

Corporates will benefit from SEPA when the standards are implemented in 2008, but the advantages will only be realised if corporates move towards becoming SEPA compliant and start looking at the ways in which they will be able to take advantage of the SEPA Schemes. What should they be aware of as Europe moves towards SEPA and what should they be doing now?

Below you will know why early migration is key, and also gives some action points for corporates.

What challenges do banks and corporates face in 2007 in terms of their preparation for SEPA's introduction in 2008? Time to Review Your SEPA Strategy!

The introduction of the single euro payments area (SEPA) in 2008 poses significant challenges for both banks and corporates. Between 2008 and 2010, existing domestic payment instruments will co-exist with the new SEPA credit transfer (SCT) and SEPA direct debit (SDD) instruments in order to enable the gradual migration of end-users. This migration period will be an expensive time for banks. As a result, one of the biggest concerns among banks and other stakeholders is how to ensure the migration period is as short as possible and that consumers and corporates do actually adopt the new SEPA instruments.

The Migration Challenge

In order to facilitate the early adoption of SEPA instruments there is no doubt that they must be better - or at least equivalent to - existing domestic products. Common sense dictates that end-users will not adopt products or services that are not as good as those they already use. To minimize the length of the migration period, banks, corporates and public authorities must all contribute to progress on SEPA.

Banks must provide the SEPA instruments on time with the right functionality and pricing to encourage adoption. The banking community has already made great progress, having agreed the rulebooks for the SCT and SDD in March 2006. This also created an environment for other large-scale innovations in areas such as e-invoicing, electronic bill presentment and e-signatures. In addition, SEPA (in conjunction with the new XML standards) will contribute to the standardization of financial reporting, particularly in the area of reconciliation. It is these developments that will drive the real benefit of SEPA for corporates - not just lower prices.

Providing the services on time is one task, but banks must also communicate and educate their end-users about these new products and how they will benefit from them. This is especially true from a consumer perspective where, in most countries, credit mandate driven models are in place for direct debit, which do not offer consumers a great deal of protection. The new SEPA instruments will address this problem. In addition, the debit mandate model within the SDD has much richer functionality compared to the equivalent domestic product (with its credit mandate driven model), which will generate less rejections and refunds and therefore provide better liquidity management and forecasting capabilities for corporates. The debate should not be compromised or polarized by discussions around the credit mandate flow (CMF) or debtor mandate flow (DMF); instead, the industry must aim for a robust, secure and future-proof model.

Public authorities also have a significant role to play especially as they will potentially be among the first adopters. To increase progress and reduce the migration period, the EPC is calling on public authorities to act as role models for end-users in their adoption of SEPA instruments.

Among corporates, there is evidence of increasing demand for information as well as raised awareness about SEPA and its benefits: this is a positive sign for further progress in 2007.

What action Points for Corporates?

First and foremost, corporates should assess the impact SEPA will have on their business and operations. This assessment applies to all corporates: SEPA will affect small- and medium-sized corporates as well large multinationals across their payment activities including administration, technology and operations.

Corporates should discuss the implications of SEPA with their technology providers, which should further accelerate their understanding of the necessary changes and therefore their readiness for SEPA. ING expects SEPA-compliant models to be adopted in line with the lifecycle of corporate ERP packages. For instance, a multinational with interfaces to several banks in multiple countries will certainly be interested in an offering from its vendor that provides it with just one XML-based SEPA interface. As a result of SEPA, corporates will also have the opportunity to consolidate their account structures and banking relationships, which will have to be considered in the context of their existing operations and systems.

In order to make the necessary adjustments, corporates should include SEPA preparation in their IT budgets over the next few years. It is uncertain how many corporates have actually included SEPA in their budgets for 2007 though.

The fourth action point for corporates is ensuring that they include the correct IBANs and BICs on all of their invoices - this is already mandatory for cross-border payments.

Finally, all corporates should determine which bank has the expertise, infrastructure and ability to process all their euro transactions and then select the right bank to be their SEPA migration adviser.

The biggest impact so far on corporates has been the requirement to format their payments messages according to the main existing schemes - the Interbank Convention on Payments (ICP) and Credeuro. The full achievement of the single euro payments area (SEPA), from a corporate's perspective, will be based on the new Scheme (Credit Transfer and Direct Debit) rules, as defined by the European Payments Council (EPC).

