The Spanish retail payment system within the Single Euro Payment Area (SEPA): Implications of implementation

Santiago Carbó Valverde[1] and Francisco Rodríguez Fernández[2]

The Single Euro Payment Area (SEPA) is a major milestone in the process of European financial integration. Spain is making good progress towards SEPA, with a very advanced adoption of technical standards in debit and credit transfers, as well as on payment card security requirements. However, it remains difficult to anticipate the overall impact on payment systems.

The creation of SEPA represents a major step forward towards increasing the ease, efficiency, and security of domestic and cross border transactions within the European Union. The potential annual savings for all stakeholders are estimated at 21.9 billion euros, with an additional 227 billion euros to be unlocked in credit lines and liquidity. Despite advances through SEPA, there are still significant differences in retail payment systems within the EU in terms of infrastructure and, in particular, related to the use of payment cards. Along these lines, this articles also analyses the impact of the crisis on the payment market and recent advances in this area. For example, the latest decisions taken in Spain, in line with other countries such as the United States and Australia, to reduce the interchange fees for debit and credit cards, with the hope of increasing payment card activity. The ultimate impact of these latest measures remains to be seen. In any event, the reduction in fees in Spain anticipates implementation of elements of EC regulation 260/2012.

Components and implications of SEPA

Integrating financial markets has been one of the major goals of the European Union over the last decades. Payment systems represent an essential part of these efforts, which are particularly relevant within the euro area, where a single currency is shared.

The different legislative initiatives have progressively converged to a more general aim which is the creation of the so-called Single Euro Payment Area (SEPA). The idea behind SEPA is that all transactions (domestic and cross-border) offer the same conditions of ease, efficiency and security.

The SEPA took its first operative steps in January 2008, when SEPA Credit Transfers were put in

[1] Bangor Business School and FUNCAS.

[2] University of Granada and FUNCAS.

place, so that credit transfers could be done under the same operative and technical standards and conditions within the EU. This was followed by the launch of the SEPA Direct Debit – also setting homogenous standards for these transactions – in 2009. SEPA covers all EU member states, as well as Iceland, Liechtenstein, Monaco, Norway, San Marino and Switzerland.

The idea behind SEPA is that all transactions (domestic and cross-border) offer the same conditions of ease, efficiency and security.

SEPA is a comprehensive project which involves several aspects of efficiency in payment systems, such as common instruments, standards, procedures and infrastructures. It involves mainly three payment instruments: credit transfers, direct debits and payment cards. The European Commission has collaborated with the European Central Bank and all central banks in SEPA countries to achieve the abovementioned goals. A number of heterogeneities in technical, pricing and competitive standards have been identified and the role of SEPA will be to turn them into common standards and practices.

Given the logical involvement of European banks in this initiative, a coordinating body is also needed for the banking industry. This is the European Payments Council (EPC), which in practical terms has been the institution defining the new instruments and standards necessary to guarantee efficiency and security for payments in SEPA. Hence, the EPC develops the payment schemes and frameworks which help to realize SEPA.

The main regulatory initiatives regarding SEPA have been the following:

- The Payment Services Directive (PSD), on the standardized set of rules applicable to all payment services provided in the European Union. The PSD was adopted in Spain by Law 13/2009 on Payment Services.

- Regulation EC 924/2009 (amended by Regulation 260/2012), which establishes equality in the fees charged for domestic and equivalent cross-border payments in euros, except for checks.

- Regulation EC 260/2012, which establishes deadlines for migration to the SEPA instruments by setting a series of technical and business requirements for credit transfers and direct debits in euros.

EC 260/2012 is the most recent regulation and perhaps the most important one to date. The regulation is also referred to as the "SEPA end-date regulation" and defines the deadlines for migration to the new SEPA instruments. The deadline for the euro area is February 1st, 2014, and for non-euro area Member States October 31st, 2016. As of these dates, the existing national euro credit transfer and direct debit schemes will be replaced. Table 1 shows a comprehensive list of SEPA key achievement dates. An amendment to the SEPA Regulation introduced a transition period of six months for euro area countries – until August 1st, 2014 – to ensure minimal disruption for consumers and businesses. During this period, banks and payment institutions will still be able to process payments that differ from the SEPA standard.

The different central banks in the EU elaborate a number of indicators reporting the status of the migration to SEPA. In the case of Spain, the latest figures provided by the Bank of Spain reveal that:

- 86.2% of the direct debits in Spain are already made following a SEPA standard as of May 2014, as compared to 85.7% for the EU average.

