

## EPC Newsletter

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### FOCUS: SEPA MIGRATION

## On Payments and Light Bulbs

Commission ready to write off SEPA via EU legislation?

21.07.10 BY GERARD HARTSINK

Today, the majority of market participants recognise that successful completion of SEPA is contingent upon setting an end date for migration through EU Regulation to the single set of SEPA Schemes developed - at the request of regulators - by the EPC. In June 2010, the Commission services tabled a Working Paper outlining a binding Community instrument which would set end dates for compliance of euro credit transfer and euro direct debit schemes with so-called "essential requirements". The Commission argues that the "essential requirements" approach has been successfully applied in (no joke) *"other fields, for example in the case of the recently adopted Regulation on the phasing-out of non-efficient light bulbs"*.

The EPC welcomes the Commission's willingness to legislate in the context of setting an end date for SEPA migration. However, there are fundamental differences between exchanging a light bulb in your kitchen and the integration of euro payment systems. Gerard Hartsink clarifies that contrary to its misleading title ("*SEPA Migration End-Date*"), this piece of financial legislation now in the pipeline reflects political pretence rather than a regulatory intervention aimed at making SEPA a reality. If endorsed by EU lawmakers, the legislative act currently envisaged would effectively derail the entire SEPA project and deprive bank customers of the benefits associated with the SEPA harmonisation initiative.

The EPC proposes to set a binding end date for migration to the single set of SEPA Schemes developed by the EPC in close dialogue with the customer community through EU Regulation. In line with expectations expressed by, amongst others, the Economic and Financial Affairs Council (ECOFIN), the European Parliament and the European Central Bank, such a Regulation should ensure that the high costs of running both legacy and SEPA Payment Schemes in parallel can be eliminated; i.e. this Regulation must stipulate end dates for the phasing out of existing national euro credit transfer and euro direct debit schemes.

### **This summary further includes the main points detailed in the article:**

The forthcoming regulatory intervention setting end dates for compliance of euro credit transfer and euro direct debit schemes with "essential requirements" as currently envisaged by the Commission services would

- **Fail to establish definitive deadlines** for the phasing out of legacy euro payment schemes.
- **Abandon, in consequence, the original SEPA vision** aimed at creating one domestic euro payments market where there would be no differentiation between domestic and cross-border euro payment transactions anymore. Instead, the Commission now seems to be content with mandating cross-border reach for euro credit transfers and direct debits

based on multiple (old and new) "interoperable" payment schemes (a " **Mini SEPA**" or less).

- **Prohibit increased competition** in the supply of payments services to the advantage of bank customers contingent upon standardisation and market integration, i.e. the replacement of a multitude of existing euro payment schemes by one single set of SEPA Schemes as previously requested by the Commission, the Economic and Financial Affairs Council (ECOFIN), the European Parliament and the European Central Bank.
- **Rule out cost savings resulting from the consolidation of cash management operations** - again to the detriment of bank customers. Migration to a single set of SEPA Schemes is the precondition for consolidation to take place.
- **Stifle innovation** due to payments being subjected to central planning by the Commission which lacks any experience in the market place. The Commission is now seemingly determined to unilaterally decree "essential requirements" and common standards applicable to euro payment schemes; i.e. to take over the development of payment functionalities. Such a procedure would directly prevent bank customers from accessing the most advanced payment services as innovation will be strangled by red tape.
- **Punish early movers** both on the demand and supply sides who - in response to earlier calls by regulators including the Commission - have already invested in the renewal of their payment architecture to comply with the single set of SEPA Payment Schemes developed by the EPC.
- **Introduce additional systemic risks** in the area of payments given the request of the Commission now for the evolution of "multiple, competing" SEPA Schemes rather than one single set of SEPA Schemes to be established.



### Has the Commission suddenly lost its grasp of the principles governing market integration?

We first highlighted the implications of the "essential requirements" approach recently championed by the Commission services in the context of SEPA migration in the previous edition of this Newsletter (see article "On SEPA and US Health Care Reform"; a link is included below). This novel approach results from the equally novel outlook of the Commission on the SEPA Payment Schemes developed by the EPC at the request of regulators including the Commission: the Commission now brands these schemes to represent a "*private monopoly*"<sup>1</sup>. The EPC does not share this perspective given the fact that the regulators de facto mandated the European banking industry to develop a single set of SEPA Schemes (for extensive related references also refer to the article "On SEPA and US Health Care Reform"). Oblivious to its earlier communications on the need to establish a single set of harmonised SEPA Schemes, the Commission at this point requests "*new and competing credit transfer and direct debit schemes to emerge under the condition that they are*

*compliant with the essential requirements*"<sup>2</sup>.

