SEPA Migration End Date Survey
May 2012

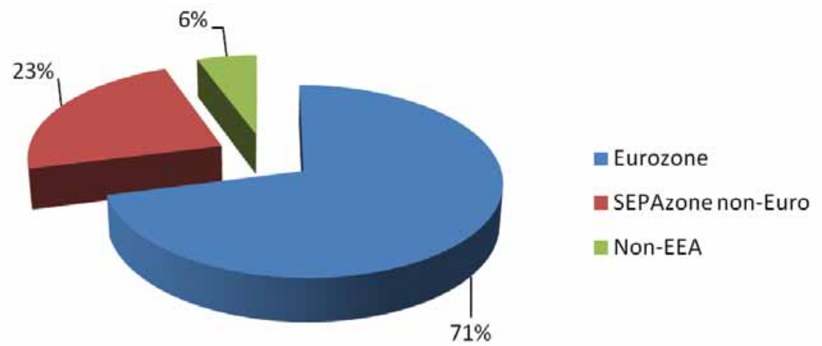
"Last call for SEPA"

SEPA Migration End Date Survey

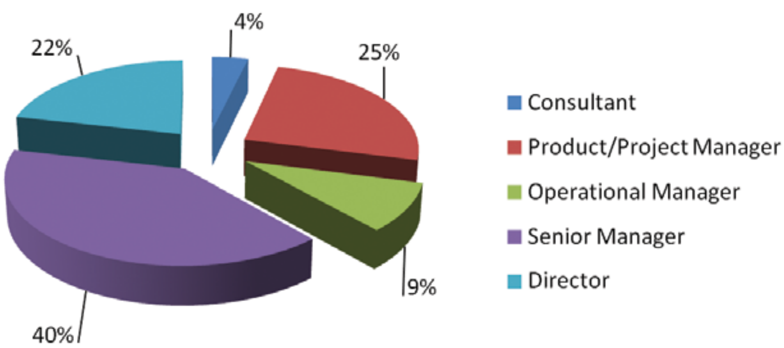
Clear2Pay

Background

The survey ran during April 2012 and was completed by a diverse mix of 107 bankers across 27 countries. Seven of these respondents were based outside the EEA with 71% inside the eurozone. Respondents were all VP level and above and most were in SEPA roles. No single EU member is represented by more than 15% of the responses and the mix of respondents covers all geographies of the EEA.



In terms of those who responded, four out of ten work in senior management positions, with a further two out of ten at director level. A quarter of the respondents are directly responsible for the implementation of SEPA as product or project managers.



Executive Summary

Acting under pressure from Europe's banks and the recently-formed SEPA Council, the European Commission drafted an initial end date regulation for SEPA migration in mid-2010. However, given the turbulence in Europe's banks and the legislative burden this placed on parliamentary time, it was only in early 2012 that the regulation was ratified by the European Parliament – complete with 111 amendments and a unified deadline for credit transfer and direct debit.

The subsequent SEPA Migration End Date (SMED) has brought the SEPA project into sharp focus and now, as the clock ticks towards the deadline of 1 February 2014, this survey looks at how banks are preparing for and looking to meet the challenges of SEPA.

What is clear is that an overwhelming majority of bankers that participated in this survey welcome the deadline – indeed through the EPC they have been calling for it for some time, which was seen as an essential component in aiding where self-regulation could not drive migration. What they did not plan on was the change in technical governance and losing effective control of the schemes that they had built. Statements from the sectoral banking associations EBF, ESBG and EACB all requested that the Commission not get involved in setting technical standards, yet this component remained in the final ratified regulation.

The setting of the SEPA Migration End Date will have a profound impact on the banking industry during the next two years. It will dictate development priorities; eat resources originally destined for other projects; and force banks to take a long hard look at their infrastructure. **Survey respondents indicate that they believe that the competitive space for SEPA will be with Corporates – and that they need better solutions and increased representation in SEPA governance.**

During implementation, banks will need to focus on retaining their portfolio of corporate customers through delivery of new services and establishing an ongoing dialogue on payment topics and beyond. It is clear that the more proactive banks are already talking to their corporate customers, seeing how they can assist with SDD mandate management and ensuring that corporates do not decide that it is easier to direct connect to schemes and clearing houses themselves using Payment Institution licenses. They are doing this because although the business model for SEPA is unclear today, what is clear is that volume becomes more important and the need for an efficient infrastructure is vital.

Just as the most forward-looking corporates are seeking to centralise financial operations in Europe, so too must the banks that service them. Payments centralisation will be one of the key benefits of a post-SMED Europe and the projects to realise this need to begin in the near future.

Reviewing their business and infrastructure in light of the upcoming migration deadline, banks have realised a number of key aspects:

- It is not at all clear what the cost and revenue streams in a post-deadline market will be
- For many banks it is not clear how they will replace the revenues traditionally generated by Multilateral Interchange Fees
- The existing infrastructure of many banks is not currently fit-for-purpose in a post-deadline market

In reality this means that banks do not have a clear view on the future business model and so will focus on pure compliance with the rules. However, rules around non-compliance are yet to be drafted – and will be created at Member State level leaving yet another grey area where **banks could capitalise on regulatory arbitrage** particularly on business components of SEPA.

Finally, banks believe that between today and the migration deadline they will need more resources and they will need to invest heavily. One of the major areas for this will be on testing. Knowledge of testing SEPA instruments is not widespread and many internal teams will not be capable of fulfilling testing needs, leading to a heavy reliance on external providers.

All-in-all, the new Regulation has brought clarity to the SEPA project and given the banking industry the migration impetus that it desired. This will begin a profound shift in the European payments current landscape. The key competitive space, corporate payments, has emerged, but the business model is still unclear and there remains much work to be done to ensure that internal systems are ready and that new customer solutions are available in good time. The road ahead is short and there is much work to be done to make SEPA a reality.

