

POSITION PAPER

**ESBG response the EC Working Paper on SEPA
Migration End-date**

23 June 2010



A. Executive summary

In Year 3 of the public debate about a “SEPA end date” ESBG certainly welcomes the opportunity to respond to a further EC Working Paper. Much about the reasons for, the scope, dimensions, conditions, and criteria, of a legislation supporting migration towards SEPA has already been said and written. It is more than time now to bring the debate to a balanced closure. Market participants on the demand and on the supply sides need certainty in terms of content and timing to plan efficiently, and deliver at the rightfully expected level of quality.

ESBG has long supported that legislation – in effect a EU Regulation – is the appropriate path. The boundaries to what the supply side may do under applicable competition legislation are all too obvious – although it must be acknowledged that the supply side has by far and large already migrated to SEPA. Certainly the justification for an EU Regulation mandating an end date cannot be market failure – but legislative constraints which prevent market players to moving beyond a certain point in a concerted way.

Having thoroughly reviewed and discussed the EC Working Paper (in spite of the unusually short timeframe available for consultation, and whilst by now one could have expected to review a draft Regulation), ESBG believes that a legislative text could support an effective mass migration towards SEPA if:

- A SEPA migration end-date Regulation bridges the views and needs of stakeholders in SEPA. The time of blaming the supply side for not delivering has passed.
- The rationale for having a Regulation on this topic is unambiguous: SEPA is a political project, and the benefits for society and for stakeholders individually cannot be achieved in any other way than by legislation, because of competition legislation constraints. Furthermore it should be well understood that the sole *raison d’être* for this Regulation must be a single purpose, i.e. to facilitate a one time migration from legacy practices and systems to pan-European ones.
- This rationale must be supported by a convincing, publicly available impact assessment – as requested by ECOFIN and the European Parliament.
- Inevitably a Regulation will have to address topics pertaining to both the inter-payment service provider space, and the payment service provider-to-payment service user space. It will be essential that when doing so room for competition on products, and innovation, be not abolished. Again, acknowledging that the *raison d’être* of this Regulation is to facilitate a one time migration, it should not prove a barrier to innovation for payments in the Internal Market, once migration is completed.
- A Regulation will also be more effective if it does not constrain the choice of payment service users with respect to pan-European payment instruments, and if it promotes competition between payment instruments.
- Such a Regulation is not a stand-alone piece of legislation. Coherence with the very recent Payment Services Directive needs to be maintained. Equally, Regulation 924/2009 must be acknowledged. The latter is in effect a pricing regulation, which caps charging of direct debit products to debtors, whilst at the same time instigating the principle that debtor banks are not allowed to recoup their costs from the creditor side. The current Working Paper proposes to extend the role debtor banks have to perform, and the responsibilities and risks they will have to undertake. It goes without saying that debtor banks will not accept to perform this role and responsibilities in the absence of a proper and stable remuneration model – which both ECOFIN and the European Parliament have called the Commission to deliver.

- As any piece of legislation, such a Regulation should remain technologically neutral, to the greatest extent possible.

B. Responses to the proposals of the Working Paper

References hereafter are (unless otherwise indicated) to the pages and sections of the 2. June 2010 EC Working paper on SEPA migration end-date.

General: for the purpose of this response it is assumed that the objective of the Commission is to legislate on the SEPA migration end date(s) by means of an EC Regulation.

Page 1 (1)

The Commission continues to present its intervention in the SEPA migration process as indispensable in the context of a suggested self-regulatory failure. The Commission fails to acknowledge that a) SEPA is the response to a political objective of European authorities, for which no strong market demand pre-existed, b) under prevailing competition legislation the supply side is not authorized to “concert” to agree neither the discontinuation of existing schemes and/or products, nor to mandate the use of specific schemes and/or products.

Page 1 (4)

The outcome of the “assessment” carried out by the Commission’s services has not yet been made public. However a “Working Document from the Commission Services (DG Markt): assessing an end-date for Migration to the pan-European Payment Instruments” has been circulated as an annex to the documents supporting the 1. SEPA Council meeting. Unfortunately this document is not an impact assessment, at best a high level summary of an impact assessment. At a minimum a description of the methodology used by the Commission to conduct the assessment should be available – but it is not. This Working Document contains actually a list of statements – there is no evidence that these are backed by appropriate research. It is not easy to be convinced that this Working document constitutes the “thorough assessment of whether legislation is needed” that ECOFIN requested in December 2009.

