion) per year for the whole Swedish banking sector. This is at least twice as much as the banking sector’s reported cost for providing the pure payment services.

* Short interest rate on less than 7 days which closely follows the interest on overnight deposits between banks

This revenue can be used to cross subsidise the pure payment service in a way that hamper competition from payment institutions that do not have this opportunity. As a matter of fact several studies confirm this as the predominant pricing mechanism in several countries.

The regulatory privilege that only credit institutions can hold deposits has put them in a position to control the flow of funds out and into bank accounts and gives them the possibility to create commercial and technical barriers for non-bank providers to access these funds when providing payment services even if their customers have authorised this.

Such commercial and technical restrictions are under scrutiny from competition authorities and it can generally be stated that *prima facie*, restrictions imposed by existing participants on entry to a market are anti-competitive, and against the public interest. Such restrictions inhibit normal market processes, under which other providers are free to enter a market in response to profit opportunities.

---

[99] Swedish Riskbank.

The regulatory framework therefore has to strike a careful balance between the necessary measures to protect the safety of the financial system and rules to ensure a level playing field and fair access to the market.

5. Transposition of FATF SR VI[100] and waiver clause for small money remitters

Remittance services are often one of the first financial services that migrants use, offering an introduction into the mainstream financial sector. They also remain the second largest financial flow to developing countries after foreign direct investment; more than double the size of net official aid. For example, they allow families to receive the needed capital for education or housing, or provide capital for the start-up and expansion of small businesses. They can account for as much as half the income of those who receive them.

In the *G8 Action Plan: Applying the power of entrepreneurship to the eradication of poverty*[101], G8 countries have made commitments both to reduce costs in the remittance sector by promoting competition and to make it easier for people in both sending and receiving countries to gain access to formal financial systems.

There is a risk that over-onerous regulation could hamper the free flow of such remittances, which at present have a sizeable impact upon economic growth in recipient countries. The Commission believes that a regulatory regime aimed at large money remitters could in fact have the opposite effect and reduce competition in this sector by increasing barriers to market entry and driving small providers underground, where the risks are increased to users and public policy.

Smaller money remitters operate outside the formal banking system (although with most of their transfers the money is deposited in a bank account at some stage). They often provide services at far lower cost than banks or large remitters and are typically the main financial service which migrant workers use. They are also more accessible as migrants can approach them in their own language, there often exist an established relationship of trust (family, friends) and the barrier of having to engage with the mainstream financial sector is missing. They are of particular importance for remittances to countries in a state of crisis where the official banking sector has collapsed. At the time of research it was impossible, for example, to send money to Somalia through banks and extremely difficult to send it to Afghanistan except through small money remitters.

In the light of G8 commitments to facilitate remittance flows, it is vital that such remitters are neither driven out of business nor underground by over-onerous regulation. If such remitters are operating underground, the risks are far higher from a counter-terrorist financing and money laundering perspective.

The core principle of Special Recommendation VI of the OECD Financial Action Task Force on Money Laundering is to establish a better knowledge of who is operating in this market in order to better fight money laundering and terrorist financing. It explicitly provides for two options for transposition into legislation, pure registration or licensing, thereby taking account of the particular structure of this market in different countries (large vs. small remitters).

---

[100] See FATF homepage www.oecd.org/fatf.

[101] www.g8usa.gov/d_060904a.htm.

In transposing this core principle the Commission believes that there is clearly a danger that the introduction of an overburdensome regulatory regime would drive some payment service providers into the unregulated sector and hence make addressing money laundering risks more difficult, or that it would put payment service providers out of business, reducing competition and choice for consumers.

Thus a targeted and close-knit approach towards underground money remittance is most promising in fulfilling the objectives of fighting terrorist financing and money laundering. The new license for payment institutions will transpose Special Recommendation VI of the OECD Financial Action Task Force in a uniform way by subjecting money remitters to the prudential regime for payment institutions.

The introduction of a waiver clause could facilitate the gradual migration of providers from the unofficial economy to the official sector where money laundering rules can be enforced. Member States would have to ensure at a minimum, registration of all money remitters but would be permitted to waive some or all of the prudential requirements for payment institutions meeting specific requirements.

The criteria would be targeted to capture the business model of small money remitters and would require that the waiver is in the public interest, covering situations where the payment institution plays a vital role in financial intermediation, providing access to payment services for underprivileged social groups (e.g. immigrants from developing countries) and immediate substitution of services is not guaranteed or is covering situations where the payment service provided is a key enabler for new technologies and electronic commerce, such as providing micro payment services or it is regarded as necessary by the supervisory authorities for the effective implementation of money laundering rules.

The application of the waiver clause would generally be limited to providers where the total amount of funds outstanding which were accepted for the provision of payment services does not exceed EUR 5 million on average over a month and EUR 6 million at any given point in time. This limit is congruent with other EU legislation, in particular the waiver clause in Directive 2000/46/EC on e-money institutions. However, waived money remitters will not benefit from a single passport until they fulfil all prudential requirements foreseen for authorised payment institutions. This targeted approach would also account for the differences in the market structure between Member States.

