# Money, Payment Systems and the European Union

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## *The Regulatory Challenges of Governance*

Edited by

Gabriella Gimigliano

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The Regulatory Challenges of Governance

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# PREFACE

# THE GOVERNANCE OF MONEY AND PAYMENT SYSTEMS WITHIN THE EU: RATIONALE AND AIMS OF A STUDY

GABRIELLA GIMIGLIANO

## 1. The Doctrinal Background

Borrowing a definition statement from Mark Bevir (Bevir, 2012, p. 1), governance covers:

> All processes of governing whether undertaken by a government, market, or network, whether over a family, tribe, formal or informal organization, or territory, and whether through laws, norms, power, or language.

Theoretically speaking, governance refers to "all processes of social organization and social coordination", while in empirical terms governance covers any "changing organizational practices within corporations, the public sector, and the global order". Since the 1980s, studies on governance have emphasized how a hierarchical organization is not strictly necessary, and that markets and networks of players can also govern, coordinate and take decisions (Bevir, 2012, p. 3).

When the term "governance" is associated with money, the mind goes directly to the traditional regulatory paradigm, i.e. the nation State-Central Banking-Currency, over which the nation State, as the sole holder of monetary sovereignty, exercises this power by means of the central bank within its territory and this is the only authority entitled to authorize to issue (and actually issue) coins and notes as legal currency, as well as managing monetary policy.

No statutory definition of monetary sovereignty has been laid down, but the legal doctrine has produced several attempts at conceptualization.

According to Rosa Maria Lastra (Lastra, 2015, p. 19), monetary sovereignty covers the power of:

- Establishing the money representing the legal tender for discharging monetary obligations
- Issuing coins and notes
- Exercising monetary policy by controlling the money supply and the interest rates
- Managing the exchange rate regime
- Imposing on capital and exchange controls
- Regulating and supervising the banking system taking part in the money creation process thanks to sight deposits
- Oversight of the proper functioning of payment systems

However, as Rosa Maria Lastra wrote, quoting Tullio Treves (Lastra, 2015, p. 14):

> 'State' sovereignty belongs to the area of fact and not to the area of law. Sovereignty as the stable and undisturbed exercise of power within a given territory is seen as a factual situation from whose existence international law draws consequences which are the rights and obligations of states.

The same holds true for monetary sovereignty.

Indeed, over time, there has been a steady erosion of the nation states' sovereignty, also in the area of monetary law. This process of erosion is still working from within and externally to the nation state, or, in other words, from upwards to downwards and vice versa.

Moving from upwards to downwards, highly interconnected financial markets have urged the national competent authorities to improve the global level of coordination in terms of sharing regulatory standards, supervisory models, and risk-monitoring procedures. This is the experience of the Basel Committee on Banking Supervision, the Financial Stability Board, the Committee on Payments and Market Infrastructures, the Committee on the Global Financial System, and the International Association of Deposit Insurers, just to mention some of them. They all work under the umbrella of the Bank for International Settlements (BIS), an international organization serving central banks, aiming to foster monetary and financial stability. In addition, the International Monetary Fund (IMF) is almost the same as the BIS. The IMF was established in 1944 to set up a framework for economic cooperation in order to avoid repeating the competitive devaluations that had contributed to the Great

Depression of the 1930s. The vocation of the IMF from this point of view is briefly explained on its website.

Any regulatory standards established under the umbrella of BIS or IMF fall within the area of the self-regulation of the central banks. Such rules will impinge on the behaviour of central banks in their countries of origin and will become compulsory rules within the national legal systems when the European or domestic lawmaker converts them into formal acts.

In the downwards-upwards direction, the concept of sovereignty is critically revised from the perspective of new and alternative means of payment. Indeed, the growth of e-commerce and mobile commerce has increased the demand for Internet-based means of payment across various jurisdictions, with lower costs for buyers and sellers, especially in the case of micro-payments, and high levels of payment security. In addition, there are also virtual currency schemes in place. They are regarded as a "digital representation of value" (ECB, 2015, p. 4), and represent forms of unregulated digital money, issued and controlled by their developers, but not necessarily interacting with the "real" world. Accordingly, the virtual currency schemes have no physical counterpart in legal tender status. In fact, not only is the issuer different from a financial intermediary, but it is also not subject to financial regulation and supervision, nor is it denominated in legal currencies (ECB, 2012, p. 3).

