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A Brief Introduction
To Payments

S€PA

Information for MEDIA

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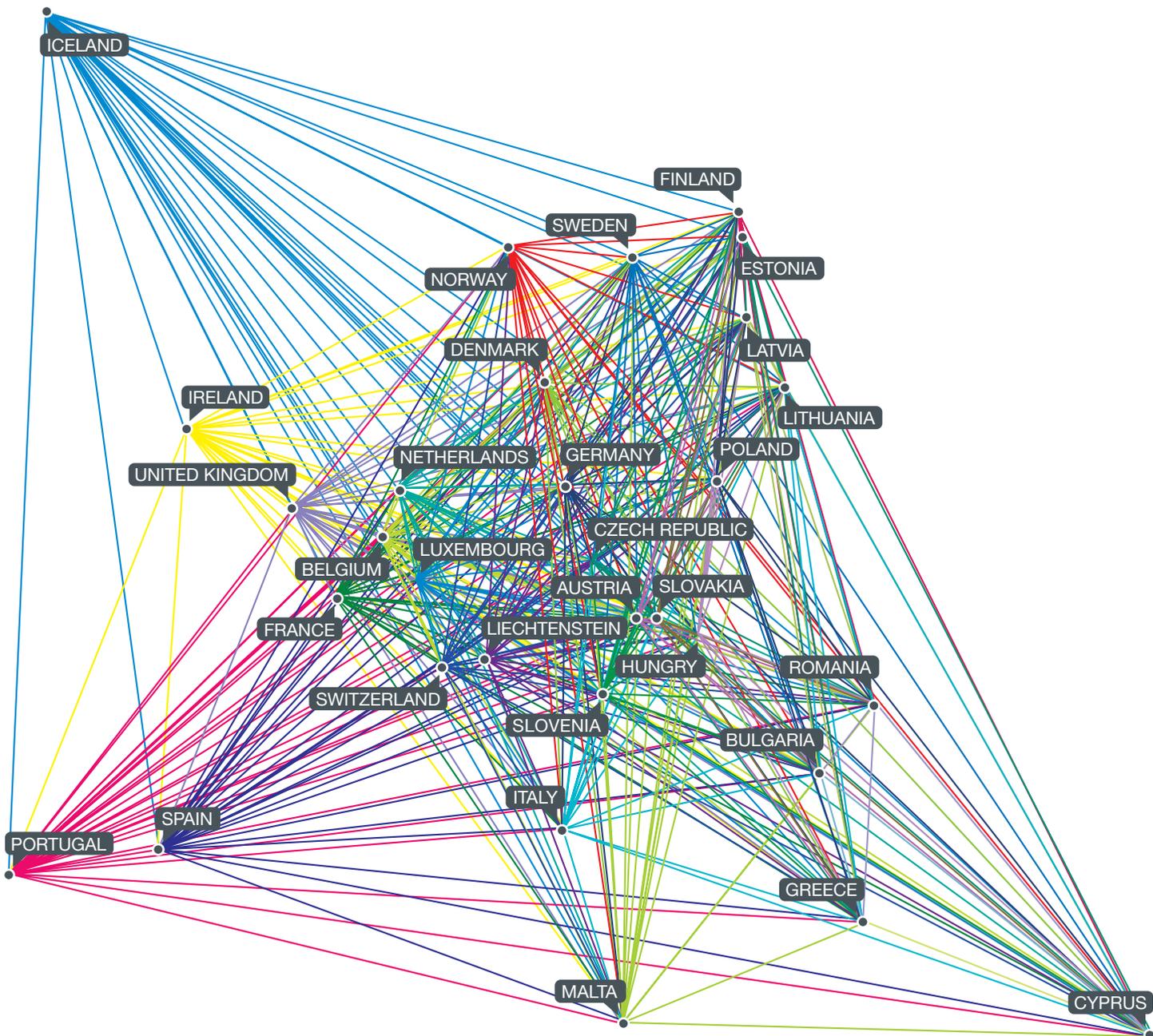
SEPA

TAKE PAYMENTS TO
THE NEXT LEVEL

TABLE OF CONTENT

SEPA FOR THE MEDIA

A BRIEF INTRODUCTION TO PAYMENTS

INTRODUCTION

1.