ANNEX 6: CORE RIGHTS AND OBLIGATIONS OF PROVIDERS AND USERS

This section offers a more detailed discussion and analysis of impacts of different optional policy elements of a regulatory proposal.

1. Authorisation of a payment transaction and rights regarding unauthorised transactions

Any payment transaction no matter if it is done by card, e-banking or a paper instruction has to be authorised by the payer towards his payment service providers. Both parties need absolute clarity and certainty about the fact when a payment has been authorised and what happens in cases where a payment has been executed without authorisation by the payer. This question might seem rather simple where the payer gives a payment order directly person-to-person to his bank and the bank can clearly identify and authenticate the origin of the payment order. The same situation becomes much more complex for remote payments initiated through a payment card or internet banking or where the payment order is given by the payee rather than the payer. With remote payments also the question of fraudulent usage of a payment verification instruments (e.g. a payment card) is becoming more important.

Box 12: Customer requirements to build trust in the remote use of payment services (results of a Commission study)[102]

From the point of view of the individual consumer the most worrying aspects of the changing nature of banking and money are the potential new forms of crime to which it gives rise. Whereas the classic bank robbery of the past involved the appropriation of gold or bank notes belonging to the bank (rather than specific customers), bank crime in the electronic age involves the unauthorised withdrawal of credit from the accounts of specific customers. Rather than the losses associated with bank crime being borne by the bank (i.e. bank customers and bank shareholders collectively) remote banking gives rise to the possibility of significant losses being borne by a few individual consumers.

To state blithely that electronic forms of banking have fewer security risks associated with them than cash banking is to miss the point. If and when the security risks materialise consumers using remote banking services can have their accounts emptied or even be forced into debt. It is the *consequence* of the risks associated with remote banking rather than the *level* of the risks that is of most concern to consumers. There is also an important point of principle at stake. Banks are in the business of providing security. It is therefore them, rather than the individual consumer who should bear the loss if criminals find ways around banking security systems.

These principles and these concerns have long since been acknowledged in the United States where consumers are protected by clear rules laid down by the Federal Electronic Funds Transfer Act of 1978 and by various State laws. The same does not appear to be true in the European Union.

Finding I: By insisting that their remote banking security systems are infallible some EU banks have passed on losses arising from criminal activity to individual consumers.

Finding II: There is evidence that EU banks have been less than open with their customers about the vulnerability to attack of their remote banking security systems. For example, many banks have

[102] Hill & Knowlton, Report for the European Commission on "Consumer Protection in Remote Banking", 1997

continued to insist to consumers that the magnetic strip card and PIN system, widely used for ATM security, cannot be cracked by criminals unless the consumer negligently reveals his or her PIN (e.g. by writing it on the ATM card). However, the relative vulnerability of this system to attack seems to be well known within banking circles. There were numerous well documented cases revealed in the study in which this security system has been cracked without a consumer revealing his or her PIN.

Finding III: Some EU consumers have suffered financial hardship as a result of banks attempting to pass on to them losses associated with criminal attacks on remote banking systems.

Main conclusions form the study to improve consumers trust and protection:

1. In particular: Provide clarity and legal certainty of applicable rules;

2. Limitation of consumer liability for unauthorised withdrawals which take place <u>after</u> the bank has been notified of the loss of an ATM card or other remote banking authorisation device / code;

3. Limitation of consumer liability for unauthorised withdrawals which take place <u>before</u> the bank has been notified of the loss; and

4. Liability of banks for economic loss caused to consumers by systems malfunctions.

A legal framework encompassing all payment services in the Single Market should provide for an unambiguous situation for both providers and users in particular in the case of fraudulent use of a payment instrument, the legal safeguards for the concerned parties have to be in place.

These legal safeguards should provide both a high level of consumer protection and the efficiency and security of the payment systems used in the Single Payment Market, while respecting the need of fraud prevention. The user of payment services should have the same high level of protection wherever they buy or use their payment services in the Single Market.

It is also important to analyse whether a general rule may be applicable to all kinds of payment services, such as internet banking, card payments etc. or whether the specific nature of a payment service justifies a special treatment in this context. Another important distinction might be between different user groups. While private user cannot be expected to be fully aware of the level of security of the payment system corporate users above micro enterprises can be expected to apply greater care with regard to the security features and the safety of the payment environment. Also applying the rule to all users has different impacts on the maximum loss incurred.

Presently, no comprehensive legislation exists at EU level on the issue of unauthorised transactions: Recommendation 97/489/EC provides for rules on the relationship between the issuer and the holder of electronic payment instruments. Directives 97/7/EC and 2002/65/EC regulate the case of fraudulent use of a card payment in distance commerce.