Crypto-currency models may really foster new complementary currency projects. Far from being a uniform model, CCs (complementary currencies) represent projects with various guiding principles and general philosophies, but they have in common the fact, as Jerome Blanc points out, that (Blanc, 2012, p. 6):

> (…) Sovereignty, as well as profit motives do not respect what can be considered a series of major distinctive features of CCs: they are designed and implemented mostly by civil society, mostly locally and grassroots, and mostly in a democratic way, emphasizing the citizen's appropriation and redefinition of money in a participative process.

Indeed, taking into account three institutionalized principles of behaviour – namely exchange, redistribution, and reciprocity – Blanc drew the differences between local currencies based upon territorial projects, community currencies based upon community projects, and complementary currencies based upon economic projects. While local currencies, in compliance with national sovereignty, attempt to strengthen territorial purposes such as the Argentinean provincial currencies, community currencies are strictly linked to a given community. In this event, the monetary system aims to achieve a “mutual” purpose, for example a social service, self-help, or environmental purpose. This is the case for time banks. Finally, Blanc highlighted monetary systems geared towards economic (but not-for-profit) purposes. Here, the guiding principle is represented by market exchange and, accordingly, the monetary system is set up to develop actions by not-for-profit organizations deemed to be of general interest. This type of CC is linked neither to a territory nor to community issues (Blanc, 2012, 7).

The regulatory flows from downwards to upwards and the reverse cross the state-based monetary legal system. However, they are intertwined, as the legal theories of money tell us.

Agreeing with the state theory of money, Mann argued that, being based on constitutional legal history, modern constitutional law, and the principle of nominalism, the state had a monopoly over currency, so only the chattels legally issued by the issuing state, denominated by reference to a unit of account and addressed as the universal means of exchange in the state of issue, could be considered to be money. This meant that there was no difference between legal tender and money. Any other means of payment, such as cheques, could discharge monetary obligations only by the consent of the creditor and debtor (Proctor, 2005, pp.15 ff.).

Furthermore, the “societary” theory of money had a purely functional approach to money. This approach argued, as economists do, that the concept of money covers any means of payment recognized as such by society. Therefore, one can infer that monetary sovereignty is no longer vested in the state, but is shared out among the people (Proctor, 2005, pp. 23 - 25).

Occupying the middle ground, there is the institutional theory of money. This approach is based on the legal experience of the euro as scriptural money, the importance given to the reduced role of coins and notes in modern trade, and the emphasis on the central bank’s task of controlling the process of money creation. The institutional theory argues that money is a credit towards a qualified debtor. Namely, money is defined as a direct or indirect claim against a central bank and this credit can be used by the people as a means of payment and a store of value. Therefore, it arises out of, and is controlled by, a central bank, as a way of preserving “its availability, functionality, and purchasing power” (Proctor, 2005, pp. 25 – 30).

The above-outlined theories represent three pillars in the landscape of money theories and define the area upon which other legal approaches have been developed (for example: Lastra, 2015, Zimmermann, 2013, Proctor, 2005, p. 40; Santoro, 2001). Apart from agreeing on one or the other legal approach, all of them apply elements of *lex monetae* and *lex contractus* or, in other words, they reason on the right to regulate the monetary system in relation to the substantive law applicable to contractual obligations.

This book investigates trends in governance concerning *lex monetae* and *lex contractus* within the European Union framework.

## 2. The European Union Framework

The European Union is a feasible institutional context in which to investigate the development of the governance of money. Indeed, the EU, considered as a "unique economic and political partnership",[1] has not laid down a clear-cut definition of money, but the member states have been carrying on a varying transfer of sovereignty and, in particular, of monetary sovereignty.

With regard to monetary sovereignty, there are different levels of regulatory actions.

Firstly, money as a means of payment is the subject of a set of regulatory actions on scriptural money taken at Community law level since the 1980s in building up an internal (or single or common) market for payment services.

The construction of the internal market falls within the so-called share competences, i.e. those areas of competence shared between the Union and the member state, where the Union is entitled to take any regulatory actions in compliance with the principle of subsidiarity and the principle of proportionality.[2]

The Treaty on the European Union (TEU) established the guiding principle and the leading values of the internal market project. Indeed, according to art. 3.2 TEU:

> The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aimed at full employment and social progress, and a high level of protection and

> improvement of the quality of the environment. It shall promote scientific and technological advancement.
>
> It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations, and protection of the rights of the child.
>
> It shall promote economic, social, and territorial cohesion, and solidarity among member states.
>
> It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe's cultural heritage is safeguarded and enhanced.

