Market intelligence report – October 2007

# Practicalities of building a SEPA Payments Business

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Contents


| | |
|---|---|
| Background | 1 |
| Executive summary | 2 |
| Bank migration and delivery | 3 |
| Customer migration | 4 |
| Core services | 6 |
| Value added services | 9 |
| Conclusion | 12 |

# Background

The Single Euro Payments Area (SEPA) is designed to level the playing field for the European payments industry and to create a seamless, cross-border environment for banks and their customers. As attractive as this may sound, the migration process will involve considerable work and costs for banks. Not only will their internal systems require adapting, but more importantly they will need to ensure their customers update their own payment processes to fit with the new SEPA schemes.

Over the past year VocaLink has been in conversation with over 150 banks across Europe about the challenges and opportunities they face when SEPA goes live on 28 January 2008. Through these discussions we discovered that the vast majority of European banks see SEPA simply as a compliance issue. It also became apparent that banks share similar concerns about how to grow their SEPA business and meet the needs of their customers.

In order to gain a deeper understanding of these concerns, VocaLink commissioned an online questionnaire with Finextra Research, the respected information source for the worldwide financial technology community.

The aim of the survey, which ran over a three week period, was to see how the banking industry is progressing with its SEPA plans, what the main priorities are and any pressing issues still to be resolved. The questionnaire was designed to ascertain what strategies banks are developing to encourage their customers to migrate.

We received an overwhelming response from executive director level respondents from leading Eurozone and non-Eurozone global banks. This report summarises the findings.

**About VocaLink**
VocaLink is the specialist provider of transactions services to banks, their corporate customers and Government departments. The company pioneered electronic payments in 1968, and has driven the transactions business ever since. On a peak day, the VocaLink automated payment platform processes over 80 million transactions. Its switching platform connects the world's busiest ATM network of over 60,000 ATMs.

The VocaLink services span domestic and international automated payments and ATM switching solutions. Services offer clients reach throughout the SEPA and beyond.

Organisations that choose VocaLink have a partner with unique experience. Clients benefit from VocaLink's economies of scale, expertise and constant innovation.

To find out how you can meet the SEPA compliance deadline easily and deliver more to your customers, visit: **www.vocalink.com/sepa**

**About Finextra**
Finextra Research is the leading newswire for the global financial technology community, with 2.5 million page views and 80,000 unique visitors per month. More than 25,000 financial technology professionals worldwide receive our free daily and weekly e-mail newsletters. Finextra additionally operates its own annual conference and exhibition for the capital markets industry, Finexpo, and collaborates with the Euro Banking Association to produce the annual pan-European payments conference EBAday. Finextra is also the official online news vendor for Swift's annual financial technology conference Sibos.

Finextra additionally hosts an online professional networking and blogging service for the global financial technology industry – **www.finextra.com/community** – and is the exclusive operator of the 7Finextra50 fintech stock index.

# Executive summary

This report provides details of the results of the Finextra Research online questionnaire commissioned by VocaLink during August and September 2007. The aim of the survey was to examine the views of the industry on the practical realities of growing a payments business under the SEPA framework. The results have been grouped into four key areas: bank migration and delivery, customer migration, core services and value added services.

**Bank migration and delivery**

Targeting both Eurozone and non-Eurozone banks, we were interested in establishing how far banks' SEPA compliance projects have progressed. Headline findings are as follows:

- Banks believe most SEPA traffic will come from cross-border payments
- Reach is likely to be a problem for over half of banks

**Customer migration**

Our survey highlights banks' planned approach and anticipated issues with customer migration:

- Most banks are planning to support corporates by managing payments with mixed message formats
- Banks are concerned about how they will encourage businesses to migrate to SEPA instruments
- Most banks expect the majority of business migration to SEPA schemes to occur after 2010

**Core services**

The banking industry's opinions on the core services under the SEPA framework, revealed that:

- Banks consider direct debits their top priority for SEPA in 2009
- Most banks will be running legacy domestic credit transfer schemes after 2010
- Most banks will be running legacy domestic direct debit schemes after 2012
- Banks anticipate delays in direct debit implementation

**Value added services**

Other findings in the report related to opinions on the value added services customers would be seeking from their banks. These included:

