



I. Introduction

The Single Euro Payments Area (SEPA) is the area in which individuals and corporates are able to make cashless payments throughout the euro area from a single payment account anywhere using a single set of payment instruments

as easily, efficiently and safely as they can today at national level.

NBA basketball is one of the most exciting but also the toughest sports. When the game is really close, it will all be decided in the fourth quarter of the game. This quarter is called "money time." It's when the best players raise their game to tip the balance. With the end of 2009 approaching, "money time" has come for SEPA. Unless the key stakeholders raise their game, show the level of commitment required, agree on a common set play and execute flawlessly, the project may not reach its full potential or could even fail, which will backfire on the entire banking community, the European Central Bank (ECB) and last but not least the European Commission.

To materialise the SEPA, two European payment instruments have been defined: the SEPA credit transfer (SCT) and the SEPA direct debit (SDD). SCT was launched at the end of January 2008 and SDD will be rolled out from November 2009. These new SEPA payment instruments are intended to replace all the former equivalent national instruments across the euro zone.

The SEPA Cards Framework has also been defined, setting out compliance principles for issuers, acquirers and cards schemes. On this basis members of the industry are considering the creation of a new European card scheme to increase competition; they receive a strong support from EU institutions.

No one ever argued that making SEPA happen was going to be easy and would happen just like that. Replacing national practices with one harmonised set of scheme rules and principles is by its very nature costly, controversial and difficult, since it touches upon the DNA of national payment markets. However, these difficulties are outweighed by the obvious benefits that SEPA will bring about. Indeed, a Single Market and Monetary Union cannot be established unless the infrastructure's backbone and the rules underpinning it are harmonised. Even if in a first step multi-country banks and companies are the most likely early beneficiaries of SEPA, SMEs and consumers will undoubtedly reap the benefits of an internal market for payments.

However, even though banks, through the European Payments Council, have met the challenge of creating EU-wide payment frameworks, the project is now at a stage where all stakeholders have to step up a gear. The momentum must be increased and clear progress must be made in the future to remove some of the blocking factors that are still threatening the success of the project.

II. An actual risk of failure

In January 2008, the European Commission commissioned a cost-benefit study related to SEPA. The research found that this project could have a highly positive benefit, representing around €123 billion in savings, if investments in compliance and migration are done rapidly and comprehensively ("SEPA Big Time" scenario). However, the study also portrayed a possible scenario where SEPA may well produce negative overall economic impacts – a potential €43 billion burden - if either demand side or supply side fail to migrate because they are still not convinced that the investments needed to make SEPA payments are useful and will pay off ("All Tied Up" scenario).

Though this study is controversial and regularly considered misleading, particularly on the cost benefits side, some banking communities fear they could fall into a scenario where SEPA does produce negative overall economic impacts.

This fear is due in particular to dual costs during an undefined transition period resulting from legacy domestic payment-schemes existing alongside the SEPA instruments (see EUROFI position paper "SEPA and the Payment services directive: ways forward to meet challenges ahead" - January 2009).

This concern is deepened in some markets where the implementation of the Payment Services Directive (PSD) may be failing to fully harmonise the legislative environment, reducing the appeal of the two SEPA instruments.

Moreover, some national banking communities are concerned that legislators have prohibited banks from continuing to apply well-established existing business models for the SEPA Direct Debit scheme (SDD).

The EU institutions should continue to make the market aware that – even in these turbulent times – SEPA remains a top priority and a "mini SEPA" (i.e. for cross-border payments only or with national variants) is not an acceptable result. The current financial crisis is causing more and more banks to focus on their domestic retail business again; payment services are at the core of this retail business. Full migration to SEPA is now even more important, as it lays the foundation for the future European retail payment business.

There are a number of very material obstacles to overcome if such a large and ambitious project is to succeed, some of which are highlighted below.

III. The urgent need to complete the SEPA project and increase the sustainability of this top-down EU project requires a greater involvement and commitment by all stakeholders among which public authorities

Many stakeholder groups, with some support from the Commission, have been insisting on more formal involvement by end users in SEPA's governance. In any case, SEPA users are diverse: Companies (large corporates, as well as small and medium-sized enterprises (SMEs)

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and Public Administrations, Banks and Central Banks, Payment institutions, Merchants and Retail Customers.

