



EUROPEAN CENTRAL BANK

**TOWARDS A SINGLE EURO PAYMENTS AREA –
Objectives and Deadlines (4th Progress Report)**

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TOWARDS A SINGLE EURO PAYMENTS AREA – OBJECTIVES AND DEADLINES (4TH PROGRESS REPORT)

EXECUTIVE SUMMARY

The Eurosystem has a vision for the Single Euro Payments Area (SEPA): a euro area in which all payments are domestic, where the current differentiation between national and cross-border payments no longer exists. This means that the SEPA project not only aims to improve the efficiency of cross-border payments. It also aims to develop common instruments, standards, procedures and infrastructures in order to foster substantial economies of scale. Within the SEPA, customers will be able to make payments throughout the whole euro area as efficiently and safely as in the national context today. If they so wish, they will be able to do so using a single payment account and a single payment card.

The SEPA is a natural consequence of the introduction of the euro. It therefore focuses on the euro area. Nevertheless, it will also contribute to improving the Single Market and to meeting the objectives of the Lisbon agenda. The SEPA will only be accepted by users, and therefore materialise, if it is future-oriented, if it anticipates how modern payment systems will look at the end of the decade, and if it exploits the new possibilities offered by progress in information technology.

It is important that the providers of the SEPA services take into account the needs of different customer segments. As the SEPA will require changes in customers' habits, solutions will have to be found which are as easy, cost-efficient and user-friendly as possible for banks' customers. In this respect, the involvement of representatives of the SEPA users – corporations, small and medium-sized enterprises, citizens and public authorities – in the project is indispensable. In addition, an appropriate communication strategy will be needed, which should be prepared already at this stage.

In 2002, the European banking community envisaged that the SEPA would be completed by the end of 2010. In 2004, the Eurosystem proposed, and the banks agreed, that consumers should be offered the possibility to use pan-European instruments as soon as January 2008. The Eurosystem sees no need to change these deadlines. However, it considers that the results expected by these dates should be more clearly defined.

The SEPA is a major European objective which in ambition, size and complexity is comparable with the changeover to the euro banknotes and coins. As a result, it must be run as a project: it can only succeed if all stakeholders involved in the process work towards the same goals and follow the same project plan with a set of agreed milestones.

It is up to the public authorities, the Eurosystem and the European Commission in particular to clarify the final objectives of the SEPA, after careful consideration of the expectations of all stakeholders.

That is the main objective of this report, which has been written after intensive consultation of the major actors, banks as well as users, at the national and at the European level. Given the political nature of the SEPA, it is also very important that public administrations, as heavy users of payment services, set an example and are among the first to move to the SEPA.

The banking industry has taken on the responsibility of delivering the SEPA products, in particular the specifications of the new payment instruments. It is up to them to develop and maintain viable and profitable business models compatible with the SEPA. Indeed, economies of scale, increased competition and greater efficiency will not only affect the banks' revenues but also their costs.

While the objectives of the SEPA and its deliverables must be defined at the euro area level, the migration path to the SEPA will mainly be organised at the national level because the starting points are different. National central banks will facilitate this process.

The SEPA instruments

At the end of the SEPA process, it is expected that all euro area **credit transfer** transactions will be processed in accordance with a single set of European schemes. In addition to the scheme presently defined by the European Payments Council (EPC), the Eurosystem expects that a standard for priority (same day) payment will be developed. Both standards should allow the incorporation of structured customer information, in order to facilitate e-invoicing and automatic account reconciliation. By 1 January 2008, the Eurosystem expects the schemes defined by the EPC to be available to customers, in parallel with the national instruments. By end-2010, the Eurosystem expects that public administrations, corporations and perhaps individuals will use exclusively the SEPA credit transfers.

The ultimate objective with regard to direct debits is that all euro area **direct debit** transactions be processed in accordance with the SEPA Direct Debit scheme defined by the EPC. This scheme will need to be complemented by additional options in order to provide suitable solutions for different customer needs (e.g. for business-to-business transactions). It is expected that the basic SEPA Direct Debit scheme will be fully operational on 1 January 2008. The date for finishing the migration from existing national direct debits to the SEPA scheme could be left to the discretion of the national migration plans. The risks associated with the possible coexistence of national and SEPA direct debit schemes after **2010** should be investigated by the EPC.

The SEPA for cards aims to move the domestic service from the national level to the euro area level. As a result, the **ultimate objective** of the SEPA project in this field is to facilitate the development of the instrument, from both the supply (banks) and demand (cardholders, merchants) points of view, across the euro area, without any differentiation within the SEPA between national and cross-border payments. With a national (debit) card today, cardholders are able to pay all over the country, with no geographical restriction. With a domestic card in the future, cardholders should be able to pay all over the euro area. As a result, national card schemes have to find a way of expanding their acceptance

network to the whole euro area. Any cardholder should be able to use his or her card at any ATM or POS (as long as the bank or merchant accepts the type of card/brand in question), at a reasonable cost and without differentiation based on the country of issue of the card. A merchant should be able to choose to deal with any acquiring bank located in any country within the euro area. Whenever a card scheme sets up an interchange fee, there should not be any differences in the fee level based on geographical factors.

In September 2005, the EPC delivered the Rulebooks for the SEPA Credit Transfer and the SEPA Direct Debit. These represent important milestones on the way to the SEPA. The Eurosystem appreciates the commitment and work undertaken by the EPC and its working groups and understands the difficulty of reaching a common agreement on such complex issues, not least the differing national practices. However, the Eurosystem encourages the EPC to complement this work by defining the few additional options mentioned above in order to allow European users to find more easily the instruments which fit their needs and expectations.

The EPC also approved the SEPA Cards Framework, which is another important milestone in completing the SEPA. However, the Eurosystem notes that the report leaves room for different interpretations and remains general on some issues. Further elaboration on this issue would therefore be welcomed.