- Banks' strategic focus will be in offering a single channel for SEPA and non-SEPA transactions
- Banks believe that the management of direct debits will be difficult
- Banks will be focusing on payment exception management to ensure good customer service

# Bank migration and delivery

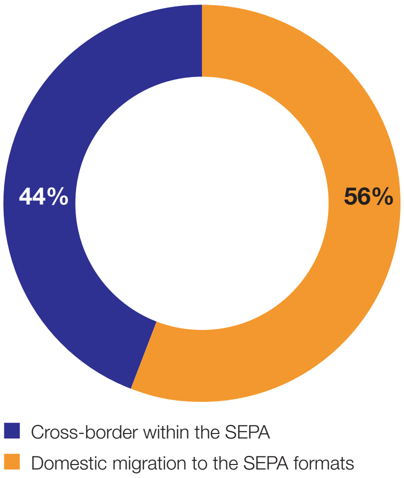
**Banks believe most SEPA traffic will come from cross-border payments**

The results of the survey highlight that 56% of banks believe that the main source of SEPA traffic in 2008/9 will be cross-border. With cross-border euro payments accounting for only 2% the total European payment volume this predicts SEPA volumes will be very low.

Further analysis indicates that this result was heavily influenced by non-Eurozone respondents who may not need to manage domestic SEPA formats as this does not account for the majority of their payments traffic.

*56% of banks believe that their key source of SEPA traffic will be cross-border within the SEPA*

**Source of SEPA traffic generation in 2008/09**




**Reach is likely to be a problem for over half of banks**

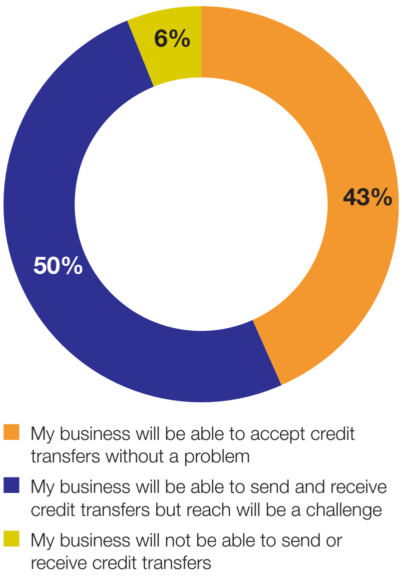
On 28 January 2008 banks are expected to be able to accept SEPA credit transfers. With this first SEPA deadline imminent, 43% expect this to happen without any problem. However, exactly half of respondents (50%) believe that while they will be able send and receive credit transfers, reach will be a challenge. While this may point to the challenge of reach across the SEPA, banks are also sending non-SEPA payments into those geographies during a period of parallel running of the old and new schemes.

For 6% of banks, however, significant concerns remain as they will not be able to send or receive credit transfers by the deadline specified in the SEPA rulebook. These banks were largely non-Eurozone domiciled banks, indicating that the SEPA challenge has not been widely understood or implemented outside of the 31 SEPA markets.

*"Our number one priority for 2009 is achieving complete reachability across the SEPA zone."*

**– director of regional payments, Dutch bank**

**Expected bank position on SEPA by 28 January 2008**



# Customer migration

**Most banks will support corporates by managing payments with mixed message formats**

Banks were asked how they intend to support corporates' SEPA payment instructions. There was a clear divide between those banks that felt it was important to protect their customers from the process changes needed to migrate to SEPA and those banks that intended to pass this task on to the corporates themselves.

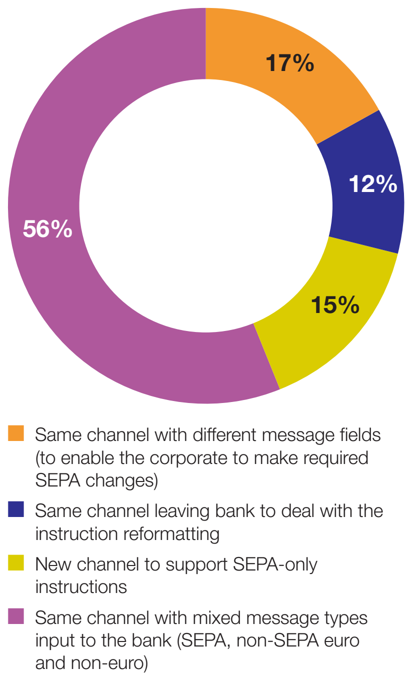
More than half (56%) of banks will upgrade the existing payments channel to handle multiple message types including both SEPA and non-SEPA formats. An additional 12% will offer the same channel to corporates and the bank will deal with any instruction reformatting.