Consequently it seems obvious that a general rule on authorisation and disputes of unauthorised transactions should be devised in order to provide both sides with the necessary legal certainty. According to an analysis of different payment services a general rule could be applicable to all electronic payment services as the legal circumstance of a valid authorisation by the user does not change with the different payment services. Also there should be a fair balance between the rights and obligations of both sides in case of unauthorised transactions. There should be no difference

made in the rule concerning the safety of a payment transaction as the user cannot be aware which security features are used by the provider in his system.

Basically the rules should establish by law the generally accepted principle that any payment transaction carried out by the provider at the expense of a payer must be covered by the authorisation of the payer. If such authorisation is missing or has been withdrawn the payment transaction was unauthorised and the provider has to reimburse the payer in case he has nevertheless executed it.

For the case of unauthorised payments where the payment verification instrument (e.g. payment card) has been lost or stolen or the security mechanisms have been manipulated it is of crucial importance to balances the incentives for both sides to contribute to the safety of the payment system.

In this respect it has to be considered what impact the legal provisions may have on the incentives of the contractual parties to fulfil their respective safekeeping obligations. For instance, legislation should not through distorted incentives increase the likelihood of fraudulent behaviour of the legitimate user i.e. so-called first-party fraud or result in passing-on to customers costs for flawed banks security systems.

Recommendation 97/489/EC provides a good basis for addressing the sharing of losses in the case of unauthorised transactions between provider and user. According to this concept the payment service provider shall not be liable if the payment service user acted with gross negligence or fraudulently. Also in cases where the payment service user has not fulfilled his contractual obligations (in particular safekeeping of the payment instrument and timely notification) he shall bear the financial consequences resulting from an unauthorised transaction before notification. This liability should not exceed EUR 150. After the payment service user has notified the payment service provider he should not be liable for the financial consequences.

The threshold of EUR 150 is based on Recommendation 97/489/EC and provides a fair balance between the liabilities and obligations of the provider and payment service user. Currently available evidence from Member States who have transposed Recommendation 97/489/EC into national law or which have similar provisions but with even lower thresholds do not give rise to the concern of distorted incentives for users or providers and seem not to have increased rates of fraud.

2. <u>Harmonised rules granting rights of refund in cases where the exact amount of the transaction or the payee was not specified</u>

The continuous delivery of many goods and services and their low cost billing is based on direct debits. The exact price may only be determined after the goods or services have been consumed. Common examples are services such as gas, electricity or telecommunication services where the unit price may be known in advance but not the units consumed. In these cases the consumer usually gives his authorisation for the payment transaction before consumption not knowing the exact price of the service.

Another example where efficient delivery and low cost billing is ensured by the use of credit cards is the guarantee of later payment for services such as car hire or hotel reservation where neither the provider of such services nor the consumer may know the exact price in advance, because consumption or use can vary.

Both consumers and suppliers must have confidence in these systems if they are to function efficiently. Consumers must be confident that they will not be unlawfully charged and where this is the case, that they have a right to refund, and suppliers that they will be paid for goods and services delivered and consumed.

The current situation is a mix between national legislation providing rights of refund in specific cases and contractual arrangements between users and providers[103]. This situation does not provide sufficient and consistent consumer protection in an open European Market and does not allow providers to develop one pan-European payment system following the same rules in all countries. Without harmonised rules to settle conflicts in particular on a cross-border level, confidence in electronic payments will be low resulting in a reduced number of transactions and problems of acceptance for new pan-European payment instruments.

Consequently it seems obvious to introduce rules ensuring an equal treatment of customers independently of their location or where they have used a payment service. Such rule should be introduced on a legal basis and applied to all types of payment services.

However, introducing rights of refund might have some undesired impacts, such as introducing uncertainty about the finality of a payment for the payee and the payment service provider, shifting the burden of dispute resolution from the user to the payment service provider, increasing the fraudulent use or a lack of incentives for suppliers to deliver high quality sales service.

In order to prevent misuse such refund rule needs to be based on strict conditions to ensure prudent use of such rights by the user and confidence of the payment service provider who has executed the payment transaction and has to refund the customer in case of a valid claim. Also the provider will have to establish effective inter-bank rules in order to provide refund to payers and retrieve the funds transferred from the other parties involved.

In order to secure the positive aspects of such a rule and to reduce negative side effects various elements of prudence can be introduced. To limit uncertainty of the parties involved the refund rights could be clearly limited to a reasonable period of time. Current market practices would suggest that 4 weeks for consumers and maybe a shorter period or contractual arrangements for corporate clients would be reasonable. Furthermore, in order to avoid fraudulent use, the payer should act in good faith and the criteria applied should limit the cases in which such refund claim can be made.

3. Acceptance and revocability of a payment order

Each payment transaction starts with a payment order, which usually is initiated by the payer or by the payee. Before the provider accepts to execute the payment order, he will check if this payment order was authorised by the payer and eventually if the payer has sufficient funds. Only after these checks he will accept the order and provide certain guarantees for the execution. From this time onwards usually a payment order cannot be revoked[104] by the user anymore. In case the provider

---

[103] Contractual arrangements and rules in Member States provide for different types of refunds and refund periods – between 1 day up to 6 weeks or in the case of contractual arrangements even longer.