- In the case of credit cards, 95% were already adapted to the EMV-security standard (the chip system designed by Europay-MasterCard-Visa) in 2013 while 99% of the electronic fund transfer at the point of sale (EFTPOS) terminals

Table 1
SEPA key dates

March 31st, 2012	Regulation No 260/2012 entered into force; pan-European reach; phasing-out of 50,000 euro ceiling for equal charges to apply.
November 1st, 2012	Cross-border transaction MIFs (multilateral interchange fees) were eliminated for direct debits.
February 1st, 2014	SEPA migration deadline for SEPA credit transfer and SEPA direct debit within the euro area; no BIC (business identifier code) to be required for national payments.
August 1st, 2014	End of six month grace period for migration to SEPA instruments in the euro area.
January 1st, 2015	Migration deadline for SEPA direct debits in Latvia. Latvia joined the euro area on January 1st, 2014. As a new euro area country, Latvia has up to one year to complete the migration. However, the stakeholders have agreed on an earlier end date for migration to SEPA credit transfers in Latvia, which is January 1st, 2014.
February 1st, 2016	No BIC to be required for cross-border payments; niche products migration complete.
October 31st, 2016	SEPA credit transfer and SEPA direct debit deadline for non-euro area countries.
February 1st, 2017	National transaction MIFs (multilateral interchange fees) to be eliminated for direct debits.

Source: European Central Bank.

in merchant stores were also prepared for EMV chip cards.

- Iberpay, which is the system in charge of processing electronic bank transfers in Spain, effectively processed 99.3% of the SEPA transactions by 2013Q2. This implies a significant improvement from the 87% in 2008Q1. Similarly, Iberpay also processed 98.3% of the SEPA transfers received by Spanish banks from abroad.

The SEPA Regulation marks February 1st, 2014 as the point at which all credit transfers and direct debits in euros will be made under the same format: SEPA Credit Transfers and SEPA Direct Debits. In addition to direct debit and credit transfers, payment cards represent a significant area for the application of SEPA in Europe. The main aim on this front is to eliminate all pre-existing legal, technical and business barriers to guarantee the necessary pan-European interoperability of cards. From a technical point of view, the transition to EMV chip cards is one important milestone but perhaps the most important and controversial feature refers to pricing decisions in payment cards. We cover the issues regarding card fees in the last section of this article, including some recent decisions taken in Spain.

From a quantitative point of view, converging to electronic payment standards and creating a single market for payments is expected to generate significant cost savings for all market participants.

Does SEPA pay-off? From a quantitative point of view, converging to electronic payment standards and creating a single market for payments is expected to generate significant cost savings for all market participants. An impact study conducted by PricewaterhouseCoopers (PwC) for the European Commission[3] dated January 16th, 2014, summarizes these benefits as estimated after the full completion of SEPA (see Table 2):

[3] http://ec.europa.eu/internal_market/payments/docs/sepa/140116_study_en.pdf

Table 2
Estimated benefits of SEPA

Panel A. Effects on stakeholders and benefit driver (billion euros)					
	Corporations	Public sector	Banks	Clearing and settlement mechanisms	Total
Price convergence	1.5	0.407	-1.9	-	0
Processing cost	11.7	2.5	7.4	0.34	21.9
Clearing cost	-	-	0.344	0.344	0
Net annual savings	13.2	2.9	5.9	0	21.9
Liquidity unlocked	179.5	38.1	9.4	NA	227

Panel B. Average saving per company and benefit driver (euros)			
	Large multinationals	Small-cap companies	Local business and public companies
Systems	43,200	11,600	120
Account maintenance	15,840	6,120	45
Statement and reporting	13,158	5,202	230
Total	71,838	22,922	395

Source: PwC and own elaboration.

- There are potential annual savings for all stakeholders (corporations, public sector, banks, and clearing and settlement mechanisms) of 21.9 billion euros as a recurring annual benefit resulting from price convergence and process efficiency (Table 2, Panel A). Part of the improvements come from a reduction of up to an estimated 9 million bank accounts, resulting in more efficient corporate euro cash-management infrastructures.

- Importantly, 227 billion euros are estimated to be unlocked in credit lines and liquidity. These benefits are realized from cash pooling and efficient improvements in clearing (Table 2, Panel A).

- If we concentrate on the average benefit per firm (Table 2, Panel B), large companies and small cap companies are expected to enjoy more cost savings from SEPA improvements although the benefits seem to extend also to other firms.