Meanwhile, 17% will take the opposite approach, offering corporates the same channel with different message fields expecting corporates to make the required changes, and just 15% will offer a new channel that supports SEPA-only instructions.

The results show the importance that some banks are placing on addressing the practical issues customers face in migrating to SEPA. These banks are assuming that corporates will not expect to be told they have to supply their payment instructions in a new format.

This is in contrast to the instructions of the EBA and EPC who are keen to see full migration occur as quickly as possible rather than prolonged by banks protecting their customers from the task of converting to SEPA formats. But it also reflects an understanding of the challenge to migrate all of these businesses to new formats, with little financial incentive in the short term.

**Bank channel strategy for business customers**



**Banks are concerned about how they will encourage businesses to migrate to SEPA instruments**

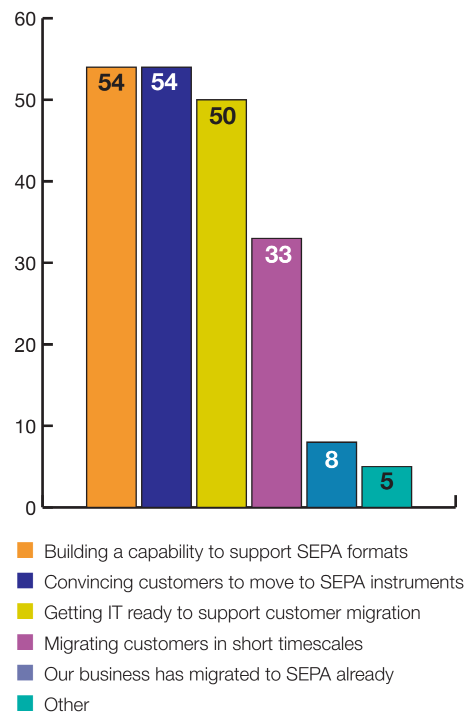
At a very practical level we asked respondents to identify the most significant issue facing their business regarding migration to SEPA. The majority of the responses centred on two issues – the ability to convince customers of the importance of moving to SEPA instruments (54%) and supporting their migration efforts in such short timescales (33%). Other issues that were evident were concerns around internal workings such as the ability to build a capability to support SEPA formats (54%) and preparing the IT needed to support customers' migration.

Only 8% of respondents were able to say that their business had already fully migrated to SEPA. There is clearly still much work to be done, both within the banks, but more interestingly, to convince the customer that there is benefit in SEPA and that speed of migration is an issue worthy of their focus. With over 450 million consumers in the SEPA, banks and corporates face a number of years of work to migrate across to the new schemes. This is a particularly acute issue with direct debit schemes, whether via electronic or paper mandates, in many cases these will need to be re-signed.

*"We must ensure that we are optimising current and future business opportunities during conversion."*

**- SEPA consultant, German Bank**

**Most significant SEPA migration issues for banks**



# Core services

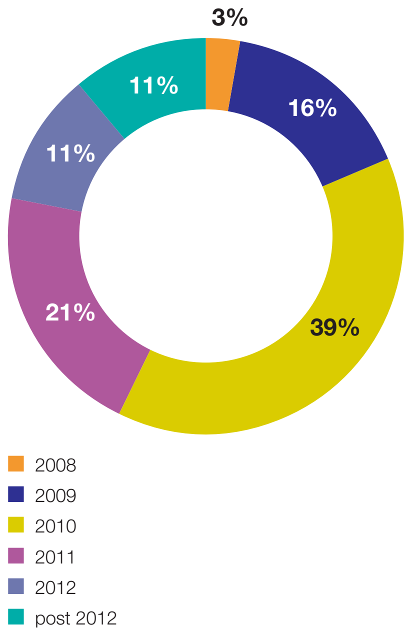
**Most banks expect the majority of business migration to SEPA schemes to occur after 2010**