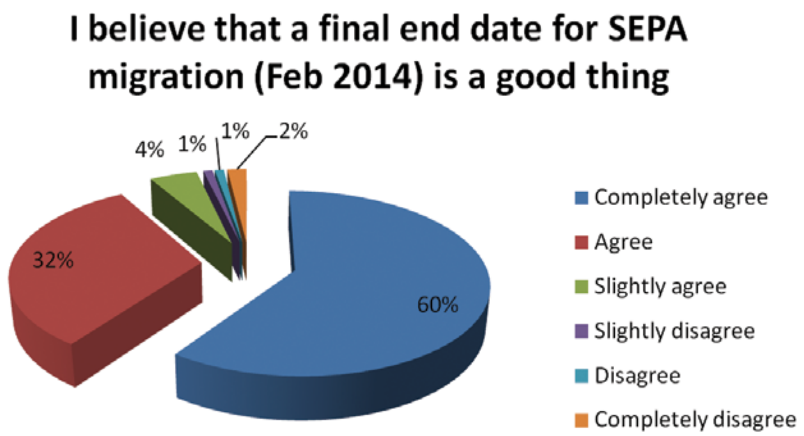
Sections:

1. The SEPA Migration End Date regulation and SEPA Governance
2. The Business of SEPA
3. SEPA infrastructure readiness
4. Risks and Competition in SEPA
5. The Strategic Impact of SEPA Migration

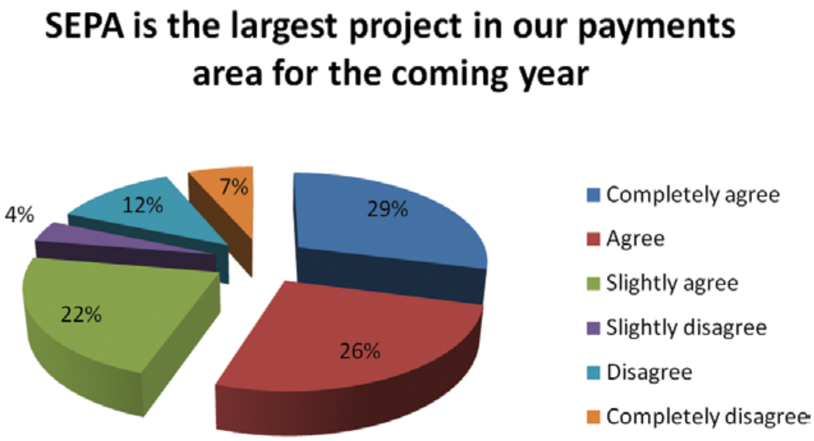
Section 1:
The SEPA Migration End Date regulation and SEPA Governance

Is the SEPA Migration End Date regulation a good thing?

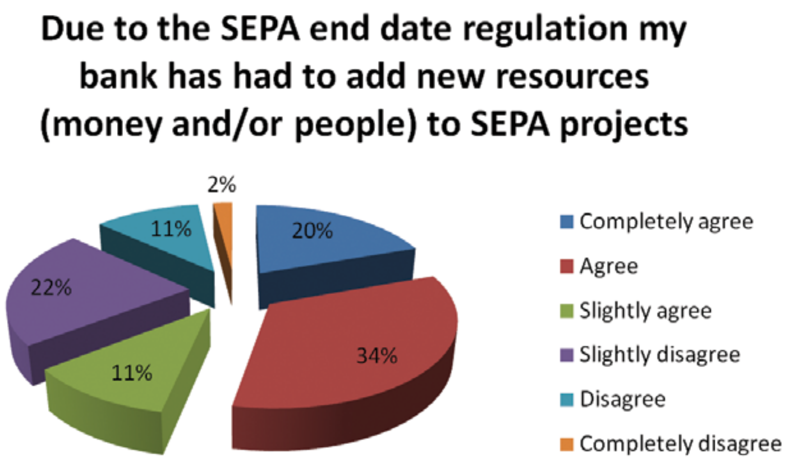
For a number of years banks, through the European Payments Council (EPC), have been crying out for a mandated migration end date for SEPA in order to allow them to timetable migration efforts and avoid a costly ongoing two-tier system. This situation was perpetuated by a European mandate for all banks to be reachable by SEPA instruments but not necessarily capable of initiating their own transactions. However, with Regulation (EU) 260/2012 being agreed by the European Parliament in early 2012, the banking industry finally got its wish. The ‘Regulation establishing technical and business requirements for credit transfers and direct debits in euro’ or SEPA Migration End Date Regulation (SMED) sets a mandatory end date for migration to SEPA instruments in Euro countries by 1 February 2014, and in the rest of the EEA by 31 October 2016. The Regulation also carried a number of other articles covering technical elements of the schemes and governance.



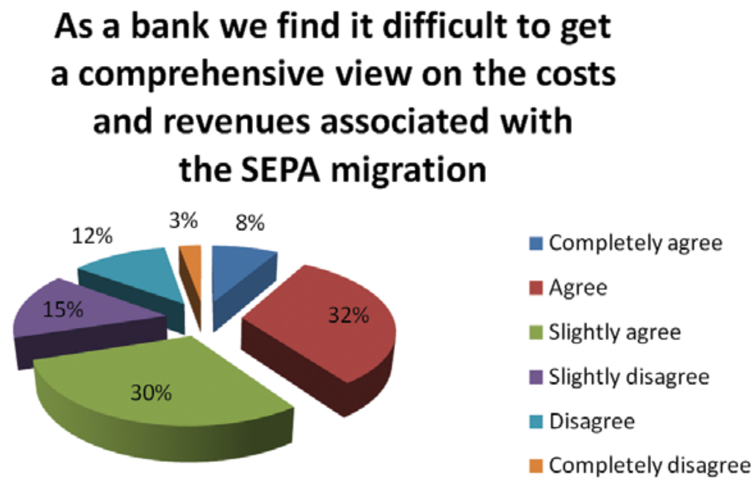
Unsurprisingly, an overwhelming number of respondents (96%) are pleased that the end date for SEPA migration has now finally been set. It has also lead to SEPA projects increasing in importance for banks across Europe with over three-quarters of respondents indicating that their bank’s largest projects in the coming year will be for SEPA.



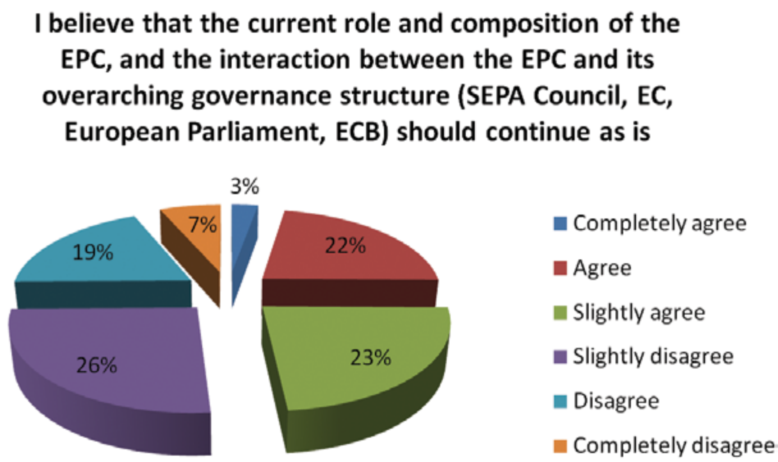
However, it seems that in the continuing austerity spirit of doing more with less, a third of banks will look to tackle these projects using existing resources rather than bringing in specialist project resource.