Nevertheless a few statements are backed by data:

- For example the Working Document acknowledges that “around 4.500 banks, representing more than 95% of the payment volume of the EU, adhere to the SCT scheme, while almost 2.700 banks, representing around 70% of the EU payment volume, adhere currently to the SDD”. Obviously the SEPA migration is not an interbank issue!
- For example the Working Document takes on the findings of the 2007 CapGemini study on “SEPA: potential benefits at stake” and concludes that “the benefits of SEPA significantly outweigh the cost and investments, in particular for the demand side of the market. An estimated EUR 84 billion of operational savings (net effect after investments) on the demand side” would be reaped if an end date also affected customer products.

The impact assessment actually could have been the opportunity for an independent, statistically-meaningful market study into the perception of SEPA, and the related expectations and possibly obstacles. Such a study would without doubt have provided much guidance in support of a smoother migration.

Page 1 (5) 1. indent

The Regulation's scope could be as broad as suggested, however it must be specified that the Regulation would only apply to transactions initiated by payers or payees and for the benefit of payees holding an account with payment service providers located in the EU.

Page 1 (5) 2. indent

The EC Working Paper proposes to align definitions "as much as possible" between the new legislation and the Payment Services Directive. It is difficult to understand why definitions cannot be fully aligned between a ceteris paribus very recent piece of legislation, and the new intended legislation. Lack of full alignment could lead to interpretation issues, and hamper the establishment of a level playing field across the EU.

Page 2 (5) 5. indent

The EC Working Paper proposes that "these essential requirements should apply to the whole payment service transaction domain, from payment user to payment user through their respective PSPs". Theoretically only the end-to-end implementation of operational rules delivers the greater benefits. One may fear that opening at this stage a debate about essential requirements a) deprives players in the payment industry from the appetite to innovate, b) establishes a payments market defined solely by legislation, c) jeopardises investments already made by the payment industry.

Page 2 (5) 7. indent

The EC Working Paper proposes that there should be "no obstacles to the opening of a payment account". Considering that the objective is to formulate a EU Regulation on the "SEPA migration end-date", only topics which are indispensable for that objective should be in scope. It is difficult to see in what respect the removal of obstacles – where they would exist – to the opening of a payment account is indispensable when setting an end date. Should this topic be included in an EU Regulation, it would go beyond what is absolutely necessary for the defined purpose.

Scope**Page 3, 2. indent**

The EC proposal that "it would be premature to cover" debit and credit cards is presented as being the undesirable result of an industry failure. However the industry stated more than 5 years ago that (as opposed to e.g. credit transfer or direct debit) it would not develop a single scheme for payment cards (but a set of high level principles and rules – the SEPA Cards Framework – complemented by standards – the "Book of Requirements" which first version has been available since 2008 and is currently being developed further).

Page 3, 4. indent

Contrary to what is proposed by the EC Working Paper, "money remittance" in euro within the EU – when these are account-to-account remittances - should be in scope. In the interbank space there is no reason for not considering money remittance instructions as credit transfers instructions.

Page 3, 5. indent

Again – as stated earlier in the present Position Paper - the rationale for having the definitions of the Payment Services Directive "tailored for the needs of this proposal"

needs to be substantiated. Different definitions will have to be evaluated one by one, and the risk for generating interpretation issues thoroughly assessed.

Page 3, Box

As already stated under Page 1 (5) 1. indent above, it must be specified that the Regulation would only apply to transactions initiated by payers or payees and for the benefit of payees holding an account with payment service providers located in the EU.

Page 3, Box, (b)

For the purpose of the present Position Paper it will be assumed that “payment card transactions” mean both payments with cards, and cash withdrawals with cards from an ATM. This should however be clarified.

Reachability, interoperability, and facilitating measures

Page 4, 1. indent

It is understood that the reachability mandated by Regulation 924/2009 for payment providers servicing debtors for a direct debit scheme will be extended to credit transfers. This principle is supported, subject to the following pre-conditions:

- 1) As the EC Working Paper does not consider mandating a single, defined credit transfer or direct debit scheme, it is possible that in future more than one such scheme exists in the EU. ESBG proposes to define “credit transfer scheme” and “direct debit scheme” as 2 common sets of rules, practices and standards agreed between payment service providers for the execution of respectively credit transfer instructions and direct debit collections. These common sets of rules, practices and standards allow to execute instructions and collections without distinction anywhere within the Community internal market, be it at national level, or at cross border level in the Community. Should there be more than one such scheme, the reachability obligation can only extend to one scheme (for respectively credit transfers and direct debits), at the choice of the payment service provider – and not to all schemes available in the market.
- 2) To meet these reachability obligations payment service providers will have to contract with one or several clearing and settlement mechanisms. It can be observed that this could turn into a cumbersome and costly exercise for many payment service providers, who could opt for becoming “indirect participants” in one or several clearing and settlement mechanisms. Whilst such an arrangement may prima facies look more economical than a direct participation, it has as consequence on one side to deprive the indirect participant of its liquidity and at times collateral management capability, it adds one or several steps to transaction execution which may make it difficult for the indirect participant to fully meet its scheme obligations or customer service levels, and it increases counterparty credit risk for the indirect participant. Therefore, in order to preserve a level playing, any mandate as to full reachability must be accompanied by a mandate to clearing and settlement mechanisms ensuring not only an absence of discrimination as to access conditions, but also that volume discounts (where they exist) granted to larger users always reflect at a minimum the marginal cost of production plus a return on investments.