→ SEPA – the Single Euro Payments Area – is an EU-wide policymaker-driven integration initiative (not a market-driven process) envisioned by the EU governments and fully supported by the European Commission and the European Central Bank as a major prerequisite to achieve the completion of the EU internal market and monetary union.

→ Following the introduction of euro notes and coins in 2002, attention focused on harmonising more than twenty national and cross border payment systems which exist in Europe today. Integrating these systems is a natural step towards making the euro a truly single and fully functioning currency.

→ SEPA will be the area where citizens, companies and other economic actors make and receive payments in euro, whether between or within national boundaries, under the same basic conditions, rights and obligations. In SEPA, people will be able to make payments in euro anywhere in Europe as easily as if they were making a payment in their home town.

→ The SEPA vision is supported by Europe's banks. The European banking industry is working together through the European Payments Council (EPC). The EPC is a joint initiative created to coordinate the definition and implementation of the necessary uniform payment standards to realise an integrated euro payments market. EPC has defined schemes, consisting of specific business rules and practices and applied them to standards for SEPA Credit Transfers and SEPA Direct Debits.

→ SEPA will become a reality when a critical mass of euro payments has migrated from legacy payment instruments to the new SEPA payment instruments. Although the European banks have decided to take a leading role in this migration by self regulation, SEPA will be realised only when key stakeholders such as corporates, small and middle-sized enterprises (SMEs) and public authorities embrace the SEPA vision and commit to implementing the necessary changes.

To facilitate a better understanding of the SEPA initiative, the EPC offers this brief introduction to payments in general and SEPA in particular. In-depth information is available at www.europeanpaymentscouncil.eu

RETAIL PAYMENTS / PAYMENT SYSTEMS

2.

➡ The term retail payments refers to payments of usually low value which are processed via payment systems that clear and settle high numbers of transactions every day (in the European Union, for example, more than 60 billion cashless payments are processed annually).

➡ Payment systems are based on business rules, data formats for the exchange of information and other procedures observed by participants in the payment markets (citizens, enterprises, public authorities et al).

2.1 SEPA - SINGLE EURO PAYMENTS AREA

➡ Payments systems have traditionally evolved within national borders, e.g. today there exist more than 20 different national systems in the EU.

➡ The initiative launched to create the Single Euro Payments Area (SEPA) aims at the realisation of one integrated system for the processing of domestic and 'cross-border' mass payments in euro between bank accounts located in SEPA. The geographical scope of SEPA encompasses the 27 EU member states, Iceland, Liechtenstein, Norway and Switzerland.

2.2 STRAIGHT-THROUGH-PROCESSING (STP)

➡ The processing of retail payments usually requires highly standardised information to ensure low cost automation or straight-through-processing (STP), e.g. processing without manual intervention.

PAYMENT TRANSACTIONS

3.

➦ A payment transaction is defined as an act, initiated by the payer or by the payee, of placing, transferring or withdrawing funds. If such a payment transaction involves the movement of funds between different bank accounts, the payment transaction will be carried out according to the terms of a prior agreement between users and providers of payments services (a so called framework contract).

➦ These terms may be laid down, for example, in the general terms and conditions of business of a credit institution or other payments services providers.

3.1 FOUR-CORNER-MODEL

➦ The four-corner-model describes the flow of information between the banks and their customers involved in a payment transaction.

3.2 CREDIT TRANSFER

➦ The credit transfer starts with the originator (payer) who initiates a payment at an originator bank in order to transfer funds to a beneficiary (payee).

➦ The credit transfer is exchanged between the originator bank and the beneficiary bank. This exchange involves a payment message exchanged between the originator bank and the beneficiary bank.

PAYMENT TRANSACTIONS

3.

3.3 REMITTANCE INFORMATION

➥ The payment instruction contains – at least – details of the originator and the originator's bank as well as of the beneficiary and the beneficiary's bank; the amount of the credit transfer and remittance information if needed.

➥ Remittance information is often used to provide the beneficiary with data needed to reconcile the payment with any underlying transaction (e.g. an invoice number). At a later stage, the beneficiary and the originator are normally informed about the transaction via an account statement.