Each stakeholder has specific interests and may bring specific contributions to SEPA's rollout. Public Administrations issue a significant number of credit transfers; together with merchants, they play an important role since the volume of their transactions would promote the use of a specific SEPA-payment instrument by others and as a result retail customers should finally benefit from the advantages of a SEPA.

An appropriate balance must be sought between the supply side objectives of the industry and ensuring a broad consensus on the advantages of SEPA and acceptance of its key outputs and outcomes.

The challenge is to put in place the different features required to successfully achieve the SEPA in an appropriate and timely manner. This includes establishing harmonised national legislative frameworks, adopting technical and business frameworks, getting Member States committed and involved, and setting up appropriate project targets and planning.

An effective governance structure is a key requisite for making this happen. By effectively involving all stakeholders in identifying EU benefits and finding common solutions the general commitment will be increased.

Moreover, the SEPA project is a top-down project that requires strong coordination and an appropriate balance between domestic specificities and EU-wide stakes. This should in particular pave the way for a reduction in possible inappropriate tendencies to keeping up existing national standards sometimes through so-called AOS – Additional Optional Services.

Revised SEPA governance should also allow the industry to tackle practical issues such as:

- Legally enabling the current Direct Debit mandate transfer to SDD;
- Obtaining the full commitment of governments and public authorities;
- Setting appropriate end dates for phasing out national credit transfers and direct debits schemes;
- Defining and coordinating national and European communication policies that are required to encourage the adoption of SEPA products.

IV. SEPA: What is needed to break the remaining deadlocks?

a. Facilitating the Direct Debit mandate transfer

In order to simplify consumer adoption, it is imperative that the direct-debit mandates signed for the old national schemes, can be used under the SDD scheme. Various categories of creditors (e.g. insurers) are legitimately insisting on a pragmatic legal solution for this. Without this, banks, creditors and consumers will face a costly burden that will reflect negatively on the new SEPA scheme and could even become a showstopper in some countries. It is essential to remove any degree of uncertainty that still exists in some countries on how migration can take place from a legal perspective. It should be at the top of the agenda for national regulators and the SEPA domestic governance body.

b. Engaging governments and public authorities

The participation of governments and public administrations in proactively migrating to SEPA schemes has always been seen as a key factor in achieving critical mass for SCT and SDD transactions. A recent survey by the Commission shows a mixed picture. In less than half of the countries involved there is some form of a centrally coordinated project among Public Administrations. For the March 2009 reporting period, the SCT migration rate (2.3%) for public administrations was lower than the overall migration rate for national transactions (2.9%). Only six countries have set an end date for the use of their national schemes by Public Administrations. These findings show that on the whole, the public sector is not yet playing the role it should be. For SEPA to succeed, Governments should put SEPA migration for their administrations high on the agenda.

It will also be beneficial if all countries in Europe transpose the PSD on time and in the same way in order to create the unified legal basis required by payment institutions and all the stakeholders to successfully implement the SEPA.

c. The need for an end date for SDD and SCT

Overall, by their very nature, top-down projects like SEPA take time to implement and involve an inherent risk of failing or only being partially completed. Ensuring adoption and commitment among a wide stakeholder population is almost impossible, unless some form of enforcement can be agreed upon. Given the often diverging views among selected interested parties, establishing end dates for full SEPA implementation is considered by some as the only means of generating sufficient momentum among all the communities involved and ensuring a timely phasing out of national payment schemes. Maintaining legacy and SEPA schemes alongside one another can imply up to 30% additional costs for banks. Though the SDD rollout will start in November 2009 in the most "advanced" markets and we are still a long way off a satisfactory level of reachability in particular due to a widespread lack of commitment and as non-euro countries have been allowed to postpone their launch date until 2014.

In light of this, the Commission recently issued a communication reiterating what is at stake and giving balanced support for end dates¹.

The EPC, representing the European banking industry for payments, considers that setting a realistic common end date by EU Regulation is key to gaining early critical mass. Today, a vast majority of payment service providers consider that only a mandatory end date will guarantee that the whole market moves towards SEPA and reaps the economic benefits rapidly. More specifically, those in favour of setting a single EU end date by regulation consider that leaving a three-year period before the end date would be sufficient to tackle the remaining unsolved issues without undue pressure.