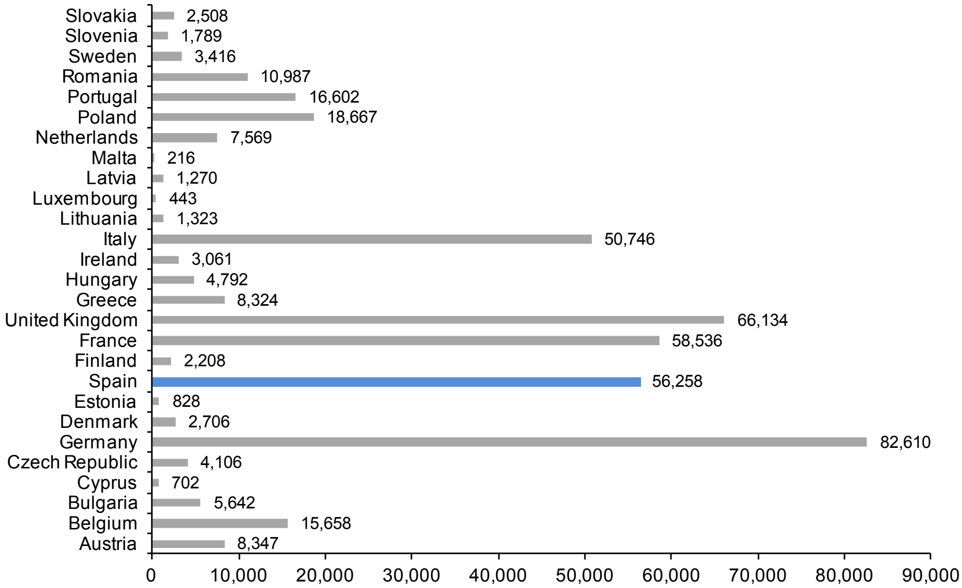
Retail payments in Spain and Europe

The previous section described the single payments area process of homogenization of technical standards. In any event, it is important to bear in mind that there are significant differences remaining in retail payment systems in the EU in terms of the infrastructure and the use of different payment instruments and, in particular, regarding card payments. The Spanish case is an interesting one as it has shown significant development in terms of infrastructure compared to European peers while the transition from paper-based to electronic-based payments is on-going.

Exhibits 1 and 2 show the number of automated teller machine (ATM) and point of sale (POS) terminals for the use of cards in the EU as of 2012. Spain had 56,258 ATMs in 2012 and only Germany (82,610), the United Kingdom (66,134) and France (58,536) have a larger ATM network

Exhibit 1

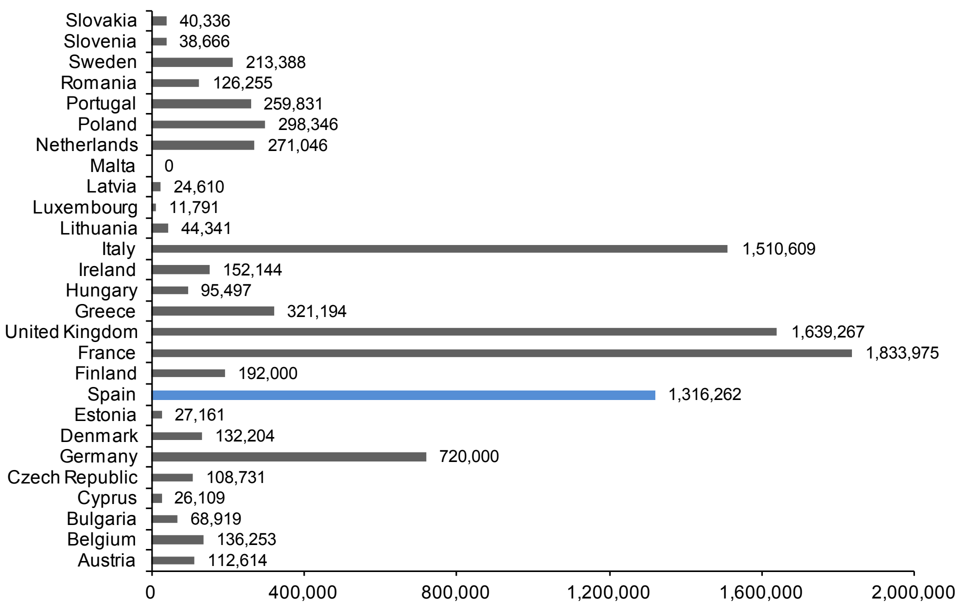
Number of ATMs in the EU (2012)



Source: European Central Bank and own elaboration.

Exhibit 2

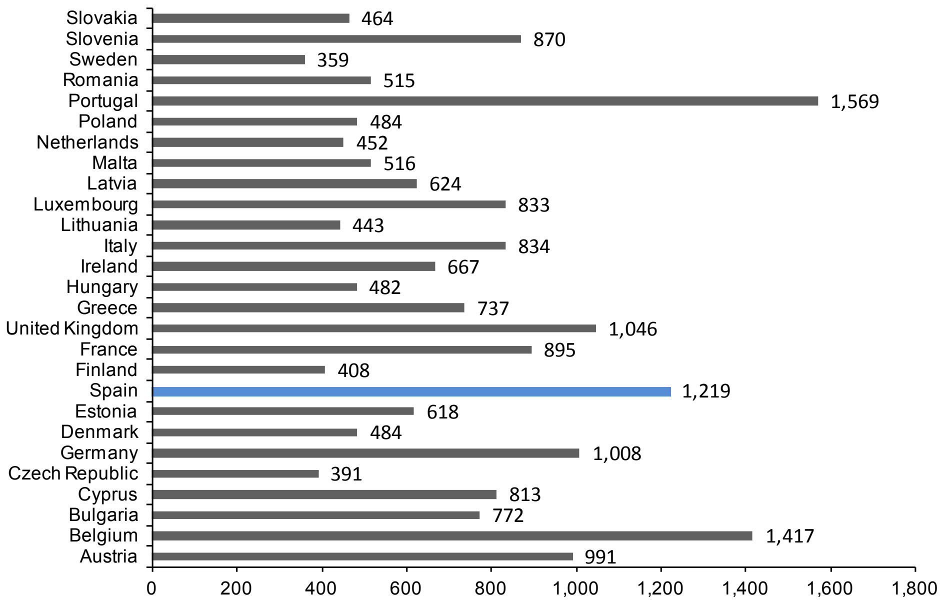
Number of POS in the EU (2012)



Source: European Central Bank and own elaboration.

