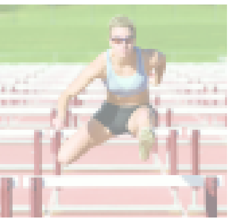
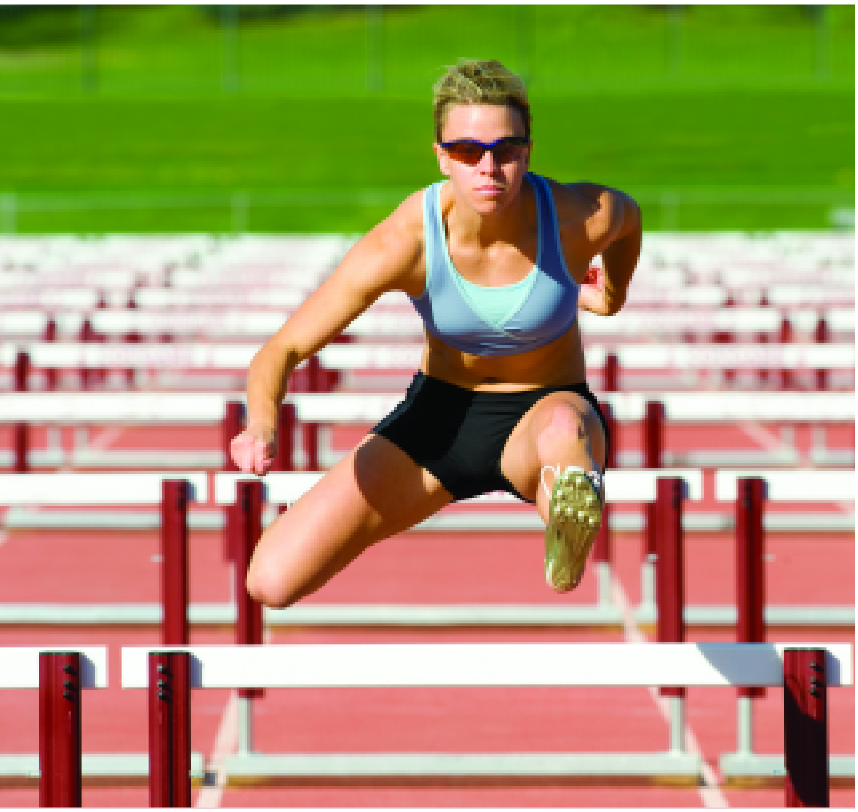


Clearing the last hurdles

AFTER A LONG AND OFTEN DIFFICULT COURSE, THE SINGLE EURO PAYMENTS AREA (SEPA) HAS YET TO FULLY DELIVER A SINGLE AND TRANSPARENT MARKET FOR EURO PAYMENTS WITHIN THE EUROPEAN UNION. **SIMON NEWSTEAD** ASSESSES THE LATEST DEVELOPMENTS AND THE LIKELY IMPACT ON COMPANIES AND FINANCIAL INSTITUTIONS.



The publication of a draft European Union regulation aimed at establishing end dates for SEPA migration brings the finishing line finally into view. But can the last hurdles be cleared?

Over the last few years the banking industry has been working on a self-regulatory basis via the European Payments Council (**www.europeanpaymentscouncil.eu**) to put in place the building blocks necessary to achieve a Single Euro Payments Area (SEPA) and deliver a single, transparent market for payment transactions in euros made within or between EU countries.

This has been a necessarily lengthy process, given the need to take account of different groups of users and stakeholders. However, the fundamental building blocks – the SEPA credit transfer (SCT), the SEPA direct debit (SDD) and the SEPA cards framework – are now agreed, in place and available for use.

Achieving critical mass usage of the new instruments has proved challenging, partly as a result of the continuing availability of legacy payment methods in individual countries across the EU. As of December 2010 eligible SEPA transactions accounted for 13.9% of credit transfers and 0.08% of direct debits.

Many in the market, whether on the supply or the demand side, are not willing to commit to making changes – even changes which will ultimately improve efficiency and lead to enhanced competitive opportunities – unless they can be sure that their counterparties will do the same and enable them to realise the promised benefits.

LEGISLATION REQUIRED TO KICKSTART SEPA MIGRATION For this reason, many stakeholders, including the European Central Bank and the European Payments Council (EPC), have been advocating European legislation to establish end dates for the replacement of relevant national legacy payment schemes by the harmonised SEPA credit transfer and direct debit schemes.

The EU Payment Services Directive has already provided some legislative support to SEPA in the sense of providing a harmonised legal environment. EU Regulation 924/2009 took a further step in this direction, by requiring that all banks currently offering euro direct debit services within the euro zone also had to be reachable for SEPA direct debits by 1 November 2010. But a clear end date for the migration process was still missing.

Against that background, last December a significant – and welcome – further step was taken with the publication of a proposal for an EU regulation "establishing technical requirements for credit transfers and direct debits in euros and amending Regulation EC 924/2009".