Concerning the monetary legal system in terms of *lex contractus*, the European Union established in its primary rules that all restrictions on the movement of capital and on payments between the member states are prohibited. However, the freedom of capital and payment has long raised several legal uncertainties on the direct applicability and scope of such freedom. Perhaps this is the reason why the soft and compulsory legal acts issued to build up the internal market for payment services have mostly referred to freedom of establishment and freedom of services.

The Union-based framework for payment services[3] covers manifold aspects of money as a means of discharging monetary obligations, although it does not claim to be a comprehensive legal framework. In particular, the Union-based framework deals with:

- The access and operation of the business of payment service provision
- The transparency obligations of professional providers
- The contracting rules in the provider-user relationships, both in single payment transactions and framework contracts
- The regulation of fund transfers and the management of money laundering risk
- Access to payment systems; [4]
- The exchange of information, and cooperation between national competent authorities

Accordingly, the EU legislative framework is made up of Commission recommendations and communications, regulations and directives of the EU Parliament and the Council, as well as the technical standards, guidelines, opinions and warnings issued by the European Banking Authority (EBA). To what extent can the EU law for payments impinge on existing national laws?

Generally speaking, the Union-based framework attempts to achieve a compromise between the protection of users' funds and data, the integrity and stability of payment systems, and the level playing field within the market. However, the full harmonization approach is coupled with some degrees of latitude for the self-regulation of providers and users in the contracting relationships and state-based regulatory initiatives.

Finally, it is worth noting that the primary and secondary European laws make no mention of CCs. This seems to leave both topics to the market processes and to state-based initiatives. However, a careful investigation of the governance processes they are spurring on is necessary as long as the Union – namely, art. 3 TEU – claims to "work for the sustainable development of Europe based on (…) a highly competitive social market economy", to "combat social exclusion and discrimination", and to "respect its rich cultural (…) diversity".

Secondly, the establishment of the Euro-system wherein *lex contractus* and *lex monetae* meet. As the third stage of the monetary integration process that began with the Delors Report, the euro is recognized as the currency of economic and monetary union (art. 3.4, Treaty on the European Union or TEU), while art. 3 of the Treaty on the Functioning of the European Union (TFEU) established that the Union has, among other things, exclusive competence in the area of monetary policy for "the member states whose currency is the euro", and this seems to counterbalance the very general statement of the above-mentioned TEU provision. The exercise of monetary policy in addition to the authorization and issuance of euro coins and notes, the conduct of foreign-exchange operations, the management of foreign reserves, and the oversight of payment systems, are entrusted to the European Central Bank (ECB) and the European System of Central Banks (ESCB).

The EU Treaties also established a set of guiding principles and policy priorities to drive the performance of the ECB and ESCB in the pursuit of monetary governance. At the top of the list is the policy maintaining the stability of prices. Later on, they state that:

> Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives as laid down in Article 3 of the Treaty on European Union.

However, the idea of a Euro-system as a closed box in a bigger container for the governance of European monetary integration disappeared soon after its establishment. The first point of contact between them was established thanks to the SEPA project and, later on, followed by the financial and sovereign debt crises. Both of them have made the monetary integration process a highly complex picture.

SEPA, or the Single Euro Payment Area, is a project launched by the EU Commission and promoted by the ECB to bridge the gap between the service levels of domestic and cross-border retail payment systems.

This is a two-tier project and is, in fact, based on the EU institutional legislative initiatives and the work of the European Payment Council (EPC), made up of representatives of financial and banking intermediaries and their associations. There is a close relationship between these two components of the project. Both insist on the regulatory, business, and technical requirements of credit transfers, direct debits, and card-based payments in euros. However, while the guidelines, general principles, and rulebooks issued by the EPC are compulsory only for its members, the institutional acts are mandatory for euro and non-euro member states, but have different deadlines.

Coming now to the financial and sovereign debt crises, these had the "merit" of addressing the drawbacks of the "asymmetries between monetary policy and fiscal policy, and between monetary policy and financial regulation, and supervision proved to be an inherent source of strain on EMU (…)" (Lastra, 2015, p. XIV). Once again, the events pointed to the weakness of the "economic" step of the European economic and monetary integration process (EMI).