3.4 DIRECT DEBIT

➥ In the case of a direct debit, the process starts with the creditor (payee) who wishes to settle a claim such as a utility bill, for example. In this case the creditor is a utility company and the debtor (payer) is a consumer. The creditor initiates the payment by presenting the direct debit collection to his bank (the creditor bank).

➥ In order to collect the payment from the debtor (payer), the payment message and the funds are exchanged between the creditor bank and the debtor bank. The debtor is informed that his account has been debited via an account statement.

CLEARING AND SETTLEMENT MECHANISMS

4.

➡ The execution of a payment transaction cannot be compared to sending an e-mail. Firstly, the execution of a payment transaction requires sending the message from bank A to bank B that funds have to be exchanged. This message also includes the information about the sender, the beneficiary, and the transaction itself. Secondly, the value of these funds must actually be exchanged between bank A and bank B.

➡ Clearing describes the process of transmitting, reconciling and, in some cases, confirming payment orders between banks (exchange of payment messages). Settlement describes the discharge of obligations with respect to the transfer of funds between banks (exchange of money, for example, between the originator bank and the beneficiary bank during the execution of a credit transfer).

4.1 INFRASTRUCTURE / CSMs

➡ The systems established to carry out clearing and settlement are referred to as infrastructures or clearing and settlement mechanisms (CSMs). These infrastructures can be banks as well as separate business entities (which may or may not be owned by banks).

➡ Traditional payment clearing (exchange of messages) and settlement systems are governed by the respective national payment conventions. SEPA requires infrastructures that support both the SEPA schemes and standards (see below).

4.2 REACHABILITY

➡ The most important criterion of a SEPA infrastructure is the reachability of all scheme participants (banks): Where a payment from bank A located anywhere in SEPA to bank B located anywhere in SEPA is requested, bank A has to be able to reach bank B bilaterally or via an infrastructure to ensure that the payment is executed on a timely basis[2].

SEPA CARDS FRAMEWORK (SCF)

5.

➦ Please refer to the 'Questions & Answers on the SEPA Cards Framework' which can be downloaded at www.europeanpaymentscouncil.eu.

➦ The SEPA for cards will be achieved to the greatest extent possible through the use of open and free standards, available to all parties within the card payment value chain. In cooperation with other stakeholders, EPC is carrying out a card standardisation programme designed to remove any technical obstacle preventing a consistent customer experience thoughout the SEPA cards market.

THE SEPA SCHEMES

6.

➡ The principles of the SEPA schemes are laid down in the SEPA Credit Transfer Scheme Rulebook, the SEPA Core Direct Debit Scheme Rulebook and the SEPA Business to Business Direct Debit Scheme Rulebook, respectively, which have been released by the EPC. The Rulebooks define business rules regarding the processing of SEPA transactions between scheme participants (banks).

> *The SEPA Scheme Rulebooks and the accompanying Implementation Guidelines, approved by the EPC, are the definitive sources of information regarding the rules and obligations of the schemes. The latest versions of the Rulebooks and Implementation Guidelines can be obtained at www.europeanpaymentscouncil.eu.*

➡ The EPC has set a number of requirements which apply equally to the SEPA Credit Transfer Scheme (SCT) and to the SEPA Direct Debit Scheme (SDD) to allow uniform, automated processing of SEPA payments.

➡ The customers' accounts are identified by an International Bank Account Number (IBAN). The banks are identified by a Bank Identifier Code (BIC). The scope of SEPA payments is limited to payments in euro between accounts held in the SEPA countries. The SEPA Business to Business Direct Debit Scheme (B2B) is the basis for the development of direct debit products allowing business customers to make payments by direct debit to other businesses. The two SEPA Direct Debit Schemes create for the first time a payment instrument that can be used for both national and SEPA-wide direct debit collections. This will effectively make the market much more competitive, to the benefit of consumers and creditors alike.

THE SEPA SCHEMES

6.

6.1 SEPA MANDATE

➡ The mandate in the SEPA Direct Debit is the expression of consent of the debtor to authorise the creditor to present payment collections, e.g. to withdraw money from the account of the debtor (payer).

