BRIEFING

Initial Appraisal of a European Commission Impact Assessment

European Parliament

Levelling off European cross-border payments in euros

Impact Assessment (SWD(2018) 084 final, SWD(2018) 085 (summary)) of a Commission proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges.

This briefing provides an initial analysis of the strengths and weaknesses of the European Commission's impact assessment (IA) accompanying its proposal for a regulation on cross-border payments, submitted on 28 March 2018. With this proposal, the Commission aims to lower the costs for cross-border transactions in euros by individuals and businesses in non-euro-area countries, so that these costs could approximate those paid for transactions in euros by individuals and businesses within euro-area countries.

The current regulatory framework, of which Regulation 924/2009 is an important building block, has equalised the fees for cross-border payments in euros within the EU with those for domestic payments in euros.[1] However, domestic payments in euros made within non-euro countries are often subject to the same high fees that are applicable to cross-border transfers in euros. Therefore, individuals and businesses in non euro countries have to pay substantially higher fees for cross-border transactions in euros than individuals and business in euro countries. As a result, the European single market remains *de facto* divided between two categories of payments and consequently two categories of transaction fees. Furthermore, there is a lack of transparency as to how much a cross-border transaction, card payment or cash withdrawal made in the local currency of the place of destination (either euro or not euro) may actually cost users having an account in a different currency. There is a lack of transparency both in the conversion rate and the conversion fees. Such a situation poses concrete challenges, which, according to the Commission, would remain unresolved if not tackled by a regulatory measure.

The current proposal, which is a part of the Commission's 2017 action plan aimed at lowering the high fees for domestic and cross-border transactions in the EU and making European financial services more transparent, is a step forward in tackling the above challenges. Furthermore, it is in line with the 2017 Commission work programme, which envisaged revising Regulation 924/2009 as part of the REFIT initiative. The proposal seeks to amend this regulation with regard to two elements: 1) the principle of alignment of fees for cross-border payments in euros with those for corresponding domestic payments in the national currency of the payment service user's Member State, also with regard to Member States that do not have the euro as their national currency; 2) the requirement on payment service providers to ensure transparency prior to a payment being made, as well as to provide users of payment services the possibility to compare the various options available to them.

Problem definition

The main problem identified by the report is the disparity between the fees for cross-border transactions sent from or received in non-euro Member States or sent in a non-euro Member State currency, and the fees charged for transactions made in euros within the euro area. As the

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Commission points out, the former category of fees (to and from the non-euro area or made in a currency other than the euro) remain excessively high and stay high even when the transactions are handled by large banks. The Commission estimates that around 160 million Europeans outside the euro area need to pay high charges for cross-border payments.[2] Furthermore, these people, together with 6.5 million non-euro area enterprises would benefit from the proposal when making cross-border credit transfers, card payments and cash withdrawals as well as other cross-border payment services.

The Commission explains that several drivers are responsible for this problem, some of which are outside the scope of the IA.[3] The most important among them appears to be the fragmentation of the retail banking markets, particularly in the non-euro-area Member States, caused by market and regulatory failures.[4] As a result, such Member States continue to rely on 'legacy infrastructures for cross-border payments' (e.g. software or hardware needed to enable transactions and cash withdrawals, as well as procedural steps). The Commission calls this a 'high-cost trap' (IA, p. 20). Combined with the low number of cross-border transactions (as compared to domestic transactions), this high-cost trap does not make it attractive for payment services providers to invest into new infrastructure. Furthermore, as Regulation 924/2009 does not apply to non-euro currencies, this results in a lesser degree of modernisation of infrastructure for cross-border transactions in non-euro countries. The operational costs therefore remain excessively high, according to the IA. The IA presents this problematic situation in greater detail in the market analysis section in Annex 4 to the report. According to the market analysis, cross-border electronic transactions from EU Member States account for around 6 % of the total number of transactions but represent a larger share in value terms, accounting for 13 % of the total value transacted (€35 trillion in 2016) (IA, p. 69).

The Commission concludes that in the absence of regulatory action, consumers and enterprises will have to wait long before they can benefit from lower fees. The high costs faced by banks will persist and may even increase as the security and maintenance costs of aging infrastructure go up (IA, p. 23).