With regard to economic integration, TFEU art. 119 provides that the member states be committed to adopting "close cooperation" on economic policies. Economic integration, together with monetary integration, is to be carried out according to a set of guiding principles:

- "Stable prices, sound public finances and monetary conditions, and a sustainable balance of payments"[5]
- "A spirit of solidarity between member states" where the Council can decide to provide appropriate measures for member states living in "severe difficulties" arising from the supply of certain products, especially energy. But the spirit of solidarity may also justify financial assistance to support a member state "seriously threatened by severe difficulties due to natural disasters or exceptional occurrences beyond its control"[6]

- The prohibition of overdraft facilities or other forms of credit facilities with the ECB or the national central banks in favour of public authorities (Union, national, or local authorities) "as shall the purchase directly from them by the European Central Bank or national central bank of debt instruments"[7]
- The prohibition of any "privileged access" by Union institutions, national governments, or other public authorities to any measures "not based on prudential considerations"[8]
- The no-bail-out clause: this means that the economic and monetary integration process does not provide the member states with mutual assistance for debts apart from the joint execution of special projects[9]
- The commitment of member states to control "excessive government deficits"[10]

In the aftermath of the crisis, this book aims to analyse the main regulatory changes to the central banking governance of the European monetary system, paying specific attention to macro- and micro- prudential regulation and supervision, as well as lending of last resort activity.

Finally, monetary governance is analyzed from a more traditional viewpoint: whether and how in the European Union the governance of central banking in the oversight of payment systems is changing. Indeed, recent studies have underlined how the structural changes in retail payment systems, open network communication and new business models may weaken the gatekeeping function of banks and central banks vis-à-vis users' funds and data protection, as well as the money laundering risk.

## 3. About the book

In the light of the rationale and the objectives previously outlined, this book is an interdisciplinary volume, examining money as a means of payment and a reserve of value within the framework of the European Union, with particular attention to community-based currencies.

This volume is divided into three parts.

Part I deals with the examination of money as a means of payment within the European Union legal framework. In particular, the volume underlines how the European policymaker has not yet made a clear-cut choice between the state, institutional, and societary theories of money. In reality, elements of each are brought together to build up an internal market for payment transactions,[11] payment systems, and payment services.

This part consists of three chapters. In Chapter 1, Agnieszka Janczuk examines the public and private sources of EU law for payments, focusing on the hybrid nature of this body of law. Following on, in Chapter 2, Gabriella Gimigliano analyzes the transparency rules, the authorization and supervision process for payment service providers, and, finally, the choice of a basic payment account able to meet the objective of financial inclusion as three main outcomes of the Union-based internal market for transferring funds. Lastly, in Chapter 3, Noah Vardi examines, with a critical eye, the impact of the EU legal framework for payment systems on the domestic private law provisions, questioning the residual role of some institutions.

Part II of the book examines the concept of money against the backdrop of the regulatory experiences of community-based currencies and legal systems from a society-centred perspective. Two phenomena are at issue: the growth of CC projects providing both bricks-and-mortar and digital means of exchange, and that of Islamic communities within the European context.

This part has three chapters. In Chapter 4, Celia de Anca examines the development of money as a means of identity, and investigates how money can contribute to building a common European identity or a community-based identity within EU cultural pluralism. In chapter 5, Valentino Cattelan analyzes the Islamic law of money in order to understand its legal and socio-economic rationale, as well as the process of accommodation within the contemporary financial system. Finally, in Chapter 6, Andrea Borroni and Marco Seghesio examine the legal issues raised by virtual currency schemes and above all the Bitcoin, reinterpreting and modernizing Hayek’s model.

Part III is devoted to central banking and to traditional or “less traditional” tasks in the aftermath of the financial and sovereign debt crises.

In Chapter 7, Marta Božina Beroš Beros analyzes the payment system oversight function and how the roles of the ECB and ESCB have changed thanks to the financial crisis so that the European level is now “taking precedence” over the national one.

Chapter 8 is devoted to macro-prudential supervision. Charilaos Mertzanis focuses on the interrelations between financial integration, financial stability, and collective action in the aftermath of the financial crisis.

Chapter 9 turns to micro-prudential stability within the European banking system. Christos Gortsos investigates the mechanism of “Chinese Walls” set up within the single supervisory mechanism to draw a clear distinction between the ECB’s new supervisory tasks and the exercise of monetary policy.

Lastly, in Chapter 10, Luigi Scipione analyzes how the ECB performs the role of lender of last resort to support the banking and public sectors against any constraints arising from its statute.