As demonstrated in our previous commentary on the subject, replacing the multitude of existing national euro payment schemes by a single set of SEPA Schemes is the indispensable precondition for market integration which - also according to the Commission's former convictions - should result in increased competition among payment service providers to the advantage of bank customers and the strengthening of the common currency. The EPC also reiterates that migration to the single set of SEPA Schemes does not imply migration to specific SEPA *products and services* offered by individual payment service providers<sup>3</sup>. Competition in the provision of payment services

takes place at the product level; harmonised scheme rules and standardisation are the very precondition for increased competition at the product level. This principle is also recognised by the European Commission and the national competition authorities in all EU Member States cooperating with each other through the European Competition Network (ECN).

The concept of "competing payment schemes", therefore, makes about as much sense as arguing that "competing" standards for railroad tracks would boost competition in the transport and cargo sectors. If the latter were to be introduced, the exact opposite would happen: train traffic would come to a grinding halt.

So, does the back flip of the Commission mean it suddenly lost its grasp of the most basic principles governing market integration? Not likely. Rather, the legislative act now envisaged to establish end dates for compliance of euro payment schemes with "essential requirements" may very well reflect the Commissions' desperate attempt to accommodate different parties pursuing opposite goals:

### **The "essential requirements" migration approach now championed by the Commission reflects its failure to create the political consensus required to make SEPA a reality**

On the one hand, the Economic and Financial Affairs Council (ECOFIN)<sup>4</sup>, the European Parliament, the European Central Bank and the SEPA Council<sup>5</sup> asked the Commission to initiate a process aimed at setting binding end dates for migration to SEPA<sup>6</sup>. In her speech at the EPC SEPA Direct Debit Launch Event on 13 October 2009, Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, pointed out: "The SEPA process was only taken seriously by industry in reaction to an EC Regulation [Regulation (EC) 2560/2001 repealed by Regulation (EC) 924/2009]. (...) The Eurosystem will continue its efforts to foster a general understanding among stakeholders that setting a realistic but ambitious end-date for migration to SCT and SDD is a necessary step in order to reap the benefits of SEPA". She also clarified that the SEPA concept entails "**using a single set of payment instruments**" (a link to this speech is included below).

Irrespective of the fact that the ECOFIN endorsed the concept of defining deadlines for migration to SEPA in December 2009<sup>7</sup>, it is well known that some individual Member States in fact oppose the idea of replacing legacy euro payment systems by a single set of SEPA Schemes. In his speech at the EPC SEPA Direct Debit Launch Event, the then EU Commissioner Charlie McCreevy reiterated: "I believe there are strong economic and societal arguments in favor of setting an end date". However, the Commissioner admitted, "there still seems to be some political reluctance to discuss the issue. Most Member States hesitate to commit themselves and tie their hands at a moment where SEPA Direct Debit is still on its launch pad and the SEPA benefits are still theoretical" (a link to this speech is included below). The Directorate-General (DG) Internal Market and Services of the European Commission in charge of a related legislative initiative is thus aware that a proposal for a binding Community instrument setting end dates for the replacement of existing national euro payment schemes by a single set of SEPA Schemes might face some substantial opposition in the Council.

Last but not least, one must assume that DG Internal Market and Services only very recently bothered finding out whether the Directorate-General Competition would sign off on EU legislation stipulating mandatory migration to the single set of SEPA Schemes developed by the EPC. Apparently, DG Internal Market and Services failed to make the case for market integration with their colleagues next door. DG Competition, at the same time, seems unaware of the assessment reached by the European Competition Network; namely that standardisation in network industries generates scale and scope advantages for users. This is the only possible explanation why now DG Internal Market and Services suddenly issues statements effectively equating the EPC with Microsoft.