Given that some of the drivers were left out of the scope of the analysis of the problem at hand, the sections dedicated to desciribing the problem would have been stronger, had the Commission explained this decision in sufficient detail. In particular, one could have also wished for more consideration to have been given to technological developments, especially with regard to the general trend of new online technologies becoming more available and cheaper for users and providers, also examinging whether this trend applies to financial services and infrastructure as well. The report does mention FinTech players offering alternative cross-border payment services, but it does not focus on these new players in significant detail. There is also a noticeable lack of balance in terms of organising the analysis of the problem of excessive costs and the problem of the lack of transparency of the costs of non-euro transactions. The latter appears to not have been sufficiently explored and is missing from the problem tree (IA, p. 22).

Objectives of the initiative

The general objective of the proposal is to reduce the fees for cross-border payments across the EU and contribute to a better integration of all EU citizens and businesses into the EU economy (IA. p. 28).

The specific objectives address various problem drivers. These include:

- covering the broadest possible range of transactions and payment service users. This specific objective seeks to address the problem of inequality between non-euro area and euro-area payment service users;
- increasing the transparency of fees in cross-border transactions. This objective would be met when the fees of cross-border transactions are not only in alignment with the domestic ones but are also clearly known to the payment service users. By reaching

this objective, the Commission intends to address the market's failure and improve competition by making fees more transparent and comparable between providers;

- pushing all EU payment service providers towards a modernisation of cross-border payment services;
- providing equal access to low-cost payments for euro area and non-euro area individuals and enterprises.

The IA report does not provide operational objectives under the preferred option, contrary to the recommendations of the better regulation guidelines.

Range of options considered

The Commission presents five policy options (including the baseline scenario). The options analysed are as follows:

Baseline: Do nothing. Under the baseline scenario, fees for cross-border transactions will not be affected by any new EU regulatory action and will largely depend on the market. In the event of market growth, there will be little incentive for payment service providers to bring the costs down, while in the event of slow or no growth, individual Member States might bring the fees down by way of individual opts-in (as Sweden did). As the IA explains, this scenario is not favourable for European citizens and businesses.

Option 1: Extending Regulation 924/2009 to local currency cross-border transactions. This option would mean equalising fees for domestic and cross-border non-euro national currency transactions, whereby the addressees would be payment service providers and there would be a two-year horizon for them to comply with the new regulation after its entry into force. This option would impose a rather costly service on service providers, at the price of a low-cost service.

Option 2: Extending Regulation 924/2009 to local currency and euro cross-border transactions. Option 2 includes Option 1 and adds a requirement to also equalise fees for cross-border transactions in euros with domestic transaction fees. The horizon to comply would be two years from the date of the new regulation's entry into force for non-euro transactions and six months for euro transactions. The Commission explains that the short period of six months for euro transactions would be justified by the fact that a common infrastructure for euro transactions is already available also to payment service providers (PSPs) in non-euro countries, allowing a quasi-immediate alignment of fees.

Option 3: Extending Regulation 924/2009 only to euro cross-border transactions. Option 3 differs from Options 1 and 2, as it would require the equalisation of fees for domestic transactions in the national currency and cross-border transactions in euros. The addressees would be payment service providers, and the compliance period would be six months from the date of entry into force of the new regulation.

Option 4: Extending Regulation 924/2009 to all cross-border transactions in the currencies of the EU Member States. Option 4 entails removing all internal borders for transactions in any EU currency. It would require PSPs to align their fees for all cross-border transactions between EU countries, effected in whatever currency, with domestic transactions, even in the case of transactions in currencies that are not the ones of the sending or receiving country. The addressees would be service providers and the compliance period would be equal to six months from the date of entry into force of the new regulation.

All options except the baseline are based on the extension of the current regulation with Option 4 being the most ambitious one.