[104] Revocability means the possibility for the originator of a payment order, be it the payer or the payee, to cancel it. This definition does not cover the right of a payer to get refund for an already executed payment transaction, e.g. reject a debit from his account based on a direct debit transaction which he did not authorise or is a case of unauthorised transactions.

finds that his conditions are not met or other inconsistencies during these checks he will refuse to execute the payment order.

Both sides of the payment relationship, provider and user, need transparency over this process and need to be aware of the point in time of acceptance, ending revocability and starting the obligations of the provider for the execution. Equally both sides need information in case of problems with any of these steps.

During the Commission's consultation on a potential new EU legal framework for payments, stakeholders raised the problem of contradictory rules concerning this process in Member States legislation and the resulting legal uncertainty and barriers for full automated processing. Stakeholders were of the opinion that transparent and harmonised EU rules on the conditions for the acceptance and revocability could improve the efficiency of existing and forthcoming payment systems. Providers notably argue, if the finality of payments kicks in at an early stage, there are no barriers to the fully automated processing of payments, which makes them cheap and efficient. Users on the other hand would prefer a late point of revocability. Both, providers and users would benefit from a clear concept of revocability, which would provide more transparency and certainty and reduce the costs of litigation.

Harmonised rules on acceptance and revocability of payment orders could improve efficiency and transparency and ensure legal certainty by determining the event when a payment order becomes irrevocable, irrespective of whether payments are processed through notified systems or not. Such rules could apply to all kinds of payments based on a distinction between payments initiated by the payer and payments initiated by or through the payee. Legal certainty would therefore be independent from technical developments and innovations and alleviate a major concern against "inflexible" legal provisions.

4. Execution of full amount and levying of fees for payment transactions

This principle is a main indicator for the effectiveness of payments in the Single Market and describes the fact that the ordered amount finally arrives at the beneficiary and did not get lost halfway or only part of the amount transferred was credited to the beneficiary. For this to be effective the payment service provider needs to ensure that the amount transferred arrives without deductions from intermediaries at the payee.

According to a transfer exercise under a Commission study contract[105] making 1 480 cross-border credit transfers in the EU–15, in 239 cases (16.2 %), the receiver received less than he expected, there were 178 cases (12.1 %) where additional charges had been levied by the bank of the beneficiary. In 61 cases (4.1 %) it was unclear why the receiver was charged; sometimes intermediary institutions levied charges, which is also in contradiction to the Cross-Border Credit Transfers Directive.

The principle of execution for the full amount specified in a payment order was already required by law for some cross-border credit transfers[106] but should be a principle fully respected for all payments by market participants. The principle intends to protect customers on the one hand and help industry to enhance automation for both national and cross-border payments on the other hand.

105 Report for the European Commission prepared by Banking Research London, 2001.

106 This issue has been addressed in the context of the Directive 97/5/EC on Cross-Border Credit Transfers and Regulation (EU) No 2560/2001 on Cross-Border Payments in euro.

Modern business needs certainty when settling bills and entering into commercial transactions. Businesses could not operate with doubt that the full amount arrives. Therefore it would be required to incorporate this rule in a EU act to ensure the application of this principle to all payments, no exception for national, or cross-border payments. This principle is already respected in most Member States for purely national payments.

For the same reasons of efficiency, reliability and legal certainty the payment service provider of the payer and the provider of the payee usually agree on "SHARE" as charging option, meaning that, irrespective of the way the payment is transferred (this might even include intermediaries), both providers levy fees only directly on their respective client and the amount is transferred without deductions.

For reasons of proportionality and reflecting the current practise this rules should not apply for payments where there is a currency exchange or where it is not made in a Member States currency. It should also not apply if the payment involves a recipient outside the EU. Setting out this rule in legislation is intended to avoid double charging and to ensure the arrival of the full amount transferred on the account of the beneficiary without any deduction in the payment chain.

5. Maximum/default execution times

The execution time is one of the main indicators for the efficiency of the payment system and has huge implications for private and commercial users as well as the economy. Long and uncertain execution time of payments creates huge costs for economic actors, in particular enterprises and is often used by providers as a non-transparent way of pricing. A modern economy needs reliable payment systems, able to effect payments within a reasonable period of time based on state-of-the-art technologies and transparent pricing.

The threshold established in 1997[107] of D+5 days maximum execution time for cross-border credit transfers seems outdated in the light of market developments and technological possibilities and should certainly not be regarded as the benchmark for an integrated EU payments market. A clear benchmark of D+1 day maximum execution time seems to better reflect reality as today most countries provide for a D+1-day execution time for national transfers, with many countries exceeding this time by providing same-day execution time and some negative exceptions with very low services levels. On a cross-border level execution time for payments has significantly improved in recent years[108] and today cross-border credit transfers take between D+1 and D+2 days depending on the channel used (correspondent banking, EBA Step 2, TARGET)..