The SEPA infrastructures and standards

The present infrastructure for the processing of retail payments has been designed to serve independent national payment systems. With the SEPA, substantial consolidation will be needed in order to allow banks and customers to benefit from economies of scale. The Eurosystem agrees that this process should be market-driven, and may not be completed by the end of 2010. However, it is expected that, by then, the payment infrastructure in the euro area will be fully **interoperable**. By 1 January 2008, the Eurosystem expects that all infrastructures still in existence will process nationally both “old” national instruments and “new” SEPA instruments, which means that they will have to be in a position to process payments made with the pan-European instruments/card schemes in parallel to national payments in their respective country.

In order to ensure that payments in the SEPA are efficient, it is essential that bank-to-customer and customer-to-bank **standards** are agreed so that the level of straight-through processing is maximised. Common security standards for payment transactions are also needed. In the field of interoperability for card schemes and infrastructures, the Eurosystem strongly encourages the EPC to start the technical work as soon as possible.

E-invoicing using payment infrastructures is a new form of service with exceptional potential. The Eurosystem therefore urges the banking sector to examine this issue in greater depth and to provide a

proposal on how the development of this new service form and its standards should be coordinated at the European level and in relation to the SEPA process.

INTRODUCTION

Since the introduction of euro banknotes and coins on 1 January 2002, citizens in the euro area have been able to make cash payments within and across all 12 countries from a single purse, using the single currency, as easily as with the previous national notes and coins. Yet what is now a reality for cash payments is still a vision for cashless payments. The introduction of the euro as the single currency of the 12 countries of the euro area will be completed only when the **Single Euro Payments Area (SEPA) becomes a reality, i.e. when individuals and corporations are able to make cashless payments throughout the euro area from a single payment account anywhere in the euro area using a single set of payment instruments as easily, efficiently and safely as they can make them today at the national level.** The SEPA goal is shared by the banking industry, user communities and political authorities. However, there are still diverging views on how and when this goal will be achieved and, despite encouraging progress in the preparatory work, the fruition of the SEPA appears to be a long way off. In particular, there is still no harmonisation of cashless retail payments, which remain predominantly based on national schemes, while national retail payment clearing and settlement infrastructures remain segmented by country.

Since the publication of its Third Progress Report on the SEPA in December 2004, the Eurosystem, in pursuit of its mandate to promote the smooth operation of payment systems, has actively followed the work undertaken by the European Payments Council (EPC), the main coordinating and decision-making body for the banking industry in SEPA matters. It has also organised high-level meetings with high-ranking bankers to work towards a common understanding of the goals of the SEPA and to obtain greater commitment from the banking industry to delivering the SEPA. Furthermore, discussion fora for representatives of consumer groups, merchants, small and medium-sized enterprises (SMEs) and corporate treasurers were set up in order to clarify what services these users expect from the SEPA. While some expectations may go beyond the scope of the SEPA, and there may be some diverging views among different groups of users, the Eurosystem considers that it now has a better view of user expectations in general, and these expectations are also reflected in this report.

Section 1 of the report formulates the general objectives of the SEPA project and the working methods that should be applied to make it successful. Section 2 defines the specific objectives for 2008 and 2010 for the individual SEPA instruments, infrastructures and standards, and evaluates the progress made towards achieving these objectives.

1. THE SEPA: GENERAL OBJECTIVES AND WORKING METHODS

1.1 The general objectives of the SEPA

1.1.1 The SEPA will eliminate national barriers

The SEPA will imply that customers can make payments throughout the whole euro area as efficiently and safely as in the national context today. This requires, in principle, that at the end of the process, euro area customers will have the possibility of using one payment account and one set of standardised instruments. When the SEPA project is completed, all euro area payments will become domestic and the current differentiation between national and cross-border payments will disappear.

In practical terms, this means that the SEPA is not a minimalist project aimed solely at improving the efficiency of cross-border payments. It is much more ambitious, as it encompasses the whole payment industry of the euro area. It is understood that a solution is required for cross-border payments, which, at present, can be inconvenient for customers because most of the payment instruments they have readily at hand for national payments cannot be used cross-border. With the SEPA, as it is defined in this report, this situation will be remedied. But, in addition, national payment instruments will be standardised at the European level, thereby allowing substantial economies of scale. Such economies of scale should benefit all agents in the payments landscape (including banks and all categories of user) and the European economy as a whole.

1.1.2 The SEPA will focus on the euro area

The SEPA is both a political and an economic objective linked to the introduction of the euro. Without the single currency, the momentum behind the SEPA would be much weaker. This is evidenced by the very limited success of earlier attempts to rationalise European payment systems in the 1990s. If it were to attempt to deal with too many countries and several currencies, the SEPA project would be more complex to implement, more difficult to justify and would also suffer from an increased risk of failure. Thus, the primary focus of the SEPA is on the euro area.

Nevertheless, the SEPA could also contribute to improving the Single Market, which is an EU objective. In addition, in the next few years, a number of EU countries are expected to join Economic and Monetary Union. Therefore, a careful balance has to be found between the absolute necessity to establish the SEPA for the euro area and, on the other hand, the need for openness to the rest of the EU.

1.1.3 The SEPA will be future-oriented

The major benefits of the SEPA, as emphasised in the Third Progress Report, will materialise only if the project is future-oriented. This is why the SEPA is not restricted to the translation of existing national procedures, infrastructures and standards into European ones. Rather, the SEPA anticipates how payment systems should look at the end of the decade, paying due attention to the new possibilities offered by progress in information technology. This forces European actors to rethink what they have so far taken for granted. In this context, the SEPA project is contributing significantly

to the Lisbon agenda, which, inter alia, aims to promote the competitiveness and dynamism of the European economy. Already today, European payment systems often have a leading position in the world in terms of automation. This competitive edge has to be preserved, and innovative solutions have to be found to meet the technological challenges in the European payment landscape.

