

EPC Newsletter Issue 10 April 2011

FOCUS: SEPA MIGRATION

The SEPA Regulation - A Progress Report

First reactions by European Parliament and Council of the European Union introduce important improvements to European Commission's proposal for a SEPA Regulation

21.04.11 BY GERARD HARTSINK

As reported in January 2011, the European Commission (the Commission) published a proposal in December 2010 for a Regulation establishing technical requirements for credit transfers and direct debits in euros (the 'Commission proposal'). The Commission proposal - commonly referred to as the 'SEPA Regulation' - states that credit transfers shall be carried out in accordance with this Regulation twelve months after it comes into force, while direct debits shall comply 24 months after it comes into force. In other words, the forthcoming Regulation will - among other things - set definitive deadlines for migration to SEPA. The legislative process is now in the remit of the European Parliament and the European Council representing European Union (EU) Member States. The European Payments Council (EPC) tabled its initial response to the Commission proposal in February 2011. Following further evaluation of the possible implications of the proposal on the SEPA Direct Debit business model, the EPC Plenary, at its meeting in March 2011, adopted the position that Article 6 on interchange fees for direct debit transactions (and related Articles and Recitals) should be removed from the Commission proposal. Gerard Hartsink comments on the legislative process in progress.

Key Information in this Article

This article includes a section which briefly explains the European Union (EU) legislative process addressing the information needs of readers who are not familiar with the process.

On 30 March 2011 the Rapporteur of the Committee on Economic and Monetary Affairs (ECON) of the European Parliament published the ECON Draft Report detailing amendments to the European Commission's (the Commission) proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros (the 'Commission proposal').

In the view of the European Payments Council (EPC) the ECON Draft Report introduces several important improvements to the Commission proposal:

- Consultation of stakeholders on modifications of the technical requirements applicable to credit transfer and direct debit transactions set out in the annex to the Commission proposal.
- Deletion of the obligation to create 'interoperability' of payment schemes.
- One end date for compliance of euro credit transfers and direct debits with the forthcoming SEPA Regulation, as opposed to two separate end dates.
- Exclusion of large value payment systems from the scope of the Regulation.

The EPC proposes to delete Article 6 on interchange fees for direct debit transactions from the Commission proposal. The arguments supporting the EPC position are detailed below.

The EPC calls on EU lawmakers to keep in mind that the Payment Services Directive (PSD) was transposed into the law of EU Member States only very recently. There are no indicators whatsoever which would imply a need to re-write the comprehensive consumer rights established by the PSD.

The EPC maintains that the forthcoming SEPA Regulation should therefore refrain from making mandatory specific direct debit mandate management features which are optional in the SEPA Direct Debit Schemes.

Making such features mandatory would make direct debits – directly or indirectly – more costly for all consumers.

A brief overview of the EU legislative process

This section is of interest in particular to readers who are not familiar with the European Union (EU) legislative process. The forthcoming Single Euro Payments Area (SEPA) Regulation will be adopted in accordance with this process.

It is the privilege of the European Commission (the Commission) to introduce proposals for EU legislation for consideration and decision by the relevant bodies (see 'Economic and Financials Affairs Council' and 'European Parliament' below). On 16 December 2010, the Commission published a proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros (the 'Commission proposal'). This Commission proposal is commonly referred to as the forthcoming 'SEPA Regulation', i.e. EU Regulation which will, among other things, establish definitive deadline(s) for migration to SEPA.

The Commission proposal is now being progressed in accordance with the 'ordinary legislative procedure' established to adopt EU legislation. This procedure is based on 'co-decision' of the European Parliament and the Council of the European Union (the Council). As defined in Article 294 of the 'Treaty of the Functioning of the European Union' (TFEU), the co-decision procedure is the legislative process which is central to the European Union's decision-making system. It is based on the principle of parity and means that neither institution (European Parliament or the Council) may adopt legislation without the other's assent (for details on the co-decision process see first link under 'Related links' below). Accordingly, the Commission proposal is now under review by both the European Parliament and the Council. Both institutions will table recommendations on how the Commission proposal should be amended. For the SEPA Regulation to come into force it is necessary that the European Parliament and the Council agree on a final version of the legal text.

The Council represents the 27 EU Member States. The Council meets in different 'configurations'. This means that when the Council meets, not all ministers of all EU governments convene, but only those ministers responsible for specific policy areas. The Economic and Financial Affairs Council (ECOFIN) is one such configuration. The ECOFIN

is composed of the economics and finance ministers of the 27 EU Member States, as well as budget ministers when required. The ECOFIN covers a number of EU policy areas such as economic policy coordination, economic surveillance, monitoring of EU Member States' budgetary policy and public finances, the euro (legal, practical and international aspects), financial markets and capital movements and economic relations with third countries.

The Commission proposal for a SEPA Regulation is now subject to review by the ECOFIN. The ECOFIN details its recommended amendments to the Commission proposal in the Presidency Compromise Proposal. The Hungarian Presidency¹ of the Council tabled its first draft compromise proposals in March and April 2011.

The European Parliament is the only directly-elected body of the EU. The European Parliament organises its work through a system of specialised committees. The committees draw up, amend and adopt legislative proposals and own-initiative reports. They also consider legislative proposals of the European Commission and ECOFIN proposals and, where necessary, draw up reports to be presented to the Plenary assembly of the European Parliament. The Commission proposal for a SEPA Regulation is considered by the Committee on Economic and Monetary Affairs (ECON) of the European Parliament. The ECON details its recommended amendments to the Commission in the ECON Report. Ms Sari Essayah, member of the ECON, is the Rapporteur of the European Parliament on the SEPA file. Ms Essayah published the ECON Draft Report on the Commission proposal on 30 March 2011.

Other parties provide opinions on the Commission proposal for a SEPA Regulation. The European Central Bank (ECB) published its opinion on the Commission proposal on 7 April 2011 (see 'related links' below).

Representatives of the Council and the ECON indicated that it is their intention to finalise the legislative process leading to the adoption of a SEPA Regulation in 2011.

The ECON Draft Report on the SEPA Regulation introduces important improvements to the Commission proposal

As mentioned above, Rapporteur Sari Essayah published the ECON Draft Report detailing amendments of the Commission proposal considered by the European Parliament on 30 March 2011. The Rapporteur indicated that amendments to the ECON Draft Report should be tabled by 16 May 2011. The intention is to submit the final ECON Draft Report to the ECON in June 2011 and to the Plenary of the European Parliament in July or September 2011 for a vote in first reading.

The ECON Draft Report is currently being analysed in detail by the EPC. Based on a first assessment, the European Payments Council (EPC) welcomes the fact that the ECON Draft Report introduces several important improvements to the Commission proposal.

The ECON Draft Report requires stakeholder consultation in the process of amending the technical requirements applicable to euro credit transfer and direct debit transaction through delegated acts

The annex to the Commission proposal lists the technical requirements to be met by euro credit transfers and direct debits as of the defined end date(s) to be established by the SEPA Regulation. The Commission proposal foresees that the legislator will confer extensive executive powers upon the Commission to unilaterally amend these technical requirements through so-called 'delegated acts'. In other words, the Commission would be empowered to change these requirements without seeking approval of the European Parliament and the Council. The EPC maintains that Articles which set out the amendment of technical requirements through delegated acts should be deleted from the Commission proposal. The arguments supporting this EPC position are set out in the detailed EPC response to the Commission proposal (see 'related links' below).

If the legislator decides however, to confer these executive powers upon the Commission, then it must - at a minimum - be ensured that any amendments of the technical requirements are subject to a recommendation of the ECB according to its role and responsibilities. In addition, any amendments of the technical requirements should reflect a consensus among all stakeholders based on adequate market consultation.

The EPC therefore welcomes that the ECON Draft Report introduces the requirements of stakeholder consultation

as regards amendment of the technical requirements through delegated acts. The EPC notes that the Council seems to support this improvement as well. The ECB opinion on the Commission proposal states that: 'The Commission shall prepare draft delegated acts in close cooperation with the Eurosystem and where relevant, with other members of the ESCB² and in consultation with service providers and user representatives'. The ECB legal opinion further states that the exercise of amending the technical requirements through delegated acts must 'ensure, inter alia, that amendments are scheduled taking into account the payment industry's business cycles'.

In the view of the EPC it would also be required that timelines for amended technical requirements to take effect must be aligned with the timelines governing the release management cycles established by international standardisation bodies and European scheme management bodies. In the case of the EPC, this means the time governing the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) Rulebooks (for more information see 'related links' below).

The ECON Draft Report proposes to delete the requirement of 'interoperability' of payment schemes

The Commission proposal implies a theoretical scenario of multiple Union-wide payment schemes for euro credit transfers and direct debits. In the view of the EPC however, the concept of 'interoperability' of multiple Union-wide schemes puts at risk the fundamental requirement of full reachability of all payment service providers (PSPs) across SEPA, counters the objective of overcoming the fragmentation of the euro payments market and disregards the principles governing an optimally efficient payment environment. The EPC therefore proposes to delete the reference to the 'interoperability' of payment schemes from the Commission proposal.

The EPC very much welcomes that the ECON Draft Report proposes to delete the reference to the interoperability of payment schemes. The ECOFIN also supports deletion of this reference. Last but not least, the ECB legal opinion on the Commission proposal suggests: 'deleting the reference to payment schemes as technical interoperability between such schemes is not regarded as operationally feasible.'

The ECON Draft Report recommends setting one end date for migration to Union-wide payment schemes

The EPC advocates setting one end date at EU level for migration to SCT and SDD. The EPC therefore welcomes that the ECON Draft Report also suggests setting one end date for compliance of euro credit transfer and direct debit schemes with the forthcoming SEPA Regulation. This is an important improvement compared to the Commission proposal which foresees two separate end dates.

The ECON Draft Report proposes to exclude large value payment systems from the scope of the SEPA Regulation

The scope of the Regulation, as set out in the Commission proposal, is too broad. Such a description would also encompass euro payments made via large value systemically important payment systems such as the ECB's TARGET2 and the Euro Banking Association's (EBA) EURO1. These payment systems should be excluded from the scope of the Regulation.

The EPC welcomes that the ECON Draft Report and the first draft compromise proposals by the Presidency of the Council and the ECB legal option clarify that large value payment systems should be excluded from the scope of the Regulation..

The EPC recognises that the first considerations of both the European Parliament and the Council, with regard to the Commission proposal, include very important improvements to the Commission proposal. These improvements would greatly contribute to ensuring the desired outcome of this regulatory initiative, i.e. realising a harmonised and integrated euro payments market.

The EPC however, remains particularly concerned with the provisions on multilateral interchange fees for direct debit transactions and technical requirements applicable to direct debit transactions that are currently foreseen to be included in the forthcoming SEPA Regulation.

The EPC proposes to delete Article 6 on interchange fees for direct debit transactions from the proposal for a SEPA Regulation

Article 6 of the Commission proposal states that 'no multilateral interchange fee per direct debit transaction or other agreed remuneration with an equivalent object or effect shall apply to direct debit transactions'.

Following further evaluation of the possible implications of the Commission proposal on the SDD business model, the EPC Plenary, at its meeting on 23 March 2011, adopted the position:

- That Article 6 (and related Articles and Recitals) should be removed from the proposal.
- That the November 2012 date mentioned in Regulation (EC) No 924/2009 should be removed from that Regulation.
- The EPC continues to support the default multilateral balancing payment (MBP) of maximum 8.8 euro cent and the commitment expressed to the Directorate-General Competition of the European Commission and the European Competition Network (ECN)³ to review the figure after the migration period.

By prohibiting multilateral interchange fees (MIFs), the Commission proposal is premature and inconsistent with the provisions of Regulation (EC) No 924/2009, in particular its 11th Recital and its Article 15.

It is questionable whether a prohibition as far-reaching as currently foreseen under Article 6 can be validly based on Article 114 of the TFEU (formerly Article 95 of the EU Treaty). In the view of the EPC, any measures based on Article 114 of the TFEU (ex-ante) 'must genuinely be to improve the conditions for the establishment and functioning of the internal market'. Accordingly, 'a mere finding of disparities between national rules and the abstract risk of infringements of fundamental freedoms or distortion of competition is not sufficient to justify the choice of Article 95 EC as a legal basis'.

As measures must be limited to what is necessary to attain its objectives, the EPC considers that this proposal infringes upon the principle of proportionality. The proportionality principle laid out in Article 5 of the Treaty on the European Union stipulates that the content and form of Union action shall not exceed what is strictly necessary to achieve the objectives of the Treaties. The objective of the SEPA Regulation is to achieve migration away from national payment schemes to pan European schemes. An Article that interferes in the cost accounting of commercial service providers is far from being strictly necessary to achieve that goal.

As the Commission must examine (and to date has failed to examine), if the objectives pursued justify negative consequences for some operators, the EPC considers that by failing to make a thorough assessment, the principle of proportionality has not been respected.

The prohibition of a per-transaction MIF would oblige banks to build a new business model at a time when they could legitimately base their forecasts on the possibility of applying cost-based MIF. Such a turnaround would infringe upon the principle of legitimate confidence in the policy which has until now been pursued in this area.

The prohibition of the principle of interbank fees infringes upon the fundamental principle of freedom of trade if this prohibition does not respect the principle of proportionality. This is the case here as the objective to strengthen the single payment services market could be met by basing the fee level on the costs for banks in supplying this service, without prohibiting them in principle.

By eliminating the possible application of interbank fees, the proposed amendment to Regulation (EC) No 924/2009 affects the freedom of enterprise beyond the limits allowed by Article 52 of the Charter of Fundamental Rights. Eliminating the possible application of interbank fees constitutes an infringement of the Community principle of an open market economy that must benefit all economic operators, notably those in the banking sector with regard to the reciprocal relations necessarily resulting from their payment services activities.

Regarding European competition law, the EPC considers that there is an error of judgment with regard to the allegedly limited nature of competition for MIF applying to direct debits. The statements in Recital 14 of the proposal appear to be based on initial assessments conducted and published in 2008. As indicated above, such a claim with regard to MIF has never been substantiated to date, notably in the various cases examined by the Directorate General (DG) Competition concerning different means of payment. Indeed, DG Competition even recently

recognised the possibility of such interbank fees, in moderate amounts, in the area of bank cards (see the recent communiqués of DG Competition concerning the MasterCard and Visa cases of 1 April 2009 and 8 December 2010).

The Commission fails to explain how the complete ban on MIFs, assuming the prohibition could be based on European competition law, must equally apply to MIFs or bilateral interchange fees (BIFs) for national transactions which are outside the scope of the European competition law rules. Furthermore, the proposal does not lay out why MIFs for return transactions (R-transactions) are fundamentally different and are allowable in principle - as opposed to regular 'per-transaction MIFs' (even though R-transaction MIFs are only allowable within the strict limitations of Article 6 (2) of the Commission proposal).

The EPC maintains its recommendation to delete Article 6 from the proposal for a SEPA Regulation.

The SEPA Regulation should refrain from re-writing consumer rights established by the Payment Services Directive (PSD)

Several of the technical requirements applicable to direct debit transactions proposed by the European Commission prescribe procedures applicable to the management of direct debit mandates. A direct debit mandate is signed by the payer to authorise the biller to collect a payment and to instruct the payer's bank to pay those collections. The Commission now intends to make it mandatory for PSPs to offer such mandate management features which are optional in the SEPA Core Direct Debit Scheme (SDD Core). The EPC reiterates that the SDD Schemes were developed throughout a five-year design process under close scrutiny of the Commission and the ECB. The ECB acts as an observer in all EPC working groups. For detailed information on this subject, refer to the dedicated EPC document 'The Principles Governing the SEPA Core Direct Debit Scheme' (see 'related links' below).

The Commission now wishes to force PSPs to offer such direct debit features which 75 percent of consumers making direct debit payments in the EU today do *not* request.⁴ In proposing these technical requirements, the Commission effectively reverses its position on the matter previously communicated to the EPC: the Commission and the ECB confirmed in their joint letter to the EPC of March 2010 that the SDD Core Scheme is based 'on proven national concepts, fully meets the respective legal requirements and - in some points - goes even further than required by the Payment Services Directive in order to better satisfy customer needs. In this joint letter of the Commission and the ECB both institutions recognised that 'factual and perceived security may not always coincide'. To make this perfectly clear: the push to make it mandatory for PSPs to offer those mandate management features set out in the Commission proposal for a SEPA Regulation is based on a 'perceived' risk scenario that is not supported by market reality. To read this joint letter of the Commission and the ECB, refer to 'Related links' below.

In analysing whether these technical requirements now proposed by the Commission are compatible with and conducive to the realisation of the SEPA objectives, it should also be kept in mind that the PSD was transposed into the national law of EU Member States only very recently (November 2009). As stated on the Commission's website, the PSD 'provides the legal foundation for the creation of an EU-wide single market for payments. The PSD aims at establishing a modern and comprehensive set of rules applicable to all payment services in the European Union. The target is to make cross-border payments as easy, efficient and secure as 'national' payments within a Member State. The PSD also seeks to improve competition by opening up payment markets to new entrants, thus fostering greater efficiency and cost-reduction. At the same time the Directive provides the necessary legal platform for the Single Euro Payments Area'⁵. A significant part of the legal framework addressed consumer protection measures including consumers' refund rights in the context of direct debits. There are no indicators whatsoever which would imply a need to re-write the comprehensive consumer rights defined by the PSD.

The PSD includes insurance for consumers against incorrectly processed direct debit. Articles 62 and 63 of the PSD specify:

- A refund right for payers if the amount of the direct debit was not specified when the authorisation was given, i.e. if the mandate completed by the payer to authorise the payee to collect payment by direct debit does not state the specific amount of the direct debit collection(s).
- A refund right for payers if the amount of the direct debit exceeds the amount specified with the authorisation (the mandate).
- Refunds may be claimed within eight weeks of the debit date for authorised transactions.

