SEPA Payments
Further challenges to come and further opportunities

How to gain competitive edge in payments in the Single Euro Payments Area (SEPA)

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With the extended implementation deadline for SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) having passed in August 2014, and the Single Euro Payments Area (SEPA) scheme now accounting for the overwhelming majority of CT and DD transactions in the Eurozone, there's a widespread assumption that SEPA harmonisation is complete. However, both for payments services providers (PSPs) and payments services users (PSUs), this is far from the truth.

In fact, there's still plenty more work to come. This partly reflects the reality that many participants have approached their initial SEPA migration primarily as a compliance project required to meet a point-in-time deadline, rather than as an opportunity to re-engineer their payments operations. It is also a function of the ongoing refinement and evolution of the SEPA scheme, with the next versions of the SCT and SDD rulebooks currently under development and scheduled to take effect from November 2015.

Against this background, a further phase of SEPA migration is now looming, focused on payments transformation—with many corporates set to take steps to consolidate their banking relationships and harmonise their processes. On the supplier side, this phase will see wider take-up of SEPA Additional Optional Services (AOS) across the ecosystem—including shorter SDD Core cycle time and e-mandates—as PSPs seek to build differentiation and win market share in a consolidating payments marketplace.

A wider impact of SEPA—one that is still unfolding—is to accelerate the global advance of the ISO XML 20022 format, which is envisaged as a worldwide standard for payment’s instructions. While there are some potential shortcomings in the way ISO20022 has been implemented under SEPA, the sheer scale of the SEPA migration means it will go a long way towards achieving not just harmonisation across Europe, but also global synchronisation around ISO20022.
SEPA migration: the current state of play

There’s a widespread assumption that migration is complete...

The migration to SEPA has proved to be a long and costly process for many banks and large corporates. As Table 1 shows, SEPA regulations began coming into force in March 2012, and the timeline is well advanced. Also, ECB figures for July 2014 indicated that 98% of credit transfer (CT) transactions in the SEPA zone were processed through the SEPA scheme, while the corresponding figure for direct debit (DD) transactions was 97%.

As a result of the percentage figures above, the widespread perception is that the migration to SEPA is complete. Many banks and corporates have closed their SEPA projects and re-allocated both human and capital resources. Taking into account the European Commission’s announcement to allow a ‘transition period’ to August 2014—widely interpreted as an extension—the proportions of transactions going through SEPA in the first half of 2014 appeared acceptable. However, this would be a misleading assumption.

Table 1. Deadlines for SEPA migration

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>31-Mar-12</td>
<td>Regulation No 260/2012 entered into force, mandating completion of migration to SCT and SDD formats by 1st February 2014 for euro states and 31st October 2016 for non-euro states</td>
</tr>
<tr>
<td>01-Nov-12</td>
<td>Cross-border transaction MIFs (multilateral interchange fees) were eliminated for direct debits.</td>
</tr>
<tr>
<td>01-Feb-14</td>
<td>SEPA migration deadline for SEPA credit transfer and SEPA direct debit within the euro area; no BIC (business identifier code) to be required for national payments.</td>
</tr>
<tr>
<td>01-Aug-14</td>
<td>End of six-month grace period for migration to SEPA instruments in the euro area.</td>
</tr>
<tr>
<td>01-Feb-16</td>
<td>No BIC to be required for cross-border payments; niche products migration complete.</td>
</tr>
<tr>
<td>31-Oct-16</td>
<td>SEPA credit transfer and SEPA direct debit deadline for non-euro area countries.</td>
</tr>
<tr>
<td>01-Feb-17</td>
<td>National transaction MIFs (multilateral interchange fees) to be eliminated for direct debits.</td>
</tr>
</tbody>
</table>
...but many SMEs have yet to migrate

So, what's the true state of play? Our experience in one full-service retail bank revealed that the top 5% of CT customers accounted for 65% of transaction volume, while the top 5% of DD customers accounted for over 90% of transaction volume. This suggests that, despite the high take-up shown by the ECB figures, the 'success story' of SEPA migration may have been inflated by large-volume corporates—and many low-volume SME customers may have yet to fully migrate to SEPA.