1.1.4 The SEPA will be user-friendly

The SEPA cannot be a project to satisfy only European visionaries and IT experts. It should address the needs of both users of electronic payment products and those of paper-based products. The SEPA will require changes in the habits of individuals, including those who are less prepared for change. It will even, in some cases, introduce additional complexities (e.g. the International Bank Account Numbers (IBANs) are longer and generally more difficult to remember than the national bank account numbers). As a result, the individuals and institutions working on the SEPA will have to find solutions which are as cost-efficient, easy and user-friendly as possible for bank customers, and in particular for retail clients. Moreover, banks and their clients should not be forced to move down the technology scale. Otherwise, there would be a risk that the SEPA will fail because of negative public reaction. The main challenge for the banking industry is to make the new SEPA instruments attractive enough to the different communities of users, i.e. to public administrations, corporations, SMEs, merchants and citizens. The SEPA should provide concrete benefits and not be an enforced standardisation exercise. Although it is expected that e-banking will have substantially developed by the end of the decade, the SEPA should still take into account the needs of many individuals who might not feel at ease with modern technologies. At the other end of the spectrum, corporate clients will adjust more easily to the new SEPA instruments. However, in many cases, their requirements differ from those of retail customers (in the field of direct debits, for example). Corporate clients will require attention on account of the complexity of the interface between their internal processes and their payment service providers. The direct costs of modifying this interface to enable the processing of SEPA instruments might be high. Corporate customers will consider such costs as a valuable investment only if the SEPA offers them the prospect of a structural business transformation and has the appeal of a possible harmonisation of domestic services in the euro area. In this regard, corporations are pushing for innovations that allow them to effectively improve their internal processes. The providers of the SEPA payment services will need to ensure that this is the case.

Finally, in moving to European solutions, the SEPA should take inspiration from the countries which have adopted the most efficient payment instruments. In no case should the SEPA entail a deterioration of the current service offered to customers.

1.1.5 The SEPA will require a communication strategy

The introduction of euro banknotes and coins was accompanied by an important publicity campaign that was launched well in advance of the actual introduction. To date, the idea of the SEPA is only known within relatively small circles. Most individuals, public administrations, merchants and SMEs, and even many large enterprises, are still unaware of the SEPA process. The banking industry will

need to inform and educate its clients in due time. In 2006, the elements of a communication strategy will have to be formulated by the EPC in cooperation with the various organisations representing the major stakeholders (banks, users, public authorities). The actual information campaign for the mass market could usefully be launched in early 2007, when the implementation phase is already under way. Other user groups require earlier information. For instance, corporate customers and software vendors need information on new technical standards as early as possible in order to start developing the necessary information and communication technology. To provide the relevant information to these users, the EPC could establish a technical information centre.

The Eurosystem will consider playing a more active role in promoting migration, provided that the EPC delivers on its commitments and that there is strong political support for the SEPA, evidenced by the willingness of public administrations to adopt SEPA payment instruments.

1.1.6 The SEPA will also benefit banks

An assumption often made, by banks and non-banks, is that the benefits of the SEPA will be derived mainly from reductions in banking fees. However, the SEPA will not only affect the revenue side of payment business; it should also improve the cost side. Several studies have shown that, currently, the revenues that banks generate from their payment business vary considerably from country to country. As the SEPA will eliminate national barriers, it will foster greater competition and, as a result, exert downward pressure not only on banks' revenues, but also on processing costs. In addition, general and large-scale standardisation will result in better opportunities to share development costs and software products.

Today, banking communities follow business models which were established in the past to fit the needs of individual countries. For banks which intend to maintain these business models at any cost, the SEPA will appear to be a project which increases costs and reduces revenues. For those banks which adjust their business models to the requirements stemming from European integration and technological progress, the SEPA will be an opportunity to take a competitive advantage.

For the banking system as a whole, the result will probably depend on the ability of banks to reduce their costs with regard to infrastructure, to the maintenance of different procedures for domestic and euro area payments, or to the manual handling in some parts of the payment processing chain. This is illustrated by the fact that the national consolidation of market infrastructure which has taken place over the past decades, based on the principles of rationalisation and automation, has led to business models which remain profitable for banks. The same evolution should apply at the euro area level, where the business case for rationalisation and a higher degree of automation also exists. In this context, investment costs for the SEPA instruments and procedures can be seen as a business development that previously occurred in a purely national context.

1.1.7 The time frame of the SEPA process will be upheld

In the White Paper of May 2002, 42 European banks and the European credit sector associations declared that a full migration to the SEPA would be achieved by the end of 2010. In March 2005, the EPC expressed its conviction that a critical mass of transactions will have migrated to the SEPA payment instruments by 2010, such that the SEPA will be irreversible. However, some banks and other stakeholders have called this deadline into question, stating that a full migration of national to SEPA instruments/schemes by 2010 is unrealistic, and that the modernisation and integration process of the retail payment market may extend beyond that date. The Eurosystem has thoroughly investigated these objections and now considers that **most of the SEPA objectives, as they are defined in this report, can be implemented by the (end of) 2010 deadline** set by the banks in 2002. It is possible that some elements of the project, and in particular those linked to infrastructure changes and the complete phasing-out of national instruments, will not be able to be fully achieved by the end of 2010. However, it is clear that the move has to be irreversible and that the phasing-out of national instruments should be well advanced at the end of 2010. In the Third Progress Report, the Eurosystem put forward a proposal whereby citizens and commercial enterprises should be offered the chance to use pan-European instruments, for national and cross-border payments, as soon as 1 January 2008. This deadline has been widely accepted by banking communities and now constitutes an important milestone in the SEPA project.

1.1.8 The SEPA objectives will focus on establishing common standards and procedures

In the Third Progress Report, the Eurosystem envisaged that the conversion of the present fragmented retail payment clearing and settlement infrastructure into an integrated European one could be completed by 2010. The Eurosystem now believes that a fully integrated European retail payment clearing and settlement infrastructure is unlikely to be achieved by 2010. Instead, it is expected that a more cooperative approach between existing and new infrastructures will allow the adoption of common standards for exchanging payment orders across systems and provide the necessary processing platforms for SEPA payments. Hence, standardisation in this field cannot be further delayed and should become the primary focus of work in order to facilitate interoperability between the different infrastructures. Cooperation and interoperability between infrastructures is a key issue to be addressed.