Conclusions are drawn by Vittorio Santoro, who gives an overview of the contributors’ positions, and offers a new and additional aspect of analysis, i.e. the role that choosing money as a unit of account can play in the discharging of monetary obligations within the payment service directive.[12]

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## Further Readings

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## Notes

[1] This is a self-definition displayed on the European Union website.
[2] See art.
[3] The concept of payment service is not defined in legislative acts. However, the Annex 5 TEU to Dir. 2015/2366/EU contains a closed list of activities regarded as payment services.
[4] Payment system is defined as “a fund transfer system with formal and standardised arrangements and common rules for the processing, clearing and/or settlement of payment transactions” (art. 4, n. (7), dir. 2015/2366/EU)
[5] See: Art. 119.3 TFEU.
[6] See: Art. 122 TFEU.
[7] See: Art. 123 TFEU.
[8] See: Art. 124 TFEU.
[9] See: Art. 125.1 TFEU.
[10] See: Art. 126 TFEU.
[11] Payment transaction is defined as “an act, initiated by the payer or on his behalf or by the payee, of placing, transferring, or withdrawing funds, irrespective of any underlying obligations between the payer and the payee” (art. 4, n. (5), dir. 2015/2366/EU).
[12] The Payment Service Directive is Dir. 2007/64/EC of 13 November 2007, published in OJEU L 319/1 of 5.12.2007.

# PART I:

# MONEY AND THE LAW OF PAYMENTS

# CHAPTER ONE

# SOURCES OF EU PAYMENTS LAW

AGNIESZKA JANCZUK-GORYWODA[1]

EU legislation recently expanded to cover an unprecedented scope of payments' rules, colonizing areas that used to be in the private domain. This substantially diminished not only scope for national rules, but also room for privately-made rules. Participation in SEPA is no longer voluntary but mandated by EU law. In spite of this, the development of the SEPA framework contracts remains the sole responsibility of the European Payments Council, which is still a private association. Thus, EU payments law retains its hybrid character.

This contribution will scrutinize the public and private sources of EU payments law. It will analyze the public-private hybrid character of EU payments law and explore its evolution towards federalization, uniformity, and publicity. It will conclude with observations concerning the legitimacy of such a hybrid system of law.

***Key Words:*** *Sources of Law, Monetary Obligations, and Payment Systems*

## 1. Introduction

This chapter considers the different sources of EU payments law. The payments law of the EU is based upon and derives from formal EU law, national laws implementing EU directives, and privately made rules. The distinctive feature of the EU payments regime is its hybrid public-private nature. The public and private systems of rules - public in the form of European directives and regulations and private in the form of multilateral

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[1] Assistant Professor, Tilburg University Law School; Research Coordinator, Tilburg Law and Economics Center (TILEC). Contact:
a.a.janczuk@tilburguniversity.edu.

agreements among payment service providers - coexist and mutually shape the structure of the European payments system. The interdependence of the two modes of governance extends beyond mere complementarity; formal law and privately made rules become *de facto*, "integrated into a single system in which the functioning of each element is necessary for the successful operation of the other." (Trubek & Trubek, 2006, p. 543) As a result, it is the combination of the two sets of rules that forms am EU governance system for payments, and they are so interwoven that neither the public nor private governance system can function without its counterpart. It is neither a public nor a private governance regime, but a truly hybrid one.

## 2. Money and Payment Systems

Payment systems consist of payment instruments, applicable law, inter-bank procedures, common technical standards, and infrastructure. All these elements, combined together, ensure that money circulates in the economy (Bank for International Settlements, 2003, p. 38).

Payment systems constitute a link between state money, private money, and credit. Their fundamental role lies in the fact that they transform money systems into credit systems (Janczuk-Gorywoda, 2015a). In monetary systems monetary obligations are discharged by transfers of money; that is, by means of final settlement. In comparison, in credit systems monetary obligations are discharged by means of credit; that is, by a promise to pay later (IOU) (Hawtrey, 1919). Banks' ability to create money and credit is closely related to payment mechanisms. Payment systems enable circulation of monetary value without the need for the parties to the underlying transaction to physically transfer monetary objects. Monetary obligations are discharged through bookkeeping entries, whereby the bank account of the payer is debited, while the bank account of the payee is credited. When transfers of monetary value take place through bookkeeping entries, payments are processed without the need for coins and banknotes to leak outside the banking system. This allows the banking system to generate multiple deposit expansions (Janczuk-Gorywoda, 2015a).

To put it differently, these are payment systems that facilitate the creation of bank money. Well-functioning payment systems fulfill a strategic function in keeping deposits at par with currency. In contrast, malfunctioning payment systems can cause customers to withdraw currency from bank deposits more frequently, increasing the currency ratio and the expected deposit outflows. As a result, banks would have to limit their credit action and increase excess reserves (Mishkin, 2007, pp. 429-431). The failures of payments infrastructure at Royal Bank of Scotland in 2012 prove that the operational risk in retail payment systems is very real and can put customers' confidence in a bank or a banking system on trial (Goff and Palmer, 2012). The closure of Cypriot banks in March 2013 was due to a different reason, yet universal lack of access to bank deposits paralyzed the whole economy (Chaffin, 2013).

