Sunshine Through the Clouds?

Research findings on progress towards SEPA migration

by Helen Sanders, Editor

The first of February 2014 has become a date that will sit alongside the millenium 'bug' on 1 January 2000, euro migration on 1 January 2002, and Lehman's collapse on 14 September 2008 in treasurers' consciousness. By this date, every organisation in the 32 SEPA (Single Euro Payment Area) countries will need to have migrated their domestic and cross-border euro credit transfer and direct debit payments and collections to the new SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) instruments. Many treasurers will read this and shrug: "yes, we know, why do we need to be told quite so many times?" Well, the reason is that not everyone has heard, and fewer have listened.

With one year to go, 1 February 2013 was therefore the date on which the SEPA stopwatch started, with the launch of myriad new websites, blogs, research and press releases on SEPA. Now, a few weeks later, in a more sober light (although the stopwatch is still ticking) a cynic may think that the release of new SEPA collateral is simply a sales ruse; indeed, one banking friend I spoke to recently had called an existing customer to discuss their SEPA migration, receiving the response, "I've said I'm not interested, thank you. I'll stick to what I do now." As Andrew Reid, Head of Cash Management Corporates, EMEA (ex-Germany) at Deutsche Bank's Global Transaction Banking, summarises,

"SEPA is not a value-added service offered by banks and consultants, but a fundamental shift in the payments environment in Europe."

> "SEPA migration is mandatory and urgent."

The fact that banks, vendors and consultants will wish to leverage SEPA as an opportunity to attract new customers is inevitable but in some respects immaterial, and bearing in mind that they are typically the ones to enable migration, they are also essential. SEPA migration is mandatory and urgent. This article outlines the findings of a recent survey carried out by TMI in association with Deutsche Bank, and provides comparisons and comments from a complementary research initiative by PricewaterhouseCoopers, the SEPA Readiness Thermometer, launched in January 2013.

Research participants

The survey was carried out during February 2013. Participants were typically senior finance and treasury professionals (85% treasury manager or above; 37% CFO/Finance Director or Group Treasurer). Although all regions were represented, over 75% of respondents were based in Europe. All sizes of company large enough to have a dedicated treasury function were included, with over 50% of companies turning over more than €1m per year.

1. Progress towards SEPA migration

The survey asked respondents what progress they had already made towards SEPA migration (figure 1). With only 10 months to go before the migration end date, 35% had fully or mostly completed their credit transfer migration, while 13% had fully or mostly completed their direct debit migration. Bearing in mind that the SEPA direct debit (SDD) schemes were launched later than SEPA credit transfers (SCT) and there has been on-going uncertainty about issues such as transfer of existing mandates, it is not surprising that migration towards SDD is at an earlier stage; however, both SCT and SDD share the same February 2014 end date. Fifty-four per cent of respondents have either not started their SCT migration or still need to make substantial progress: 29% had not started at all. A similar proportion have yet to start, or not yet materially completed their migration to SDD. These statistics are similar to those in PwC's recent SEPA Readiness Thermometer, published in February 2013, which noted that nearly 22% had not yet embarked on their SEPA project.

One of the most surprising, and troubling findings in figure 1 is the proportion of companies that noted that SEPA was not applicable to their business. Bearing in mind that some respondents were located outside Europe, this may not appear surprising; however, closer examination of the results revealed that almost 10% of Europe-based respondents did not believe that SEPA was relevant to their business. Two-thirds of these represented companies with a turnover between €250m - €1bn. Sebastian di Paolo, Global Head of Corporate Treasury Solutions at PwC, notes in the Preface to the SEPA Readiness Barometer that,

"Many respondents have an incomplete understanding of, and underestimate, what being SEPA-ready entails.....55% of organisations are at risk of missing the February 2014 deadline."

This is unsurprising as many SEPA projects take between six and nine months to complete, particularly if direct debit migration is required, plus the time required to scope the project, obtain the necessary budget and allocate resources. One respondent noted that they had no desire to migrate to SEPA, so would not do so. As Andrew Reid, Head of Cash Management Corporates, EMEA (ex-Germany), Global Transaction Banking, Deutsche Bank notes,

"It is surprising that such extreme views still exist. Based on the results of this survey, as well as feedback we have received from a recent series of workshops for corporates and non-bank financial institutions, some companies are only now realising that SEPA migration is no longer optional."