A "TECHNICAL REQUIREMENTS" APPROACH BRINGS CHALLENGES However, instead of setting explicit dates by which legacy national payment schemes must migrate to the

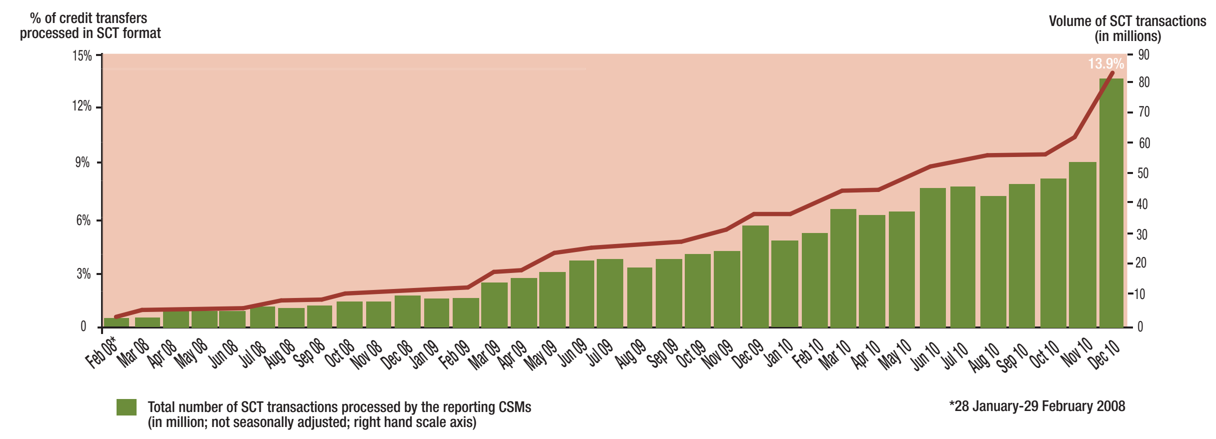
SEPA schemes, the approach adopted in the proposal is a much more complex one of mandating a set of technical standards that credit transfer and direct debit schemes used for euro transactions must meet by certain end dates: 12 months after the "in force" date of the regulation for credit transfers and 24 months for direct debits (so potentially end-2012 and end-2013, respectively, if the regulation is finalised by the end of this year).

Of course, the intention is that these mandatory requirements should be largely based on the technical features of the SEPA credit transfer and SEPA direct debit schemes. But enshrining technical detail in regulation, as currently proposed, always entails a number of challenges and risks – and in this case, the risks are potentially to the full and final implementation of a harmonised SEPA.

There is a risk, for example, that the regulation will not define precisely enough the technical standards to be met, allowing for divergence and continuing variations to messaging formats at the national level – and potentially even the continued existence of current national payment schemes alongside their SEPA equivalents. This would result in a "mini SEPA" outcome, where different requirements and schemes continue to co-exist, forcing companies and their banks to maintain different processes and systems for different countries and diluting the benefits of SEPA.

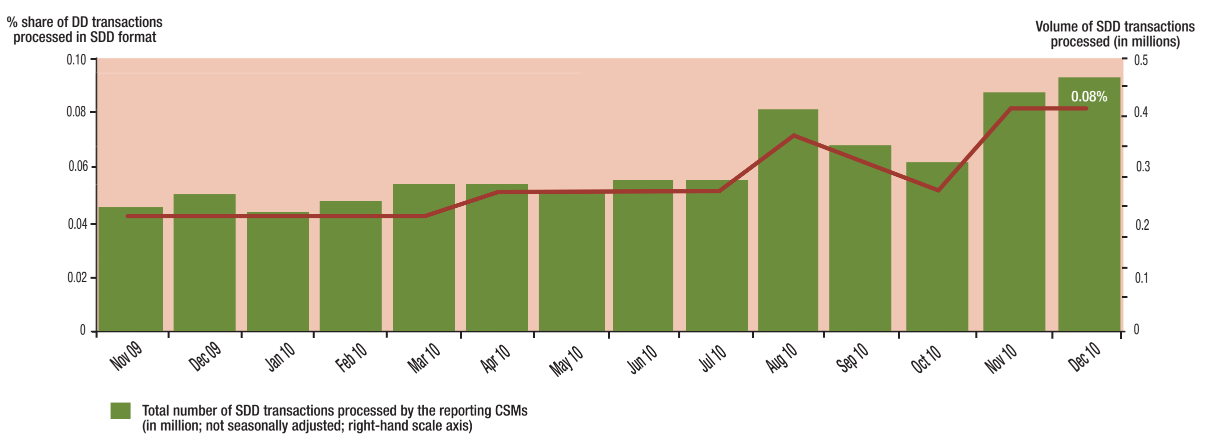
MANY IN THE MARKET, WHETHER ON THE SUPPLY OR THE DEMAND SIDE, ARE NOT WILLING TO COMMIT TO MAKING CHANGES UNLESS THEY CAN BE SURE THAT THEIR COUNTERPARTIES WILL DO THE SAME.