Page 4, Box, Interoperability

The proposal that “payment systems should be interoperable” calls for 2 remarks:

- 1) The paragraph on Interoperability talks about payment systems, processing, and schemes. These 3 terms need to be well defined. For “payment” system, the PSD definition should be retained. For “scheme”, the definition proposed by ESBG in its response to Page 4, 1. indent above, should be retained. It should furthermore be recalled that scheme management should be dissociated from transaction processing, with payment systems (“clearing and settlement mechanisms”) used by payment service providers to meet their obligations under one or several schemes becoming interoperable according to rules independent from scheme rules.
- 2) However general interoperability between payment systems should not be mandated. It should always be subject to appropriate risk and business assessment by each of the potentially interoperating parties.

Page 4, Box, Facilitating measures, 2. bullet

The EC Working Paper proposes that “A payer using credit transfers to transfer funds from his payment account to other payment accounts with payment service providers located in the same Member State should not refuse credit transfers to payment accounts with payment service providers located in another Member State and reachable in accordance with the abovementioned reachability provision”. This proposal is strongly opposed for 2 reasons:

- 1) Payment service users must retain the freedom to choose the payment instrument they wish to use in each circumstance. At most, the payment instrument actually used should result from an agreement between payer and payee – and not from any past pattern of payment instrument usage.
- 2) This disposition would privilege one specific payment instrument i.e. credit transfers to the detriment of others. This is not acceptable as it affects the necessary open competition between payment instruments in the market place. Only such competition will ultimately enable users to enjoy the “tight price” for each payment transaction.

However, if instead of “payer” the Commission here meant to say “payment service provider”, then the proposed facilitating measure would be acceptable – provided other remarks made in this Position Paper are taken into consideration.

End dates, essential requirements for credit transfers and direct debits

Page 5, 2. indent

The EC Working Paper proposes that “end-dates should apply to euro area Member States, while non-euro area Member States would be granted a transitional period, based on their limited euro payment transaction volumes”. In order to ensure coherence, any transitional period for direct debit should not be different from the transitional period defined in Regulation 924/2009 (Art. 8.4).

For credit transfers denominated in euro the case for a transitional period is more difficult to make. The geographical scope for the migration should be all transactions denominated in euro using a euro clearing and settlement mechanism in any and across all EU Member States – not only eurozone countries. Post-migration any EU

credit/payment institution should be able to reach any other EU institution using a SEPA Scheme – not reverting to the use of a legacy cross-border system.

Page 5, 3. indent

The EC Working Paper proposes that “any further improvement or innovation would have to be in line with the requirements set by the legislator”. Whilst the objective of such a proposal can be understood, ESBG must caution against potential, negative, consequences. Examples abound where product innovation has been curtailed due to the (very often, unintended) effects of legislation. Therefore ESBG strongly recommends that an end date Regulation (including “Essential Requirements” should there be any) remains as technology-neutral as possible, in particular with respect to the payment service user-to-payment service provider space. For example any reference to ISO 20022 must be avoided. At most reference could be made to an open standard, approved by a recognized international standardisation organization, such as ISO. (Note: this is provided strictly as an example, and is not meant to suggest that ISO 20022 could be considered as obsolete, or calling for adjustment, in the near future).

Page 6, Box, 4. bullet

It should be acknowledged that within today’s payment system infrastructure the BIC is also required (in addition to the IBAN) to unambiguously identify payment accounts – regardless of services provided in the payment service provider-to-payment service user space in this respect.

Page 6, Box, 6. bullet

The EC Working Paper proposes that “Where a payment service user initiates or receives bulk payments, message formats based on ISO 20022 should be used”. This should not be a disposition of a Regulation. Transaction formats between payment service user and payment service provider must be defined by their bilateral, contractual agreement, although recognized European standardisation bodies may issue recommendations in this respect. Where payment service user choice is available it should be rooted on pricing and service.

Page 6, Box, 7. bullet

The EC Working Paper proposes that “In order to take account of technological and market developments, the Commission may be allowed to adopt delegated acts which may be necessary to update the essential requirements regarding reachability, interoperability, the standards mentioned in the above paragraphs as well as the essential requirements presented in Annex (see page 11)”.

This proposed disposition is evidence to the point made by ESBG in its remark on Page 5, 3. indent above, i.e. that any legislation must remain technologically neutral to the greatest extent possible. Should that condition be adhered to, then the proposed disposition becomes redundant, as there would be no further need to urgently amend a Regulation, outside the standard impact assessment and public consultation processes which should be followed by the Commission.