Exhibit 3

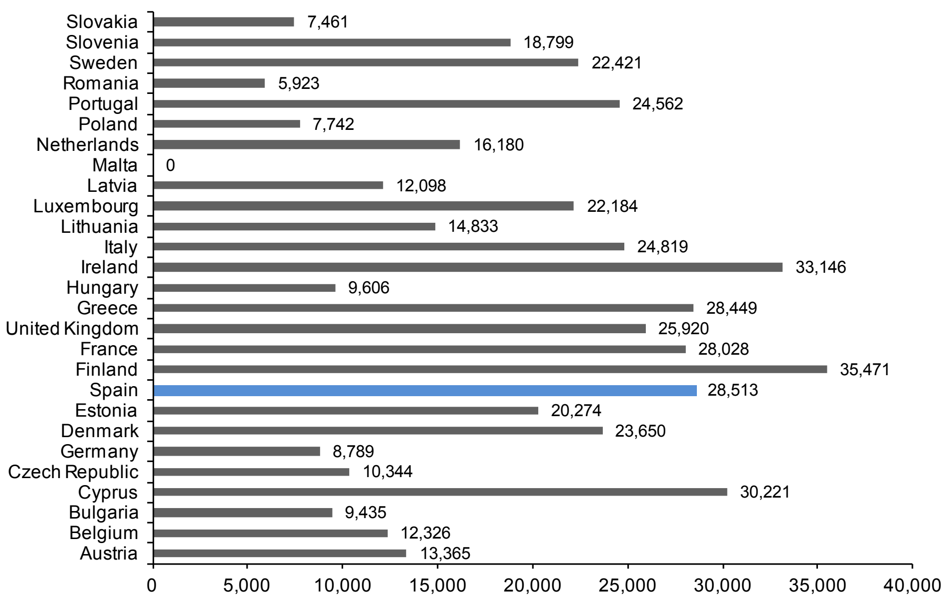
ATMs per million inhabitants in the EU (2012)



Source: European Central Bank and own elaboration.

Exhibit 4

POS per million inhabitants in the EU (2012)



Source: European Central Bank and own elaboration.

in the EU. As for POS terminals, Spain with 1.3 million also has the fourth largest network after France (1.8 million), the United Kingdom (1.6) and Italy (1.5).

The relative importance of the Spanish network of ATM and POS machines can be better observed when these figures are expressed in terms of units per inhabitants. In particular, the ratio ATM per million inhabitants (Exhibit 3) was 1,219 in Spain in 2012 and only Portugal shows a higher ratio (1,569).

Similarly, the ratio POS per million inhabitants (Exhibit 4) was 28,513 in Spain in 2012, only lower than that of Finland (35,471), Ireland (33,146) and Cyprus (30,221).

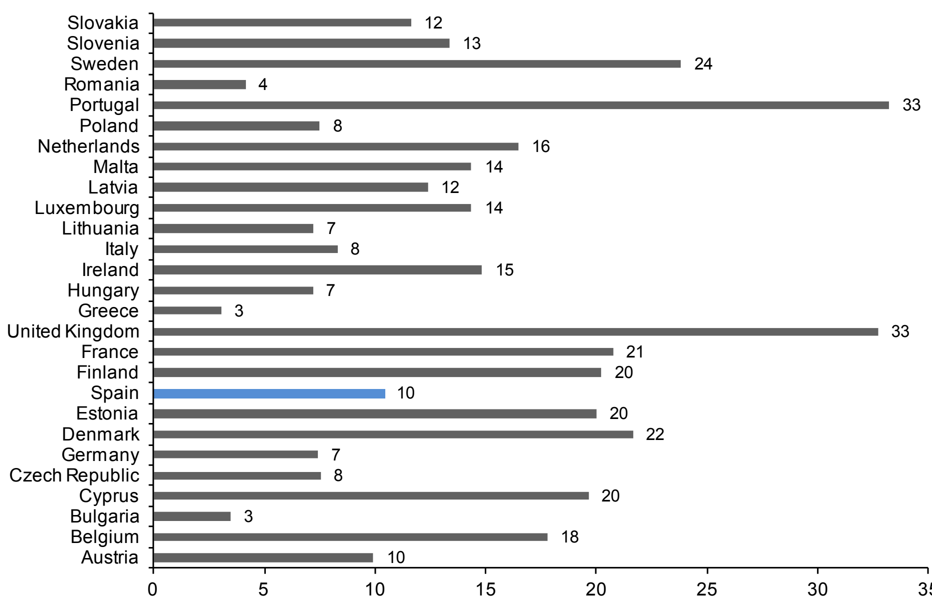
However, even if Spain has deployed one of the largest networks for card use in Europe, the use of cards still remain at an average EU level. In particular, the value of card payment transactions as a percentage of GDP was 10% in 2012. In other countries, such as the United Kingdom or Portugal, the use of cards exceeds 30% of GDP while in others such as Sweden, France, Finland or Denmark it is larger than 20% (Exhibit 5).

