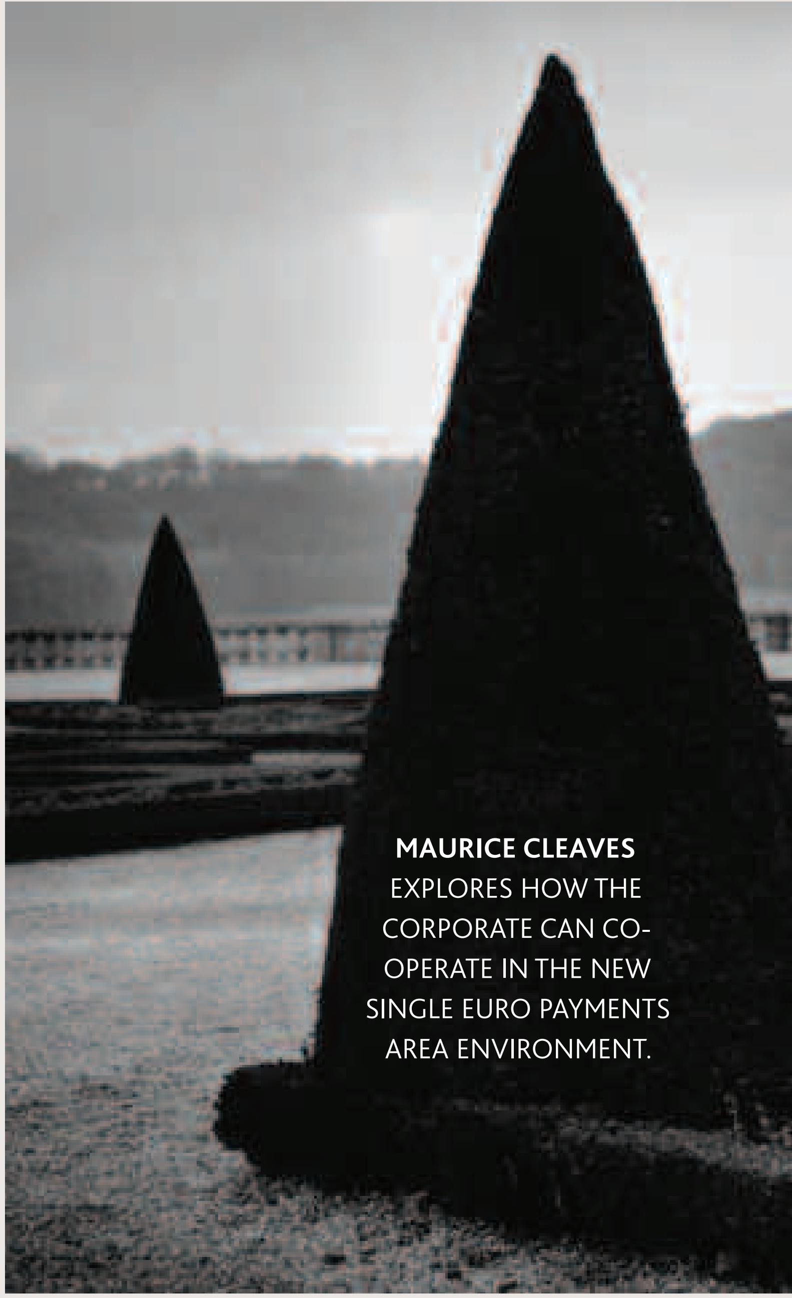


The introduction of the euro in 1999 replaced the national currencies of 12 member states (11 at first, with Greece following later), but it is the roadmap that the European Union put in place a year later which really addresses the underlying nature of cross-border trade within the euro zone. Part of the plan is the creation of the Single Euro Payments Area (SEPA) to help achieve economic and monetary union in Europe by 2010. Responsibility for realising SEPA rests with the banking industry and, to boost progress, a European Payments Council consisting of representatives from European banks and banking associations was set up in 2002.

SEPA encompasses electronic debit and credit cards, the use of ATMs, bank accounts, direct debits and payments. Considerable progress has been made in implementing SEPA for credit transfers with the introduction of the Interbank Convention on Payments and EBA Step2 as a pan-European automated clearing house for low-value payments. Usage of Step2 has been good and some headway has been made on the definition of the Pan-European Direct Debit (PEDD), with a European Payments Council working group expected to come up with a PEDD rulebook by September 2005. But the number of national direct debit schemes across Europe hinders progress and, while the PEDD scheme may be developed by the 2006 deadline, it is unlikely to be fully operational.

Other successes include the commitment to pilot a card processing framework in 2006 based on arrangements on card acquisition, processing and transparency. There has also been agreement on the harmonisation of cash issuances, recycling, distribution and infrastructure.