A consolidation of existing infrastructures will contribute to reducing the production costs for payments and therefore to fully exploiting the savings opportunities of the SEPA. Hence, the Eurosystem expects that, each system having its own investment cycle, consolidation will take place progressively when systems consider their next investment cycle. At that point in time, the owners of a payment system (or of a card scheme) should carefully consider the opportunities for consolidation available in the euro area.

1.2 The working methods

1.2.1 The move to the SEPA must be run as a project

The SEPA is a major European objective, which in ambition, size and complexity is comparable with the changeover to the euro and the introduction of euro banknotes and coins. It must therefore be run as a project, with all the rigour that this implies. To a large extent, the move to the euro banknotes and coins is a source of inspiration on how this project should be managed.

The SEPA can only succeed if all stakeholders involved in the process work towards the same goals and follow the same project plan with a set of agreed milestones. The SEPA project is linked to the introduction of the euro, but also to the Single Market and the Lisbon agenda, which are major political and economic objectives of the European Union. Against this background, the final objectives of the SEPA should be clarified after careful consideration of the expectations of all stakeholders. This is the main purpose of this report.

So far, the Eurosystem and the European Commission have provided guidance to the banking sector, using various methods (reports, speeches, interviews, etc.). In this report, which has been discussed with the European Commission, the Eurosystem endeavours to make this guidance more explicit and comprehensive.

In line with the project principles, public authorities will refrain from substantially modifying the objectives during the life of the project. Otherwise, there would be a risk that the banking industry, which is mainly in charge of the implementation of the SEPA project, would fail to deliver in time.

The banking industry is responsible for delivering the SEPA products, and it is up to the banks to develop and maintain viable and profitable payment business models that are compatible with the SEPA. Yet while it is easy to allocate this responsibility to the euro area banking community in an abstract sense, it is very difficult in concrete terms. The euro area banking industry is a very heterogeneous group consisting of thousands of banks with very different business models. There are banks with a local, national or international focus, banks serving specific customer segments, not to mention the special purpose banks. Yet even banks that are active internationally and expect to process an increasing amount of SEPA payments fear that, if they are the first to move towards the SEPA, they will have to bear a large share of the initial costs of delivering the SEPA products without being able to reap the full benefits because there may initially be a lack of customer demand. This concern must be countered by ensuring that the euro area banking communities migrate in a consistent manner towards the SEPA.

The creation in 2002 of the EPC, as the main coordinating and decision-making body for the banking industry for SEPA matters, was a considerable achievement, as already underlined by the Eurosystem in earlier reports. In line with the project principles, it is important that the EPC keeps its present

leading role, at least until the completion of the project. Solutions have to be found at the national level to ensure that the decisions of the EPC are implemented by **all euro area banks**.

1.2.2 Users must be involved

In order to facilitate the adoption of the SEPA products by the final users (see Section 1.1.4), it is important to involve their representatives in the project. It is advisable for the EPC to find ways of better involving consumer organisations and representatives of merchants, SMEs and corporate treasurers in its work. Public administrations also need to be more directly involved.

1.2.3 Public administrations are invited to lead by example

Public administrations initiate and receive large volumes of payments for salaries, social benefits, taxes, etc. Because of the political nature of the SEPA, it is very important that public administrations set an example and are among the first to move to the SEPA. When public administrations face the choice between national and SEPA payment instruments, they are invited to use the latter, which also entail specific benefits for them. The Eurosystem intends to discuss with the relevant government organisations how this process can be undertaken.

1.2.4 National migration towards the SEPA must be well-organised

As the lead time for the implementation of the SEPA instruments and the SEPA Cards Framework is relatively short, the Eurosystem is prepared to facilitate the national migration to the SEPA, drawing on the experience gained from the 2002 euro cash changeover.

As with the cash changeover, most of the migration work will have to be performed at the national level because, even if the end result of the migration is the same everywhere in the euro area, the starting points are different. It is crucial that effective organisation is already in place in each country in 2006. Representatives of all stakeholders with an interest in the SEPA, i.e. banking communities, corporate treasurers, SMEs, merchants, consumer organisations and public authorities/government agencies, should be involved in the SEPA migration. National central banks (NCBs) will facilitate this process. It is expected that the national structures responsible for migration will identify what needs to be migrated (instruments, card schemes, standards, business practices, infrastructure) by when in order to comply with the SEPA deadlines set out in this report and in the EPC documents. For each phase of the migration process, a detailed roadmap needs to be established with concrete and measurable milestones which allow comprehensive monitoring of the progress.

Although most of the work related to migration needs to be performed at the national level, there will be a need for coordination at the European level. In order for the first SEPA deliveries to be ready by 2008, functional detailed plans and checklists are needed on all levels for each instrument. Given the complexity of this project, it is important that progress be monitored in a very structured and regular way. The Eurosystem expects the EPC, as the project manager, to take overall responsibility for defining and implementing such a monitoring framework for each phase of the migration process,

including a detailed roadmap with concrete and measurable milestones. In addition, it is the responsibility of the EPC to define, in cooperation with the different stakeholders (including NCBs when they operate the automated clearing houses (ACHs)), clear and unambiguous criteria with which to assess SEPA compliance. All parties should undertake a self-assessment and the EPC should express a view on all evaluations.

The Eurosystem will also actively monitor the SEPA migration and expects national migration roadmaps to be available by mid-2006.

2. SPECIFIC OBJECTIVES FOR THE SEPA INSTRUMENTS, INFRASTRUCTURES AND STANDARDS, AND THE PROGRESS MADE TOWARDS MEETING THEM

In 2005, the EPC and its working groups invested substantial effort and resources in the development of the Rulebooks for the two schemes defined by the EPC: the SEPA Credit Transfer and the SEPA Direct Debit. The EPC also defined a SEPA Cards Framework. In September 2005, the EPC adopted the two SEPA instrument Rulebooks for national consultation and approved the SEPA Cards Framework. In the same month, the Roll-out Committee (ROC) was established. This committee will report to the EPC Plenary and will be responsible for a number of scheme management functions until a permanent scheme management entity is put in place in June 2006. Adherence Agreements, setting out the legal framework for the SEPA schemes, are also under development.

