

Experts in the News

SEPA - Happily Ever After?

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Introduction

So, what is happening with the European payments endeavour? Has the implementation of the Payment Services Directive (PSD) gone smoothly? Are we now heading rapidly towards the Single Euro Payments Area (SEPA) or back to national trenches? Will centralisation of payables and receivables under common standards become the new reality or are we looking at prolonged co-existence of domestic formats and schemes with SEPA?

SEPA has been a discussion topic for quite some years now, but there always seems to be a new twist in the tale. For some time the market has been anticipating action on the regulatory front, to get mass-migration to SEPA kick-started and recent developments indicate that this waiting period may be over soon. The EU Commission now has an EU Regulation draft prepared-with release expected during the autumn of 2010. However, despite almost all respondents to the various EC consultations on SEPA migration having expressed their support for clear end dates to migrate domestic scheme-based Euro credit transfers and direct debits to the new SEPA standards, accompanied by a wind down of legacy schemes and systems, the EC is currently contemplating a rather different course of action.

Let us take a look at what has happened over the last few months, and what we can expect to see next.

Living with PSD-initial experiences

Starting with the Payment Services Directive (PSD), whilst many countries failed to meet the transposition deadline of 1 November 2009 the good news is that at this point in time only Poland and Iceland still have to complete this task and both will hopefully have done so by the end of the year. In the months since November 2009 a number of issues have emerged as banks and other payment service providers (PSPs) put their new processes into action. Some were perhaps just teething troubles, but nine months on several issues remain, suggesting that a number of providers have more to do to in establishing clear conditions and procedures for their customers.

Examples of issues seen thus far include instances of inconsistent usage and handling of charging options (OUR/SHA/BEN) as well as cases of significant and/or unexpected deductions/lifting fees applied by beneficiary banks without having clearly agreed those in advance with their customers.

To help resolve these issues, in June 2010 the European Banking Industry's PSD Expert Group (PSD EG), chaired by Citi, published an Addendum to its original PSD market guidance document from August last year. In respect of the continuing confusion surrounding the charging option question, the PSD EG has, in line with the sharing principle of charges, proposed the usage of SHA as a best practice for all intra-EEA payments in EEA currency, irrespective of whether a currency conversion is preceding the transaction or not, thus mirroring the forward-looking principle adopted in the SEPA schemes on this point.



The case for SEPA migration and what's at risk

The last point highlights the fact that the best way of resolving many of the issues that have been experienced since the PSD went live would be to move to full adoption of the SEPA schemes. Handling issues such as, for example, the mandated 'sharing of charges principle' or the streamlined approach to managing payment returns, were all anticipated in the context of SEPA with solutions having been designed for these schemes.

Beyond that of course, the harmonisation of financial infrastructures and standards that full migration to SEPA is intended to trigger presents tremendous additional opportunities. At a macro level, an independent study conducted at the request of the EC estimated that the replacement of existing national payment systems by SEPA would hold a market potential of more than •100 billion in savings and efficiencies, cumulative over six years and benefitting the users of payment services.

At a practical level, SEPA, when fully realised, would provide opportunities for businesses to implement standardised and automated solutions allowing for payables and receivables centralisation and end-to-end straight through processing. SEPA is intended to remove existing obstacles to efficiency (due to different national payment schemes, formats and systems across the market) as well as to facilitate an overall improvement in cash management and liquidity/cash forecasting capabilities for businesses across Europe.

So, against this promising background, and with all these key benefits on offer once SEPA migration is completed, where do we stand today-some two and a half years after the launch of SEPA credit transfers and nine months after the launch of SEPA direct debits? Well, with SEPA credit transfers reaching a mere 8.8% of eligible Euro retail payments traffic in June this year and SEPA direct debits, despite their final launch in November 2009, delivering a negligible 0.05% thus far, it is clear that market forces are currently weak. That is, the same market forces that were expected to drive enthusiastically towards SEPA migration At risk, therefore, are all the benefits that were expected to flow through to users.

In addition, it is possible that if SEPA migration is not achieved in a reasonably short timeframe, additional innovative services such as e-invoicing, e-payments and e-mandates will never come to fruition, because the business case may never be sufficiently compelling in a fragmented EU market. The current market inertia already demonstrates the difficulty in establishing innovative end-to-end solutions such as the e-mandate. In the absence of a broadly rolled-out SEPA there is no practical way of building on this standard to offer value added services as well as new methods and access channels for executing Euro transaction.

The end-date debate

So, non-realisation of full SEPA migration, which is the very likely outcome in the absence of an end-date, would result in the failure of this entire set of regulatory and self-regulatory measures and compromise the achievement of EU payments integration. What has been the reaction of the EU authorities?

Despite-or maybe because of-SEPA being a politically inspired self-regulatory project, the EC and European Central Bank (ECB) were both originally of the view that migration could be achieved naturally as a consequence of market forces expected to be at play. However, the lack of progress on SEPA adoption has prompted a gradual but major re-think of this stance.