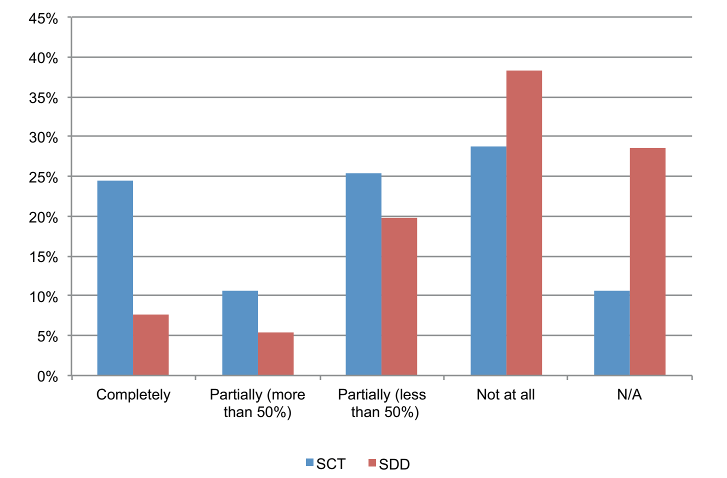
2. Factors delaying SEPA migration to date

Respondents cited a variety of reasons for not completing their SEPA migration before now (figure 2). For SCT, the most common issues included the need to focus on other priorities (36%), lack of awareness or expertise in SEPA within the business (19%). A similar number of respondents noted that they had delayed their project in order to include SEPA migration as part of a wider cash management project (19%). These same challenges have hindered SDD migration but to an even greater degree.

Within these findings, however, there are some interesting points of note. The most frequently cited challenge, that of SEPA migration being delayed by other business priorities, is one that can no longer be considered valid. SEPA migration is mandatory, and non-compliance brings considerable risks; for example, failure of essential payments (such as interest payments, salaries etc.) and increased payment costs. If suppliers have not migrated to SEPA, collections will be delayed, resulting in working capital challenges and potentially increased borrowing costs. Andrew Reid, Deutsche Bank observes,

"For some time now, banks and vendors have been emphasising the benefits of SEPA migration to create a business case for SEPA, which regulators hoped would be sufficient incentive to fuel a market-driven migration. It became clear the message was not sufficiently compelling to make migration a priority, and therefore the regulators were required to step in to make SEPA migration mandatory. The business case for corporate treasurers and finance managers is therefore no longer to articulate the benefits of SEPA, but the need for compliance."

Figure 1 - Progress towards SEPA migration



> Non-compliance brings considerable risks.

Treasurers' and finance managers' aim to include SEPA migration as part of a wider cash management project (e.g., optimise payments and collections, centralise, standardise or simplify cash and liquidity management) is entirely in line with the original aim of SEPA, i.e., to create a harmonised payment landscape in Europe. The problem is that time is running out fast, so for many companies, the focus must now be on compliance, with a further project phase to leverage the benefits of SEPA.

3. Outstanding SEPA challenges

While it may be interesting to note what factors have delayed SEPA migration up until now, it is more important to consider what issues treasurers and finance managers think will continue to pose challenges (figure 3). The four most considerable challenges noted by respondents are the following:

- 26% Insufficient support from banks/ vendors
- 24% Need for greater regulatory clarity
- 23% Lack of budget/ resourcing
- 23% Other business priorities

These findings differ somewhat from those of PwC, who note,

> The onus is on each corporate to approach its banks to engage their advice.

"System-related work streams are clearly keeping respondent awake. 81% of all respondents rate these as the number one concern."

