STANDARD SOLUTION

VINCENT DE BUSSCHER, **IAN CLARK** AND **VINCENT DUQUESNE** PROVIDE AN UPDATE FROM PRICEWATERHOUSECOOPERS AND THE EUROPEAN ASSOCIATION OF CORPORATE TREASURERS ON THE DEVELOPMENTS AROUND PAYMENT TRANSMISSIONS IN EUROPE.

Market participants believed – or at least very strongly hoped – that the launch of the euro on 1 January 1999 would reduce the cost and simplify the process of making cross-border payments through the development of standardised formats and technology. How wrong can you be? Since that date, nothing much has changed to ease the life of most companies.

On 19 December 2001, the European Parliament and the European Council issued a directive that introduces the concept of a single European payment area (Sepa). While domestic payment systems are advanced in most euro zone countries, non-urgent cross-border payments have never been the priority for the commission, the European Central Bank (ECB) or national central banks. While for urgent payments there is a requirement for euro zone systems to be compatible with the Trans-european Automated Realtime Gross Settlement Express Transfer System (Target), each country is free to use its own formats and standards, with no compatibility requirements. The consequences are a lack of transparency in the cross-border payment cost structure, inefficiency for all parties and the consequential effect on value dating of transactions.

The banking sector has recently created the European Payment Council (EPC) in an effort to meet the demands of the European Commission with respect to the harmonisation of cross-border payments. The European Association of Corporate Treasurers (EACT) is willing to play an active role in this process to ensure that all aspects affecting companies are covered.

The Euro Bankers' Association (EBA), together with the Società Interbancaria per l'Automazione (SIA) and Swift, has put forward an initial solution to the initiation of cross-border bulk payments. This is – or should be – the first step towards the creation of a true integrated European system, the Pan-European Automated Clearing House (Peach).

Businesses have been calling for banks and regulators to come together and to agree on a euro zone standardised format and payment infrastructure that will support zone-wide connectivity at a price similar to that of domestic payments. Unlike the US, the euro zone regulator, the ECB, does not have responsibility for European payment systems other than Target, which was principally designed as a mechanism to permit the movement of euro zone liquidity between central banks. While this role has expanded high-value urgent payments, no moves have been made to incorporate an equivalent low-value non-urgent payment system. Nor does the euro zone have a body equivalent to the American National Standards Institute (ANSI), responsible for developing and maintaining payment standards.

The Commission has focused on reducing the overall cost for retail and quasi-retail customers of the current fragmented system and has not sought to promote the ECB as the zone-wide regulator and controller of standards for euro payment transactions. However, both the Commission and the ECB are now taking an active interest in third-party initiatives such as EBA-Step 2 and 3.

CONNECTIVITY IS KEY FOR CORPORATES. Treasurers, unwilling to wait for this process to run its course, have taken the initiative in the past year, with regard to connectivity and message standards that will support straight-through processing (STP). A number of them agreed upon the need to co-ordinate their approach and formed a discussion panel that included their key business partners – consultants, banks and IT suppliers. Initially, the panel will focus on identifying common payment issues and experiences, and exploring possible solutions on a cross-national/cross-industry basis.

The technological improvements supporting STP have made it feasible to minimise the number of manual interventions in the payment process. But companies still bear the costs and burden of legacy inefficiencies in bank processes and internal systems. While they tend to have a global or pan-European view of the problem, regulators, central banks and domestic payment clearing systems are largely nationally focused.

In parallel with the accelerating pace of EBA developments, companies have been participating in the development of access and connectivity standards, such as Twist XML standards, for financial transactions. In the same way Swift has become a standard for banks, a similar standard is essential to connect businesses to banks, as well as to each other. Swift itself is in discussion with the Twist development group to ensure that a single suite of standards is established for global application. The power of the Swift and the Twist groups is in their membership. Swift standards are accepted globally by banks and it is expected that Twist standards, having been developed jointly between banks, systems suppliers and companies, will find similar global acceptance.

Already, access for companies to the banking 'club' has been enhanced by the development of the Swift Member Administered Closed User Group (MA-CUG), which uses SwiftNet standards, and effectively provides corporate access to Swift through a sponsoring bank. However, it is not suitable for small- and medium-sized companies, and less complex solutions will need to be developed to ensure global applicability.

If we look elsewhere in the market, we still see a lot of competition between countries, banks and software suppliers and it will be difficult to find a consensus on a single system or a 'single model', interoperability, governance rules and other basics necessary for a regional clearing system. Companies favour a relatively uncomplicated, standardised 'product' that will allow Interoperability between their financial systems and the banking world. In many respects, the company does not need to be involved in the fine details of payment clearing. Its primary interest is achieving a low-cost efficient payment and the ability to receive timely details of receipts with adequate information attached.