With the first positive sign of a new attitude already showing itself during the creation of Regulation 924/2009 (the successor to Regulation 2560/2001), which included a new requirement to ensure that those banks/PSPs that offer domestic Euro direct debits today should be compelled to join the SEPA Direct Debit Core scheme by 31st October 2010, SEPA has effectively started its new life as a 'co-regulation' initiative. Whilst self-regulation was useful and necessary



during the scheme design phase, the adoption now clearly needs a 'top down push' to get in gear..

Positively, there seems to be agreement between EU regulators that the required answer to get SEPA off the ground for good is to be found in EU legal intervention. Following ample stakeholder feedback to the EU Commission during 2009, confirming the need for legislative action, the Economic and Financial Affairs Council (ECOFIN) as well as the European Parliament (EP) have both confirmed that a potential legislative next step in that direction should be investigated and that according to the EP.

An end-date Regulation - but to what end exactly?

As a result, in the last few months things have finally got moving - maybe even too fast for some. During March 2010, the industry received a discussion paper titled "SEPA Migration End-Date" from the EU Commission. In investigative mode at that point, views were sought as to what type of legislative intervention would be appropriate; what the scope and content of any legislative text should be, and finally how to address the question of whether/how to allow the preservation of certain niche existing services at domestic level. A key question is centred on standards and scheme adoption and whether this should be imposed directly and on whom, or whether one could develop 'essential requirements' that would broadly set out the key pillars of SEPA and hence tip the balance towards mass migration whilst staying neutral enough not to limit future innovation and competition.

The ECB, continuing to fully back SEPA migration, clearly stated in its response that "there is a clear need for a binding EU regulation that sets an end date for migration to SEPA credit transfers and SEPA direct debits" and further that "a legally binding instrument is considered as necessary for a successful migration to SEPA as the project would otherwise be under serious risk of failure." Other stakeholders, in fact the vast majority of them, endorsed the next steps along the same lines, advocating clear end dates via an EU Regulation that would mandate migration to the SEPA schemes and ensure the closure of domestic schemes for processing domestic scheme-based Euro credit transfers and direct debits.

On the assumption that the EU Commission would take this very clear and consistent set of stakeholder comments and views on board, the payments industry then put itself in expectant waiting mode, hoping to see a regulatory proposal as soon as possible.

The good news is that this wait will not be for long as it seems that the Commission is on track to deliver a legislative proposal to the EP and Council this autumn. There is also however some potential bad news (at least for the time being) due to the perception on the Commission's side that endorsing migration to SEPA schemes in an explicit way would somehow prevent competition and would appear like endorsing a monopoly. The irony is that the opposite is in fact likely to be true.

Having one set of schemes as opposed to a variety of local ones is what is needed to level the playing field and thus support further competition in the payments space in Europe. At the same time the efficiency gains delivered by harmonised standards and formats to businesses across Europe will only unfold if fragmentation gives way to integration.

However, what is about to be revealed in the autumn, in the absence of an unlikely radical change of approach in the meantime, is a potentially concerning proposal for a Regulation in which the word SEPA will be more or less removed from the legal text! And even more surprisingly it seems that the text may contemplate a scope that is expected to cover all Euro credit transfers and direct debits with no qualifying distinction being made between high value and low value or urgent and non-urgent transactions.

Further, the positive elements in the proposal will include requirements such as full 'reach' across the Euro zone for transactions executed under a scheme that works in the same way domestically as cross-border; the adoption on the ISO20022 XML standards in the inter-bank/PSP space; the introduction of IBAN for domestic customer payments; and the establishment of guiding principles for the retention of existing niche domestic Euro credit transfer/direct debit-type services at Member State level.

If the proposal, as seems likely, will not opt for clearly mandating a migration to SEPA schemes and the closure of legacy domestic schemes, but instead will lay down certain rules (the 'essential requirements') to be followed in the context of all Euro credit transfers and direct debits with the underlying expectation of creating competition between payment schemes, such an approach could have the unintended and unfortunate consequence of actually limiting competition where it should really be taking place-i.e. between banks/PSPs and also between infrastructure providers-at the same time as failing to give a clear outlook as to when cost savings for users resulting from the consolidation of cash management operations would eventually kick in.

Conclusion

So, returning to the title of this article, is SEPA finally starting to approach the 'happily ever after stage' - or are there still high risks that this saga will have a quite different ending?

The positive news is that from a standardisation perspective the critical building blocks -the SEPA schemes in particular-are in place, and there is a broad market and regulatory consensus that an EU Regulation is necessary to instil the planning certainty that is essential to bring about SEPA migration and unlock the benefits on offer.

The clear challenge though will be to ensure that the ongoing dialogue between the regulators and the market results in a Regulation that, whether it contains 'essential requirements' or a simpler approach, clearly promotes the movement from legacy domestic Euro retail credit transfers and direct debit schemes to the SEPA schemes and requires these legacy schemes at domestic level to be switched off for good.

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