Article 58 of the PSD ensures a refund right for unauthorised direct debits. Refunds may be claimed within 13 months for unauthorised transactions. This insurance protects consumers against incorrectly executed direct debits.

The Commission will review the PSD - including its provisions detailing consumer rights - in 2012. Based on this review the Commission will decide whether modifications to the PSD are required. Today there is no evidence whatsoever which would indicate that the consumer protection established by the PSD with regard to direct debit payments would be insufficient.

The SDD Core Scheme, developed by the EPC is fully aligned with the PSD - and even exceeds the requirements of the PSD. The SDD Core Scheme grants consumers a 'no-questions-asked' refund right during the eight weeks following a debit from a consumer's account, e.g. during this time any funds collected by SDD will be credited back to the consumer's account upon request.

Given that there is no basis to assume that the consumer rights defined in the PSD would fall short, it is not evident why the Commission would want to overwrite the PSD with the forthcoming SEPA Regulation in this regard. Introducing additional mandate management obligations for banks via the forthcoming SEPA Regulation, implies that the Commission has no confidence in the PSD. The Commission however, is the principal author of the PSD. The Commission also championed the PSD as a major achievement in the area of consumer protection only 18 months ago.

If the EU legislator endorses the mandate management obligations proposed by the Commission, direct debits will become more costly - directly or indirectly -for all consumers

If the legislator would endorse the technical requirements proposed by the European Commission with regard to direct debit mandate management features, then it would be mandatory for the almost 4000 PSPs and early movers on the demand side that have already implemented the SDD Core Scheme to re-invest in the adaptation of their payment architecture. Subsequently, direct debits will become more costly - directly or indirectly - for all consumers. This outcome would counteract the stated objective of the European Parliament, the ECOFIN, the ECB and the Commission itself, that SEPA should trigger a downward spiral as regards the pricing of payment services. It would be detrimental to the SEPA objectives if direct debit users are pushed to accept mandatory features such as additional mandate checks which lead to increased costs for all direct debit users.

Making mandatory those features which are currently optional in the SDD Core Scheme may prove detrimental to the needs of direct debit users, because the instrument may be felt to be too cumbersome to be used. In consequence, the market will either retain or revert to other - less efficient - payment instruments in the long run. The right balance between efficiency and security must be met. To strike this balance, it is necessary to analyse the requirements applicable to direct debits not in isolation but in comparison to alternative instruments.

The forthcoming SEPA Regulation should therefore refrain from making mandatory such features which are optional in the SDD Schemes developed by the EPC.

Focus must be on SEPA migration

The scene is set to bring SEPA to its successful conclusion. The EPC believes that this objective, i.e. setting definitive deadlines for the replacement of national euro credit transfer and direct debit schemes by a single set of harmonised SEPA payment schemes - should remain the focus in the debate on the forthcoming SEPA Regulation. The detailed comments of the EPC on the Commission's proposal are available on the EPC Website (see also 'Related links' below).

Gerard Hartsink is the Chair of the EPC.

Related links:

For more information on the 'ordinary legislative procedure' (co-decision) governing the European Union legislative process, click [here](#)

[Update March 2011: EPC Response to the Proposal for a Regulation Establishing Technical Requirements for](#)

[Credit Transfers and Direct Debits in Euros Published on 16 December 2010](#)

[EPC Background Document: The Principles Governing the SEPA Core Direct Debit Scheme \(EPC017-11\)](#). This document is part of the detailed EPC response to the European Commission proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros (see first link above)

[Joint letter of the European Commission and the European Central Bank to the EPC regarding SEPA Direct Debit, March 2010](#). In this letter, both institutions confirmed that the SEPA Core Direct Debit Scheme is based 'on proven national concepts, fully meets the respective legal requirements and - in some points - goes even further than required by the Payment Services Directive in order to better satisfy customer needs'

[Committee on Economic and Monetary Affairs \(ECON\) of the European Parliament Draft Report on the proposal for a regulation establishing technical requirements for credit transfers and direct debits in euros \(March 2011\)](#)

[Opinion of the European Central Bank on the proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros \(April 2011\)](#)

[European Commission Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in Euros \(December 2010\)](#)

[What is a Payment Scheme?](#) - Dedicated Page on the EPC Website

[SCT / SDD Rulebook Release Management and Scheme Development](#) - Dedicated Page on the EPC Website

[EPC publication: SEPA Direct Debit for Consumers - a Convenient and Secure Way to Make Payments](#)

[EPC publication: Who is Who in SEPA?](#)

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[Happy New Year? Post-crisis EU financial sector reform: the impact of 'Basel III' on payments \(EPC Newsletter, Issue 9, January 2011\)](#)

[So What's in a Name? Explaining Payment Schemes, Instruments and Systems. Clarity on payment terms is critical in the debate over the approach to setting end dates for migration to SEPA through EU Regulation \(EPC Newsletter, Issue 8, October 2010\)](#)

¹The Presidency of the Council of the European Union rotates between EU Member States every six months. The Presidency is held by Hungary in the first half of 2011. There is - in parallel - a permanent President of the Council. The first permanent President of the Council, former Belgian Prime Minister Herman Van Rompuy, was appointed in a special EU summit on 19 December 2009.

²The European System of Central Banks (ESCB) is composed of the European Central Bank (ECB) and the national central banks (NCBs) of all 27 European Union Member States.

³The European Commission and the national competition authorities in all European Union Member States cooperate with each other through the European Competition Network (ECN).

⁴The SEPA Direct Debit model relies on the direct debit model used in a large number of EU Member States including Austria, Germany, the Netherlands and Spain. The latter four countries represent those EU Member States where direct debits are used much more often to make payments than in other countries. Out of some 17 billion direct debits processed in the euro area in 2008, approximately 13 billion direct debits -

or 73 percent - were processed in Austria, Germany, the Netherlands and Spain. The SDD Core Scheme is built on the pre-SEPA direct debit model used in these four (and many other) EU countries.

⁵European Commission information on the Payment Services Directive (PSD):

http://ec.europa.eu/internal_market/payments/framework/index_en.htm

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FRINGE OBSERVATIONS ON SEPA

Innovacompegration (This is Not a Typo)

Reflections on the best approach to innovation, integration and competition in payments

21.04.11 BY JAVIER SANTAMARÍA

The general objective of European integration is to better the lives of some 500 million consumers and 25 million businesses across the European Union (EU). Migration to SEPA is viewed as one important element of the strategy promoted by European authorities to further this cause. The payments industry is happy to assist in the matter and has delivered, as requested, a set of harmonised SEPA payment schemes (among other things). So far, so good. The risk at this point however, is that expectations regarding the immediate impact of market integration on innovation and competition are blown out of proportion. At the same time, the authorities now seem to mistakenly assume that ingenuity, inventiveness and the readiness to develop new products and services could be decreed by law. In this article, Javier Santamaría analyses the different factors impacting integration, innovation and competition and advocates that 'each cobbler sticks to his last'. In other words, the European authorities should restrict themselves to setting the conditions for market integration and leave innovation to the market players. The 'Fringe Observations on SEPA' highlights aspects transcending the day-to-day management of the process, aimed at making SEPA a reality in the foreseeable future.

Key Information in this Article

Contrary to habitual complaints from European authorities, innovation in the payments market is alive and kicking. To ensure it stays that way, regulatory restraint in this area should be the order of the day.

It is not within the scope of European authorities to determine which innovations should be generalised based on common standards. This decision must be left to market forces to ensure that only those solutions which indeed meet market demand are standardised through cooperative efforts by the banking industry.

The expectations of European authorities regarding the impact of SEPA on cross-border competition in the payments market are unrealistic. Payment habits and business models established on both the demand and supply sides will only change gradually once SEPA is achieved. Regulatory hyper activism would not change that fact.

SEPA market integration is not the result of market forces. It requires the political will and mandate to make it a reality. Regulatory intervention should be restricted to setting the conditions required to execute and conclude the integration exercise, by establishing end dates for migration to the SEPA payment schemes.

On innovation and okapis

To try to understand European Union (EU) policy in the area of payments, it is necessary to get a grip on concepts such as integration, standardisation, competition and innovation, as these terms are often used when discussing the Single Euro Payments Area (SEPA). A clear understanding of these terms should help to highlight the interdependency between these concepts (if any) and to identify the role of the European authorities (if any) in the

advancement of these concepts. This article will use innovation as the basis and yardstick of this analysis, albeit the most elusive of the terms under consideration.

'Innovation is the multi-stage process whereby organisations transform ideas into improved products, service or processes, in order to advance, compete and differentiate themselves successfully in their marketplace¹. Anyone familiar with this definition and some basic knowledge of zoology knows that innovation is best treated as an okapi. The okapi is a mammal native to the Ituri Rainforest, located in the north east of the Democratic Republic of the Congo, in Central Africa. Although the okapi bears striped markings reminiscent of the zebra, it is most closely related to the giraffe². The okapis are solitary and only occasionally gather. Okapis are shy and will not breed if they feel that they are being watched.

Innovation first takes place when individual businesses seek to differentiate themselves in the marketplace. Innovation will also disappear without the right incentives, due to the effort and resources required to transform a new idea into a product or solution. Innovation will also wilt in an environment of heavy and uncompromising regulation and obsessive supervision. This will be exacerbated if such regulation is written by people who have seen business in action as much as they have seen okapis - which we assume is none in the case of most EU regulators located in Brussels.

The one notable difference between okapis and innovation is that okapis are a near threatened species. In contrast, innovation in the payment sector is alive and kicking. During the Financial Infrastructure Week, which took place in March 2011 in Rio de Janeiro, 121 innovations were reported to the Payment and Settlement Systems Committee in the Bank for International Settlements. The individual projects covered all areas relevant to the payment industry including initiation, processing, exchange and clearing, plus a whole range of products and services. The innovators are active across the entire sector representing central banks, financial institutions and non-financial institutions amongst others.

Innovation incentivised by market demand is happening. To ensure it stays that way, regulatory restraint in this area needs to be adhered to. European authorities should therefore curb their habitual complaining about an imaginary lack of innovation and start to recognise market reality instead.

On innovation and competition

Innovation in the business environment is generally the result of 'selfishness meets altruism', whereby the innovator seeks a reward (more profit) in recognition of the fact that increased profit is subject to delivering additional value to the customer. As pointed out in a previous edition of this newsletter, any payment service provider (PSP) active in the market is free to choose a payment strategy and to define services and products which add value to the underlying basic operating principles. Therefore, the product portfolios of PSPs differ necessarily and each one sends a distinct message to its customers stressing the differences and value added compared to products and services offered by competitors. As a result of product promotion by competitors in the commercial payments environment, we are already witnessing diversity, differentiation, creativity and specialisation benefiting individual customers.

Competition will happen naturally if the right conditions, such as strategically promising opportunities and incentives, are in place. Innovation is a direct consequence of competition in action.

On innovation and market integration

Integration usually relies on standardisation, harmonisation and the definition of common rules. Development of and migration to the harmonised set of SEPA payment schemes is a prime example of the case in point. SEPA can be compared to other integration initiatives aimed at creating frameworks, which prescribe standardised processes to be observed by actors operating in network industries. The SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) Schemes represent the integration of multiple sets of individual national payment schemes at a European level. Migration to a single set of SEPA payment schemes would allow multiple PSPs to offer a broad range of diversified payment services and products for euro credit transfers and euro direct debits SEPA-wide. Similar examples of standardisation in network industries can be found in the areas of telecommunication, television and radio or transportation. In the area of payments, the introduction of the euro can also be regarded as a means of standardisation.

Standardisation - in payments and other areas - takes place in the cooperative space. The rules and standards which make up a SEPA payment scheme are defined by PSPs in the cooperative environment - that is the European Payments Council (EPC). As outlined earlier in the article, innovation generally relies on the ingenuity of individual providers, however there are many incidents in the payment industry when market integration, such as standardisation, actually resulted in innovation and vice versa.

To give just one example: the first banks that installed automated teller machines (ATMs) were deemed innovative because they provided new services to their customers so that they could withdraw their funds more conveniently. At the very beginning, this innovation created a competitive advantage. When it became generalised, the community of banks could add more value by connecting ATMs and providing a network of ATMs, therefore making it even easier for customers to access their money. The community acted innovatively when doing so.

This example shows that innovation created at the cooperative level - by the community rather than the individual PSP - is ideally based on a pre-existing value that releases its potential when, through means of standards and common rules, it may get generalised. The cooperative effort is effective by extending reach and expanding the network, based on a set of harmonised operational and technical standards and the agreement of common business rules. This means that the growing network provides additional value to the market.

This example also demonstrates how integration and innovation should ideally happen in subsequent phases, as this way forces the industry to repeat the virtuous cycle. Integration is the best basis for innovative initiatives to be pursued by individual service providers. Only in integrated markets does innovation reach its full potential. Once the market has matured further, the supply side will be moved to act innovatively again - and more integration is then required. The larger the network at the start, the greater the potential benefits, as integration multiplies the incentives for innovation.

The SEPA harmonisation exercise is just another example of integration as an expression of innovation. The EPC developed the SCT and SDD Schemes, the latter of which allows both payers and payees for the first time to make and collect cross-border direct debits. Thousands of banks across Europe have implemented these schemes. In doing so, they were the first in the world to deploy the global ISO 20022 message standards developed by the International Organization for Standardization. ISO 20022 message standards are generally recognised as the hottest thing in payment town. Re-engineering financial services, based on SEPA payment schemes and ISO message standards, drives forward automation and the dematerialisation of business processes. In other words, European banks have created the network which empowers bank customers to realise significant efficiency gains and fully explore the internal market.

That being said however, SEPA is only one example of an integration initiative fostering innovation in the payments market. The concept itself was certainly not invented by the European authorities on a quest to promote EU integration. Self regulation by banks in the area of payments is the long-established approach in all national communities - and now in SEPA. Banks created those network conditions, which allow innovation to release its full potential, before the start of SEPA initiatives and they will most likely continue to do so in the future.

On regulator ambitions to mandate 'innovacompegration'

The article so far demonstrates how innovation usually happens first in the competitive business environment. Innovation is used by market participants to differentiate their commercial offerings from the rest. Innovators should not be asked to make their innovations available for free as this would destroy the foundations of competition. Innovation must also be left to market forces to ensure that only those initiatives which meet market demand are the ones that survive and set the benchmark for new 'standard' solutions. Only when individual initiatives have passed that test, should cooperative efforts aimed at generalising such solutions be progressed. It is the market that judges which developments are ripe for further standardisation and generalisation - not the regulator. The authorities that now claim the role of referee to judge which innovative ideas must remain and which should be given up will effectively prevent innovation to materialise. (For more details on the subject please refer to the article 'The Good, the Bad, the Ugly and a Knight in Shining Armour? European Commission requests unprecedented powers to determine payment functionalities, see 'related links' below).

To avoid the risk of regulatory hyper activism, the authorities might also reconsider their expectations with regards

to the impact of market integration on competition. When the SEPA programme was launched some ten years ago there was an understanding that some barriers should be removed to allow cross-border competition in the payments market. It was not perceived that competition was lacking at a national level (national competition authorities would have intervened if that was the case). Replacing the multitude of existing national euro payment schemes for credit transfers and direct debit by a set of harmonised SEPA payment schemes is one step further to market integration, but it will not bring, ipso facto, more competition. The expectation that cross-border competition will dramatically increase while integration of the euro payments market is in its infant stages is unrealistic: integrating payment schemes does not provide enough incentives to trigger such a development.

Business is not a sports game and commercial providers run financial risks which may end in failure. The substance of competition is essentially a by-product of two or more providers with the same overarching objectives such as: winning more clients, being more profitable and gaining further market share. As the marketplace has limits, these variables are generally bound to a zero-sum game and what one provider gets is lost by another. There is evidence that banks compete within the national payment markets, which is logical because the vast majority of payments are made domestically. It is difficult to compete in a 'domestic' euro payments market made up of 32 countries, which today exists only in theory. Cross-border competition in SEPA will take time to materialise, even once migration to the single set of SEPA payment schemes is completed. The removal of national barriers in the payments market will bring value, but not as much as expected and as quickly as desired. It will take time to change ingrained payment habits on both the demand and supply sides. Payments continue to rely on proximity effects: merchants prefer to bank with a nearby institution they can contact easily; consumers still open accounts based on closeness to their home or work and where staff speak their language. Even large corporations make similar considerations when searching for solutions that best meet their needs. Consequently they will regularly choose large banks with an overlapping footprint in the markets where both are present.

The most zealous EU integrator will not change the fact that payment habits and business models on both the demand and supply sides will only change gradually once SEPA is a reality.

It must be re-stated, as many times as necessary, that the integration of the national euro payment markets into a single European one is a process that would have never occurred spontaneously. It requires the political will and mandate to achieve it. It is therefore the task of the European legislator to set the legal and regulatory conditions required to conclude this market integration exercise and to establish end dates for migration to the SEPA payment schemes. SEPA - or integration - is however not an end in itself. It is an interim stage that should not be judged on the direct outcomes, but on the situation it leaves for the market to reap further benefits. SEPA is a seed rather than a fruit. Regulatory action should be restricted to sow that seed and focus on integration, not on 'innovacompegration'. The latter would potentially result in a scenario best described as 'operation successful, patient dead'.

Javier Santamaría represents Banco Santander. Banco Santander is a member of the European Payments Council.

