An imminent arrival

IT'S TIME TO BRING CORPORATE TREASURERS UP TO DATE WITH WHAT THEY NEED TO KNOW ABOUT THE SEPA EURO PAYMENTS AREA.

Executive summary

The introduction of the Single Euro Payments Area (SEPA) at the end of January 2008 heralds a revolution in payments instruments for euro mass payments. Corporations should be able to make payments throughout the euro zone area from a single bank account, using a single set of payment instruments, as easily and safely as they do in a national context.

The Single Euro Payments Area (SEPA) is scheduled to go live on 28 January 2008 with the SEPA Credit Transfer. The SEPA Direct Debit will follow in 2009. This European Commission (EC) and European Central Bank-backed initiative is designed to create standardised payment instruments for euro mass payments. The vision for SEPA is that all euro payments within the European Union should become domestic and reach a level of safety and efficiency at least on par with the best performing national payment systems.

The objective is to establish a single payments area that replaces the many national payment schemes in 27 countries across the European Union. The number of payment schemes is regarded as an obstacle to commercial harmonisation within the euro zone, as well as the wider European Union and European Economic Area. In terms of geographical reach, SEPA will apply to euro payments within the EU and Iceland, Norway, Liechtenstein, as well as Switzerland.

THE IMPORTANCE OF SEPA
The introduction of SEPA is comparable to the introduction of euro notes and coins; the only difference is SEPA is receiving less media attention. SEPA is set to impact all organisations: large corporates, mid-cap companies, smaller businesses and the public sector.

Citizens and corporations should be able to make payments throughout the euro zone area from a single bank account, using a single set of payment instruments, as easily and safely as they do in a national context. Payments instruments which will be subject to harmonisation include credit transfers, direct debits and cards.

The introduction of SEPA has had a considerable impact on the payment strategies of domestic banks across Europe. The cash management sector has been the focus of consolidation prior to SEPA with a handful of banks emerging to serve a global market. The cost of getting ready for SEPA and the need to reconsider the positioning of a bank's place in the market is likely to prompt further consolidation, increased competition and the emergence of a business model focused on co-operation and sourcing strategies. SEPA will also put a lot of pressure on prices for payment transactions across Europe, further accelerating competition and pushing consolidation trends to a new level.

THE PRESENT SITUATION The present situation is that payments schemes and infrastructures differs with messaging formats not only varying from country to country but also from to bank to bank. Payment instrument usage has different levels of adoption across Europe, i.e. some countries still rely heavily on cheque payments whereas others are very direct debit-heavy. Every country has its own technical standards and legal framework for account numbering, data exchange formats and direct debit

mandates. While there will inevitably be costs in preparing and ultimately migrating to SEPA these should not be exaggerated. It is possible to access SEPA without large upfront investments in systems as banks are prepared to help clients through the transition phase. The SEPA initiative marks the start not the end of European harmonisation. Over the next decade the EU payments landscape will continue to alter significantly. And while there will be long-term benefits, corporates are going to be prepared to continue to adapt to new processes and infrastructures.

THE CORPORATE PERSPECTIVE While corporates' preparations for SEPA should be well underway by now, they can still turn to institutions such as Deutsche Bank for sources of information, guidance, advice and updates.

The introduction of SEPA will be of benefit to corporates that conduct business in EU countries. The introduction of SEPA will herald harmonised formats, processing rules and regulations on a pan-EU basis. It is also likely to see an increase in centralised corporate structures for multi-national corporates driven or at least accelerated by SEPA deliverables such as improved automation, simple and unified format structures, and less overhead through fewer accounts.

The key benefits of SEPA are:

- The potential to consolidate payment accounts in one country (or at least reduce the number of accounts), thereby improving working capital management and reducing overhead cost.
- Increasing efficiencies through end-to-end delivery of data elements and harmonised return reason codes – particularly in the reconciliation process.
- An overall fall in the costs of making euro payments across the EU (both in terms of paying less for cross-border transactions as well as increasing competition among banks).
- An impetus to set up centralised cash management functions such as shared service centres (SSCs) and payment/collection factories.
- The introduction of the new direct debit which is the first collection instrument that can be used at a pan-European level (expected from 2009 when all EU countries are required to have implemented the European Payment Services Directive into national law). This direct debit could act as a stimulus for corporates to expand into new European markets and territories.
- The final aim would be that all euro mass payments within the SEPA area are local transactions with the same level of speed and comfort. There should be no difference whether a payment is made from Frankfurt to Paris or to Heidelberg.

In terms of preparing for SEPA, corporates need to be aware that they will be impacted if business partners migrate to SEPA. This is particularly important if, for instance, business partners include new SEPA data elements in their payments (such as utilising new reference fields or providing IBAN/BIC information instead of the legacy account number) which would lead to account statements that will look different. Especially when it comes to automatically reconciling electronic account statements (e.g. the widely used MT940), different types of information in unexpected fields might have an impact on matching procedures within a company. It is advisable to ask banking partners for updated format specifications and potentially sample files that could be tested with internal systems.

