SEPA Impact Analysis by Main Players

Individuals / Personal customers

Customers will not necessarily take a pan-European perspective on their use of payments. Their priority is for convenient, attractive and cost-efficient payment solutions. SEPA recognizes that a European customer must be able to pay in the Euro zone in a standard way with the same conditions wherever they are and whatever is used as a means of payment.

New means of payment will become available and transaction volumes will also increase. For example, with increased usage of the Internet due to Broadband/ADSL, there is likely to be a greater uptake of electronic trading and therefore electronic payment origination. Moreover Broadband development will lead to new access routes to payment origination:

> Direct “Single Message” to the issuer
> Person to person (P to P) e.g. Paypal
> Prepaid Card
> Mix of payment instruments.

This will be happening within a framework of fixed prices instead of per- transaction or value-based fees.

In a single payments payment zone, individuals will get easier access to cross- border payment services. They will also have a larger choice of banks who can service their needs in any part of the Euro zone. Moreover they will be offered new payments cards based on co-branding and the evolution of the direct debit.

FROM COMPLIANCE TO BUSINESS BENEFIT

Corporates

While SEPA is especially relevant for corporates, they will have to decide whether to be aggressive in leveraging SEPA to drive efficiencies and centralisation initiatives to take advantage of opportunities like:

> Common payments tools inside the SEPA zone
> Reduced cost of cross-border payments and the ability to negotiate reduced rates on payments processing from banks which adopt the centralised model, leading to a corporate having one single banking relationship in one country for the whole Euro zone
> Availability and acceptance of new payments cards
> Centralisation of payments processing, leading to benefits of scale. In some cases, this can lead to outsourcing of this function in a low cost location e.g. Eastern Europe
> Further centralisation of treasury operations in the Euro zone
> Enhanced opportunities for netting, pooling and cash flow management in the Euro zone.

For corporates, the business case will have to integrate a number of factors:

> The costs of changing processes and banking relationships
> The impact of altering the interchange fees, because this will change the financial relationship between acquirer and issuer
> The ability of corporates to centralise their own payment processing and treasury operations
> The ability to integrate European banking services efficiently into their operations and leverage Straight Through Processing (STP) within their whole business.

FROM COMPLIANCE TO BUSINESS BENEFIT

Credit Card Acquirers & Transaction Processors

These businesses are banks and card processing companies involved in card acquisition. Allowing for a few exceptions, they currently provide domestic services only – the capture of transactions within the country of operation. There is already a general perception that there are too many processors in the European market, with at least 18 in the European Union countries.

The Euro zone countries are at different levels of maturity in the use of cards. In France for example, the market is a late adopter of transfer/debit product usage, notably in the use of a 'card' for Internet payments. Other countries have more readily adopted cashless payment in conjunction with increased Internet usage.

At the moment different countries within the Euro zone also have differing habits. Cash usage is still very high in Germany, while deferred debit cards are extensively used in France. This has restricted the number of credit cards being issued compared to other countries such as the UK.

The introduction of SEPA will have a number of financial impacts upon credit card acquirers and transaction processors:

> There will no longer be any price differentiation across the Euro zone, irrespective of national cost base
> Businesses will need to weigh the cost of developing capability against the uncertainty of how much additional business will be won
> There will be a further reduction of interchange fees, cutting deeply into card issuers' revenues.

In order to successfully address these financial impacts, key decisions must be taken.

Some players will need to decide whether they compete, merge/migrate or leave the market altogether. This has already started to happen. Banksys, the Belgian payments network recently acquired by Atos Origin, announced its intention to migrate the issuing of domestic cards to Maestro.

Others players will need to decide whether to expand services within the value chain in which they operate, or expand into associated SEPA areas such as Automated Clearing House access. Large international processors will be able to clear and settle transactions within their own "area of service" without having to clear through the ICS's network. However, that is not the most important part of expected savings. It's a cost advantage for acquirers and issuers, which can be used to improve their cost structure. But they will have to prepare the business case to prove the benefit.

Credit card processors will face a reduction in revenue as a result of SEPA, due to reduced fees per transaction. The key decision then will be how to recoup the lost revenue. There are a variety of linked options:

> Re-price banking card services e.g. annual card fees increased
> Implementation of transaction based prices. But it should be noted that this is a bank's decision and it's not viable in some markets where there is a high degree of competition or where mono-line card providers are operating
> Lower the cost of transaction processing by utilising third-party processors and their potential for consolidating transactions processing and generating economies of scale
> Develop shared service centres for back-office operations to gain pan-Euro zone economies of scale and attract greater business volume
> Create full acquiring services across the Euro zone to achieve reduced price entry to new markets.