Related link:

[Update March 2011: EPC Response to the Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in euros](#)

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¹Baregheh A, Rowley J and Sambrook S. (2009) Towards a multidisciplinary definition of innovation, Management decision, vol. 47, no. 8, pp. 1323-1339

²Wikipedia

ARTICLE177

OPINION AND EDITORIAL

Dare to be Bold: Electronic Legal Tender is an Option

A SEPA legal tender model spanning both cash and electronic payments

21.04.11 BY NORBERT BIELEFELD

Key strategic initiatives launched by European Union (EU) policy makers in the past decade including the *2010 Lisbon Agenda*, the *Europe 2020 Strategy*, the *Digital Agenda for Europe* and the SEPA programme imply that migration to electronic payments becomes a principal objective. If this objective is truly as important to policy makers as they state - then they should ensure that there is coherence across agendas. This is essential when it comes to the use of cash as a payment instrument. The analysis of the European Commission's recommendation on 'the scope and effects of legal tender of euro banknotes and coins' however, illustrates the prevailing inconsistencies in the regulator's approach. The recommendation artificially inflates further the perceived value of cash as a payment instrument in scope, to the detriment of a broader use of those electronic instruments which will ensure Europe's competitiveness in the wider economy. Norbert Bielefeld analyses the consequences of an ambiguous cash agenda and points to an alternative approach: the pre-conditions for moving to electronic tender are almost fulfilled.

Key Information in this Article

In March 2010, the European Commission adopted a recommendation outlining ten guiding principles clarifying the scope and effects of the legal tender of euro cash in the euro area. This recommendation forcefully asserts the position of physical cash (banknotes and coins) as legal tender.

The recommendation contradicts the strategic objective defined by European Union (EU) policy makers to incentivise a shift to electronic payment instruments which corollary is to reduce the societal costs resulting from the use of cash.

Latest data projects that over the coming decade Western Europe will see the slowest growth of non-cash payments volumes of any region globally. Contradictory EU policies will exacerbate the negative effects of this development on Europe's relevance in international standardisation bodies, its influence on providers of payment solutions and ability to transact more efficiently.

Recent progress in the European payments market, including implementation of the Payment Services Directive and the SEPA payment instruments however, could pave the way to an effective alternative approach: a SEPA legal tender model spanning both cash and electronic payments. In such a model, the quality of legal tender would be awarded to any SEPA payment instrument.

Coherence of the political agendas between cash and other instruments is vital

Until 20 May 2010, European citizens have the opportunity to submit to the European Commission their design for a coin to be issued at the end of the year to commemorate 'ten years of the euro in your pocket'. The winner will be announced on 30 June 2011. There can be no doubt that the winner will - justifiably - take pride from his / her award and the author would like to add his congratulations ex ante - but should the European policymakers be equally proud?

The euro has established itself as one the key world currencies and withstood the financial crisis. The fact that we are going to celebrate its first decade of existence with a coin however, should make us pause. In these times of not only worldwide competition and scramble for efficiency, but also craze for social media and everything digital, it is remarkable that Europe will commemorate its single currency with a standardised coin much similar to the first one

which appeared some 3000 years ago?

Certainly, the Single Euro Payments Area (SEPA) goal cannot imply that there is a single agenda for all stakeholders. If this objective however, is truly as important to them as they state - then policy makers should ensure that there is coherence across agendas. This need for coherence is essential when it comes to payment instruments and the use of cash as a payment instrument. This article explores the current contradictions, highlights some potential consequences and points to an alternative approach.

The European Commission's recommendation on 'the scope and effects of legal tender of euro banknotes and coins'

During 2009 the European Commission convened an expert group consisting of representatives from ministries of finance and national central banks of the euro area. The mission of the expert group was to make recommendations towards establishing a common understanding of what a single currency as legal tender means and how this legal tender should be protected. The expert group presented its conclusions in January 2010, on the basis of which the European Commission adopted a recommendation in March 2010. The European Commission intends to review the implementation of this recommendation three years after its adoption in March 2013. It will then assess whether regulatory measures are needed to achieve the objectives underpinning the recommendation. The European Commission's recommendation lays down ten guiding principles.

Five of them are about the general acceptance of banknotes and coins:

1. The concept of legal tender should rely on three main elements: a mandatory acceptance of banknotes and coins, for their full face value, with a power to discharge debts.
2. Acceptance of payments in cash should be the rule. Refusal is only possible if grounded on reasons related to the 'good faith' principle (for example, if the retailer does not have enough change).
3. The acceptance of high value denomination banknotes should also be the rule.
4. No surcharges should be imposed on payments in cash.
5. European Union (EU) Member States should refrain from accepting new rounding rules to the nearest five cents.

Five further guiding principles deal with several aspects concerning the protection of legal tender:

1. Stained banknotes should be sent back to the national central banks as they might be stolen.
2. Total destruction of banknotes and coins by individuals in small quantities should not be prohibited.
3. EU Member States should take appropriate measures to prevent euro collector coins from being used as means of payments.
4. The competence to destroy fit euro coins should not belong to national authorities in isolation anymore.
5. Modification of banknotes and coins for artistic purposes should be tolerated.

There is a striking imbalance between these two sets of guiding principles promoted through a single recommendation - the contents of which did not undergo public consultation. The five last guiding principles either further clarify dispositions present in existing European or national legislation or Regulation (e.g. the framework for professional cash handlers for the detection of counterfeit and unfit notes), or deal with marginal occurrences (e.g. modification for artistic purposes). The five first guiding principles however, forcefully assert the position of physical cash (banknotes and coins) as legal tender.

Is it coherent with the SEPA project?

The ambition of the 2000 Lisbon Agenda was to transform Europe into the most efficient economy in the world. Creating an internal market for electronic payments (to become known as SEPA) was a pillar of this initiative. This ambition has in essence been reaffirmed through the Europe 2020 Strategy, in which the digital agenda calls for a 'vibrant digital single market'. Action two within this document is to 'Ensure the completion of SEPA eventually by binding legal measures fixing an end date for migration before 2010 and facilitate the emergence of an interoperable European e-invoicing framework through a communication on e-invoicing and by establishing a multistakeholder forum'.

There shouldn't be any misunderstanding: for the policymaker the future of payments - and beyond - is electronic, digital, or any synonym thereof. In 2008 however, there were still (according to the latest Retail Banking Research Report¹) some 301 billion transactions made with cash in the EU, compared with 79 billion non-cash transactions (according to the European Central Bank (ECB) Blue Book from the same year), or about four times more. So is there really any need for a policymaker to reinforce the place of cash?

Furthermore, the use of cash as a payment instrument is not harmonious across the EU, which triggers further distortions throughout payment service user value propositions and payment service provider cost structures. Data for the number of cash transactions per EU Member State is lacking, but data for non-cash transactions provide a good 'mirror image'. There is a wide dispersion of usage across the EU: although on average each EU citizen makes 189 non-cash payments a year, a Finn makes 369 such payments and a Bulgarian a paltry 22. Clearly this and similar gaps cannot be accounted for by economic differences only: there are other motives for this wide disparity in the usage of cash across the EU.

These do not matter per se. Baselines are very different across EU Member States in every respect and they result from local practices, rules and legislation. There is however, something that all EU citizens hold in common with respect to payment instruments: they generally perceive cash as being free of charge. This puts electronic payment instruments - the target of the SEPA initiative and the digital agenda in general - at a disadvantage. The European Commission recommendation on legal tender only reinforces this disadvantage. This puts at risk more than the SEPA project.

The worldwide race for efficiency: where will Europe be in 2020?

In February 2011, the Boston Consulting Group released a study 'Winning After the Storm' on the payments world by 2020. This study includes a projection of non-cash payment volumes by region by 2020. Although the regions in the study do not perfectly match the definition of SEPA, the fact that 'Western Europe' traditionally accounts for 96 percent of SEPA would seem to allow discussion of the findings (**figure 1: projection of non-cash payment volumes by region by 2020**).

It is projected that over the coming decade Western Europe will see the slowest growth of non-cash payments volumes of any region. Even North America (the largest non-cash payments region in the world to-date) will outpace Western Europe. The authors of the study found that SEPA is unlikely to have any material contribution to more non-cash payments over the next decade. This is a pity. What is at stake here is much more than a mere Olympics of payment volumes. This is about Europe's voice in international standardisation bodies, Europe's influence on providers of payment solutions, and Europe's ability to transact more efficiently. On all counts, slipping in the ranks of the worldwide non-cash payments competition does not bode well neither for European payment service providers, nor their users.

Cash as legal tender: ancillary effects

The European Commission's recommendation on 'the scope and effects of legal tender of euro banknotes and coins' holds further, rather negative implications for European citizens. By preventing a fair competition - on the basis of transparent features and benefits - to take place between the various payment instruments available to payment service users, it actually places the burden of cash usage on those preferring non-cash payment instruments, as demonstrated with the chart (**figure 2: correlation between non-cash transaction per capita index and account charges index**).

The chart evidences the close correlation which exists across EU Member States between the non-cash transaction per capita index per country (the 'mirror image' of cash usage, as defined above) and the account charges index for an average payment service user. The latter pays generally more, or much more, in bank account and related transaction charges whenever cash is used more and more often as a payment instrument in his / her country.

One may harbour doubts as to how fair this is from a societal perspective, in particular when another dimension is taken into consideration. One of the features often quoted by the defenders of cash is anonymity. The high denomination banknotes (euro 200 and 500) whose acceptance is promoted by the European Commission's recommendation on legal tender represent almost 40 percent of the euro 820 billion of notes issued. These notes are almost never returned to a central bank, they are hoarded and some of them are used for and are the proceeds

from the underground economy. The chart below (using again the 'mirror image' of cash usage as one variable) evidences the strong correlation between the level of use of cash in a EU Member State and the relative size of the shadow economy (**figure 3: comparison of shadow economy versus non-cash payments indexes**).

Going forward, should users of non-cash payment instruments continue to pay for the cost of cash, which is also used to either purchase legitimate goods or services, but where at least one party to the transaction wishes it to remain anonymous, or access illegal goods or services, where both parties to the transaction have an interest in remaining anonymous? Surely there has to be a better message for the European citizen.

A SEPA legal tender model

There can be no discussion that the euro must be a credible currency: notes (and coins) must look 'right' and counterfeiting must be difficult yet easy to detect. How much does the European Commission's recommendation on legal tender really contribute to the acceptance of the euro? Actually, the net societal value of this recommendation should be challenged on the basis of the evidence provided in this article. The recommendation artificially inflates further the perceived value of the payment instrument in scope, to the detriment of a broader use of those instruments which will ensure Europe's competitiveness in the wider economy.

A forward looking solution could however be rather close. Europe's payment systems have proven that they are secure and reliable and they are certainly well overseen. The Payment Services Directive has provided for much enhanced consumer protection for non-cash payment instruments and both this Directive as well as the e-Money Directive ² (now being transposed) allow for quality competition. Bancarisation (the number of people holding a bank account) is almost complete (acknowledging that a very small percentage of the population would not hold an account under any circumstances) and solutions covered by the two Directives referred to above exist which allow for catering to these exceptions, thus ensuring access to convenient and secure means of payment for all segments of society. These assets and developments pave the way for a SEPA legal tender model spanning both cash and electronic payments which would notably fully transpose the principle of 'indifference' between payment instruments so often referred to by policymakers. In such a model, either discounting or surcharging for the use of any payment instrument would be allowed, in order to enable genuine competition in the marketplace. Merchants would no longer be compelled to accept high denomination banknotes, and the quality of legal tender would be awarded to any SEPA payment instrument.

A bold proposal? Not any bolder than any of the proposals which have brought the EU forward since the Treaty of Rome. What are we waiting for?

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[Overcoming the Homer Simpson in Us. How to create a 'less-cash' society \(EPC Newsletter, Issue 2, April 2009\)](#)

¹Retail Banking Research. The Future of Cash (January 2010).

²Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions.

ARTICLE171

OPINION AND EDITORIAL

More Europe is Needed, Not Less

Lessons learnt from the financial crisis

21.04.11 BY GRAHAM BISHOP

The financial analyst Graham Bishop closely monitors the impact of the financial crisis on the Economic and Monetary Union of the European Union (EU). At the height of the crisis, EU leaders decided on more Europe, not less. This strategy was confirmed in response to recent pressures on the single currency resulting from the fiscal situation in several EU Member States. The single market, designed to ensure the 'free movement of people, goods, services and capital' (Single European Act 1987), is universally seen as delivering enormous benefits in terms of growth, employment and quality of life. The European crisis management highlights the 'de facto solidarity' among EU Member States already requested by Robert Schuman, a founding father of the EU, in the 1950s. Rather than abandon or slow down the process, several measures have therefore been implemented to strengthen the internal market and the euro. Setting definitive deadlines for the transition to the Single Euro Payments Area (SEPA) through forthcoming EU Regulation is one important step in this direction. Once SEPA is completed, this author argues, European citizens will effectively be empowered to influence government policies such as participation in the common currency.

Key Information in this Article

In addition to the post-crisis financial sector reforms carried out at European Union (EU) level, the European Commission has proposed several measures to promote further market integration:

- European Commission Communication: Towards a Single Market Act – for a Highly Competitive Social Market Economy (October 2010).
- European Commission Communication: Europe 2020 – A Strategy for Smart, Sustainable and Inclusive Growth (March 2010).
- European Commission Communication: A Digital Agenda for Europe (May 2010).
- European Commission Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in Euros (December 2010). This proposal is commonly referred to as the forthcoming SEPA Regulation.

The impact of SEPA, this author argues, transcends payments and cash management: once SEPA is completed, European citizens are empowered to effectively influence government policies such as participation in the common currency.

The notion that EU integration would aggravate the impact of the crisis is mistaken

In the first edition of the European Payments Council (EPC) Newsletter published in January 2009, then Commissioner Charlie McCreevy, the former Head of the European Commission's Directorate-General Internal Market and Services, stated: "In the aftermath of a full blown financial crisis, whose consequences are still being worked through in the banking industry and whose wider effects on the real economy have still to be felt, I believe it paramount that we keep a clear and constant focus on SEPA and its benefits. I believe SEPA can be part of the solution". This assessment echoes the firm stance taken by EU leaders at the height of the crisis when they decided that more Europe was needed, not less. At one level, it could have been argued that the single market in both money and financial services had allowed the financial crisis to radiate shock waves from one country to another. This argument, however, disregards the experience of other crisis situations. The oil crisis of 1974, for

example, showed clearly that shocks would be transmitted across national borders - one way or another. Then, the transmission mechanism was sharp currency devaluations and dramatic changes in interest rates as well as budgets.

This time round, there was not even any discussion about the relative merits of maintaining the course of EU integration in the face of the crisis. Rather than abandon or even slow down the process, the EU Member States collectively decided to implement a host of measures with a view to speed up market integration and strengthen the common currency.

Driving forward EU integration: the European Commission work programme for 2011

The European Commission has embarked on an ambitious program to push market integration to the next level. A particular focus of the European Commission going forward will be the protection of small investors and ordinary consumers: initiatives will include legislation on access to basic banking services, and action to promote responsible lending and borrowing practices on mortgages. These and other proposals will complete the European Commission's ambitious reform programme for the financial sector.

In April 2011, the European Commission set out a series of concrete solutions for further integration in the final text of the *Single Market Act* (see link below). The Single Market Act, specifically, aims to deliver twelve projects on which to re-launch the Single Market for 2012. These twelve instruments of growth, competitiveness and social progress range from worker mobility to small and medium-sized businesses (SME) finance and consumer protection, via digital content, taxation and trans-European networks. Each instrument is accompanied by a flagship initiative on which the European Commission undertakes to make proposals during the coming months, the aim being to gain final approval from the European Parliament and the European Council representing EU Member States before the end of 2012. Each instrument also contains other, equally important proposals which should benefit from the momentum generated by the flagship initiative in order to make progress.

In March 2010, the European Commission launched the *Europe 2020 Strategy* (see link below) to exit the financial crisis and prepare the EU economy for the challenges of the next decade. Europe 2020 sets out a vision to achieve high levels of employment, a low carbon economy, productivity and social cohesion, to be implemented through concrete actions at EU and national levels.

In May 2010, the European Commission published *A Digital Agenda for Europe* (see link below), which defines the key enabling role that the use of information and communication technologies (ICT) will have to play if Europe wants to succeed in its ambitions for 2020. The *Digital Agenda for Europe* is one of the seven so-called flagship initiatives of the European Commission's *Europe 2020 Strategy*. The Digital Agenda for Europe defines the completion of SEPA through binding legal measures as one key action item.

Last but not least, in December 2010 the European Commission published the proposal for a regulation of the European Parliament and of the Council¹ establishing technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009. This proposal states, in part, that credit transfers shall be carried out in accordance with this Regulation twelve months after it comes into force; direct debits shall comply 24 months after it comes into force.

The fact that initiatives launched by the European Commission may elicit different reactions from different stakeholders notwithstanding, they demonstrate the case at hand: the European response to the financial crisis relies on concerted action to complete market integration.

The revolutionary political implications associated with SEPA

The political choice of more Europe rather than less also reflects the new - and revolutionary - reality created by the Single Euro Payments Area (SEPA). While payments are an intensely technical area, the political implications are immense - and completely underestimated by the political class in some EU Member States. The impact of SEPA far exceeds payments, cash management and related services. SEPA establishes an effective 'referendum veto' to be exercised by citizens whose national governments might contemplate leaving the euro. In SEPA, citizens are empowered to embed the freedom and the choices associated with the single market so deeply in the economy to

make it impossible for any EU government which adopted the euro to abandon the common currency. It is hard to imagine that citizens and enterprises accustomed to these choices would want to leave the euro once they considered what they individually would give up by way of returning to narrow, national offerings for trade in goods and services.

With SEPA, any citizen who fears that his home state is about to leave the euro to implement a major devaluation can protect themselves by transferring their liquid funds into a bank in another euro country - in an instant and at negligible cost. In effect, this is a free option for all citizens and amounts to an instantaneous referendum on government policy. Such an outflow of retail liquidity from a banking system would cause its rapid collapse. The quiet run out of deposits in the Irish banks last year demonstrated the power of depositors to force radical political change.