Synthesis of each option's characteristics (IA, p. 32)

Options	Baseline	Option 1	Option 2	**Option 3 (preferred option)**	Option 4
Transactions issued from	N/A	Non-euro Member States	Non-euro Member States	**Non-euro Member States**	All Member States
Scope of transactions	N/A	Local currency cross-border transactions	Local currency and euro cross-border transactions	**Euro cross-border transactions**	All cross-border transactions in the currency of an EU Member State
Total horizon for improvements	Long	Two years	Six months euro; two years local currency	**Six months**	Six months euro; two years local currency; four years other currencies

In addition to the analysed options, the IA also briefly addresses the option that had been discarded at an early stage, namely capping the cost of cross-border transfers at 3 %, in line with the UN Global Sustainable Development Goals for remittances. As the Commission explains, this option was discarded because it would be too expensive for cross-border transactions within the EU. The Commission furthermore argues that it would also be difficult to find a common benchmark for all EU Member States to which to align prices, as conditions differ from one country to another (IA, p. 33). The range of realistic options appears to be limited to Options 2 and 3, and can therefore be considered rather narrow. Furthermore, it is not clear whether the options (including the preferred Option 3) achieve the objective of increasing the transparency of transactions, in partucular with regard to the role of the European Banking Authority (EBA). According to the Commission, increased transparency would need to be achieved through the adoption of specific regulatory technical standards (RTS), to be managed by the EBA. Any further exploration of the RTS would require an impact assessment of its own, to be prepared by the EBA (IA, p. 55)[5].

Scope of the impact assessment

The Commission compares the options against four criteria, namely the effectiveness of the options in achieving the objectives, their cost-efficiency, their coherence with broader EU policies, and their effect on key stakeholders (including individuals, SMEs and companies). In this impact assessment, the Commission has opted not to assess environmental or social impacts. Instead, it looks primarily at the economic impacts, comparing the costs and benefits of each option and rating them for each specific objective as well as according to the baseline scenario (the lowest rating is given to the highest costs and the maximum rating is given to the maximum scope of transactions covered). The cost comparison is done mostly in quantitative terms and is summarised on p. 37 of the IA. The preferred option in this logic is the one ensuring the 'best possible attainment of the stated objectives, while at the same time imposing the lowest costs and the best impacts on stakeholders while being coherent with broader EU policy goals' (IA, p. 34). The Commission explains that the direct benefits for consumers and SMEs will amount to €900 million.

The impact assessment pays considerable attention to the impact of a future UK exit from the EU. It does not however change the preference towards Option 3 (IA, p. 56). The UK's exit would further reduce the attractiveness of Option 4, because the benefit of extending the regulation to other non-euro currencies would be reduced as compared to the high potential volume of GBP payments[6].

The Commission identifies Option 3 as the preferred one. That means extending the existing Regulation 924/2009, so that fees for cross-border payments in euros are equalised with the price of the corresponding national transactions in the national currency of non-euro countries. In practice, under the preferred option, payment service providers would need to change their fee tables when invoicing their clients. The Commission explains that Option 3 appears to be the most efficient, because it covers 80 % of the volume of the total transactions of non-euro Member States. The Commission refers to stakeholder support being the strongest for Options 2 and 3, however, as pointed out elsewhere in this appraisal, without going into further detail.

Subsidiarity / proportionality

Article 114 (stipulating the competences of the European institutions regarding the establishment and functioning of the internal market) of the Treaty on the Functioning of the European Union is the legal basis for the proposal.

The Commission explains that during the 17 years over which the current regulation has been in force, only Sweden has used the opt-in. As Member States have not taken action on their own, tackling the problem at EU level is preferable than leaving it to individual Member States or the market. According to the Commission, because the revenues deriving from cross-border payments are significant, it is likely that non-regulatory measures would fail to put enough pressure on payment service providers. Therefore, The Commission sees legislative action at EU level as the most effective response.

Member States' parliaments have not submitted reasoned opinions.

Budgetary or public finance implications

According to the IA, the administrative costs of adapting fee documentation would be €1.5 million and the enforcement costs for increased compliance handling would amount to €700 000 for all Member States (IA, p. 68). The proposal has no budgetary implications for the EU institutions.

SME test / Competitiveness

According to the Commission, the proposal will have a positive impact on SMEs. SMEs based in the euro area will benefit from a potentially higher demand from consumers and enterprises in non-euro Member States, because the barrier for cross-border payments will be lowered. Logically, SMEs based in the non-euro area will benefit from having easier access to the citizens and enterprises in the euro area in terms of the cost of financial transactions. The report points out that SMEs stand to benefit from the proposal particularly because they are not in a position to negotiate payment fees and charges with their service providers (as compared to bigger enterprises). The IA does not provide information as to the share of SMEs among the payment service users affected by the current situation. The Commission cites an independent UK case study to illustrate the benefits for SMEs. UK SMEs can pay up to GBP4 billion a year for hidden fees in cross-border transactions. The proposal would only address the part of these transactions made in euros, but according to the IA, it would still make a significant contribution in terms of reducing SMEs' costs.

