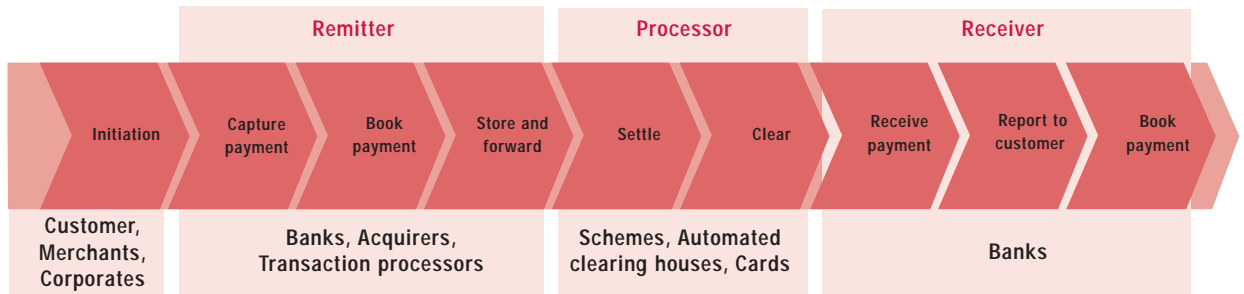


FROM COMPLIANCE TO BUSINESS BENEFIT



Introduction

The objective of SEPA, as stated by the European Commission, is to "facilitate the exchange of cross-border flows" and "reduce the processing costs of European operators, largely processing (and invoicing) today as 'international' operations". SEPA covers credit transfers, card infrastructures and direct debits, and its introduction will have a pervasive effect on the Euro zone payments market. In order to gauge the effect it is instructive to note that, in our estimation, the payments industry represents between 3% and 4% of the Gross Domestic Product of the Euro zone.

The introduction of SEPA is likely to both influence and have an impact upon all the players in the payments market.

In the value chain above, less than 20% of all the processing costs are borne by the processor; the vast bulk of the costs are borne by the banks and card operators. The cost changes in payments brought about by SEPA will thus have a significant impact on the banks as well as the processors.

The stage is therefore set for major systemic changes in the infrastructure of European banking. One of the key barriers to doing financial services business in the Euro zone, namely the national border, will be eliminated. Strategically, all the main payments stakeholders will be affected, albeit in different ways:

- > The intended beneficiaries of SEPA are the banks' customers, both corporate and personal – and we believe they will indeed be the winners.
- > Arguably the biggest impact of SEPA will be on banks because payments are core to their business. We estimate that the European banking industry as a whole earns 30% of its revenue from payments. In addition, the Euro zone is

one of the regions in the world with the most variable pricing; hence the rationale for SEPA.

- > New competition will be created principally through the Pan-European Automated Clearing House (PE-ACH). By looking at the payments infrastructure it becomes clear that the speed of change for bank-to-processor interoperability and processor-to-processor interoperability are likely to be different. The main structural development will therefore be the creation of the PE-ACH. A PE-ACH for this purpose is defined as a processor that has:
 - > The capability to process European instruments such as credit transfers and direct debits with no alternation of data
 - > A capability to cover all the Euro zone countries.

The obvious candidates to create PE-ACHs are the current national automated clearing houses but significant investment will be needed.

While it seems obvious to state that SEPA is a new regulation, it should be remembered that it is designed to simplify and replace the country equivalent regulation and open up competition. Therefore SEPA should be thought of as a step towards deregulation. It is likely to have a similar effect to the deregulation of European telecommunications operators in recent years. Following deregulation, the primary target for new entrants into the telecommunication market was corporate accounts because the way in which they behaved was more stable than personal accounts.

Clearly, SEPA is still evolving. While a number of key decisions have been made in each Euro zone country, there are many more to make. We will be covering these later on in the paper.

The race to derive business benefit rather than merely comply with SEPA will determine the real winners and losers.