

IMPLEMENTATION OF SEPA ELEMENTS IN SERBIA AND THE EFFECTS ON SMEs SECTOR

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Abstract

The European Union is in the process of creating integrated payment system in the euro zone within the SEPA project. This paper discussed the importance of the implementation of certain elements of this system to creating a more favorable business environment of SMEs in Serbia. The first part is dedicated to the analysis of objectives, characteristics, advantages and perspectives of the SEPA concept. Second part deals with analysis of the institutional foundations of the existing payment systems in Serbia. In this particular part there is a review of achieved level of compatibility of infrastructure and instruments with the European system, and the importance of the actual project implementation in the SEPA direct debit basis focused in the improving business environment of SMEs.

Key words: SEPA, payment system, direct debit, direct credit, SME sector

Introduction

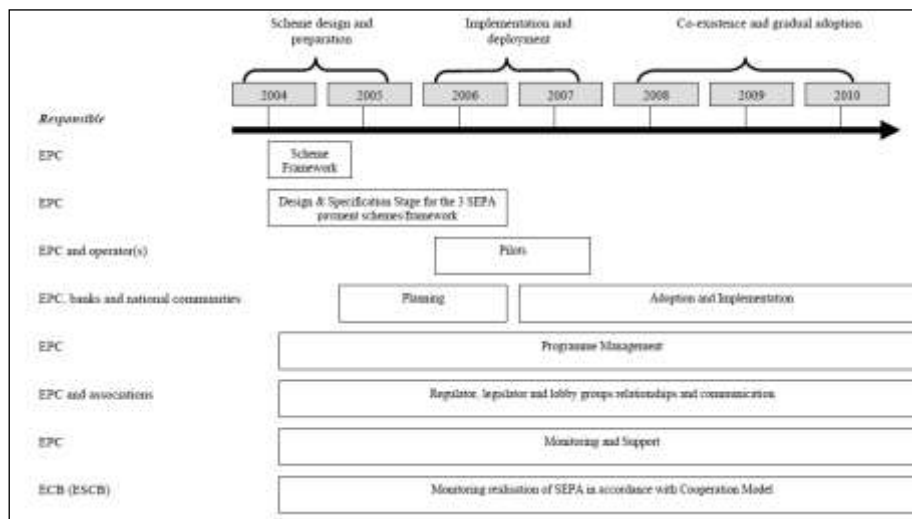
The need for setting up an integral payment system in the Euro-area (**Single Euro Payment Area - SEPA**) emerged from the negative effects of incompatibility of individual national payment systems on the competitiveness of the European economy, after the introduction of the euro as a single currency. Regarding that national payment systems of European countries maintain specific solutions designed for the needs of their users, there is a significant difference in terms of technology, procedures, standards, types of services, the bank fees and the content used in the area of interbanking clearing and payments process. In such circumstances, companies had to have separate accounts for business in different countries, and citizens were not able to complete cross-border payment or purchase of goods and services with only one account.

To solve the deficiencies, as a first step, EU adopted Directive (2001) with the intent of the **harmonization of fees for payments services**. With regulation No. 2560/2001, the EU has introduced new rules for calculating fees for cross-border payments between EU member states. The rules are applied to all banks in the EU countries as well as to retail and corporate customers. Purpose of the new set of rules was: to enable companies to **transfer money fast, safely and cheaply** from one end of the EU to the other; to **harmonized the fees for domestic and cross-border payments** within the EU and to make it possible for the banks to **process payments automatically**, without manual processing. However, the key problem was not solved. Despite the introduction of **Trans-European Automated Real-time Gross Settlement Express Transfer System TARGET**, various instruments and standards still existed, so companies had to keep different accounts for business in different countries. On the other side, citizens were faced with significantly higher fees for cross-border payments and for collecting cash, comparing to the national fees. Therefore, the largest European banks and financial institutions set up a professional body - **The European Payments Council** (<http://www.europeanpaymentscouncil.eu>), whose task was to establish a unified, efficient payment system in Euro-zone. Then, **The Council of Ministers for Economic and Financial Affairs - ECOFIN Council** formulated the **Payment Services Directive**.

