

The logo for Sungard, consisting of the word "SUNGARD" in a bold, white, sans-serif font on a black rectangular background.

SEPA: An Essential Guide for
Corporate Treasurers

THE SINGLE EURO
PAYMENTS AREA
(SEPA):

AN ESSENTIAL GUIDE
FOR CORPORATE
TREASURERS

INTRODUCTION

The Single Euro Payments Area (SEPA) has featured prominently in the financial media over the past year, and since its official launch in January 2008, SEPA will continue to gain in momentum and will affect every corporation, of every size, with business in the eurozone. But what is SEPA, what benefits does it bring for non-financial corporations and what does it mean in practice? In this Guide, we bring you key facts on SEPA, its implications and how to take advantage of the new opportunities which it provides.

Like any financial initiative, SEPA is riddled with acronyms – we have tried to explain each one during the course of this Guide, and there is a Glossary at the end for your reference.

KEY FACTS ON SEPA

WHAT IS SEPA?

The introduction of the Euro in 1999 made many aspects of European financial management more straightforward. From a consumer point of view, it meant that the same notes and coins could be used anywhere in the eurozone; from a corporate perspective, foreign exchange implications were eliminated. However, in practice the benefits have not extended far beyond this. In particular, while the Euro is the common currency, transactions across different eurozone countries are still treated as cross-border transactions, and domestic payment instruments in each country remain very diverse. The Single Euro Payments Area (SEPA) was first announced by the European Payments Council (EPC) in 2002 soon after Euro notes and coins were first introduced, as a means of achieving a single market in payment services.

The implementation of a single payments area is, in many ways, more complex than the introduction of a single currency, as payments instruments, clearing mechanisms and the legislation to support the payments process need to be harmonised across all countries. Although all eurozone countries are committed to SEPA, each one has a different background in terms of payments culture and instruments, legislation and domestic clearing arrangements. Furthermore, with 310 million citizens, 16-18 million companies and 8,000 banks affected, although SEPA has now been officially launched, the migration will be a gradual process and full migration is likely to take many years.

PAYMENT INSTRUMENTS

One of the key elements of SEPA is the introduction of new, pan-European payments instruments. There are four types of payment (fig 1) below, as follows:



CREDIT TRANSFERS

The SEPA Credit transfer (SCT) was the first instrument to “go live” on 28 January 2008. The new instrument definition includes rules, procedures and timeframes for processing credit transfers, with features including:

- Applicable across the eurozone;
 - Full amount must be credited to the customer account, with fees charged separately;
 - Maximum settlement time of three business days initially (T+3), reducing to T+1 by January 2012. Banks may choose to process SCTs more quickly if they wish;
 - IBAN (Interbank Account Numbers) and BIC (Bank Identifier Codes) are mandatory account identifiers;
 - Standard rules apply for handling rejected and returned payments;
 - The Credit transfer scheme is developed independently of a specific processing infrastructure (as opposed to domestic clearing houses).
- This means that any infrastructure provider/clearing house can process SCTs on behalf of any bank in the eurozone (known as a Pan-European Automated Clearing House or PE-ACH) to encourage choice, competition and efficiency in payments processing.

DIRECT DEBITS

SEPA direct debits (SDD) have proved controversial due to the significant differences which exist across eurozone countries both in their adoption of direct debits and the way in which domestic direct debit schemes operate today. One of the outcomes of this debate has been a delay on the final definition and introduction of the SDD, which although originally anticipated for launch in January 2008, has now been postponed to November 2009. Although still subject to change, some of the features of the SDD include:

- Applicable across the eurozone;
- One-off or recurrent direct debits, with the same legal status;
- IBAN and BIC are mandatory account identifiers;
- Direct debit mandate can be a manual or electronic, including support for an electronic signature;
- Direct debit mandate to be retained by creditor bank both while valid and after expiry/cancellation;
- Debtor and the debtor bank has the right to reject a direct debit;
- Debtor is entitled to a refund from his bank, which can also claim a refund from the creditor bank. Disputes are resolved between the debtor and creditor directly;
- A direct debit mandate which has not been used for 18 months must be cancelled by the creditor;
- Maximum settlement time is five business days for one-off direct debits and two days for recurring direct debits;
- Rules for handling rejected and returned payments;
- The Direct debit scheme is developed independently of a specific processing infrastructure, as with Credit transfers;

In addition to retail direct debits, a business-to-business (B2B) direct debit scheme is also being developed.