THE OBJECTIVE IS TO ESTABLISH A SINGLE PAYMENTS AREA THAT REPLACES THE MANY NATIONAL PAYMENT SCHEMES IN 27 COUNTRIES ACROSS THE EUROPEAN UNION.

Consolidation – A benefit of SEPA is that corporates with business in multiple euro locations will be able to consolidate the number of banking relationships they require. For many corporates due to the lack of standardisation, payments have been managed on a decentralised basis. This is particularly true for retail businesses, heavily reliant on direct debits. SEPA will enable a centralisation of systems and processes, reducing the number of payment interfaces. In turn this will allow for greater visibility, better control and reduced costs.

Large corporations – Many large corporates have already created payment factories and rationalised the number of banking partners, especially for cash management services. Many now use only one payment format type, such as IDOC or EDIFACT. In maintaining centralised services these corporates will benefit from harmonised processes, legal frameworks and handling rules for SEPA instruments. Also, they stand to benefit from the full end-to-end data delivery, additional reference information fields, and harmonised return information. All this should drive further automation, higher straight-through processing (STP) rates and raise overall efficiency of centralised structures.

Mid-sized corporations – SEPA allows mid-sized corporations to invest in payment centralisations with an enhanced prospect of a return on investment. As such, it acts as an accelerator to existing trends since it drastically reduces complexity. Until the introduction of SEPA, the investment required for Enterprise Resource Planning (ERP) Systems and internal developments in order to set up a payment factory or SSC would not have been justified in terms of the achieved economies of scale. SEPA should also provide a boost encouraging small and mid-sized companies to broaden their business beyond traditional domestic markets.

WHAT CORPORATES SHOULD EXPECT FROM THEIR BANK Once SEPA is introduced in January 2008, banks should handle all SEPA-compliant payments in the same way as domestic retail payments. This means a significant reduction in transaction costs for corporate clients with cross-border euro payments. It should be noted that Deutsche Bank will be passing on the full advantage of SEPA to clients from day one, thus turning the medium-term SEPA benefits into immediate reality. The bank will be going beyond the requirements of the current EU regulated payment pricing model, which applies only to payments of less than €50,000. All euro-denominated payments that are SEPA-compliant (i.e. they carry an IBAN and a BIC, and are within the SEPA geography, among a few other criteria) will be handled and priced as local, in-country payments.

THE DEUTSCHE BANK RESPONSE TO SEPA

As a leading European transaction bank, Deutsche Bank has sought to play a key role in the development of SEPA. Deutsche Bank saw SEPA as an opportunity for European banks and corporates to introduce efficiencies into the growing volume of intra-EU cross-border payments. From the start of the SEPA process, Deutsche Bank has been active in the European Payments Council (EPC) that created and governs the rules for the new SEPA instruments. The bank has engaged corporate clients across Europe to gather feedback and shape these new instruments and continues to do so for further developing a competitive, leading-edge payments landscape in Europe.

In order to provide the bank's client base with a leading-edge payments offering, Deutsche Bank's objectives for the internal SEPA processing platform are:

- To provide existing and new clients with a single platform to manage euro credit transfers and direct debits anywhere in SEPA, regardless of account location and without the need for opening new accounts at a central location. Focus was on scale and efficiency to ensure competitive cost levels
- To capitalise on Deutsche Bank's multiple format acceptance and translation abilities for SEPA transactions, including support of global XML for SEPA as well as continued acceptance of other formats such as IDOC, EDIFACT, CSV etc.
- To develop a platform that would evolve to meet future requirements and offer corporate clients new products and services.

Corporate business value

The primary objective of Deutsche Bank's SEPA approach to the corporate market has been to minimise disruption and efforts for its clients while enabling them to realise the benefits of SEPA at an early stage. With this objective in mind, the bank has developed a four-prong approach for the launch of SEPA in January 2008.

Immediate Financial Benefits

Deutsche Bank will take the pressure of SEPA migration timelines by delivering immediate financial benefits to its corporate client base. From 28 January 2008 on, the bank will lower its price for SEPA-compliant payments to the local, in-country level. All non-urgent euro payments (within the SEPA geography) regardless of the amount, format or access channel will have the same, low price attached to them.

Supporting legacy payments

Deutsche Bank will support corporate clients in the transition to SEPA. While the SEPA XML format is mandatory for inter-bank payment messaging, the EPC only recommended the same format to be used for corporate to bank communication. So while the bank will support SEPA XML from the start, it will also enable customers to initiate SEPA transactions using existing formats such as EDIFACT, CSV or IDOC. As SEPA gains mass adoption from the user community, it is expected SEPA XML will eventually become the commodity messaging format.