Proposing a harmonised maximum execution time of D+1 day for all credit transfers in Euro and the same as a default rule[109] for all other payments will fix the threshold at the current industry standard and service level in most countries; it will also give industry an incentive to improve execution time to D+1 where this is not yet the case and provide users with the necessary legal certainty. In particular this will give the right political signal to the European Payments Council (EPC) – which is currently working on the development of pan-European payment schemes – to

---

107 Directive 97/5/EC on Cross-Border Credit Transfers.

108 Independent studies ordered by the Commission and carried out by Retail Banking Research (RBR) showed an average transfer time of 2.97 days for cross-border credit transfers in 2001. This is a significant reduction from RBR's 1993 and 1994 studies which found an average of 4.61 days and 4.79 days respectively.

109 "Default rule" refers to the fact that for all other payments than credit transfers the execution time of D+1 should only apply in so far as the contractual parties have not explicitly agreed on a different execution time.

base its work on a D+1 day execution cycle thereby aligning efficiency in the EU market with the level of the best performing Member States payment markets

Given the lead time of at least 2 years for adoption and implementation of the proposed rule, payments industry will have the necessary time to adjust existing inter-bank rules and systems in an economic way. For the new pan-European payment schemes of the EPC an even longer time period for implementation is provided, scheduling implementation for 2008 and migration for 2010.

However, EU regulation of maximum execution times should not impair the efficiency of national payment markets, where they already provide for real time or same day execution. Therefore Member States are encouraged to keep existing rules and low execution times for national payments.

Also, a standard on maximum execution time should not impair the efficiency of micro payment systems[110] which are dedicated to the efficient payment of very small amounts. Such payment systems are deemed one of the key enablers for e-commerce and effective distribution of digital content (e.g. pay for a mobile phone ringtone, an online newspaper article or cinema ticket). The business models used to provide such payments often do not follow the logic of immediate transfer of the funds, as this would be too costly but usually work offline, collecting a number of small payments at the point of sale before the total amount is transferred to the recipient. Another example are business models where the payment service provider and the content provider enter into a revenue sharing agreement, which again does not follow the logic of straight transfer of funds. To impose a maximum or default execution time would very likely make it impossible for most systems to operate and was not deemed necessary and proportionate from a customer protection point of view.

[110] Such systems are defined as dedicated payment systems for payments below EUR 50. Payment systems which handle standard payments which are also above the threshold of EUR 50 are not covered by this definition.

6. Availability of funds and value dates

Costs and charges of payment services shall be transparent to the user to create the necessary incentives to ensure that the lowest cost and most efficient payment services thrive at the expense of the more expensive or less efficient ones. Some fees and charges are very transparent and it is relatively easy to make choices based on them. Others are not transparent, but may be just as important in influencing which payment instrument is used and what the resulting cost to the economy is. Self-regulation has not always proved to be successful as means to achieve more transparency for users.

Values dates are part of payment service providers pricing policy. The value date is the reference date used by the payment service provider for his customer in the calculation of interest on the funds held in an account. By all consumer and user associations and many Member States the use of value dates is regarded as a non-transparent pricing method, because it makes it extremely difficult for the payment service user to examine the real price he is paying for the payment service, hindering transparency and competition. Therefore, some Member States have already banned this business practise and in some other countries banks have dropped this pricing mechanism as a result of public pressure.

It is widely believed that value dates are misleading for the consumer and that they are an 'indirect charge' hiding the cost of the service. To decree transparency concerning value dates seems to be not enough the protect users from being misled by the complicated system of value dates. A common rule to prohibit the use of value dating to the disadvantage of customers could help the payer to establish the effective price of the payment services and facilitate the use of more transparent pricing methods by providers.

7. Liability for the execution of a payment transaction

To ensure reliable and efficient execution of payment transactions, in particular when complementing the purchase of goods and services or other economic transaction in the Single Market and with third countries, it is important that payments are executed correctly in accordance with the conditions agreed with the user.

However, today banks are not providing any guarantee for the correct execution of a payment transaction. In case something goes wrong the user is stuck with following up on the problem himself trying to recuperate his funds lost somewhere in the payments chain. This problem is made worse if the payment involves a provider abroad or outside the EU.

It is evident that the user is not in the best position – in particular in cross-border transactions – to assess the risk of a particular transfer, the reliability of intermediaries, the security of the system or other aspect that might lead to a loss of funds transferred.

On the other hand the payment service provider is acting as a specialised intermediary and can assess risks involved in executing a payment transaction much better than the payment service user. The payment services provider decides on the setup of the payment system, makes arrangements to recall misplaced or wrongly allocated funds and decides in most cases on the chain of intermediaries involved in the execution of a transaction. Furthermore the large number of transaction payment service providers normally carry out makes it easier for them to mutualise the risk costs of errors or malfunctioning in the payment chain and reflect this risk costs in their charges.

