

# Are ACHs rising to the SEPA challenge?

The Single Euro Payments Area (SEPA) promises to change the dynamics of the European payments industry in the longer term. If SEPA were starting with a clean slate, what role would be assigned to ACHs and how many would the market need to handle low value payments efficiently? How are existing infrastructures adapting to new conditions? *Dialogue* brought together four industry experts with differing perspectives to discuss these issues.

**Given where we are today, would you prefer to see cooperation or competition among automated clearing houses (ACHs) in Europe? What do you think the market wants?**

**Martin Wilson, VocaLink:** Since the introduction of SEPA we have entered a new competitive market. SEPA and the PSD (Payment Services Directive) are giving banks the opportunity to source their services from a smaller number of consolidated markets infrastructures. In due course, ACHs (if that term survives) will be less distinguishable by the local markets that they serve (given the standardisation across these markets), than by the volume of transactions that they process and the additional services that they offer.

I see cooperation for those basic services such as clearing and settlement and competition for services that add value, enabling banks to realise their own strategic objectives. The term ACH has less relevance in the pan-European or global market that we are moving towards. In VocaLink, whilst we

provide 'ACH' services such as clearing and settlement to domestic and pan-European markets, we do far more than that through our value-added services, expertise and scale, enabling our customers to leverage our capabilities to drive their own commercial strategies. Let's not forget that competition drives innovation.

**Manfred Schuck, Equens:** SEPA expectations include efficiency as well as competition, which constitutes a sort of contradiction in itself. If there were only one single provider for ACH services, it would probably be quite efficient, but there would be no competition. On the other hand, if a number of competitors would not cooperate on infrastructure to a certain level, it would be impossible to create an efficient SEPA.

I therefore believe that cooperation on infrastructure and competition on services, combined with a consolidation in the processing market, will lead to a limited number of very cost-efficient competitors. So I do not prefer one over the other, I am convinced we

have to do both! Market feedback supports this vision.

**Arthur Brieske, Deutsche Bank:** The successful implementation of SEPA Credit Transfer has already demonstrated the real value in cooperation between banks and PE-ACH (pan-European ACH). The establishment of harmonised basic schemes, business rules and technical standards provide a common framework and new options for banks regarding how to clear and settle their SEPA transactions.

The ability to have choices gives banks much needed competition amongst infrastructure providers regarding operational efficiency, reach, breadth and depth of services, including quality and customer service levels. Competition is healthy for driving innovation and keeping prices low, which is what the market demands. For example, a core objective of SEPA – providing an efficient, low-cost, and competitive payments landscape – is predicated on sticking to the SEPA principles of using market forces and network effects.

## The participants



Arthur Brieske, head of global payments strategy and ACH infrastructures, Global Transaction Banking, Deutsche Bank

Vincent Questiaux, low value payments market manager, SEPA program manager, SWIFT

Manfred Schuck, general manager, marketing and sales, Equens

Martin Wilson, chief commercial officer, VocaLink

**Vincent Questiaux, SWIFT:** I would agree with my colleagues: both cooperation and competition are crucial to build a better market place to the benefit of our common customers banks.

Cooperation is important to build that common base service layer that enables true competition, bringing enhanced product offerings and better pricing to the customer. Without the common base layer, competition does not deliver the expected benefits as the differentiation is based on standards, formats and schemes rather than on services that add value.

SWIFT is well positioned to comment on this: the company is delivering in both spaces on a day-to-day basis. We develop standards and interoperability enablers (SEPA testing platform, SEPA directories, CSM (clearing and settlement mechanism) market practices) supporting the construction and the operations of an interoperable infrastructure, and at the same time we are enriching our FileAct messaging services (new pricing per payment, file header copy mechanism), bringing more value at a better price to the customers adopting the service.

### To what extent do legacy national instruments still represent an obstacle to rationalisation in the European ACH landscape?