Flexible account strategy

Deutsche Bank is providing a flexible account model to make SEPA migration easier and more convenient. Under this structure, existing client accounts in all the bank's branches

Corporate Action

- Include SEPA in financial/ liquidity strategic planning.
- Evaluate potential rationalisation opportunities in European accounts receivable/payable set up.
- Conduct impact analysis to determine potential changes on treasury and AP/AR systems.
- Assess SEPA impact on impending projects and systems landscape.
- Focus on getting IBAN/BIC information from your business partners and/or utilise translation services (account no – IBAN) that are going to be offered by the banking industry.
- Nominate a responsible individual with the appropriate level of seniority within your organisation to be responsible for SEPA implementation, co-ordination and communication.

Changing the euro payments landscape

Why introduce SEPA? SEPA can be seen as the natural extension of the introduction of the euro in 1999 and more specifically, the use of euro bank notes and coins which came into circulation in January 2002. While the majority of EU inhabitants have been using a single currency for almost six years, the market for retail payments has retained strong national characteristics. Differences in legal frameworks, payment instructions and schemes, infrastructures and standards, as well as efficiency and products have led to a fragmented market. SEPA is designed to remove local barriers and increase efficiencies by creating one single, harmonised market for payments. A market that is very competitive and has no barriers always drives efficiencies and fair price levels. In short: with SEPA, Europe will grow a little closer together.

within the euro zone and the UK can be used to process all transactions including SEPA compliant transfers. So clients will not have to open new accounts in a central location to be able to access and benefit from SEPA processing.

SEPA-related added value services

Deutsche Bank has also developed a number of new product features aimed at helping clients with their transaction initiation and reconciliation processes. Examples include the re-conversion of International Bank Account Number/ Bank Identifier Codes (IBAN/BICs) into national account numbers and the completion of certain payment orders where BICs are not included in an original payment instruction. Ultimately these value added services will allow for a SEPA transition that not only takes into consideration the clients' migration challenges and timelines, but also the pace of changes within the markets with respect to the migration of clearing systems.

THE SEPA PRODUCTS

SEPA credit transfers (SCTs)

The SCT will go live on 28 January 2008. It will be the first SEPA instrument in the market and is set to replace existing local payment instruments in all EU countries over the next few years. The SCT by definition is to be unlimited in value and there are no deductions from the principal of the payment meaning that the beneficiary receives funds in full. The scheme will also permit the end-to-end carrying of remittance data to ensure delivery through to the beneficiary. The scheme provides for a maximum execution time of three days between any point in the SEPA, although many payments may arrive more quickly as is commonplace now. In terms of execution time, the new European legal framework even reduces the maximum to one day after a transition period until 2012.

SEPA Direct Debits (SDD)

SEPA Direct Debits (SDD) will go live in 2009 once the European Payment Services Directive is implemented into national law by all member states. The SDD represents a truly new instrument as there is today no cross-border direct debit capability in Europe. As such, it has been difficult for corporates to effectively centralise collection systems due to varying local standards for mandates, formats and processes. With SEPA-driven harmonisation, large organisations in particular will be able to benefit from introducing centralised SDD collection factories for the euro zone. The SDD delivers the same set of rules and standards around end-to-end data delivery and available data fields. The basis for a SDD is a signed mandate where the core data elements of this mandate flow with each direct debit transaction. This enables banks to provide optional mandate checking services. In addition, the SDD provides additional transparency for liquidity and cashflow planning since it requires a due date at which the item will be cleared and debit and credit entries will be booked. System and processes have to be adapted to the SEPA data elements and processing rules which may differ significantly compared to today's local direct debit schemes. Also, corporates will need to build up or enhance mandate handling databases that cater to the distinct new timeline requirements of the SDD. (At the time of writing, some uncertainty remains in terms of portability of mandates, as well as process for B2B direct debits.)

Automation

SEPA is standardising messaging about payment status and remittance information and will usher in a greater level of automatic reconciliation. SEPA's dedicated order reference fields and full reference information cannot be truncated or altered at any point during the inter-bank communication. This allows for greater level of straight-through processing (STP) and greater standardisation of payment instructions for accounts receivable/payable. Dedicated order reference fields as well as standardised return reason codes across Europe will ease reconciliation efforts.

SEPA transition timetable

The transition to SEPA will take place between 2008 and 2012. Whereas the exact timings have not yet been determined, i.e. a concrete end-date for legacy systems has not been formerly set for each country, SEPA is clearly aimed at replacing nation schemes in the medium term. National payment and collection instruments will co-exist through the transition period and can still be used for the time being. However, taking into account project lead times and potential implementation efforts in complex IT environments, the SEPA migration should not be put off for long. The national phase-out is expected to be completed in most countries by 2012.