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Graph1. Phases of SEPA implementation



Source³

The result of these activities was the project of establishing a unified system of payments in the euro region - SEPA, which would solve all mentioned disadvantages of existing payment system.

The process of implementation of SEPA project has organized in several phases, during the period 2004-2011.

- I. **The first phase - Design and preparation** (January 2004 - June 2006) contained creation and design of payment system.
- II. **The second phase Implementation and deployment** (mid. 2006 – 31st December 2007) was dedicated to the process of introduction, learning about and testing new SEPA instruments.
- III. **The third phase Co-existence and gradual adoption** (January 2008. – 31st December 2010) is envisaged as a transition phase toward a new system.
- IV. **The fourth phase** (2011) should be only the implementation phase of SEPA payment system.

1. SEPA and the competitiveness of EU economy

SEPA payment system is primarily designed for the retail payments i.e. small and micro payments, which amount is below 50 000 euro. This system is **integral** (covering the entire Euro-zone), **comprehensive** (applied to all payments) and **imperative system** (because it commits all participants to carry out what is written in Directive). Its application involves the use of a single currency (euro), the use of unique standards and business practices, the use of a unique set of payment instruments, the establishment of effective infrastructure, mutually legal framework with clear regulations and ensures favorable prices of payment transactions.

Construction of unique payment infrastructure requires the introduction of uniform rules and standards for SEPA transactions. As SEPA payment system incorporates different channels, mechanisms and instruments, each of its parts are based on the principles that are **partly mutual and partly specific**. Common features that each of the SEPA subsystems contain is related to the effective implementation of all payments and specific characteristics are related only to certain subsystems i.e. segments. On the other hand, specific standards need to ensure functionality of each subsystem, as a part of a network. Defined standards are presented in the form of a single scheme and published as **Rules books** for each different segment of payment. SEPA common rules are related to credit transfers/payment (**SEPA**

³ <http://www.europeanpaymentscouncil.eu/documents/Roadmap%20public%20version%204th%20April%20amended%20March%202008.pdf>

Credit Transfer - SCT) and direct debit/charge (**SEPA Direct Debit - SDD**). The SCT was implemented until January 2008 and the implementation of SDD will start during the 2009.

A unique scheme for credit transfers, **SEPA Credit Transfer - SCT**⁴ provides a set of rules and procedures for credit transfers from account to account. These procedures include the situation when clients make payments over the available amount (within a specified value and time limit) and use a credit card as a legal payment instrument. Rules books provide a unique level of service and time frame in which financial institutions must perform this operation.

A unique scheme for direct debit, **SEPA Direct Debit - SDD**⁵ provides a set of rules and procedures for the approval and recording of the money transfer from the account of a buyer to the account of the seller of goods or services, or to the account of another recipient. In this segment, it is a debit account that allows bank clients to make payments only to the amount actually available, without the exceeding. In this case, clients also use traditional payment card as an instrument. Terms of direct payments (SDD mechanism) determine the level of service and the shortest time frame in which financial institutions must be able to execute payment transaction. SDD exists in two forms (models):

- 1) When the debtor gives direct instruction to the vendor to charge his account and
- 2) When the debtor gives instruction to his bank to charge his account.

The global domain of SEPA project includes SEPA Scheme (common rules for SCT and SDD transactions), SEPA framework (for credit cards, cash and a mechanism for clearing and settlement) and the SEPA infrastructure (the technological standards, technical infrastructure and legal framework).

It is undoubtedly that the system will work in the future only as an **electronic transfer**. Also, is expected to be open for the development of additional services of payment system such as **e-invoicing** and **e-reconciliation**. The first type of additional services (*e-invoicing*) refers to the ability for sending electronic invoices direct to the customer's bank by the seller and their automatic billing after bank's confirmation, on the basis of instructions from the seller that are already included in the invoice itself. Other additional service (*e-reconciliation*) refers to electronic settlement of debtor's and creditor's accounts, in specified time, for which the participants agree. It is also expected that the integration of payment systems will open a space for the new payment technologies, but some of them are not predictable yet.