The implementation of a single payments area is, in many ways, more complex than the introduction of a single currency, as payments instruments, clearing mechanisms and the legislation to support the payments process need to be harmonised across all countries. Although all eurozone countries are committed to SEPA, each one has a different background in terms of payments culture and instruments, legislation and domestic clearing arrangements. Furthermore, with 310 million citizens, 16-18 million companies and 8,000 banks affected, although SEPA has now been officially launched, the migration will be a gradual process and full migration is likely to take many years.

CARDS

Both debit and credit cards will be affected by SEPA with a new framework (the SEPA card framework – SCF) to which issuers, acquirers, card schemes and operators will have to adapt. Features of the SCF include:

- All SEPA debit and credit cards will be valid across all other eurozone countries;
- Merchants will be able to accept all SEPA cards from a single terminal;
- Payment card processors will be able to operate in any eurozone country;
- Credit/debit card fees will be the same in any eurozone country.

CASH

While the Single Euro Cash Area (SECA) has been in operation since 2002, the ECB approved a roadmap and timetable of changes to the Eurosystem's cash services in February 2007 which will affect the banking industry, retailers and cash-in-transit companies.

LEGAL BASIS FOR SEPA

With different legislation for payments in each of the eurozone countries, SEPA can only truly exist if legislative frameworks are harmonized. The Payment Services Directive (PSD) was adopted in November 2007 and must be incorporated into national law by November 2009. Note that all European Union countries, including those which have not adopted the Euro, such as the United Kingdom, are subject to the PSD.

The PSD covers three areas:

- Market access requirements (i.e. the right to provide payment services)
- Transparency and information requirements
- Rights and obligations of users and providers of payment services

i)Market Access Requirements

The PSD introduces a new EU-wide licensing regime for "Payment Institutions". This will allow non-bank payment service providers to offer their services across the eurozone if they have a license obtained in any EU Member State.

ii)Transparency and information requirements

The PSD provides simplified, harmonised rules for information requirements which payment service providers must fulfil. This applies both to SEPA and existing national payment products.

iii)Rights and obligations of users and providers of payment services

The PSD standardises the core rights and obligations of users and providers of payment services across national boundaries. It will also harmonise the current legal requirements in the individual EU Member States.

STANDARDIZATION

Common payment instruments across the eurozone require a standard way of exchanging payment messages, contrary to the diverse formats and levels of automation which previously existed across countries. SEPA requires common information ('data elements') for SCTs and SDDs, outlined in the SEPA Credit Transfer Rulebook and SEPA Direct Debit Scheme Rulebook respectively.

The standards for processing SEPA payment messages have been agreed by the International Organization for Standardization (ISO) known as UNIFI (universal financial industry message standard) or ISO 20022 (the UNIFI ISO 20022 XML standard). ISO 20022 is the compulsory format for bank-to-bank messages but at present, it is only a recommendation for bank-to-customer messages. Treasurers and payment managers should actively encourage their banks to provide files using this format as interfaces with different banks can then be established using the same format, reducing the cost and inconvenience of setting up interfaces and contributing towards greater bank independence.

