THE PRICE OF SINGLE PAYMENTS

NEW PAYMENT SOLUTIONS ARE BEING DEVELOPED TO MEET EU CROSS-BORDER SETTLEMENT NEEDS, BUT EVERY ONE WILL BRING ITS COSTS WHEN IT COMES TO MARKET-WIDE ADOPTION. **COLIN DIGBY** REPORTS.

The 12 existing euro 'in' countries currently operate in excess of 30 clearing systems, each with distinctive clearing practices, different structures, processes, formats, account numbers and bank codes. The harmonisation and consolidation of this environment continues to be a central challenge for consumers, corporates and banks alike. The processing of euro payments within this environment remains particularly challenging and the recent advent of cross-border payments regulation and new payment standards, including the introduction of International Bank Account Numbers (IBANs), is perversely adding a further layer of complexity, rather than facilitating the intended reduction in complexity and costs.

On May 1 this year, 10 new accession countries joined the existing 15 member states of the European Union (EU). The enlarged EU, with all 25 countries, operates in excess of 50 clearing systems and as a result, the creation of a truly efficient infrastructure to support the European financial market has now become an even bigger task to tackle.

On the upside, it is anticipated that in some instances these accession countries may even have the ability to leapfrog the legacy challenges of their more established Western European counterparts, as they invest in new technology and systems that may not have existed at all in their markets.

Today's risks, high costs and inefficiencies arose partly because cross-border clearance and settlement still takes place on a market-by-market, country-by-country basis. National regulations, systems and market practices need to be replaced by an enhanced, more efficient infrastructure that is interoperable across the whole of Europe. Whilst being created, and indeed once completed, this changing environment will have a material impact on the way in which corporates manage their payments and underlying liquidity.

The banks have the task of creating a Single Euro Payment Area (SEPA). This, in effect, is the creation of a pan-European payments architecture to support the needs of the EU's 450 million consumers more efficiently and at a lower cost.

The key pan-European infrastructures currently under development are Euro Banking Association Step 2 – a pan-European Automated Clearing House (PE-ACH) system; PE-DD – a pan-European Direct Debit system and Trans-European Real-Time Gross Settlement Express Transfer (TARGET). Each of these have challenges to overcome before they are fully embraced by the market as a whole.

In terms of short-term efficiency, the creation of this new payments infrastructure is hardly the uncovering of the Holy Grail. There are many efficient clearing systems still operating at a country level and there has to be a process of evolution, in terms of these systems either becoming obsolete or maturing into pan-European solutions. Some of them will no doubt have aspirations to evolve into something bigger. Those with a more dynamic commercial approach, open accessibility and the ability to adapt rapidly to the new environment, will no doubt evolve and prove to be worthy adversaries to the new *de facto* systems. It is hoped the development of any competing infrastructures does not add a further layer of complexity. It should ensure an efficient market in terms of healthy competition, but should not detract from the need to create an efficient and 'standardised' payments market.

'HIGH COSTS AND INEFFICIENCIES AROSE BECAUSE CROSS-BORDER CLEARANCE AND SETTLEMENT STILL TAKES PLACE ON A MARKET-TO-MARKET AND COUNTRY-TO-COUNTRY BASIS'

Some of the new infrastructures will initially 'piggy-back' on the existing in-country equivalent payment systems. For example, EBA Step 2 will rely on the underlying low-value clearing systems in each member country to provide the underlying clearing. In effect, this will initially be a network that sits across the top of the existing ACH systems. This is workable, but may not be the best solution. The alternative would be the immediate replacement of infrastructures and this would require billions of dollars to be spent.

A positive and immediate impact of an expanded EU is to bring more countries under the umbrella of a common set of standards and rules. This will not create a single region (from a cash management perspective), but it does facilitate a movement by corporates to concentrate more of their financial processing into a single centre, bringing more discipline to the treasury management and payables and receivables functions (see *Getting a fair share*, page 32). It will also facilitate more efficient liquidity management solutions as the underlying cash is brought under this greater control

‘THE COMMITMENT BY THE 10 ACCESSION COUNTRIES TO ADOPT THE EURO WILL EXTEND USE OF THE EURO FOR CROSS-BORDER SETTLEMENTS’

and discipline. Corporates may retain their existing centres to handle an expanded Europe, or consider the attractiveness of relocating centralised pan-European services into one of the accession countries. A number of multi-national corporations have already set-up Shared Service Centres (SSCs) in Hungary, Poland, the Czech Republic and other countries in Central Europe.

The commitment by the 10 accession countries to adopt the euro as their local currency over the next few years will naturally extend use of the euro for cross-border settlements. This is in addition to the natural growth we are already seeing in the euro as a reserve and settlement currency globally. Furthermore, the recent EU cross-border payments regulation provides for more certainty, clarity around charges and value dating and lower transaction costs for cross-border euro payments within the EU (see *Evolution of the euro*, page 43). This will also act as a driver to further euro adoption. For pan-European corporates, all these factors increase the value proposition of updating payment and reconciliation systems to be truly ‘euro-compliant’, and yield the significant benefits on offer. A good banking partner should be able to provide the help and guidance needed by its clients to strike the right balance between efficient straight-through processing (STP) of payments and investment in system upgrades.

Another impact of the expanding Europe, which is worth considering, is that it provides additional impetus to adopt a wider European perspective to the corporate cash management model, and, as a result, the global view. Whilst upgrading processes and systems to leverage the euro, consideration should be given to the rest of the region as well. Central and Eastern Europe and the Nordic region are sometimes left in isolation, creating additional process and management challenges, as well as leaving inefficient liquidity pockets outside the main arena.

The pragmatic treasury or cash manager will ultimately want the best results for the least cost and resource dedication. In reality this means prioritising countries according to their importance to the corporation’s business as well as their ‘cash management friendliness’, or the lack of it as the case may be! They should expect help and guidance from providers of banking services and technology solutions, but need to ensure that any enhancements are generic enough to meet long-term goals as well as immediate objectives. Solutions for today may not be worth the investment if there is a high risk of obsolescence.

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