General benefits of introducing a single payment system in the Euro-zone should be reflected in the **increase of the competitiveness of the European economy by providing a simple, efficient and low-cost payment system**. If, on the other hand, we look at the positive effects of the individual participants (consumers, trade sector, companies and banks) they differ significantly.

For **consumers** basic benefits should be the possibilities to have only one bank account for all payments in the entire zone and less complicated use of payment cards with lower fees.

Traders (merchants) will have benefits in the area of payment cards. Lower costs and higher speed of transactions are some of them, but probably the most important is the fact that the only one institution will process all payments, regardless of credit card issuer. In the previous period, the major problem of traders, in terms of credit cards, was that they must sign contracts with each individual issuer. The number of issuers is very large and they are located in different countries, so the payment fees they charge are varying from one to another. In accordance to this change, POS terminals that are used for processing must be able to support all types of payment cards.

Banks and institutions that are engaged in the field of payment system should feel the positive effects of the SEPA system in various aspects. In the integrated payment area banks get the opportunity to offer their services in the whole Euro-zone. This will affect the mobility of banks and the increase of their mutual competitive fight. Individual banks will have a larger possibility to cover a wider geographic area, with a better quality of service and lower prices. As a result, the business activities on the macro level will be more harmonized.

⁴ http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=136

⁵ http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=219

Companies should improve their efficiency and effectiveness based on the multiple ways and mechanisms to simplify management of their payments. The key change is related to introduction of a **single account for all inflows and outflows**, regardless of relations between different countries. This would eliminate the disadvantages of previous solutions in which the companies had to operate through a separate account for the domicile and foreign payments and through a separate account in case they have a foreign office. Higher level of economic and efficiency would be realized in the development of additional payment system services, that we already mentioned *e-invoicing* and *e-reconciliation*. According to some estimation, transition from cash to electronic payment will provide savings about 28 billion euro per year, while the transition with *e-invoicing* will provide additional savings that could be ranged between 50 and 100 billion euro (9, p.15).

2. General characteristics of the payment system in Serbia

During the last few years Serbia was carried out a series of reforms in the economic and financial sector, where the need of reforming the payment system was a prerequisite for further development. Through several projects, system was fundamentally reformed in line with global trends of implementation of higher quality instruments, procedures and infrastructure in the payment systems, under the influence of market competition and technological progress.

Today, Serbia has a modern and efficient payment system that is based on international standards and best practice of EU countries. Relevant international institutions (IMF, IBRD, ECB) testify about the results that Serbia achieved in this area. Mission of **Financial Sector Assessment Program FSAP** in March 2006 has evaluated payment system in Serbia with highest scores in all the relevant criteria.

The aim of the reform of payment system in Serbia was to provide:

- 1) Adjustment of our national payment infrastructure to European payment infrastructure;
- 2) Creation of basic conditions for the development of financial markets and banking business, in accordance with the content of e-banking and
- 3) Effective fight against the gray economy.

Existing activities that are conducted by a special importance were:

- 1) Abolition of the existing system in financial transactions which were monopoly,
- 2) Introduction of systems for securities trading, and
- 3) Introduction of payment cards in the system of retail, non-cash payments.

Abolition of monopolistic system in the payment area is certainly a significant change. The basic institutional assumptions for the implementation of these changes was made with new **Law of Payment Operations** (*Zakon o platnom prometu*), which anticipated transfer of payments from ZOP (Zavod za obra un i pla anja) to commercial banks (as of January , 200). This law also prescribed the conditions of technical and technological capability of banks to carry out these tasks, to use electronic payment orders, electronic transfer of funds and the new clearing system.

This institutional change abolished the difference in the organization of payment transactions in the country and abroad. In that way, Serbia eliminate the most limiting factor for the merging of national and international payment system, particularly in the field of unification of instruments, technologies and organizations (in the institutional and instrumental sense). A foreign practice, a new type of segmentation was established on the basis of economic characteristics of transactions – (1) Gross value transaction and (2) Small value transactions.