MIGRATION TIMELINE

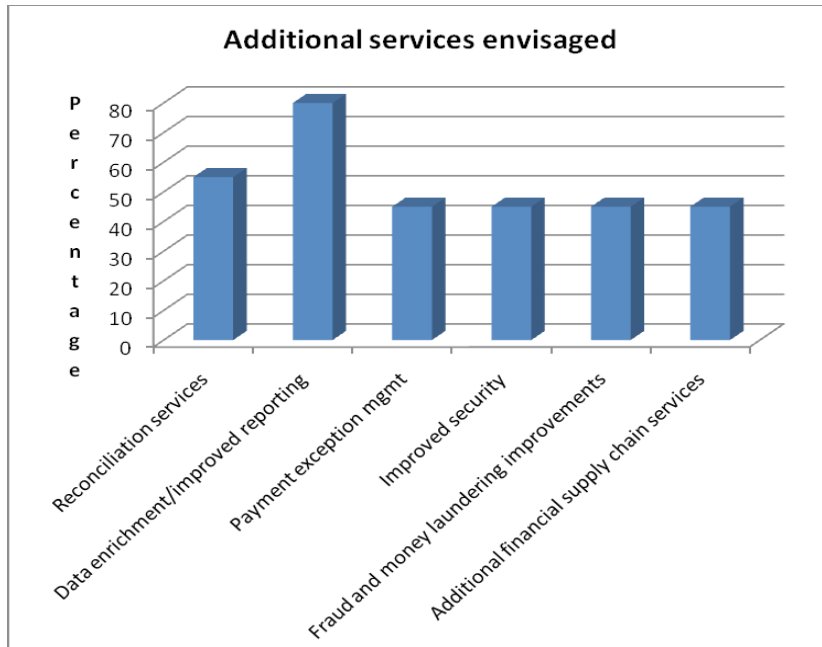
The migration to SEPA in each country will vary as each one has a different starting point. Most eurozone countries have now published their national migration plans for moving to SEPA.

The official transition period for SEPA was January 2008 to December 2010, by which time existing domestic payment products should be phased out (with the exception of "manual" payment instruments such as cheques which remain outside the scope of SEPA). However, with the SDD and PSD both due for launch in November 2009, the migration to SEPA could be a longer and more drawn-out process. Although there is still some way to go, SCTs are already a reality, so should corporate treasurers wait to migrate to SEPA until they are forced to do so, or should you embrace SEPA as a strategic element in your cash management and payments framework and use it as a catalyst for reducing costs and improving efficiencies?

BENEFITS OF SEPA

Not every company will benefit from SEPA to the same extent, according to a wide range of factors:

- The volume of Euro cross border payments. Transaction costs for SCTs are lower than for existing cross border payments, so there is potentially significant advantage for companies with high volumes of cross-border payments or smaller companies whose cross-border fees are material compared to the scale of enterprise, such as SMEs with pan-European export/import businesses.
- The complexity of European cash management. Companies with operations in different European countries will frequently work with different banks and maintain Euro accounts in each country. There are various reasons why a company chooses to work with more than one bank, but SEPA potentially allows cash management structures to be simplified by reducing the number of Euro accounts, and in many cases, to reduce the number of cash management banks.
- The cost and sophistication of domestic payment instruments. Payment costs in different parts of Europe are inconsistent today, with companies in countries such as Spain and Italy paying far higher payment fees, both for domestic and cross-border payments, than those in Belgium, Netherlands and Germany for example. Companies in “high cost” countries would benefit from migrating to SEPA earlier than those in “low cost” countries, even if their payments activity is primarily or exclusively domestic. Secondly, introducing payment instruments which are universally acceptable is not an easy process, so the SEPA payment instruments will inevitably be more or less favourable compared with existing payment types.
- The effort required to migrate. The effort to migrate to SEPA will vary across different companies, industries and countries, making SEPA more or less attractive proposition in the short term. For example, the SDD is substantially different to the existing, popular direct debit in Spain, so there will be substantial effort required by companies with high volumes of direct debits, such as utilities, telecoms firms and mortgage lenders.
- The ability to take advantage of additional services. The SEPA payment products have been designed to enable banks to provide additional optional services (AOS) on top of the basic SEPA instrument. These include enhanced information for reconciliation, invoicing and other services designed to help optimise the financial supply chain. Not all banks have yet finalised their plans for offering AOS to their corporate customers, but a recent independent survey (Asymmetric Solutions Ltd, March 2008) illustrated that banks are focusing primarily on the following areas:



Source: Asymmetric Solutions Ltd

However, in addition to the initial benefits of SEPA payments, there are secondary benefits which can be more compelling, and more universal. In particular:

The ability to centralise pan-European payments and collections. Centralisation of financial functions, such as treasury, has been a trend for a number of years. As part of this trend, increasing numbers of companies are seeking to centralise their payments and/or collections activity. With different payments instruments and regulation across eurozone countries, this has been difficult to implement for companies operating across geographies. With SEPA, establishing centralised pan-European payments or collections functions becomes far more straightforward. The benefits of both a payments hub (or 'payments factory') and centralised collections can be substantial (see SunGard AvantGard Insights whitepaper: 'Shared Services - Making the Move from Cost Leader to Value Generator' (<http://www.sungard.com/sharedservicecenters/default.aspx?id=781>)) and SEPA removes many of these barriers. As well as the operational benefits of centralising these functions, a primary outcome is increased visibility and reduced volatility of cashflow, allowing the company to release cash from the working capital cycle.

- The ability to standardise payments messaging with cash management banks. As discussed above, SEPA payments messages are structured in accordance with ISO 2002. Banks are obliged to support this standard for bank-to-bank SEPA payments, but the opportunity for bank-to-corporate messages is also substantial. In particular, by using a common standard for communicating with all cash management banks, only a single file format needs to be established for all banks with which your business communicates, which makes interfacing easier and cheaper; furthermore, you achieve a greater degree of bank independence.

SEPA IN PRACTICE

So what should you do to take early advantage of the potential benefits of SEPA for your business?

	Review	Potential Improvements	Potential Outcomes
Banking Relationships	What banking relationships do you have today to support your Euro business?	Rationalize banking relationships	<ul style="list-style-type: none"> •Reduce internal and external payment costs, including transaction costs, resourcing, systems and interfaces; •Increase visibility over European cash; •Reduce working capital requirement; •Improve automation and efficiency in payments operations; •Ensure consistent payment processes and controls; •Achieve bank independence
Euro Bank Accounts	What Euro bank accounts do you have today?	Reduce Euro bank accounts	
Cash Management Structures	What cash management structures do you have in place for centralizing your cash in Europe?	Simplify cash management structures	
Banking Interfaces	What interfaces do you have in place today to support your Euro business? What information do you exchange through these interfaces?	Reduce number of banking interfaces	
Payment Costs	What are your European payment costs today? Transaction costs: cross border, Domestic Bank Interface costs, Internal systems costs, Internal resource costs	Reduce transaction costs by migrating to SEPA payments Rationalize interfaces, internal systems costs and reduce internal resource requirements	
Centralization	What value and volume of payments are managed at a business unit level/ decentralized?	Increase centralization, eg. through a payments factory Rationalise interfaces, internal systems costs and reduce internal resource requirements	

To complete this analysis fully, you may need to consult with your bank(s) and treasury and payment system suppliers (or a reputable vendor in this field if you do not have systems in one of these areas). Of course, you may equally want to review these issues globally as well as regionally; however, as every corporation will need to migration to SEPA payments in due course, SEPA should be seen as a positive catalyst for change, with the potential to improve the way you conduct your business across Europe.

CONCLUSION

SEPA is a challenge and an opportunity for both banks and corporations but to gain the full advantage, both parties need to understand both sides of the equation: the bank view and the corporate view. SEPA as it exists today is just the start and it will continue to develop in the coming years as banks are able to offer a wider range of services. The earlier corporations migrate to SEPA, the greater their ability to optimise their payments processing in terms of cost, capital optimisation, standardisation and centralisation.

GLOSSARY

BIC	Bank Identifier Code
EPC	European Payments Council
IBAN	Interbank Account Number
ISO 20022	XML standard for the financial services industry
PE-ACH	Pan-European Automated Clearing House
PSD	Payment Services Directive
SCF	SEPA Card Framework
SCT	SEPA Credit Transfer
SDD	SEPA Direct Debit
SECA	Single Euro Cash Area
SEPA	Single Euro Payments Area
TMS	Treasury management system
UNIFI	Universal financial services messaging standard

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