There was no clear, common view on the timings for business migration to SEPA. The most popular view was that migration would occur in 2010 (39%), while as many as 43% believed that migration would occur post-2010. More worryingly a further 11% felt this period could extend to beyond 2012, thus exceeding the EU Commission's stated final deadline. This is mostly due to the delay in cross-border direct debit as a result of the delay in implementation of the Payment Services Directive (PSD). Customers will want a comprehensive solution from day one so it is predicted that the bulk migration of credit transfers and direct debits will only begin after the introduction of cross-border direct debit (November 2009).

*"When we migrate our key priority will be providing value added services for corporate"*

**- head of payments systems, Greek bank**

**Date bank plans to migrate the majority of businesses to SEPA**



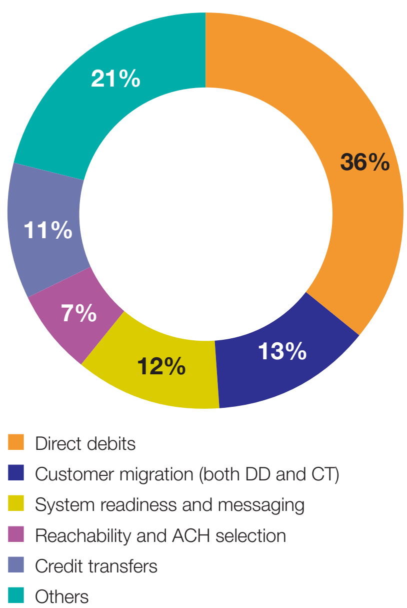

**Banks consider direct debits their top priority for SEPA in 2009**

When asked what the number one priority related for SEPA would be in 2009, 36% of responses related to direct debits, while 13% concerned customer migration – a percentage mirrored by those who highlighted system readiness and migration as their chief concern. The delay in the transposition of the PSD into local law (November 2009 deadline) has an impact on the migration of customers for direct debit and so this result is not unexpected.

*"Our priority is to have our customer trained to use SEPA payments"*

**– bank executive, Italian bank**

**Number one priority related to SEPA for 2009**

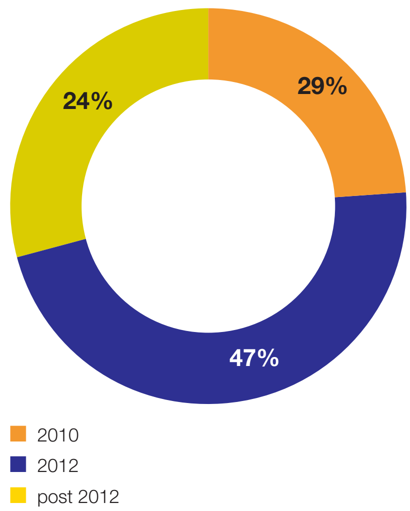


**Most banks will be running legacy domestic credit transfer schemes after 2010**

Our results show that the majority of banks expect to be utilising two formats for credit transfers until 2012 at the earliest, with only 24% stating that they will have fully migrated by 2010.

This presents a challenge for the industry – the original target dates the ECB outlined for the migration phase of SEPA set an objective of gradual market migration, so that by the end of 2010, a critical mass of transactions has migrated. By any measure, 24% cannot realistically be considered critical mass.

**End date for legacy domestic credit transfer schemes**

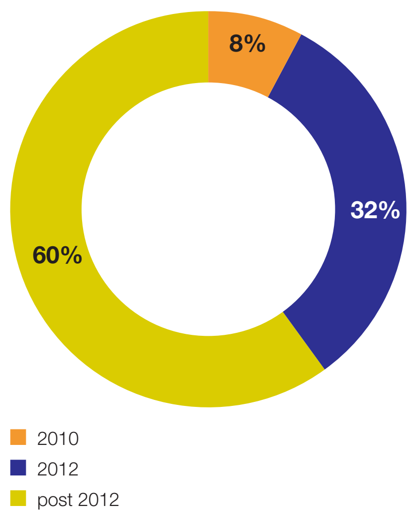



**Most banks will be running legacy domestic direct debit schemes after 2012**

Our results show that the vast majority of banks expect to be running two systems for direct debits until 2012 at the earliest, with only 8% stating that they will have fully migrated by 2010.