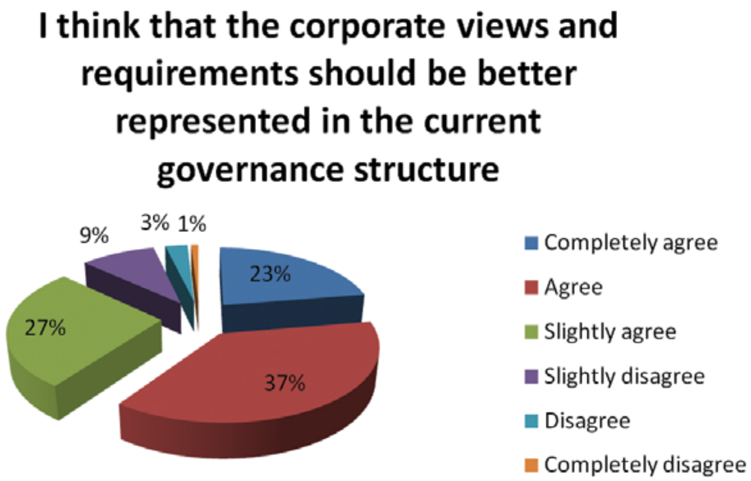
And only a similar third of banks feel that they have a comprehensive view on the costs and revenues associated with the SEPA migration. Given that SEPA is a political project and that the investment is mandated, it is clear that banks still do not have a clear view on the financial aspects. This is particularly pertinent as Regulation 260/2012 also supersedes a previous regulation (EC) 924/2009, which first mandated removal of Multilateral Interchange Fees (MIFs) that supported the cost infrastructure of these transactions in the past and were the mainstay of many payment departments. Within the new regulation banks remain able to charge for R-transactions at no more than the 'actual costs of handling an R-transaction by the most cost-efficient comparable PSP that is a representative party to the arrangement in terms of volume of transactions and nature of services', which frankly makes it unsurprising that many are still in the dark over future cost models.



On announcing the SMED regulation, European Commissioner Barnier, DG Internal Markets and Services, called for a focus on 'reducing the cost of payments for the consumer' and this has already begun to resonate with respondents. It is clear that the current governance structure for SEPA is not viewed as fit-for-purpose with over half of banks (52%) agreeing that something needs to change.



One of the key elements of the SEPA project is to increase payment interoperability across the EEA and thereby reduce the number of banking relationships required by a consumer or corporate to work or operate in a number of European countries. This will likely mean that competition for the business of these pan-European players will increase in the coming years. Banks recognise this new competition, but many are lacking the knowledge required to tackle the challenge due to a historical lack of involvement, particularly of Corporates, in SEPA governance. An overwhelming majority of European banks (87%) would now like to see greater involvement of these players in future definition of SEPA and its instruments.

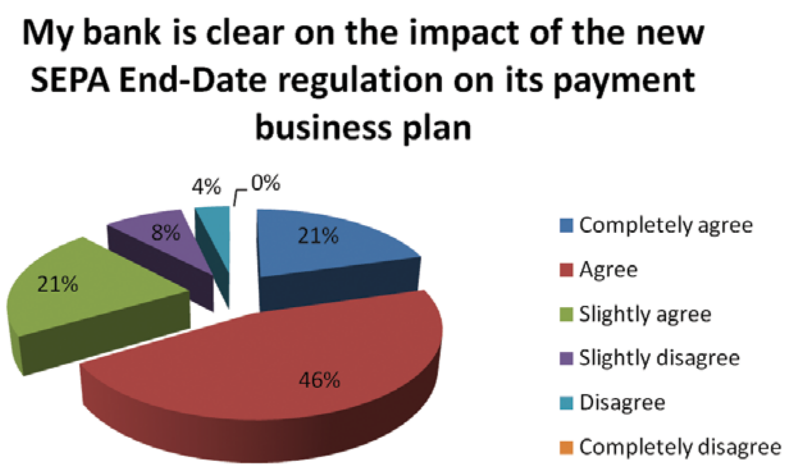


Section 2:
The Business of SEPA

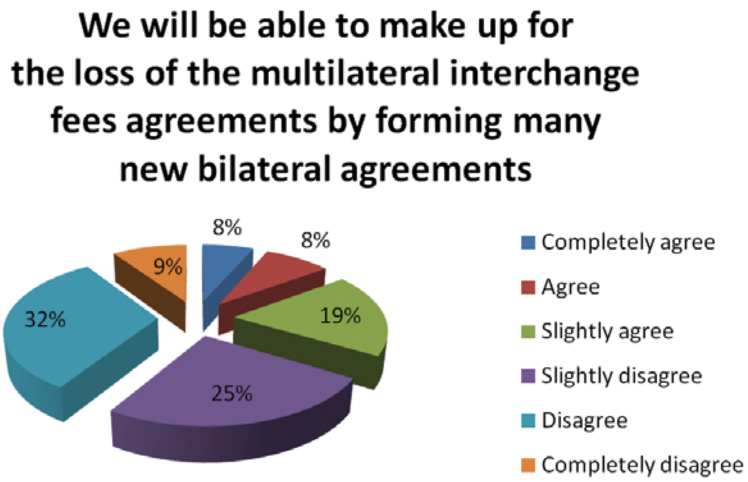
Are banks ready at a business level to capitalise on the opportunities of SEPA migration?

Despite an admission in section 1 of the survey that they don't have a comprehensive view of the costs and revenues associated with SEPA migration, banks are indeed more confident that they are clear on the impact of SMED on their payment business plan, with only 12% feeling uncomfortable with the potential impact. This is potentially due to the later date at which MIFs are forbidden for national direct debits (1 February 2017) and focussing on the physical cost of migration rather than the long term payments business impact of the SEPA project.

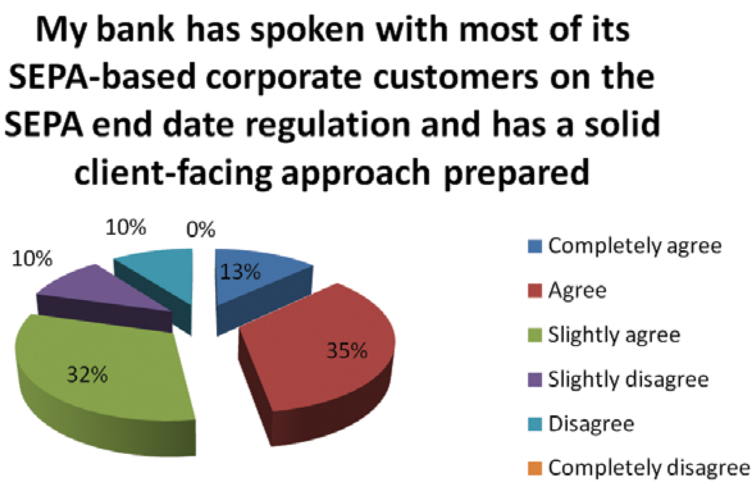
Despite the fact that they are an easy way to fund transactional payments infrastructure and allow easy sharing of the cost burden, the EC believes that MIFs are bad for the end users of payments systems as they do not incentivise banks to increase efficiency. Essentially, MIFs (Multilateral Interchange Fees) can prevent a competitive market from being in place and introduce complacency. Perhaps this is true, particularly when MIFs are not revisited often and the market remains static for long periods of time. One of the main changes post-SMED will be that banks need to look at alternative financing and profit structures for payments infrastructure, whether that be leveraging R-transactions fees, AOS fees, payments outsourcing or managing multiple bilateral agreements.