Companies are already taking part in some of these groups (for example, the Corporate Reference Group of the Trade and Business Group [TBG 5] of the UN/CEFACT initiative) or are participating in pilot projects and consultations with banks on an individual basis. The EACT and the national associations will establish a link with these companies to be informed, discuss the issues and validate the solutions with a wider and more representative base of end users.

THE NEED FOR A PRAGMATIC APPROACH IN THE MEANTIME. The somewhat ad hoc situation set out above indicates the need for a more co-ordinated, systematic and pragmatic interim approach to the issue. We have discussed corporate activity and developing standards between themselves and banks, but prior to these being finalised and implemented, it is crucial companies take some basic actions to ensure that payments are made most efficiently.

There are, of course, many ways of making a payment. However, for the purposes of this article, we will assume that companies will not continue using cheques cross-border. All non-domestic euro zone payments should be initiated electronically and processed to the beneficiary account without the creation of paper, and ideally without manual intervention (see *Box 1)*.

Where a value date has been applied to a payment, the paying bank will select a method that will guarantee payment on the day. In a structured file transmission, adequate payment envelope types should be defined in order to reflect the various payment categories and consequently the payment routes. The 'envelopes' need to be readable by all market participants processing transactions in order to facilitate and optimise communication. The company should be free to choose its entry point to the network knowing that the 'envelope' contains information which is handled on an STP basis by its paying bank.

Size may also be an issue, since many domestic automated clearing house (ACH) clearing systems have value caps, since they are intended for retail and relatively low-value payments. While the payment cap is not generally an issue for domestic payments, many cross-border payments will typically be of higher value.

THE EBA STEP 3 INITIATIVE. The treasurer's ideal, is a 'European payment initiation' system that supports access using a single solution (as with Multicash in Germany) to all his or her banks, anywhere in the EU, handles payment instructions of the standard and local instruments, and receives confirmations and account information, in a secure way. For companies and banks alike, payment initiation is the most crucial part of the payment cycle, representing almost 50% of the total cost of the end-to-end process.

Today, payment initiation formats are mostly standardised at country level (ETEBAC, ISABEL, CBI and the like). The objective of the EBA's euro zone payment project, Step 1-3, is to create the infrastructure of a 'pan-European payment clearing house'. This project is currently at Step 2, which is a limited version of the final solution. The EBA is on track with the release of Step 2, but Step 3 is now on hold because the EBA and the banks needed to concentrate on Peach and bedding down Step 2. However, given its importance for bank and corporate STP, they will resume Step 3 development shortly, and will be looking for contributions and validation of their development plans from firms.

COMING TOGETHER. Finally, the pieces are beginning to come together. Companies, banks, treasury associations and other regulatory bodies are beginning to ask the same questions, and are unwilling to hear answers from outside their own country. Initiatives such as Peach and the EBA's Step 3 are strong movements in the right direction. It is still an open question whether the ECB is to become both euro zone regulator and director of cross-border payment systems. This will require a change in the mandate of the ECB, or perhaps inserting a piece of text that was forgotten.

Vincent De Busscher is Manager Consultant at PriceWaterhouseCoopers in Belgium.
vincent.de.busscher@pwc.be
www.pwcglobal.com
Ian Clark is a Senior Manager in PricewaterhouseCoopers International Banking and Cash Management Advisory Group and is a member of the EACT.
ian.j.clark@uk.pwc.com
www.pwcglobal.com
Vincent Duquesne is Director Treasury Europe and A/P for Millennium Chemicals Inc and is a member of the EACT.
vincent.duquesne@millenniumchem.com
www.millenniumchem.com

Box 1
Making a payment

Typically, making a payment requires:

- Selection of the payment instrument by the payer – ACH, direct debit, EBPP, wire, etc.
- Selection of the access mechanism to the payment network:
  - by the payer using file transfer to the clearing house;
  - by the payer using the transfer by a bank; and
  - by the payee using EBPP or direct debit.
- Selection of the most efficient payment route to the beneficiary's account: normally made by the paying bank.
- Execution of the payment instruction by a bank or other authorised entity.
- Transfer of payment between clearing houses.
- Beneficiary bank credits the beneficiary.
- Settlement of the transaction between paying and beneficiary banks, probably by a clearing house and Target.

To achieve this relatively simple process, it is essential that certain things are in place:

- an actual or virtual euro zone clearing house network, using a regional or network bank; and
- agreed standards for transmission of payment instructions to banks containing sufficient information for transaction to be processed by the paying bank through to the beneficiary's bank.

Such information will include at least the following:

- currency;
- amount;
- value date;
- beneficiary name or identifier;
- bank of beneficiary, including IBAN numbers and BIC references;
- payment references sufficiently detailed to facilitate STP by the beneficiary; and
- date of execution or value date (typically, ACH payments are not value dated).