This is hardly surprising, given that it has been especially difficult to sell the business case for SEPA to SMEs, many of whom rarely transact cross-border, particularly with regard to Direct Debits. Their comparatively low transaction volumes and public profile has reduced their ability to voice their concerns, but SEPA remains a considerable challenge. For example, conversion services remain highly prevalent—but in order to comply with the regulations, these services must expire by February 2016. The implication is that banks who have not proactively encouraged their SME customers to fully migrate to XML have only delayed the inevitable. By February 2016 these SMEs will have to submit ISO20022 files to their banks in order to conduct SEPA transactions.

SEPA deadline extensions undermine enforcement

A further factor is that the act of extending the SEPA deadline to August 2014 had the unintended consequence of reducing the authority with which banks could urge their customers to migrate. While some SEPA zone countries—such as Belgium, Ireland and Spain—adopted shorter transition periods than the six months proposed by the European Commission, even the credibility of these dates proved unreliable.

At least one SEPA-zone country in which Accenture operates allowed the processing of legacy transactions until August 2014, despite having notified the ECB of a shorter transition period. This lack of a strong and cohesive approach to the enforcement of end-date regulation now raises questions as to how the February 2016 end date for use of conversion services and scheme derogations will be managed and enforced.

The difference between 'migrated' and 'SEPA ready'...

Meanwhile, even for the corporates and financial institutions that have migrated successfully, questions remain as to whether their SEPA projects have sought to leverage SEPA as a long-term opportunity, or have simply treated it as an imminent regulatory necessity.

Also, a number of corporates have experienced considerable difficulties in reconciling SEPA Direct Debit (SDD) unpaid transactions—an issue that is not helped by the lack of harmonisation both in how different payments service providers (PSPs) interpret the use of ISO reason codes, and also in the way unpaid transactions are communicated to the creditor and debited from the creditor account. These issues suggest that, in countries that have signed up to waivers under Article 16 of the SEPA regulations, there may be considerable work left to do in advance of the derogation end-dates of 1st February 2016.

Figure 1. National indicators for SEPA Credit Transfers, July 2014

![Graph showing national indicators for SEPA Credit Transfers, July 2014](source: ECB1. Data from banks, as % of all CTs, country break-down)

Figure 2. National indicators for SEPA Direct Debits, July 2014

![Graph showing national indicators for SEPA Direct Debits, July 2014](source: ECB2. Data from banks, as % of all CTs, country break-down)
...points to hurdles along the way to a harmonised banking union

Taken together, the flaws that have emerged in SEPA’s steady progress tend to have a common theme: they reflect a tactical and short-term approach that has resulted in delays to the full-scale implementation of ISO XML 20022. A further effect is to place barriers in the way of a fully harmonised banking union across the SEPA zone.

Although the ISO XML 20022 standards provide for a common language in which SEPA transactions are executed, the associated business and operational processes for both PSUs and PSPs remain vastly different in different geographies within the SEPA area. In addition to officially recognised Additional Optional Services (AOS—see information panel), each jurisdiction has developed its own interpretation of the SEPA Scheme Rules. These varying interpretations by national authorities mean, for example, that a mandate authorised over the telephone or online may be acceptable in some jurisdictions but deemed insufficient in others. The guidelines produced in different jurisdictions also vary in how they balance strict adherence to the SEPA Rulebooks with a more ‘common sense’ or ‘practical’ approach. A practical approach is clearly more flexible for consumers and corporate clients, but banks and corporates have remained confused as to whether such decisions can be deemed compliant.

Although relatively minor in themselves, these inconsistencies are complicating the efforts being made by some corporates to consolidate their banking relationships or expand to new territories. Further confusion is being added by the lack of a structured forum of communication within which the relevant industry bodies or PSPs from each jurisdiction can relay queries or information.

Solving these issues is not just a matter of formulating coherent guidelines within countries. On a national level PSPs have developed efficient means of inter-bank communication in the event of any problems arising with their core banking systems or the processing of a particular transaction. In some cases these PSPs have agreed on SLAs that apply to their responses to these communications. However, if an issue arises with a similar transaction between—for example—a PSP in Spain and a PSP in Italy, a resolution relying on the issuing of SWIFT messages is likely to be slower and more cumbersome.

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**SEPA optional features**

The SEPA Direct Debit (SDD) Core Rulebook provides PSPs participating in the scheme with the opportunity to offer one or more of three optional scheme features. These are:

**Shorter SDD Core time cycle (COR1)**

Under the standard time cycle, the debtor bank must receive the request for a first or one-off DD collection at least five business days prior to the due date. For subsequent DD collections, this falls to at least two business days. The SDD Core Rulebook offers the possibility of using a shorter time cycle for both first (or one-off) and recurrent DD payments, by allowing the creditor bank to send the payments to the debtor bank at the latest one inter-bank business day prior to the due date.

