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The SEPA end date debate

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At the end of last year the European Commission unveiled its proposals for the end dates for the Single Euro Payments Area. As was widely anticipated, migration towards pan-European Credit Transfer and Direct Debit instruments is expected to be complete by early 2012 and 2013 respectively, if the European Parliament and member states approve the proposals.

The EC earlier published its 'essential requirements' only approach in March and June 2010 and the SEPA Council was also established to try to bring the demand and the supply side closer together to achieve an end date schedule and finally complete the migration to SEPA. The fear of lots of mini-SEPAs, where some fully migrate and others don't, enabling some legacy payments systems to survive, thereby negating the original harmonisation intention has stalked the debate, however, and worried banks.

The latest version of the proposals hasn't necessarily calmed industry fears that the whole project could go still off the rails, and take-up remains low. Once the regulation comes into force, which the EC is obviously hoping will happen quickly in 2011, SCTs will be mandatory one year later, making Q1 2012 the effective end date for these payment instruments, with direct debits following on after another year in 2013 – but even Michel Barnier, the EC Internal Market and Services Commissioner, hedges his bets: in a statement, he said, "the proposal fixes end dates to make this pan-European system a reality, *hopefully* as early as 2012."

Before then, there will be a lot of lobbying from all sides. On the eve of the EC announcement in December, *Banking Technology*, in partnership with Logica, brought together a group of experts just prior to the pronouncement to discuss the implications of the deadline and the work that remains to be done.

"In terms of a timetable, we are looking at issuance immediately and a year for consultation in the market – and not just in the banking industry, it's important that all stakeholders are involved," said Mike Brennan, vice president and UK country product manager at Deutsche Bank Global Transaction Banking. "One of the biggest concerns I have is the timing of when the actual end dates will be and what I mean by that is we are hearing about 12 months and 24 months – 12 for SEPA Credit Transfers and 24 for SEPA Direct Debits – after the implementation into law, so for me there may initially be ambiguity about when that clock starts ticking."

The lack of clarity has made it hard to sell the SEPA concept to customers, both on the financial services side and among corporates, and if those who advocate pushing the dates back even further get their way, it will be hard to keep what little momentum the project has gathered.

"From a political standpoint, depending on the energy and desire to get this through the European Parliament – and the undertaking of the due diligence around offering stakeholders the opportunity to opine on what's in there – we could potentially be looking at dates further out than 2012 or 2013," said Brennan. "One of my big fears is how to engender the energy that is required to make this thing happen quickly? Deutsche Bank, as an early adopter and major supporter of SEPA, is very keen to see it succeed. From our perspective, we've held client advisory boards and continue to do so, using these forums to gauge and drive interest and to describe the benefits of these schemes."

This fear of inertia was echoed by another panellist. "When you talk to customers they say that it's been 10 years coming, but they are aware of the SEPA advantages. For more than 10, or even 25, years our customers have been making payments in different countries, and the fact is we haven't had adequate payment mechanisms in recent years. Our customers have been through a painful exercise and have established country accounts and country formats in their processes. Basically, we talk about SEPA benefits – and they are absolutely real – but our customers have existing infrastructures," said Lars Schwabe, JP Morgan Treasury Services, market manager Euro/SEPA. "The only benefit to them really is when they go after an additional market where the same kind of rules, the same kind of standards, apply."

Michael Burkie, BNY Mellon Treasury Services, EMEA Market Development, said that the benefits of SEPA are hard to