To leave this situation to contractual arrangements does not seem to have the desired effect, to establish responsibility of the provider for the correct execution of payments as a fundamental principle. Therefore a common rule enshrined in legislation on the strict liability of a payment service provider for the correct execution of payment transactions which he has accepted from customers for execution seems to be the best solution. This is expected to increase the overall efficiency and reliability of the payment system. It also shifts the existing cost for incorrect payments to the party running the payment system, who is in a much better position to influence the cost than the user. Finally, the cost will be mutualised by providers and incorporated in the price of the service, so that it will become transparent unlike today when complete intransparency of the potentially high cost for the user prevails. Today costs are borne by society and the users, which have no control over the payment system or transparency of the risks and costs of a particular payment transaction.

A particularly important question in this respect is the geographical scope of the rule. Should the rule be imposed only to intra-EU payments in Member States currencies or should it be extended to cover all payment services provided in the EU and covered under an agreement with an EU payment service provider (including payments coming from third countries to the EU or which are destined to third countries in all currencies traded in the EU including third country currencies).

The arguments against an EU-wide scope of the rule are that payment systems are based on inter-bank agreements which differ inside and outside the EU. While such a rule could be well reflected in inter-bank agreements between European banks this is not the same for global inter-bank agreements. Therefore the payment industry voiced concerns that a rule covering all currencies and all transactions including those where only either the payer or the payee are located in the EU would not be covered by existing inter-bank agreements, which are difficult to be changed in the short-term. To alleviate this problem the rule could in those cases where the payment is coming from or destined to third countries be limited to a liability to ensure the correct execution of the payment between the European bank's client and the recipient bank in the third country. The rule would therefore not cover the correct execution between the recipient bank and the recipient in the third country, which is also congruent with international inter-bank agreements.

The arguments in favour of an EU-wide scope covering all currencies are that restricting the scope of this liability rule to intra-EU payments in euro or Member States currencies would limit the smooth functioning of the Single Market and would further fragment the market along the borders of currencies. The EU is the biggest trading block in the world and has huge numbers of payments flowing in and out of the EU. For the part of these payment services that are provided by EU service providers, corporate users need legal certainty when making or receiving a payment to or from a party outside the EU. In addition EU citizens travel extensively outside the EU and expect to be protected by the same rules governing their contract with the payment service provider in the EU, even when they use their e.g. credit cards outside the EU.

The overall objective of a EU rule on this subject is to ensure the smooth, efficient and reliable functioning of all payment services used by citizens and businesses in the Single Market without regard to the currency used or the country of origin. Therefore the liability for the correct execution should apply to all payment services, national and cross-border, provided by payment service providers in the EU to payment service user, without regard to the currency used. Since, only when citizens and businesses can make payments throughout the EU, as easily and safely as in the national context today, will the objective of a real Single Payment Market be achieved. For users it should not make any difference where their payment service provider is located or in which currency the payment transaction is executed.

However the rule should also take into account the concerns voiced by payment service providers about applying this rule to payments where the payee is located outside the EU or in cases of *force majeure* or other legal obligations such as money laundering rules that prevent the correct execution of a payment transaction. Therefore the rule could be limited and not apply in cases of *force majeure* or other legal obligations that prevent the correct execution and for cases where the payee is located outside the EU only insofar as this is in line with international inter-bank agreements, covering the arrival of funds of a payment transaction up to the payment service provider of the recipient.

8. Dispute settlement mechanisms

Alternative Dispute Resolution provides extrajudicial procedures for resolving civil or commercial disputes[111]. It is also used in the area of payments in order to limit the legal costs of judicial resolution and to accelerate the resolution of disputes via arbitrage and mediation.

The Single Market has increased the movement of persons, goods, services and also payments across the European Union; this has led to an increase in cross-border disputes and the need to find solutions in order to create customer confidence. As a consequence, alternative dispute resolution mechanisms have been established and their use has considerably increased in the EU.

During the consultation process, all stakeholders have recognised that an extension of alternative dispute resolution mechanisms to all payments – national and cross-border – could bring further benefits for the Single Payment Market. It would be in line with the philosophy of the Single Market as a domestic market and equality of treatment between national and cross-border payments. Such procedures can boost payment service users' confidence provided that they meet minimum criteria guaranteeing the impartiality of the body responsible and the efficiency and transparency of proceedings.

Therefore an extension of alternative dispute resolution mechanisms in the Single Market to all categories of payments, national and cross-border, should be considered. However, there is no obligation for providers or users to use these facilities. Following the example of in Directive 97/5/EC, it seems to be sensible to build on existing schemes[112] and leave the practical establishment to the Member States.

[111] See also Commission Green Paper on alternative dispute resolution in civil and commercial law (COM (2002) 196 final).

[112] In the field of financial services and in particular payments, FIN-NET is regarded as an important tool for increasing confidence in cross-border trade and financial transactions. Currently, there is an obligation for Member States to ensure the existence of appropriate alternative dispute resolution procedures in the field of cross-border credit transfers (Directive 97/5/EC, Article 10). The bodies in the Member States operating alternative dispute resolution procedures cooperate for cross-border disputes in the FIN-NET network.