The short story explained above tells us that sound and efficient payment systems are crucial for the smooth functioning of the economy.

## 3. Treaty Provisions

As trade expands, it needs to be supported by a payment system of an adequate scale. Therefore, since the very beginning, the Treaty of Rome contained the principle of free movement of payments. The drafters of the Treaty of Rome were well aware that free circulation of payments within the internal market was essential for economic integration.

Free movement of payments is not typically considered as one of the fundamental freedoms constituting the cornerstone of the EU internal market. However, the free movement of payments belonged to the basic freedoms established by the Treaty of Rome. The original Article 106 EC (repealed)[2] required member states to liberalize "any payments connected with the movement of goods, services, or capital, and any transfers of capital and earnings, to the extent that the movement of goods, services, capital, and persons between member states has been liberalised pursuant to this Treaty." What is more, it performed a special role, as it was considered to be ancillary to the other four freedoms. To be completed, any transaction in goods or services needs to be complemented by a corresponding payment. The same holds for movements of capital and labor. Thus, movements in the four "factors of production" could not be effectively liberalized without the corresponding liberalization of the payments' movements.

In the judgment of *Luisi and Carbone*[3] in 1984, the Court of Justice confirmed that freedom of payments supported the functioning of other transactions liberalized by the Treaty. The case concerned two Italian residents, Ms. Graziana Luisi and Mr. Giuseppe Carbone, who had been fined by the Italian Minister of the Treasury for having acquired more than the permitted amount of foreign currency to pay for medical treatment and various services as tourists in France and Germany. The Italian legislation then in force had set a maximum annual allowance for "exportation" of foreign currency for the purposes of tourism and medical treatment. Ms. Luisi and Mr. Carbone alleged that provisions limiting the means of payment in foreign currencies for the purposes of tourism and medical care were incompatible with EU law.

The two cases were referred to the ECJ, which, among others, was asked whether the transfer of foreign currency for the purposes of tourism and travel intended for business, education, and medical treatment should be regarded as a current payment or as a movement of capital, in particular when banknotes are transferred physically. The difference between the movement of a current payment and of capital was crucial because under the capital movement's directives then in force there was no requirement to liberalize the physical transfer of banknotes, however, Article 106 EC (repealed) did require that current payments in relation to other Treaty freedoms be liberalized (Usher, 2000, p. 11).

The ECJ upheld the free circulation of payments and currencies in connection with tourism, medical treatment, education, or business. It confirmed that payments perform an ancillary function to other freedoms and hence whenever the monetary transfer "corresponds to an obligation to pay arising from a transaction involving the movement of goods or services" it may not be classified as a movement of capital.[4] This view was confirmed in further cases that viewed restrictions on payment movements as restrictions on the free movement of goods (Usher, 2000, pp. 9-10).

The ECJ also emphasized the autonomous character of the free movement of payments. In *Luisi and Carbone*, the ECJ drew a sharp line between current payments and capital movements, defining the former as "transfers of foreign exchange which constitute the consideration within the context of an underlying transaction", and movements of capital as "financial operations essentially concerned with the investment of the funds in question rather than remuneration of a service."[5] The two freedoms were held to be different, and current payments were not subject to the limitations imposed on cross-border capital movements. Moreover, while the Treaty provisions on capital movements were not directly effective at that time, the ECJ confirmed that the then art. 106 EC (repealed), concerning free movement of payments, gave rise to rights enforceable by individuals in their national courts (Usher, 2000, pp. 7-8). As an autonomous freedom, payments' movements in the EU followed their own pace and logic of liberalization (Usher, 2000, p. 12).

Thus, the free movement of payments held a strong position of a directly effective fundamental Treaty freedom. Over the years it was relied on to remove various national provisions restricting circulation of payments across borders. Nevertheless, in the first three decades of the EU the Treaty provisions were only used to remove the obstacles to cross-border payments while no positive legislation was enacted.