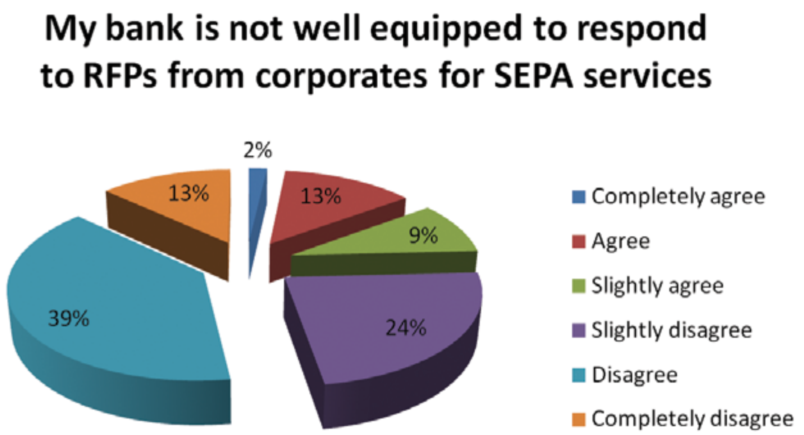
One thing that is sure though, the concession offered in SMED to allow bilateral agreements is not seen by banks as positive enough to off-set the loss of MIFs. Over half (52%) believe that this concession will not solve their issue. Perhaps this could create a competitive space in SEPA where those managing many bilateral agreements effectively could have an edge over less relationship-based banks. It may even be a space in which new agreement brokers could appear to facilitate revenue generation.



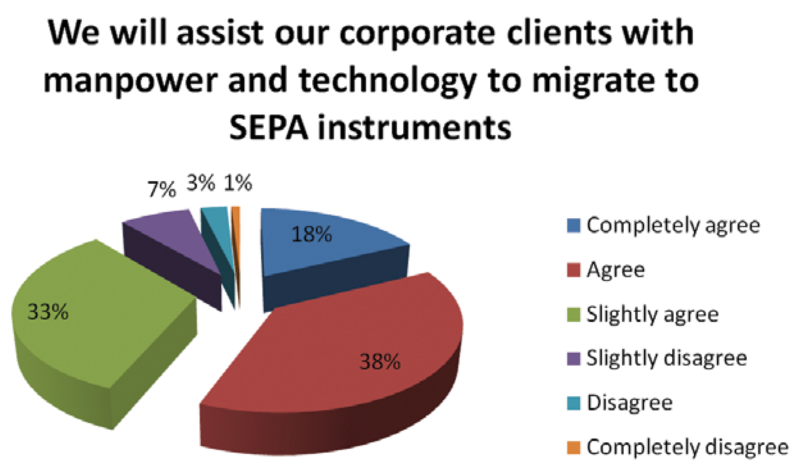
However, with the vast majority of SEPA payments facilitating Customer-to-Business (C2B) and Business-to-Business (B2B) payments, the ability for banks to engage their corporate customers is now more important than ever. One of the major architectural changes is the shift in mandate management for direct debits in about half of the European countries. SEPA Direct Debits (SDD) and its B2B equivalent are Creditor Mandate Flow (CMF) instruments where the holder of the mandate is the creditor or their representative bank. This is in direct opposition to many previous schemes where the mandates were held by the debtor or their representative bank (Debtor Mandate Flow or DMF). In essence this means that Corporates in countries where the legacy scheme was DMF, will now need to take responsibility for SDD mandates. Communicating and supporting this migration will be a major task in the run-up to the SEPA Migration End Date, yet over half of banks have not yet approached their Corporate clients to discuss the impact of SMED.



Perhaps as a consequence of this, over a quarter (26%) of banks are not ready to respond to incoming RFPs from Corporate clients that have researched the impact themselves and are looking for new SEPA services. Given that Europe's Corporates will invariably seek to reduce the number of core banking relationships that they hold, this indicates a significant percentage of banks that have not fully considered life after SMED and is in stark contrast to the confidence that they indicated in understanding the impact of SMED on their payments business plan.

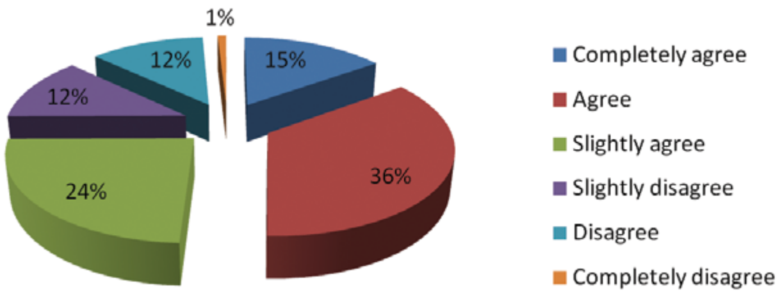


However, many banks (89%) believe that they will be able to support Corporate customers by offering tools and resources to help solve SEPA migration issues. Given the scarcity of bank-offered tools apparently available today, this suggests that the next two years will see new services and solutions for Corporates brought online by banks – and is perhaps one of the reasons for the addition of new SEPA resources in two-thirds of European banks (see section 1).



More specifically, three-quarters of banks agree that creditor banks should provide or propose a mandate management tool to support all of their business clients for SDD. A number of third party solutions to do just this are currently being touted by major vendors and this will be an essential service for banks to support in the future.