➡ Under the SEPA Direct Debit Scheme the debtor issues two instructions on signing the mandate form: (a) authorising the creditor to collect payments from the debtor's bank account by direct debit and (b) instructing the debtor bank to make the direct debit payments as instructed by the creditor. The mandate may be issued in paper form or electronically (see 'e-mandate' below under 'SEPA: Next Steps').

6.2 MANDATE MIGRATION

➡ To facilitate the change-over for businesses to the SEPA Direct Debit Scheme it is imperative that mandates existing today can equally be used under the new SEPA Scheme.

➡ Since existing mandates in the different SEPA communities vary considerably it is the responsibility of each community to choose the appropriate approach that will ensure a user-friendly and legally sound way of mandate migration. In some SEPA countries the support of national legislators will be required.

6.3 SCHEME PARTICIPANT

➡ A scheme participant is a bank or a payment institution which has formally adhered to the SEPA schemes. The SEPA Credit Transfer Scheme was launched in January 2008. At www.europeanpaymentscouncil. eu a list of the SEPA Credit Transfer scheme participants can be obtained.

➡ The general SEPA-wide launch date for the SEPA Direct Debit Schemes has now been set in principle by the EPC for November 2009. This launch date coincides with the deadline for all EU member states to have adopted the EU Payment Services Directive (PSD) into national law.

6.4 ADDITIONAL OPTIONAL SERVICES (AOS)

➡ For the SEPA Schemes it is recognised that individual scheme participants (banks) will provide complementary services based on the schemes so as to meet specific customer needs. It is also possible that communities of scheme participants (bank groups) will develop such complementary services. These services are known as community Additional Optional Services (AOS).

6.5 INTERNATIONAL BANK ACCOUNT NUMBER (IBAN)

➡ The International Bank Account Number (IBAN) is based on ISO standard 13616. The IBAN comprises an international part – the country code and the check digits – and a national component.

➡ While the length of the IBAN varies from country to country, it is the same within a country. The check digit can be used to determine whether the IBAN is correct.

➡ This check can be made by the customer himself or by his bank when the payment is initiated. Should the IBAN not be correct, the payment will be queried. The most important aspect regarding the IBAN is that it allows the identification of any account in the SEPA area.

6.6 BANK IDENTIFIER CODE (BIC)

➡ The Bank Identifier Code (BIC) is the world-wide identifier code for banks based on ISO standard 9362.

➡ The implementation of SEPA payment instruments means bank customers need to use both IBAN and BIC.

➡ The SEPA communities will provide conversion services to facilitate the change-over for businesses as they will have to update their databases containing customer account information to IBAN and BIC.

6.7 SHARE (SHA)

➡ In the SCT scheme, the Share (SHA) principle applies, which means that the originator and beneficiary are charged separately and individually by the originator bank and beneficiary bank, respectively.

➡ This is to ensure that charges are not deducted from the amount of the payment. The basis and level of charges to customers are entirely a matter for individual banks.

According to a recent study conducted by request of the European Commission, the replacement of existing national payment systems by SEPA holds a market potential of up to €123 billion in benefits, cumulative over six years and benefiting the users of payment services.

6.8 MIGRATION

➡ The SEPA vision as held by the political initiators of the process, e.g. the EU-governments, the European Commission and the Governing Council of the European Central Bank, expect in the long term the replacement of euro legacy payment instruments by SEPA payment instruments in the euro area (migration). EPC holds the view that migration of legacy systems is a matter to be determined by the responsible bodies at a national level.

PAYMENT SERVICES DIRECTIVE

7.

➡ The Payment Services Directive (PSD) adopted by the Council and the European Parliament aims at establishing a modern and comprehensive set of rules applicable to all electronic payment services – not just SEPA services – in the European Union.

➡ The PSD is of particular relevance with respect to the introduction of the SEPA Direct Debit due to the fact that the PSD establishes common rules for the authorisation and the revocation of debits.

➡ Therefore, the general SEPA-wide launch date for the SEPA Direct Debit Schemes has now been set in principle by the EPC for November 2009. This launch date coincides with the deadline for all EU member states to have adopted the Payment Services Directive into national law.

