THE SINGLE EURO PAYMENTS AREA (SEPA) – THE PAN – EUROPEAN MARKET FOR THE EUROPEAN INTEGRATION

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1. The formal launch of SEPA payment instruments by EU banks

On the 28th January 2008 SEPA (the Single Euro Payments Area) went live and European banks will formally launch the first SEPA payment instrument, for credit transfers. This marks the first step in a migration process over the next few years during which customers will move in a market-led process from existing national electronic payment instruments to the new SEPA instruments. This is a logical extension to the introduction of the euro and will produce substantial benefits through a more competitive and efficient payments market.

SEPA is the new Single Euro Payments Area that enables people to make payments throughout the euro area as quickly, safely and easily as they make national payments. In SEPA, all euro payments are considered domestic and are made with one set of payment instruments. SEPA is thus a natural progression to the introduction of the euro and another major step in realising the full potential of the single market for Europe. SEPA payments can also be used for euro payments within the EU outside the euro area, as well as in a number of neighbouring countries.

The European Central Bank (ECB) and the European Commission (EC) acknowledge the substantial preparatory work undertaken by European banks, under the aegis of the European Payments Council, to create SEPA. Today therefore marks an important milestone in the SEPA migration process with the official launch of the SEPA payment instrument for credit transfers. For technical and legal reasons, the launch of the SEPA payment instrument for direct debits will take place subsequently, but should occur no later than 1 November 2009. For card payments the SEPA Cards Framework has been in force since 1 January 2008.

SEPA will make a significant contribution to the Lisbon agenda. It will improve the efficiency of EU payments markets and stimulate innovation, thereby increasing the competitiveness of the European economy. In the public sector, SEPA could be used as a platform to drive e-Government, thus contributing to the efficient delivery of public services.

SEPA will create huge benefits, as shown by two studies by the ECB and the EC. In particular, the study carried out by the EC shows that the potential benefits from SEPA in payments markets alone could exceed €123 billion over the next six years, and a further €238 billion if SEPA can be used as a platform for electronic invoicing.

The two studies also show that the process of SEPA migration will be a challenge, especially for banks. According to the ECB study, banks may significantly reduce their costs, but will face increased competition. SEPA will also offer banks an opportunity to market new, value-added services related to the payment chain. Therefore, the ECB and the EC call on banks to maintain momentum in the SEPA process so that users can migrate quickly in a market-led process to the new SEPA payment instruments and the costs of dual payments (i.e. existing national payment instruments plus the new SEPA standards) can be kept to the minimum. This also calls for the rapid launch of the new SEPA payment instrument for direct debits and the full adoption of the SEPA Cards Framework by relevant stakeholders.

As heavy users of payment instruments, corporates and public administrations stand to gain substantially from the efficiencies made possible by SEPA. They should therefore play an important role in the success of SEPA by being early adopters of SEPA instruments in a market-driven process avoiding deterioration in the price and performance characteristics compared with existing national payment instruments.

2. The characteristics of the SEPA project

The main objective of the SEPA is to harmonise the way we make and process payments. SEPA will enable customers to make cashless euro payments to anyone located anywhere in the euro area using only a single bank account and a single set of payment instruments. The main work is done by the banking industry under the leadership of the EPC. Standards and practices of payments have so far been organised differently in almost every country in the euro area. Banks are competitors in the separate markets. Now they work together and are re-organising the way euro payments are made and processed. The SEPA requieres are the following, namely:

- the single currency;
- a single set of euro payment instruments – credit transfers, direct debits and card payments;
- common technical standards and business practices;
- efficient processing infrastructures for euro payments;
- one harmonised legal basis;
- the ongoing development of new customer – oriented services.

SEPA will turn the fragmented national markets for euro payments into a single domestic one. This will increase business opportunities and competition among providers of payment services. It will bring down prices for customers and raise the quality of services. Customers will finally benefit from the single currency for cashless payments, too.

For the Eurosystem, SEPA means the full implementation of the single currency. For the European Commission it is important for complementing the Single Market. SEPA is therefore an important step in European integration.

The involved parties of the SEPA are:

- providers of services and infrastructures;
- users;
- public authorities.

Providers of services and infrastructures

The *European banking industry* is in charge of the project. In 2002 it established the *"European Payments Council" (EPC)*. The EPC has developed the building blocks for SEPA. It is a self-regulatory body comprising more than 65 European banks, including the three European credit sector associations and the *"Euro Banking Association" (EBA).* Besides the EU countries Iceland, Liechtenstein, Norway and Switzerland are also represented.