**Electronic mandate (e-mandate)**

The SDD Core Scheme includes the option to issue a mandate electronically, with the debtor bank validating the e-mandates issued by a payer wishing to make payments by SDD either itself or through a validation service.

**Advance mandate information (AMI)**

This optional feature enables the debtor bank to widen its mandate management options, allowing—for example—more time for the debtor bank to validate whether a payer authorised a DD collection.
As we have highlighted, there are still many challenges to be faced. However, the fact remains that SEPA does offer an immense opportunity for the harmonisation of payments infrastructure across the Eurozone’s member states. The SEPA ‘principle of equal charges’, under which PSPs must apply the same charges for comparable cross-border and domestic payments in euro and within the SEPA zone, provides clear and obvious benefits for companies doing business in the 34 SEPA countries.

Similarly, the abolition of transaction multilateral interchange fees (MIFs) for cross-border direct debits further strengthens SEPA’s ability to grow competition, not just for corporates but PSPs as well. Ironically, the abolition of transaction MIFs for national direct debits will not be enforced by regulation until 1st February 2017, underlining the focus on cross-border transactions.

All these advances mean PSPs are now in a position to market their services on a European level, with the result that corporates now have an unprecedented level of choice when it comes to selecting their banking partners. This in turn opens the way to two further trends for financial services industry in Europe: consolidation of banking organisations and services, and enhancements through implementation of optional SEPA services.

**Trend 1: Industry and service consolidation**

Once the dust settles on the SEPA migration and corporates are confident that the outstanding issues have been resolved, we are likely to see increased levels of banking consolidation and ‘payment-on-behalf-of’ (POBO) structures. These POBO structures enable large corporates to rationalise all their accounting and payment functions for multiple subsidiaries or departments to a governing or holding entity operating a single bank account.

A common concern with these structures is that the name of the payer—the POBO entity—often bears no relation to the company with which the beneficiary originally did business. This mismatch can cause confusion for the beneficiary’s accounts receivable and reconciliation functions. However, the SEPA Credit Transfer ISO 20022 PAIN.001 file addresses this concern, by providing the option to include details of the ‘ultimate’ payer and transmit these with the payment. These end-to-end transaction details—along with detailed unpaid reason codes—can enhance the efficiency of reconciliation and enable unpaid items to be identified and rectified with greater speed.

As a result, SEPA will enable corporates both to refine their payments processes, and also to take advantage of increased competition and scale to reduce their banking fees. At the same time, increased competition between PSPs will drive price convergence and a need for greater efficiencies, innovation and market differentiation.

**Trend 2: Enhancement through optional services**

Given the scale of change required for SEPA compliance, it is understandable that many financial institutions chose to initially focus on the core requirements and non-optional elements. However, now that significant progress has been made many banks are looking towards implementation of those additional optional services (AOS) which would provide the greatest benefit to end users.

At the time of writing, only three countries are operating the COR1 optional element of the SEPA Direct Debit scheme. Under COR1, direct debit transactions can be submitted through central clearing on the day before collection is due, regardless of whether the collection is a one-off, first or a recurrent collection in a series. This is in contrast to the advance submission requirement of five days for one-off or first collections, and two days for recurrent collections in the standard core direct debit scheme. This difference is significant for corporates, as the COR1 option offers them greater agility and tighter control over their cash flows. However, realising these benefits depends on the ability of both the creditor and debtor bank to receive and process the payment in a much shorter time period.

The Direct Debit B2B scheme is a further option where take-up is not fully complete. At the time of writing, it is supported by only 88% of the financial institutions registered as SEPA-ready participants in the Direct Debit Core scheme. As with the COR1 option, the B2B scheme brings major benefits for corporate customers. As a result, it is a service that all financial institutions must work towards implementing, or risk losing their customers to more advanced competitors across the SEPA zone.

A further option yet to be fully leveraged is the use of e-mandates to automate the entire end-to-end processing and management of SEPA DD mandates. E-mandates also enable the use of SEPA direct debit instruments in e-commerce transactions, such as online subscription-based services. Although some countries have their own solutions for this need, such as iDeal in the Netherlands, a pan-European consensus on the use and processing of e-mandates has yet to be reached. The catalyst for achieving this is likely to be services such as MyBank, the e-mandate solution developed by EBA Clearing, which is due to be launched in late 2014.
ISO20022 implementation under SEPA: some lessons to learn

The ISO20022 standard has long been anticipated as a mechanism to facilitate straight through processing via a globally accepted communications standard—and the implementation of ISO20022 as part of the SEPA programme has enforced the uptake of the standard across Europe.