The delivery of the Rulebooks and the SEPA Cards Framework represents a major achievement for the EPC. Very complex issues had to be resolved, mainly because current national practices are so varied. The cost of reaching agreements on the Rulebooks and the SEPA Cards Framework, however, is that the delivered products are in some cases limited to basic features and would need to be complemented in order to fulfil the requirements set by users.

In order to follow the principles of good project management, the Eurosystem urges the EPC to approve the Rulebooks in March 2006. It is vital for the SEPA project that the present achievements be frozen and that they cannot continuously be challenged. However, the Eurosystem also urges the EPC to identify the issues which will require further elaboration and might possibly complement the Rulebooks. This list of issues should be limited and a clear deadline set for each item. In the following sections, the report clarifies a number of concrete deliverables and the expected timing for their completion. It also underlines the issues that the Eurosystem would like the EPC to address in the coming months.

2.1 Credit transfers

The objective

The **ultimate objective** of the SEPA in this field is for all euro area credit transfer transactions to be processed in accordance with the SEPA Credit Transfer scheme defined by the EPC. This objective should be reached in two steps.

The SEPA timetable

By 1 January 2008, the Eurosystem expects that the standard SEPA Credit Transfer defined by the EPC and the priority credit transfer will be made available to customers, in parallel with the national instruments, to be used in both a national and a cross-border context. Customer-to-bank and bank-to-customer standards/interfaces will also have been developed and made available to customers.

By end-2010, the Eurosystem expects that public administrations, corporations and perhaps individuals will use exclusively SEPA credit transfers.

Where are we?

The SEPA Credit Transfer Rulebook, in the version adopted by the EPC in September 2005 for national consultation, defines a basic credit transfer for non-time-critical payments. It will ensure full reachability, guarantee that the full amount is credited to the recipient's account, and place no limit on the value of the payment.

In the present version of the Rulebook, the execution time for the transfer should not exceed three banking days from the date of acceptance. In its latest proposal for a directive on payment services in the internal market, the European Commission envisages setting a legal requirement that would reduce the maximum execution time to one banking day (D+1) by 2010. The Eurosystem will study the feasibility of the proposal, which however could require high investment by the banking sector in some EU countries. Although the draft directive has not yet been approved by the EU Council and the European Parliament, the Eurosystem – in light of the above – encourages the EPC to study carefully the possibility to modify the specification of the SEPA Credit Transfer before its final adoption in March 2006 so as to avoid uncertainties concerning the objectives of the SEPA in this field.

The Eurosystem, in its analysis of the SEPA Credit Transfer Rulebook, has pointed out to the EPC a number of features that the EPC should urgently define in order to complement the basic service defined in the Rulebook.

First, a **priority credit transfer scheme with same-day settlement** is needed for payments that customers deem to be urgent. This scheme should be a non-proprietary, open standard, not tailored to fit a specific infrastructure, and made available to all interested banks. In order to meet this requirement, a priority credit transfer scheme should be endorsed by the EPC, which should also monitor its implementation. It is understood that it would be left to each bank to decide whether it wishes to offer this service or not. The priority credit transfer standard should be developed in close cooperation with the providers of infrastructures which may process it in future.

Second, in compliance with a strong request from corporate treasurers, generic **customer-to-bank and bank-to-customer standards** should be developed. These should provide, as part of the business rules and data models, the possibility of including **structured remittance information and a code for automatic reconciliation** at sufficient length to enable full end-to-end straight-through processing. In this respect, the Eurosystem appreciates that the EPC, in its December 2005 Plenary, expressed its willingness to work in this direction, in cooperation with corporate treasurers. It would be useful for banks to offer a simplified version of this standard for those customers who prefer to continue using a paper-based credit transfer form. The EPC is invited to investigate the possibility of developing a SEPA standard for a paper-based credit transfer form (and the corresponding web-payment design) to be used for pan-European credit transfers (as from 2008) to avoid the development of country-specific standards; the work already started some years ago in this field should be continued. However, there is certainly no intention to encourage the use of paper-based instruments; these should gradually be

replaced by more efficient electronic instruments, but their use by a large proportion of bank customers is a reality which needs to be catered for.

2.2 Direct debits

The objective

The **ultimate objective** for direct debits is for all euro area direct debit transactions to be processed in accordance with the SEPA Direct Debit scheme defined by the EPC. This scheme may have different options to provide suitable solutions for different customer needs, e.g. for business-to-consumer and business-to-business transactions. Furthermore, it may also have different options for mandate handling in order to address the different habits across the SEPA.

The SEPA timetable

It is expected that, on **1 January 2008**, the basic SEPA Direct Debit scheme will be fully operational, and be made available for business-to-consumer and for business-to-business transactions. Possible additional options, which are currently being investigated, should be made available in 2008.

The EPC is invited to examine the drawbacks of the coexistence of national and SEPA direct debit schemes after the **end of 2010** (implying different rights and obligations for customers, for example in terms of revocation time and mandate handling).

The date of the end of the migration from existing national to SEPA direct debits should be left to the discretion of the national migration plans.

Where are we?

The SEPA Direct Debit Rulebook was adopted by the EPC in September 2005 for national consultation. The aim of the SEPA Direct Debit Rulebook is to express a complete set of business rules, practices and standards which will govern the SEPA Direct Debit scheme. It thus contains provisions on the scope of the scheme, the roles and responsibilities of the participants, business and operational rules and the legal and contractual framework.