But the full magnitude of these public policy benefits cannot accrue until SEPA is complete; i.e. existing national payment schemes for euro credit transfers and direct debits have been replaced by a set of harmonised SEPA payment schemes.

Lessons learnt

There are enough political talking heads around who have made it their business to cite the financial crisis as an argument against the single market and the common currency. The joint response of EU Member States to the crisis effectively counteracts this attitude. It may just so happen that the efforts underway to achieve tangible progress on the route to market integration will help European citizens and businesses to recall the actual benefits and increased choices they enjoy thanks to EU integration and the introduction of the euro. While this qualifies as a valuable lesson learned, it must not be interpreted as an excuse to trigger another credit crunch resulting in an economic meltdown.

Graham Bishop is an independent financial analyst.

Related links:

Grahambishop.com

[The EU Fiscal Crisis: Forcing Eurozone Political Union in 2011? By Graham Bishop](#)

[European Commission Communication: Single Market Act Twelve Levers to Boost Growth and Strengthen Confidence \(Final Text April 2011\)](#)

[European Commission Communication: EUROPE 2020 - A Strategy for Smart, Sustainable and Inclusive Growth \(March 2010\)](#)

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¹The Council of the European Union represents EU Member States.

ARTICLE170

LEGAL AND REGULATORY ISSUES

Moving Into New Territory

The impact of the e-money Directive on payment service providers

21.04.11 BY DERMOT TURING

The post-crisis financial sector reforms carried out at European Union (EU) level will have a major impact on payment service providers. The European Payments Council (EPC) Newsletter reports on EU financial reform legislation affecting payments and cash management services. This article analyses the impact of Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions - in short, the e-money Directive. EU Member States must implement the e-money Directive by 30 April 2011 into their respective national laws. In its communication 'A Digital Agenda for Europe', published in May 2010, the European Commission expresses the expectation that the e-money Directive will: 'open the way for new market entrants to offer innovative electronic money solutions - such as mobile wallets - without a loss of protection of consumer funds'. The European Commission projects that this new market could be as large as ten billion euros by 2012. Dermot Turing, Partner in the international financial regulatory team at Clifford Chance, points out the challenges inherent to legislation designed to regulate new technologies, business models and providers in the payments market.

Key Information in this Article

New technology makes for new opportunities in the payments industry, but working out which legal and regulatory rules apply to new types of business can be challenging.

The new Directive 2009/110/EC, on the taking up, pursuit and prudential supervision of the business of electronic money institutions – in short, the e-money Directive, allows issuers of electronic money (such as pre-paid cards) to compete with banks and other payment service providers more easily, while providing greater safety to customers in respect of their funds.

New laws and regulations however, do not bring total clarity and banks and other service providers will need to understand how they work to assess their competitive position and to ensure that any services they provide to new-technology firms, comply with all relevant rules.

Furthermore, even when the law is clear, there are important differences between the levels of protection given to customers, as a recent case in the UK illustrates. There are evident gaps in the regulatory framework and banks and e-money institutions may be able to offer a superior service in terms of quality and protection to their clients.

Banking and payments technologies have evolved and consumers increasingly rely on trusted third parties to look after their money in non-banking contexts. Today, you can pay for things on your mobile phone and you can send money to other parts of the world without using a bank. You can buy a card which enables you to get money out of an automated teller machine (ATM) while on holiday, without drawing on your bank account, and you can pay for goods bought online without needing to use a credit card. These are all things which were difficult to imagine, as recently as in the 1990s. Law and regulation however, struggle to keep up with these technological and commercial developments.

The Payment Services Directive (PSD) therefore created a handful of new regulated activities in the payments space. These include issuing and acquiring payment instruments, money remittance and providing IT-based

payment consent mechanisms applicable to electronic and mobile payment service providers, in practice. Very little definition was given about these new types of activity, therefore, although an existing merchant acquirer knows he is a merchant acquirer; a person with a new business model may struggle to apply the definitions of the PSD, to work out whether he needs a payment institution licence. Sometimes the frontier between 'subject to regulation' and 'outside the scope of regulation' is fuzzy and difficult to place. The situation is not helped as the scope of relevant European Union (EU) law and regulation constantly changes in order to keep up with technological developments. These difficulties also arise with regard to electronic money (e-money).

E-money has been the subject of two Directives. In April 2002, the first e-money Directive took effect in EU Member States. This set out basic regulatory rules for providers of cash-equivalent payment solutions, such as pre-paid cards. The central idea was that e-money institutions should be regulated in a manner similar to banks and that their business activities should be restricted to reduce risk for customers. The second one, Directive 2009/110/EC, on the taking up, pursuit and prudential supervision of the business of e-money institutions - in short, the new e-money Directive - must be transposed by EU Member States no later than 30 April 2011. The new Directive builds on the foundation of the first one, reinforcing the regulatory regime, but introducing some new ideas. In broad terms, these are:

- e-money institutions can engage in a wider range of payment-related activities, allowing them to compete better with payment institutions and banks in the payment space.
- e-money institutions, such as payment institutions, will have to safeguard funds received in exchange for e-money.
- There are more detailed rules on the terms and conditions applicable to e-money, such as issuance, redeemability and interest.

The impact of the e-money Directive on banks

While the e-money Directive primarily seeks to regulate related activities carried out by organisations which do not hold banking licences, it is also relevant to the banks. Banks and infrastructures provide services to the businesses which are developing the new models for payments, and this can result in a number of questions for the banks such as:

- Does it matter for the bank if its client was not licensed, but should have been?
- Can the bank rely on its client to carry out anti-money-laundering or other due diligence, to the standard needed by the bank to satisfy its own regulatory requirements?
- Will the bank be subject to the PSD or other regulatory requirements in providing services to an e-money institution, a payment institution, or another bank?
- What outsourcing requirements are imposed by the regulators of the bank's clients?

Fortunately for the e-money Directive, there is guidance and help from official sources (see 'related links' below). Firms which may worry that they are walking along a frontier and are unsure whether they have strayed beyond the zone of safety will be able to gain comfort from these.

Lessons learnt from the Crown Currency Exchange case

Even when the frontier is clearly shown on the map, there is a risk that the laws which do apply seem poorly designed. Banks and other payment service providers will wish to understand how the law applies to their competitors, because some types of providers may be able to offer better customer protection than others. As noted above, e-money issuers have to take steps to protect funds received from clients - this rule is similar to one in the PSD, which regulates 'payment institutions'. Unfortunately for some customers, the protection given by the PSD may not be as good as it seems.

Client money and its safety continues to be a major preoccupation with regulators policing the new world of e-money. In the UK there has been a recent case involving a money remittance firm called Crown Currency Exchange, which was registered as a 'small payment institution' (SPI) under the PSD. Banks are different from other types of payment service providers - they are 'credit institutions', which means that they are allowed to lend out the money they take on deposit to borrowers. Because a deposit involves credit risk on the bank, banks are subject to stringent prudential regulatory requirements. In contrast, payment institutions are restricted in the type of

business they can do and are normally required to protect their clients' money from loss, particularly in the event of the institution's insolvency.

The Crown Currency Exchange case involved a payment institution which coupled its money remittance service with a foreign exchange service. The Crown Currency Exchange took clients' funds, promising them a long-term fixed currency exchange rate. Unfortunately, the firm's gamble on exchange rates was a bad one and the firm went into insolvency. As the Crown Currency Exchange was only an SPI, it did not have to segregate client funds, and the customers lost their money. Press reports indicate that 13,000 customers were affected, losing up to 10,000 UK pounds each. The UK Financial Services Authority (FSA) said: "If a firm is registered as an SPI, we monitor how it conducts its payment services activities, such as making sure it transfers funds in a timely manner and discloses its charges for payment services clearly to customers. We are not able to check other parts of an SPI's business, like its solvency or how it conducts business that does not involve a payment service. An SPI will not be covered by the Financial Services Compensation Scheme (FSCS) and the obligation in the [PSD] to safeguard customer funds does not apply to them (though an SPI may choose to safeguard customer funds). You should check a firm's entry on our Register before using its services to find out whether you are protected by the FSCS if things go wrong" (see also 'related links' below).

What this case shows is that even regulated payment institutions can expose their clients to risk. We can expect the border guards to be increasingly vigilant as more firms seek opportunities in the financial services sector and as new business models are rolled out. Banks and established payment service providers may be able to find opportunities by offering established systems and controls to the newcomers to help them avoid the pitfalls, and to complement the exciting new technologies with the stability of more traditional platforms.

Dermot Turing is a Partner in the international financial regulatory team at Clifford Chance.

Related links:

[European Commission FAQ on the e-money Directive](#)

The Financial Services Authority (FSA) is the regulator of the financial services industry in the UK. The FSA makes available the following document: ['The FSA's role under the Electronic Money Regulations 2011 - our approach'](#).

[FSA Report on Crown Currency Exchange](#)

Related article in this issue:

[The SEPA Regulation - A Progress Report. First reactions by European Parliament and Council of the European Union introduce important improvements to European Commission's proposal for a SEPA Regulation](#)

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[Happy New Year? Post-crisis EU financial sector reform: the impact of 'Basel III' on payments \(EPC Newsletter, Issue 9, January 2011\)](#)

ARTICLE178

SEPA FOR CARDS

Time to Prepare the Eulogy - 'Six Feet Under' for the Magnetic Stripe in SEPA

Eurosystem recommends migration to chip-only cards

21.04.11 BY WIEBE RUTTENBERG AND MONIKA HEMPEL

The Seventh Progress Report published by the European Central Bank (ECB) / Eurosystem in October 2010, recommends that from 2012 onwards, all newly issued SEPA cards should be issued, by default, as 'chip-only' cards. If the industry decides to keep the magnetic stripe for practical reasons, any data enabling magnetic stripe transactions should be removed. The

industry will however, have to be prepared to offer the cardholder legacy magnetic stripe cards upon request, as long as there are still regions outside SEPA which have not fully migrated to EMV. Monika Hempel and Wiebe Ruttenberg comment on the expected demise of the magnetic stripe in Europe. Readers who are interested in this article are invited to join the transatlantic dialogue on this subject. The article 'The Magnetic Stripe: Why it is Hard for Americans to Say Good-Bye. In the US, clinging to old-fashioned payment methods is more than just a bad habit' outlines the less enthusiastic American perspective.

Key Information in this Article

The process of attaching a magnetic stripe to a plastic card was invented fifty years ago. At that time, the addition of the magnetic stripe to payment cards was a valuable tool in combating credit card fraud.

Today, the magnetic stripe as a tool to combat fraud has become blunt. Cards equipped with the magnetic stripe are vulnerable to skimming, i.e. the unauthorised reading and subsequent use of data contained in the magnetic stripe.

Card data abuse has become a global problem which causes huge losses for financial institutions worldwide. Given the vulnerability of magnetic stripe cards, and in support of the European payment industry's commitment to migrate to chip and personal identification number (PIN) technology in the area of cards, the Eurosystem has recommended in its Seventh SEPA Progress Report that all new SEPA cards should, by default, be issued as chip-only cards from 2012 onwards.

The Eurosystem's approach consists of three layers:

- From 2012 onwards, all newly issued cards should be issued as chip only cards.
- If the industry decides to keep the magnetic stripe for practical reasons, e.g. to access self-service areas of bank branches and at automated teller machines (ATMs), it should not contain any payment-related data.
- Legacy magnetic stripe cards may be issued on customer request, e.g. when customers travel outside of Europe.

Historical background of the magnetic stripe

Thirty years ago, the Walkman - a portable personal stereo audio cassette player - became one of the icons of youth culture and the 'bête noire' of a parent's generation. Like many great innovations of its time, it died out not with a bang, but a whimper. Today, other technologies perform the functions of magnetic tape for recording and playing back music and movies and the iPod, iPhone, iPad have taken the place of the Walkman.

Fifty years ago, one generation earlier, the process of attaching a magnetic stripe to a plastic card was invented. At that time, the addition of the magnetic stripe to payment cards was a valuable tool in combating credit card fraud, as it automated the tedious process of comparing account numbers with blacklists of fraudulent accounts at the point of sale.

Today, after half a century of accelerated technological progress, the magnetic stripe as a tool to combat fraud has become blunt. It has become vulnerable to skimming, i.e. the unauthorised reading and subsequent use of the data contained in the magnetic stripe. Card data abuse has become a global problem which causes huge losses for financial institutions worldwide. At the same time, according to Europol, which had to take action against card fraud networks on numerous occasions, criminals can still consider payment card fraud as a profitable and relatively low-risk business.

Reaction by the financial industry and status of EMV migration

The European Payments Council (EPC) has reacted to this situation. The SEPA Cards Framework (SCF) states the requirement that by the end of 2010, all cards, point of sale (POS) terminals and automated teller machines (ATMs) in the Single Euro Payments Area (SEPA) should be EMV-compliant, i.e. they should support the use of chip and on the acquiring side, the personal identification number (PIN). According to the SCF, magnetic stripe-based transactions are not SCF-compliant after 2010.

Furthermore, the EPC recommends in the resolution on 'Preventing Card Fraud in a Mature EMV Environment' that card schemes should grant issuers with the option to adopt a chip-only approach, be it by issuing chip-only cards or by allowing them to refuse magnetic stripe transactions. By using the chip instead of the magnetic stripe, stronger cryptographic algorithms can be used to authenticate cards and the cardholder.

The European Central Bank (ECB) monitors the migration from magnetic stripe to EMV chip for payment cards, POS terminals and ATMs in the European Union (EU) and euro area, and regularly publishes the results on the ECB website¹. According to the ECB's SEPA card indicators for EMV-migration, at the end of the fourth quarter 2010, the migration status of cards in the euro area was 82 percent, POS terminals stood at 88 percent and ATMs at 95 percent². Nevertheless, the vast majority of SEPA cards are still equipped with a magnetic stripe.

The completion of the migration towards EMV Specifications for payment cards, POS terminals and ATMs is an important prerequisite for migration at transaction level, i.e. card payment transactions with EMV-compliant cards at EMV-compliant terminals, using EMV technology in the processing of the transaction. The ECB also monitors the progress in this area and has found that at the end of the second quarter 2010, 57 percent of all POS transactions in the euro area were EMV transactions.

Migration at the transaction level however, lags behind due to the fact that the card is still often 'swiped' (i.e. the magnetic stripe is read) instead of 'dipped' (required to read the chip). Furthermore, a certain number of card payment transactions in the euro area are made by travellers from countries where the migration to EMV has not yet started. For instance, travellers from the US who shop in Europe still use their magnetic stripe credit and debit cards, and merchants who want to do business with them - as well as the acquiring banks - still have to accept that. Americans have started to realise however, that there are situations - such as train ticket vending machines - where only chip and PIN are accepted. In such situations, they have to revert to cash.

In the US, the magnetic stripe is a 'die hard' technology. This may have some historic reasons, such as relatively low telecommunication costs for card validation by phone in the US, compared to higher costs in Europe before the liberalisation of the telecommunication industry, as well as consumer habits and preferences. Nevertheless, it is a fact that the presence of magnetic stripes with customer and account identification data makes the card vulnerable to skimming.

Chip only Eurosystem recommendation

Because of this vulnerability and in support of the European payment industry in its migration to chip and PIN, the Eurosystem has recommended in its Seventh SEPA Progress Report that all new SEPA cards should, by default, be issued as chip-only cards from 2012 onwards. The Eurosystem's approach consists of three layers:

Firstly, from 2012 onwards, all newly issued cards should be issued as chip only cards, reflecting a gradual approach, with no big bang scenario. Secondly, if the industry decides to keep the magnetic stripe for practical reasons (e.g. to access to self-service areas of bank branches and at ATMs), it should not contain any payment-related data. Thirdly, legacy magnetic stripe cards may be issued on customer request (e.g. for travelling outside Europe).

For the sake of clarity, it is emphasised here that the Eurosystem's recommendation addresses only the issuing side of the card payment. It does not address the acquiring side. Merchants and acquiring banks remain free to accept magnetic stripe-only cards carried by non-European card holders.

Europe should strive to achieve an increased level of security for card transactions and, in doing so, should not be held back by decisions taken in other parts of the world.

Concern over card fraud is taken seriously

The concern over card fraud is illustrated by the decision of 22 Belgian banks to block their debit cards for usage outside Europe as of January 2011³. According to the Belgian financial sector federation, 98 percent of debit cards would not be affected by that measure since they have never been used outside of Europe. Cardholders who require use of their debit cards outside of Europe are offered individual solutions by the issuing banks. It has been reported that this measure has already lead to a decrease in fraud due to skimming. While this is a first step in

combating fraud, in the long run, it is recommended that steps should be taken to tackle the problem of skimming at its root by removing the magnetic stripe.

At first sight, cardholders might perceive this as a deterioration of service. On the other hand, consumers are increasingly aware of security issues regarding cards, and it cannot be denied that many card holders are more and more uncomfortable with using their cards due to increasing security concerns. These concerns have been triggered by media coverage of the theft of millions of credit card numbers from payment processors, international card skimming networks and payment card fraudsters. Thus, raising consumer awareness of the risks relating to magnetic stripe may help to alleviate the perceived inconvenience.

Like the cassette Walkman, which was retired by Sony in 2010, the heydays of the magnetic stripe on cards are over. It will not go six feet under in Europe all at once, but it is time to prepare the eulogy.

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The views expressed are those of the authors and therefore should not be reported as representing the views of the European Central Bank.

Related links:

[European Central Bank \(ECB\) Single Euro Payments Area - Seventh Progress Report. \(October 2010\)](#)

[EPC Resolution: Preventing Card Fraud in a Mature EMV Environment](#)

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¹<http://www.ecb.europa.eu/paym/sepa/about/indicators/html/index.en.html>

²Figures will be published on the ECB website before long.