Waiver for niche products

Page 7, Box

As stated earlier in this Position Paper, the sole objective of an EU Regulation on end date should be to facilitate the migration of a very significant mass of legacy credit transfers and direct debits to SEPA products. At least 80% of respectively the legacy credit transfers and direct debits in scope and generated within each Member State should migrate. The balance of transactions may be constituted of niche and other products, some of which may migrate too when a number of market and/or technical conditions are fulfilled.

Payment account opening

Page 8, Box

As already remarked by ESBG under Page 2 (5), 7. indent above, considering that the objective is to formulate an EU Regulation on the “SEPA migration end-date”, only topics which are indispensable for that objective should be in scope. It is difficult to see in what respect the removal of obstacles – where they would exist – to the opening of a payment account is indispensable when setting an end date. Should this topic be included in an EU Regulation, it would go beyond what is absolutely necessary for the defined purpose.

Transitional provisions

Page 10, 2. indent

As already remarked by ESBG under Page 5, 2. indent above – and taken into consideration the full extent of the remark made there - any transitional period for direct debit should not be different from the transitional period defined in Regulation 924/2009 (Art. 8.4). For credit transfers denominated in euro the case for a transitional period is more difficult to make. The geographical scope for the migration should be all transactions in euro in all EU Member States – not only eurozone countries. Post-migration any EU credit/payment institution should be able to reach any other EU institution using a SEPA Scheme – not reverting to the use of a legacy cross-border system.

Annex: Essential requirements

“Essential requirements” should not be included in any Regulation. Such inclusion will stymie innovation, encourage the possible emergence of would-be schemes choosing and picking a few requirements to claim compliance, and lead to the legislator becoming the owner of payment standards and rules – again not a desirable step towards a competitive and innovative market. In this respect ESBG would like to refer the Commission to its response to DG Markt’s request to PSMEG Members for input with respect to “essential requirements” into a possible EC Regulation on SEPA end dates (Doc ESBG 0402/10 Version 1.0 dated 9. April 2010). Most of the items listed under “essential requirements” in the EC consultative paper are far too technical to be included in a legislative text – this would certainly conflict with the technological neutrality objective.

ESBG however has performed a gap analysis between the Essential Requirements proposed in the EC Working Paper, and the SEPA Credit Transfer and Core Direct Debit Rulebooks. This gap analysis leads to the following remarks:

- a) Technical

- The suggestion that payment schemes allow for significantly longer remittance data fields than provided for in the standard seems rather perilous to implement.
- The Commission is invited to clarify what is meant by the essential requirements for the payer's payment service provider to provide to the payee's payment service provider:
 - "the BIC code of the payer's payment service provider (if not agreed otherwise);
 - "the BIC code of the payee's payment service provider (if not agreed otherwise);

b) Policy

- It would certainly be sensible to making a distinction between essential requirements applicable in the case where the payment service user is a consumer, and other cases. Enterprises (defined as per the Commission's usual definition) should be allowed to agree between themselves, and with their respective service providers, requirements beyond and above the Essential Requirements applicable to consumers.
- The suggestion that "once data is available in electronic form payment transactions should allow for a fully automated, electronic processing in all process stages throughout the payment chain (end-to-end straight through processing), enabling the entire payment process to be conducted electronically without the need for re-keying or manual intervention". The efficiency objective of this disposition is certainly supported by ESBG, and there can be no doubt that payment service providers are vying to achieve such efficiency. However it must be recalled that the format(s) for submitting instructions/collections is always a matter for the contractual relationship between payment service user and payment service provider. Therefore the proposed disposition should be no more than a recommendation or recital.
- The question whether the IBAN of the account of the payer may be passed through to the payee has been the object of industry analysis for some time. Whilst this may be a requirement from certain payee categories (notably for reconciliation purposes), it would seem that there is concern in some countries that such data may be misused by ill intended payees or even third parties. In addition, it would seem that legislation in some countries would not permit such data to be passed on. Accordingly, this should not be one of the Essential Requirements.
- The "Essential Requirement" that "a payer should have the possibility to instruct his payment service provider to limit a direct debit collection to a certain amount or its periodicity" should remain outside the scope of any scheme rules, and is for the bilateral relationship between payer and his payment service provider.



About ESBG (European Savings Banks Group)

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5967 billion (1 January 2008). It represents the interest of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG Members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG Member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.



European Savings Banks Group - aisbl
Rue Marie-Thérèse, 11 B-1000 Brussels
Tel: +32 2 211 11 11
Fax : +32 2 211 11 99
Info@savings-banks.eu www.esbg.eu

Published by ESBG. June 2010