Central Bank took over the function of operational involvement in the inter-banking clearing. Model is selected in accordance with the trends and practices of developed countries and transition countries. In the process of creating **settlement points** between the banks, Serbia accepted the combined use of **net billing** (with a greater number of inter-banking accounts during the days/three) **for small payments** and **RTGS for large payments**, which works on the waiting list principles. In a technical sense, they are configured as one system that works on a single platform, with the operator and owner of the Central Bank of Serbia (NBS). Later, in 2005 Serbia introduced the possibility for banks to perform small payments in the RTGS, under the same costs as to the clearing payments.

Inter-bank clearing is carried out in the checks clearing system by the Banks association of Serbia, while the performance of obligations by net positions is realized through the RTGS system of National Bank of Serbia.

Technical and technological solutions for the functioning of the RTGS system made in accordance with international standards. Based on the alternative possibilities of connecting banks over three independent lines (SWIFT, a private network and the Internet), in case of system failure, it is possible to switch very quickly from the system out of the line to the backup system, sending messages in the SWIFT or XML format and ensuring security of data, using pairs of private and public keys.

Clearing of international payments, based on the principles of multilateral net calculation, was introduced in 2007. It is performed for the account of private and legal persons whose banks have headquarters in Serbia and in the territory of the state with which the National Bank of Serbia made an agreement on carrying out the calculation of net international payments. Participants in the clearing process are central banks that are signatories of the agreement and the bank with its central bank signed agreement based on participation in international payments. At the moment, this agreement is signed with the Central Bank of Bosnia and Herzegovina and Montenegro. It allows further lowering the costs of payment transactions, increase efficiency, establish singularity with foreign exchange payments in the country and facilitate cooperation with countries in the region and providing support for free trade.

3. Clearing of international payment and European integration

Clearing mechanism of international payments in foreign currency is now executing by the NBS, for the first time in history. The main reasons for this solution lie in the possibility that it provides a further increase of efficiency of payment systems, and indirectly the entire economy. In that sense, this mechanism enables further lowering costs of payment transactions, establishing the identity of international payment, foreign exchange payments in the country, raising the efficiency of payment transactions, providing additional support for cooperation with other countries in the region and free trade in general (CEFTA) and the contribution to the preparation for European integration (SEPA).

Starting from the assumption that the standards and rules that SEPA brings in the nearest future will become a matrix, which almost all European countries will seek to adapt, the NBS has acceded to making regulations which ensure the establishment of clearing with the foreign exchange and payment transactions by direct debit. The NBS made the Decision for inter-clearing payment in foreign currency⁶, Operational rules for inter-clearing payment in foreign currency⁷ and the Decision on carrying out payments by direct debit⁸.

This legislation established the mechanisms that will facilitate easier connectivity and functioning of the payment system in our country with countries in the environment, and in the future to pave the way for swift connection of domestic foreign currency payment system with those who will work in the EU.

The overall mechanism of communication function in accordance with SWIFT standards according to which the use of two types of accounts as follows: MT-103 messages for the transfer of funds for the account of the user, and MT-102 messages that contain a group of payment for the account of the user. Orders execution is based on the method of approval limits and waiting lists. Participant may request from their central banks to increase or decrease the limit, which are granted depending on the conditions to be fulfilled. Sent message (how to meet the requirements for participation in the clearing system) is recorded in the bank account within the limit. If a negative position exceeds approved limits, a message goes to the wait. At the end of the cycle multilateral net position are calculated and the Central Bank get the information of net position of their banks.

⁶ Odluka o me ubankarskom kliringu pla anja u devizama

⁷ Operativna pravila za me ubankarski kliring pla anja u devizama

⁸ Odluka o obavljanju platnog prometa po osnovu direktnih zadu enja

Alignment between the central banks is done through the account of the banks in the first-class international bank (in this case to the Deutsche Bank). Central banks are granting and charging bank accounts for their net position from the clearing, a bill is considered to be finite when each bank receives the billing statement of your account for clearing. This agreement is signed with the Central Bank of Bosnia and Herzegovina and Montenegro.

4. Direct debit and SMEs in Serbia

Major incompatibility with the principles of SEPA concept, at this moment in Serbia, exists in the area of operational function of direct payment. In order to eliminate these shortcomings, the NBS and Association of Serbian Banks were decided to implement SEPA concept in the field of direct debit. Institutional basis for implementation of that concept is Decision on carrying out payments by direct debit, prepared by the NBS in 2007.