³<http://www.febelfin.be/export/sites/default/febelfin/pdf/fr/communiqués/2011/pr12012011fr.pdf>

ARTICLE176

SEPA FOR CARDS

The Magnetic Stripe: Why it is Hard for Americans to Say Good-Bye In the US, clinging to old-fashioned payment methods is more than just a bad habit

21.04.11 BY BOB SULLIVAN

As reported in the January 2011 edition of this newsletter, the European Payments Council (EPC) approved in December 2010 the resolution 'Preventing Card Fraud in a Mature EMV Environment'. EMV is an industry standard to implement chip and personal identification number (PIN) security for point of sale (POS) card transactions. At the end of 2010, 81 percent of cards, 89 percent of POS and 96 percent of Automatic Teller Machines (ATMs) in SEPA were EMV-compliant. Card fraud is now migrating rapidly to points of least resistance, i.e. countries which have not implemented chip and PIN technology. Much to the frustration of European banks, the US is one of them. The US cards market continues to rely on magnetic stripe

technology which allows fraudsters to 'skim' (copy) data stored on the magnetic stripe. To-date, EMV-compliant cards issued in Europe continue to carry the magnetic stripe. European banks are therefore increasingly liable for losses resulting from European card holders falling victim to fraudulent card payments made in the US with counterfeited cards. The EPC resolution seeks to limit the potential impact of an incomplete migration to EMV outside SEPA based on the EMV chip-only option. In other words, European banks might consider issuing cards without the magnetic stripe in the future. Bob Sullivan, a US-based payments journalist, explains why Americans seem so reluctant to add any new security features to their old-fashioned magnetic stripe payment cards.

Key Information in this Article

US banks generally perceive fraud losses to be less than the cost of upgrading the card infrastructure to comply with EMV standards. Until those lines cross, there are no incentives for the US financial system to engage in such a dramatic change.

It might however be worth the while to do the math again. Some US card industry observers recently indicated that losses due to fraudulent card transactions in the US might already exceed the costs of EMV migration.

It should not be expected that the US government will enforce migration to EMV.

US consumers are satisfied with the fraud fighting measures other than chip and personal identification number (PIN) technology, which are currently in place. In their view, having to enter a PIN when making a card payment creates a 'solution in search of a problem'.

More could be done however to enlist consumers as fraud-fighters and to convince them of the added value of chip and PIN technology. US travellers whose magnetic stripe cards are increasingly refused as a means of payment in Europe, could be the first to ask for change.

It will take a combination of consumer education, ease of use, cost-saving technological advancements, clearer fraud accountability and government enticements to break down the Americans' loyalty to the magnetic stripe card.

A brief history of the magnetic stripe credit card - and the American affection for it

The European experience of EMV migration in the cards market seems to present a clear-cut case: less fraud, more account holder peace of mind, a step into the 21st century. So - what's not to love? Plenty say American consumers and banks, who seem to be clinging to their old-fashioned magnetic stripe credit cards as if their banking system depended on it. Chip and PIN is old hat on the European side of the pond, but US banks - and consumers - are no closer to upgrading their card infrastructure than they were in 1999, when American Express first tried selling Americans 'Blue' smart cards. This is hardly the first time Europeans and Americans have seen things differently. It is clear that some people in Europe are at their wit's end about the Americans and for anyone anxious to change it is difficult to understand why the Americans seem to try so hard to keep things the same. For starters, in some ways, the banking system here does depend on the old ways.

An ingenious technology of its time, the magnetic stripe was invented in the 1960s by adding tape-recorder-like magnetic tape to a payment card. Magnetic tape itself was a remarkable invention, with its roots in the 1920s, when it was first used by musicians to record audio. In the 1950s, computer scientists began using it to record data, setting the stage for the 'magnetic stripe card'.

In the 1960s, credit card fraud was skyrocketing and clerks were stuck manually comparing account numbers embossed on cards with printed lists of accounts linked to fraud. The addition of the magnetic stripe allowed cashiers to automate this process - one swipe and the number could be recognised by a computer. More importantly, the account number could be transmitted over a phone line to a centralised list of fraudulent accounts. Back in those days, the magnetic stripe had fraudsters on the run for quite a while.

As this technology approaches its 50th anniversary however, it is looking as outdated as the IBM Selectric typewriter, which was introduced at about the same time. Criminals figured out how to circumvent the magnetic stripe's fraud-fighting features by the mid-1980s, when IBM killed the Selectric in favour of the Wheel Writer.

If Europeans are both frustrated and confused by America's fondness for magnetic stripe technology, it is understandable.

"European card issuers have been fed up since the Heartland Payment Systems¹ breach, where the mega-million dollar investments they made in chip cards were defeated by their cardholders shopping, traveling and eating out in the US using their magnetic stripe enabled credit (and debit) cards that were processed by Heartland," said Avivah Litan, a prominent payments analyst at research firm Gartner. "European issuers have been talking about stopping their cardholders from using the mag stripe on their plastic cards since that time, and they are still fed up."

Up until now, EMV-compliant cards issued in Europe continue to carry the magnetic stripe currently important for access to terminals. The European Payments Council (EPC) resolution 'Preventing Card Fraud in a Mature EMV Environment' seeks to limit the potential impact of an incomplete migration to EMV outside the Single Euro Payments Area (SEPA) based on the EMV chip-only option. In other words, the EPC recommends that card schemes grant card issuers in SEPA the option to issue chip-only cards or to allow them to refuse magnetic stripe transactions if they so wish. These options are subject to contractual communication with the cardholder. European merchants might increasingly opt not to accept magnetic stripe cards.

The EPC resolution is a bold step. Its impact on the US market however will be limited - let's just say Europe coughed, but America didn't catch a cold. Why the stubbornness? Let me try to explain.

The factors driving fraud fighting activities and related costs are different in Europe and the US

In some ways, the reason for American resistance can be summed up in one word: money. When speaking privately to any fraud analyst, the admission will come rather quickly. US banks generally perceive fraud losses to be less than the cost of upgrading the old magnetic stripe infrastructure. Quite simply, until those lines cross, no rickety coalition of banks or retailers would seriously consider such massive restructuring - at least not without government intervention. If you're wondering when that might come, you'll be wondering a long time. Banks hold wide-ranging power in Washington D.C., a reality highlighted by the meagre financial reforms imposed in the wake of the 2008 financial meltdown. In fact, US banks are already out in full force to roll them back. Washington will not impose the massive cost associated with EMV implementation on banks. The market will therefore have to dictate when magnetic stripe cards will finally die, and that market is taking its sweet old time deciding.

The divergence of fraud-fighting systems on both sides of the Atlantic - and the US' 50 year old loyalty to the magnetic stripe - is less crazy than it sounds, comments Benjamin Jun, Vice President of Technology at Cryptography Research, a firm that helps banks protect data. In the 1980s, as fraud-fighting efforts developed, international long-distance phone calls across Europe were very expensive. At the time it was standard practice to verify cardholder data by calling a centralised database. In an effort to reduce related costs, European banks made their credit cards secure on their own by developing a decentralised, self-contained system. That led to placing tiny computer chips on each card that were smart enough to be used for validation without the need to call a central bank. Instead, users enter PIN codes that can be checked against data on the chip for authenticity.

In the US on the other hand, national telecommunications costs were relatively inexpensive, so it made sense for American banks to maintain their centralised fraud systems and continue to have merchants 'phone home' with each transaction.

"In the US it costs 25 US cents to clear a transaction. In Europe, the costs were much higher. So they solved the problem by throwing more money at it", Jun adds. "Their system has been upgraded more quickly because their fraud rates required it".

It might however be worth the while to do the math again. Some US card industry observers recently indicated that losses due to fraudulent card transactions in the US might already exceed the costs of EMV migration.

False starts: efforts to put smart plastic into the hands of US consumers have so far failed

The efforts made so far to put smart plastic in the hands of US consumers have been tepid at best. In the mid-1990s, American Express dived into the smart card end of the pool with its 'Blue' card. The card offered dual use - both magnetic stripe and chip authentication - but virtually no consumers used the chip for anything. This is because the chip had nothing to talk to. The card was vaguely aimed at helping consumers feel better about online shopping, but American Express required them to buy their own smart card readers, which could be attached to their home computers while surfing on the Internet. In retrospect, it was a bad misinterpretation of the market, as nobody would even pay five US dollars for this smart card reader. Ultimately, consumers have since then realised that US law capped their loss liability at 50 US dollars, and most banks waived even that amount when fraud occurred, they had no desire to pay anything to feel safer about credit card use. In fact, as we'll see later, consumers have indicated they wouldn't do 'anything' for added security.

Smart card enthusiasts then went in the opposite direction looking for patrons and got Target on board, the nation's second largest retailer. In the early part of the last decade, the store announced it would begin a major pilot programme installing smart card readers at checkout terminals around the country, as well as adding chips to its Target-branded credit cards. Without participation from major banks however, very few consumers carried smart cards - and Target's smart card readers remained lonely, too. The pilot never really got off the ground.

These failed efforts show that it's not quite accurate to say that money is the simple cause of US sluggishness. It's more accurate to say that there is simply no solid value proposition for anyone in the payments chain to engage in EMV migration due to costs relating to fraud losses. Consumers aren't losing money, so they won't pay. Banks have figured out how to minimise losses using clever back-end tools, so why should they pay? And finally, large retailers collect electronic signatures to protect themselves from high card-not-present fraud losses, while small retailers have no interest in cluttering up their tills with another machine that brings monthly fees and maintenance costs.

In business, and in life for that matter, change almost never occurs until the current circumstances are so uncomfortable they force it. No one in the US is really that uncomfortable with the magnetic stripe.

Consumer behaviour beats all

There is an untapped source for this discomfort possibly to materialise, however - consumer perceptions. Negative consumer sentiment will be the driving force behind any future change. For the past five years an estimated ten million US adults say they have been victims of identity (ID) theft. As a result, concern about this mysterious crime runs so high that millions pay roughly 10 US dollars every month for ID theft prevention services that offer little actual value. Yet none of that 'angst' - both real and exaggerated - has led to consumers clamouring for more secure credit cards.

Bitterness at banks has reached an all-time high in the US, in the wake of costly taxpayer bailouts and aggressive foreclosures. Bankers now rank with lawyers and journalists as the most disliked professionals, yet, there is one type of bank communication consumers surprisingly enjoy - the 'we think your card is being used for fraud' warning call.

Developed by Falcon more than ten years ago, banks search for patterns in purchasing behaviour that fall well outside the norm. For example, if a 1,000 US dollar-a-month spender in Seattle suddenly buys a 3,000 US dollar diamond ring in London, the unlikely purchase triggers a flag, which then triggers a call to the consumer (the cardholder).

Results from numerous surveys reveal that consumers are greatly comforted by these calls, which make them feel that for once, the bank is on their side. Banks loathed to give them up, as they can also create upsell opportunities, plus consumers would miss them. More importantly however, behaviourists report that consumers have become 'used' to the calls. By some counts, half of all US adults have received such a call at least once in their lives. Once upon a time, fraud warning calls might have been disturbing. Now, they barely register them. In other words, credit card fraud is seen as part of life to the US consumer. They will not be crying out for new fraud-fighting tools any time soon.

US consumers are also seen as creatures of habit. Banks know that the average US consumer holds around ten credit cards and the vast majority will only make one attempt before switching to another form of payment. Who wants to be first out the gate with a card that could introduce even the slightest hassle? Swiping is easier than

entering a PIN code. Pulling out a card that requires a PIN will feel a bit like adding an extra 'u' to words like favour and behaviour - 'it's just a nuisance, but why do I have to take this extra step?'

That makes smart cards the dreaded 'solution in search of a problem', in the US.

What will it take?

Payments experts know that this attitude does not reflect reality; the problem can be spotted on balance sheets everywhere. US consumers are also encountering new frustrations when they travel outside the US as they find more and more locations - such as automated train ticket booths in Ireland - that simply won't take their supposedly trusted magnetic stripe cards. As more European retailers and banks follow the measures set out in the EPC resolution on card fraud prevention in a mature EMV environment, US consumers might even more often experience that their magnetic stripe cards are not accepted as a means of payment. Jilted US consumers will surely bring their frustrations back with them when they go home. That's a start.

Perhaps the slow-but-steady march toward global standards in the mobile phone industry might also be instructive here. For years, US travellers looked on with jealousy as GSM phone carrying Europeans called friends seamlessly from either continent, while US travellers were stuck renting disposable phones at European airports. The moment US shoppers are forced to rent a European smart credit card, or have any experience remotely similar, would certainly inject some urgency into the conversation they will have with their card-issuing bank.

But at some point, an element of morality should be injected into this discussion: no one should simply glance the other way at crime. It might be hard at first for US banks to adopt the moral high ground and enlist consumers in a fight against crime. All parties might however be surprised at the willingness of consumers to be deputised in an effort to fight still-rampant identity theft. Convince them that they are losing this fight because they are using the equivalent of an old typewriter, and that they could instead be using the payment world's equivalent of an iPad, and you might have them clamouring for a new kind of credit card upgrade.

It will however not be easy, and it will not happen soon. It will surely take a combination of consumer education, ease of use, cost-saving technological advancements, more clear fraud accounting and government enticements to break down the Americans' loyalty to the magnetic stripe. Only then will they send it off to its rightful place, which is right next to the IBM Selectric typewriter in the history museum.

Bob Sullivan is a reporter for msnbc.com and author of three books dealing with consumer payment issues, including New York Times best sellers 'Gotcha Capitalism' and 'Stop Getting Ripped Off'.

Related links:

To read Bob Sullivan's blog 'The Red Tape Chronicles' on msnbc.com, follow this link: www.RedTape.msnbc.com

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¹Heartland Payment Systems® is a U.S.-based company providing debit / prepaid / credit card processing, online payments, check processing and payroll services.

ARTICLE175

SEPA CASE STUDIES

The Trailblazer

THE FINLANDS

Kela, the Social Insurance Institution of Finland, completes migration to the SEPA Credit Transfer

21.04.11 BY ANNELI SEPPÄLÄ (INTERVIEW)

Kela, the Social Insurance Institution of Finland, disburses benefits under a broad range of social security schemes, which services the majority of Finnish citizens. Kela is at the forefront of European bank customers who opted for early SEPA implementation in recognition of the long-term benefits associated with the transition to SEPA payment schemes and standards. Kela is also representative of the Finnish public sector, which spearheads SEPA migration by public administrations in the European Union.

According to the European Commission Services fourth survey entitled: 'Public Administrations' Preparedness and Migration to SEPA', published in February 2011, public administrations in Finland boasted a SEPA Credit Transfer (SCT) migration rate of 74.8 percent in October 2010. The overall SCT migration rate in the euro area at the time stood at 9.6 percent. Anneli Seppälä, the Payment Processing Manager of Kela, reports on the Kela SEPA project and shares its lessons learnt from the migration process.

Key Information in this Article

Kela, the Social Insurance Institution of Finland, designed its SEPA implementation project based on the results of an in-depth analysis carried out over a period of six months. This analysis identified all changes and resources required to become SEPA compliant. Given that Kela does not collect direct debits and does not make card payments, the project focused on the implementation of SEPA Credit Transfer (SCT). Kela also opted to implement the ISO 20022 message standards.

The Kela SEPA project was based on the following premises:

- The entire project is to be managed in-house.
- Kela adapted all systems to be fully SEPA compliant rather than to rely on conversion services.
- A full-time SEPA project coordinator was appointed.

Kela sent its first SCT payments in May 2009. As of October 2010, all Kela benefit payments were SEPA compliant. In 2010, Kela disbursed some 21.6 million SCTs.

The Kela SEPA project was concluded at the end of 2010.

Managing social security benefits in Finland

Kela, the Social Insurance Institution of Finland, disburses payments to the majority of the Finnish population. The institution manages more than one hundred different types of benefits and compensation schemes. The annual value of benefits and compensations amounted to approximately 12.2 billion euros (in 2010). Kela makes some 33.3 million payments annually, which include 250,000 cross-border payments.

Disbursement of benefits varies from 25,000 to 795,000 transactions per day. The number of daily transactions depends on what kinds of benefits are handled on a given day. When monthly paid benefits (for example, child allowance or general housing allowance) are disbursed, the number of transactions can rise to 795,000. On days when only benefits paid daily (for example, sickness allowance) are compensated, the number of transactions amounts to between 25,000 and 31,000.

According to the Kela 2009 Annual Report, the agency disbursed:

- Health insurance reimbursements to 4.1 million citizens.
- Pension benefits to 735,000 citizens.

- Unemployment benefits to 256,000 citizens.
- Child maintenance allowances to 95,000 children.
- Family allowances benefitting one million children.

At the end of 2009, Kela's service network covered 251 main local offices, complemented by additional branches and citizen service centres.

Kela customers increasingly manage their transactions on the internet. In 2009, Kela recorded twelve million visits to its website, with 12.6 percent of all benefit applications submitted using the online facility. Families with children and students were found to be the most eager users of online services.

The Kela SEPA project - questions and answers

EPC Newsletter: When did your organisation decide to set up the Single Euro Payments Area (SEPA) implementation project?

Anneli Seppälä: In October 2007, we set up a dedicated work team of our payment experts to analyse which changes would be required within the organisation in order to migrate to SEPA. This research also identified the staff to be appointed to the Kela SEPA implementation team. Based on this analysis, we developed a very specific project plan which led to the start of the actual Kela SEPA project in May 2008.

As Kela does not collect direct debits and does not make card payments, its SEPA project focused on the implementation of the SEPA Credit Transfer (SCT) Scheme. We also opted to implement the ISO 20022 message standards, based on the XML syntax in the customer-to-bank space. Later we will set up a separate project to implement the ISO 20022 message standards in the bank-to-customer space, such as account and transaction reporting and the new international RF creditor reference standard ISO 11649.