## 4. Secondary Law: Before the Private Governance

Removing obstacles to cross-border payments in the EU did not in itself improve the performance of cross-border payments. Legal frameworks for payments in the EU were fragmented along national borders. Both rules for inter-bank procedures, as well as rules governing the relationship between banks and their customers, were differentiated. This fragmentation created uncertainty as to the mutual rights and obligations of the parties involved in a payment transaction. Uncertainty was augmented by the fact that many member states lacked a comprehensive payments law. Instead, payments used to be governed by a patchwork of general contract law specified in case law, consumer protection rules, and private framework contracts governing particular types of payments.

When the Single European Act of 1985 brought a new impetus for the internal market, the Commission placed harmonization of payments' rules high on the agenda. It recognized that both inter-bank and bank-to-bank rules had to be harmonized. However, early on it decided that banks themselves were best placed to proceed with the harmonization of interbank rules, while the Commission would engage in the harmonization of bank-to-customer rules.

Despite numerous declarations on the need for positive integration, the first piece of EU secondary law for retail payments was only enacted in 1997. Directive 5/97 on Cross-border Credit Transfers was, moreover, rather limited in scope. It was a minimum harmonization directive, which established transparency rules for the pricing of cross-border payment transfers, and rules regarding the time limits within which cross-border credit transfers should be executed. Directive 5/97 was the first important step towards the creation of the European payments law, however, its importance was undermined by largely diversified implementation by member states. What is more, the requirements of Directive 5/97 were far below the level of service practice for domestic payments.

The introduction of the single currency in 1999 and the unification of monetary policy for members of the Eurozone was a game changer. The newly established ECB and the Euro-system were worried that the high costs and low efficiency of cross-border payments might undermine acceptance of the euro by European citizens (European Central Bank, 1999, p. 5 and 12). So, the Euro-system became more directly involved as “catalysts” for the integration of retail payments, and pushed banks to create “a single payment area” by the end of the transition period for the introduction of the euro, that is by January 1, 2002 (European Central Bank, 1999, p. 8 and 12). Likewise, the Commission intensified its pressure and listed integration of retail payment systems as being of “utmost urgency” among the measures that it considered necessary for the completion of the internal market for financial services in the 1999 Financial Services Action Plan (FSAP).[6]

### 4.1. Regulation 2560/2001 on cross-border payments in euros

Dissatisfied with the lack of sufficient progress made by the banking industry, in 2000 the Commission proposed what was to become the first powerful piece of EU legislation for retail payments: Regulation 2560/2001 on cross-border payments in euros.[7] Regulation 2560/2001 was a very slim piece of legislation. Its single most important provision stated that charges for comparable domestic and cross-border credit transfers in euros had to be equal.[8] As it was a regulation, the obligation was directly applicable to all providers of credit transfers in the EU. In essence, Regulation 2560/2001 was not a piece of EU payments law, but rather a price regulation applicable to payments. Under Regulation 2560/2001, users of credit transfers across the EU had the right to receive the cross-border service at the same price as the domestic one. But apart from this, Regulation 2560/2001 did not contain any provisions making cross-border payments easier or more transparent. It also did not harmonize any payments rules.

Regulation 2560/2001 entered into force despite the fact that the infrastructure, banks’ internal procedures, as well as inter-bank rules for cross-border payments, had not been modernized and were still to a large extent responsible for high costs of cross-border credit transfers. In essence, Regulation 2560/2001 shifted the cost of inefficient cross-border credit transfers onto the banking industry.[9] This regulatory move was intended to induce banks to finally create the internal market for payments. Nonetheless, cross-border payments represented only some 3% of the overall payments volume, so this in itself would not necessarily have induced banks to undertake the expenses related to the development of the transnational payments system. However, Regulation 2560/2001 was also perceived as a demonstration of the Commission's power. The earlier regulatory threats were not very credible. In contrast, the speed of the legislative process for Regulation 2560/2001—which was less than a year—and the introduction of price regulation, sent a signal to the banking industry that the Commission could proceed with a more extensive regulation of payments.

As a result, Regulation 2560/2001 prompted banks to act. In 2002, banks founded the European Payments Council (EPC) - a dedicated body for the European payments - and formulated the vision of the Single Euro Payments Area (SEPA). SEPA would become the private cornerstone of the hybrid public-private governance for EU payments, and will be discussed in the next section.

## 5. Private Governance for EU Payments

Following the adoption of Regulation 2560/2001 in 2002, banks established the EPC as a European banking industry's governance structure to realize the SEPA, which they defined as "an area where citizens, companies, and other economic actors will be able to make and receive payments in euros, within Europe… whether between or within national boundaries and under the same basic conditions, rights, and obligations, regardless of their location." (European Payments Council, 2004, Section 3.2).