The migration from one direct debit scheme to another requires a significant degree of coordination between market participants. This is likely to account for the perceived delay.

**End date for legacy domestic direct debit schemes**



**Banks anticipate delays in direct debit implementation**

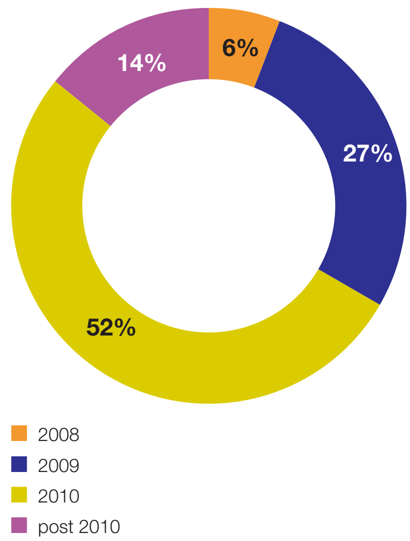
Many banks do not expect the timetable set by the EBA and EPC for full SEPA migration to be strictly adhered to. When asked at what point corporate businesses will start offering SEPA Direct Debit instructions, over half (52%) believed this would not be until 2010, while a further 14% felt it would be post-2010.

The sentiment around direct debit implementation was further reinforced when we asked when banks expected their customers to migrate the vast majority of their payments to SEPA schemes. The vast majority of the banks surveyed (81%) suggested this would be post 2010. This correlates with the transposition of the Payment Services Directive into national legislation across the SEPA to support cross-border direct debit. The immediate focus is clear from the comments we received:

*"We must deliver at least one SEPA direct debit product to our customers and to accept also SEPA direct debits."*

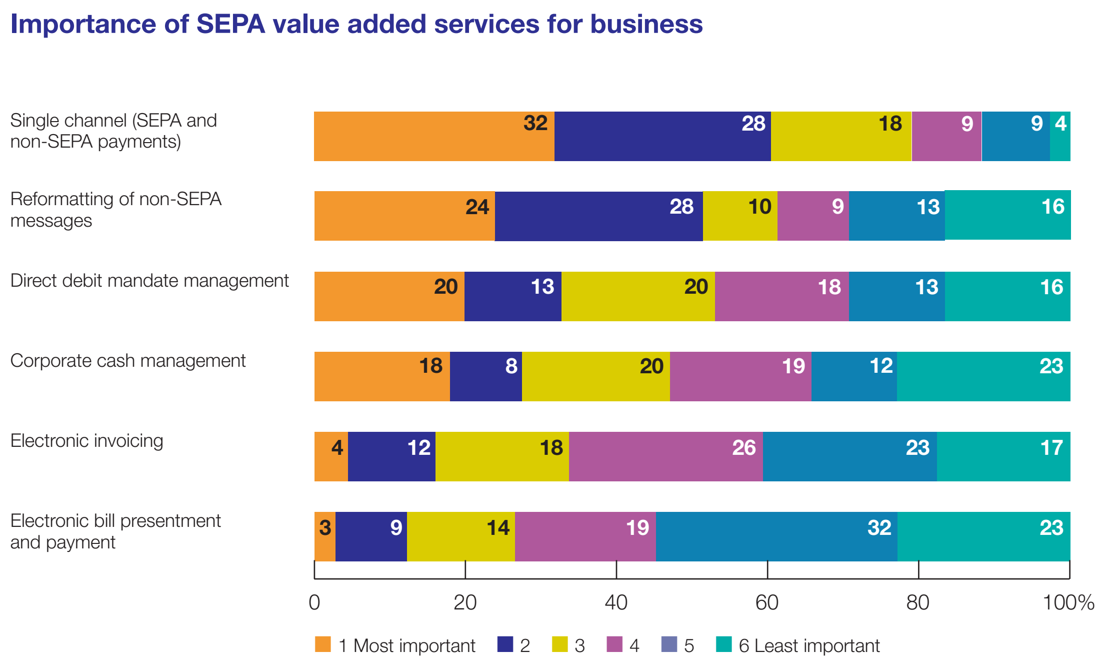
**- director, Greek bank**

**Expected business implementation date for SEPA direct debits**



# Value added services

**Bank strategic focus will be in offering single channel SEPA and non-SEPA transactions**




The ability to cater for both SEPA and non-SEPA payments in one channel was highlighted as the most important value-added service that banks could offer their customers, with 32% ranking it as their top priority. This was closely followed by the formatting of non-SEPA messages into SEPA (24%) and direct debit mandate management (20%).