A major difficulty which the EPC had to overcome in preparing the SEPA Direct Debit Rulebook was that national mandate handling practices differ widely in terms of their issue, amendment and cancellation. In some countries, the debtor gives a mandate directly to the creditor, and the banking sector is not involved in the handling of mandates. In such countries, debtors have extended rights to reject direct debits. In other countries, the debtor gives a mandate to its bank, either directly or through the creditor, in order to implement a direct debit. The SEPA Direct Debit is closer to the first model. However, in the national consultations organised by the EPC at the end of 2005, it emerged that, in several countries, users felt uncomfortable with the model chosen. As a consequence, in December 2005, the EPC decided to investigate whether additional procedures for the handling of mandates

could be implemented. The relevant findings must be presented to the EPC Plenary in September 2006, and it is possible that the EPC will add further options to the present scheme.

It is clear that the direct debit scheme proposed by the EPC is particularly suitable for mass payments from consumers to corporations, utilities or public administrations (e.g. electricity bills or tax payments). The scheme is less appropriate for business-to-business transactions which typically require different parameters (e.g. shorter revocation times and shorter execution times). The EPC agreed in December 2005 to examine the possibility of defining options in the scheme which would better suit this category of payments. The Eurosystem encourages the EPC to pursue this task in order to find a suitable solution for corporate clients. It is important, however, that the choice of option be available to both the creditor, which may offer one or more options, and the debtor, which may decide whether or not to accept the options offered by the creditor. This means that the banking sector would have to be able to handle all solutions, and national implementation plans should not prevent the use of any of them.

Finally, throughout the development of the SEPA Direct Debit Rulebook, the Eurosystem has repeatedly stressed that a basic success criterion for the new scheme is the **reachability of all debtor banks** by any SEPA Direct Debit transaction. This requires that all euro area banks are able to receive direct debit instructions from creditor banks using the new scheme and standards. The current version of the Rulebook does not provide any information on how full reachability can be attained. The EPC is invited to address this issue without delay, at the latest by September 2006, in order to ensure that the relevant measures are in place before the SEPA Direct Debit is offered to all users in January 2008.

2.3 Card payments

The objective

Card payments are convenient for users and relatively inexpensive to process for the banking system. The advantages of card payments are particularly strong in the field of face-to-face payments, where the only alternatives are cash and, in some countries, cheques. The SEPA for cards aims to move the domestic service from the national level to the euro area level. As a result, the **ultimate objective** of the SEPA project in this field is to facilitate the development of the instrument, from the point of view of both supply (banks) and demand (cardholders, merchants), across the euro area, without any differentiation within the SEPA between national and cross-border payments. With a national (debit) card today, cardholders are able to pay all over the country, with no geographical restriction. With a domestic card in the future, cardholders should be able to pay all over the euro area. As a result, national card schemes have to find a way of expanding their acceptance networks to the whole euro area. Any cardholder should be able to use his or her card at any automated teller machine (ATM) or point of sale (POS) (as long as the bank or the merchant accepts the type of card/brand in question), at a reasonable cost and without differentiation based on the country of issue of the card. A merchant should be able to choose to deal with any acquiring bank located in any country within the euro area.

Whenever a card scheme sets up an interchange fee, there should not be any differences in the fee level based on geographical factors.

The SEPA timetable

The Eurosystem expects that **by 1 January 2008:**

- all technical and contractual provisions, business practices and standards which have resulted in a national segmentation of the euro area will have been eliminated;
- appropriate technical and contractual provisions, business practices and standards will have been defined (in particular, the technical standards for cards, technical acceptance devices (POSs and ATMs), communication interfaces, processing platforms, etc.) ensuring interoperability and thus flexibility and independence in the choice of service providers;
- should an interchange fee be levied, a transparent, cost-based methodology will have been defined and submitted for approval to the European Commission;
- a comprehensive strategy will have been developed in order to reduce card fraud, in particular in the cross-border context.

By the end of 2010, the ultimate objective of the SEPA should have been reached. All card schemes will be compliant with the EMV standard, including the use of the personal identification number (PIN). Cardholders and merchants will be offered two lines of service only: a domestic service, identical for the whole euro area, and an international service for euro area cardholders using their card outside the euro area.

Where are we?

The SEPA Cards Framework, in the version adopted by the EPC in September 2005, aims to establish an environment in which there are neither technical, legal nor commercial barriers preventing stakeholders (card schemes, cardholders, issuers, acquirers and merchants) from using or providing card payment services without any border considerations within the euro area. Bearing in mind that agreement had to be sought from national banking communities operating in countries with very different card scheme landscapes, the SEPA Cards Framework can be regarded as a very valuable achievement. However, it is relatively general and leaves too much room for interpretation. In this respect, the Eurosystem now expects that the EPC will define compliance criteria to be used to certify whether or not a scheme is compliant with the SEPA Cards Framework. This will help both the EPC and the Eurosystem to monitor progress towards the ultimate objective of the SEPA in relation to cards.

Card schemes are part of the market infrastructure. Their functioning is subject to very high economies of scale and also to network effects. Therefore, as explained in Section 1.1.8, consolidation in the SEPA is necessary, even if it takes place relatively slowly. It is important that the future European model provides a very high degree of efficiency.

At present, in each country of the euro area, at least one card scheme operates at the national level, offering, in general, a high service level at a reasonable price. Most banks also adhere to at least one international scheme, to be used for transactions made out of the country. Transposing this successful model into the euro area context requires the emergence of European schemes that would serve part or all of the SEPA, coupled with continued recourse to international card schemes for pan-European reach and/or out-of-region transactions. International card schemes could be among these euro area schemes, provided that, instead of their present dual offering of national and cross-border payments, they start offering a dual service involving euro area and out-of-region transactions.

Other solutions for fulfilling the SEPA objectives could be offered by one or more of the existing national schemes, or through alliances between existing card schemes (both national and international).

The Eurosystem recognises the merits of the various options, and will follow with interest the intentions of both banks and card schemes. However, the Eurosystem understands that options can be implemented by the end of 2010 only if interoperability standards are made available quickly, allowing a reduction in the average cost of card transactions. In this context, the Eurosystem expects that banks and card schemes will take into account the view of other stakeholders, in particular merchant and consumer organisations, in order to facilitate the emergence of solutions which are favourable to all parties, and not just to the banking sector. Indeed, the Eurosystem expects that the SEPA will, on average, reduce the costs of card transactions. It would view very negatively any initiative that would lead to an unjustified increase in the level of fees currently charged at the national level.