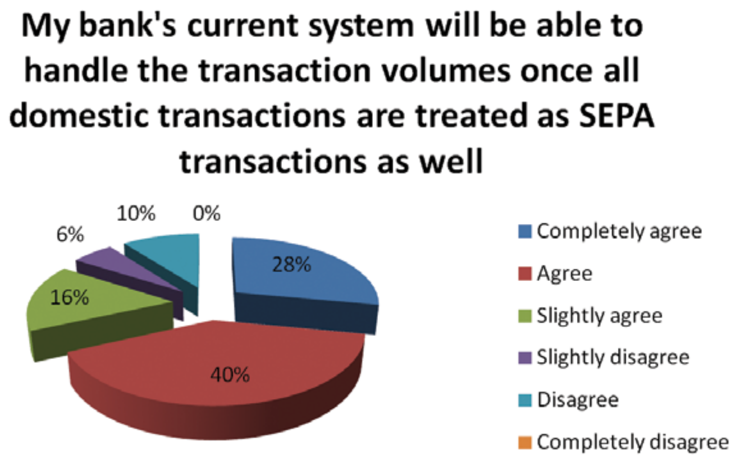
Creditor banks should provide or propose a mandate management tool to support all of their business clients for SDD



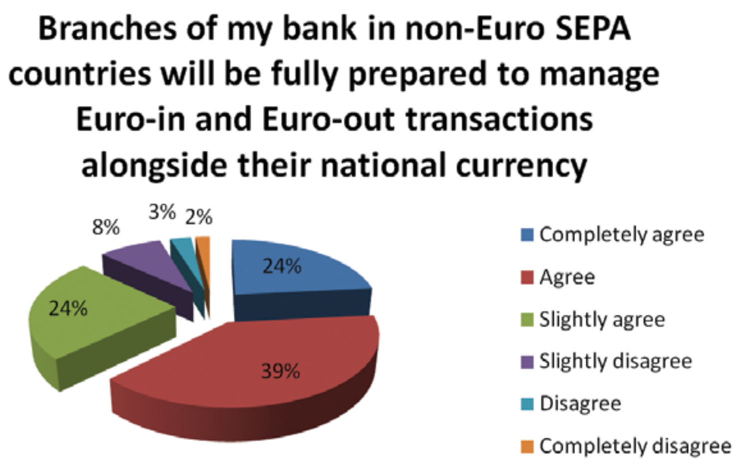
Section 3:
SEPA infrastructure readiness

Are banks ready for the infrastructure changes needed to migrate to SEPA instruments?

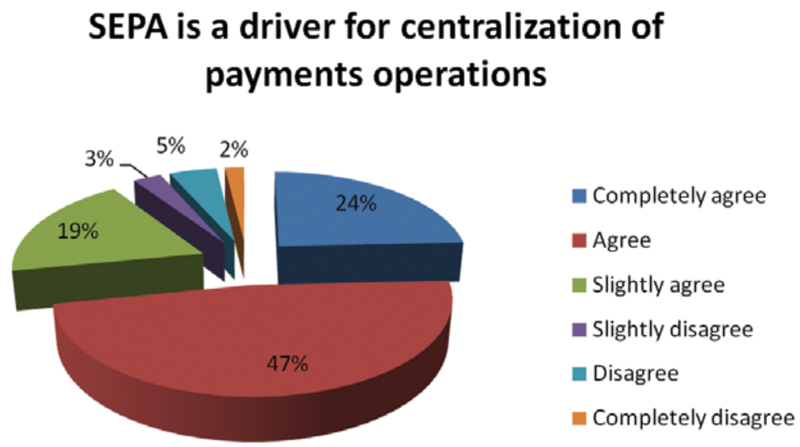
With some of Europe's banks already involved in national or group-level projects to prepare for SEPA, confidence remains high that current systems will be able to handle the large volumes of SEPA transactions in a post-SMED environment. Indeed 84% of respondents felt that it was likely that current systems would do the job. However, given the need for a renewed focus on payments efficiency and the changing business model for SEPA instruments, this optimism does not necessarily reflect a confidence to do so at the lowest cost.



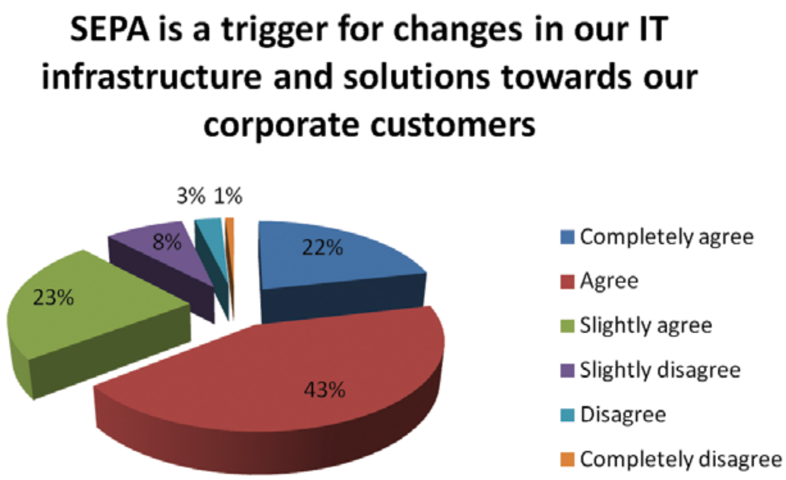
While the national/cross-border duality will disappear on the whole for Eurozone banks by 1 February 2014, those in the EEA (SEPAzone) but with a national currency that isn't Euro will need to deal with a duality of systems and business model as an ongoing reality after 31 October 2016. Some banks are not yet fully prepared to deal with this.



One of the anticipated benefits of the SEPA project was the ability for payment activities to be centralised for Europe generating consequent economies and efficiencies. Indeed, one of the central pillars of the SEPA business case drawn up by Capgemini on behalf of the European Commission[1] was the precisely this activity. Again, an overwhelming number of respondents (90%) believe that SEPA is a driver for the centralisation of payments operations.



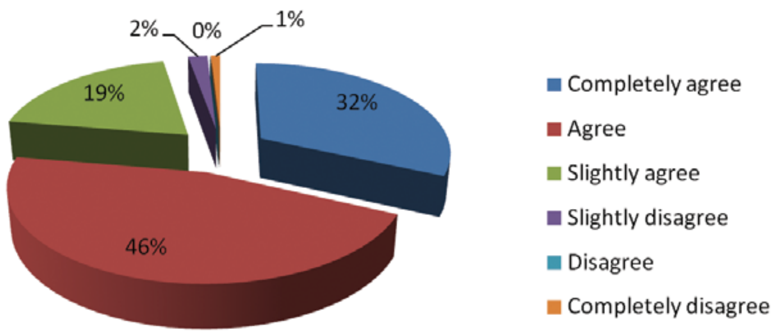
As such, 91% of respondents also believe that SEPA is a trigger for changes to IT infrastructure and solutions towards corporate customers. Given that it is likely that Corporates will also be looking at the need to centralise payments operations and analysing their banking relationships, the recognition of change is a huge step forwards for Europe's banks. What shape should this new infrastructure take and what should be the Corporate solutions? Neither answer is currently clear, which should make the coming two years a phase of tremendous flux in this market.



1. 'SEPA: potential benefits at stake', report for the European Commission, Capgemini Consulting, 2007.