The Commission considers that there will be a positive impact on the competitiveness of EU enterprises, as they would be able to reach a wider pool of providers at a lower cost. The IA report points out that the EU economy in general will become more competitive thanks to a tighter economic integration resulting from the removal of payment cost-related barriers (IA, p. 56).

Simplification and other regulatory implications

The revision of the existing regulation aims to provide a more efficient and effective regulatory framework by achieving simplification of the legislation. The preferred option would enhance the effectiveness of the existing regulatory framework by making the pricing of cross-border transactions clearer and more transparent. Furthermore, the direct regulatory benefits from reduced fees for cross-border payments are expected to amount to €900 million.

Quality of data, research and analysis

While preparing the impact assessment, the Commission contracted an external consultancy (Deloitte), assigning it the task of making a study to analyse the data gathered in all of the non-euro Member States as well as three of the euro Member States.[7] The study looked at volumes of payments as well as internal costs borne by payment service users and providers of euro and non-euro transactions. It needs to be stated here that the Deloitte study aimed to analyse only the scenario of extending the regulation to all currencies used in the EU (Option 4). Therefore the other options, including the preferred one, were left outside the scope of the largest analytical exercise. Furthermore, the lack of data on cross-border exchanges among non-euro Member States placed a serious limitation on the analysis presented in the IA report. The IA relied on data from eight non-euro area Member States, while in the case of Poland and the Czech Republic the Commission suspected statistical anomaly, as the figures they provided were not coherent with those of other Member States. The Commission mentions that in preparing the impact assessment, it used various other sources, such as reports from McKinsey and CapGemini, without providing any furtther details. The IA does not make a reference to a 2011 mid-term review of the application of Regulation 924, which appears to be directly relevant to the analysis.[8] The Commission refers to the 2013 evaluation of the impact of Regulation 924, and considers the conclusions of that exercise still valid (IA. p. 85).

Stakeholder consultation

The Commission explains that the stakeholders were consulted primarily as part of the review of the existing regulation with the aim 'to collect feedback and allow a wide range of relevant actors to provide their view on the issue' (IA, p. 61). This open public consultation was held between July and October 2017 and ran for 14 weeks. The Commission received responses from 150 respondents in 21 Member States, and two non-EU states (Norway and the US). The majority of respondents were based in the euro area (58.2 %). Some 44 % of respondents considered non-euro transactions within the EU as very expensive and 14 % considered them not expensive. Some 62 % of individuals and 59 % of companies considered payments service transactions expensive. At the same time, a large number of respondents had no opinion on the issue (28.2 %). A summary of the outcomes of the stakeholder consultation can be found in Annex 2 to the IA report (IA, p. 61). The report notes that stakeholders among market users and consumers 'voiced their support for the proposal, but general support was voiced to opt for the more ambitious policy options' (IA, p. 67). Without further information, which is regrettably lacking in the report, it is difficult to see what were the exact options preferred by the stakeholders, and is therefore difficult to assess the claim made in the report about the support given by the stakeholders to the preferred Option 3.

Monitoring and evaluation

The Commission envisages an evaluation to be conducted three years after the entry into force of the proposed regulation. The evaluation would aim to assess the effect of the regulation on transaction fees and the currency conversion. The IA report provides the following indicators for the ex-post evaluation: increase in the volume of euro transactions and a decrease in the volume of transactions in other currencies (as compared with the trends for domestic transactions). Some of the monitoring provisions appear to be rather vague and difficult to use in practice. Such is the case with the recommendation to look at 'market developments', in order to assess whether the proposal should be extended to all EU Member States' currencies and not only the euro in the future. On the face of it, making such an assessment would require applying a range of more precise monitoring indicators as well as holding stakeholder consultations. More importantly, it is unclear whether three years will provide sufficient time for the new data to become available and representative, as the preferred option gives payment service providers a time horizon of six months to comply with the new regulation. Of importance here is the already mentioned lack of data from non-euro Member States. If this problem is not addressed, it will likely affect the quality of the monitoring and evaluation exercise.

