



SEPA – AN AMBITIOUS PROJECT IN THE FIELD OF PAYMENT SYSTEMS

Ing. Peter Holička, National Bank of Slovakia

The field of payment systems is no different to any other professional field in having a lot of specialized terms and abbreviations. For those not directly involved, abbreviations such as STP, RTGS, DNS, EPC, SEPA, and EMV are largely meaningless. But for those who work in payment systems, they often enable the fast and accurate designation of the event or system being spoken about.

Among the new professional terms is SEPA. The aim of the following article is to explain what this acronym stands for and what it is about.

SEPA stands for the Single Euro Payments Area. This is in essence an ambitious project that will eventually affect all of us as consumers.

On 1 January 1999, Stage 3 of Economic and Monetary Union was launched with the introduction of the euro single currency, a step that was expected to eliminate most of the barriers to the free movement of goods and services. Within the newly established euro area, a market was to be created in which the single currency could be used as freely as currencies had previously been used in the individual countries. On 1 January 2002, the euro "materialized" into banknotes and coins. But although those ideas about the removal of barriers started to be fulfilled in regard to the cash form of payment systems, there was little change in the non-cash transfers of small amounts (retail payment systems) following the introduction of the single currency. In this field, there continued to be a fragmented market in which each euro area country conducted internal payments far more effectively and faster in comparison with cross-border payments between individual countries. This was apparent, for example, in the disproportionate difference between the charges that banks' customers paid for cross-border payments and for internal payments. The reason was the relatively permanent high share of manual work involved in cross-border payments, the absence of a pan-European payments infrastructure, and the existence of national payment systems based on various, historically-derived procedures, legislation and transaction processing methods. The concept of a single market allowing the free movement of goods and services was therefore not realized. Progress in integration was achieved only in regard to payment systems for large-value transactions, with the implementation of the payment systems TARGET and Euro1. The integration process in this field is to continue with the implementation of the TARGET2 system in 2007, which will provide its users with harmonized services and prices.

A step towards improving retail payment systems was made in 2001 with the issuance of Regulation (EC) No.

2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro. The legislation was designed to remove differences in the charges for internal and cross-border payments made in euros and to raise the level of automated processing of cross-border transactions through the introduction of standards in this area. EC regulations are legal acts that have immediate application in all Member States of the European Union without having to be transposed into national law on a country by country basis. This Regulation required, among other things, that cross-border transfers in euros (prior to 31 December 2005, for transactions worth up to EUR 12,500, and from 1 January 2006, up to EUR 50,000) be subject to the same charges as are imposed on internal payments.

In June 2002, representatives of 50 European banks and associations founded the European Payments Council (EPC). In May of this year, the EPC published the so-called "White Book", in which it set out its intention to establish SEPA.

The main mission of the SEPA project is to create an area in which all non-cash payments in euro are internal payments, i.e. an area where the difference between internal and cross-border payments ceases to exist. Another of the project's objectives is to develop a common set of payment instruments, standards and procedures. Its scope, size and complexity reflects an objective that is comparable to the introduction of euro banknotes and coins. It is a huge and ambitious project which is market-driven and should operate on self-regulatory principles. It is at the same time significantly contributing to the fulfilment of the Lisbon agenda. Since this project represents a logical continuation of the euro's introduction as a single currency, it represents a project of the euro area. Within SEPA, customers will be able to make payments throughout the euro area as efficiently and safely as they are making today within the payment systems of individual countries.

The coordination body of the SEPA project is the



European Payments Council. The EPC structure comprises the Plenary, coordination working groups and the following working groups:

- Customer and Business Requirements Working Group,
- STP Working Group (Straight-Through-Processing, i.e. processes which minimize human contact in the processing of transactions),
- Cards Working Group,
- Cash Working Group,
- Infrastructure Working Group,
- TARGET Working Group.

The objective is to establish a framework of rules for the three basic payment instruments which meets the aims and requirements of SEPA. This includes:

- the SEPA Credit Transfer Scheme,
- the SEPA Direct Debit Scheme,
- the SEPA Cards Framework.

The SEPA Credit Transfer Scheme and SEPA Direct Debit Scheme are to be regulated by "Rulebooks", which for each payment instrument will lay down the scope of regulation, the tasks and responsibilities of participants, the commercial and operational rules, as well as the legislative and legal framework for the payment instrument. They were proposed in order to regulate these instruments between banks and to allow scope for competition in the bank-customer relationship.

The SEPA for payment cards aims to move card-related services from the domestic to the euro area level; in other words, to facilitate the establishment of a payment instrument that could be used equally for national payments and cross-border payments in the euro area. Any cardholder should in future be able to use their card in any ATM or POS in the euro area. The point is that no card products at the national level should have their acceptance restricted to one country. Besides, the framework lays down standardized procedures and processes for the acceptance of cards and certification of terminals, and procedures aimed at preventing and eliminating fraud. The basic standard for payment cards is EMV (Europay, MasterCard, VISA). The cards issued within this framework should be based on a chip platform.

In regard to cheques and payment instruments not compatible with SEPA requirements, it is expected that they will gradually be phased out. The SEPA project does not provide for the use of such instruments in cross-border payments.

The said schemes of individual payment instruments are not specific products, but rather rules and conventions based on which providers of payment services will develop new products.

