THE MARKET DEMANDS MORE ACTION ON A SINGLE EUROPEAN PAYMENT AREA. BUT ARE THE BANKS LISTENING? **STEVEN GROPPI** OF JPMORGAN TREASURY SERVICES THINKS NOT.

IS ANYBODY LISTENING OUT THERE?

Being a group of small sovereign countries in close proximity to each other helped Europe to develop into one of the most politically and culturally diverse regions in the world. While this variety undoubtedly helped the region to become a leader in arts, ideas and business, it also made the day-to-day mechanisms of inter-country trade and commerce extremely complicated.

When the euro was introduced on 1 January 1999, it was expected to make financial transactions and transfers between different European countries easier, cheaper and more efficient. In particular, the concept of a single European payment area (Sepa) is intended to reduce complexity and cost within the payments environment by creating a market where money could move as efficiently and inexpensively throughout the European Union (EU) as it does within the borders of individual countries. Unfortunately, progress in implementing this new efficient clearing environment has been slower than expected and, as a result, has attracted much criticism from the corporate community.

The banking community must acknowledge that the present pace of progress towards Sepa is bound to lead to difficulties. Within the existing 15 European Union (EU) member countries, there are in excess of 30 clearing systems, all highly effective within their own countries, but their proprietary nature creates difficulties for integration with other systems. These difficulties will be accentuated even further in May 2004, when an additional 10 countries join the EU.

It is envisaged that within 10 years every one of these 25 countries will adopt the euro as its national currency, and organisations within these countries will be bitterly frustrated if they have to rely on the existing duplicated, complex array of systems, standards and processes. The clearing systems in the US took 60 years to converge into the unified and efficient systems used today, Europe cannot take over half a century to achieve something on a similar scale – a task perhaps made even more complex in Europe, with the broader range of cultures, languages and methodologies employed.

The implementation of a truly efficient pan-European payments infrastructure will only be achieved by listening to the corporate market in order to address the need for common standards across Europe. This should ensure that end-to-end processing efficiencies are fully achieved. Equally, working in partnership with the public sector operators of the market infrastructure will also be a crucial element of the work ahead. Banks, regulators and businesses need to agree on the best approach and move more quickly towards Sepa.

STANDARDS AND REGULATORY BODIES. At present, however, there is little in the way of standards to guide this shift towards Sepa. Even the trans-European automated real-time gross settlement express transfer system (Target) hardly qualifies. For urgent payments there is a requirement for European systems to be compatible with Target, however each country is free to use its own formats and standards without compatibility requirements. This has serious consequences, including a lack of transparency in the cross-border payments cost structure, inefficiency for many parties and the consequential effects on value dating of transactions. But there is some light at the end of the tunnel, in that the Target 2 initiative aims for a single unified Target platform by 2007.

The European regulator, the European Central Bank (ECB), does not have responsibility for European payment systems, other than Target. In addition, Europe does not presently have a body that is responsible for developing and maintaining payment standards. This void is somewhat filled by individual strands within the market, such as RosettaNet, Twist and, to some extent, the European Payments Council (EPC) in terms of its recommendations. But the lack of payment standards is a real issue for companies. How bank service providers, the market infrastructures and companies work together to develop standards that create true efficiency – end-to-end straight-through processing (STP) – is a question that remains to be answered. The RosettaNet and Twist initiatives may deliver some of the answers.

MORE INVESTMENT IS NEEDED. Many within the banking industry feel that the investment made to date to create a more efficient payment infrastructure is merely a down payment. Considerably more must be invested in the infrastructure in order to achieve the desired results. The banking community needs to be cognisant of the fact that any reluctance to drive change and to make appropriate investments could result in regulators imposing change in the form of stricter conditions and tighter timeframes. If this were to happen, it would mean increased, and unplanned, costs for all of the banks. Striking an appropriate balance between encouraging regulators to impose change and allowing a more flexible free-market to evolve will be a key challenge for both banks and businesses going forward.

PAN-EUROPEAN AUTOMATED CLEARING HOUSE (PE-ACH). Much of the effort and attention in the push towards Sepa has been focused on a standard Pan-European automated clearing house (PE-ACH), and Step 2, introduced by the Euro Banking Association (EBA), is widely considered to be a front-runner. Most of the public debate concerning Sepa has focused on the need to agree on and implement a single system. However, this is unlikely to be the end solution. The argument could be made that there is a strong economic rationale to having more than one PE-ACH, or other public euro payment infrastructures. It is feasible that the creation of two or three competing systems across Europe would result in much lower costs for companies and consumers, helping to create the efficient competitive market that many are calling for.

INTERNATIONAL BANK ACCOUNT NUMBERS (IBANS). EBA Step 2 utilises Swift standards, a welcome development within the low-value payments world – convergence of standards for low- and high-value payments. International bank account numbers (Ibans) play a vital role within this new environment. But while they are intended to improve standardisation, efficiency and STP, they seem to be having an adverse affect in the short-term. Treasurers have to now manage Ibans of up to 34 digits, as well as the old domestic account number formats – and in many cases both – within their systems. Some countries require Ibans for cross-border euro payments only; others require them for domestic and cross-border euro payments. Companies and banks now have to manage this additional complexity, which all adds to the operational costs of treasury. There is a market view that Ibans should either be adopted wholesale, or not at all, but not in the way they are being utilised now.

OUT WITH THE OLD. It is important within any business to acknowledge the cycle of business services; the decline of products as demand wanes and products mature as new products and services emerge. It is equally a challenge to know when to embrace the new world and when to release the old. Perhaps now is a good time to consider the releasing of the old and the embracing of the new within the European payments environment.

Collectively, we need to have the vision to design, create and implement a more effective infrastructure. This will mean letting go of some of the old mindsets and methodologies. Some of these methods may seem perfectly reasonable and commonplace today, but banks need to be able to see further into the future and visualise the long-term dynamics and associated benefits of an effective payments infrastructure across Europe.

A CALL TO ACTION. Indeed, banks should not just be listening to companies, but actively encouraging them to make their opinions known. By the same token, treasurers have a responsibility to put some pressure on their banks to move forward with Sepa.

Open dialogue with the corporate community is absolutely essential in order to understand their exact needs and the obstacles to moving forward. JPMorgan Treasury Services recently organised an interactive client forum to address the question of 'barriers to agreeing the optimal standards and payment infrastructure for efficient cash management in a single Europe'. The corporate attendees felt that operating standards were core to operating efficiency and required simple standards to emerge in payment systems and instruments, fewer messaging standards between businesses and banks, as well as within the systems used by companies. They also felt their opinions were not being heard clearly by the banks, and expressed a desire to be more involved in driving decision-making.

Some progress has been made in creating forums for discussion, for instance, the European Association of Corporate Treasurers (EACT) met with the EPC earlier this year. This was a very welcome dialogue, but there is still a long way to go before corporates are fully integrated into the process. The market requires action now and corporates need to have a common voice in order to work in partnership with their banks to reap the benefits of Sepa.

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