SEPA DATA FORMAT

8.

8.1 UNIFI (ISO 20022) XML MESSAGE STANDARD

➡ A common data format that is used by all the parties in a payment transaction is essential for cost-efficient handling of billions of payments. Today, dozens of different data formats are in place to process payments across different national clearing systems in the European Union. The realisation of SEPA therefore requires agreement on a common set of data to be exchanged in a common syntax. The SEPA Data Format is based on the global UNIFI (ISO 20022) XML Message Standard.

➡ This format is binding for the exchange of payments between banks. However, banks may continue to accept other formats from customers for SEPA payments.

8.2 ISO 20022

➡ ISO, the International Organisation for Standardisation, has done work on modelling financial industry messages. This is set out in ISO Standard 20022 (see www.iso20022.org). This standard provides a methodology for defining business processes and the related data elements which can then be translated into different syntaxes such as XML. In the ISO process, business requirements are defined for all global markets. This means that each community / market such as SEPA will need to define within the global standard its own version, specific to its own situation. For example, data elements specific to the US and Asian markets would be excluded from the SEPA requirements, while the use of IBAN would be mandatory for identifying a customer's account.

8.3 EXTENSIBLE MARKUP LANGUAGE (XML)

➡ The Extensible Markup Language (XML) syntax was recommended by ISO as the physical data model. XML is a general-purpose specification for creating custom markup languages. It is classified as an extensible language, because it allows its users to define their own elements. Its primary purpose is to facilitate the sharing of structured data across different information systems such as the internet. XML is recommended by the World Wide Web Consortium. It is a fee-free open standard.

➡ With the launch of the SEPA Credit Transfer, EU banks are the first in the world to deploy a new format based on global standards (ISO 20022 XML) for mass euro payment transactions. This innovation is likely to have an impact far beyond Europe, as corporates and banks in Asia and in the Americas have already started to realise the global implications of 31 countries moving jointly towards this international standard.

Bottom-line: The SEPA Data Format is a globally compatible, future-oriented standard in line with up-to-date international developments regarding the exchange of financial industry messages. The European banking industry is leading the way in terms of innovation in global payments.

SEPA: NEXT STEPS

9.

9.1 CUSTOMER-TO-BANK MESSAGES

➔ With respect to the SEPA Credit Transfer Scheme Rulebook and the SEPA Direct Debit Scheme Rulebooks the EPC has developed specific Implementation Guidelines. These Implementation Guidelines detail the usage rules as defined by the EPC to be observed in the bank-to-bank relationship.

➔ The goal is to ensure a common and uniform interpretation of the SEPA standards by those professionals everywhere in SEPA who develop the technical basis for the processing of SEPA transactions between banks.

➔ Such specific Implementation Guidelines, however, are not yet in place with respect to the use of the SEPA schemes in the customer-to-bank area. As a result, Implementation Guidelines developed at national level to facilitate the initiation of a SEPA payment exist today which interpret the Rulebook differently.

➔ Work has been carried out by the EPC to further enhance the Implementation Guidelines applying to the UNIFI (ISO 20022) XML customer-to-bank messages.

➔ These EPC guidelines are based on a number of existing community guidelines. Harmonised specifications for the customer-to-bank area are available in September 2008 for optional but strongly recommended implementation in February 2009 for SEPA Credit Transfer and in November 2009 for SEPA Direct Debit.

Such guidelines are of particular importance to businesses and public administrations, respectively, in their communication with their banks.

9.2 E & M CHANNELS

➔ The EPC is currently developing electronic and mobile channels for the instruction of SEPA payments including necessary standards and security requirements. This will allow customers to initiate SEPA payments either online or via a mobile phone.

9.3 E-MANDATE

➔ The SEPA Direct Debit Scheme has been designed to permit the development of additional features in response to customer needs.

➔ Work has been undertaken to add to the Core Scheme mandates created through the use of electronic channels – called e-mandates. The inclusion of this new possibility for the creation of e-mandates brings further advantages to debtors: the debtor avoids the inconvenience of printing, signing and mailing a paper form to the creditor by using a fully electronic process.