SEEKING EFFICIENCIES Straight-Through-Processing (STP) at the banks' end has improved as financial institutions have had to seek efficiencies in order to be able to charge the same for a cross-border payment with a value up to €12,500 as for a similar domestic payment. Banks will be required to do the same for cross-border payments up to €50,000 from 1 January 2006. They continue to work with their customers to achieve STP in areas from payment generation to receivables matching, since STP is vital in reducing expenses. However, there remains a large number of systems and protocols to cope with.

The use of International Bank Account Numbers (IBANs) for payments has increased considerably and the current push is for all electronic cross-border payments to carry a Bank Identifier Code (BIC) and IBAN by 2007. But adoption of these standards as a domestic format has been limited.

From a customer perspective, the cost of making SEPA-compliant payments has already come down to domestic levels, provided the payments are appropriately formatted, bringing enormous benefits to corporates in terms of cross-border payments. Nevertheless, many will be paying more for domestic payments.

There is a clear expectation from the European Central Bank and the EU that SEPA must be fully implemented by 2010. The EU is unlikely to allow any derailment of these plans, as was demonstrated when EU Regulation 2560/2001 was introduced to deliver SEPA for credit transfers.

While the current volume of cross-border transactions is not significant, one of SEPA's main aims is successful economic and monetary union, which will boost cross-border payments. Major steps that still need to be taken for this to happen include the standardisation of formats for delivery of payments across the EU and the introduction of priority cross-border payments (Prieuro).

The level of opportunity that corporates have today for cross-border cash management has not existed at any time in the last 20 years. Corporates can play a key role in bringing about cost-effective, easy-to-use and transparent systems providing for cheaper payments but they have choices to make and changes to execute.

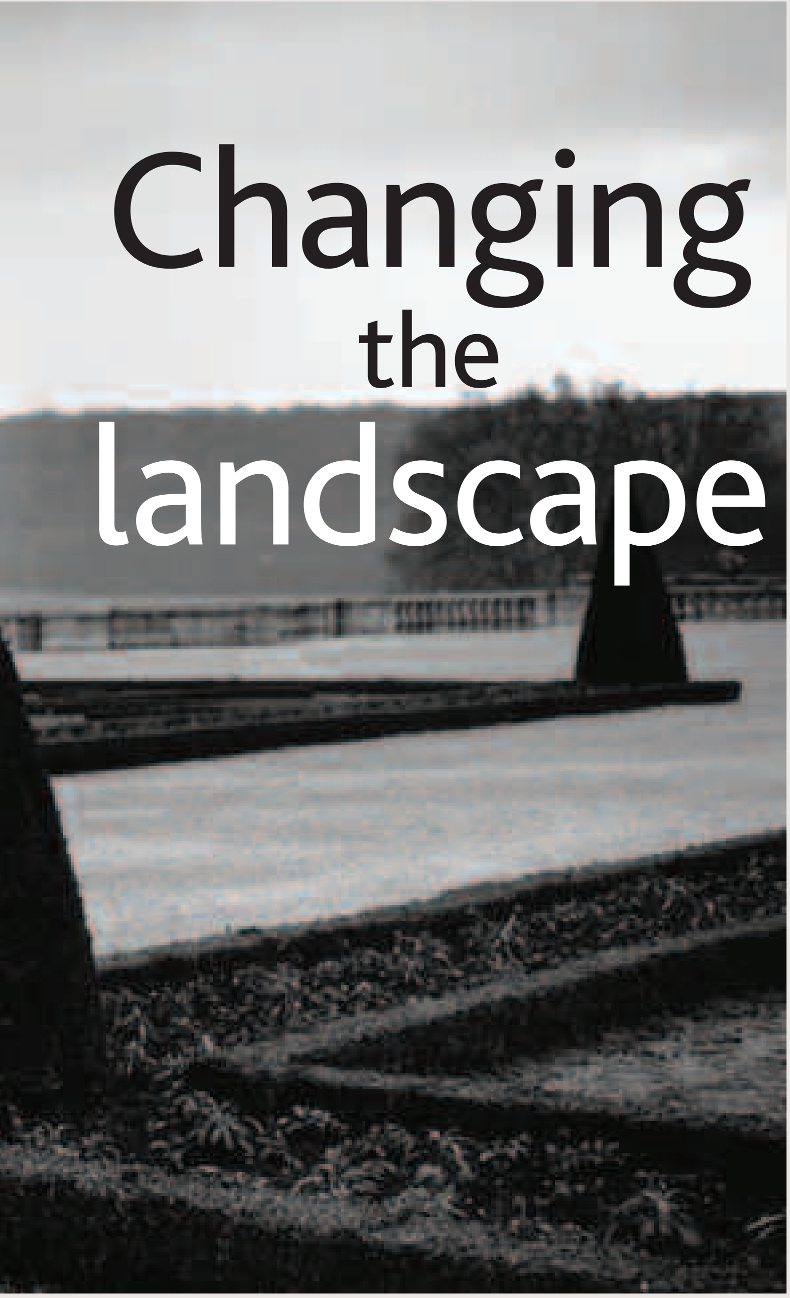
Corporates need to evaluate the benefits of initiatives such as RosettaNet, TWIST and the other alternatives that exist. Corporates of all sizes must support the particular initiative they feel is right for them or they may subsequently find themselves having to work with a solution that does not suit their needs.