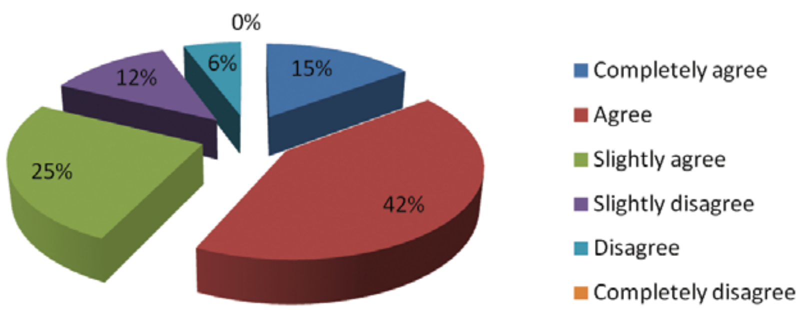
And of course, with any system or solution change there needs to be a reciprocal focus on testing. Particularly with the large-scale infrastructure updates demanded by SEPA migration and the apparent leveraging of existing systems to manage SEPA transactions, testing has never been more vital in the banking world. All but 3% of respondents foresee increased testing efforts during SEPA migration – and perhaps this indicates another of the areas where the expected increase in resource and effort will be focussed during SEPA migration.

The migration to SEPA leads to increased testing efforts for my bank



Perhaps more importantly though, respondents felt less confident that their internal IT teams were ready to cope with the additional testing load. Whether this is due to lack of knowledge or a lack of resource, it is clear that SEPA testing will be a clear area of growth for the European market in the coming few years.

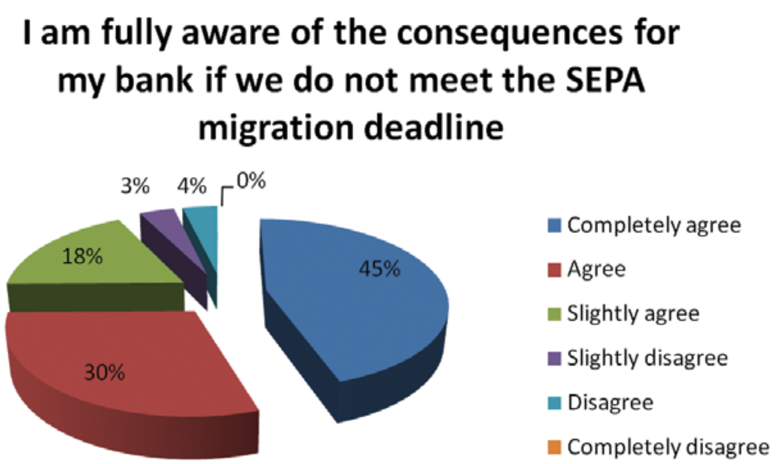
My bank's IT team is ready to take on the additional testing requirements



Section 4:
Risks and Competition in SEPA

What are the expected risks for banks as the end date approaches?

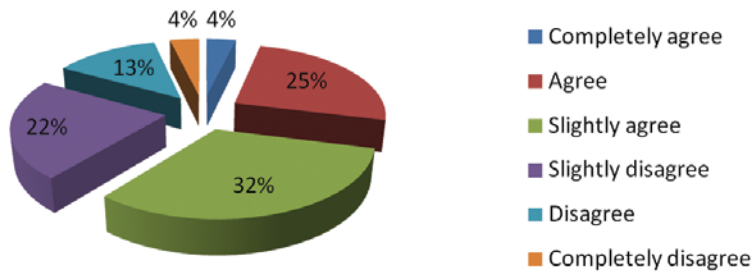
Article 11 of SMED is the first mention of the possible consequences of non-compliance with migration to SEPA. Sadly it has delegated penalties and rules for non-compliance to Member States, which essentially means that it will become a matter of national politics whether or not banks need to be ready for the end date. Member States have until 1 February 2013 to announce their rules and it is only then that banks will have a complete picture of the legal implications of non-compliance. However, as 93% of our respondents indicated, this regulatory penalty is not the major issue with non-compliance rather their inability to continue offering European payment services when other correspondent banks have already migrated fully to SEPA instruments. Indeed, once the waiver for niche products ends in 2017, there are no longer any payments that can be made within the Eurozone without using SEPA instruments – and so this becomes the true deadline for SEPA migration.



However, the cost and complication of the SEPA migration is levied almost entirely on the banks – primarily due to the fact that they are the owners of the legacy systems from which payments are being migrated. This opens the door widely for new entrants to the payments market, particularly those non-banks looking to take advantage of semi-regulation available through Payments Institution and European e-Money licenses introduced during the past few years. Already a number of notable Corporates have begun exploiting licensing to obtain card scheme membership or direct connect to clearing houses and payment mechanisms.

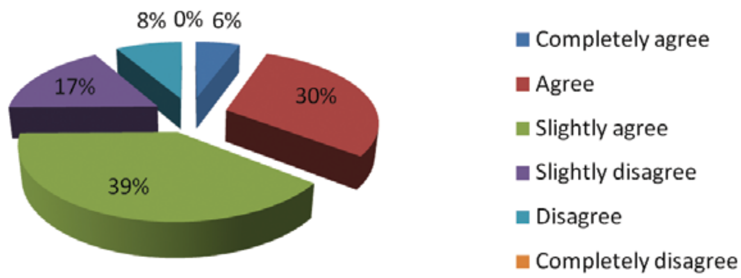
This, coupled with new third-party decoupled payment methods such as PayPal, Skrill and Facebook credits, and the breakdown of closed national markets, could see the volume of payments available to banks diminish in the coming years and change the opinion that payments are a service that must be offered by a bank. Many bankers (74%) already recognise this trend and will consequently seek to put Corporates off the idea by offering new services in this space.

I expect an increasing numbers of non-banks or payment institutions may connect directly to clearing systems and reduce payment volumes for banks

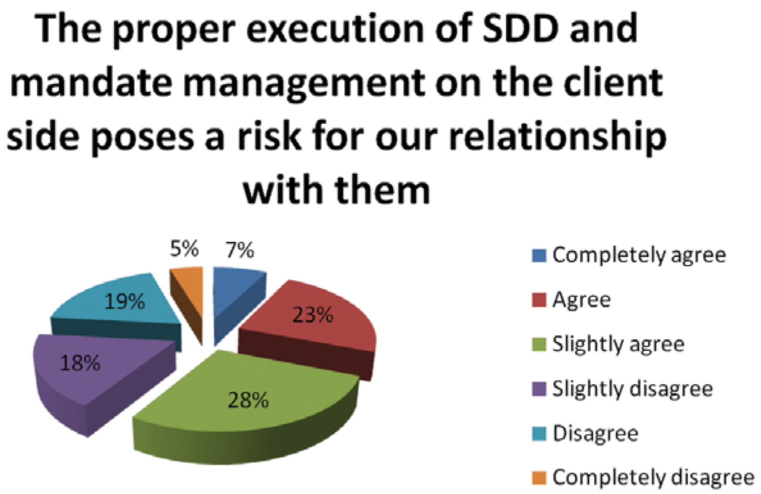


Similarly banks will no longer be able to rely on the payment volumes from Corporates that have been an important part of their business model. With a Corporate being able to initiate or receive a payment from anywhere in the SEPAzone, there will be a consequent reduction in the number of banking relationships that they need to hold. Three-quarters of respondents recognise this trend and many are already looking at how they can leverage this opportunity in a potential land-grab for Corporate payments business.