The SEPA project consists of three stages – planning, implementation, and migration. The planning stage

should come to a conclusion in 2006, when a framework for all SEPA payment instruments is expected to be approved. Banks should be working on the product preparation process so that customers can be offered the products from 1 January 2008. There is expected to be a certain period where the original products and SEPA products co-exist. By the end of 2010 at the latest, the substantial majority of offered products should be based on SEPA standards. SEPA products should be competitive with the best products and services offered by banks today. With strong competition in products, there should be a gradual decline in prices.

The major benefits of SEPA will materialize only if the project is future-oriented. This is why SEPA is not restricted to the translation of existing national procedures, infrastructures and standards into European ones. Rather, SEPA anticipates how payment systems should look at the end of the decade, paying due attention to the new possibilities offered by progress in information technology.

A project as huge as SEPA is inconceivable without the inclusion of all users, or at least the representatives of the different groups of users, in the planning and design stage and in the implementation stage, nor is it conceivable without effective communication with them. Effective communication should contribute to the smoother adoption of the new products and to the legitimacy of the process. It is therefore necessary to take as much account as possible of the interests of those who use such services. SEPA will require a change in consumer habits, and therefore the attempts to find solutions which are as simple as possible for users and available at a reasonable price.

The migration process in individual countries should be organized at the national level. Each euro area country is expected to produce plans in this respect by the end of 2006.

The SEPA project is being supported by both the European Commission and the European Central Bank. The Commission has come out with a proposal for a new directive on payment services that would give legislative backing to the implementation of SEPA. Based on the current stage in its preparation, the directive should be ready by the end of 2006, with each Member State expected to transpose it into their national law by the middle of 2008, at the latest. The directive will, among other things, facilitate the admission of payment institutions as new providers of payment services. This should contribute to greater competition and ultimately to lower prices for consumers.

Apart from the SEPA project, discussion has recently begun on the need for a Single Euro Cash Area (SECA). The aim of this project should be to harmonize procedures in the processing of cash throughout euro area



countries. This is because the cash supply system in these countries is characterized by a variety of procedures.

The SEPA project will bring structural changes throughout the European Union, but especially in the euro area countries. Apart from the said payment instruments (credit transfer, direct debit, payment cards), SEPA addresses a related group of issues, for example, the framework of infrastructures for clearing and settlement mechanisms. Of key importance will be the modification of retail payment infrastructures in order to enable mutual cooperation between these systems. Until 1 January 2008, it will be necessary to adjust the individual retail payment infrastructures so that they are interoperable with the original national payment instruments and also the new SEPA payment instruments. They will therefore have to handle the processing of transactions according to both the original standards and the new SEPA ones.

The ability to process SEPA payment instruments is one of the basic conditions for the admissibility of new payment instruments to consumers in 2008. The existing infrastructure can be expected gradually to close down and consolidate. It may also be expected that the number of retail payment systems will decline through natural development. System operators will have to take strategic decisions regarding the further development of their systems. There is the possibility that the system changes will not take place within the stipulated period, before the end of 2010. Such decisions are often taken at the end of investment cycles, which for a number of systems will come after 2010.

In connection with the SEPA project, the introduction

of common methods, procedures, fully automated processes, and standards is often only mentioned in respect of cross-border payments. Such an approach would see the SEPA payment instruments used only for cross-border payments, with no one using them for internal payments. The result would be a "mini SEPA", and that would be considered an unacceptable outcome of the project and its de facto failure.

The SEPA project counts on the gradual inclusion of other countries as and when they join the euro area. Since 1 January 2005, the Slovak Association of Banks has been a member of the European Payments Council. The Working Committee for Banks and the Financial Sector, which operates under the National Bank of Slovakia and aims to coordinate work on the introduction of the euro in this area, has established a sub-committee for SEPA issues. The objective of this sub-committee is to draw up a plan for migration to SEPA. This bears witness to active approach being taken by the banking sector in Slovakia – a country preparing for the euro changeover.

It is clear from recent development in the SEPA field that the key question is no longer whether SEPA yes or not, but what is the best route for getting there. The next years will show how successful the implementation of this ambitious project will be.

Like any other project, SEPA has its problems. This article has not aimed to describe the current status of the project, nor the problems related with it, but rather what lies behind this new term, one that has recently been increasingly featured in the pages of professional journals and is more and more discussed in both domestic and international fora.

Single Euro Payments Area

Joint Statement from the European Commission and the European Central Bank

The European Commission (Commission) and the European Central Bank (ECB) share a common vision for the Single Euro Payments Area (SEPA) and the process leading to its realization. Both institutions are co-operating closely in this process and encourage the European banking industry and the other relevant stakeholders to create the technical conditions for the realization of the Single Euro Payment Area by the end of 2010.

Significant progress towards SEPA has already been achieved by the European Payments Council (EPC) towards the establishment of the schemes, frameworks and the necessary standards underlying SEPA. The Commission and the ECB take the opportunity to stress their support for the objectives set by the EPC for January 2008:

- That EU citizens, enterprises and public administ-

rations should have the possibility to use the SEPA credit transfer and the SEPA direct debit payment instruments defined by the EPC.

- That the technical barriers to cross-border acceptance of card payments and cash withdrawals in euro should be removed. In addition, appropriate technical and contractual provisions and standards should be defined to ensure interoperability.
- That the necessary conditions for infrastructures to become SEPA-scheme compliant are in place. As a minimum, this calls for open and common standards that are available to all EU processing services and infrastructure providers for euro payments, so as to prepare for interoperability and effective competition.

Source: ECB Press Release of 4 May 2006 (abridged).