**Arthur Brieske, Deutsche Bank:** Rationalisation has already begun in some markets as the cost of maintaining legacy local/national ACHs far outweighs benefits of a few remaining legacy national instruments not covered by the core SEPA schemes and planned Additional Optional Services. Legacy national instruments should be viewed as opportunities for banks to provide value-added services on a pan-European basis and not as obstacles for rationalisation.

**Martin Wilson, VocaLink:** While legacy instruments will prevent some ACHs from progressing, the most advanced infrastructures are able to handle a variety of formats and standards. For example, in our own case, the VocaLink platform is capable of processing the UK, SEPA and Swedish formats whilst also offering a host of legacy services for markets across Europe. This places ACHs in to a position whereby they need to decide to invest, in order to extend the range and geography of

their services, or focus solely on their domestic market. In VocaLink we have developed the capability to manage multiple currencies and schemes and introduced new ones such as the Faster Payments service which has already processed over 6 million transactions.

**Manfred Schuck, Equens:** The SEPA Credit Transfer proves that SEPA is alive. Although the transaction numbers still seem relatively small, there is no precedent of any payments instrument growing this fast. If this growth continues, the increasing efficiency of SEPA payments will attract additional users, leaving hardly any room for legacy national instruments finally.

On the other hand, we will have to deal with local legacy instruments for quite some time. But if the rationalisation goes along the lines of current ACHs and other providers, legacy instruments will hardly be an obstacle as the respective services can still be supported during the period of migration to SEPA.

**Vincent Questiaux, SWIFT:** The go-live of the SEPA Credit Transfers was a very positive sign to the



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market, showing that SEPA was more than a set of rulebooks. But this is just a start: for SEPA to deliver its full benefits to the end-customers, the efficient legacy payments instruments that are in place today at the level of the domestic markets need to be ‘SEPA-ised’ as well. Success in this next step is as crucial as the go-live was for the SEPA vision to deliver its full benefits.

Infrastructures and banks have to continue working closely with the EPC (European Payments Council) in this regard in order to ensure that differentiation among the new SEPA products is built on levels of service, product innovation and functionality rather than on standards, formats or legacy features with no value added.

The creation of the so called ‘mini-SEPA’s should be avoided at all costs. The EPC has a driving role to play here by defining and conducting a transparent process for the definition and registration of the Additional Optional Services that Arthur refers to, at a pan-European level.

**The EPC has defined common positions for the banking community on core payments services in a SEPA context. Is the only real issue therefore how best to deliver those services?**

**Martin Wilson, VocaLink:** No, there are other issues. Whilst the EPC has developed common standards, the real challenge now is to build upon those common foundations to develop services on a pan-European basis for banks and their customers that are at least as sophisticated and accessible – if not more so – than the services that these users receive today in each of their local markets.

**Manfred Schuck, Equens:** Basically any provider that is not able to perform well on these services will be out of business. However, several providers will be able to do so, and they will have to distinguish themselves on services and quality.

**Vincent Questiaux, SWIFT:** Delivering new products to the market is always a challenge, but ensuring adoption of the new products by a critical mass of customers is another one... This is the next barrier in making SEPA a reality. Today, banks seem to struggle in building and selling SEPA value propositions, in particular when it comes to SEPA direct debits, and corporate customers do not want to jump without a clear business case.

There are a number of open issues on the table: the functional regression with respect to legacy instruments; the lack of clarity around the corporate-to-bank

interface; and the risk management issues related to the use of the new SEPA direct debits, to mention the major ones.

A so called ‘end date’, forcing banking communities to phase out legacy instruments, has been requested by a number of market players for months and today the idea seems to be supported by the regulators as well. Defining such an end date will probably accelerate the resolution of these issues. But who will define what end date and when? That’s the question.

**Are ACHs talking to each other directly about how interoperable they could or should be?**

**Martin Wilson, VocaLink:** Yes, ACHs have been cooperating for many years through the EACHA (European ACH Association) initiative that has in turn led to the development of an interoperability framework. More importantly, we have the ability to interface with banks’ back office systems to manage all their payment types through our payments bureau and reach all destinations in Europe and beyond.