ANNEX 7: DISTRIBUTION OF IMPACTS AMONG STAKEHOLDERS AND COST-BENEFIT ANALYSIS

1. COSTS, BENEFITS AND RISKS OF THE DIFFERENT RULES

Costs, benefits and risks of the options to harmonise core rights and obligations of users and providers versus maintaining the status quo			
Options	**Costs**	**Benefits**	**Risks**
Rules on authorisation of payments and sharing of losses for unauthorised transactions			
A: Harmonise	• Changes in the level of protection in the different MS can result in a cost increase for some providers and users in countries with a higher/lower level of protection or where no threshold for the sharing of losses existed before.	• One rule for the entire EU which facilitates the development of EU-wide services and cross-border service provision • Lower compliance costs for pan-European actors. • Better consumer protection.	• Unintended effects: Limitation of losses in the case of unauthorised transactions could be a negative incentive for providers and users to prevent fraudulent use of the payment system and to invest in the security of the system.
B: Not harmonise	• No level playing field • Potentially high costs for economy created by a lack of trust of users in the safety of electronic payment systems and fall back to expensive cash or paper based payments.	• No adjustment costs for providers	

Options	Costs	Benefits	Risks
Rights of refund			
A: Harmonise	• The provider will have to establish effective inter-bank rules in order to provide refund to payers and retrieve the funds transferred from the other parties involved. • The costs will potentially be factored in the transaction prices.	• Higher confidence in payment services, increase in number of transactions. • The total cost of refunds and disputed transactions is likely to be reduces by better compliance, prudence and sanctions of all parties involved (e.g: consumer, banks and merchant)	• Unintended effects: Fraudulent use by consumers and less interest of consumer in knowing the reliability of supplier. Less interest of supplier to build up a good reputation
B: Not harmonise	• Reduced number of transactions. Lower confidence in payment systems. • Different rules in Member States providing for different types of refunds and refund periods between 1 day and up to 6 weeks. No harmonised rules to settle cross-border conflicts.	• Possibly lower transaction prices in cases where stricter refund rules existed but costs for unauthorised transactions are solely borne by the consumer often with little chance to solve the problem and claim a refund from the other party (e.g. merchant, service provider)	• Unintended effects: Less prudence of providers when debiting user's accounts. Fraudulent behaviour of creditors/payee's is not effectively sanctioned.
Revocability			
A: Harmonise		• Higher transparency. • Higher legal certainty. • Reduced costs.	

B: Not harmonise	• Reduced legal certainty. • Higher costs of litigation.		

Options	Costs	Benefits	Risks
Principle of execution for full amount			
A: Harmonise	• Adjustment costs for providers for adapting rules in the interbank relationship and devising new systems for remunerating intermediaries	• Legal certainty and better protection of users • More efficient payment system, and legal certainty for the providers involved	
B: Not harmonise	• High costs for users for late payments and non-fulfilment of contractual obligations between transacting parties • Higher costs for initiating and receiving banks in cases where intermediaries have made unauthorised deductions from the transferred amount		• High risk that the efficiency and smooth functioning of economic transactions is impaired which depend on the successful fulfilment of a claim, ergo payment of the full amount.
Maximum/default execution times			
A: Harmonise	• Cost of upgrading less efficient systems to comply with D+1 execution time for credit transfers in euro.	• Legal certainty and better protection of users • More efficient payment system.	
B: Not harmonise	• Low efficiency. • No legal certainty of transacting parties over the actual execution		• Efficiency and smooth functioning of economic transactions which depend on the reliability of

	time.		fulfilment of a claim, ergo payment within a specified time is impaired.

Options	Costs	Benefits	Risks
Availability and value dates			
A: Harmonise		• More transparency, currently hidden costs (float) will be transparent to user, eventually as higher transaction costs. • More competition.	
B: Not harmonise	• Reduced transparency, hidden costs. • Reduced competition.		
Liability for the execution of the transaction			
A: Harmonise	• Transactions costs will be higher. Providers will pass on costs.	• The provider can measure better the risk than the client. • Higher confidence and efficiency	
B: Not harmonise	• Reduced security • Uncontrollable risk for users • Non-transparent costs for users	• Lower prices.	• Efficiency of economic transactions which depend on the certainty over the correct execution is impaired.
Establishment of procedures for settlement of disputes			
A: Harmonise	• Costs of establishment of these procedures.	• Higher consumer protection. Fast resolution of disputes.	
B: Not harmonise	• Reduced protection.	• Lower costs.	