Furthermore, besides mentioning that a number of reporting arrangements have been revised, the report does not give any further details on this issue. Given that the national reporting arrangements in some countries (for example, in the EEA), in particular for tax purposes, appear to be incomparable, a better explanation of the revised reporting arrangements would have been useful.

Commission Regulatory Scrutiny Board

The RSB gave a positive opinion on a draft version of the IA on 14 February 2018. However, it indicated several points that merited improvement. For example, in the Board's opinion, the IA report does not explain its assumption why the currently small market share of online and Fintech services does not have the potential to grow to a size capable of addressing the problem. As was mentioned elsewhere in this appraisal, the final version of the IA does not cover Fintech companies in more detail. More importantly, the RSB suggested improving the formulation of the options. As the RSB noted, the IA could deliberate on different solutions for cross-border transactions in euros and in local currencies together, as part of one option. Furthermore, the RSB pointed out that the report could have addressed in greater detail various 'soft measures' aimed at enhancing transparency (e.g. a fee calculator). The final report does not mention those measures in any substantial detail. As the IA does not explain what revisions were made in the final version (instead, it only states that the Board gave a positive opinion), it is impossible to make an informed judgement of whether any improvements were introduced to it. The absence of a separate section specifying the revisions made according to the comments of the RSB is contrary to the recommendations of the better regulation guidelines.

Coherence between the Commission's legislative proposal and the IA

The proposal follows the preferred Option 3, i.e., the price of a cross-border payment transaction in euros within the European Union should not be different from that of a domestic transaction within a Member State conducted in the national currency of that Member State. The most important element of the preferred option - the principle that payment service providers must align fees for cross-border payments in euros with those for corresponding domestic payments in the national currency of the payment service user's Member State - is coherent with Article 1(2) of the proposal. The provisions on monitoring, laid out in the IA and the proposal, also appear to be coherent. Finally, the proposal includes provisions that the IA does not cover in substantial detail, namely those related to the role of the EBA in addressing the objective of increasing the transparency of conversion fees.

Conclusions

While the overall argument in favour of cheaper cross-border payments across the euro and non-euro Member States appears sensible, this impact assessment could have been stronger in terms of discussing the specifics of the financial infrastructure in non-euro Member States and the shortcomings of the cross-border payments market related to these specifics. A more detailed comparison of options, including the economic impacts (particularly as related to SMEs), would have been helpful, as would a more substantiated analysis of the feasibility of the envisaged monitoring and evaluation mechanisms, as well as the role of the EBA in addressing the transparency problem.

ENDNOTES

[1] The current legal framework, SEPA, includes Directive 2007/64/EC, Directive (EU) 2015/2366, Regulation (EU) 260/2012 and Regulation (EU) 924/2009.

[2] For example, a transaction between Finland and Bulgaria can cost up to 24 euro cross-border, as compared to one euro for the domestic (Bulgaria-Bulgaria) transaction.

[3] The drivers left outside the problem tree are as follows: lack of commitment to join the euro in several Member States, low volumes of cross-border transactions compared to domestic transactions, and weak competitive pressure in the cross-border payments market including from FinTechs (IA, p. 22).

[4] Non-euro Member States are: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Sweden, Denmark (opt-out) and the United Kingdom (opt-out).

[5] According to the Commission, increased transparency would need to be achieved through the adoption of specific regulatory technical standards (RTS), to be managed by the EBA. Any further exploration of the RTS would require an impact assessment of its own, to be prepared by the EBA (IA, p. 55).

[6] According to the IA, the UK has a dominant share within the transactions made by the non-euro country group. The share of the UK in credit transfers and card payments is about 80 % of the total non-euro payments value. Furthermore, based on its GDP, the UK should represent about 60 % of cross-border non-euro transactions from EU Member States (IA, p. 56).

[7] The Commission does not provide a link to this study in the IA report. However, it can be accessed at https://ec.europa.eu/info/sites/info/files/180328-study-cross-border-transaction-fees-extension_en.pdf .

[8] http://ec.europa.eu/internal_market/payments/docs/framework/130724_study-impact-psd_en.pdf

This briefing, prepared for the Economic and Monetary Affairs (ECON) Committee, analyses whether the principal criteria laid down in the Commission's Better Regulation Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to have been met by the IA. It does not attempt to deal with the substance of the proposal.

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