

Will SEPA deliver on its promises?

By Joergen Jensen, director of product management, Wall Street Systems, May 2008

The Single Euro Payment Area (SEPA) initiative forms part of The Lisbon Strategy; the aim of which is to make Europe the most competitive environment in which to do business. The vision for SEPA is to provide an area in which all Euro payments within the EU are effectively domestic, and where the current differentiation between national and cross-border payments no longer exists. Not only does SEPA aim to improve the efficiency of cross-border payments, but also to develop common instruments, standards, procedures and infrastructures in order to generate significant economies of scale. Ultimately, customers should be able to make payments throughout the whole Euro area in the same way as they do within national borders.

For corporations, the successful introduction of SEPA should have several benefits. These include lower costs for both payments and format interfaces, particularly as increased competition among banks is likely to drive prices further down and result in improved service levels. Another advantage would be the reduction in the number of bank accounts required across Europe, leading to increased efficiencies. In addition, SEPA would enable better visibility into cash positions, improved reconciliation of invoices (the payment would carry a minimum of 140 characters of remittance data) and increased productivity due to less manual labour.

Achieving the vision for SEPA is a major undertaking, and expectations are high. Although some progress has been made, the path to SEPA has not been as smooth as many had hoped, and a number of fundamental issues have emerged.

It is important to notice that the 'E' in SEPA stands for Euro – not for European. This means that it only addresses Euro payments, not the other currencies used in the EU. It is easy to make the assumption that SEPA embraces all European currencies, but in fact there are some notable exceptions – not least pound sterling. The utopia of a single area in which there is no distinction between domestic and cross-border payments cannot therefore extend to the whole of Europe in its current incarnation.

As it stands, SEPA can only accommodate credit transfers. There has been a long and arduous delay with the Direct Debit directive. The reason behind this is that direct debit functions vary greatly within the different countries of the Euro zone. EU domestic laws therefore need to be harmonised to enable a EU wide direct debit. Further this could mean that that organisations have to contact all of their clients to renew each and every direct debit mandate. Not only is this time and cost consumptive, but clients may discover that they are paying for services that they no longer need or want. An effective review of an entire portfolio of direct debits might therefore result in certain organisations taking an unwanted revenue hit.

Legal debates and processes are not known for their swift resolutions. The delay incurred as a result of trying to resolve this issue – current estimations indicate that this could be until the latter half of 2009 – might also mean that organisations which are either considering or in the process of implementing SEPA-led projects may decide that they are no longer as crucial, and push them further down the agenda.

When assessing the more practical side to SEPA, it is important to note that in order to be able to make a SEPA payment both the IBAN (International Bank Account Number: a unique code for the identification of bank accounts worldwide) and BIC (Bank Identifier Code) are required. In most cases these numbers can be calculated from existing domestic bank account numbers and bank identifiers, but not always, which means that corporates will need to ask their suppliers to provide these numbers in order to be fully SEPA compliant. Once again, this is likely to be a time consuming and costly process, particularly if suppliers prove to be less than responsive.

SEPA demands that for inter-bank communication the ISO 20022 format should be used. This has led to an expectation that this format should also be used for corporate to bank communication, but this has not been the case so far. Most corporates are in a holding pattern, and currently only a few have converted to the new format.

To compound the issue, the attempted implementation of the SEPA directive into laws at the national level has revealed further issues such as the differing requirements for central bank reporting. These mean that despite honourable intentions, different implementations of the ISO 20022 format would nonetheless be required for sending payment instructions in different countries. Inevitably, this will lead to a delayed update of the ISO 20022 format for corporate to bank communication as well.

As would probably be expected, virtually all major banks are now ready to handle SEPA formats. But some smaller banks – without the same resources and infrastructure – are not. As a consequence, corporates sending payments in the SEPA format cannot be sure that it will arrive at its destination as a SEPA format. The payment will still be made, but it could be delayed or incur charges which a SEPA payment would not. Not only this, but SEPA dictates that a minimum of 140 characters of remittance data should be transported through to the recipient of the payment. Not all back office systems are capable of processing this information though, which means that informative remittance data may be lost.

When assessing progress with SEPA, it is also worth a brief analysis of the UK banking initiative – the Faster Payments Service (FPS). FPS is designed to increase the speed of low value, high volume consumer to consumer or business to business payments so that they are virtually in real time. Prior to FPS, it took approximately three days for a beneficiary to receive the funds after a payment was initiated. The Clearing House Automated Payment System (CHAPS) service offers same day Euro and pound sterling payments for high value transactions but the charges are high so it has not been an alternative for low value payments.

Existing indicators suggest that FPS will be considered a success. So far, 13 banks and building societies – representing over 97% of UK payment traffic – participate in the new service. Future developments should mean that other financial institutions will be able to take part as well, either as fully fledged members or via agreements with existing members, similar to other payment systems. The Faster Payments infrastructure will be launched at the end of May 2008, which is when banks will be able to roll out the service to their customers. FPS will run alongside existing payment schemes in the UK such as BACS and CHAPS.

The hope is that the FPS service will revolutionise the UK's automated payments infrastructure, which as a result will be one of the most effective in the world. Similar lofty aspirations have been touted for SEPA, but it is impossible to ignore the obstacles in its path.

Despite all of the potential legal and practical barriers, SEPA can reasonably be expected to make at least some valuable progress towards its goal of uniform, effectively borderless payments. Initially it was hoped that SEPA would generate critical mass by 2010. Taking the factors outlined above into account, it would seem that the

timeline could in fact extend beyond this date. Nonetheless, by focusing on the original brief and staying true to the fundamental aims of this initiative, corporates should still be able to benefit from the reduced costs and increased efficiencies on offer – they may just have to wait a little longer for them to take effect.

– ENDS –