Spain shows a larger development compared to European peers in the use of banks as conduits for their payments. In particular, where direct debits (mainly to pay receipts) are concerned. Direct debits represented 42% of total bank transfers in Spain in 2012. The ratio is only larger in Germany (48%), another country where the use of other payment instruments (such as cards) is not among the largest in the EU either (Exhibit 6). However, other electronic transactions through banks, such as credit transfers (channeling funds between accounts) are only 15% of bank transfers in Spain. The weight of credit transfers is larger in Eastern EU countries and in particular in Bulgaria where they reached 82% in 2012 (Exhibit 7).

Exhibit 5

Card transactions in the EU (2012)

(percentage of GDP)

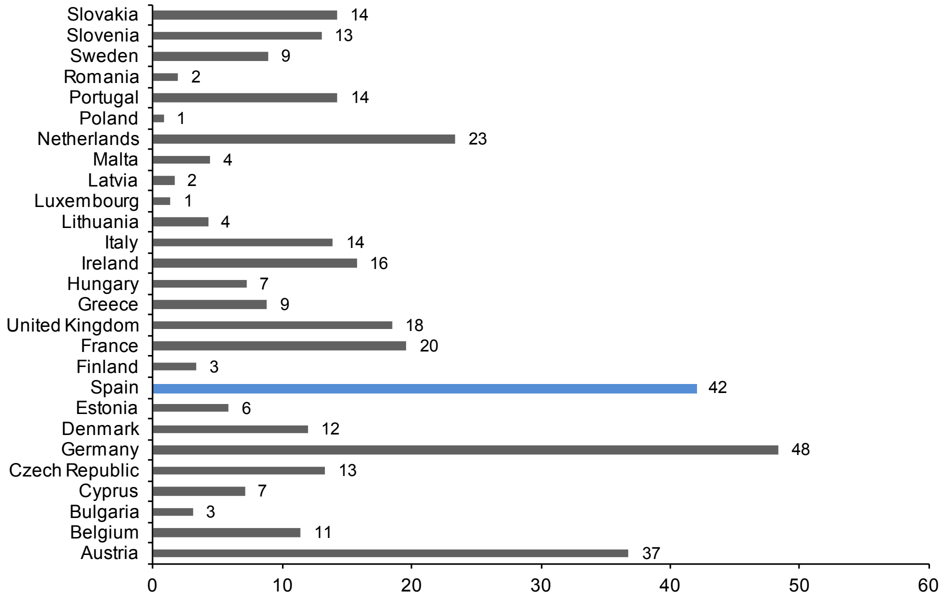


Source: European Central Bank and own elaboration.

Exhibit 6

Weight of direct debit on total electronic bank transfers in the EU (2012)

(percentage)

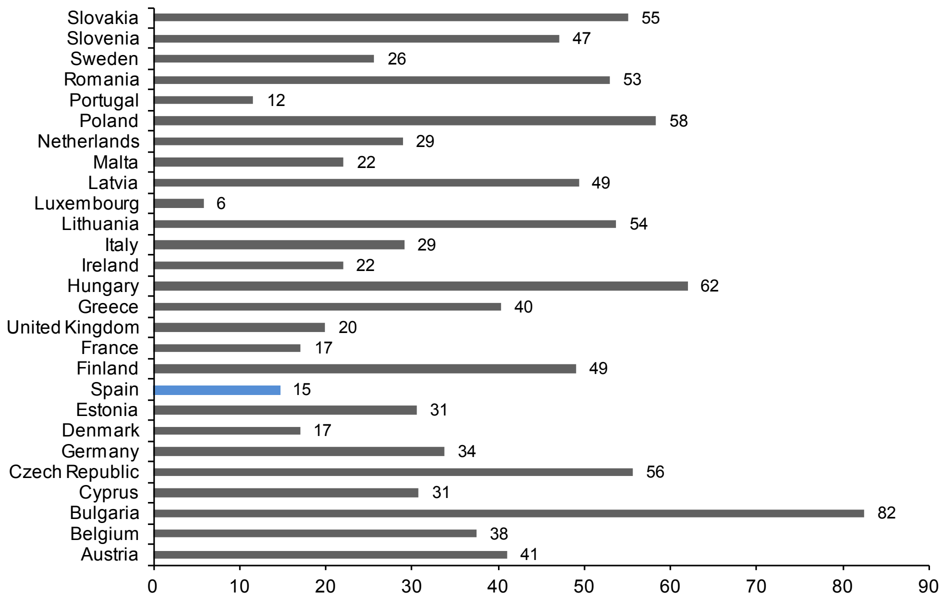


Source: European Central Bank and own elaboration.