The SEPA migration has effectively acted as a test-case for large-scale synchronised implementation of ISO20022, and will help to drive further development of the standard across the globe. Already, ISO20022 has been adopted in various countries outside Europe including Japan, Qatar and Egypt, with implementations being planned for Malaysia (2015), Canada (2020) & Australia (2017).

Building on the growing uptake of the standard, it is likely that regulators will now look to extend its usage to other financial communications, in an effort to achieve the straight through processing and interoperability that ISO20022 advocates envisage. Partly as a result, additional ISO20022 messages are likely to grow in popularity in the near future, including usage of ISO20022 for electronic bank account management (eBAM), eInvoicing, bank services billing (BSB) and liquidity reporting.

**IBAN versus BIC**

A concern that some PSPs are now starting to focus on is the SEPA ‘IBAN–only’ rule, which specifies that PSUs do not have to provide their PSP with the Business Identifier Code (BIC) of their payee/debtor when initiating a Credit Transfer or Direct Debit transaction. This rule is already in force for national transactions as from 1st February 2014 (although derogations allow for extension until 1st February 2016) and will also apply to cross-border transactions from 1st February 2016.

Although the originator of a transaction is not obliged to provide their PSP with the BIC of the account to be credited/debited, the PSP will still be required to indicate the BIC within their interbank communications. Consequently, PSPs must have the ability to either derive the correct BIC or obtain the BIC from a central repository. In response, the EPC has recommended that the NCB/issuing authority of each of the 34 SEPA countries be responsible for maintaining lists of national sort code/BIC tables to support BIC conversion services. Additionally, SWIFT now offers subscription services (IBAN Plus & SEPA Plus) which allow banks or corporate users to validate IBANs and to derive the associated BIC. SWIFT claims that the data-quality levels are currently in the region of 99%, with a target of 100% in 2015 as further input is obtained from financial instructions and national authorities.

Regardless of these services, the potential effort involved in retrieving BIC details for SCT or SDD transactions represents a challenge for many PSPs, particularly those of a small scale. A potential exception to the rule, as defined in the SEPA Regulation, is that PSUs may request a BIC from their SCT payee or SDD debtor, but “only where necessary”. While this exception is vague, it could be interpreted as being applicable to cases where the originators PSP is unable to convert or derive the required BIC.
Ongoing refinement and clarification...

With the next versions of the SCT and SDD rulebooks currently under development and scheduled to take effect from November 2015, there will be continuing refinement and clarification of the SEPA scheme. To date, the SEPA rulebooks and regulation have allowed for a high degree of flexibility across the EU payments market, encompassing business guidelines, national variations, AOS and exemptions/derogations. The ongoing updates to the SEPA rulebooks reflect the scheme’s flexible and dynamic nature—characteristics that can sometimes be at odds with the drive for harmonisation.

Going forward, developments will be increasingly guided by the Euro Retail Payments Board (ERPB), which held its first meeting in May 2014. The members agreed to set up two working groups with immediate effect, composed of stakeholders from the supply and demand side—the first on post-migration issues relating to the SEPA CT and SEPA DD schemes, and the second on pan-European electronic mandate solutions for SEPA direct debits. Additional working groups focusing on mobile and innovative payments are to be investigated, and will likely help frame the development of regulation and supporting structures for SEPA direct debits. As the SEPA scheme evolves, there are many options to be examined and questions to be addressed, both for regulators and banks. For example, will the current AOS be moved to mandatory status, in order to drive cohesive development of services to the ultimate benefit of users? And with niche products needing to be standardised and phased out, will the SEPA rulebooks be extended to include all transactions denominated in euro?

Furthermore, the potential to integrate e-invoicing with payment processing could open up opportunity for new services provided by PSPs. Meanwhile, a potential legal issue is that member states’ tax or social security legislation may require companies or individuals to hold a national euro account, thus limiting the potential for cross-border competition.