Given these multiple and interlinked options, card businesses will have to carefully consider their overall strategy and customer propositions.

FROM COMPLIANCE TO BUSINESS BENEFIT

Banks

As we said in the introduction, SEPA's impact will be felt most by banks, because they bear most of the cost in the payment value chain. We estimate that the cost banks bear in the payment value chain is as high as 85% of the total, the rest being with the clearer or processor. It's also worth reiterating that payments provide core revenue for banks; they earn around 30% of their revenues from this product. The introduction of SEPA therefore means that banks must review their strategy and business model in order to address the impact upon both their revenues and their costs.

The risk of decreased revenues mainly comes from three areas:
> Reduced income per transaction ("Euro price" alignment and competition)
> Market share reduction related to competition and new entrants
> The risk of disintermediation in the payment process for new payment instruments and new payment usage, but not for the traditional payments with electronic payment originations as the main competitors, e.g. SWIFT and Visa.

The cost issue arises from the need to meet the requirements of SEPA. Banks will be under pressure to invest in the implementation of new applications and infrastructures, whilst maintaining their organizational structures. These investments will typically be provided through a centralized processing model.

Therefore, banks have to address several issues. Banks that already have international implementations are in a good position to service corporate customers by offering a full access capability to all clearing operations, whilst also being able to meet domestic requirements.

Most of the domestic banks will also have to provide international payment services. In this context, they have to decide upon the right strategy:
> To attack the market by themselves and bear all the costs needed to integrate SEPA requirements.
> To merge or sign partnerships with international networks or Payment Service Providers which have the same strategy.

Generally speaking, banks must consider whether to be 'merely compliant' with SEPA or whether to offer a full capability of access to all clearing schemes. The decision will be based on a strategy to grow by increasing the volume of non-card payments, in order to compensate for reduced income per transaction.

Other issues

IBAN and BIC will replace the local account number and banking code. How this happens will be driven by decisions within the EPC. But there can be no justification to run both the new and the old system in parallel. However, so called garage (or bilateral) clearing will continue to exist at least for some time to come.

Here too, investments are significant:
> Banks will have a portfolio of payments systems linked into each of the clearing operations of the countries in which they do business
> They will have to address the issue of inheriting multiple payments systems often developed by line of business or product type.

To optimise investments, banks need to take a streamlined approach towards an objective of achieving the greatest efficiency:
> Common processes and applications in the Euro zone
> A focus on STP initiatives throughout payments process
> A single shared service centre for payment processing where all activities benefit from economies of scale
> Development of "best in market" payments centres subject to skills availability and salary costs
> Using a white label service to outsource their cross-border payments processing where there are scale benefits.

Banks will also need to develop effective marketing for new or changed products and services:

> Services that deliver differentiation: Large corporates are very receptive to services such as real-time cash reporting, receivables reconciliation and remittance advice provision.

> A range of "consulting services": Europe is not one integrated market in customer behaviour and use of payments instruments. The creation of a simple market for payments will need significant selling to customers, and there will be large-scale training and educational opportunities.

> Secure payments services: Security and fraud must be addressed by banks in order to reassure customers and win their confidence.

> Services based on innovation: During the period of SEPA implementation (2006–2010), new technologies will be introduced into the payments market. These include contactless identification, biometry, electronic billing and financial transactions, and IP technology. If we consider the risks associated with SEPA – a decrease in income and an increase in costs – it's clear that banks need to develop services/offers with added value for their customers. We believe that the way to do this, is to embrace and develop new technologies that will deliver innovative services.

Four critical success factors

To sum up the challenges and opportunities for banks, we believe there are four key factors:

> **The ability to execute**
Those banks which are the first to market with efficient SEPA payments and who target corporate clients, will provide themselves and their customers with compelling business cases for high volume payments processing

> **The ability to differentiate products/services**
Creating new price or non-price customer propositions that differentiate a bank from its competitors, along with the ability to offer a full range of services

> **The ability to provide a 'statement of intent' to the market**
This should be as soon as possible, backed up by adequate marketing and communications campaigns

> **The ability to implement industrialised production**
This is key for payments processes and applications.