Perhaps this is an appropriate occasion to remind all parties concerned that the EPC is a not-for-profit organisation which makes all its deliverables; i.e. the SEPA Scheme Rulebooks and adjacent Implementation Guidelines as well as any other documentation, available for download free of charge on the EPC web site. The EPC is not a supplier of technology or any goods or services. It should further be kept in mind that the SEPA Schemes developed by the EPC have open access criteria in line with Article 28 of the Payment Services Directive (PSD).

The Commission has had a full decade to build the political consensus required to replace national legacy euro payment schemes by a single set of SEPA Schemes as of an end date set by a binding Community instrument. An

opportunity wasted, given the Commission's unrealistic expectations that SEPA should evolve through a "market-driven" process. The legislative initiative now under consideration reflects the Commission's surrender to market and political realities detrimental to SEPA rather than an attempt at remediating the situation in light of the fact that the Commission now envisages the continued operations of multiple (old and new) euro payment schemes.

The forthcoming regulatory intervention seeks to set end dates for compliance of euro payment schemes with so-called "essential requirements", and although this might make life easier for the Commission throughout the legislative process, it will derail the entire SEPA project and deprive bank customers of the benefits associated with the SEPA harmonisation exercise if endorsed by the legislator. Additional objectionable consequences of this legislative act as presently conceptualised are detailed below.

## **Self-regulation by banks is neither intended nor designed to impose migration to SEPA payment instruments on the demand side**

In this context, the EPC stresses that the Commission's assessment in its Working Paper of June 2010 that "*self-regulatory efforts [by the banking industry] have proven not sufficient to drive forward concerted migration to SEPA on both the supply and demand sides*" misrepresents the role of the EPC in the SEPA process. Self-regulatory efforts by the European banking industry cooperating in the EPC are exclusively aimed at defining the business rules and standards governing the SEPA Schemes and Frameworks and to engage the banking industry in the process of implementing these Schemes and standards. As a result of self-regulation by banks only, payment service providers representing more than 95 per cent of SEPA payment volumes today offer services and products based on the SEPA Credit Scheme and PSPs representing almost 70 per cent of SEPA payment volumes are rolling out services and products based on the SEPA Direct Debit Schemes. The EPC also took the necessary steps to alert all banks in the euro area of their obligation to be reachable for cross-border direct debits as of 1 November 2010.

These figures demonstrate that self-regulation produced precisely and successfully the tangible results requested by the political drivers of the SEPA initiative; e.g. development and implementation of a single set of SEPA Payment Schemes by the banking industry. Self-regulation by banks, however, is neither intended nor designed to impose migration to SEPA Payment Instruments on the demand side - as the Commission's Working Paper seems to imply. The EPC is responsible for the development of SEPA Schemes and Frameworks - not the overall management of the SEPA process.

## **There is a material difference between light bulbs and payment systems**

The EPC assumes that the rationale underlying a regulatory intervention based on "essential requirements" may be effective in some areas; however, it is incompatible with a process aimed at the integration of euro payment systems; i.e. the replacement of legacy euro payment schemes by harmonised SEPA Payment Schemes. The Commission argues that the "essential requirements" approach would have been successfully applied in "*other fields, for example in the case of the recently adopted Regulation on the phasing-out of non-efficient light bulbs*"<sup>8</sup>.

Granted, individual manufacturers of light bulbs should be able to produce, package and sell a product compliant with relevant requirements. Likewise, the individual light bulb user should not encounter major difficulties in making use of such a light bulb - he or she will simply have to take good care not to fall off the chair when replacing a light bulb in an overhead lighting device.

The Straight-through-Processing (no manual intervention) of 71.5 billion non-cash payment transactions in the European Union<sup>9</sup> annually, by contrast, requires agreement on the business rules and standards governing the execution of payment transactions. Payment services can only be delivered SEPA-wide if the banks of all customers adhere to the same business rules and standards. To grasp the level of detail that needs to be agreed upon to ensure the proper functioning of a payment scheme, we refer, for illustrative purposes, to the SEPA Credit Transfer Scheme Rulebook and the SEPA Direct Debit Scheme Rulebooks and related Implementation Guidelines posted on the EPC web site. For any given payment to be correctly executed under a specific payment scheme, the scheme rules must be observed - at a minimum - by the following parties: the payer's bank<sup>10</sup>, the entity facilitating the clearing and settlement<sup>11</sup> of funds between two banks, and the payee's bank. In the absence of such scheme rules

observed by these parties, it is impossible to execute a payment.