To ensure coordination with other stakeholders, we participated in two SEPA meetings, organised by the Federation of Finnish Financial Services. Given that Kela has relationships with several banks, we also attended some 20 meetings with individual banks throughout the process.

EPC Newsletter: Given that there was no legal obligation for Kela to implement SEPA - what motivated your organisation to engage in the SEPA process at such an early stage?

Anneli Seppälä: In Finland, the banks announced very clearly in the early stages that, according to the official Finnish SEPA Migration Plan, they would also implement ISO 20022 in the customer-to-bank space by the end of 2010. After that the domestic customer-to-bank standards would not be used at all. There was no other alternative than to start the SEPA project. Because of the multitude of IT systems impacted, it was of utmost importance to start the project at once to be ready by the requested deadline.

The Finnish Migration Plan was later modified so that the banks could offer domestic standards and services through national legacy clearing systems as a special service until the end of October 2011. Kela however, had no reason to change the original timetable. The required changes had already been implemented and many more development projects were already in the pipeline.

EPC Newsletter: Which steps did Kela take to implement SCT and the ISO 20022 message standards?

Anneli Seppälä: The Kela SEPA team was led by a steering group, which oversaw the entire project. The steering group approved individual project plans and timetables, guided the work and signed off the results. A separate coordination group managed a total of 37 implementation projects and sub-projects. The coordination group defined the tasks, timelines and milestones of the individual project teams and monitored their progress to ensure that overall project goals were met. Timelines were determined taking into consideration in-house processes as well as external dependencies such as legislation at European and national level, SCT readiness of banks cooperating with Kela and the SCT Scheme Rulebook release management cycle of the European Payments Council (EPC). In addition, the coordination group specified principles to be observed in the process of adapting systems and procedures to comply with SCT. The coordination group was headed by the project manager.

Major projects handled by individual teams included updating the giro forms used to initiate credit transfers, all systems that operate on the basis of account numbers and bank codes to allow use of the International Bank

Account Number (IBAN) and the Business Identifier Code (BIC). Transitioning to IBAN and BIC also required adaptation of all relevant databases as well as online forms and electronic services enabling beneficiaries to communicate with Kela. IT systems were updated to ensure that ISO 20022 payment initiation messages could be generated, which constituted another very important work stream. Kela also implemented the ISO 20022 message standards for non-SEPA cross-border payments. We actually created a new payment system to be able to send ISO 20022 payment initiation messages to the banks. This new payment system also handles return messages. Last but not least, additional web services and a public key infrastructure (PKI) were implemented.

EPC Newsletter: What were Kela's timelines to achieve SCT readiness?

Anneli Seppälä: The SEPA Kela project plan defined 18 separate phases. During each phase specific milestones had to be met. We decided on a phased migration approach rather than a 'big bang' scenario to achieve SCT readiness for payment volumes handled under separate benefit schemes and through different banks. In our in-house SEPA project lingo, we described this as 'adding' another benefit scheme and 'adding' another bank to SCT. Many of the 37 individual implementation projects, managed by the coordination group, were tasked to achieve SCT readiness of a specific social security scheme. Other projects focused on the necessary adaptation of relevant IT and payment systems, databases and other interfaces. The timelines of the SEPA Kela project were aligned with the official SEPA Migration Plan of Finland. Kela therefore aimed for the migration of all its payments to SCT by the end of 2010.

We sent our first 10,000 SCT payments in May 2009 and since October 2010 all Kela benefit payments are SCT payments. In 2010, Kela disbursed some 21.6 million SEPA credit transfers. The Kela SEPA coordination group concluded its work at the end of 2010.

EPC Newsletter: Please describe the resources required to implement the SCT Scheme and the ISO 20022 message standards?

Anneli Seppälä: More than 200 people were involved in the Kela SEPA project. The hours dedicated to the project including adaption of all IT systems amounted to the equivalent of 50 man years. The resources and number of staff hours required slightly exceeded initial estimates.

EPC Newsletter: What were the main challenges in the implementation project?

Anneli Seppälä: Due to very careful planning, based on the initial in-depth analysis of changes required to implement SCT and the ISO 20022 message standards in the customer-to-bank communication, the process evolved quite smoothly. It was necessary however to adapt some of our original target dates in response to the shifting timelines of other players. As mentioned before, Kela has relationships with different banks, which did not all progress at the same pace in terms of achieving SEPA-readiness.

Target dates of the Finnish legislator to finalise legislation impacting SEPA implementation also continued to change. In some cases the IT system updates of relevant counterparties took longer than we expected. Incidentally, the details concerning benefits disbursed through Kela did not show correctly on account statements, which then meant unforeseen trouble shooting until the problem could be fixed. We did however manage to meet the overall project deadline despite these challenges.

EPC Newsletter: What are the most important lessons learnt?

Anneli Seppälä: The Kela SEPA project relied on the following premises: firstly, we decided to manage the entire process in-house. Due to the fact that we appointed in-house staff to upgrade all relevant IT systems, rather than to rely on external providers, we were in control of the process at all times. Secondly, our goal was to create long-term SEPA-compliant solutions rather than to rely on conversion services used to 'translate' legacy formats into 'SEPA lookalikes'. We also opted to implement the required web services and PKI instead of choosing an interim solution. As a result, all Kela systems are now SEPA compliant. Lastly, it proved very important to have a full time SEPA project coordinator.

EPC Newsletter: Taking into consideration the resources involved in delivering the Kela SEPA project, what have been the main benefits of SEPA implementation?

Anneli Seppälä: The main benefit and success has been in the handling of the Kela payment business based on

SCT and the ISO 20022 message standards, which works very well. Our experience confirms that our payment processes are more efficient following SEPA implementation.

Anneli Seppälä is the Payment Processing Manager of Kela, the Social Insurance Institution of Finland.

Related links:

[Kela Annual Report 2009 \(English language\)](#)

[European Commission Services' Fourth Survey on Public Administrations' Preparedness and Migration to SEPA \(February 2011\)](#)

[EPC Publication 'SEPA for the Public Sector'](#)

[EPC Publication 'SEPA for the Public Sector' - translations into all EU languages provided by the European Central Bank in cooperation with EU national central banks](#)

The EPC Website features a dedicated page '**SEPA Migration - Reports, Case Studies and Indicators**'. This page includes articles reporting on the migration experience in the different SEPA countries. To view this page click [here](#).

Related article in this issue:

[Facing the Facts in April 2011. The EPC Newsletter Tracks the Progress of SEPA Migration](#)

Related articles in previous issues:

[Facing Up to the IT Challenge. Choosing the right IT strategy for SEPA compliance \(EPC Newsletter, Issue 8, October 2010\)](#)

[Searching for Enlightenment? The new book 'ISO 20022 For Dummies' has all the answers! \(EPC Newsletter, Issue 8, October 2010\)](#)

[The Global Data Highway. The ISO 20022 catalogue of financial services Messages: a progress report \(EPC Newsletter, Issue 8, October 2010\)](#)

ARTICLE169

SEPA DIRECT DEBIT (SDD)

SEPA Direct Debit for Billers: The SDD Mandate

EPC Newsletter series provides support for billers preparing migration to the SDD Schemes

21.04.11 BY JAVIER SANTAMARÍA AND HERMAN SEGERS

During the last quarter of 2010, the European Payments Council (EPC) commissioned an independent online insight provider to undertake a survey on the EPC Newsletter. This activity, which aimed to analyse how readers perceived the newsletter, its relevance to their work and recommendations for future issues, identified SEPA Direct Debit (SDD) as one of three topics that readers would like to learn more about. This article kicks off a series which provides information on specific aspects of SDD Schemes, relevant in particular to billers preparing for migration to SDD. In this context, the EPC invites readers to be mindful of expected forthcoming European Union (EU) Regulation, which will set a deadline for the replacement of existing national euro direct debit schemes by a harmonised European direct debit scheme. To facilitate migration to the SDD Schemes, it is imperative that mandates existing today can be used under the SDD Schemes. The mandate is the authorisation by the payer, underlying a direct debit collection. According to the European Commission Services' *Second Annual Progress Report*

on the State of SEPA Migration in 2009 this issue has been addressed in all EU Member States 'with the important exception of Germany'. Billers offering direct debit as a means of payment however, will have to make SDD mandate forms available to be completed by their customers when entering new direct debit agreements after migration to SDD. Javier Santamaría and Herman Segers outline the requirements of the SDD mandate.

Key Information in this Article

A mandate is signed by the payer to authorise the biller to collect a payment and to instruct the payer's bank to pay those collections. The mandate can be issued in paper form or electronically. This article focuses on the paper SEPA Direct Debit (SDD) mandate form.

The payer completes and signs a paper-based SDD mandate and sends it directly to the biller. It is the responsibility of the biller to store the mandate.

The SDD Rulebooks, developed by the European Payments Council (EPC), define the information that must be included in a SDD mandate. Mandate forms to be completed by payers are usually made available by billers themselves, provided the biller offers SDD as a means of payment.

The EPC provides guidance to billers on how to create user-friendly mandate forms compliant with the SDD Rulebook. The EPC also provides translations of the English language SDD mandate text featured in the SDD Rulebooks, into the languages of the 32 SEPA countries.

Links to further useful information on the SDD mandate are included at the end of this article.

The SEPA Direct Debit Schemes in a nutshell

The SEPA Core Direct Debit Scheme (SDD Core) and the SEPA Business to Business Direct Debit (SDD B2B) Scheme developed by the European Payments Council (EPC) - like any other direct debit scheme - are based on the following concept: 'I request money from someone else, and, with his prior approval, I can credit it to myself'. The SEPA Direct Debit Schemes (SDD Schemes) - for the first time ever - enable consumers to make cross-border direct debit payments throughout the 32 Single Euro Payments Area (SEPA) countries ¹. At the same time, the SDD Schemes can of course be used domestically. The payer and the biller² must each hold an account with a payment service provider (PSP) located in SEPA. The accounts may be in euro or in any other currency. The transfer of funds (money) between the payer's bank and the biller's bank always takes place in the euro currency. Currency conversion aspects are out of scope of this article.

For more information on the SDD Schemes, refer to the EPC publication 'Shortcut to SEPA Direct Debit' (see 'related links' below). This four page publication summarises the main features of the SDD Schemes in non-technical terms, including their key benefits.

What is a SDD mandate?

The SDD Schemes allow a biller to collect funds from a payer's account provided that a signed mandate has been granted by the payer to the biller. A mandate is signed by the payer to authorise the biller to collect a payment and to instruct the payer's bank to pay those collections. The mandate can be issued in paper form or electronically. The mandate must be signed by either the payer who is the account holder of the bank account to be debited or by a representative of the payer authorised to sign the mandate on his behalf.

How must SDD mandates be stored?

The SDD Schemes are based on a direct debit model, referred to as the 'creditor-driven mandate flow' (CMF) - the creditor is the biller. This means that the payer completes and signs a paper-based mandate and sends it directly to the biller. In this scenario, the payer's bank does not receive any mandate related information directly from its own customer. The payer's bank receives the mandate related information with the first collection. To learn more about the CMF model, refer to the dedicated page on the EPC Website (see 'related links' below).

Any paper mandate, together with any related amendments or information concerning its cancellation or lapse, must be stored intact by the biller, according to national legal requirements and the terms and conditions of the bank of the biller. After cancellation by the payer, the mandate must be stored by the biller according to the applicable national legal requirements and the terms and conditions of the biller's bank.

The signed mandate - regardless whether it is paper-based or electronic - must be stored by the biller for as long as the mandate exists and for an additional fourteen months after the last collection presented. This is necessary because the Payment Services Directive (PSD) stipulates a refund right for a payer during the thirteen months following the debiting of an account in the event of an unauthorised collection. If a payer requests a refund of a direct debit collection, claiming an unauthorised collection, the biller must be able to produce a copy of the underlying mandate if he wishes to prove that the collection was duly authorised.

Expiration of the SDD mandate

The mandate expires 36 months after the last initiated collection. This means: if a biller does not present a collection under a mandate for a period of 36 months, the biller must cancel the mandate and is no longer allowed to initiate collections based on this cancelled mandate. The 36 month period starts from the date of the latest collection presented, even if rejected, returned or refunded. Should the payer and the biller agree to re-establish payment by direct debit for goods or services exchanged, a new mandate must be issued.

To learn more about the option to issue an electronic mandate (e-mandate), refer to the article 'Have it Your Way! The EPC e-mandate option: a secure way to authorise a SEPA Direct Debit payment' (see 'related articles in previous issues' below).

This article covers the information that must be included in a paper SDD mandate form as defined in the SDD Core Rulebook.

How to create a user-friendly paper SDD mandate form

Mandate forms, to be completed by payers, are usually made available by billers themselves, provided the biller offers SDD as a means of payment. The illustration of the mandate as it appears in the SDD Core Rulebook (see 'related links' below) features the most comprehensive layout possible. In actual usage, however, the SDD mandate may be streamlined in a number of ways without losing any essential content while still remaining compliant with the rulebook (see, as one example, the SDD sample mandate under 'related links' below). The EPC offers guidance to billers on the creation of streamlined, easy-to-use SDD paper mandates. This information is set out in the EPC document 'Guidelines for the Appearance of Mandates' (see 'related links' below). This document features additional examples of SDD mandate forms, compliant with the SDD Core Rulebook. The EPC also provides translations of the mandate text as specified in the SDD Rulebooks into the SEPA languages (see also 'related links' below).

In many cases, the mandate form itself does not have to include all the information required for the authorisation of a SDD collection, provided that this information can be obtained from other sources. It also needs to be kept in mind that most of the information included in a SDD mandate can actually be supplemented by the biller and may as such already be part of the mandate form which the biller creates. Payers who complete and sign such mandate forms will eventually provide virtually the same information with a SDD mandate as in any mandate issued under most national direct debit schemes existing today. The SDD mandate is in fact an easy-to-use tool for payers and billers alike.

What information must be included in a SDD mandate?

The specific information to appear in a SDD mandate is defined in section 4.7.2 of the SDD Core Rulebook (see 'related links' below). The mandate is issued in the language of the country of residence of the payer. If more than one official language exists in the country of residence of the payer, the mandate information may be featured in several languages. English language text may be added if the biller is not able to determine with certainty the language of the payer prior to completion of the mandate form.

The biller should ensure that the information on the mandate form is clearly legible and easily intelligible to the payer. The mandate should provide for a separate field headlined 'Creditor's Use Only'. Information included in this field should reflect any additional and / or separate agreements between the biller and the payer which is not related to the authorisation of the direct debit collection. The SDD Rulebook does not standardise the font or the colours used in the mandate.

The SDD paper mandate must feature the headline 'SEPA Direct Debit mandate'. It is mandatory to include the term 'SEPA' in this headline, regardless of the language in which the mandate is issued. A translation of the term 'SEPA' may be added.

The following fields or data elements are mandatory in any SDD mandate:

1. The unique identifier of the mandate ('unique' in the sense that upon request of a third party to obtain a copy of the mandate identified by this unique identifier, the biller must be able to provide a copy of the mandate paper based unambiguously on this identifier).
2. Name of the payer.
3. Address of the payer (street and street number).
4. Payer's postal code and city of residence of the payer.
5. The payer's country of residence.
6. The payer's account number (International Bank Account Number - IBAN).
7. The Business Identifier Code (BIC) of the payer's bank.
8. Company name of the biller.
9. Identifier of the biller (each biller is identified in the SDD Schemes by a unique identifier provided to the biller, by the bank of the biller).
10. Address of the biller (street and street number).
11. The biller's postal code and city where biller is located.
12. The country where the biller is located.
13. Type of payment (one-off collection or recurrent collections).
14. Line indicating place and time of signature.
15. Signature(s).

The following optional fields or data elements may be included in a SDD mandate:

1. Payer identification code: this code may be provided by the payer as agreed with the biller, e.g. a customer identifier specific to the biller's organisation.
2. Name of the payer reference party: the reference party is the party on whose behalf the payer is signing the mandate, e.g. a family relation of the payer such as parents -paying for their children - the reference party.
3. Identification code of the payer reference party: the code agreed between the biller and the payer on the identification code of the reference party (see under 2).
4. Name of the biller reference party: the reference party of the biller is a third party on whose behalf the biller is collecting payments. This third party may be the party contracting with the payer in the underlying contract. The mandate is established to make the necessary payments related to the goods and /or services delivered as agreed in that contract.
5. Identification code of the biller reference party: an identifier of the reference party of the biller (see under 4) provided by the biller to the payer when the payer is completing the mandate.
6. Underlying contract identifier: the identifier of the contract between the biller and the payer specifying the

goods or services exchanged. This contract is the basis upon which the mandate is signed in case the customer wishes to pay by SDD for the goods or services received.

7. Contract description: description of the underlying contract as proposed by the biller.

These optional fields should only be included on the mandate form if the biller intends to use these fields.

It is the responsibility of the biller to communicate the data elements included in the paper mandate to his bank when initiating a collection, i.e. the biller must transfer this data electronically to his bank without altering its content. The biller's bank then transmits this data to the bank of the payer as part of the collection message. This process is referred to as the 'dematerialisation of the mandate'. The SDD Rulebook provides options for the payer's bank to contact the payer to allow him to verify authorisation of a direct debit collection if the payer requires such a mandate check.