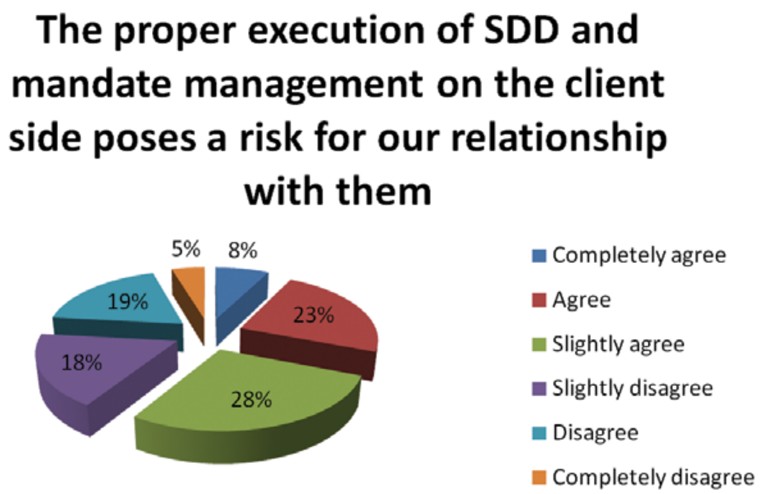
I expect our corporate customers to reduce the number of bank relationships that they hold as a result of SEPA migration



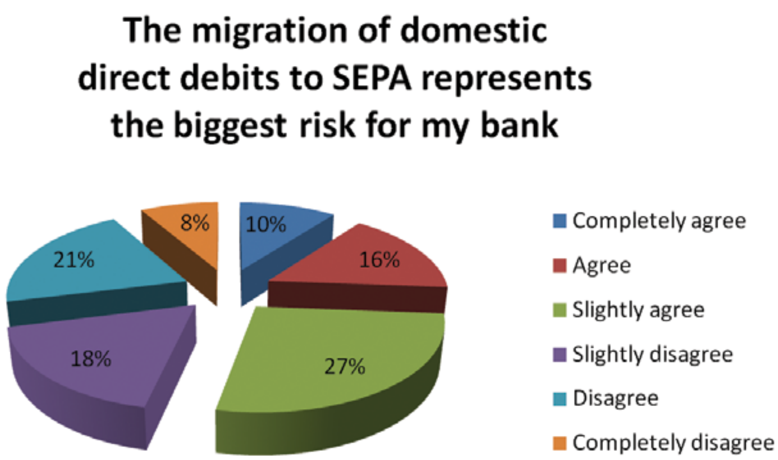
One of the major areas where banks need to make sure that they have a solution to provide or propose is in SDD mandate management. Many Corporates will now have a new responsibility thanks to SDD, and banks in former DMF markets will be at a strong disadvantage to those in existing CMF markets as this is a new area at which they need to look. With solutions providers already approaching large Corporates directly – and the most active of Chief Treasurers already looking themselves at the market, it is clear to just over half of our respondents (58%) that this creates a risk for their relationships with existing clients.



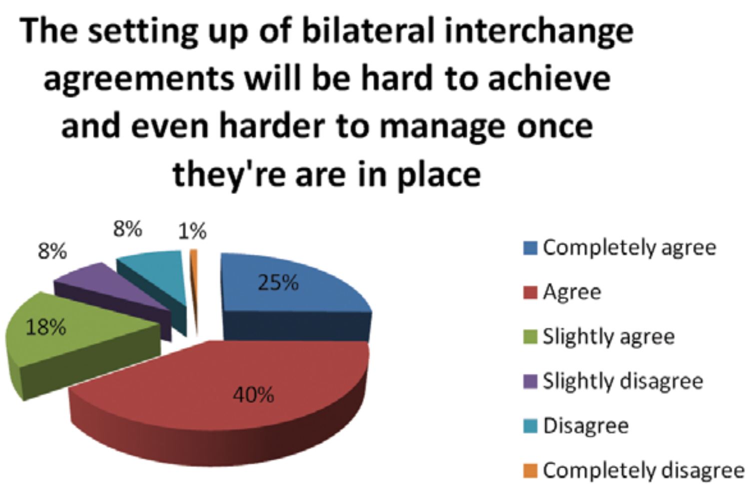
Additionally as banks will be required to support incoming files from Corporates in legacy formats beyond the deadline for their own migration, there will be a new rationale for working with Corporates to ensure that they migrate as quickly as possible to new formats. However, two-thirds of respondents believed that their bank will be able to cope with the changeover beyond the migration end date.



Further reinforcing the split between domestic DMF markets and those with CMF schemes (roughly 50:50) is analysis of the risk migrating domestic direct debit mandates towards the new scheme. Article 7 of SMED states that existing mandates remain valid, which is a huge relief for banks operating under CMF already. However, where there is a change from domestic DMF to CMF under SEPA SDD, there is a potential risk for banks. It is clear that debtor banks will need to migrate management of the mandates towards the creditor and/or their representative banks. This migration opens up a number of questions for the Corporate as both a creditor and a debtor and could be the trigger for analysis of banking relationships.



Finally, with all of this in place, SMED has removed the possibility for banks to maintain MIFs, instead offering bilateral agreements as an alternative. Given the increasing complexity of the European payments landscape, the majority of respondents (83%) believe that managing these bilateral agreements will be an exceptionally hard task – perhaps even impossible – and so will greatly impact the SEPA business model. Again, this is where deported 'three party' schemes such as PayPal can gain strong momentum as they do not have a need to look at where costs can be recouped due to control of both sides of the transaction.

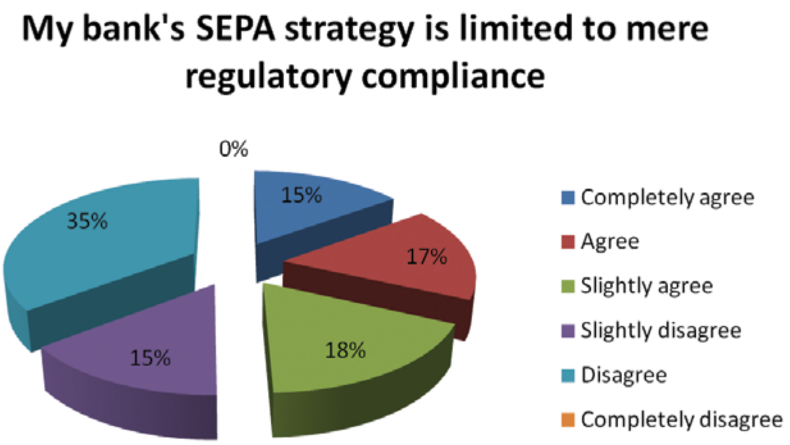


Section 5:
The Strategic Impact of SEPA Migration

Is SEPA the panacea that the European Commission expected?