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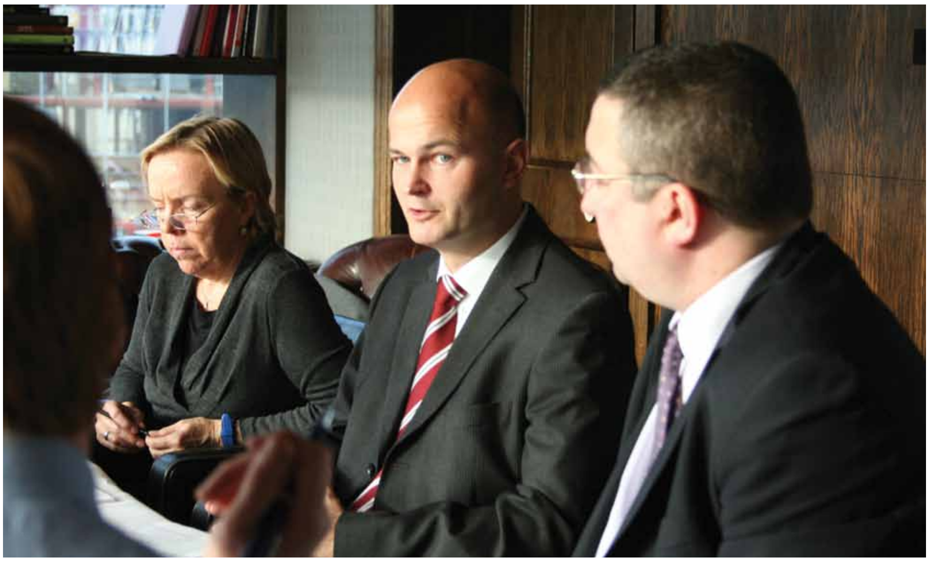

quantify. "If you look at what SEPA offers clients – reduced transaction processing costs, easier access to new markets, possibly new clients – overall the net gain compared to what they will have to spend in-house on IT and infrastructure change will greatly outweigh the benefits."

He also questioned the benefit to most banks other than the large players. "I'm pretty certain that they're having a great number of small, second, third, fourth or fifth tier banks coming to them and saying "we give up: please help us", as they are to us too – but if you are a second tier bank that has multi-regional aspirations, it's a real dilemma."

Aside from the timetable, there are other aspects of the proposed new regulation that muddy the waters further, said Brennan. "In the official draft it talks about euro payments – what does that actually mean? Are we talking about migration of the existing non-urgent euro domestic legacy Automated Clearing House push payments or does that scope broaden into the urgent world. I'll refrain from using the terminology of high-value/low-value because I think that's gone away now, or at least is a phrase that is disappearing. So there is that area, and in addition there is a piece about account opening. It is broader than just what, selfishly as an industry, we are looking for in the sense of having finality."

This could lead to a two-tier, disparate implementation of SEPA, which many in the industry – notably Gerald Hartsink,

chairman of the European Payments Council – have spoken out against. There is a distinct possibility of the major economic powerhouses in Europe committing to going the whole hog, but others on the economic periphery may say no way.

Jean Pierre Arens, global sales director at Logica, said that much of the discussion is driven by large banks, but this is not who the SEPA legislation is intended to benefit. "We have around the table organisations who address global transaction banking, so naturally go after the second tier and third tier of banks, and for insourcing we have people who look after the major corporations in Europe but if you look at the wider financial services market, there are people, admittedly not around this table – and I mean people who are serving large retail environments – who will have many more questions than you 'in terms of what does it mean for us'," he said. "I mean people who only have a national strength and so have no interest at all as soon as you go cross border.

"If we look at this second and third tier – and obviously I'm not going to make publicity for Logica, but my largest customer is sitting in front of me using our systems to insource SEPA in this environment – we are a strong believer that tier three will not spend the money internally but will go to people like you, knowing that they will still have to spend money to link their internal systems to whatever you provide to them. It costs, whether you bear it when you acquire the client or not, and whether it squares off against the benefits. Tier two's are always asking, 'should I do it or should I outsource it?' Not a lot of them have a business plan that helps them define the answer."

This has long been an area where large players have been active, and it is one that poses difficulties for the institution that is about to hand over its business to what is in most respects a competitor.

"Every organisation does struggle with that dilemma: how much control do you give over? Do you give over just a file of payments? And then you are avoiding the cost of developing, potentially, XML capabilities," said Brennan. "It's a very slow burn when you start talking to another financial institution about an outsourcing solution. That said, we now have on our books over 100 financial institutions that we support and help them to gain access to the SEPA instruments – predominantly, not surprisingly, the SEPA Credit Transfer – and we see that we can continue to play a role in that space, delivering our white label solutions, essentially giving another financial institution the ability to send their transactions to us, meaning they don't have to be XML-enabled."

