Bank on a SEPA pay-off

TONY RICHTER WELCOMES THE LATEST CHANGES THAT WILL MAKE THE SINGLE EURO PAYMENTS AREA A REALITY AND USHER IN BIG BENEFITS FOR TREASURERS.

Executive summary

With SEPA credit transfer already up and running, SEPA direct debit coming into force in November, and an end date for legacy systems starting to loom, a large increase in SEPA volumes is widely anticipated in the next 18 months. The migration to SEPA should generate big cost savings for corporates, offer a simpler way to do business and provide liquidity management benefits and greater visibility of cash.

The Single Euro Payments Area (SEPA) credit transfer today allows the originator to send a euro payment to any bank anywhere in the SEPA zone for the same price as a domestic European payment. Price is key as SEPA credit transfer removes the notion of cross-border pricing within SEPA – but only as long as the beneficiary bank (the one receiving the payment) is a member of the SEPA scheme.

Around half of the 9,000 banks in Europe are adhering to SEPA credit transfer and account for 98% of transactions by payment volume. Customers who engage in this type of payment therefore don't have to worry whether SEPA credit transfers can be accepted. SEPA credit transfer has been in place for over a year and more banks are coming on stream.

It is important – particularly in the UK – to remember that while a SEPA payment is made in euros, the originator or beneficiary can initiate the payment in any currency and ask either the sending or receiving bank to execute a foreign exchange (FX) deal so that the payment can be made in euros. So, for instance, a sterling account may be debited and converted into euros to make a SEPA payment.

SEPA credit transfer is a mass payment instrument with no upper value limit. Although the rule is that a credit transfer may take up to three working days to be credited, in many cases the credit is made on the same day. In other words, the market is moving to same-day payments.

To date, the market take-up of SEPA credit transfer has been modest at 1.7% of all payments in Europe. But as the end date for domestic systems starts to become a reality, the migration from legacy to SEPA will accelerate and volumes will increase as customers actively use SEPA credit transfer.

Encouraged by the European Commission, the banks can do more to facilitate the use of SEPA credit transfer. Banks have to be in a position to handle significantly higher volumes of SEPA credit transfers than is the case today. But in the current economic environment, neither companies nor government entities are looking to invest in the necessary systems upgrade unless forced to do so by a looming end date for national systems.

This is the key point that emerges when HSBC talks to its customers about SEPA. We are beginning to receive more enquiries, especially from large corporate and government players. While consumer enquiries about SEPA are still very low there is a notably greater interest for our corporate and commercial banking services. Around 75% of European cash management requests for proposal (RFPs) we are currently receiving are asking for information on our ability to cope with SEPA.

Those larger companies that haven't yet made the switch to SEPA are actively thinking about it. If we make an assumption that the migration will happen at some point between 2012 and 2014, you can see that the leaders in the market are beginning to make the switchover, with others making the change nearer the switchover date. Whatever the

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actual date, we can say with some confidence that over the next 18 months we will begin to see a large increase in the SEPA volumes.

It is worth bearing in mind that the success of SEPA depends on the public sector as well as the private sector. When thinking about this market it is important to bear in mind that many different types of state entities across Europe are high-volume payment users for transactions such as tax refunds and tax credits, social security and pension payments. So a key driver of SEPA take-up is the migration of government agencies from their domestic payment environment.

SEPA DIRECT DEBIT November 2009 sees the launch of SEPA direct debit. By using SEPA direct debit, a creditor – for example, a large utility or a telco – will be able to collect funds in euros by way of a direct debit from any euro bank account in the SEPA zone. In essence this move makes Europe a single domestic market for direct debits.

Treasurers will be able to foresee some of the cash management advantages of this move. For instance, today a German telecoms company with a French subsidiary has to collect from its French customers domestically in France whereas in a SEPA direct debit world the head office will be able to collect French direct debits with the money transferred directly to a bank account in Germany. Such a move should see huge cost savings, offer a simpler way to do business and provide liquidity management benefits and greater visibility of cash.

The regulatory environment continues to evolve. New regulation was introduced at the end of April 2009 which clarified issues surrounding SEPA direct debits.

First, the regulations resolve the direct debit interchange fee. Historically, these fees have been charged by banks in six of the EU countries. However, the EU competition commission has deemed these fees anti-competitive in a SEPA environment. The fees can remain within SEPA at a rate of 8.8 euro cents per transaction for an interim period until 2012, after which the banks must withdraw the charges. The banks in the six countries concerned have three years to change their business model. It is interesting to note that in countries such as France and Greece, which have the interchange fee, the current domestic level is higher than 8.8 euro cents. In other words SEPA direct debit will become cheaper in some instances than domestic direct debits..

Second, the latest regulation will make it mandatory for banks in the euro zone to accept SEPA direct debit by 1 November 2010. Banks in non-euro countries have been given until 2014 until SEPA direct debit becomes mandatory. The effect of these rules is that the launch of SEPA direct debit on 1 November 2009 will essentially be a soft launch because banks don't have to be reachable until November 2010.

From the point of view of the creditor, such as utilities or public bodies, it has to be asked whether they will make the necessary changes to their enterprise resource planning systems to deal with SEPA direct debit before November 2010 if some banks are offering it while others are not. Parallel running will be difficult, so many companies will probably opt to carry on with domestic direct debit schemes for another 12 months.

Important SEPA decisions will continue to emerge over the next few months and banks, public entities and corporates need to ensure they are up to date so they can take advantage of the opportunities and implications as they arise.

Box 1: SEPA backgrounder

In the Single Euro Payments Area (SEPA), businesses, public entities and individuals are able to make a direct euro payment under the same basic conditions, rights and obligations regardless of the country in which the payment is made or received. SEPA consists of the 27 EU member states along with Iceland, Liechtenstein, Norway and Switzerland.

SEPA is a pan-European low-value euro payments initiative. it runs alongside Target 2, the real-time high-value gross settlement system for euro transactions. SEPA and Target 2 are sometimes confused.

The first SEPA instrument, launched in January 2008, was SEPA credit transfer. SEPA direct debit will be launched in November 2009.

SEPA credit transfer and direct debit payment schemes will initially run in parallel with existing domestic (national) payments systems in European countries. But all other low-value payment systems in countries whose currency is the euro will eventually close and all traffic migrate to SEPA.

One of the hottest debates surrounding SEPA is the need for an end date for the closure of national systems and the compulsory migration of all traffic to SEPA. HSBC is expecting this migration to happen some time between 2012 and 2014. Every business, public entity and individual with a banking relationship somewhere in the euro area/Europe will eventually be affected by SEPA, even if that does not seem likely today.

SEPA is also sometimes confused with the Payment Services Directive. The directive, which implements EU legislation, is also due to take effect in November 2009 at the same time as SEPA direct debit. But while SEPA direct debit is dependent on part of the Payment Services Directive, the directive is much broader in scope than SEPA, covering all electronic payments across the EU, including currencies such as sterling and zloty.

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