When the European Commission brought Regulation 2560/2001 into effect, the EPC set out the conditions for how a Euro payment in the EU could be processed without deduction charges, and established new pan-European inter-bank charging principles in its interbank convention on Payments (ICP). If a corporate fulfils the ICP's requirements for its payments messages, it can be sure that the beneficiary will receive the funds in full, as well as a guarantee of the timeframe within which the beneficiary will receive those funds. In line with EU Regulation 2560/2001, the requirements apply to all payments up to €50,000.

Impact of IBAN and BIC

One of the significant issues for corporates in the lead up to SEPA is adhering to the requirements of the ICP and the consequence of not formatting messages correctly. According to the ICP, the intermediary bank receiving the payment or the beneficiary bank is entitled to charge for the additional work resulting from transactions that do not meet the ICP's prescribed STP standards. Such charges are generally referred to as repair charges and they can be applied by the receiving bank if:

- A message does not contain a valid IBAN in the correct field.
- BICs are not used in fields 52A to 57A.
- Fields 23E or 72 contain text.
- Fields 26T or 77B are used.

Though the repair charges are sent to the originating bank, ultimately, these charges will be passed back to the corporate customer. The concern for corporates is that the ICP has not defined an amount or upper limit for a repair charge. To be fair, it would have been difficult for the EPC to tackle the level of repair charges since the area of pricing is generally fraught with anti-competition issues. Neither is the timeframe within which a repair charge can be sent specified (it could turn up three months after the message was sent, for instance) or a maximum time limit defined. To make matters more complicated, there is also no industry standard for the reasons a beneficiary bank must give, or the format in which the reasons must be provided, when it sends back a repair charge.

In addition to the ICP, there is also a BIC and IBAN resolution, which came into force at the beginning of 2006. This states that for intra EU/EEA euro cross-border customer credit transfers, IBAN and BIC will be recognised as the only beneficiary customer account identifier and bank routing designation. If there is no valid BIC or IBAN in the payments message, a bank can treat the transfer as a 'value added service', regardless of the amount of the payment. In other words, a

non-STP charge can be sent back. Under the Resolution, starting this year, banks will be able to reject any payment if it doesn't contain a BIC or IBAN. As a result, corporates will not only have to deal with repair charges, they could be faced with interest costs if the beneficiary does not receive their funds on time, which could be significantly more expensive than a repair cost. Because of this change, the importance of collecting IBAN and BIC information should not be underestimated. The threat of rejection or return of a payment is real. We have seen recent communications by banks in certain countries stating that if an MT101 (multi-bank payment) request is received without an IBAN or BIC then the instruction will be held while the client is contacted to provide the required information. These communications imply that if the bank is not able to contact the client, or if the client cannot supply the required information, the payment will be held. This will undoubtedly lead to processing delays. On the receipt side, we have yet to come across a bank stating that it would reject a receipt if it did not contain a BIC or IBAN. Currently, the main concern is about a payment being rejected.

Corporates have to remember that omitting IBAN and BIC information will not just lead to a small non-STP charge. Soon, it could result in a payment not being processed within the required timeframe. If the collection of this data was not important before, it certainly is now.

What if the beneficiary says that they can not provide IBAN and BIC details? If the beneficiary holds an account with a bank located in the EU in the business of effecting cross border payments, then EU regulation 2560/2001 Article 5 applies: 'With effect from 1 July 2003, institutions shall indicate on statements of account of each customer, or in an annex thereto, his IBAN and the institution's BIC'.

EU Regulations are directly applicable to EU member states, while EU Directives must first be incorporated into national legislative before they become effective.

Credit Transfers

As part of the EPC's roadmap towards achieving SEPA, a new payment scheme will be created - the SEPA Credit Transfer Scheme - which will address basic credit transfers. As of 1 January 2008, the Scheme is expected to replace Credeuro and the ICP. Corporates should be aware of the Scheme's intention (as of December 2006) to be unlimited in value, ensure that there are no deductions from the principal of the payment (so that the beneficiary receives funds in full), ensure delivery of remittance data all the way through to the beneficiary, and ensure wide reach.