For others, given the different nature and status of the SEPA subprojects, it currently seems preferable to allow different dates for each scheme. They believe that while the SCT scheme is fairly stable when it comes to its core principles there are still key issues to be resolved for the SDD scheme (validity of pre-SDD mandates, business model

¹ "Rapid migration is crucial in order to minimise the costly period of running legacy and SEPA systems in parallel. Public authorities should play a key role here. An efficient monitoring of the migration process will help anticipate and remedy possible migration problems. Setting an end-date to the SEPA changeover could significantly boost the SEPA migration process" - EU Commission press release "Single Euro Payments Area: Commission presents actions to make SEPA a success"

Crucial improvements are required to achieve the SEPA

post 2012, necessary agreement on a sufficient period for stabilising the different schemes).

To meet all parties' expectations, it is perhaps appropriate for the EPC, the ECB and the Commission to agree jointly on the appropriate dates and the conditions for achieving migration to SEPA. Once established, migration could be pushed through by strong directional governance from the EPC and monitoring at national level to ensure general compliance.

V. Card standards: positioning SEPA in a global context

On July 31, 2009, the EPC published the "SEPA Cards Standardisation Volume" for public consultation (until October 30, 2009). The EPC intends to publish a revised version of this "Volume" by end 2009. The standardisation process has been considered to be sub-optimal so far, mainly due to the lack of dedicated resources and some project governance issues, where selected interest groups within the EPC constituency are seen to have excessive influence. Measures are being taken by the EPC to ensure tighter governance and process management and to set European standards that take into account the potential global requirements. Global inter-operability of cards and terminals could increase the level of efficiency in card processing and thereby contribute to a more competitive market.

VI. Business model – when will there be certainty?

a. SDD

The Commission has spoken out against the very principle of interchange fees for direct debit. Today, banks are just temporarily entitled to charge an interchange fee for SEPA Direct Debits "MBP" (8.8 €cents until end 2012) for cross-border transactions and the existing charging mechanism will be tolerated for national direct debit transactions until December 31, 2012.

In this context, particularly in countries where some form of interbank fee currently exists, banks may have to develop additional fee bearing services for customers to offset the loss of revenues; they may also consider the feasibility to adapt specific features from existing business models working without interbank fee. In any case, banks have been urged to define new business models for national and cross-border direct debits to be applied post 2012. Achieving this, within a short period and with little information upon the criteria that EU and national competition authorities will apply in this respect, is a risky challenge.

At the same time, for political reasons, it should be advantageous for creditors (supposedly the primary beneficiaries of a widespread adoption of the SEPA direct debit) to set up rebate policies. Indeed, EU institutions have to demonstrate that the SEPA direct debit is a win-win solution and not just an additional expense to be covered by EU consumers. This is also seen as an issue by banks that fear this may unduly tarnish their image.

b. Cards

Though not strictly related to SEPA, the concept of a multilateral interchange fee (MIF) for card payments (in case no arrangement is in place between the issuer and the acquirer) still represents a very effective and transparent mechanism for establishing a fair balance of costs and benefits between the two sides of the business.

The still immense costs caused by the use of cash highlight the need for further important investments into debit card infrastructures and stress the necessity of efficient balancing mechanisms.

In this respect, it may be wise to quote some findings gathered in a document issued recently by the US Federal Reserve Research².

1. "The core economic and policy issues concern the effects of interchange fees on the extent of card use and the welfare of different parties in the economy. However, determining whether observed patterns of card fees (including interchange fees) and card usage are socially optimal is an extremely difficult task."
2. "A few characteristics of an efficient interchange fee are worth noting:
 - In general, an efficient interchange fee is not solely dependent on the cost of producing a card-based transaction nor is it equal to zero.
 - An efficient interchange fee may yield prices for card services to each side of the market that are "unbalanced" in the sense that one side pays a higher price than the other.
 - The efficient interchange fee for a particular card network is difficult to determine empirically."
3. "Although no findings are completely robust, most models suggest that, when merchant prices do not vary by payment method:
 - Profit maximization does not, in general, lead a network to set an interchange fee at the efficient level. In theory, privately-set interchange fees can be either too high or too low relative to the efficient interchange fee, depending on a number of factors, including the cost and demand considerations underlying the merchant decision to accept cards and the extent of competition among issuing and acquiring banks.
 - In most markets, an increase in the level of competition among firms generates downward pressure on prices; however, this is not necessarily true for interchange fees."
4. "In several countries, central banks or competition authorities have taken action aimed at reducing interchange fees. In particular, the effects of any intervention are uncertain and may involve unintended consequences. Among these possible consequences is the unintended redistribution of costs and benefits of card transactions across merchants, banks, card users, and non-card users. In addition to these general concerns, each of these options has specific benefits and costs that should be carefully considered by policy-makers before taking any legislative or regulatory action. The various options differ in their transparency and ease of implementation, as well as in the extent to which they may be able to redress any potential inefficiencies in the payment card market."