Much less urgency was attached to the provision of enhanced corporate cash management services (18%), electronic invoicing (4%) and electronic bill presentment and payment (3%), suggesting that banks are currently focusing on the issues they expect to see immediately after the January 2008 deadline – that of reconciling SEPA and non-SEPA payment instructions. Meanwhile, the more value-adding services, such as electronic invoicing and bill presentment are not seen as an immediate priority in the development of the e-SEPA, but more of a long-term aim.

Catering for both SEPA and non-SEPA payment instructions may be the immediate priority for banks, but in the slightly longer term, the task of managing direct debit mandates across SEPA emerged as the most important facing banks.

*"Our focus is on value added cash management solutions in preparation for direct debit NLF adherence."*

**– general manager, Norwegian bank**

**Banks believe that the management of direct debits will be difficult**

The importance of direct debit management as an issue can largely be explained as a result of the expected difficulty involved in implementing, developing and deploying the new regime.

When asked, 44% of banks said that direct debit mandates will be "difficult to manage", while a further 27% admitted that they had yet to work out an answer to managing this issue. Just 7% felt that direct debit mandates would be easier to manage as a result of SEPA.

For the small minority of banks that anticipated an easier process for direct debits in the SEPA, the reasons given reflected the fact that they had spent time and money creating detailed and robust solutions. Additionally, others felt that the process would eventually become easier to manage as a result of EPC standardisation and the common legal landscape that SEPA will eventually bring to Europe.

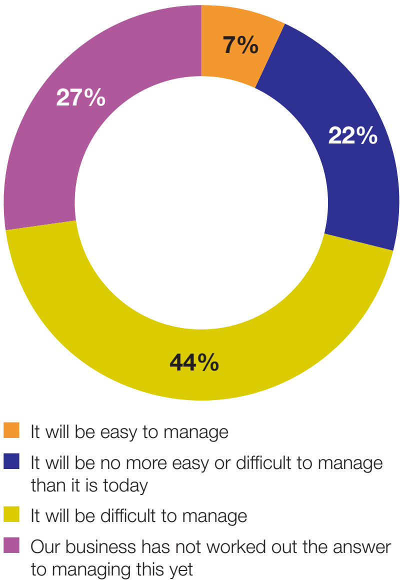
But the majority of respondents' comments pertained to the anticipated complexity. "*Until now we have not offered a cross-border direct debit product so we assume that there will be difficulties, at least in the beginning,*" said one bank.

The lack of clarity in the marketplace was cited as a cause of complexity, with one bank commenting that "*so far the scheme has not been worked out properly and there are no customer-bank specifications available*". The role of the customer was also highlighted as a problem, particularly as consumer awareness of the changes involved is so low.

*"Ask your mum and dad what they know about SEPA and SEPA direct debits and you will know why it will be so difficult to manage"*