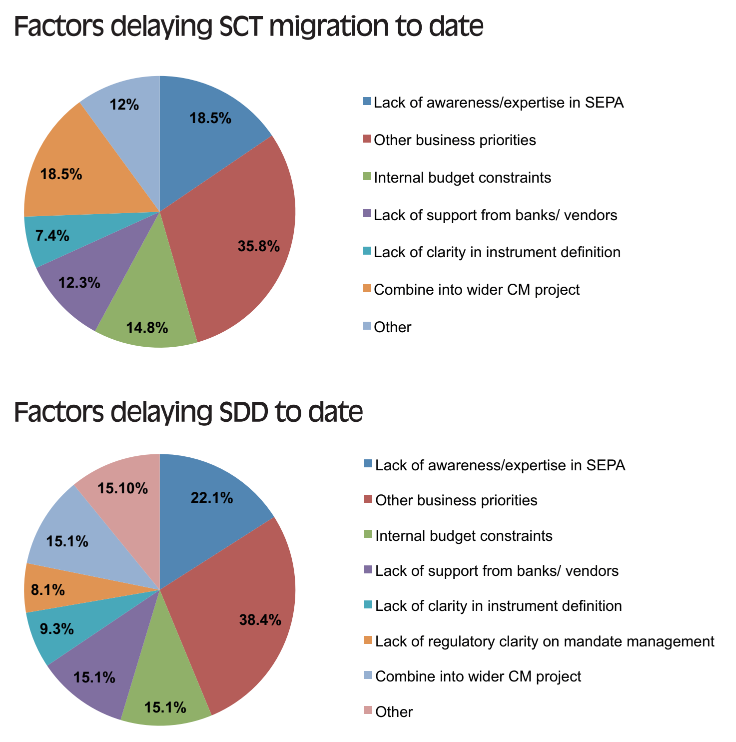
This divergence may be due in part to the timing of the questionnaire, as there has been a great deal of SEPA solution information and technical migration advice released since the start of the year; secondly, there were differences between the two surveys in the way that respondents were asked to rank outstanding challenges. It is interesting to look at each of the four points above in more detail: firstly, the perception of the lack of support from banks and vendors.

Lack of bank and vendor support

The main issue here is which banks and which vendors. SEPA will be more or less important to a bank depending on how important European payments processing will be to its business strategy in the future. For those that do not see this activity as central to their business, the investment will be minimal, and their customers should be seeking alternatives. However, this is not the case for most of the large, international banks (whether regional or global) with which most mid-sized and large corporations work. It is undoubtedly the case that banks have developed their SEPA strategy at different rates, and it has not always been easy to secure or foster the appropriate expertise. However, SEPA is a vital commercial opportunity for many large regional and global banks, so they are competing vigorously for European payments, collections and cash management market share. It is also important for their own reputation that their customers are well-prepared for SEPA. Consequently, there is considerable help and support available from major payment banks operating in Europe. The onus is on each corporate to approach its banks to engage their advice, rather than waiting for the bank to initiate contact. Andrew Reid, Deutsche Bank comments,

"The result reflects corporates' perception that SEPA is principally a banking-led campaign, or a wider industry initiative. As we have just discussed, some companies still believe that SEPA migration is optional, and more of a sales opportunity for banks. Others also assume that banks will perform the migration for them. However, the fact is that banks' service offerings will vary, and they will also differ across markets. Likewise, it is not yet clear what conversion services banks will legally be permitted to perform in the future, what capacity constraints they may face in migrating mass client bases and what technical challenges may arise. While there is undoubtedly help available to support migration, corporate treasurers and finance managers need to take ownership of their own migration projects and be aware of all risks."

Figure 2 - Factors delaying SCT and SDD migration to date



A similar situation exists for key treasury and payment system vendors, although I was surprised that as late as November 2012, a major treasury management system vendor queried why they would need to know anything about SEPA. This was an exception, however, and like the banks, technology vendors have invested in solutions, partnerships and expertise to support SEPA migration. Again, they have developed these at different rates, and some ERP vendors are still lacking in some functionality. However, some vendors are providing highly efficient and proven conversion services to facilitate SEPA conversion, but corporates need to engage with them to take advantage of these services, and also recognise that an investment will be required for SEPA.

Despite protestations that (banks and) vendors are unable to provide sufficient support for migration, the reality is that treasurers and finance managers recognise the importance of the role that they play in migration. For example, the survey asked respondents how they had, or anticipated transferring to XML-based formats. Sixty-four per cent chose to use an ERP or third party vendor solution, compared with only 21% who anticipated performing this in-house. A further 20% had not yet decided, however. One respondent noted, "I expect my bank to do this for me." Banks and vendors are important enablers, but ultimately, this is a project that needs to be owned by each company: after all, it is not the bank or the vendor that will experience the ramifications of non-compliance.