Exhibit 7

Weight of credit transfers on total electronic bank transfers in the EU (2012)

(percentage)

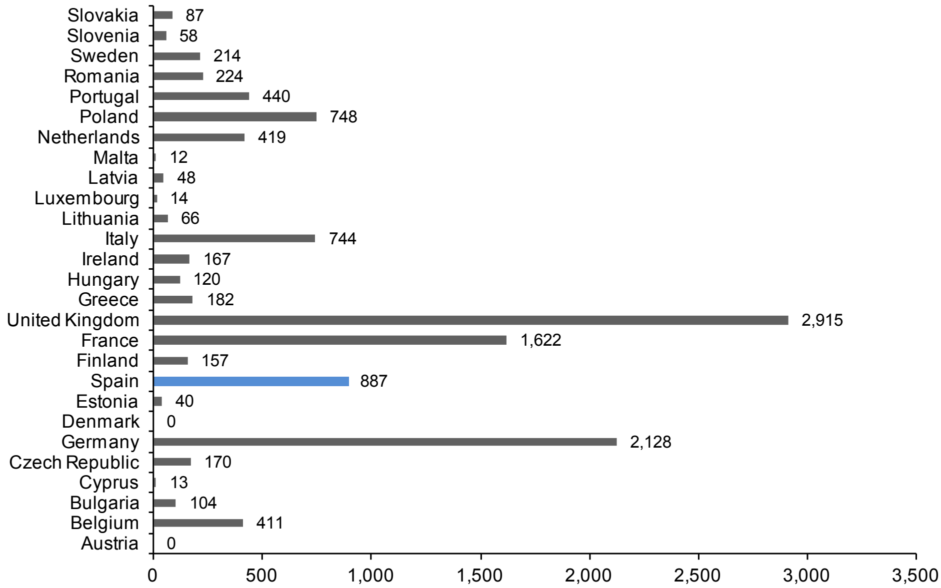


Source: European Central Bank and own elaboration.

Exhibit 8

Number of cash withdrawals at ATMs in the EU (2012)

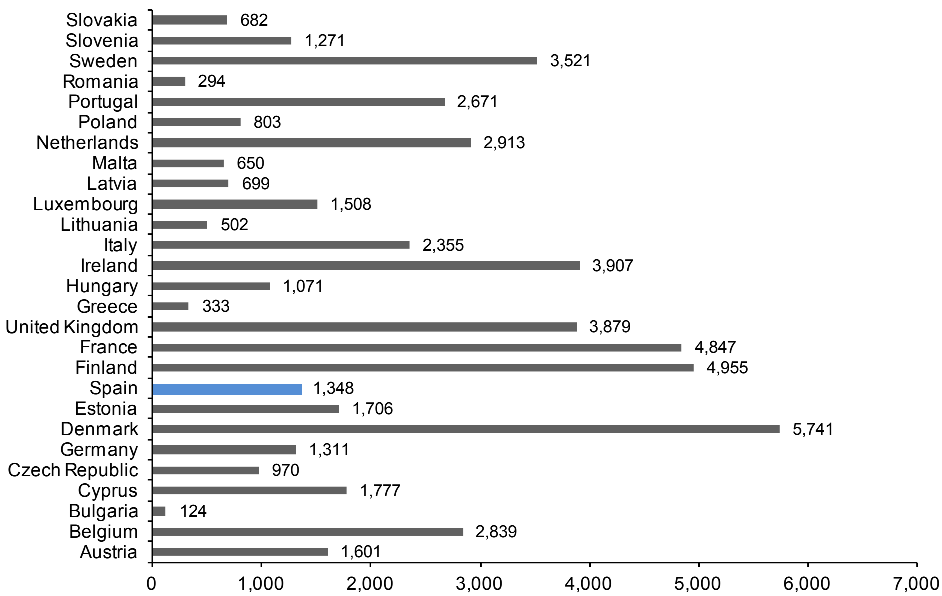
(million)



Source: European Central Bank and own elaboration.

Exhibit 9

Value of POS transactions per card in the EU (2012)



Source: European Central Bank and own elaboration.

One of the reasons to explain the relatively lower weight of card payment transactions in Spain is the alternative use of cards as a device for cash withdrawals at ATMs. Exhibit 8 depicts the number of cash withdrawals at ATMs. There were 887 million transactions in 2012, an absolute figure that was only larger in the United Kingdom (2,915 million), Germany (2,128 million) and France (1,622 million). This explains, to some extent, the relatively lower value of card transactions at the point of sale (Exhibit 9). The total value of POS transactions per card was 1,348 euros in Spain in 2012, considerably lower than in Denmark (5,741), Finland (4,955), France (4,847), Ireland (3,907) and the United Kingdom (3,879). One of the reasons that explain such differences is the importance of bank branches in Spain and the large availability of branches and ATMs in the country. Precisely, ATMs were first deployed as a way of moving some cash-management related bank services out of the branch and they were developed in parallel to POS machines. However, the aim of POS machines is to promote cashless payments and, therefore, these conflicting goals for ATMs and POS may overlap for some time.