## The end of SEPA as we know it

Should the Commission services, seemingly not driven by reason on this occasion, determine to further pursue a regulatory intervention based on the "essential requirements" approach, a related Regulation or Directive, if endorsed by the legislator, would:

- **Fail to establish definitive deadlines** for the phasing out of legacy euro payment schemes.
- **Abandon, in consequence, the original SEPA vision** aimed at creating one domestic euro payments market where there would be no differentiation between domestic and cross-border euro payment transactions anymore. Instead, the Commission now seems to be content with mandating cross-border reach for euro credit transfers and direct debits based on multiple (old and new), "interoperable" payment schemes. (a "Mini SEPA" or less).
- **Prohibit increased competition** in the supply of payments services to the advantage of bank customers. Increased competition is contingent upon standardisation and market integration; i.e. the replacement of a multitude of existing euro payment schemes by one single set of SEPA Schemes as previously requested by the Commission, the Economic and Financial Affairs Council (ECOFIN), the European Parliament and the European Central Bank.
- **Rule out cost savings** resulting from the consolidation of cash management operations - again to the detriment of bank customers. Migration to a single set of SEPA Schemes is the precondition for consolidation to take place.
- **Stifle innovation** due to payments being subjected to central planning by the Commission which lacks any experience in the market place. The Commission is now seemingly determined to unilaterally decree "essential requirements" and common standards applicable to euro payment schemes; i.e. to take over the development of payment functionalities. Such procedure would directly prevent bank customers from accessing the most advanced payment services as innovation will be strangled by red tape.
- **Punish early movers** both on the demand and supply sides who - in response to earlier calls by regulators including the Commission - have already invested in the renewal of their payment architecture to comply with the single set of SEPA Payment Schemes developed by the EPC.
- **Introduce additional systemic risks** in the area of payments given the request of the Commission now for the evolution of "multiple, competing" SEPA Schemes rather than one single set of SEPA Schemes to be established.

For a further detailed analysis of the implications of the Commission services' Working Paper of June 2010 regarding this forthcoming legislative initiative, refer to the formal response of the EPC to the Commission in this matter (see link included below).

## The Commission should restore a minimum of planning security for all market participants as soon as possible

The Commission indicated that it plans to introduce a formal proposal for a binding Community instrument pertaining to euro payment schemes in September or October 2010. Unless the implications of this forthcoming piece of legislation listed above reflect unintended consequences of the wording of the Commission services' Working Paper of June 2010, the EPC invites the Commission to get back to the drawing board. The EPC proposes to set a binding end date for migration to the SEPA Schemes developed by the EPC in close dialogue with the customer community through EU Regulation. In line with expectations expressed by, amongst others, the Economic and Financial Affairs Council (ECOFIN), the European Parliament and the European Central Bank, such a Regulation should ensure that the high costs of running both legacy and SEPA Payment Schemes in parallel can be eliminated; i.e. this Regulation must stipulate end dates for the phasing out of existing national euro credit transfer and euro direct debit schemes.

In any event, the Commission should clarify its further course of action as soon as possible to restore a minimum of planning security for all market participants. Due to the Commission's recent contributions to the SEPA debate, regrettably, a common understanding of the SEPA objectives no longer exists at this point.

*Gerard Hartsink is the Chair of the European Payments Council.*

## Related links:

[Commission services' Working Paper of June 2010 pertaining to a forthcoming binding Community instrument setting end dates for compliance of euro credit transfer and euro direct debit schemes with "essential requirements" and common standards](#)

[EPC Response to the Commission services' Working Paper of June 2010](#)

[European Commission Discussion Paper "SEPA Migration End-Date" of March 2010](#)

[Speech Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the EPC SEPA Direct Debit Launch Event on 13 October 2009 in Brussels](#)

[Speech of former EU Commissioner Charlie McCreevy at the EPC SEPA Direct Debit Launch Event on 13 October 2009 in Brussels](#)

[ECOFIN Conclusions on SEPA \(December 2009\)](#)

## Related articles in this issue:

[Promoting the SEPA Vision. European Commission and ECB establish SEPA Council](#)

[Why change? Why me? Why now? The political mismanagement of the SEPA process reinforces resistance to change](#)

[SEPA in the Context of the Financial Crisis. Retail payments business proves to be resilient](#)