In response to the requirement for more urgent transfers, the EBA will launch a Priority Payments Scheme. This will not be limited to payments settled through the EBA-operated clearing systems, and should ensure that the time between the receipt of the payment instruction and the credit to the beneficiary's account, will be no longer than four hours, provided that the rules of the scheme have been adhered to. Since payments affected through the SEPA Credit Transfer Scheme do not have a value limit, we continue to see a shift away from differentiating payments between high-value and low-value to differentiating between urgent and non-urgent payments.

Critical Issue for Corporates

The critical issue for corporates is to understand the ICP's IBAN message requirements and to have the appropriate records database and payments processes in place. This is where banks can help. Banks should communicate with their corporate customers and provide them with formatting guidelines to translate the ICP requirements into what it means to these corporates. How banks handle repair charges needs to be more consistent. JPMorgan, for example, charges customers up front for payments that don't meet the requirements of the ICP scheme so the customer has certainty of timing as well as certainty of the amount charged, instead of waiting to see how much of the charges are passed back by the beneficiary bank. In addition, the bank provides monthly billing statements that detail why a payment failed to meet the ICP STP criteria. This allows customers to avoid repeating mistakes and having to amend their data. Taking action now will not only enable the avoidance of repair charges but will remove the risk of interest charges that customers could face starting in 2007.

There are also opportunities for banks to add value through use of the ICP. For instance, JPMorgan recently rolled out a free automated service for clients to review payments against the ICP STP criteria. If the service determines that the requirements are met, it ensures that they are coded as SHA. The service allows corporates and EEA banks that want to ensure the beneficiary receives the full amount of the funds, and whose systems can not automatically determine if a payment instruction meets the ICP STP criteria, to automatically change payment instructions to SHA from OUR. As a result, the beneficiary receives the funds in full but the corporate or EEA bank initiating the payment will not receive a charge claim back from a bank further down the payment chain.

For corporates, the interim period between 2007 and 2008 could represent a challenge. From 2007, IBAN and BIC are mandatory for euro cross-border customer credit transfers. However, domestic transactions can still operate using national account numbers. This will only be an issue if a corporate needs to make both a domestic payment and a cross-border payment to the same beneficiary, and if the corporate's ERP system can only maintain one account number for the beneficiary. One solution will be to use a bank that is capable of extracting a domestic account number from the IBAN, in which case the corporate only needs to retain IBAN data.

From 2008 through to the end of 2010, the European Commission expects domestic payment volumes to migrate to the SEPA Schemes. IBAN and BIC are mandatory components of the SEPA Schemes. If there isn't an IBAN and BIC then a payment or a direct debit cannot be made through the Schemes.

SEPA: Still some Way to Go

While SEPA will help improve the payments landscape across Europe, it does not address all of the problems in the payments sector. In theory, once SEPA is fully implemented, a corporate could open an account in France and manage all of its payments through wire transfer or ACH to beneficiaries in Spain. In reality, there may still be corporate tax issues and central bank reporting implications, which could act as a barrier to a truly harmonised European payments market. Central bank reporting (CBR) is already an issue. In most countries where it is required, there is a €12,500 threshold, while the threshold under EU Regulation 2560 was increased from €12,500 to €50,000 in January 2006. In a true pan-European payments market, which SEPA is supposed to be, these CBR reporting inconsistencies will have to end.

That said, this particular issue might soon be resolved. At a SEPA conference in November 2006 in London, Eva King at the European Commission stated that the review of Regulation 2560/2001 might recommend removing the balance of payments reporting requirement. Equally, though the SEPA Scheme rules are being put into place at a high level, there is a clear separation between the Scheme and operators of the Scheme. The Scheme rules, therefore, are not intended to describe what the operators of the systems are going to look like or how they will change. Nor do they explain how the European payments infrastructure as a whole will change. These factors will be determined by market forces, and while a single infrastructure that could be referred to as a pan-European ACH (PEACH) may not come into effect immediately, it is only a matter of time before market forces drive the change. We have finally seen the first results of these market forces with the announcement of the merger between Interpay Nederland (the Dutch ACH processor) and Transaktionsinstitut (a major German low value payment processor) to form Equens.

