The Changing Landscape of European Payments

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Cash Management
Agenda

• The Global View
• The Single Euro Payments Area (SEPA)
• Regulatory Requirements
• SEPA Schemes
• The Payment Services Directive
• TARGET2
• The Future and Impacts
The Global Domestic View

- Higher value entering traditional low-value systems. Redefined as Urgent and Non-Urgent
- Paper rich markets are showing dramatic declines in the shift to electronics
- Commoditization continues at an increased pace

Source: BCG Global Payments database, 2006
The Single Euro Payments Area
What is SEPA?

- The Single Euro Payment Area (SEPA) will be the area where citizens, companies and other economic actors will be able to make and receive payments in euros, within Europe, whether between or within national boundaries under the same basic conditions, rights and obligations, regardless of their location.

<table>
<thead>
<tr>
<th>Today</th>
<th>Tomorrow</th>
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<tbody>
<tr>
<td></td>
<td>12 euro 29</td>
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<tr>
<td>Population</td>
<td>310m 470m</td>
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<tr>
<td>Corporates</td>
<td>17m 25m</td>
</tr>
<tr>
<td>Banks</td>
<td>7–8k 9k</td>
</tr>
<tr>
<td>ACH Schemes</td>
<td>10 20+</td>
</tr>
<tr>
<td>Card Schemes</td>
<td>14+ 18+</td>
</tr>
<tr>
<td>POS</td>
<td>4.5m 6.2m</td>
</tr>
<tr>
<td>ATMs</td>
<td>238k 326k</td>
</tr>
<tr>
<td>Electronic transactions</td>
<td>50bn 73bn¹</td>
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</tbody>
</table>

¹ Not all euro transactions

Source: European Payments Council, June 16, 2006
## SEPA countries

<table>
<thead>
<tr>
<th>Austria</th>
<th>Hungary</th>
<th>Slovakia</th>
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<tr>
<td>Belgium</td>
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<td>Cyprus</td>
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<td>Czech Republic</td>
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<td>Germany</td>
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<td>Norway</td>
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<td>Greece</td>
<td>Portugal</td>
<td>Switzerland</td>
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## What is SEPA?

<table>
<thead>
<tr>
<th>Today—different country implementations</th>
<th>Tomorrow—harmonised SEPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>National/local solutions</td>
<td>Common solutions with additional optional services</td>
</tr>
<tr>
<td>Different schemes, experiences, standards, consumer protection laws</td>
<td>Common core payment instruments and experiences, consistent standards, application of harmonised consumer protection laws</td>
</tr>
<tr>
<td>No interoperability of national schemes</td>
<td>Improved interoperability</td>
</tr>
<tr>
<td>Different country implementations</td>
<td>Harmonisation and consolidation</td>
</tr>
<tr>
<td>Cross border complexity and risk</td>
<td>Reduced complexity, improved efficiency</td>
</tr>
</tbody>
</table>
## The Velocity of Change...so far

<table>
<thead>
<tr>
<th>Year</th>
<th>Timeline for SEPA</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>EC paper “Making Payments in the Internal Market”</td>
<td>Set long term principles for harmonisation</td>
</tr>
<tr>
<td>1992</td>
<td>EC paper “Easier Cross Border Payments—Breaking the Barriers”</td>
<td>Identifies key enablers for a common payments landscape</td>
</tr>
<tr>
<td>1993–96</td>
<td>EC + banking industry co-operation on cross border payments</td>
<td>New products and providers emerge and a gradual improvement in service levels</td>
</tr>
<tr>
<td>1997</td>
<td>Directive on Cross-Border Credit Transfers</td>
<td>Established minimum information and performance requirements for cross-border credit transfers</td>
</tr>
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<td>1999</td>
<td>ECB “Improving Cross Border Retail Payment Services”</td>
<td>Outlined objectives for improving cross border payments</td>
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<tr>
<td>2001</td>
<td>EC Regulation on Cross Border Charges—Regulation 2560/2001</td>
<td>Elimination of differences between charges for national cross-border payments in the EU on a country by country basis</td>
</tr>
<tr>
<td>2001</td>
<td>ECB “Towards an Integrated Infrastructure for Credit Transfers in euro”</td>
<td>Defined the basis of a new credit transfer payment instrument</td>
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<tr>
<td>2002</td>
<td>Creation of EPC</td>
<td>Banking sector commitment to SEPA concept</td>
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<tr>
<td>2003</td>
<td>Establishment of EBA STEP2</td>
<td>First PE-ACH created</td>
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</tbody>
</table>
| 2004–06 | EPC development of new schemes and frameworks | Major EPC deliverables:  
- Two Scheme Rulebooks (credit transfers and direct debit)  
- Two frameworks (cards and cash), developed and agreed  
- Standards recommendations, data model and implementation guidelines finalised  
- PE-ACH/CSM Framework agreed |