Lack of regulatory clarity

The second issue noted was the lack of regulatory clarity that still existed. Andrew Reid, Deutsche Bank urges, *"It remains the case that greater regulatory clarity in some areas, such as in direct debit mandate transfer and management, would be useful. However, this is not a reason to delay migration.*

The challenge for regulators is that the new SDD schemes are replacing a wide range of existing schemes that each has its own legal, structural and operational requirements, so the transition is different in each case. Andrew Reid, Deutsche Bank explains further,

"Sepa Direct Debits (SDDs) require the creditor to manage and store direct debit mandates (for both the business-to-business and business-to-consumer direct debit) and in some markets this is a change compared to the domestic direct debit. Bridging this gap requires both a migration of existing mandates to SDD mandates as well as a change in business process to align technology systems and ensure regulatory compliance. This is by definition a complex and multi-faceted process."

Regulatory clarity is, of course, desirable, but final questions are unlikely to be resolved until a critical mass of companies have been through the migration process which will flag up what clarification may still be required.

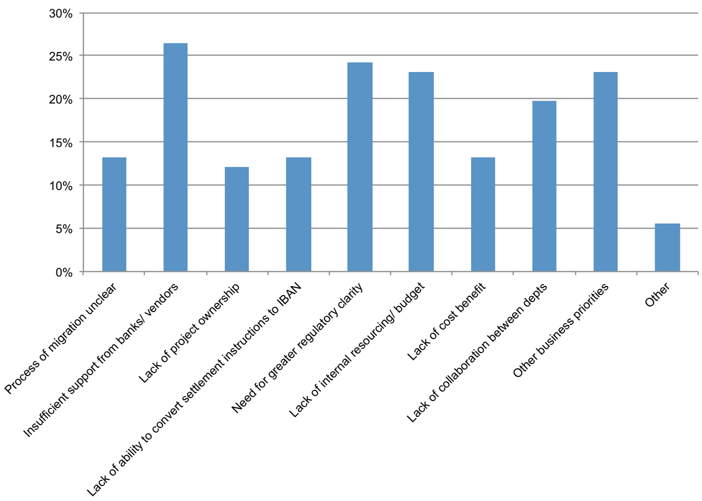
Budget and resourcing constraints

The third issue is the lack of budget and resourcing, and linked to this, the challenge of co-ordinating SEPA migration alongside other business priorities. Andrew Reid responds,

"The lacking sense of urgency is still an issue; similarly, a lack of internal resourcing and budgets are also still posing challenges. While organisations will always be faced with competing priorities, the mandatory nature of SEPA and the potential risks of non-compliance must compel companies to prioritise SEPA on their agendas and allocate the budget and resourcing required for migration."

As we have said a number of times in TMI, and will probably say again, SEPA is a

Figure 3 - Outstanding SEPA migration challenges



compliance issue, and the financial and reputational risk of non-compliance is substantial. Treasurers and finance managers have a responsibility for managing compliance risk relating to the company's financial activities, and consequently, migration must now be a priority. However, few companies have the luxury of being able to engage additional resourcing for a SEPA project, so the project scope needs to be defined according to the compliance requirement, timeline and resourcing, and key project tasks defined accordingly. As Andrew Reid, Deutsche Bank suggests,

"We have been communicating with our customers in terms of 'SEPA musts' and SEPA 'coulds' depending on the scale of task at each organisation, and the amount of resourcing that can be dedicated to the project and the level of desire to consider broader transformation projects. We then see what must be done to ensure compliance (the 'SEPA musts') and the scope that exists to leverage the undoubted advantages ('SEPA coulds') either during the initial project or as a second phase. For example, these could include standardising file formats globally based on XML, centralising cash management, payments or collections, introducing in-house banking and payments-on-behalf-of. Fundamentally, we recognise the need to place ourselves squarely in the mind of each individual treasurer and finance, and structure a plan according to the degree of centralisation that exists, the technical landscape, the degree of autonomy, level of ambition and availability of budget or resourcing."

One significant point that PwC's SEPA Readiness Thermometer makes in respect of project resourcing is the importance of a multi-disciplinary team:

"The statistics on the composition of the project teams raises concern about companies' understanding of the full impact of the 1 February 2014 deadline. They suggest that SEPA readiness is primarily seen as an IT and banking issue and less as a wider business continuity issue of how organisations settle their obligations with trading partners and, for example, employees."

SEPA will impact on virtually every domestic and cross-border financial transaction in the Eurozone, including supplier, customer and employee payments, so all those that have an interest or engagement with any one of these processes will need to be involved in the SEPA project to some degree, including legal, procurement, sales and human resources.