➔ The e-mandate facility is based on secure, widely used online banking services of the debtor bank. The debtor can re-use his online banking credentials. No additional means of identification are necessary. The EPC intends to deliver the e-mandate solution by end 2008.

9.4 BANK-TO-CUSTOMER MESSAGES

➡ Ultimately, the 'outcome' of a payment transaction must be communicated by a bank to the customer. This information takes place via electronic or paper-based reporting messages (reports, notifications and account statements) which inform a bank customer about payment transactions affecting his account.

➡ The ISO standards necessary to allow the development of uniform reporting messages for SEPA transactions have only recently been approved by ISO itself. The opportunity of giving guidance (e.g. to create Implementation Guidelines) for the SEPA-wide use of these messages in the bank-to-customer communication is under consideration by the EPC.

9.5 E-INVOICING

➡ Electronic invoicing or e-invoicing is a solution for secure exchange of electronic invoices inclusive the relevant data between suppliers and buyers involving the upgrade of their sales and procurements systems.

➡ The purpose of electronic invoicing is to streamline the administration of the billing and payment process by eliminating paper handling for both buyers and suppliers. E-invoices can be archived in an electronic format making it easier and cheaper to retrieve them when necessary.

➡ E-invoicing is a relatively new concept with few examples of local authorities and private sector organisations using it at the moment. The development of a European standard for e-invoicing is outside of the scope of the EPC. The EPC is closely monitoring the progress of an expert group set up by the European Commission, which is evaluating a way forward to define a European Electronic Invoicing Framework. It is believed by some that the availability of an e-invoicing standard would encourage the implementation of SEPA schemes, in particular by small and medium-sized enterprises.

10.

➡ The SEPA vision will not be realised via the existence of high-quality SEPA schemes and standards alone – just as the EU monetary union did not materialise simply because of the existence of euro notes and coins.

➡ The vast majority of users never asked for SEPA payment instruments with a view to replacing national ones. SEPA is not a market-driven process. SEPA is an EU-wide policymaker-driven integration initiative designed to generate macro-economic benefits and technological innovation. Macro-economic benefits, however, may not be a key determining factor for individual businesses when it comes to investment decisions. Even when considering the substantial benefits of SEPA payment solutions, it has to be recognised that existing payment applications are generally viewed to work well. In other words, businesses may have other priorities than upgrading their payment processes.

SEPA is an EU-wide policymaker-driven integration initiative – not a market-driven process. It is therefore essential that the political initiators of the SEPA process create the incentives needed to facilitate the change-over for users.

EUROPEAN COMMISSION:

- Secure the continued commitment of EU governments to the realisation of SEPA
- Create the appropriate regulatory and legal environment for the SEPA instruments to be implemented
- Provide support on a scale comparable to the introduction of the euro

EU GOVERNMENTS:

- Ensure consistent transposition of the Payment Services Directive (PSD) as of 1 November 2009
- Encourage and support SEPA implementation by public authorities at national, regional and local level. The buy-in of public administrations is of vital importance as the public sector generates more than 20 per cent of payment traffic in the EU
- Collectively agree end-dates for migration of the public sector to SEPA payment instruments
- Allocate the resources for SEPA implementation and migration in annual budgets **now**
- Require the use of SEPA standards in public procurements for payment services allowing banks to deliver SEPA payments services to any public administration in the SEPA area
- Design and implement incentives which will facilitate the change-over from legacy payment instruments to SEPA for the business community – such as granting tax breaks for early movers, for example
- Facilitate, if necessary, the continued use of existing direct debit mandates under the SEPA Direct Debit Scheme

EUROPEAN CENTRAL BANK:

- Differing balance-of-payments reporting requirements as established by various national central banks pose legal barriers to the concept of **one** domestic euro payments market and must be removed – immediately
- For the change over to the euro a substantial communication budget was made available; a comparable communication effort should be afforded for SEPA implementation by the European Central Bank acting as a principle catalyst of the SEPA process

At this point, the success of SEPA depends – above all – on the continued commitment and practical support of the political drivers of this project.

WHERE TO DIRECT
MEDIA INQUIRIES

11.

Please contact the
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