The *European clearing and settlement industry* process SEPA payments. They have to ensure that anyone in the euro area can be reached. They must therefore comply with the rules defined by the EPC. The European clearing houses have organised themselves in the *"European Automated Clearing House Association" (EACHA)*. EACHA is developing procedures to ensure that in the future all infrastructures will be interoperable.

A number of *European companies* have joined forces in the *"European Associations of Corporate Treasurers" (EACT)*. These companies have euro-wide business and a strong interest in SEPA. The EACT is involved in developing standards for services which will reduce manual intervention in the handling of payments. These services include e-invoicing and e-reconciliation. The aim is automated processing ("end-to-end straight-through processing" - e2e STP) which will substantially reduce the costs of making and receiving payments.

Users

Governments and public administrations are a key user group. They make both national and cross-border payments. Such payments are related for example, to pensions, social security and taxation. *Companies* - especially if they have business across the euro area - and *consumers* in the euro area are another key user group which makes and receives euro retail payments.

Public authorities

The *Eurosystem* comprises the ECB and the national central banks of the euro area. According to the Treaty establishing the European Community, the Eurosystem has the task of promoting the smooth operation of payment systems and of safeguarding financial stability. SEPA is important for fulfilling this task. But payment services are offered in a private, open market. Therefore the Eurosystem would like the market to coordinate itself. The Eurosystem is *actively supporting SEPA*.

The *European Commission* has created the legal framework for SEPA with the *Payment Services Directive (PSD).* SEPA is important for the *Single Market.* The Single Market was created by the EU. In some areas it still needs to be completed. Retail payments are one example.

3. Terms of reference for the SEPA – compliance of infrastructures

The Eurosystem supports the creation of the Single Euro Payments Area (SEPA), which will enable retail payments in euro to be made throughout the euro area under the same basic conditions from a single account, regardless of its location. Infrastructures play an important role in achieving the objectives of SEPA. Acting as a catalyst, the Eurosystem has therefore defined four criteria that infrastructures should fulfil in order to be considered SEPA-compliant in the view of the Eurosystem. Compliance with these requirements should be assessed by the infrastructure providers themselves. The criteria were published in the 5th Progress Report on SEPA and represent the Eurosystem's long-term vision for the processing of payments, interoperability among infrastructures, sending and receiving capacity and choice for banks. The Eurosystem foresees that relevant infrastructures in the euro area will gradually develop towards compliance with all four criteria, but neither expects nor requires all infrastructures to do so.

Infrastructure providers that offer interbank funds transfer systems to banks and that intend to become SEPA-compliant in accordance with these criteria should publish self-assessments to demonstrate their compliance. The Eurosystem does not expect entities to undertake self-assessment if they offer this service in a limited scope only (i.e. an intra-bank and/or intra-group clearing and settlement arrangement, typically where both the originator/creditor and beneficiary/debtor have their accounts within the same bank or group), or if SEPA-compliance by infrastructures is not relevant (i.e. in the case of a form of purely bilateral non-structured clearing and settlement, such as correspondent banks).

To achieve the desired transparency, the Eurosystem expects major infrastructure providers aiming to meet the SEPA compliance criteria to conduct self-assessments on a regular basis and make them publicly available. The terms of reference provide guidance for this purpose, namely:

Criterion 1 – Processing capabilities.

To promote the SEPA–compliance of infrastructures, infrastructures are asked to comply with the requirements of the PEACH/CSM Framework, the SCT Rulebook and/or the SDD Rulebook(s), the Implementation Guidelines and the associated UNIFI (ISO 20022) XML standards, and to be ready to support scheme testing as planned by the EPC.

Criterion 2 – Interoperability

To promote the SEPA–compliance of infrastructures, infrastructures are asked to adopt interoperability rules, i.e. interface specifications and business procedures for the exchange of SEPA credit transfers and SEPA direct debit payment orders between banks and infrastructures, and between infrastructures, that are preferably mutually agreed upon by the relevant CSMs, and undertake to establish a link with any other infrastructure upon request, based on the principle that the cost for establishing the link is borne by the requesting infrastructure.

Criterion 3 – Reachability

To promote the SEPA–compliance of infrastructures, infrastructures are asked to be able to send or receive euro payments to and from all banks in the euro area, either directly or indirectly through intermediary banks, or through links between infrastructures (in other words, to provide full reachability).

Criterion 4 – Choice for banks

To promote the SEPA–compliance of infrastructures, infrastructures are asked to enable financial institutions to make infrastructure choices based on service and price, and therefore not to apply undue access restrictions, nor to set obligations for users to process certain types of payment in a specific infrastructure, or via specific proprietary standards, nor to impose participation obligations on users of other infrastructures, and to ensure full transparency of services and pricing.