**Manfred Schuck, Equens:** Equens is one of the founding members of EACHA, which fills a natural space next to the EPC, which represents the market of financial institutions

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as well as the ECB/EC, representing the governments and supervisors. Each covers its own space, but all three are needed to cover all relevant aspects of SEPA. For that matter, Equens already has the first interoperability connections with other ACHs up and running.

**Vincent Questiaux, SWIFT:** From a technical perspective, I strongly believe that interoperability is a key enabler of SEPA, and this for all payments flows: bank-to-ACH, ACH-to-ACH, ACH-to-bank and bank-to-bank. In this specific case, EACHA has recognised the value of interoperability delivered by the SWIFTNet messaging platform across SEPA by selecting FileAct for inter-ACH connectivity. I also see a number of banks following the same route.

**Arthur Brieske, Deutsche Bank:** Interoperability between legacy local/national ACHs is not a sustainable model considering the introduction of costs associated with non-value-added activities that are unable to be absorbed in a low margin business. This is more of an issue as compliance and regulatory costs are already beginning to squeeze margins even further. Additionally, the complexity associated with returns and investigations in such a model increases indirect costs to banks and

creates added points of failure that can also potentially reduce STP (straight-through processing) rates.

**With most people anticipating increased competition among existing ACHs, is there scope for large banks and/or IT companies to offer competitive processing services? Is that an attractive idea?**

**Manfred Schuck, Equens:** Obviously there is. ACHs, banks and IT companies have their own specific capabilities, which they can use to distinguish their services from competitors with a different background. However, competition between them already exists. Each plays a role in certain market segments. SEPA will offer scale opportunities for all three of them, but the basic positions will not change drastically because SEPA doesn't differ that much from current domestic markets, apart from its scale.

**Arthur Brieske, Deutsche Bank:** The introduction of SEPA offers banks new and more efficient options for pan-European clearing and settlement, such as PE-ACH and bi-lateral file exchange, and marks the beginning of the end to legacy local/national ACHs within the eurozone. Bi-lateral file exchange

provides a highly efficient way for banks to clear and settle transactions amongst themselves and will act as a competitive processing service to PE-ACH.

**Martin Wilson, VocaLink:** Many banks and IT service providers already offer a range of payments services. However, the majority of banks procuring these services struggle with giving core processing business to organisations that are themselves competitors (for example other banks) or to organisations that cannot be held to the same industry standards and protocols as the banks themselves (for example IT companies). In the past, ACHs offered a secure and trusted basis for transactions processing – particularly in the non-compete space. As the market forces consolidation, these newly emerging payment processors will be able to offer superior volumes than banks themselves, a better breadth of service than basic correspondent banking and a more relevant range of value-added services than the IT companies – all via existing channels which have been proven over many years. Having said that, we will also see the term 'ACH' drifting out of usage as the larger and successful expand the range and depth of services that they provide to the payments industry and the function of clearing and settlement becomes a commodity



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that is expected of any player in the space, not a differentiator in itself.

**Manfred Schuck, Equens:** I believe that the ACHs are in a good position to retain or even enlarge their market share. They have the experience and specific knowledge that IT companies lack, and, as Martin says, they are not in competition with their customers in the way large processing banks are.

**Vincent Questiaux, SWIFT:** I am convinced that this increased competition is a reality and is positive overall. Value propositions and customer segments may differ across transaction banks, ACHs or IT processors, but in the end, all payments service providers will be competing for the same portion of the pie, which will foster innovation and drag prices down.

However, increased competition should not come with increased operational risks: the domestic retail economies are entirely based on the reliability and the resiliency of these infrastructures. All processors should take this into account when building new services, and regulators should monitor it.

**Can ‘reach’ compensate for lack of volume to sustain the ACH business model?**

**Manfred Schuck, Equens:** No! If there is a lack of volume a costly, non-competitive central solution for reach is fine. But how can there be a lack of volume? ACHs can combine their current domestic volumes in a smart way with the SEPA volumes by making use of EACHA-like infrastructures. So the volume already exists.

