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COMMENT ON REGULATION NO 2560/2001

Executive Summary

Regulation (EC) No 2560/2001 on Cross-Border Payments in Euro arguably does not work as intended in Latvia. Latvia has 22 banks and one branch of a foreign bank. Practices respecting cross-border payments in Euro differ substantially among them. A documentary review of the practices of 10 of the 23 institutions shows that some banks violate wholesale the prescriptions of the Regulation; other banks are substantially, but not fully, in compliance with the Regulation; other banks comply with the Regulation. Latvian banks offer OUR, SHARE and BEN as modes of payment as does Spain. However, it does not appear that this practice is intended to circumvent the Regulation, based on the principle of SHARE, by artificial means.

The major focus of price discrimination respecting funds transfer is the preference accorded the national currency. Cross-border payments in Euro are priced substantially higher than similar transactions made in LATS (LVL). It is commonplace for a bank customer, including consumers, to have multiple currency accounts often provided automatically upon opening an account with a Latvian bank. In addition, some banks offer discounts when cross-border transfers in Euro are made to partner or affiliated banks. While banks may argue that these distinctions do not violate Article 3, the practice creates a two tiered pricing system for cross-border payments in Euro. Individual arrangements may contradict the policy objectives of the Regulation.

Bank fees for cross-border transfers in Euro differ widely; the market is competitive for rates. The reasons for non-compliance with the Regulation are beyond the scope of this comment. However, there is a need for effective enforcement and sanctions for violations of the Regulation.¹ As the Commission notes on page 5 of the “Consultative Document”

¹ The views expressed in this commentary are those of the author and all mistakes are mine. The analysis and conclusions are based on review of published information. Actual bank practice may vary. Mathias M.

the Regulation's geographic scope applies to Latvia. The author is unaware of any exception regarding the Regulation provided in the Accession Treaty.

Introduction

The European Commission has published a working document entitled "Consultative Document to contribute to the Preparation of a Report on the Application of Regulation (EC) No. 2560/2001 on Cross-border Payments in euro". [See OJ L 34 of 28 December 2001, p. 13]. The Commission has invited interested parties to submit comments on the questions raised in the evaluation process by 6 January 2006. The Riga Graduate School of Law (RGSL) hereby submits its comments, limited to select questions raised in the Consultative Document, regarding the operation of the Regulation in the Member State of the Republic of Latvia as the Regulation pertains to funds transfers.²

The Republic of Latvia acceded to the European Union on 1 May 2004. The population of Latvia is approximately 2.3 million. The real economic growth rate, measured in 2004, is 7.6%, and the economy is expected to continue its robust growth in the short term. More than 60% of the labour force is employed in the services sector. Latvia has 22 credit institutions established and licensed by the Financial and Capital Market Commission, the consolidated supervisor (FKTK at <http://www.fktk.lv>), and has one branch [Nordea Bank Finland PLC Latvia Branch] established under the freedom of establishment provisions of the EC Treaty. Ninety-eight (98) foreign credit institutions have notified the FKTK of the intent to provide financial services into Latvia. The banking sector in Latvia is highly developed and sophisticated.

The currency in Latvia is the LAT (LVL). On 1 January 2005, the LVL was pegged to the Euro at the rate of LVL 1= €1.42287.³ Latvia is a multi-currency environment where domestic transactions for certain purposes, including real estate transactions, are routinely made in LVL, USD and Euro. Cross-border payments are significant as Latvia is a transit country for payments between East and West, though data has not been collected as to the quantity of the transactions. Consequently, the cost of cross-border transactions is important for consumers and commercial actors.

The RGSL is a graduate school of law offering an LL.M in International and European Union Law. It is an independent part of the University of Latvia. The RGSL is not only an educational facility but also a research center and policy advisor. This comment is submitted in its latter capacity. As the Commission notes on page 5 of its Consultative Document, Regulation (EC) No. 2560/2001 on Cross-border Payments in Euro applies to Latvia as to cross-border payments in euro. Therefore, the practical application of the Regulation in Latvia is of interest to the RGSL.

Methodology

Siems, Associate Professor of International Commercial Law at the RGSL, and Martins Zalans of Liepa Skopina/Borenus, Riga, Latvia, offered helpful insights and observations.

² Time did not permit an analysis of other electronic payments such as ATM withdrawals.

³ Alternatively, LVL .702804 = €1.