2. DISTRIBUTION OF IMPACTS AMONST STAKEHOLDERS

Impact of changing status quo to a common approach about rights and obligations					
Options	**Providers** **(At national scale)**	**Pan-European providers**	**Payees**	**Payers**	**Member States/** **Administrations**
Revocability	++	++	+	+	++
Determining the event when a payment order becomes irrevocable. Applicable to all kinds of payments based on a distinction between those initiated by the payer and those initiated by the payee.	+ Transparency and legal certainty.	+ Transparency and legal certainty. Improved efficiency, one rule for the entire EU.	+ Transparency and legal certainty both cross-border and domestic.	+ Transparency and legal certainty both cross-border and domestic.	+ Transparency and legal certainty foster the smooth and efficient functioning of the payments market

+ = Δ Gain – = Δ Loss = neutral

Options	Providers (At national scale)	Pan-European providers	Payees	Payers	Member States/ Administrations
Principle of execution for full amount	=	=	++	++	++
Ensuring the arrival of the full amount transferred on the account of the beneficiary without any deduction in the payment chain.			+ Higher protection. Increased Transparency.	+ Higher protection. Increased Transparency.	+ Transparency and legal certainty foster the smooth and efficient functioning of the payments market
D+1-day maximum/default execution time	–	–	++	++	++
A D+1-day default execution time for all payments with the exception of credit transfers in euro where this is a maximum rule and national payments where higher standards should be kept	+/– No lowering of existing service levels in most markets. Costs for less efficient systems to be modernised	+/– No lowering of existing service levels vis-à-vis national markets. Costs for less efficient systems to be	++ Higher efficiency, better service.	++ Higher efficiency, better service.	++ High efficiency of some national markets is not impaired. General improvement for all cross-border payments and improvement of low

		modernised			efficiency markets

Options	Providers (At national scale)	Pan-European providers	Payees	Payers	Member States/ Administrations
Availability and value dates	+/–	+/–	+	+	=
The moment when interests start to accrue on an account should coincide with the time the transaction is debited to the users´ account and for the payee with the time when the transaction is credited.	+/– The increase in competition due to higher prices comparability could mean business opportunities for most efficient providers and risk of market share loss for less efficient ones.	+/– The increase in competition due to higher prices comparability could mean business opportunities for most efficient providers and risk of market share loss for less efficient ones.	+ More transparency due to price comparability.	+ More transparency due to price comparability.	=

Rights of refund	+/–	+/–	+/–	+/–	++
Only granted if the payer is acting in good faith, his authorisation did not include the exact amount of the transaction or payee and the amount is contrary to an average payer's legitimate expectations in the same situation.	– Risk of higher costs[113]. + Higher confidence in payment systems. Higher number of transactions.	– Risk of higher costs. + Higher confidence in payment systems. Higher number of transactions.	+ Higher number of customers will accept e.g. direct debits providing the payee with faster access to funds.	+ Higher consumer protection. More confidence in electronic payment instruments in particular direct debits and cards.	++ More confidence in electronic payment instruments, facilitates dispute settlement and provides a high level of consumer protection both nationally and on cross-border level.

113 Actually, this may not be the case for all service providers since it may already be applied de facto.

Options	Providers (At national scale)	Pan-European providers	Payees	Payers	Member States/ Administrations
Liability for the execution of the transaction	–	–	++	++	+
The payment service provider shall give an unconditional undertaking for payment transactions he has accepted for execution.	– Higher risks. (The risk has shifted from the consumer to the provider).	– Higher risks. (The risk has shifted from the consumer to the provider).	++ Higher confidence in payment systems. Higher number of transactions. Risks shifted to provider.	++ Risk is transparent, and where relevant externalised in prices Higher protection. Incentives for improved risk management by provider.	+ More efficient functioning of the payments market

Options	Providers (At national scale)	Pan-European providers	Payees	Payers	Member States/ Administrations
Authorisation of payments and sharing of losses for unauthorised transactions	+/–	+	++	++	+
The user must respect the safekeeping requirements and notification in case of lost or stolen payment verification instrument. Provider should refund in case of unauthorised transaction excepting gross negligence or fraud. The liability of user should not exceed EUR 150.	+/– Cost depends on current regulation in each Member State.[114] + Legal certainty and transparency	+ Cost depends on current regulation in each Member State. Same rules in the entire EU and legal certainty and transparency	++ Risk is transparent for users and where relevant externalised in prices Same rules in the entire EU, transparency and legal certainty	++ Risk is transparent for users and where relevant externalised in prices. Same rules in the entire EU, transparency and legal certainty	+ Simplification of legal framework, potentially more out of court settlement of disputes

[114] In some Member States there is already a lower threshold put in place by regulation. Also some Member States have transposed Recommendation 97/489/EC which contained the threshold of EUR 150. Additionally some providers have already caped the absolute amount of loss to the user in case of lost, stolen or misappropriated payment verification instruments.

Options	**Providers** **(At national scale)**	**Pan-European providers**	**Payees**	**Payers**	**Member States/** **Administrations**
Establishment of procedures for settlement of disputes	+	+	+	+	+/–
Extrajudicial procedures for resolving civil or commercial disputes.	+ Lower costs due to faster resolution of disputes.	+ Lower costs due to faster resolution of disputes.	+ Lower cost and faster resolution of disputes.	+ Lower cost and faster resolution of disputes.	+ Less judicial cases. – Cost of establishment of these procedures.