## Related articles in previous issue:

[On SEPA and US Health Care Reform. The EC paper "SEPA Migration End-Date": a commentary \(EPC Newsletter, Issue 6, April 2010; this article analyses a Discussion Paper tabled by the European Commission in March 2010 outlining alternative approaches, including regulatory intervention, aimed at ensuring migration to SEPA\)](#)

[Clarity and Incentives needed. ECOFIN conclusions of December 2009 on setting an end date for migration to SEPA \(EPC Newsletter, Issue 5, January 2010\)](#)

[The X Factor. Are EU governments still committed to making SEPA a reality? \(EPC Newsletter, Issue 4, October 2009\)](#)

<sup>1</sup>European Commission Discussion Paper "SEPA Migration End-Date" (PSMEG/002/10), section 2.1 (15), page 3. A link to this Discussion Paper is included at the end of this article.

<sup>2</sup>European Commission Discussion Paper "SEPA Migration End-Date" of March 2010 (PSMEG/002/10), section 2.3 (20), page 4. A link to this Discussion Paper is included at the end of this article.

<sup>3</sup>The EPC SEPA Scheme Rulebooks and corresponding Implementation Guidelines based on global ISO standards (the SEPA Schemes) describe sets of rules and standards that have to be observed by payment service providers when executing SEPA payment transactions. The Rulebooks are instruction manuals which provide a common understanding between banks on how to move funds and remittance information (maximum 4 x 35 characters) from account A to account B within SEPA. The rules and standards which make up a payment scheme are defined by payment service providers in a collaborative space - that is the EPC. The particular SEPA payment products and services offered to the customer are developed by individual payment service providers or groups thereof operating in a competitive environment. Mandating migration to a single set of harmonised SEPA payment schemes is the condition that must be met to ensure continued innovation in the payments market to the benefit of customers.

<sup>4</sup>The ECOFIN comprises the Finance and Economic Ministers of EU Member States.

<sup>5</sup>The objective of the SEPA Council chaired by the European Central Bank and the European Commission is to promote the realisation of an integrated euro retail payments market by ensuring proper stakeholder involvement at a high level and by fostering consensus on the next steps

towards the realisation of SEPA. The SEPA Council includes representatives of both the supply and the demand sides. At its first meeting in June 2010, the SEPA Council endorsed a formal declaration stressing its "support for the establishment of end-date(s) for migration to SEPA Credit Transfers and SEPA Direct Debits by means of legislation at EU level". See also the separate article on the SEPA Council titled "Promoting the SEPA Vision" in this edition of the EPC Newsletter.

<sup>6</sup>Refer to the article "On SEPA and US Health Care Reform" in the previous issue of this Newsletter for extensive references regarding the calls of the ECOFIN, the European Parliament and the European Central Bank to set binding end dates for migration to SEPA: [http://www.europeanpaymentscouncil.eu/article.cfm?articles\\_uuid=3A0930B5-EB05-B21D-9E35D23E2721C3F1](http://www.europeanpaymentscouncil.eu/article.cfm?articles_uuid=3A0930B5-EB05-B21D-9E35D23E2721C3F1)

<sup>7</sup>ECOFIN Conclusions on SEPA (December 2009) available at [http://www.europeanpaymentscouncil.eu/knowledge\\_bank\\_detail.cfm?documents\\_id=343](http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=343)

<sup>8</sup>European Commission Discussion Paper "SEPA Migration End-Date" of March 2010; section 2.3 (21), page 4. A link to this Discussion Paper is included at the end of this article.

<sup>9</sup>According to the Payments Statistics compiled by the European Central Bank, there were slightly more than 78 billion non-cash transactions in the EU in 2008 (latest figure available). This figure includes payments made using credit transfers, direct debits, cards, cheques, e-money and "other payment instruments". Without cheques this figure amounts to approximately 72.5 billion transactions; without cheques, e-money and "other payment instruments", this figure amounts to 71.5 billion (SEPA transactions do not cover payments by cheque, e-money or "other transactions").

<sup>10</sup>The EPC Newsletter uses the term "bank" in a non-discriminatory fashion; the term as used in the EPC Newsletter does not exclude payment service providers other than banks.

<sup>11</sup>Clearing and Settlement Mechanism (CSM).

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