The Web sites of 10 banks in Latvia were visited to collect information on fees related to retail inter-bank transfers and payments.⁴ The Web sites contained information on fees charged on in-house transfers and on transfers to other institutions in the local currency and in foreign currencies, including the Euro, both domestic and cross-border transactions. The results were analyzed against the objectives and mandatory rules of the Regulation to determine whether these 10 Latvian banks were in compliance with the Regulation, to demonstrate the banking practices followed in Latvia and to provide information to the Commission.

Answers to Questions numbered 9.1.2 Presented on Page 33

Q1. Have issues related to the use of different cost options for transfers in euro been resolved?

A. If the Commission has decided that the Regulation should clearly state that “SHARE is the only option” (p.8), then the short answer is “no”. Banks in Latvia generally price discriminate on the mode of payment selected by the customer: OUR, SHARE or BEN. The meaning of these terms generally is set forth in footnotes to the price list of fees. A good example of this practice is the “Transfers Price List for Individuals” published by Latvian Business Bank JSC.⁵ The standard charges for correspondent banking fees related to a transfer in Euro (no distinction made between domestic and cross-border transactions) are set forth in this table:

Amount in €	OUR	SHARE	BEN
Up to 10.000	LVL 18	LVL 12	Free
10.000.01 to 25.000	LVL 28	LVL 12	Free
25.000.01 to 50.000	LVL 38	LVL 12	Free
Over 50.000.01	0,13 [max of LVL 70]	LVL 12	Free

The price chart of fees is clear, but not free of problems measured against the Regulation. The clarity of the chart conforms to the transparency requirements of Article 8 of the Regulation. However, the bank’s system of charges violates Article 3(2) by failing to draw the minimum baseline at €12.500. Latvian Business Bank overcharges for transfers between the amount of €10.000.01 and €12.500. Moreover, it is not clear why the bank charges a higher price based on the amount transferred. For example, in the United States, “Fedwire Funds Service” uses volume based pricing fees. The fee per transfer for the first 2,500 transfers per month is \$.20 independent of the amount transferred. An

⁴ The ten banks were: Rietumu Banka, Multibanka, Parex Banka, SEB Unibanka, Latvian Business Bank, Nord/LB, Komerbanka Baltikums, Trasta Komerbanka, Lateko, and Paritate Banka.

⁵ Information based on that provided by bank at http://eng.lbb.lv/page204.juse?menu_id=245 under “Transfers Price List for Individuals” PDF document; last visited 5 January 2006.

empirical study of actual costs incurred by banks for cross-border Euro transfers would be helpful in evaluating the efficiency of the system and the “mark up” charged by the bank. Further, assuming that the bank charges identical fees based on mode of payment selected by the customer for domestic and cross-border payments in Euro, the bank’s procedures do not violate the express language of the Regulation.⁶

Finally, this specific inquiry begs the question. The purpose of the Regulation was to create a domestic payment area for the Euro and to efface distinctions in terms of cost between “internal” and “external” transfers of currency. The modes of payment permit several banks to veil the total cost of the transfer to the originator unless the latter selects OUR, since unlike Latvian Business Bank the pricing charts of other banks are not equally clear and transparent. If fees are deducted during the transfer process or charged against the beneficiary, thereby leaving the beneficiary with less money than amount transferred, the parties may not know the total cost of the transfer prior to submission of the order by the originator.

Q2. Do Banks continue to ask consumers whether they want to pay all the charges (OUR) or share the charges (SHARE); does the customer usually choose to pay all (OUR)?

A. In general, the answer is yes as to both.

Q3. Do other problems in this field exist?

A. Yes. In Latvia, respecting some institutions, the cost of the transfer does not vary between domestic and foreign transfers. Respecting other institutions the cost of the transfer depends on the destination of the transfer and the beneficiary’s location. In addition, some banks provide discounts for payments made to specified institutions.

To illustrate, compare SEB Unibanka with Multibanka.⁷ SEB makes the following main distinctions regarding transfers: (1) ordinary foreign currency transfers, (2) ordinary LVL transfers, (3) Fast foreign and LVL transfers, (4) foreign currency transfers with specified banks in Estonia and Lithuania, and (5) Euro and USD transfers with specified banks in Latvia. SEB then breaks down these main categories into subcategories explained as follows. This pattern of division of services and prices dependent upon the identity of the currency and special bank relationships is a recurrent feature of the Latvian banking system.