Validity of existing mandates under the SDD Scheme

To facilitate migration of bank customers to the SDD Scheme, it is imperative that mandates existing today can be used under the SEPA Scheme, even if these do not happen to meet all the requirements of the SEPA mandate. Where necessary, EU Member States must devise legislative solutions to ensure the continued legal validity of existing mandates under the SDD Scheme. According to the European Commission's Services' *Second Annual Progress Report on the State of SEPA Migration in 2009* this issue has been addressed in all EU Member States 'with the important exception of Germany'. Direct debits are used twice as much in Germany as in the rest of the European Union³. Billers wishing to learn more about solutions implemented at national level to ensure the continued validity of existing mandates under the SDD Scheme, should contact relevant institutions at national level or their local PSP(s). The SEPA pages of the European Central Bank website feature SEPA-related contact links at national level. To view this contact information, click [here](#).

The EPC is aware of potential difficulties faced by billers who wish to transition to the SDD Scheme using existing mandates which may not be fully compliant with the scheme requirements on form and content of SDD mandates. The EPC therefore introduced into the SDD Rulebooks, a specific section which provides significant practical assistance to billers by waiving certain requirements for these legacy mandates if used under the SDD Scheme. For more information on this subject refer to the article 'Creditors: Help is Here. EPC introduces rules on the use of legacy mandates under the SDD Scheme' (see 'related articles in previous issues' below).

Javier Santamaría is the Chair of the EPC SEPA Payment Schemes Working Group. Herman Segers is the former Secretary General of the EPC. He also served as the editor of the SDD Rulebooks for many years.

Related links:

[The SEPA Core Direct Debit Rulebook Mandate Illustration \(most comprehensive layout possible\)](#)

[Sample of a user-friendly SDD mandate](#)

[Guidelines for the Appearance of Mandates in the SDD Core Scheme](#)

[SDD Core Rulebook Version 4.1 \(see chapter 4.7.2 'The Mandate'\)](#)

[SDD Core Mandate Translations into the SEPA Languages](#)

The SDD Schemes are based on the so-called 'creditor-driven mandate flow' (CMF). The EPC Website features a page which explains the CMF model. To view this page, click [here](#)

The EPC Website features a page dedicated to the SDD mandate. To view this page, click [here](#)

EPC Publication: [Shortcut to the SEPA Direct Debit Schemes](#)

EPC Publication: [SEPA Direct Debit for Consumers - a Convenient and Secure Way to Make Payments](#)

Related articles in this issue:

[The SEPA Regulation - A Progress Report. First reactions by European Parliament and Council of the European Union introduce important improvements to European Commission's proposal for a SEPA Regulation](#)

[SEPA Scheme Change Management. Public consultation starts in May 2011](#)

Related articles in previous issues:

[Have it Your Way! The EPC e-mandate option: a secure way to authorise a SEPA Direct Debit payment \(EPC Newsletter, Issue 6, April 2010\)](#)

[Creditors: Help is Here. EPC introduces rules on the use of legacy mandates under the SDD Scheme \(EPC Newsletter, Issue 2, April 2009\)](#)

¹SEPA currently consists of the 27 EU Member States plus Iceland, Liechtenstein, Norway, Monaco and Switzerland.

²The technical terms used in the SDD Rulebooks refer to the payer as 'debtor' and to the biller as 'creditor'.

³SEPA: Uniform Payment Instruments for Europe. Association of German Banks. 4th revised edition. December 2010.

ARTICLE179

EPC LATEST NEWS

SEPA Scheme Change Management Public consultation starts in May 2011

21.04.11 BY JAVIER SANTAMARÍA

The SEPA payment schemes developed by the European Payments Council (EPC), in close dialogue with the user community, evolve over time to reflect changes in market needs and updates in standards. Each SEPA Scheme Rulebook (SEPA Credit Transfer, SEPA Core Direct Debit and SEPA Business to Business Direct Debit) contains the Scheme Management Internal Rules, which define the change management process applicable to the rulebooks. Any proposed changes to the SEPA Schemes are subject to a three-month public consultation. If the proposed changes are broadly accepted in the user community, they are taken forward. Javier Santamaría invites stakeholders to participate in the public consultation on possible modifications to be introduced into the next release of the SEPA Scheme Rulebooks. The consultation starts mid May 2011.

Key Information in this Article

The annual SEPA scheme change management process is based on the following principles:

Any stakeholder may introduce suggestions for changes to the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) Rulebooks.

All suggestions for changes to the scheme rulebooks received by the end of February 2011 are evaluated by the European Payments Council (EPC) SEPA Payment Schemes Working Group (SPS WG) and channelled into one single set of changes per rulebook (a change request), which is then released for a three month public consultation in May 2011.

Updated versions of the rulebooks are published following approval by the EPC Plenary in September 2011. These rulebooks then take effect from November 2012.

The documentation relevant to the 2011 public consultation on modifications to the SCT and SDD Rulebooks will be published on the EPC Website in May 2011. Links to this documentation can be found in the 'related links' section.

Get involved!

The SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) Schemes evolve based on a transparent change management process, which provides all stakeholders with the opportunity to introduce suggestions for changes to

the Single European Payments Area (SEPA) Schemes. The principles governing the evolution of the SEPA Schemes are set out in section three of the SEPA Scheme Management Internal Rules (see 'related links' below). The annual change management cycle follows a set schedule.

As a first step, each year the European Payments Council (EPC) invites stakeholders to submit suggestions for changes to the SEPA payment schemes by the end of February 2011. In consideration of the suggestions received, the EPC SEPA Payments Working Group (SPS WG) develops a single change request per rulebook. The preparation of the change request involves analysis of the suggestions for changes received, including a cost-benefit analysis, dialogue with the initiator and, if appropriate, market research. Based on this analysis, the SPS WG decides whether to accept a suggestion for change into the change management process or not.

Initiators of any suggestions for changes are notified of the decision taken by the SPS WG. All suggestions to modify the rulebooks received by the EPC - irrespective of whether they have been accepted into the change management process - are published on the EPC Website, permitting such a list to be openly viewed by all stakeholders.

The change requests will be released for a three month public consultation in May 2011.

Taking into account comments received during the consultation, the SPS WG completes a change proposal for approval by the EPC Plenary in September 2011.

To ensure planning security for all market participants, publication of the updated rulebooks follows a predictable rulebook release management cycle. In accordance with industry best practice, payment service providers and their suppliers have a one year lead time to address rulebook updates prior to such updates taking effect. The EPC publishes updated versions of the rulebooks annually in November 2011. The updated versions then take effect in the third week of November 2012, to allow for alignment with [SWIFT](#) message releases.

As a result of this annual change cycle, the SCT and SDD Schemes incorporate numerous features introduced by end users.

Javier Santamaría is the Chair of the EPC SEPA Payment Schemes Working Group.

Related links:

A link to the documentation relevant to the 2011 public consultation on modifications to the SEPA Credit Transfer and SEPA Direct Debit Schemes will be included here once available.

[What is a Payment Scheme?](#) - Dedicated page on the EPC Website

[SEPA Credit Transfer](#) - Dedicated page on the EPC Website

[SEPA Direct Debit](#) - Dedicated page on the EPC Website

[Scheme Management Internal Rules - Extract - Chapter three](#) (this chapter describes the principles governing EPC scheme development)

Related articles in this issue:

[The SEPA Regulation - A Progress Report. First reactions by European Parliament and Council of the European Union introduce important improvements to European Commission's proposal for a SEPA Regulation](#)

[Innovacompegration \(This is Not a Typo\). Reflections on the best approach to innovation, integration and competition in payments](#)

Related articles in previous issues:

[The Good, the Bad, the Ugly* and a Knight in Shining Armour? European Commission requests unprecedented powers to determine payment functionalities \(EPC Newsletter, Issue 9, January 2011\)](#)

[So what's in a Name? Explaining payment schemes, instruments and systems. Clarity on payment terms is critical in the debate over the approach to setting end dates for migration to SEPA through EU Regulation \(EPC Newsletter, Issue 8, October 2010\)](#)

ARTICLE180

EPC LATEST NEWS

EPC Plenary Meeting Update

Main decisions taken in March 2011

21.04.11 BY GERARD HARTSINK

Gerard Hartsink summarises the main decisions agreed in the European Payments Council (EPC) Plenary meeting, which took place in March 2011. The main decisions are highlighted in the information box at the start of this article.

Key Information in this Article

Main decisions agreed by the European Payments Council (EPC) Plenary in March 2011.

The EPC Plenary (the Plenary) adopted the following positions:

- That Article 6, concerning interchange fees for direct debit transactions (and related Articles and Recitals) should be removed from the European Commission's proposal for a Regulation establishing technical requirements for credit transfer and direct debits in euros.
- That the November 2012 date, which is mentioned in Regulation (EC) No 924/2009, should be removed from that Regulation.
- The EPC continues to support the default multilateral balancing payment (MBP) of maximum 8.8 euro cents and the commitment expressed to the Directorate-General Competition of the European Commission and the European Competition Network (ECN) to review the figure after the migration period.

The Plenary resolved to establish the EPC Clearing and Settlement Forum.

The Plenary approved the EPC's Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines, which will be published on the EPC Website for public consultation at the end of April 2011.

The Plenary invites external consultancy firms to respond to a request for a proposal to carry out an analysis of the business to business needs regarding SEPA Credit Transfer (SCT).

The Plenary noted the publication of the EPC Annual Activity Report 2010.

The European Payments Council's position on Article 6 (interchange fees for direct debit transactions) of the European Commission's proposal for a SEPA Regulation

On 16 December 2010, the European Commission (the Commission) published a proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros (the Commission proposal). This Commission proposal is commonly referred to as the forthcoming Single Euro Payments Area (SEPA) Regulation. The European Payments Council (EPC) first published its response to the Commission proposal in February 2011.

Following further evaluation of the possible implications of the Commission proposal on the SEPA Direct Debit (SDD) business model, the EPC Plenary (the Plenary) adopted the following position during its March 2011 meeting:

- That Article 6, concerning interchange fees for direct debit transactions (and related Articles and Recitals) should be removed from the proposal.
- That the November 2012 date, which is mentioned in Regulation (EC) No 924/2009, should be removed from that Regulation.
- The EPC continues to support the default multilateral balancing payment (MBP) of maximum 8.8 euro cents and the commitment expressed to the Directorate-General Competition of the European Commission and the European Competition Network (ECN) to review the figure after the migration period.

and the European Competition Network (ECN)' to review the figure after the migration period.

The updated version of the EPC documentation, setting out the EPC's comments on the Commission proposal, was published on the EPC Website following the Plenary meeting in March 2011 (see 'related files' below). For detailed information regarding the EPC's position on Article 6 concerning interchange fees for direct debit transactions, as included in the Commission proposal for the SEPA Regulation, please also find a link to a separate article on this forthcoming Regulation below.

Establishment of an EPC Clearing and Settlement Forum

The term 'payment system', as defined in the Payment Services Directive (PSD), means a funds transfer system with formal and standardised arrangements and common rules for the processing, clearing and / or settlement of payment transactions. In other words, a funds transfer system enables the exchange of funds (money) and messages between two payment service providers (PSPs) executing a payment transaction. These fund transfer systems can be PSPs as well as separate business - public or private - entities (which may or may not be owned by banks).

In the SEPA context, a payment system in the meaning of a 'funds transfer system', is referred to as a clearing and settlement mechanism (CSM). Services offered by competing CSMs based on the SEPA payment schemes, are governed by market forces and are outside the EPC's remit as there is a clear separation between the EPC as the SEPA Scheme Manager and CSMs. The EPC approved the principles for the CSMs in its 'PE-ACH/CSM Framework' (see 'related links' below). PE-ACH stands for pan-European automated clearing house.

Following further dialogue between the EPC and CSMs, the Plenary resolved to establish the 'EPC Clearing and Settlement Forum' (ECSF). The objectives of the ECSF are to strengthen the dialogue between the EPC as the Scheme Manager for the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) Schemes and a standardisation body developing scheme rules and standards for the euro payments industry and the organisations taking care of clearing and settlement. The ECSF will also provide a platform to share best practices to secure end-to-end processing of SEPA payments

The focus should be exclusively on the SCT and SDD Schemes and technical and operational issues. The ECSF will be co-chaired by the Chair of the EPC SEPA Payment Schemes Working Group and a representative of the CSMs.

Approval of Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines for consultation

The Plenary approved the EPC's Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines, to be released at the end of April 2011 on the EPC Website for public consultation. Stakeholders are invited and encouraged to provide comments by 15 June 2011, with a final document expected to be published by October 2011. These guidelines will enable the quick development and implementation of mobile solutions by: promoting the use of open standards; clarifying the roles of key stakeholders; positioning the responsibilities of the EPC in relation to other industry bodies and defining the adequate level of security for the entire mobile payment value chain in order to establish confidence in this environment. Please see the link to a separate article on this subject in the 'related links' section.

Analysis of the business to business needs regarding SCT: request for a proposal from consultancy firms

As reported in the previous EPC Newsletter, various market players indicated that there are several requirements for additional features and services specific for the business to business (B2B) use of credit transfers. In subsequent discussions in the EPC's Customer Stakeholder Forum (CSF), the concept of a service level agreement (SLA) for SCT or an optional SCT Rulebook was brought forward by the stakeholders. The Plenary resolved in December 2010 that the SEPA Payment Schemes Working Group should carry out a study, for review, as to whether there is a market need to initiate work to accommodate specific B2B credit transfer requirements. It was subsequently decided that a study will be carried out by an external consultancy. The EPC has therefore published a letter (see

'related links' below) inviting offers from external candidates to carry out this study. The deadline for receipt of offers is 20 May 2011.

Publication of the EPC Annual Activity Report 2010

The Plenary noted that the EPC Annual Activity Report 2010 (see 'related links' below) was published in March 2011. The report highlights further progress achieved in all areas covered by the EPC work programme. It is an informative, non-technical resource for readers wishing to learn more about the EPC's activities. The report covers the evolution of the SCT and SDD Schemes, the EPC e-mandates e-operating model, SEPA for cards, mobile and online SEPA payments, the EPC cash repositioning strategy aimed at the creation of the Single Euro Cash Area (SECA), and information security.

Gerard Hartsink is the Chair of the EPC.

Related links:

[Update March 2011: EPC Response to the Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in Euros](#)

[Invitation to Suppliers to Submit a Proposal to Conduct a SEPA-wide Survey for Corporate Needs on SEPA Credit Transfer \(Letter EPC040-11\)](#)

[EPC PE-ACH/CSM Framework](#)

[EPC Annual Activity Report 2010 - the definitive progress report on the EPC work programme](#)

Related articles in this issue:

[The SEPA Regulation - A Progress Report. First reactions by European Parliament and Council of the European Union introduce important improvements to European Commission's proposal for a SEPA Regulation](#)

[Have Your Say. EPC Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines: consultation starts in April 2011](#)

¹The European Commission and the national competition authorities in all European Union Member States cooperate with each other through the European Competition Network (ECN).

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SEPA STANDARDS

Have Your Say

EPC Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines: consultation starts in April 2011

20.04.11 BY DAG-INGE FLATRAAKER

The European Payments Council (EPC) is committed to advancing a sustainable mobile contactless payments ecosystem through the delivery of implementation guidelines that promote an interoperable and flexible architecture.

The EPC's Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines are scheduled to be released at the end of April 2011 on the EPC Website. Stakeholders are invited and encouraged to provide comments by 15 June 2011, with a final document expected to be published by October 2011.

The soon-to-launch document will be the EPC's most recent contribution to the development of

this ecosystem. It will enable the quick development and implementation of mobile solutions by: promoting the use of open standards; clarifying the roles of key stakeholders; positioning the responsibilities of the EPC in relation to other industry bodies and defining the adequate level of security for the whole mobile payment value chain in order to establish confidence in this environment.

In this article, Dag-Inge Flatraaker, provides an overview of the mobile proximity payments marketplace, EPC's work within the area and the progress that has been achieved. He will detail the content offered within these latest guidelines and calls on the industry to take the opportunity to review and provide feedback prior to final publication.

The EPC calls on the industry to get involved and provide feedback to the Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines by 15 June 2011.

Key Information in this Article

The European Payments Council (EPC) is dedicating resources to advance a sustainable mobile contactless payments ecosystem through the delivery of implementation guidelines that promote an interoperable and flexible architecture.

The EPC aims to achieve its goal by:

- Aligning its work with relevant industry associations and engaging in outreach activities with stakeholders.
- Developing documents that inform the payments community and other relevant participants on the delivery requirements necessary to deploy mobile contactless payments.
- Advancing implementation guidelines that define technical standards and specifications, clarify roles and responsibilities and summarise lifecycle management and architecture requirements. The entire project is managed in-house.

The EPC calls on the industry to get involved and provide feedback to the Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines by 15 June 2011. The final version of these guidelines is expected to be published in October 2011.

Advancing mobile contactless payments using near field communications

Mobile phones have achieved full market penetration and rich service levels in most, if not all, European Union (EU) and European Economic Area (EEA) Member States, making the mobile channel ideal for leveraging and promoting the use of Single Euro Payments Area (SEPA) payment instruments.

The use of mobile devices to undertake payment activity has necessitated the development of new business relationships, which has resulted in different industry sectors working together for the first time. This level of market convergence requires an infrastructure that will support advanced functionality and robust security, yet which meets a range of business and technical needs. Most importantly, mobile payment services must be user-friendly by delivering tangible benefits and convenience when implemented to consumers and merchants.

The European Payments Council (EPC) recognises that this landscape will only be achievable through the creation, delivery and maintenance of an interoperable mobile payments ecosystem based on open standards. To ensure a sustainable framework, the infrastructure implemented today must be scalable and flexible to the future needs of both end users and the organisations delivering the mobile payment services.

Although the EPC is eager to advance activity in all areas of mobile payments - including mobile remote payments where two parties are able to send and receive funds irrespective of where they are located - initial resources are focused on mobile contactless card payments, where the mobile device needs to be in close proximity to a point-of-sale terminal. The forthcoming EPC Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines are exclusive to mobile contactless payments using near field communications (NFC) technology ¹.

The EPC is also developing implementation guidelines for mobile remote payments to be released at a later stage.