4. SEPA payment instruments

'Payment instruments' is the umbrella term for means of payment. In SEPA, the three most important will be harmonised across the euro area. In addition, the handling of cash will be harmonised, too.

- Credit transfers
- Direct debit
- Card payments
- Cash

Credit transfers

The SEPA credit transfers (SCT) scheme defines common rules and processes for credit transfers in euro between banks (also called "interbank payment scheme"). The scheme defines a common service level and the maximum time frame for processing credit transfers. Banks must adhere to these minimum requirements.

Features

- SEPA-wide reachability - any customer can be reached.
- The full amount is credited. Any fees should be charged separately to

make it more transparent for the consumer.

- No limit on the value of the payment.
- Maximum settlement time is three business days (as from january 2012 a payment must be credited to the receiver at the lastest by the end of the next business day (D+1). This is laid down in the Payment Services Directive (PSD)).
- IBAN and BIC are used as account identifiers
- Rules for handling rejected and returned payments
- Credit transfer scheme is separated from the processing infrastructure

Direct debit

The SEPA direct debit (SDD) scheme defines common rules and procedures for direct debits in euro between banks (an "interbank payment scheme"). As is the case for credit transfers the scheme defines a certain service level and maximum time frame under which banks must be able to process the payment.

Features

- SEPA-wide reachability - direct debits can be made to any receiver.
- Covers both recurrent and one-off payments in euro.
- Maximum settlement time is five business days for the first payment and two business days for recurrent ones.
- IBAN and BIC are used as account identifiers.
- Rules for handling rejected and returned payments.
- Direct debit scheme is separated from the processing infrastructure.
- A special business-to-business (B2B) direct debit scheme is also being developed.

Card payments

The EPC has developed a set of high-level principles for SEPA card payments. Issuers, acquirers, card schemes and operators will have to adapt to them. The principles are referred to as the SEPA card framework (SCF).

Features

- Cardholders can pay with one card all over the euro area.
- Merchants will be able to accept all SEPA cards from a single terminal.
- Payment card processors will be able to compete with each other and to offer their services throughout the euro area. This will make the market for processing card payments more competitive, reliable and cost-efficient.

Cash

The smooth operation of payment systems requires a mix of payment instruments including cash. The Single Euro Cash Area (SECA) is already a reality from a consumer perspective. In order to create SECA also for professional cash handlers, the ECB has agreed on a number of measures with a view to contributing to a fair competitive environment regarding the Eurosystem's cash services.

These measures affect in particular the banking industry and cash-in-transit companies. In the euro area only the ECB has the right to authorise the issue of banknotes. The national central banks (NCBs) of the euro area put them into circulation by providing them to the banking sector. Banknotes are mainly distributed to the public via ATMs.

In February 2007, the Governing Council of the ECB approved the timetable and a roadmap for more convergence of national central bank (NCB) cash services in the medium term. The objective is to allow the different stakeholders (for example banks, cash-in-transit industry, retailers) - in particular those with a lot of cross-border cash activities - to benefit fully from the common currency (in all euro area countries) and to achieve a fair competitive environment.

5. Conclusions

The Eurosystem promotes "the smooth operation of payment systems". SEPA will contribute to that because it will harmonise the way we pay cashless. That is why the Eurosystem has a strong interest in SEPA. To minimise interference with the free, private market for payment services, the Eurosystem does not act as a key player. It offers its support but prefers the market to organise and complete the harmonisation by itself as much as possible.

"The Commission and the ECB see SEPA as an integrated market for payment services which is subject to effective competition and where there is no distinction between cross-border and national payments within the euro area. This calls for the removal of all technical, legal and commercial barriers between the current national payment markets" (European Comision and ECB, 2006).

Since 2002, euro banknotes and coins have been used everywhere in the euro area, regardless of national borders. The same should apply to cashless payments. SEPA will achieve this. Therefore, the Eurosystem wants SEPA. SEPA will complete the introduction of the euro as the single currency of the euro area. This in turn will help the economy to exploit the full benefits of the single market.

The Eurosystem does not see SEPA as a 'one-shot' operation. SEPA is the new retail payment market in the euro area. It will constantly evolve with new technological developments and innovations. The first step, the realisation of SEPA itself, concerns the bank-to-bank domain. Once the SEPA components are in place, the next step will focus on the customer-to-banks domain and the development of SEPA-wide value-added services. These services will make life even easier for customers and banks, as paper is eliminated from the payment process and end-to-end straight-through processing (STP) achieved. This next step is called "***eSEPA***".

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