Chart 1: Credit transfer transactions processed in SEPA format in the euro area

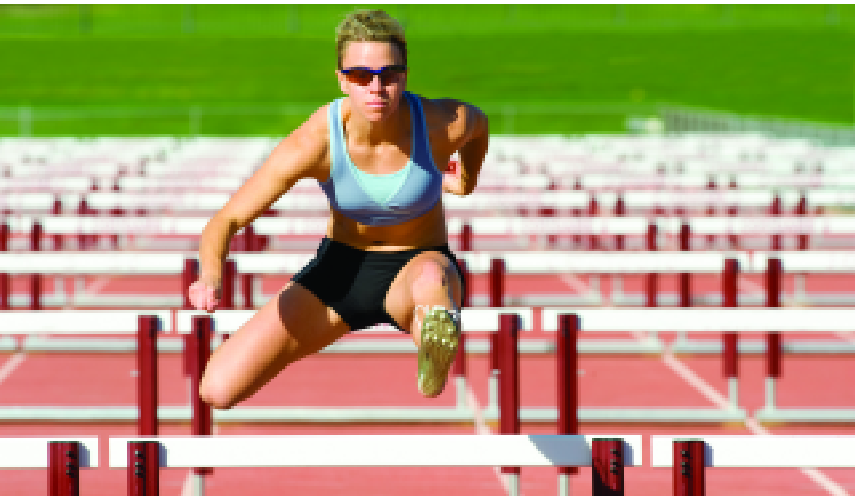


Source: www.ecb.int

Chart 2: Direct debit transactions processed in SEPA format in the euro area



Source: www.ecb.int



On the other hand, there is also the opposite risk – that the regulation might be far too prescriptive, hampering future development and innovation, or requiring legislative changes to allow for new requirements. A related problem is that, as published, the proposed regulation includes all credit transfers, except bank-to-bank credit transfers, within its scope. This would mean that high-value customer-related euro payments, such as treasury and liquidity management payments through systems such as TARGET2 and EURO 1, would be required to meet the same technical standards even though these payment systems have never been viewed as falling within SEPA and have not until now been included in SEPA preparations. This would incur major additional costs to the industry.

SELECTED CHANGES TO THE CURRENT DRAFT WILL BE ESSENTIAL These difficulties result in part from the choice of the technical requirements approach. The EPC and many other stakeholders would have preferred a "clean" approach which simply required existing domestic euro ACH-type payment schemes to migrate to the SEPA schemes, but there were deemed to be political and competition sensitivities around taking such a direct approach.

That is not to say the technical requirements approach cannot be made to work; it can, but only so long as the final text is written in a way which is not overly prescriptive, ensures full migration without divergence into multiple mini-SEPAs and does not impose unnecessarily high transition costs on payments service providers or their customers.

So, as published, the proposed regulation was rather controversial, and review and amendment is proving to be necessary in order to take into account market concerns. The regulation is, of course, subject to the usual EU co-decision process, meaning that before it can be formally adopted, it needs to be agreed between three bodies: the European Parliament and Council as well as the Commission. Hungary, the current holder of the Council presidency, has already tabled two draft compromise texts for discussion within the Council and is aiming to have an agreed Council position ready by the end of June. Meanwhile, the European Parliament has also been working on the text, and expects to establish its position via a vote in its ECON Committee by the end of June, to be followed by a vote by the full Parliament in September.

So at the moment everything is still on track to finalise the regulation by the end of this year, but it is clear that the next few months will be pivotal indeed.

MOVING FORWARD Companies, consumers and the financial services industry all stand to benefit from the success of SEPA – but only if it genuinely delivers an uncompromisingly harmonised environment that allows all players to reap the benefits of simplified processing, without stifling future development and innovation. In order to reach the necessary critical mass of SEPA credit transfer and SEPA direct debits, SEPA must clear these last hurdles.

So with this objective in mind, RBS will continue to put effort into providing constructive comment and suggested improvements to the current proposals, both bilaterally and working through key industry bodies at a national and EU level, including the EPC and the European Banking Federation via its Payment Regulatory Expert Group.

LOOKING AHEAD AT THE POST-REGULATION LANDSCAPE FOR INNOVATION As the SEPA regulation takes effect and the adoption of SEPA instruments gradually increases, it will in turn drive the business case for further developments associated with SEPA – such as e-SEPA (electronic mandates and e-payment solutions).

Similarly, efforts to make e-invoicing a reality – a bigger prize for many corporates than SEPA itself – is likely to accelerate as SEPA gains ground.

Another payment area likely to see major advances is cards. The SEPA cards framework was introduced in January 2008, and, although there have not been specific migration deadlines associated with it, the push to increase standardisation for every stage of the card process – cardholder to merchant; merchant to acquirer; acquirer to scheme; and scheme to issuer – will accelerate once SEPA is a reality for credit transfers and direct debits. For banks and their clients alike, the benefits of standardisation and consolidation will start to arrive in the mainstream once SEPA overcomes its last hurdles. Centralisation through payments factories and shared services centres will become easier and there will be other benefits. Companies will find it easier to win business in foreign markets and, ultimately, e-invoicing will become a reality, with potentially huge benefits for the entire supply chain.

We are on the verge of a major change and RBS is ready to support its customers as it unfolds.

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