Source: EBA, Making SEPA a Reality—Version 0.9, June 2006
Timeline to SEPA Compliance

Detailed Timelines The EPC has created a timetable for the development and implementation of SEPA:

2005—2006: Design and Preparation

- The first phase of the EPC timetable for SEPA involves the design of the SEPA CT and DD instruments and the Cards Framework. The development of standards and the specification of the technical detail and security are scheduled to be completed by the end of Q3 2006.

2006—2007: Implementation and Deployment

- A part of the second phase of the EPC timetable, the implementation phase has started in 2006; it overlaps with standards and specification. The pilot phase is scheduled to start at the beginning of 2007 and the launch both of the SEPA credit and direct debit instruments is expected to take place in Q3 2007.

- 2008—2010+: Co-existence and Migration

- The third phase of the SEPA project will be a transitional period characterised by a co-existence of national and SEPA schemes and a gradual migration to the latter from January 2008 to the end of 2010 and beyond.

Harmonisation will prove to be complex

Source: EBA, report on SEPA completion, July 2006
The Velocity of Change...to come

SEPA Implementation and Migration

- From 2008 the three SEPA payment instruments: Credit transfers, direct debits and cards—will operate alongside existing national processes, with full migration achieved from the end of 2010 onwards

- After the transition purely national solutions for core credit transfers and direct debits, and purely national payment card schemes will no longer exist

- The implementation of SEPA will be driven by national central banks, banks, payment associations, schemes, and public authorities in each country in the euro-area. The EPC’s ongoing role will be to manage and maintain the Schemes, develop business rules and standards to communicate with all parties and to monitor

Harmonisation will prove to be complex
What the EU Commission Expects

- A harmonised and efficient payments market
- Standardised rights and obligations for providers and users, with emphasis on high level of consumer protection
- Competition between banks and processors
- Co-operation between banks and processors
- Benefits stated will also include
  - Mobile payments and collections services to meet the needs of a mobile population
  - Substantial reduction of costs surrounding payments
  - Simplification of payments
  - Improved cash flow for companies
What Corporates Expect from SEPA

- Transparency and lower cost for transactions
- Standardisation of Format
- Reliable transmission of a fixed amount of remittance data - less time on reconciliation
- IBAN and BIC is the way forward for domestic and cross border payments—SEPA means there is no cross border within EU! But...
  - IBAN’s and BICs are not “nice to haves”. They should be viewed as necessities
  - Not just for cross-border urgent payments, but for domestic non-urgent payments as well
  - They should be included on all your invoices
  - All EUR Zone banks have to supply them by law
- Opportunity to rationalise account structures
- Potential to simplify Liquidity management
- Time Critical Payments (Target2)
- Opportunity to further reduce Cheques
Preparing for SEPA

From Multiple Accounts...

To a Single Account?

Perhaps, ultimately, but fewer accounts more immediately
Main Characteristics—SEPA Credit Transfer Scheme

- Core and basic euro credit transfers
- Non-critical payment instruction
- Reliable, predictable execution time
- Open standards
- As fully automated as possible
- All core and basic credit transfers in euro in SEPA to be processed under the conditions of the scheme
  - Full Reach
  - IBAN +BIC
  - 140 character remittance
  - D+3
  - Returns standards
- To enable development of healthy and competitive market
- XML
Main Characteristic - SEPA Direct Debit Schemes

- 4 corner model, main actors are debtor, debtor bank creditor bank and creditor

- Other parties to participate in the service include:
  - Clearing and Settlement Mechanisms (CSM’s)
  - Intermediary banks
  - Scheme Management Entity - to be created under the auspices of the EPC

- D+5 initial set-up

- Cycle time D+2 ongoing debits

- Mandates

- Debtor and Creditor must hold an account within SEPA

- Recurrent and one off collections permitted, no legal difference between the two instrument types