The case of payment cards in Spain: Impact of the crisis and recent developments

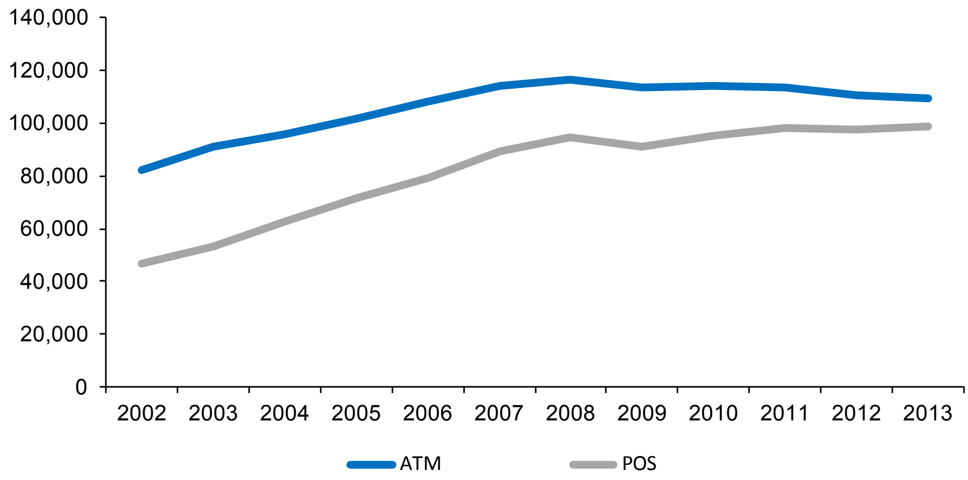
In this section, we specifically focus on Spain with the aim of examining the evolution of payment cards in the last few years, including the impact of the crisis and some recent regulatory developments.

Exhibit 10 shows the value of transactions at ATM and POS terminals in Spain from 2002 to 2013. Over this eleven year period, the value of POS transactions has doubled, from 46.8 billion euros to 98.5 billion euros. The value of transactions at ATMs was 1.3 times larger in 2013 than in 2002 and it reached 109.2 billion euros in 2013. While the impact of the crisis seems clear on ATM transactions (continuously falling since 2007), the value of POS purchases with cards only fell in 2009. If the same path continues –and considering the impact of SEPA on card use– one might expect the value of POS transactions to exceed that of cash withdrawals by 2017.

Exhibit 10

Value of transactions at ATM and POS terminals in Spain

(million euros)

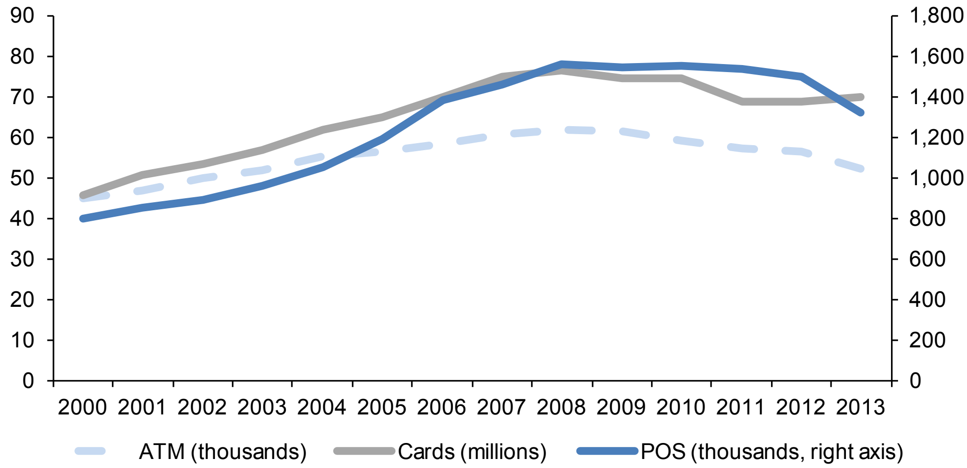


Sources: Bank of Spain and own elaboration.

Exhibit 11

Number of ATMs, EFTPOS terminals and cards in Spain

(million euros)



Sources: Bank of Spain and own elaboration.

As for the infrastructure, the intense consolidation and closing of branches during the bank restructuring process since 2009 has also affected the number of cards, ATMs and POS machines (Exhibit 11). In particular, the number of ATMs has decreased from 61,400 in 2009 to 52,200 in 2013. POS terminals reached their peak in 2010 at 1.55 million and have then fallen to 1.32 million in 2013.

One of the main features regarding the setting of incentives for higher card use in Spain has been pricing regulation. Lowering interchange fees may induce more merchants to start accepting payment cards. However, this would also increase cardholder fees, possibly causing a decrease in card use. The level of the interchange fee has thus received substantial international attention.