Going Forward and Latest Developments

Progress is being made towards the implementation and governance of the Schemes. Below are some recent developments:

- An **Adherence Agreement** will be issued by the EPC. Banks will be required to sign the agreement indicating that they will be taking part in the SEPA Schemes. The number of Adherence Agreements that are appropriately returned will serve as a key indicator of likely success towards implementing the Schemes starting from 1 January 2008 and to what extent true reach will be achieved.
- It appears likely, given recent comments by Jean-Michel Godeffroy of the European Central Bank (ECB), that the ECB will provide a definition of **SEPA compliance**. This will enable corporates to determine which banks are truly SEPA compliant.
- **Scheme governance** is moving closer to resolution since national consultation has taken place on the EPC's draft proposal.
- **Testing** is beginning to take place. At SIBOS in Sydney last year, SWIFT announced that 17 major banks will test the compliance of payments with SEPA standards across the eurozone from Q3 2007. SWIFT will provide the messaging platform, testing solutions, services and the organisational infrastructure to support this initiative in co-ordination with the EPC and banks. Major banks across Europe, as well as EBA Clearing, have joined the initiative. Corporates will also be able to participate in the test. Testing will be organised through ACHs, bilateral clearing and other clearing and settlement mechanisms across

Europe.

- **Priority payments** are being addressed. The EBA has been developing a scheme to address the need for a service to ensure end-to-end euro payments can be achieved in less than four hours.

A bank's key role in ensuring corporates are ready for SEPA is to help their clients comply and understand SEPA as easily as possible. The responsibility of educating corporates about the SEPA Schemes is a collective responsibility to be shared by corporate industry bodies, such as banks, infrastructures/ACHs and the EPC.

Many small and medium-sized corporates deal mostly within their national borders so SEPA may not affect them materially until 2008, when national ACH schemes will begin to convert to the pan-European schemes. SEPA will, however, make it easier for small and medium-size corporates to expand their businesses across European borders through the Pan-European Direct Debit (PEDD), for example. For larger corporates doing cross-border business, they will already have had to implement the changes required by the ICP and EPC Resolution regarding the use of IBAN and BICs. There is no doubt that corporates will benefit from SEPA for a number of reasons. They will benefit from the creation of a clear choice of payments types, in the ability to simplify their liquidity and cash management structures, and in being able to ensure that remittance information is accurately transmitted and received. The advantages of SEPA, however, will only be realised if corporates take action and become SEPA compliant.

Action Points for Corporates

For a corporate to position itself effectively for SEPA in the near term, it should ensure that:

1. BIC and IBAN details are clearly placed on all invoices.
2. It obtains IBAN and BIC details for all of its counterparts, not just for cross-border counterparts.
3. It ensures its banks are capable of formatting payments to comply with the ICP, and are able to provide services to facilitate the conversion of IBANs to domestic account numbers. In addition, once a clear definition has been provided for SEPA compliance, a corporate should check that its banks are indeed SEPA compliant, and, if it is not included in the definition of SEPA Compliance, confirm that its banks have signed the Adherence Agreement.

To get the most out of SEPA, a corporate should, in the medium term, consider the following:

1. How it might better utilise reliable remittance information. The SEPA Credit Transfer Scheme provides for remittance information of up to 140 characters. While this will not meet all requirements, the fact that one can rely on the data being transmitted to the beneficiary holding their account with a Scheme member merits review. The review should apply to both accounts payable and accounts receivable processes.
2. Handling of reject code information. One feature of the SEPA Credit Transfer Scheme is defined rejection codes. Depending on volumes, consideration should be given to the handling of these error codes in an automated manner to improve efficiency in data management.
3. Migrating from existing national schemes to the SEPA Schemes. At this point a 'drop dead date' is not expected for the national schemes. However, there will come a point when the national schemes will close as it becomes apparent that they are no longer cost effective. Therefore, a gap analysis will be necessary to establish key gaps and differences between the SEPA Schemes and the national scheme in question. For example, the reclaim period for a direct debit is likely to be different in the SEPA Scheme than the national scheme.
4. Impact of bank XML adoption. The communication standard between banks taking part in the Schemes will be XML. As corporates move away from bank specific solutions continues, XML could provide a solution, and it is likely that more banks will offer these solutions to

their clients. Corporates should review the use of XML and the provision of bank solutions that facilitate XML communication between the bank and the corporate.

In addition to all of the above, a corporate should review their locations and entities to see whether further efficiencies can be achieved by taking advantage of SEPA. However, for the time being the reality is that other issues, such as CBR and taxation differences, will mean that decisions around changing locations will continue to be complex.