**Arthur Brieske, Deutsche Bank:** Reach is an important ingredient for a successful ACH model. However, the efficiency of the model is what will drive its sustainability and volume will play a significant role in driving efficiency.

**Martin Wilson, VocaLink:** Reach, like clearing and settlement capability, is a hygiene factor, expected from any provider in this space. Cross-border traffic accounts for less than 2% of bank traffic and these banks have existing connections via a CSM or bilateral and correspondent channels for this traffic. For those ACHs that respond to the changing market they will be able to compensate for any lack of volume by developing better, faster or cheaper value-added services that are either pan-European in applicability or interoperable on a pan-European scale.

**How can ACHs provide reach? How can a strict implementation of standards amongst ACHs be organised? Will it happen naturally or should an institution like the EPC or the ECB organise it?**

**Martin Wilson, VocaLink:** Reach can be achieved by connecting to other CSMs, by connecting to local ACHs or by developing your own connectivity through other partnerships. VocaLink uses all of these methods and can reach all destinations in Europe. Ultimately banks will have freedom to choose. If the local ACHs fail to keep pace with demand, they will be overtaken by more advanced payments providers and infrastructures.

**Manfred Schuck, Equens:** In EACHA’s interoperability framework, ACHs have created their own, open standards to provide reach in a self-regulating manner. They have filled the gap and now take their natural position. The implementation is taking place as we speak – even without central initiatives.

**Arthur Brieske, Deutsche Bank:** With the launch of the SEPA Credit Transfer, pan-European clearing via PE-ACH was introduced, which provides reach to the vast majority of market

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participants. This model should be used as a benchmark for ACHs interested in competing on a pan-European basis. Now is the time to focus on the growth of SEPA while setting firm end-dates regarding legacy local/national schemes and infrastructures.

**Vincent Questiaux, SWIFT:** Banks, ACHs and PE-ACH are all in a position to provide reach within their community. The key resides in guaranteeing interoperability among operators across the communities to avoid the creation of mini-SEPA. To achieve this, all operators should systematically test their SEPA implementations against a common reference, and share the same minimal set of reference data and market practices. But experience in the financial industry is that this hardly ever happens naturally. It needs to be proactively managed.

**Beside interoperability, reach requires a messaging solution. Has the internet now gained the necessary resilience and security to allow ACHs to service any financial institutions in Europe?**

**Manfred Schuck, Equens:** I would like to make a distinction between the internet as a network infrastructure and the open standards

that are used on the internet. The internet infrastructure is a perfect solution for small-to-medium scale, non-critical, added-value services. Combined with additional security features the internet also offers efficient messaging solutions for services with high numbers of end users, like internet banking or internet payments.

For medium to high volume, critical messaging services between financial institutions, dedicated infrastructures, such as the SWIFT service offering, are still more efficient, more secure and more solid. But these dedicated solutions should be based on open standards and protocols as much as possible. The internet protocols, however, are mainly meant to serve large communities of low-scale users, which make them not yet particularly suitable for SEPA reach solutions.

**Martin Wilson, VocaLink:** It’s true that the internet is gaining credibility as a trusted means of handling payments and the success of services run by VocaLink such as its Euro Payments Capture service and Bacstel-IP are evidence of this. However, banks will also want certainty that the requisite security, fraud and anti-money-laundering measures have been put in place by the relevant ACH, so you do have to build additional resilience around the channel.

**Vincent Questiaux, SWIFT:** The internet as a network is already largely used in a banking context and is probably the right solution to connect to a large number of heterogeneous and small-volume users. In line with this, the new SWIFT Alliance Lite interface will leverage the reach of the internet to securely connect small-volume financial institutions and corporates to the SWIFT network.