In SEB Unibanka, an ordinary Euro payment to EU countries (thus a cross-border transfer) in an amount up to €12.500 is priced at LVL 4 for a transfer designated SHARE

⁶ The Commission states, “...the Regulation ... is based on the principle of SHARE since SHARE is the only available option at the national level, except in Spain”. (p. 7). However, the Regulation does not contain any express language either in the Recital or the statutory text explicitly setting forth this standard.

⁷ SEB Unibanka information taken from

<http://www.seb.lv/en/private/services/accounts/transfers/ibank/?print=1&tarif=1> last visited 5 January 2006; Multibanka information taken from http://www.multibanka.com/eng/index.php?x=02_02 last visited 5 January 2006 [listing fees for transfers] and http://www.multibanka.com/eng/index.php?x=02_10 last visited 5 January 2006 [listing correspondent bank commissions].

and priced at LVL 14 for a transfer designated OUR.⁸ It is not clear whether the same rate applies to a domestic transfer in Euro between Unibanka and another institution in Latvia, as an “ordinary foreign currency transfer” designated SHARE costs LVL 8 and LVL 14 for OUR. It would appear incongruent to make this distinction but the language of the bank’s information is ambiguous. Therefore, it is assumed that there is no difference in price between a domestic and foreign transfer and therefore, in this respect, the bank is in compliance with the Regulation.

The striking difference turns on the cost of transfers in LVL. They are a fraction of the cost of transfers in Euro: (1) LVL .25 for transfers in an amount up to LVL 50.000 and (2) LVL 1 for transfers in an amount exceeding LVL 50.000. This price discrimination in favor of the LVL is not *per se* a violation of the Regulation but it favors the use of the local currency and disfavors the use of Euro transfers. Transactions in LVL are less costly than transactions in Euro because Latvia does not have a Euro payment system.⁹ The broad objective of the Regulation is to create a single domestic market in Euros. Since the Regulation was adopted prior to admission of the 10 candidate Member States who are not members of the Euro zone, the argument that Latvian banks price discriminate in favor of the state currency appears completely permissible.

Moreover, SEB Unibanka provides different treatment of foreign currency transfers, presumably including the Euro, to institutions within and outside Latvia with which the bank has established special relationships. This procedure creates a two-tier system. Cross-border transfers to specified institutions in Estonia and Lithuania are priced at LVL 1, as opposed to LVL 4 for an ordinary cross-border Euro transfer to banks outside the special network. Domestic transfers in Euro and USD to specified banks in Latvia are priced at LVL 5, as opposed to LVL 4 for an ordinary cross-border Euro transfer.¹⁰ Whether this practice violates Article 3(2) of the Regulation is debatable. However, the practical effect is that customers of an identical bank will pay different rates for cross-border payments in Euro depending upon private agreements entered into by the bank with partner institutions.

Multibanka takes an entirely different approach to funds transfer pricing. The commission rates for cross-border transfers in Euro depend upon three factors: (1) the bank’s price for the transfer based on nature of service, (2) the country of destination, and (3) the amount of the transfer. The baseline cost of the correspondent bank commission for a domestic transfer in Euro is LVL 5 for a transfer up to €12.500 and 0.1% LVL (max LVL 50) for a transfer exceeding the amount of €12.500.01. The same rates apply to Euro transfers to Germany. However, transfers to other EU countries bear a different rate. For example, a cross-border euro transfer to France is priced at LVL 10 for amounts up to €12.500 and priced at 0.15% (max LVL 75) for amounts exceeding 12.500.01.

⁸ Ordinary refers to the 2-day time period to make the transfer provided the order is received by the bank prior to 17:00. Faster transfers are more expensive.

⁹ Latvia uses German banks to conduct transactions in Euro. With access to TARGET and/or full adoption of the Euro, this practice will change and should lead to price reductions. Noteworthy is the fact that, in some instances, cross-border dollar transactions are cheaper than Euro transactions.

¹⁰ These domestic transfers are not predicated on distinctions between OUR, SHARE or BEN.

Multibanka's price list does not distinguish among the modes of payment: OUR, SHARE or BEN. Rather, the customer must calculate the total price of the transfer based upon the price charged by the bank and the allocation of the "Correspondent Bank's Commissions" between the parties to determine the actual cost. Multibanka's schedule of payments violates the Regulation's requirement of price equalization specified at Article 3(2).

Q3. Are consumers aware of their rights in this area?