The main purpose of the EPC has been to support and promote SEPA so that it can be achieved through self-regulation, and meet regulators and stakeholders' expectations as efficiently as possible (European Payments Council, 2004, Section 2.2). Banks focused on three payment instruments: credit transfers, direct debits, and payment cards.

The EPC has undertaken to ensure interoperability among payment service providers for cross-border payments. It elaborated uniform business rules and technical standards for two types of payment transactions: credit transfer and direct debit. These rules are contained in multilateral framework contracts (rulebooks) and have contractual force, as between participating payment service providers and as between payment service providers and the EPC.[10] They regulate mutual rights and obligations of payment service providers with regards to SEPA payments.

SEPA rulebooks represent a cornerstone of the integrated European payments system, but they are also not sufficient to achieve this goal. As just mentioned, the main objective of SEPA rulebooks is to secure inter-bank[16] operability for cross-border payments, and they only harmonize rules governing relationships among payment service providers and other intermediaries. As a principle, the relationship between payment service providers and customers is not regulated by SEPA rulebooks. However, in order to secure automated processing of payments, certain rights and obligations of payment service providers towards payment service users need also be harmonized. This is where the public regulation steps in.

## 6. Secondary Law: After Private Governance

### 6.1. Payment Services Directive

From the very start, the EPC insisted that privately made rules would not be sufficient to realize SEPA. The then existing patchwork of mandatory laws affecting payments in various member states would deprive privately made rules of effectiveness. Recognizing the concerns of the banking industry as valid, the Commission started work on “The New Legislative Framework” for payments as soon as the EPC began to develop SEPA rulebooks.[17] In 2007 this New Legislative Framework was adopted as Directive 64/2007 on Payment Services in the Internal Market (PSD).[11]

The PSD represents a major achievement towards completion of financial integration within the EU, and in particular, in the integration of payments. The PSD aimed at rationalizing and simplifying the existing patchwork of European and national rules for payments, and providing the market with a single set of coherent legal rules. It combines the goal of enhanced market competition with that of high consumer protection. The PSD is a mix of public and private law provisions, mingling contract rules on payments and the prudential regime for payment institutions.

The PSD consists of three building blocks. The first block creates authorization and a supervisory regime for payment institutions, the second block contains information requirements, and the third building block includes core rights and obligations of payment services providers and users.

Reading the PSD, one can hardly see any reference to SEPA.[12] However, a noticeable feature of the PSD is that its contractual rules deal mainly with the relationship between banks and their customers, with some limited provisions for the inter-bank sphere only.[13] This approach contrasts with, for instance, the UNCITRAL Model Law on International Credit Transfers of 1992 ("Model Law").[14] The PSD was influenced by the Model Law (European Commission, 2002, p. 9), yet there are a number of differences between the two instruments.[15] In particular, the Model Law contains rather complex contract rules for the inter-bank sphere, whereas consumer protection is not its concern (Bollen, 2007).

In contrast, the PSD was conceived as a primarily consumer protection law. The inter-bank sphere was, from the outset, meant to be harmonized by the EPC in its SEPA rulebooks. While this was a conscious choice by the EU legislator, it was also influenced by the fact that, within member states, bank-to-consumer rules were affected by national consumer protection laws of a mandatory nature, while inter-bank rules were mainly the domain of private framework contracts.

## 6.2. Regulation 924/2009

The SEPA rulebooks and the PSD represent a significant achievement for the creation of the European integrated payments' system. However, soon after they entered into force, it became clear that they were not sufficient. SEPA rulebooks are private contracts and they become binding for those banks that sign "Adherence Agreements" in which they declare to be bound by SEPA rulebooks. The majority of banks in Europe quickly did exactly that. Yet, the Adherence Agreements only specify that participating banks would adhere to the SEPA rulebooks when sending or receiving SEPA payments; they did not oblige banks to actually offer SEPA payments, nor did they oblige them to cease using existing national payments.

As migration to SEPA has been complex and expensive, it soon turned out that it would not happen voluntarily on a sufficient scale. Thus, early on, political discussion ensued over this key element that needed to be completed if the EU integrated payments' system was to become reality. Political commitment to this regulatory goal prompted the EU institutions to adopt additional regulations supporting SEPA.

First, in 2009 the EU adopted Regulation 924/2009 on cross-border payments intended to facilitate cross-border direct debits.[16] Regulation 924/2009 replaced the earlier Regulation 2560/2001 and extended the principle of equal charges to direct debits. Regulation 924/2009 states explicitly that its aim is to "facilitate the launch of the SEPA direct debit