Using the internet end-to-end as a channel to transport payments messages bank-to-bank or bank-to-ACH is a different story: our experience at SWIFT shows that the benefits of using a reliable and secure central messaging platform like SWIFTNet clearly outweighs the potential savings that can be achieved with the internet on traffic costs. In addition, using SWIFTNet allows for additional services to be rendered on payments files by the messaging infrastructure such as archiving, copying, validation, standards conversion and routing.

Open messaging protocols and architectures used over the internet like SOAP are also entering the business space. SWIFT is currently working on different adaptors that would allow customers to re-use these over the SWIFTNet platform. But there again the key resides in maintaining the interoperability of the messaging platform across businesses, borders and communities. ▶

**To what extent are we dealing with perceived rather than actual problems? After all, are bank customers up in arms about the quality of service they are receiving from their banks when it comes to the processing of non-urgent payments?**

**Martin Wilson, VocaLink:** Bank customers are not 'up in arms' about the quality of service but many have publicly expressed frustration about a range of issues. These include the cost of banking across many countries, the lack of common products and services for one customer operating in many jurisdictions, the inability to manage multi-country liquidity centrally, and the need for multiple relationships and banking interfaces. There is also a concern over the lack of new services that reflect the increasing internet, mobile and international features of modern-day living. Payment providers with central infrastructures, such as VocaLink, enable banks to overcome these customer challenges by offering services which cater for these customer demands at a lower cost, a lower risk and with a faster time to market.

**Manfred Schuck, Equens:** The quality of the basic services around the processing of non-urgent payments isn't perceived as problematic, at least not in the markets we are currently active in. There is, however, a widespread awareness of risks related to payments, especially with cards and on the internet. This awareness may be based on incidents rather than on structural problems, but the financial industry, including processors, has to deal with it. We are in a business in which trust is essential, and a lack of trust will tremendously decrease the

efficiency potentials of electronic payments.

**Vincent Questiaux, SWIFT:** Maybe the basic service on retail payments is satisfactory, but banks need to respond to new market requirements. On the consumer side, there is a clear need to make 'making payments' more convenient, using new channels like mobile phones, for instance. Corporate customers, meanwhile, want to achieve cost savings and improve their STP rates by better integrating financial processes like e-invoicing into the end-to-end supply chain. If banks do not move, others players like PayPal, telecom operators or IT providers will eat the pie.

Now let's face it: we are starting to see competition between various players that used to operate in more protected environments. That will demonstrate whether the basic services should be improved or not. And it will also show whether these improvements are being made with the support of or around market infrastructure providers.

**If you were starting with a blank slate, how would you structure the processing of bulk and low value payments in the eurozone?**

**Martin Wilson, VocaLink:** A small number, probably three or four, providers of payments services, offering interoperable pan-European payments processing. Having more than one offering ensures competition, innovation and product diversity. Each infrastructure would compete on price, quality of service and the ability to bring new products and services to market. I would also look to a new governance structure where these payment providers were able to operate with the commercial

freedom to respond to market needs, providing choice to their customers, the banks.

**Vincent Questiaux, SWIFT:** I think that SEPA will help us to get there. But the industry will probably need a programme-management-based approach to SEPA implementation that would include, for instance, a clear decision on the end-date, a stricter definition of the minimum requirements to achieve interoperability, and more. This would require not only cooperation between market players but also strong leadership by some stakeholders.

**Manfred Schuck, Equens:** Currently the majority of payments take place within national boundaries. The introduction of SEPA will not change that because payments are merely bound to the natural boundaries of the markets. And these boundaries will not change suddenly because of SEPA.

On the other hand we have to make sure that the structure of the payments industry does not restrict the development of SEPA. Creating specific, small-scale and therefore less efficient SEPA infrastructures will hinder the cross-border development of the underlying markets.

I therefore think that the new SEPA processing and the old domestic processing should be integrated as far as possible. This will lead to efficient SEPA payments, because of their integration with large amounts of payments within national boundaries. Furthermore, it will also lead to a single perception of payments, national or cross-border, which helps to overcome national boundaries and develop one European internal market. I believe that is the most important reason for the development of SEPA. 