The ability to move to an XML-environment is one of the virtues of SEPA, many say. "My interpretation is that it is a must, we have to do it, but it depends on the strategy the bank follows," says JP Morgan's Schwabe. "For instance, we made a decision in 2006 to invest in SEPA and replace our infrastructure entirely, enabling me to say today that JP Morgan has end-to-end processes in XML if a customer wants to do that. Alternatively, we offer filters and converters if a customer is not ready and XML-enabled. That's a

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different approach to some other banks, which are using filters as well, but the other way round – their internal systems are still on legacy environments. I am not concerned about when we have to turn off the legacy switches because we are ready – and so are other big players – because we have made significant investments. Obviously, when it comes to the moment to turn off the legacy systems, those banks that have made a minimal investment are now concerned." Conversely, many larger banks are worried that their investments won't be rewarded if lots of mini-SEPAs are allowed and the 'essential requirements' approach is followed.

But whether all SEPA transactions have to be processed end-to-end in XML, as is suggested by the EC, will be another area where there is lobbying for change. "It is our view that we can deliver the benefits of SEPA, from the European Commission's perspective without necessarily having to go that extra step," said Brennan. "I know that the end-to-end basis talks about batches rather than single individual transactions, but one assumes that is about taking the retail market away from having to provide XML and I think that makes a lot of sense. The other concern I would have, is, are we going to find ourselves in the situation we did with Y2K and the introduction of the euro where good IT resources are going to be scarce if everyone who is not SEPA ready is racing to get over the line. That will not be a concern for us at Deutsche Bank because we are ready but it may be an issue."

Schwabe said that the move to XML and ISO20022 messaging is one of the benefits for financial customers and corporates that could be pushed by the industry: "For me it is all about the benefit, and I'm not that negative about the benefit. Of course customers have made investments and have had their interfaces built, so the question is the benefits – we may say it is making payments in 17 countries from one account instead of having locally domiciled accounts, but the real benefit is having one format, one procedure and one process flow internally. Some banks tell their customers that if they want to send French payments, here is the format, here is the format for Spain:

we have taken a service attitude, but the question is, do we ask customers to send us XML/ISO 20022, or do we continue to say that they can send us flat files, or EDIFACT or whatever they want to do?"

Brennan said that there was an issue of choice, particularly in the retail market. "I'm a great believer in drawing a line between the collaborative and the competitive space, which is why end-to-end slightly concerns me. Why should a consumer or a corporate be railroaded to pursue a particular format? I'm thinking of XML here, which is why I would personally lobby against the use of XML on an end-to-end basis," he said.

However, it is clear that there is a gap between the large banks on one hand, and both the smaller banks and the corporate sector on the other. This can clearly be seen in terms of their preparation, said Burkie: "Both your fine institutions [*addressing JPM and Deutsche bank here*] have spent millions to do this, so you're committed and what you need now is the volumes to come to you so you're justified. However, if I look at the figures, of all the payments in Europe in 2009 just 5% were SEPA payments, this year it was 9% – so it's growing, no question, but in my personal opinion there is a huge gap still to be bridged between investment and return. Their benefits have never been quantified, and even today I think you'd be struggling to articulate what those benefits are."

Arens said that in Logica's experience, preparations are surprisingly low. "We like to work with tier one clients. We have 50 of them, three of them represented here, but not all of them are ready for SEPA," he said. "A lot of them have just added a small layer to an obsolete system, so it is even more obsolete, and it is going to explode as soon as the volumes rise. There is a lot to be done to get to minimal compliance, without even mentioning things like mandate management, around payment processing in general and SEPA in particular."

"From a banking perspective, we are all under pressure to deliver on SEPA, but if you are a single country bank and you have the vision to either take the plunge and build an XML capability and become a direct participant of the schemes – or to use another bank to access the scheme – you then have the ability to provide non urgent euro services across the SEPA map in a uniform manner. There are advantages for all," said Brennan.

Burkie believes that this ignores the realities of the modern, interconnected world. "You mention one-country banks? There is no such bank," he said. "Any bank will have customers that want to send payments to the US, or Asia or Latin America, so a one-country European bank can be SEPA-compliant, but it is still working in an environment – or its clients are – that is non-SEPA compliant, so there is an overhead in maintaining correspondents and links to

Photos: David Bannister

outside the SEPA environment."