4. Anticipated benefits of SEPA

Despite the perceived challenges and in some cases negativity or apathy about SEPA migration, only 10% of respondents believed that SEPA will offer no

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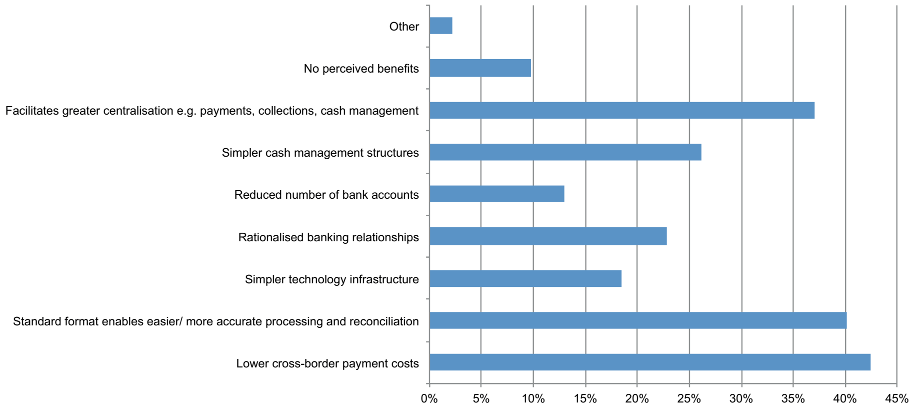
Figure 4 - Anticipated/ realised benefits of SEPA



advantages in the future. The most commonly cited advantage, which applies predominantly to multinational corporations operating in Europe, is the reduced cost of cross-border payments (42%). Other perceived benefits included opportunities for standardisation and automation of payments and collections processing, and greater simplification of cash management and banking structures, and the technology infrastructure that underpins these activities. These advantages are not restricted to activities in the Eurozone alone: the XML ISO 20022 formats on which SEPA payments are based have global applicability and have rapidly become an international standard supported by banks and market infrastructure providers in Asia and North America.

Compliance has to be the priority for most companies now, bearing in mind the rapidly dwindling time available before the migration end date, as PwC notes in the SEPA Readiness Thermometer,

"Although organisations clearly aim at leveraging SEPA for more efficiency and cost reduction, most respondents for now focus on compliance to the SEPA requirements and parked efficiency for a second phase after February 2014."

However, as Andrew Reid, Deutsche Bank concludes,

"If a SEPA migration project is done well, there is still the opportunity to build in the benefits later, and improve the bottom line."

> "The XML ISO 20022 formats on which SEPA payments are based have global applicability."

Forcing a change in the weather

There are potentially dark clouds ahead, as PwC envisages in the SEPA Readiness Thermometer,

"If our belief were to materialise, all organisations, the payments industry and politicians should need to brace themselves for a major hiccup in payment processing in the period immediately after 1 February 2014. Consequently all participants should prepare for a worst case scenario."

However, a 1 February 2014 D-Day is almost entirely avoidable by taking steps towards compliance, and engaging with suppliers to ensure that they do the same. It is too late now to be spending time and energy arguing about the relative merits of SEPA compared with legacy in-country payment schemes: pragmatism is now the order of the day (in contrast with either idealism or indeed grumpiness) in order to make SEPA work both within each individual organisation and more widely across the industry. By doing so, the ultimate benefits will be maximised, and the risks and outcomes of non-compliance minimised. □

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Useful SEPA resources (non-definitive list)

European Payments Council – List of National Migration Plans and Country Resources
http://www.ecb.int/paym/sepa/about/countries/html/index.en.html

BNP Paribas – SEPA Website
http://sepa.bnpparibas.com/sepa/en

Citi – SEPA Guidance
http://www.citibank.com/transactionservices/home/sa/a2/sepa/ab_guidance.pdf

Deutsche Bank – The Ultimate Guide to SEPA Migration
http://www.gtb.db.com/docs/12_09_17_The_ultimate_Guide_to_SEPA_Migration_E.pdf

ING – SEPA Website, including SEPA Training and iPad edition
http://www.ingsepa.com

PWC – SEPA Readiness Thermometer
http://www.pwc.com/en_GX/gx/audit-services/corporate-treasury-solutions/assets/pwc-sepa-readiness-thermometer-state-of-play-with-one-year-to-go.pdf

Sentenial – SEPA Solutions
https://www.sentenial.com/en

SunGard – SEPA Insights
http://blogs.sungard.com/fs_paymentinsights/