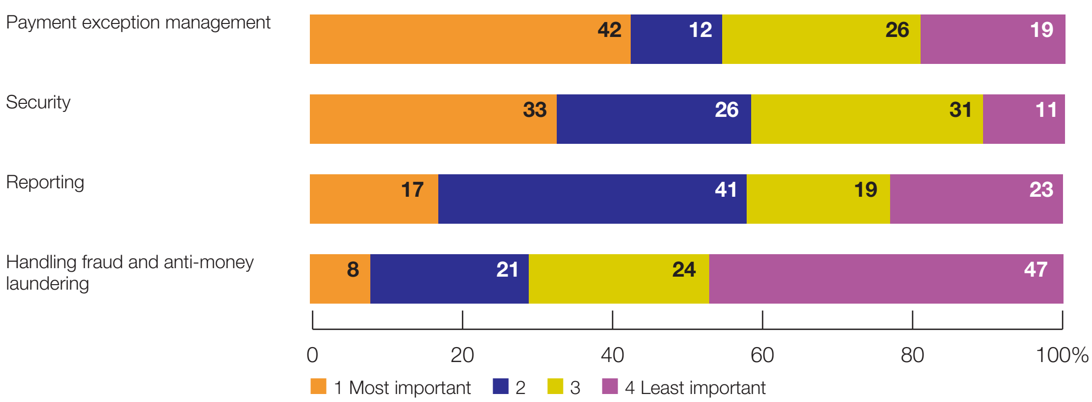
**- head of payments, Luxemburg bank**

**Ease of SEPA direct debit mandate management**



**Banks will be focusing on payment exception management to ensure good customer service**

### Key considerations for delivering premier SEPA service to customers




When banks were asked how they would rank payment exception management; security; reporting; and handling fraud and anti-money laundering, the majority (42%) selected payments exception management as the key area, followed by security (33%), reporting (17%) and fraud prevention (8%).

While more detailed reporting and improved fraud prevention measures may well develop as key business benefits of SEPA over time, the more immediate concerns were that payments exceptions are costly to manage. In addition to the direct cost, repairing banks' outbound messages impacts on the quality of customer service, particularly when a high level of repair is necessary to address problems with incoming payment instructions that are incorrectly formatted.

*"We will be focused on new product development."*

**– head of industry, UK bank**

# Conclusion

The Single Euro Payment Area (SEPA) is almost upon us and as an industry we are all preparing for the challenges posed by the transformation. There can be no doubt that the dawn of the SEPA is a disruptive event for the European economy – arguably the most disruptive event in the retail payments market since the invention of card payments. Through our conversations with over 150 banks in the past year, we have found that many banks continue to see SEPA as an obstacle rather than an opportunity. The results within this report highlight the difficulties banks face in meeting customer needs.

The majority of banks taking part in our survey confirmed that they will need a solution that enables message reformatting, and the ability to send all payments through a single channel. Both of these services require large scale development and significant investment, which will be difficult to justify for many banks given that eventually their corporate customers will have the ability to send through SEPA-formatted payments. The solution for banks looking to offer a comprehensive solution to their customers is a partnership with one of the few Clearing and Settlement Mechanisms (CSMs) offering such a service to indirect participants thereby removing the need for investment.

SEPA is considered by many in the industry to be the single largest project in Europe since Y2K. Banks and businesses alike must undertake the migration to SEPA accounting systems to support this change and yet there is little incentive for most bank customers to embrace the change. Our survey highlights that only 17% of banks are using this as an opportunity to pursue an aggressive customer migration strategy by providing services that minimise the impact to business users. As a result, those banks expecting business customers to make the required changes to adopt SEPA message formats may lose out.

Many respondents to our survey say they are planning to offer services such as direct debit mandate management and enhanced customer cash management. These services will not only encourage client migration but support a strategy to win new business through differentiation, with competitive advantage over those banks that merely seek to comply.

Perhaps the most surprising result of our survey is that while 43% of respondents believed that they will be ready for the 28 January deadline, exactly half of respondents stated that reach will be a challenge.

Banks are developing a broad range of strategies to respond to the challenges of SEPA. However, the answer must address not only compliance and reach but also serve the needs of an ever changing market. The payments industry is set to become ever more defined by customer service. Partnership is becoming increasingly important to deliver first class customer service and ensure sufficient speed to market with new services. Only those who embrace the opportunity will survive and flourish. At VocaLink we have been working with banks across the SEPA to define and develop a range of services that will enable our clients not only to survive but to flourish in this new competitive environment. Our Euro CSM has some of Europe's most significant banks as direct participants and our roadmap of value added services will drive competitive advantage and reduce the pain of migrating to SEPA for you and your customers. If you would like to talk to VocaLink about your SEPA requirements, please contact us on +44 (0) 870 165 0019 or by email at info@vocalink.com.

We would like to thank those of you who took the time to participate in this survey, and we trust you found this report of interest. If you need extra copies of this report you can contact VocaLink or download an electronic version on www.finextra.com.

**Martin Wilson, Chief Marketing Officer, VocaLink**

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