Avoiding market fragmentation: industry association and stakeholder outreach

The EPC is working with key groups to establish the necessary standards and business rules to leverage the full potential of the mobile channel for the initiation and receipt of SEPA payments in an interoperable environment. In addition to its on-going liaison activities with relevant bodies to monitor and contribute to the advancement of mobile payment activity, the EPC has established three formal relationships to progress its work in this area:

- **GlobalPlatform** is an international association which standardises the management of applications on secure chip technology. The liaison between the EPC and GlobalPlatform will ensure that the mobile contactless technical specifications and use cases of each organisation are compatible as far as possible and meet pre-defined technical common requirements.
- **GSMA**, the worldwide mobile communications industry body, has worked with the EPC to deliver joint industry white papers (see below).
- **Mobey Forum** is the global cross-industry consortium which contributes to the mobile financial services ecosystem from the perspective of banks. The EPC's cooperation with this group seeks to share knowledge and best practice to ensure the definition of compelling mobile payment use cases, which promote the benefits of deploying interoperable mobile payment technology.

Making it happen: summary of achievements

The EPC released two documents in 2010 to clarify its role in creating an interoperable mobile ecosystem in SEPA. These papers are a starting point in the process of defining the responsibilities of stakeholders and synchronising technical requirements with existing industry standards.

The white paper on mobile payments was the first document to be published in July 2010. This paper creates awareness on how to best combine the benefits of state-of-the art SEPA payment instruments for credit transfers, direct debits and card payments via a mobile phone. It explores how mobile payment services can be delivered through cooperation and understanding between service providers active in the banking industry and the new players emerging in the mobile ecosystem.

In October 2010, the EPC and GSMA jointly published the paper Mobile Contactless Payments Service Management Roles - Requirements and Specifications. This document describes the provision and lifecycle management - including distribution, configuration, activation, maintenance and deletion - of banks' mobile contactless payment applications when residing on a UICC 2; a secure element (SE) also known as a SIM, which is located in a mobile handset. It also outlines the role of the trusted service manager (TSM), an independent and trusted third party that facilitates the provisioning and secure management of mobile contactless services and defines a minimum set of requirements for a TSM to interface with banks and mobile network operators.

The implementation guidelines: the next phase of activity

The EPC Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines are the EPC's next step in making SEPA mobile contactless payments a reality. To ensure the delivery of the most comprehensive guidelines, the EPC has analysed the latest specifications and drawn on materials from EMVCo, the EMV® standards body, GlobalPlatform, Mobey Forum and its existing working relationship with the GSMA.

This latest document explicitly offers a description of the mobile contactless payments ecosystem today and the stakeholders involved, to provide a clear understanding of the technology available and its deployment within the market. This enhanced level of clarity will ensure adherence to an adequate level of security measures and appropriate governance by payment service providers.

Bringing this document to market will enable the quick development and implementation of mobile solutions. It will achieve this by:

- Promoting the use of open standards, which will avoid market fragmentation and the deployment of proprietary solutions with limited geographical reach.
- Providing transparency to market participants by clarifying the roles of key stakeholders.

- Stating the position and responsibilities of the EPC in relation to other industry bodies.
- Defining the adequate level of security for the whole mobile contactless payment value chain in order to establish confidence in this environment.

Guideline summary: key content offered

Following an extensive analysis of different SE alternatives, the document details the diverse service models and processes involved in the provisioning and the lifecycle management of a mobile contactless payment application residing in a mobile phone SE. As well as advancing the EPC's work in relation to the UICC, the document covers embedded SEs and micro secure digital (SD) cards. Time has been taken by the EPC to detail the technical infrastructure as well as the essential security requirements for each component within this complex architecture.

In addition to developing SE implementation guidelines, this document acknowledges the different aspects of processing a mobile contactless SEPA card payment such as transaction flows, cardholder verification methods and risk management. It also provides an overview of standards and specifications defined by other standard and industry bodies active in this ecosystem, to offer an unambiguous overview of how this converging landscape interlinks with different stakeholders and their associate rules and regulations.

Throughout the development of this work, the EPC has identified further gaps that need to be addressed to ensure a secure, sustainable and scalable mobile contactless payment ecosystem that will support full SEPA market penetration for all SEs. The guidelines conclude by outlining these next steps for the industry to maximise the reach and mass market adoption of this convenient and accessible payment technology.

Don't miss the opportunity to have your say

The EPC will release the Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines by the end of April 2011 on the EPC Website for consultation. Stakeholder comments are encouraged and welcomed by 15 June 2011. These will be reviewed and the guidelines amended accordingly prior to final publication in October 2011.

Dag-Inge Flatraaker is the Chair of the EPC M-Channel Working Group.

Related links:

The link to the documents relevant to the consultation on the EPC Mobile Contactless SEPA Card Payments Interoperability Implementation Guidelines will be published here end April 2011

[EPC Annual Activity Report 2010](#) (Chapter 10 provides an update on the EPC's work in the area of mobile payments)

[EPC White Paper on Mobile Payments](#)

[Joint EPC and GSMA paper 'Mobile Contactless Payments Service Management Roles - Requirements and Specifications'](#)

¹NFC refers to contactless technology that enables data to be transmitted wirelessly over short distances.

²Universal Integrated Circuit Card.

ARTICLE173

SEPA MARKET UPTAKE

Facing the Facts in April 2011

The EPC Newsletter tracks the progress of SEPA migration

21.04.11 BY GERARD HARTSINK

Each issue of the European Payments Council (EPC) Newsletter monitors the latest available data reflecting the rate of SEPA market uptake. In addition to providing a SEPA migration progress report, this article also discusses the progress of the legislative process aimed at the adoption of a European Union (EU) Regulation establishing technical requirements for credit transfers and direct debits in euros. This forthcoming legislative act is commonly referred to as the SEPA Regulation. This article links to sources relevant to this EU legislative initiative and information on the EU legislative process. Gerard Hartsink tables the facts and the figures.

Key Information in this Article

Data cited in this article represents the latest figures available at the time of European Payments Council (EPC) Newsletter publication (21 April 2011).

As of February 2011, the share of SEPA Credit Transfers (SCTs), as a percentage of the total volume of credit transfers generated by bank customers, amounts to 15.7 percent (European Central Bank SEPA Indicators).

As of February 2011, the share of SEPA Direct Debit (SDD), as a percentage of the total volume of direct debits generated by bank customers, amounts to 0.09 percent (European Central Bank SEPA Indicators).

At the end of 2010, 81 percent of cards, 89 percent of points of sale (POS) and 96 percent of automatic teller machines (ATMs) in SEPA were EMV-compliant. EMV is an industry standard to implement chip and personal identification number (PIN) security for POS card transactions.

As of October 2010, the SCT migration rate for the replying public administrations in the euro area was 14.5 percent (European Commission's Fourth Survey on Public Administrations' Preparedness and Migration to SEPA published in February 2011).

The proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros, published by the European Commission in December 2010 states, in part, that credit transfers will be carried out in accordance with this Regulation twelve months after it comes into force; direct debits shall comply 24 months after it comes into force. The European Commission's proposal – commonly referred to as the SEPA Regulation – is under review by the European Parliament and the European Economic and Financial Affairs Council.

Percentage of banks in SEPA offering SEPA Credit Transfer services

The European Payments Council (EPC) launched the SEPA Credit Transfer (SCT) Scheme in January 2008. As of April 2011, nearly 4500 banks in 32 countries offered SCT services for euro payments. Today, the payment service providers (PSPs) offering SCT services represent more than 95 percent of payment volumes in Europe. Due to mergers and acquisitions, the absolute number of SCT Scheme participants (PSPs offering SCT services) has slightly decreased compared to previous Single European Payment Area (SEPA) market uptake reports featured in this newsletter. The EPC SCT Participant Register, which lists scheme participants, is publicly available at http://epc.cbnet.info/content/adherence_database.

Percentage of SCT transactions compared to the total volume of credit transfers generated by customers

According to the SCT indicators compiled by the European Central Bank (ECB), the share of SCTs, as a percentage of the total volume of credit transfers generated by bank customers, amounts to 15.7 percent as of February 2011. The ECB SCT Indicators can be viewed at <http://www.ecb.europa.eu/paym/sepa/about/indicators/html/index.en.html>.

A figure of 100 percent would indicate that only SEPA services are used and have fully replaced non-SEPA instruments. The SCT Indicators are based on aggregated data provided by clearing and settlement infrastructures in the euro area processing SEPA transactions. This data avoids double counting by excluding, for example, SEPA transactions sent via links between infrastructures. The data also excludes 'on-us' transactions (SCTs between accounts at the same bank) as well as transactions cleared between banks bilaterally or via correspondent

banking. The ECB SCT Indicators also show SCT market uptake by country.

Percentage of banks in SEPA offering SEPA Direct Debit services

The EPC launched the SEPA Core Direct Debit Scheme (SDD Core) and the SEPA Business to Business Direct Debit Scheme (SDD B2B) on 2 November 2009. As of April 2011, 3909 banks, representing more than 80 percent of SEPA payments volume have signed up to the SDD Core Scheme. Of those, 3381 banks also adhere to the SDD B2B Scheme. The separate EPC Participant Registers for the SDD Core and the SDD B2B Schemes list the scheme participants taking part in the SEPA Direct Debit (SDD) Schemes. These registers are publicly available at http://epc.cbnet.info/content/adherence_database.

All branches of banks in the euro area must be reachable for cross-border direct debits; e.g. SDD Core, since 1 November 2010 as mandated by Regulation (EC) No 924/2009 (Article 8). In April 2010 the European Commission services published a Note on Application of Article 8 of Regulation (EC) No 924/2009 - Reachability for Direct Debit Transactions. This guidance note states that it is the location of the branch of a credit institution (whether it is inside or outside the euro area), and not the location of the parent company, that determines whether the reachability obligation and deadline applies. Furthermore, no distinction should be made between branches with head offices located outside the European Union (EU) and those with head offices inside the EU.

Percentage of SDD transactions compared to the total volume generated by customers

According to the SDD Indicators compiled by the ECB, as of November 2010 the share of SDD Core, as a percentage of the total volume of direct debits generated by bank customers, amounts to 0.08 percent. The ECB SDD Indicators can be viewed at <http://www.ecb.europa.eu/paym/sepa/about/indicators/html/index.en.html>.

The figures are based on aggregated data from several clearing and settlement infrastructures/systems located in the euro area. As such, SDD transactions which are cleared bilaterally or processed within the same institution are excluded from this indicator.

SEPA for cards: tracking EMV roll-out

As reported in previous issues of the EPC Newsletter, good progress is being made in the realisation of a SEPA for cards, which aims to enable a consistent customer experience when making or accepting payments with cards throughout the euro area. The EPC's SEPA Cards Framework (SCF) outlines high level principles and rules which will deliver this consistent experience when implemented by banks and card schemes. The SCF recognises the EMV standard for SEPA-wide acceptance of payments with cards at very high levels of security. EMV is an industry standard to implement chip and personal identification number (PIN) security for point of sale (POS) card transactions. An important indicator on the progress in this area is the number of cards, POS and automated teller machines (ATMs) in the market that use chip and PIN for the authorisation of a card payment. More specifically, the percentage of EMV-compliant cards, POS and ATMs in SEPA is monitored.

At the end of 2010, 81 percent of cards, 89 percent of POS and 96 percent of ATMs in SEPA were EMV-compliant.

The progress of EMV roll-out, based on these EPC findings and other relevant data on the subject, are reflected by the ECB SEPA Card Indicators at <http://www.ecb.europa.eu/paym/sepa/about/indicators/html/index.en.html>.

Public sector: SEPA ready?

In February 2011, the European Commission published its Fourth Survey on Public Administrations' Preparedness and Migration to SEPA (see 'related links' below). The survey reflects migration by the public sector as of October 2010. The main findings of the survey are:

- Public administrations' (PAs) migration to SCT has accelerated at an impressive pace over the last eight months. For the reporting period, the SCT migration rate for the replying PAs in the euro area was 14.5 percent versus 2.7 percent in the previous survey. For the first time, SCT migration by PAs exceeds the corresponding rate for the overall market (14.5 percent versus 9.6 percent in October 2010).

- In particular PAs in Finland, Belgium, Austria, Spain, France and Germany have made significant progress over the last eight months.
- Migration to SDD however, remains marginal due to the fact that in the case of many PAs, direct debits are generally not used. In October 2010, the SDD migration rate for the replying PAs in the euro area was 0.24 percent.

Setting a deadline for migration to SEPA

As confirmed by the findings of a study requested by the European Commission in 2007, the benefits for bank customers inherent to the SEPA harmonisation exercise are contingent upon swift migration to a single set of SEPA payment instruments by both the demand and the supply sides¹. The EPC recognises the value of setting a deadline for migration to SEPA services. An end date for phasing out legacy euro payment instruments creates awareness, ensures planning security for all market participants and confirms the commitment to making SEPA a reality. In line with expectations expressed by EU finance ministers, the European Parliament and the ECB, the EPC believes that end dates must be set for the phasing out of existing national euro credit transfer and euro direct debit schemes to ensure that the high costs of running multiple payment schemes in parallel can be eliminated.

In the Seventh Progress Report on SEPA, published by the ECB / Eurosystem in October 2010, it is stated that the 'Eurosystem expects SCT and SDD to become the credit transfer and direct debit schemes used for euro payments in the EU. After the SEPA migration end date, they will have replaced national legacy credit transfer and direct debit schemes for euro payments'. The European Parliament called on the European Commission to set a 'clear, appropriate and binding end date, which date should not be later than 31 December 2012, for migrating to SEPA products'². On 2 December 2009, the European Economic and Financial Affairs Council (ECOFIN - comprising the economics and finance ministers of the EU Member States) considered 'that establishing definitive end-dates for SDD and SCT migration would provide the clarity and the incentive needed by the market, ensuring that the substantial benefits of SEPA are rapidly achieved and that the high costs of running both legacy and SEPA products in parallel can be eliminated'. At its inaugural meeting in June 2010, the SEPA Council - bringing together representatives of both the demand and supply sides including the EPC - endorsed a formal declaration stressing 'their strong 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'.

On 16 December 2010, the European Commission published a proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euros. This is commonly referred to as the proposal for the forthcoming SEPA Regulation. The explanatory memorandum accompanying the proposal states that 'full integration of the payment market will only be achieved once Union-wide payment instruments replace completely the national legacy instruments'. The proposal clarifies that the end dates to be established for compliance with the technical requirements refer to the point in time when these requirements 'need to be fulfilled by Union-wide credit transfers and direct debits'. The proposal states, in part, that credit transfers shall be carried out in accordance with this Regulation twelve months after it comes into force. Direct debits shall comply 24 months after it comes into force.

This proposal is currently reviewed by the EU legislative bodies, i.e. the European Parliament and the European Council representing EU governments (see 'related links' below for more information on the EU legislative process and relevant sources).

The EPC published its updated response to the European Commission's proposal for a SEPA Regulation in March 2011 (see also 'related links' below).

Gerard Hartsink is the Chair of the EPC.

Related links:

For more information on co-decision or the 'ordinary legislative procedure'/ European Union legislative process, click [here](#)

[European Commission Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in Euros \(December 2010\)](#)

[Update March 2011: EPC Response to the Proposal for a Regulation Establishing Technical Requirements for](#)

[Credit Transfers and Direct Debits in Euros published on 16 December 2010](#)

[Committee on Economic and Monetary Affairs \(ECON\): Draft Report on the Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in Euros \(March 2011\)](#)

[Opinion of the European Central Bank on a Proposal for a Regulation Establishing Technical Requirements for Credit Transfers and Direct Debits in Euros \(April 2011\)](#)

[European Commission Services' Fourth Survey on Public Administrations' Preparedness and Migration to SEPA \(February 2011\)](#)

The EPC Website features a dedicated page 'SEPA Migration - Reports, Case Studies and Indicators'. This page also features EPC Newsletter articles reporting on the migration experience in the different SEPA countries. To view this page click [here](#)

[Translations of the EPC publication 'SEPA for the Public Sector' in all EU Languages Courtesy of the European Central Bank in Cooperation with EU National Central Banks](#)

[SEPA Council: Formal Declaration on End-Date\(s\) \(June 2010\)](#)

[ECOFIN Conclusions on SEPA of December 2009 \(October 2010\)](#)

[Regulation \(EC\) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the community and repealing Regulation \(EC\) No 2560/2001](#)

[European Commission: Note on Application of Article 8 of Regulation \(EC\) No 924/2009 - Reachability for Direct Debit Transactions](#)

Related articles in this issue:

[The SEPA Regulation - A Progress Report. First reactions by European Parliament and Council of the European Union introduce important improvements to European Commission's proposal for a SEPA Regulation](#)

[The Trailblazer. Kela, the Social Insurance Institution of Finland, Completes Migration to the SEPA Credit Transfer](#)

[Time to Prepare the Eulogy - 'Six Feet Under' for the Magnetic Stripe in SEPA. Eurosystem recommends migration to chip-only cards](#)

[The Magnetic Stripe: Why it is Hard for Americans to Say Good-Bye. In the US, clinging to old-fashioned payment methods is more than just a bad habit](#)

Related article in previous issue:

[So What's in a Name? Explaining payment schemes, instruments and systems. Clarity on payment terms is critical in the debate over the approach to setting end dates for migration to SEPA through EU Regulation \(EPC Newsletter, Issue 8, October 2010\)](#)

¹SEPA: Potential Benefits at Stake (Capgemini) available at http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=2
http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=283

²European Parliament Resolutions on the Implementation of the Single Euro Payments Area:
<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2009-0139&language=EN&ring=B6-2009-0111> (March 2009) and
<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2010-0057+0+DOC+XML+V0//EN> (March 2010)

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