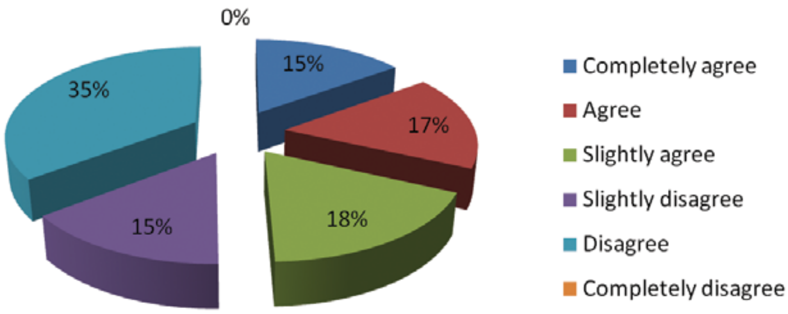
Whereas in previous sections of the survey large swathes of the respondents agreed with the sentiments expressed, in this final section there is a real polarisation of opinions. And perhaps this is rightly so as we took a look at the strategic impacts of SEPA on Europe's banks.

Only 65% of respondents believed that SMED has had a major impact on their SEPA strategy. With many banks already in the throes of SEPA migration this is understandable, but still perhaps indicates that many banks have under-estimated the impact of SMED on their ongoing payments business and do not see the incoming threat from other European banks and potential non-bank players.



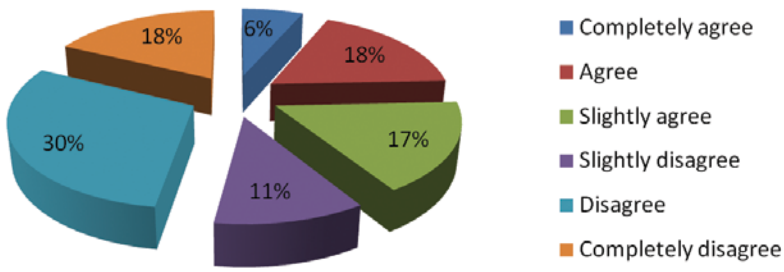
It also seems that 60% seem to be confining their strategy to mere compliance, perhaps waiting to see how the new post-SMED market shapes up before committing to capturing the new opportunities. This creates a free run at the market for those players wishing to commit to a growth strategy at this point – perhaps seeking to capture Corporate clients from less adventurous banks or looking to be still in the game once the migration shake-down has caused banks to reconsider their future in the payments market.

My bank's SEPA strategy is limited to mere regulatory compliance

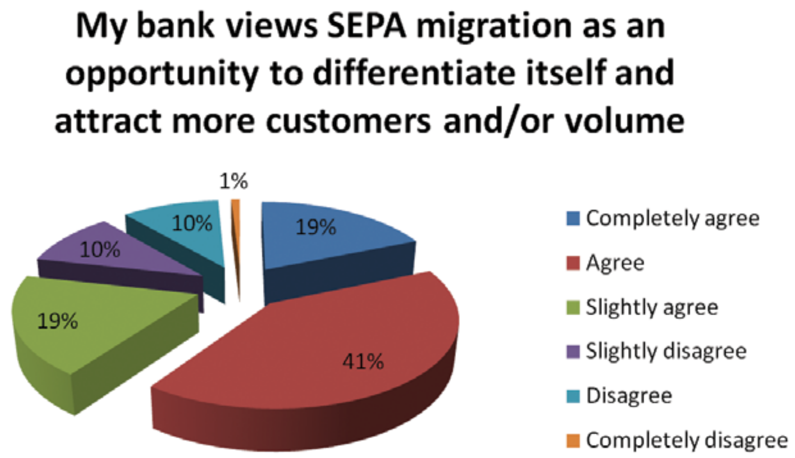


Indeed a significant percentage (31%) of respondents believe that SEPA has made them rethink whether payments are to remain part of their core banking proposition. Given that there is a well-defined lower limit where payments operations can be efficient and effective, this view is not contradictory to the growing understanding that payments operations need to be centralised within a bank.

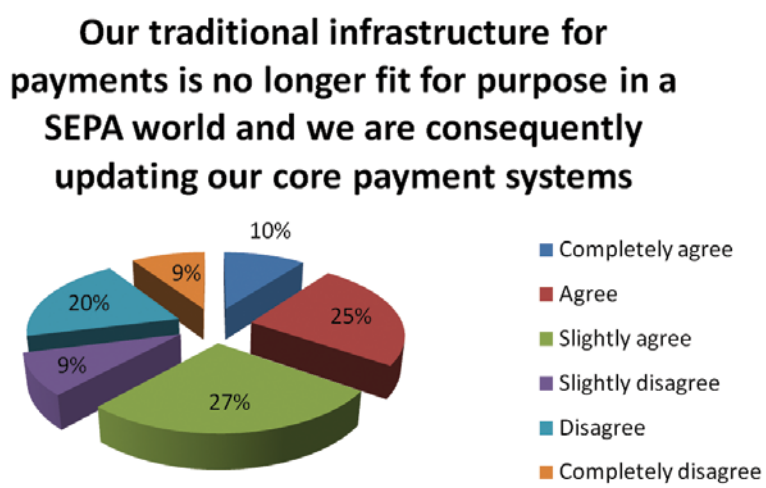
SEPA has made my bank rethink whether payments are really our core banking proposition



Core business or not however, over three-quarters of the respondents believe that their bank will look to leverage the SEPA migration as a business opportunity, seeking to attract more customers and payments volume with a view to achieving that golden lower limit and beyond. With a number of Additional Optional Services (AOS) already defined under the EPC SEPA schemes, and many innovations under development, it is clear that SEPA migration offers the opportunities to banks willing to take the risk.



One consequence of looking at the processing business of payments is that two-thirds of respondents recognise that their traditional infrastructure is not fit-for-purpose post-SMED and so the coming few years will likely be a succession of banking infrastructure upgrades. With many of these being major projects eating all of the banks resource, it is likely that nice-to-have projects will be put on the shelf until migration is complete – indeed SEPA could put European payments on hold for the next few years.



This report is the result of a survey executed by Finextra in co-operation with Clear2Pay.
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