Although the Law provides the execution of direct debit transactions (Art. 23 and 24) actually Serbia use the system of involuntary payment (Art. 47-49), which is not in accordance with the EU due to non-transparency. The existing system allows I, II and III order of priorities, according to which primacy belongs to the debt to the state, until the claims of business entities are in the III right priorities. Realization of transfer charges on the basis of I and II order of priorities will be made only through a process of enforced payment. Banks do not have insight into the basis of payment and a debtor does not have possibility to pay off a debt in the cheaper way. The level of control is lower at charging I and II degree of priority than III (in the case of I and II relations are between the applicant-enforced service charge, and in III applicant-bank service-charges enforced). With such a solution it is not possible for banks provide to their customers complete services in order of III priorities for client-creditor basis for billing and account receivable must take to the bank of your debtors (can not work to complete in your bank).

The basic principles of direct debit system in Serbia are as follows:

- 1) The ability of business customers to initiate the charge of the accounts of their debtor in their own bank;
- 2) Standardization of performance account debit in accordance with the SEPA rules;
- 3) Increasing of security in the implementation of base charges on the basis of a single registry of mandates;
- 4) Enabling the establishment of quality relationships between business entities;
- 5) Implementation by phases, connected with other services of payment system (Compulsory toll);
- 6) The possibility of connecting the authorities in the clearing system and
- 7) Cheaper implementation of the transfer charges.

It is expected that the introduction of inter-bank clearing system by debit accounts have significant positive effects on SMEs, either directly or indirectly, through the influence of the banking institutions, the state and authorities.

In the functioning of inter-bank clearing system, debit accounts by economic entities will be able to keep in different way and in that case to regulate better their mutual relations and to have greater security and lower cost of financial transactions.

- 1) It is believed that the implementation of a single registry, base charge or so called mandate, would provide an essential prerequisite for the verification of financial discipline of each business entity before the establishment of business relations.
- 2) Enabling charging of tax, duty and judicial claims by direct debit system would allow a significant decrease in the price of these transactions compared of their implementation of the system of enforced payment. According to current indicators, tariff charges, which is forced 3,000.00 dinars on the basis of legal persons and 1,300.00 dinars by entrepreneurs to be reduced to 80.00 per account in the system by inter-banking clearing system of debit accounts (see. 7, pp. 74).

Replacement of the enforced system with a system of direct debit is a further step in the development of market infrastructure for the payments and an important element in the realization of the prerequisites for inclusion of the banking system of Serbia in the single European payment area. Banking institutions, with the application of the methodology and standards of international payments, will be able to provide the necessary preconditions for the expansion of their offers and servicing their customers.

Conclusion

Payment system of Serbia is adapted to trends in the world, especially in the EU's process of legislative, technical and technological and professional and organizational significance. Instruments of payment transactions in Serbia containing all necessary data defined SEPA rules, credit transfer is also adaptable to a large extent SEPA rules and framework of the functioning of credit card is compliant with the possibility of functioning of one card for the entire zone. The latest step is the establishment of efficient and effective easily clearing mechanism of international payments in foreign currency through the NBS. Process of the elimination of incompatibility with the principles of SEPA concept in the domain of the functioning of the operating system of direct charge/debit is in progress.

When we try to estimate importance of the implementation of SEPA elements in Serbia and particularly in SMEs sector, it is important to bear in mind that, beside the need of establishing compatibility of payment systems, it is very important to change the business environment for SMEs. This additional dimension of influence stems from the characteristics of SEPA, i.e. the primary focusing on small and micro-payment and the establishment of a unified payment systems in the function of the increase in the competitiveness of the economy.

These goals and characteristics of SEPA concept determine its significance and prospects of development in terms of the current global financial crisis. In today's turbulent financial conditions SEPA gaining importance and remains a top priority because of its effect on efficiency and economy of operations. These effects will certainly be for Serbia in the coming period of exceptional importance, regardless of the pace of its approximation of the EU.

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