The international card schemes will play a central role in the consolidation process. The banking industry will rely on them to offer, in all cases, an out-of-region service of the same high quality as the cross-border service that they offer today. They will also have the opportunity to offer a euro area service, alone or through alliances. The Eurosystem invites the international card schemes not to use their unique position in the out-of-region field in order to foster artificially their competitive position in the euro area. National card schemes are invited to seek possible ways of coordinating their activities in order to allow customers to continue to benefit in the whole euro area from a service that is as simple, efficient and low-priced as the present national service.

The SEPA Cards Framework refers extensively to standardisation, but it does so in rather broad terms. In the field of fraud prevention, the commitment to achieve full EMV compliance by the end of 2010 is to be praised. The adoption of uniform EMV specifications is a prerequisite for the complete success of this measure. However, detailed work plans for developing and implementing **standards for every phase of the card payment transaction** and for combatting **fraud types** other than those covered by EMV are still missing.

In addition to the SEPA Cards Framework, the EPC has been dedicating resources to drafting the **SEPA Card Fraud Database Opportunity and Feasibility Study**. The Eurosystem welcomes this initiative. A card fraud database aims to make data available to banks regarding the fraud rate experienced by merchants. Such databases are typically offered by individual card schemes. As a tool to combat fraud, there would obviously be value in such a database being established at the euro area level, provided that it is legally sound and based on objective criteria. The Eurosystem stands ready to discuss this issue with the EPC.

The SEPA Cards Framework is also relatively vague as far as **interchange fees are concerned**. The Eurosystem understands that a series of safeguards must be put in place when the banking industry collectively addresses this topic, which raises sensitive issues in terms of competition. But progress in this field is essential. The SEPA Cards Framework should be complemented by principles for an interchange fee policy. The Eurosystem notes that the SEPA Cards Framework allows the establishment of agreements on the interchange fee level within geographical sub-groups of card scheme members. The Eurosystem strongly invites the EPC to reconsider this provision because differentiation on purely geographical grounds is not compatible with the SEPA concept. In any case, should interchange fees be levied, they should reflect the reduction in processing costs for card payments in the SEPA.

2.4 Cash, cheques and other non-SEPA retail payment instruments

Although euro area citizens have been living since 1 January 2002 in a SEPA for cash, i.e. using the same banknotes and coins, the cash supply system in the euro area is characterised by the coexistence of multiple national infrastructures, based on different business models. Accordingly, for credit institutions and other professional cash handlers there is not yet a “Single Euro Cash Area” (SECA). Harmonisation in this field is required because cash is, and will probably remain, the most extensively used payment instrument.

The Eurosystem and the EPC have established a constructive dialogue on how to achieve greater harmonisation of NCB operational conditions. The aim is to create a level playing-field, where basic functions performed by NCBs will be interchangeable.

As third parties play a significant role in enhancing cash processing efficiency, the SECA Framework identifies a range of best practices that banks should take into account when outsourcing part of their cash processing activities. It also proposes a dialogue with third parties on issues of common interest, notably designing common initiatives against euro counterfeiting, identifying ways of containing the societal cost of cash, and reaching a common understanding on standardisation issues. With regard to the latter point, while some standards have already been delivered (e.g. common definition of fit/unfit euro banknotes), others are outstanding, e.g. coin and banknote packaging, security requirements for euro cash transportation with *interchangeability* as the main objective.

Cheques and other non-SEPA instruments will not be used on a cross-border basis within the euro area. These instruments will thus ultimately disappear when it becomes clear to their users that other means of payment provide better service. **By 1 January 2008**, it is expected that national banking communities in the euro area will have put in place a strategy for promoting the use of alternative electronic means of payment, decreasing cross-subsidies and providing customers with transparent prices. **By the end of 2010**, once the SEPA instruments have been adopted by customers, the use of cheques and other non-SEPA instruments is expected to follow a clear downward trend (however, national payment instruments for which a SEPA alternative is not available could continue to exist as long as there is demand for them). Because the use of non-SEPA instruments is so different across countries, it is understood that this process will be monitored at the national level and that the EPC will not be involved.

2.5 Retail payment clearing and settlement infrastructures

The objective

The **ultimate objective** of the SEPA in this field is threefold: first, retail payment systems have to be able to process the SEPA instruments and to be fully interoperable; second, existing market infrastructures should consolidate in order to exploit economies of scale; and third, modern technology should allow further cost reductions to be made. It is expected that, as a result, the number of retail payment clearing and settlement infrastructures and the costs related to their services will decrease substantially. However, the Eurosystem agrees with the banks that the process should be market-driven; it may therefore require time and may not be fully completed by end-2010.

The SEPA timetable

By 1 January 2008, the Eurosystem expects that retail payment infrastructures will process **nationally** both “old” national instruments and “new” SEPA instruments, which means they will have to be in a position to receive and process payments made with the pan-European instruments in parallel to national payments. In practical terms, this means that, for an interim period, retail payment infrastructures will be required to process pan-European and national standards, as well as, possibly, to effect a conversion between the two. The ability to process pan-European payment instruments is a prerequisite for ensuring the availability of these instruments to customers by 2008.

By end-2010, all euro area retail payment clearing and settlement infrastructures will process SEPA instruments **within the euro area**. In order to reach that goal, they will have to be completely interoperable, which means that they should be able to address or receive, directly or indirectly, payment orders from any bank in the euro area.

Where are we?