As SEPA beds in, a new phase is now in prospect during which corporates will move to realise the full benefits of SEPA. This is likely to see companies pursuing fundamental finance transformation through initiatives such as consolidating their payments processing with selected suppliers and creating shared-service payments factories—whether in-house or outsourced—to maximise efficiency, visibility and standardisation.

Non-euro SEPA countries: benefiting from a later end-date

The countries that fall within SEPA for euro transactions but are not within the Eurozone, such as the UK, are permitted to continue conducting domestic euro-denominated transactions using non-SEPA compliant formats until 31 October 2016. After that date, SEPA formats will be mandatory. The IBAN only rule will also apply from February 2016 for cross border SEPA transactions.

The October 2016 compliance deadline for non-euro SEPA countries is well after the new SEPA rulebooks come into effect in November 2015, following widespread stakeholder and participant feedback from May to August 2014. It is also likely that pan-European e-mandate solutions will be in wider use by October 2016, alongside other developments. Furthermore, the SEPA governance model will have evolved further, including the bedding-in of the Euro Retail Payments Board.

Since the bulk of euro-denominated transactions originating from the UK are international transactions, it is unsurprising that the UK has already migrated to take advantage of SEPA. While many of the other non-euro countries that fall within SEPA already have SEPA implementation under way to various extents, their later end-date gives them an opportunity to learn lessons from implementations elsewhere, and provide the benefit of being able to move directly onto a more advanced iteration of the SEPA scheme rules.
SEPA is not over...

SEPA has created a complex international payments ecosystem in which all the challenges and opportunities have yet to be fully identified. Meanwhile, obstacles still stand in the way of full SEPA migration and the harmonisation of the European payments market. However, opportunities also exist to leverage the investment already committed in SEPA programmes to drive further competition, process automation and the ease of monetary movement within and across the EU’s member states.

Overall, what’s clear is that the change and disruption driven by SEPA is far from over. For example, SEPA migration compliance has highlighted to many banks with legacy payment systems that those legacy systems are expensive to maintain, especially since changes have to be duplicated in multiple places to ensure compliance. As a result, SEPA has prompted some banks to investigate replacing their legacy systems, through consolidation onto a single new platform, or even outsourcing. In addition, banks have begun to question how best to take advantage of the standardisation which SEPA and ISO20022 messaging has delivered. Consequently, more banks are now looking to provide automated cash management services to corporates via XML files, online SDD mandate management and so on.

SEPA itself will continue to evolve as the existing scheme is refined and improved and as new disruptions in the payments industry are addressed. And participants on both the supply and demand sides will need to sustain their focus and investment around SEPA to keep pace.

...and other change drivers will continue

Furthermore, the European Payment Services Directive (PSD) II is on the horizon, and this will drive a need for additional changes. For example, the current drafts of PSD II include a modification of the rules surrounding refunds for unauthorised transactions.

The changes in prospect do not end there. The migration to real-time payments is a global trend that is gaining momentum—and this could be a further consideration for SEPA in the future, as real-time SEPA payments come onto the agenda. Also, with the advent of SEPA, corporate cash management services are becoming more competitive and more commoditised, meaning banks are having to focus on service quality and differentiated services to stay competitive and retain corporate customers. One area that was widely neglected during SEPA migration is international payments, and this is becoming a key competitive battleground in the struggle to retain and acquire corporate customers—especially as globalisation continues and the global economy recovers.

As all these developments and further change drivers come down the line, both PSPs and corporates must ensure that their responses are strategic rather than reactive. This means that modifications must no longer be applied as peripheral tweaks but fully integrated into core systems, business processes and customer offerings. To achieve this, banks and corporates will need to move away from a series of discrete, tactical compliance projects, and instead adopt an ongoing, joined-up and forward-thinking approach to SEPA.
SEPA has not been a mere regulatory obligation. It has already fundamentally changed the payments landscape across 34 countries—and more is yet to come.

As SEPA continues to bed in and evolve, and as corporates look to harness its full potential benefits, banks have the opportunity to put themselves ahead of the competition by providing the efficient, comprehensive and responsive services that users are seeking. As businesses move to consolidate their payments with a smaller number of chosen suppliers, those PSPs with a clear competitive edge will pull away from the rest.

The race to harness the full opportunities of SEPA is on—and those banks that move now with certainty and pace will be best placed to win out.
Contact us

To find out how Accenture can help your bank succeed in the SEPA environment of the future, please contact:

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Notes

1 http://www.ecb.europa.eu
2 http://www.ecb.europa.eu

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