As the non-banker in the room, Logica's Arens has a different perspective. "I'm sorry gentlemen, but you are talking banking between bankers, and SEPA was not launched for bankers," he said. "What we see as a service company that works 15% for banks and 85% for corporates is that the corporates are coming back to you to push you to be ready for SEPA whatever the end date will be. They will not play around whether its 2012, 13 or 14 [as we know the EC has since advocated 2012 and 2013]. Where we are helping some corporates, they are saying 'we're going to give some of our financial processing to you for the next three years', and it has become standard in the contract to say it has to do SEPA."

Arens said that, in the corporate world, "there are now a lot of questions coming up around what you can do in terms of value-added services around SEPA," such as mandate management. "At the moment it is not critical but large corporates know they will soon be dealing with a large legal issue. So that is an area that banks can go back to customers and offer services," he said.

Part of the reason for this is that the corporate world sees that they will have to be able to interconnect to governmental bodies, which are all at some stage going to enforce the use of SEPA instruments and standards.

"The next thing is going to be the government arena, and that is going to be linked to the famous end date debate," said Arens. "Politically, they are going to say that it is the right moment to go to it, just as they do for e-procurement services, and they will say 'if you want to do business with me as a government it has to be SEPA-compliant'. You can see that as a cost or you can see it as an opportunity: it's up to you to choose your business plan to make the best out of it."

Part of the issue is that a lot of the commentary around SEPA migration has been negative, focusing on costs and the loss of revenue for banks. "We banks have not done well in educating our customers, but it's not only the banks, it's governments and others, like the press, who should have joined forces and been involved. If we'd told the customers better, we wouldn't only be at 10% uptake – we wouldn't be at 100% either because customers don't have all their counterparty IBANs in their systems yet – but we would be further down the road and the acceptance rate would have been higher. I'm very supportive of SEPA but there has been proportionally more negative coverage of SEPA in the press," said Schwabe. "Treasurers may not be so aware of examples like Luxembourg with 100% SEPA usage or Belgium where it's approaching 30% because the government has been more supportive than others. In Germany one of the government pensions departments has already changed to 100% SEPA payments, which is one of the reasons that we are at 10% – imagine if all the rest moved ..."

"If you don't know where you're going, every road will lead to it"

Brennan agreed: "As an industry we haven't done as good a job of publicising where we have switched traffic to SEPA as maybe we could have," he said. "At Deutsche, 80 to 90% of traffic in Spain, Italy and Belgium is pushed through the SEPA instruments; and we've got France and The Netherlands ready to go.

There are also plenty of developments happening outside the traditional payments world, which is changing very rapidly. Towards the end of last year there were several announcements from local authorities in the UK, and one central government department in particular that is testing paying social security benefits with pre-paid Visa cards, which short-circuits the whole thing and provides a mechanism that ignores the arguments that banks have been having for the past 15 years.

"It means that SEPA is not moving fast enough, technology is continuing and people are progressing, and taking initiatives that will make some of the SEPA instruments no longer useful," said Arens. "An example is Finland where e-invoicing has pushed direct debits into a corner. Luxembourg and Belgium, for instance, agreed earlier to work together – it's not that they are doing it better; it is just that they have the structures to work together."

Brennan felt that this is something of a red-herring: "On Payment Institutions, as they are known in the PSD, we have seen successes and we've seen an explosion of new payment volumes in the market, rather than an attrition of existing business from traditional Payment Service Providers, but let's not overlook the fact that the additional volumes are not being processed over new instruments. They are still running over the card processing and ACH legacy rails."

Speaking before the end dates were finally set by the EC, all of our participants agreed that whatever the deadline, the SEPA hare is running and sitting on the fence is no longer an option.

"I still firmly believe that there is the political will to get this done, but I'd caveat that by saying that if you don't have the timelines defined, it will be more challenging to gain the attention of your senior management and secure the required budget," said Brennan. "From a bank perspective, if you haven't started then you should begin now. For banks, the cost of parallel running on legacy platforms is going to be prohibitive – that's why the end date final migration debate has been so intense."

Arens said that for both financial institutions and corporate customers, there should be no hesitation. "For one of our large financial services customers we recently quoted them an old saying, 'if you don't know where you're going, every road will lead to it'," he said. "There is still a lot of hesitation around. If you want to be a winner, you can't wait. Now is when you should be setting your strategy, updating your systems and planning your services. If you wait for a year of lobbying or think an end date won't be enforced, you will lose." ***BT***