Corporates have to determine how they will deal with counterparties as regards factors such as how payments are made, trading terms and which systems are used. BICs and IBANs for all

Executive summary

- Changing regulation in Europe, market consolidation and advances in technology have all played a part in altering the shape of the cross-border cash management landscape in Europe. The introduction of the Single Euro Payments Area (SEPA) has had an enormous impact, but is it moving the industry to a cross-border cash management nirvana, and what can corporates do to get as close as possible to perfection?

Changing the landscape



counterparties must be captured. Existing infrastructure may need to be adapted to hold this information as some treasury management solutions do not provide the facility to store these details alongside the traditional formats still used for domestic payments.

KNOW YOUR CUSTOMER In addition, the increasing focus on knowing your customer and anti-money laundering by regulators is making the process of account opening and documenting more cumbersome. As the risk of fraud rises, banks are increasingly encouraging corporates away from manual communication methods such as fax. The implementation of more automated communication brings with it the benefits of data storage and STP, and therefore potentially lowers fees. Corporates should be outlining these and other requirements to Enterprise Resource Planning (ERP) and workstation suppliers in order to ensure successful systems integration.

In addition, corporate treasurers should be aware of the emergence of new payments channels such as the Prieuro and the Office of Fair Trading-sponsored Faster Payment Initiative in the UK and consider whether they could meet their needs better than traditional options such as automated clearing house.

With the predicted rise in consolidation of banking providers, those corporates who wish to enter into a longer-term banking arrangement need to be confident that their chosen provider is going to be around for some time. Not all banks will have the appetite and capacity to support multiple standards, systems and interfaces and many will continue the trend of outsourcing to larger players or ultimately decide to get out of the business altogether. To achieve full end-to-end processing efficiencies there needs to be simplification at all points in the payments cycle, not just in banks' back offices and in the clearing and settlement systems, but also at a corporate interface level. For banks, the substantial investment required in adapting systems stifles innovation and decreases the ability to enhance treasury and cash management offerings.

In terms of bank balance management there are further opportunities open to corporates who typically hold isolated pockets of cash with a number of banks in different locations. As more countries adopt the euro, the number of locations in which we see liquidity could rise to over 25 locations – as many as 35, depending upon the number of countries wishing to join the EU. This might be an issue were it not for the fact that an efficient payments infrastructure is in sight. Again, if corporates work to influence this structure they could create a situation in which their balance sheets could become increasingly liquid and their competitiveness versus non-European corporates may grow. This includes expressing their needs around intra-day liquidity and real-time settlement. Coupled with access to multi-bank solutions and help in automating and integrating their bank suppliers into their liquidity strategy, the potential upside looks very positive.

CONTROL OVER LIQUIDITY The future looks even more attractive if one considers the possibility that, in 15 years' time when SEPA will have been achieved, other factors such as a harmonised tax system, a more efficient liquidity regime within TARGET 2 and an end to central bank reporting may also be in place, providing corporates with much more control over their liquidity. This partly assumes a move away from cheques, which seems to be happening. In France, for example, in 2004 the number of cheques issued fell behind credit transfers and direct debits for the first time. The use of cheques has also fallen dramatically in the UK. In 15 years' time we can expect to see a substantial demise in their popularity.

In Europe we often look with envy at the US for the size of its trading bloc, its low number of payments systems and its two automated clearing houses compared with our 25. Although we may sometimes think of the US model as transparent and effective, its support of the still widespread use of cheques hinders an otherwise efficient process. A pan-European cross-border cheque system has already been ruled out by the European Central Bank since the industry has the benefit of seeing that cheques are a declining market. Successful implementation of SEPA has the potential to make Europe as efficient for payments as the US.

But how efficient will the new landscape be unless all market participants play a strong role in its development? Regulation has a habit of creating unintended consequences in areas such as processes and pricing unless the market assists in ironing out any potential inefficiencies. Regulation, particularly where it stems from extensive market consultation, can be very effective but changes rushed through without appropriate industry involvement can be damaging. There has been more regulatory and technological change in the last five years than in the previous decade, and corporates have a part to play in helping to introduce format and communication standardisation which works for them and their providers.

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