A. It is not clear whether consumers are aware of their rights and no data is collected to quantify the frequency and value of retail cross-border payments in Euro. Anecdotal evidence suggests that individuals in Latvia make cross-border payments in Euro. An astute consumer can sort through the pricing charts of various banks to make a comparative analysis of costs. However, based on the information published by SEB Unibanka and Multibanka, while both banks provide information to their customers about charges for domestic and cross-border transfers in Euro and other currencies, the information is arguably not in "readily comprehensible form" as required by Article 4(1). Both retail and commercial customers may have difficulty navigating through the price charts to determine the actual cost of the transfer. If a customer selects any mode of payment other than OUR, the total cost of the transfer is unknown to the customer. In addition, information in some bank publications is wrong. For example, Parex Bank defines SHARE as payment of correspondent bank's charges by beneficiary.¹¹ Lastly some banks – Rietumu Banka – offer only two options: OUR and BEN and do not offer SHARE.¹² Finally, in some cases, more than one price chart must be consulted to determine total cost.

Q4. Do stakeholders believe that Regulation (EC) No 2560/2001 should be amended to avoid any artificial circumvention of the Regulation and thus resolve the problem described above?

A. The following observations may be made on an analysis of banking practices in Latvia. First, the primary discrimination in price of funds transfers stems from the currency being transferred not whether the transfer is domestic or cross-border. Transfers in LVL are significantly cheaper than transfers in other currencies including the Euro, due to the lack of a Euro payment system in Latvia. Second, the pricing pattern for cross-border transactions in Euros is spread wide and differs substantially from institution to institution. Third, some banks comply with the Regulation while others do not. Fourth, unless it shown that customers select OUR with a high probability and that bank fees are predatory regarding this mode of payment, market discipline should be adequate to force the cost of transactions down providing customers are given correct information and

¹¹ Parex bank information found at <http://www.parexgroup.com/en/fees/transfers/> last visited 5 January 2006 [list entitled "Money Transfers (On-line Banking :: DIGI Firma)".

¹² Rietumu Banka information found at <http://www.rietumu.com/eng.nsf/page?ReadForm&pid=1&page=fees&fid=998BC7A730245317C2256F8800459071-1&menuref=5e52b261415295e4c2256ba6003725e2&p=P&r=N> last visited 5 January 2006 [list entitled "Wire Transfers"].

provided customers comparative shop for the lowest price. The differences in OUR, SHARE and BEN relate to allocation of cost and not to equalization of charges – the main objective of the Regulation.

The Regulation should be amended to prohibit artificial circumvention of its rules if a bank does not apply the Regulation simply by claiming that it does not apply to OUR or BEN. However, the Regulation could be re-crafted to permit all modes of payment and still require equalization of domestic and cross-border fees. It is acknowledged that the Commission notes that the Credeuro Convention only accepts “domestic SHARE” payments. (p.8) A revised regulation also should address the question of “bonuses” and “discounts” based on private inter-bank agreements. In the Latvian context, what is needed most is enforcement of the law.

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Q5. Are prices equalized or do problems still exist?

A. Problems still exist. Take Parex Bank for example. Prices depend on several factors unrelated to the requirements of the Regulation. The cost of a Euro transfer to a bank with a “direct clearing link” is €5. The list of banks with a “direct clearing link” are certain, but not all, domestic banks and banks in Estonia and Lithuania. The price of a Euro transfer with banks holding accounts with Parex bank, including its Swiss subsidiary, is €3. The price of a Euro transfer to any other bank, where the beneficiary pays for correspondent bank charges [incorrectly designated SHARE], is €9. The price of a Euro transfer where the originator pays all charges (OUR) is €9 plus 0.1% of amount (min €12, max €50).

Answer to Other Issues: 9.4.3 Enforcement

Latvia has a consolidated financial regulator – the Financial Capital and Market Commission. It also has an Ombudsman of the Association of Commercial Banks.¹³ The FKTK should have the explicit authority to apply sanctions for non-observance of the provisions of the Regulation. As noted, there are instances in Latvia of bank non-compliance with the Regulation. An amended regulation also should provide for cooperation among competent authorities for cross-border issues.

Concluding Remark

It is recommended that the Commission develop a uniform payments code for Europe. *E.g.*, Hal S. Scott, *Corporate Wire Transfers and the New Payments Code*, 83 Colum. L. Rev. 1664 (1983)[discussing the unification of noncash payments under a single code; though the code was not adopted, the concept of unifying payment law merits consideration]. The EC legislative process historically has dealt with payment issues in a piece meal manner. Important topics such as credit cards have been left out completely. A uniform payments code would simplify clarify and unify the law of payments in Europe.

¹³ See http://eng.bankasoc.lv/car/ombud/regulations/index_2.php .