



Sepa – the time to act is now

*The imminent introduction of Sepa is already driving market dynamics and will bring substantive changes to the payments market and beyond. For banks, strategic choices have to be made now argues Manfred Schuck**

The launch of the Single Euro Payment Area (Sepa) is becoming reality. The intrusive and technical changes in the European payments market that will result will also cause substantial dynamics in other domains. Local conventions will have to make room for a business approach based on international market demand. Efficiently communicating communities will challenge the traditional bilateral international collaboration between banks. Payment processors are striving

for economies of scale, which will result in consolidation.

In this dynamic environment choices have to be made by all market participants. Not only for the short run, which most already have done, but mainly on strategic choices for the long run when Sepa will mature and volumes will increase.

Approximately 8,000 European banks know that their Sepa Credit Transfer offering must be ready on 28 January 2008. For some time now

banks have been preparing themselves for Sepa within the European Payment Council (EPC), internally, and in cooperation with their payment processors. However, quite a few are waiting to make their final decisions on which community they want to belong to and which Sepa compliant processor to choose.

These decisions are derived from the strategically far reaching choice how to take position on the European payments market. The world of payment

processors is also in flux, prompted in part by the generally accepted view that economies of scale of 10 billion transactions to be processed is the minimum an enterprise requires in order to survive. Some processors are opting for organic growth. Others, like Equens, choose for a growth strategy by both organic growth and by combining expertise and market shares with international merger partners.

To realise their growth objectives some payment processors, like Equens, have elected to use a dual strategy for both payments and cards, so as to be able to offer banks a complete service portfolio. Despite the gradual convergence of payments and card transactions, this article will only focus on developments in the area of payments.

The prerequisites

Various essential elements, which are required to build Sepa in accordance with its architectural design, have already been created or are in the final stages of completion. To start with, these include the Sepa Credit Transfer Scheme Rulebook, the Sepa Direct Debit Scheme Rulebook and the Sepa Implementation Guidelines issued by the EPC. Then there is the PE-ACH/CSM Framework, issued by the EPC, which provides guidelines for ensuring that Clearing & Settlement Mechanisms (CSMs) are SEPA-compliant and provide the basis for interoperability. The third element is the Payment Service Directive (PSD) for the EU-broad harmonisation of the legal and regulatory environment. And fourth and finally, there is Target2, a European Central Bank initiative aimed at creating a single shared platform for European banks to settle their payments with other European banks.

The simultaneous introduction of the above-mentioned architectural elements is essential for the practical

implementation of Sepa. However, a full-fledged Sepa world will lead to considerable changes in existing business models. It will require a wide range of practical solutions. These aspects are not handled by the architectural design – they must be dealt with by all market players.

One of the essential elements is the availability of pan-European clearing & settlement mechanisms. Sepa is not about connecting national payment environments; it's about creating a European world for euro payments. Detaching payments from the national environments that have evolved during a period of many decades and converting them to an equally versatile offer based on the Sepa method will be a process that – in practice – will require a significant amount of willingness to change. The expectation is that this will take a few years yet, in spite of pressure from the ECB and the start date of 28 January 2008.

Clearing and settlement

In terms of clearing and settlement two tracks are apparent. The first is to set up a Pan-European Automated Clearing House, (PE-ACH). However, if things go no further than one PE-ACH, one of the important reasons for implementing Sepa - creating conditions for better market dynamics - will not be met. From a technical perspective it is also practically impossible, because this would mean that 8,000 banks have to be connected to one single point. Not to mention the risk. After all, having only one, single PE-ACH also means one single point of failure.

This is the reason for the second track – co-initiated by Equens – of multiple European clearing houses operating alongside one another, in order to create interoperability between banks and between each other. The European Automated Clearing House Association (EACHA) has developed

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interoperability standards for payments across communities that have grouped around payment processors.

Minimising the capital burden will be a key concern for banks. Last August the EACHA took an important step by authorising Version 3.0 of the Technical Interoperability Framework for SEPA-compliant Giro Payments Processing which will be used as the basis for bilateral interoperability agreements between banks and ACHs. This makes new standards available for the exchange of transactions between communities. It also creates alternatives for banks for choosing how many transactions they want to route via which channel. This particularly makes more sense in a time in which international bank mergers are blurring the original community borders. And in which banks choose the community for their mutual clearing & settlement that



can satisfy their requirements and that minimises their capital burden.

Increased interoperability

The higher level of interoperability thanks to the EACHA standards has a number of positive consequences. First of all, banks can choose which community to connect to. Their choice can be based on the capabilities of that specific community such as reach within the community. It can also be based on the capabilities of bilateral connections between the communities, costs per transaction, or Additional Optional Services (AOS). In this way market dynamics will lead them to their most suitable processor(s). And once TARGET2, the central clearing system between the national central banks is fully operational, the traditional correspondent banking system can be gradually phased out.

At the moment about twenty ACH communities exist throughout Europe. Each of these will attempt to grow in size during the coming period and – if that fails – may elect to specialise. However, one logical development is that a considerable group will disappear. It is technically feasible that separate banks could play a role in processing, but this seems unlikely for the most of them. The processing business is a volume business, certainly for the standard SEPA service provision within and between communities. This must be offered at low prices, even though it requires large investments in systems. Banks will ask themselves whether this is part of their core business and whether they want to allocate their scarce economic capital this way.

In the light of the nearing launch on 28 January 2008 the challenge

for banks is to decide which community(ies) to belong to, which technological standards to adopt, and how to implement these. The options are the existing PE-ACH (in fact EBA) or a CSM community. EBA today has a network for cross border payments, but only for small volumes. And there are risks attached to exclusivity too. The CSM proposition is strong – also in the light of the track records of its participants – especially those who have extended their reach by signing bilateral contracts with other CSM's, those who can deliver additional optional services, and at the same time offer access to PE-ACH capabilities. In short, there are options for every strategy but little time left to decide. ■

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