- Refund period
Key SEPA Scheme Challenges

- New schemes are not as sophisticated as ACH’s in select markets,
- Scheme and infrastructure governance models,
- Delivery of strong project management behind the SEPA initiative,
- Achieve significant reduction in processing costs,
- Use of direct debit interchange,
- Communications protocols,
- Future proofing such as e-invoicing,
- Standardisation, and
- Consolidation and harmonisation will not be delivered quickly enough!
The Payment Services Directive
Payment Services Directive

Scope: All EU currencies, No payment limit, Both legs in EU

- New players with access to the payment systems - payment institutions
  - Such players will have capital requirements and fall under AML legislation

- Transparency of Information and charges before, during and after a transaction e.g.,
  - Technical requirement for equipment used
  - Obligations and liabilities
  - Spending ceilings
  - Point of acceptance
  - Law
  - Compliant procedures
  - Charges and interest (including reference and actual exchange rates)

- Clarification of rights and responsibilities
Payment Services Directive

- New definitions e.g. for acceptance, authentication, availability of funds, consent
- New procedures for ways of handling disputes
- D+3 to 2010, then D+2 without exceptions (currency conversions etc). Recital will state that D+1 should be the goal for the post 2014 period
- No value dating
- Fees can only be levied directly on payer and payee, each bearing their own costs - no BeneD
- Account Number primacy
- Cash deposits must be credited next working day
- Banks must take responsibility of ensuring their correspondent banks comply with these terms
- PSD is the Legal Basis for SEPA harmonisation
- But technical interpretation issues remain
Timeline to PSD Implementation

- 12 Sept Vote in ECON Committee
- 25 Oct Vote in European Parliament
- Oct Vote in Council of Ministers
- November? - Agreement between Parliament and Minister
- Next...Adoption through National Governments
- Adoption by banking community expected as best practice before legal adoption through national governments - by July 2008?
Target 2
Objectives - Target 2

- Driven by three nation central banks (Banque de France, Banca d’Italia, Deutsche Bundesbank)
- Single shared platform (SSP) approach
- Payment from German to French bank will be exactly the same as payment between German banks
- Migration will be in four stages—Germany is in first stage
- TARGET and SSP will co-exist during migration period
- Opening hours will be same as TARGET
- Causing change already
Target 2 - Single Shared Platform

- Increased levels of resiliency and business continuity
- Increased prioritisation of payments
- SWIFT-based messaging
- Staged implementation
Timing

- Migration in four stages/windows
- Live date delayed until Nov 2007
- Testing scheduled to start in May 2007

<table>
<thead>
<tr>
<th>Group 1 - 19/11/07</th>
<th>Group 2 - 18/02/08</th>
<th>Group 3 - 19/05/08</th>
<th>Group 4 - 15/09/08</th>
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Impact On the Existing Payments Landscape
Reinvestment in Euro-in Clearing houses

- German banks are likely to continue to clear most payments bilaterally
- Six French banks have created STET
- Spanish banks are considering all options
- Austrian central bank working toward the establishment of an ACH
- Belgian central bank is investing in a SEPA solution before shutting down CEC
- Way forward in Italy is not clear

EBA has already established STEP2 for pan-European credits and has won investment from 59 banks for M-PEDD
Not all banks will be able to fulfil the regulatory or financial requirements for clearing membership, so will connect indirectly.
Key take-aways

- 2008 is a start date for SEPA
- IBAN and BIC is the way forward for domestic and cross border payments—SEPA means there is no cross border within EU! But...
  - IBAN’s and BICs are not “nice to haves”. They should be viewed as necessities
  - Not just for cross-border urgent payments, but for domestic non-urgent payments as well
  - They should be included on all your invoices
  - All EUR Zone banks have to supply them by law
- Single Schemes for EU/EEA + Switzerland.
- If a single infrastructure works for RTGS why can’t it work for ACH? Could TARGET 2 be the future backbone?
- The end of cheques?
- Will corporates want to interact with banks via XML?
- Reliable transmission of a fixed amount of remittance data—less time on reconciliation!
- There have to be a lot of rapid discussions between the existing operators to ensure interoperability...is regulation necessary?
Conclusion

The experience of this industry, certainly at JPMorgan, suggests that embracing inevitable change as quickly as possible is the only way to survive—and surprisingly, often leads to exciting new opportunities.
Questions & further information

If you have any additional questions, please email them to...

tss.emea.events@jpmorgan.com

For more information on SEPA, please visit...

www.jpmorgan.com/visit/destination