² "Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues" Robin A. Prager, Mark D. Manuszak, Elizabeth K. Kiser, and Ron Borzekowski - 2009-23 - Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs - Federal Reserve Board, Washington, D.C.

Setting such fees at a commercially viable level is critical in order to maintain the required level of investment and innovation in the cards business. Advice from the FED could be used as the basis for the EU Institutions and the Banking Community to establish an urgent EU project to define and apply sound commercial principles that will provide the necessary business model certainty sought by banks.

VII. e-SEPA: new opportunities for the industry, for end-users and for strengthening SEPA's image

An interesting by-product of the SDD scheme is the introduction of e-mandates. It will allow a payer to electronically sign a direct debit mandate on the creditor's website. Typically, payers will self-authenticate using the same method as when transacting online with their bank. To enable inter-operability within SEPA for such e-mandates, the EPC has designed an e-Operating Model that establishes the various roles in the transaction chain.

The use of bank-driven authentication is an opportunity for the banking sector in that it allows consumers to provide evidence of who they are across various potential services, even outside of the banking domain. Other industry sectors could benefit from this, as they would not have to develop additional authentication methods, while consumers would be allowed to use a method that they are already familiar with and which they trust.

Following the same logic, the EPC is also working on an e-payment framework. It will consist of principles that ensure inter-operability and facilitate online payments, using IBAN and bank-driven authentication in combination with a SEPA scheme transaction, for instance an SEPA credit transfer. Transactions initiated through any scheme based on the framework would provide a payment guarantee to the merchant and payment finality to both payer and payee.

e-Payment products already exist today at national level in some markets (e.g. Austria, Germany, Sweden, Netherlands). Following the adoption of the e-payment framework, it will be up to the market to design products and compete for business. The development of a harmonized e-payment framework provides the banking sector and EU Institutions with a unique opportunity to demonstrate that SEPA brings value and innovation and does not only consist in technical harmonization, which may in turn result in an increase in fees.

VIII. SEPA - two priorities: on time delivery and crucial structural improvements

For the SEPA project to reach its full potential, all stakeholders must demonstrate their firm commitment at both national and EU level. They should promote the key success factors for an optimal and irreversible migration to allow the various stakeholders to reap maximum benefits from their investments. Rapidly fixing the issue of a possible end date for migration and creating pragmatic and easy ways to migrate existing Direct Debit mandates is a must.

An effective and efficient EU-wide project management approach involving all stakeholders is also urgently required.

As far as direct debits are concerned, the lack of a business model for the long term (past 2012) remains a concern in some markets. It is necessary to establish a greater degree of clarity and certainty for the business models across all payment types, including cards. Involving the wider stakeholder community in the decision-making process for delivering SEPA may be part of the answer.

The SEPA project also needs governance improvements. In this respect, EU Institutions have to find a way to accurately and appropriately identify the different interests of SEPA users. The general commitment will be strengthened.

IX. The encouraging but challenging most recent views of the Commission

The European Commission has recently adopted a Communication on Completing SEPA: a Roadmap for 2009-2012 in response to the Communication on 'Driving European recovery'. This communication emphasises appropriate priorities and targets

- Foster migration
- Increase SEPA awareness and promote SEPA products
- Design a sound legal environment and strengthen SEPA compliance
- Promote innovation
- Ensure necessary standardisation, interoperability and security
- Clarify and improve SEPA governance.

To achieve them within a very tight timeframe:

- The banking community, in addition to setting payment standards and defining new business models where relevant, has to ensure their rapid migration to and the promotion of the SEPA products.
- Members states must
 - Set up and implement national migration plans paying particular attention to improving SEPA awareness. This requires a dedicated communications effort;
 - Provide political endorsement to setting a possible end date;
 - Be early users of SEPA products.
- EU Institutions must
 - Provide clarifications on the criteria which the payment schemes business models have to comply with;
 - Taking initiatives to rapidly fix up the issue of the end date for migration;
 - Set up the "overarching EU SEPA governance body" intended to define a shared strategic vision of the SEPA, monitor and support SEPA migration and guarantee an appropriate level of transparency and accountability toward end users.

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