To promote the adoption of the SEPA by euro area retail payment clearing and settlement infrastructures, the EPC is currently investigating the establishment of a **framework for the evolution of retail clearing and settlement infrastructures in the SEPA**, including **principles for SEPA**

scheme compliance. The Eurosystem encourages work in this field, as it addresses a shift in focus that was identified in 2005. As reflected in the Third Progress Report, banks, as users or shareholders of the existing retail payment clearing and settlement infrastructures, initially promoted the concept of a pan-European automated clearing house (PEACH), which would have required banks either to close their system and move to another infrastructure or to transform proven and efficient national arrangements into PEACHes. In 2005, it became increasingly clear that a third alternative was being considered, as a number of existing national ACHs declared their intention to become SEPA-compliant without necessarily transforming themselves into a PEACH. Provided that the requirements for SEPA compliance are soundly formulated and that there are no obstacles to open and fair competition between PEACH providers and SEPA-compliant infrastructures (e.g. no cross-subsidisation between the processing of national instruments and SEPA-compliant instruments), the Eurosystem does not foresee problems with this more open approach. The Eurosystem will encourage both the migration of national to SEPA-compliant infrastructures and the establishment of additional PEACH providers to create the necessary competition in the market.

In order for existing retail payment infrastructures to become SEPA-compliant, they must be able to send or receive payments to and from all banks in the euro area, directly or indirectly through intermediary banks or through links between infrastructures. A prerequisite for the establishment of links between infrastructures is the adoption of common standards for the exchange of payment orders across systems. Without standardised message formats and bank and customer identification codes, the need for manual intervention would both slow down the processing and make it more expensive. This process is very similar to the establishment of links between real-time gross settlement systems which made possible the creation of the TARGET system. The Eurosystem invites the euro area retail payment clearing and settlement infrastructures provided by both NCBs and the private sector to establish an appropriate forum to discuss how full interoperability could be achieved.

Once common message and data standards are available, no infrastructure should refuse to establish a link with another. Transactions between infrastructures could be settled in TARGET2. Furthermore, current geographical access restrictions to infrastructures should be eliminated. In parallel, any obligation to process certain types of payment in a specific infrastructure should disappear. The removal of access restrictions and entry barriers also implies that financial institutions should be in a position to make a choice in their use of retail payment clearing and settlement infrastructures based on service and price. Full transparency of services and pricing should be ensured. Overall, it is expected that, through market pressure, a number of infrastructures will progressively disappear, in particular at the end of their investment cycle, when system owners or users might realise that they could find better solutions elsewhere in the euro area.

2.6 Standards

One of the achievements of the EPC in terms of governance has been to bring the European Committee for Banking Standards under the umbrella of the EPC. This change was needed in order to streamline the work of the banking industry in the standardisation field.

In order for payments in the SEPA to be efficient, it is essential that end-to-end standards are agreed so that the level of straight-through processing is maximised. In this respect, the adoption of message standards is an important achievement. The EPC has decided, in principle, to opt for the ISO 20022 – UNiversal Financial Industry message standard (UNIFI), and a language based on XML. The EPC has signed a Memorandum of Understanding with SWIFT, according to which SWIFT will be responsible for the development of the messages for the SEPA Credit Transfer and SEPA Direct Debit. Furthermore, the definition of the SEPA data model, the decision to recommend the use of UNIFI messages in the customer-to-bank domain and the development of implementation guidelines for their use are also positive developments. It is important that, as stated by the EPC, the SEPA data model allows the implementation of value added services in addition to the basic services. The standards for card transactions are not beyond the scope of the EPC; they are part of the expectations for 2008, as mentioned in Section 2.3.

It is also important that work be completed quickly on two remaining issues: the identifiers needed in the SEPA payment messages (only the IBAN, or also the Bank Identifier Code (BIC)?), and the standards of security for payment transactions.

The wide distribution of IBANs and BICs is a major recent achievement of the European banking industry. There are still doubts about whether customers can use only the IBAN or whether they also have to use BICs. The EPC is urged to clarify this issue, ideally before June 2006, in order to facilitate communication with users. The Eurosystem welcomes the work of the EPC's Operations, Infrastructure and Technology Standards Support Group on a long-term solution for bank and customer identification and payment routing. In particular, the Eurosystem stresses the need to simplify the bank and customer identifiers with a view to moving towards a long-term scenario while avoiding too many changes for customers.

In addition, the Eurosystem welcomes the activity started by the Security of Payment Task Force (SPTF). It is important that the end-to-end security of payment transactions undertaken with SEPA instruments (i.e. cards, credit transfers and direct debits) is ensured in a harmonised way, on the basis of best practices and standards. For cards, this implies that the EPC identify security standards covering all steps of the transaction process (see Section 2.3) and that those standards, to be implemented in a harmonised way, become part of the SEPA Cards Framework. For credit transfers and direct debits, the decision of the EPC's SPTF to undertake a stocktaking exercise of national security practices in the customer-to-bank domain is particularly welcome. If this exercise finds that there are no major differences across European countries, the identified best practices will be

considered for the scope of the SEPA. If significant differences are identified, however, the EPC may work out a common level of security practices. Whatever the case, the outcome should be reflected in the relevant payment instrument schemes. In addition, the EPC should look at the interoperability of security devices and electronic documents with a focus on e-signature. The objective should be to make available a set of security best practices and standards for SEPA payment instruments to be implemented as soon as possible and no later than 2010.

In the field of interoperability, for card schemes and for retail payment infrastructures, the Eurosystem strongly encourages the EPC to start the technical work as soon as possible, including the definition of common settlement procedures for these entities.

LIST OF ABBREVIATIONS

ACH	automated clearing house
ATM	automated teller machine
BIC	Bank Identifier Code
EMV	Europay International, MasterCard International, Visa International
EPC	European Payments Council
EU	European Union
IBAN	International Bank Account Number
IT	information technology
NCB	national central bank
PEACH	pan-European automated clearing house
PIN	personal identification number
POS	point of sale
ROC	Roll-out Committee (of the EPC)
SECA	Single Euro Cash Area
SEPA	Single Euro Payments Area
SMEs	small and medium-sized enterprises
SPTF	Security of Payment Task Force (of the EPC)
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TARGET	Trans-European Automated Real-time Gross settlement Express Transfer system
UNIFI	ISO 20022 – UNiversal Financial Industry message standard

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