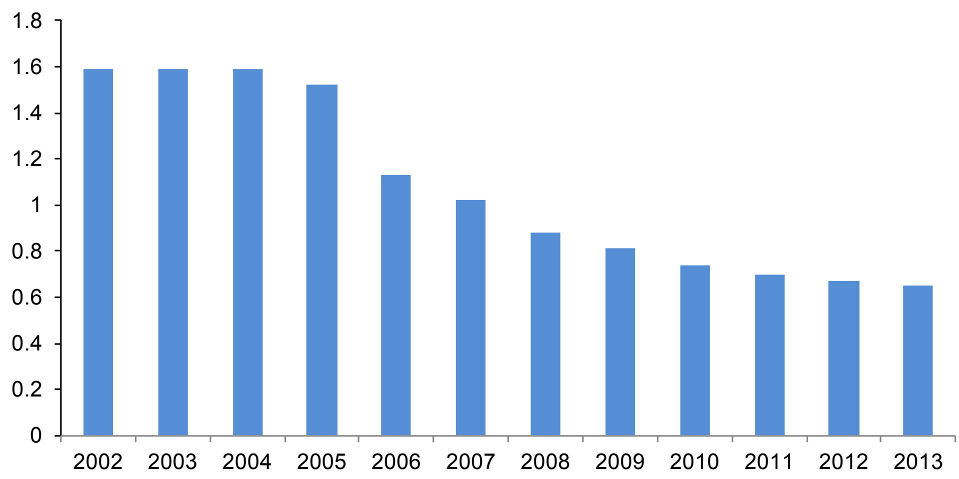
One of the main features regarding the setting of incentives for higher card use in Spain has been pricing regulation. This is a polemic issue internationally. The main disagreements stem from the network structure of the payment card market, where there is not only one single buyer and seller. Payment card networks are comprised of consumers, their financial institutions (known as issuers), merchants, their financial institutions (known as acquirers) and a network operator or platform. A consumer makes a purchase from a merchant. Generally, the merchant charges the same price regardless of the type of payment instrument used to make the purchase. Consumers often pay annual membership fees to their financial institutions for credit cards and may pay service charges for a bundle of services associated with transactions accounts including debit card services. Merchants pay fees known as merchant discounts. Acquirers pay interchange fees to issuers. Economic theory regarding interchange fees predicts that by lowering the interchange fees, some merchants not currently accepting card payments may start to accept them. However, lowering interchange fees would increase cardholder fees and, consequently, some of them may abandon their payment cards or use them less frequently. In general, there is no consensus in the literature on what is the optimal level of interchange fee. This fact is very relevant because these fees are highly correlated to those charged to merchants and to cardholders. The only consensus is that the optimal interchange fee (and consequently merchant fee) is not zero. The level of the interchange fee has received substantial international attention. For example, the Dodd-Frank Wall Street Reform in the U.S. gives the Federal Reserve the authority to regulate U.S. debit card interchange fees to promote a more efficient retail payment system. The Reserve Bank of Australia regulated interchange fees in 2002 after concluding that consumers did not face the correct incentives to use the most efficient payment instrument. The European Commission in 2007 ruled that MasterCard's interchange fees violated the EU's antitrust laws. Alternatively, the reduction in interchange fees may also occur without regulatory intervention as occurred in the United States when card networks convinced large department stores and grocery stores to accept payment cards by reducing interchange fees which resulted in lower merchant fees. This has also been traditionally the case of Spain. In particular, since December 2005, when the Spanish government promoted an agreement between payment networks and merchant associations to establish a timetable to progressively reduce interchange fees from 2005 to 2009, with different schedules for debit and credit cards. Average debit card interchange fees declined from 0.39 to 0.31 euros/transaction from 2005 to 2009, while the average credit card interchange fee fell from 1.23 to 0.67%.

However, most recently, following the EC 260/2012 SEPA regulation discussed above, the Spanish government has decided to decrease interchange fees on credit and debit cards. In particular, the banks will be limited to charging a maximum of 0.2% in the case of debit cards and 0.3% in the case of credit cards. This should also reduce merchant fees, which currently average 0.65%, as shown in Exhibit 12.

It is unclear what the effect of such reductions will be. In theory, the decision tries to follow the logic that suggests that interchange fees should be close to the marginal costs of the service, but this cost is very difficult to estimate in practice. At the same time, the industry has made

Exhibit 12

Average merchant discount fees for card purchases in Spain (2002-2013)
(percentage)



Sources: Bank of Spain and own elaboration.

substantial investments in payment infrastructure, as shown in this article, and only a significant increase in card use for purchase transactions can compensate the effect of a reduction in fees. However, calculating this effect is also difficult in an environment in which the effects of the crisis on the use of cards cannot be separated from the effect of the reduction of the fees themselves.

In any event, with this reduction in fees, Spain has anticipated implementing the provisions of EC 260/2012 regarding interchange fees.