Perspectives on Single Euro Payments Area adoption in the light of the financial crisis

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Abstract. *The scope of this article is to point out how the present financial crisis is affecting the European payments landscape and the Single Euro Payments Area implementation. The current unpredictable and very challenging market situation has not fundamentally changed the fact that payment services need to continue modernization in order to become more flexible, agile and adapt in order to comply with its important purpose in society. SEPA is needed to ensure the new modern payment platform that can enable Europe to move beyond basic services, increase payments efficiency, embrace innovation and integrate further services in the trade process. Today, the turbulent market conditions could have the effect of accentuating rather than reducing the business case imperative and momentum to achieving full SEPA implementation.*

Key words: *Single Euro Payments Area, credit crunch, corporate bodies, cash management, financial turmoil.*

Introduction

The European Union governments set ambitious goals for Europe in the Lisbon Agenda with the proclamation of creating the most prosperous and successful position for the EU in the global economy. In order to expand the European single market, the national-orientated payment systems needed to convert, and distinctive payment habits and cultures needed to merge towards more harmonized patterns. This is a demanding objective for 31 mature economies, many of them with proud histories of how patterns and cultures have evolved over centuries and decades. This is not an easy task to overcome and it needs the right balance of change process management in order to insure that important value in existing services is not diminished in the new harmonized European services. Change must move towards something better in order to justify the burdens and possible pain points of the process. In its premises, Single Euro Payments Area is an initiative of the aiming at harmonizing the system of cashless payments in the extended Euro zone, creating a coordinated environment of rules, standards and procedures, working as a single domestic payments market in which citizens and economics actors are able to make payments as easily and inexpensively as in their home countries.

2008 was a challenging year for the project: it brought the first successful, visible deliverables of SEPA to the market with the introduction of the Credit Transfer and Card Framework. However, much remains to be done to achieve the full objects, and progress needs to continue.

Moving into 2009, there was a major change happening that wasn't expected at the time the vision of SEPA was outlined. Even within the past few months, the banking industry has further consolidated and changed, and we are now starting to see the true impact of the financial turmoil on the real economy throughout Europe, with no one remaining unaffected.

The early 1990s was the last time that several European countries experienced serious financial crisis[1]. The Nordic region banks were left with no option but t move away from paper-based and manual solution towards electronic and more value-creating services for their customers. And if the scope previously was primarily to solve the problems on a country and community level-basing solutions on country proprietary regulations, standards and networks-one outcome of the financial crises was the new era and evolution of e-payment services for the benefit of all parties.

Why has Europe been so badly affected? First, Collateralized debt obligations (CDOs) were traded worldwide and financial institutions all over the world, including many in Europe, became exposed to them and to other instruments whose value directly or indirectly fell as a result of the sub-prime loan defaults in the United States. Second, although there has been very little sub-prime lending in Europe, some members states have also seen significant downturns in their own housing markets. Third, given that financial markets are global and financial institutions trade with each other worldwide, EU financial institutions are directly affected when US institutions get into trouble. Sentiment also plays an important part-the extreme crisis of confidence in the US financial markets in recent weeks immediately spreads elsewhere-as is always the case in such circumstances. Fourth, all this has coincided with other global shocks, particularly soaring oil and commodity prices, resulting in rising inflation and with inflation and with exchange rate volatility. Those factors too have led to an economic downturn everywhere and have also had a negative affect on stock markets and therefore on the amount of capital available to banks to resist the current pressure.

In 2010, no country is isolated. Trade and business deals flow across all physical state borders, emphasizing the need for widely accessible and secure ways of effecting payments. The current crisis can also create a strong momentum to lift the market to the next level of modernization and dematerialization, but this time not merely with a single country dimension. Now it is time to take the European step.

The article is structured to answer three research questions:

A. How is the credit crisis changing the payments landscape for both corporate bodies and banks? What does the market analysis show?

B. How can a business case for SEPA and the Payments Services Directive be made in the current economic climate?

C. Is Single Euro Payments Area at a crossroads?

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[1] Gnevko, Slava, (2009), *Carpe Diem: the Business Case for SEPA and the PSD During an Economic Slowdown?,* p. 5;

A. But what does SEPA really mean for businesses as a corporate? This initiative will be a key accelerator in reducing the number of accounts you need to hold through the use of in-house banks and pan-European accounts, as well as ensure interoperability through open formats and connectivity. In particular, SEPA offers multinationals the opportunity to centralize payment and collection initiation by establishing shared service centers or payment factories, as well as reduce the number of bank relationships as consolidation of the banking industry creates truly pan-European banks. The present financial turmoil has clearly shown the importance of liquidity and cash management and the superiority of retail deposits as a source of bank financing. In addition, the focus on driving further working capital efficiencies has never been as important. There are plenty of opportunities for improvement, though, and corporate bodies should look to take advantage of the tools and techniques that are available today.

For corporations, SEPA can provide advantages to sell cash and liquidity management services; for consumers, it can help attract retail deposits. Moreover, payments are a profitable business in its own right-providing a regular, reliable source of income with average annual volume growth of 8-9%[2]. The way to survive in today's climate is to be pro-active and more quickly. Due to the credit crunch, all corporations need to „go back to basics"[3] in terms of pan-European liquidity management. The increasing automation of daily treasury operations is enabling corporate treasurers to take a more strategic role within the company. The treasury role now encompasses group-wide business solutions; working capital, risk management, productivity management; involvement in dispute resolution; a collaborative role with the CFO; and a leading and more visible role as a key decision maker in regional and global activities. This is particularly important against the backdrop of the credit crunch, as the priorities in terms of liquidity management have changed in the last few months. For example, guaranteeing the availability of funds and that those funds are used to their maximum potential have asserted themselves as the priority for all corporate bodies right now.

Despite the crisis, payments remain an attractive business and one where a bank will wish to maintain its competitive edge. To capitalize on these investments, it is crucial that SEPA migration is kept on time and on track-the redundant cots of running duplicate payments systems must be avoided. Therefore although it seems like a new market model, it's actually a return to the old model that has not been seen in recent years of big acquisitions, an increased focus on investment banking products and international growth[4]. Predominantly, banks make money on their core businesses; it has been the peripherical activities where they have experienced the biggest losses, such as in assets generated from the investment banking model of originate and distribute. Today, 'back to basics' has become the banks' rallying call to combat the credit crisis. Previously, banks were expected to grow their bottom

[2] Lund, Berit, (2009), *The Status of SEPA in 2009*, p. 4;
[3] Brissaud, Oliver, (2008), *Credit Crunch-Impact on corporates,* p. 3;
[4] Shepard, Simon, (2009), *The Impact of the Credit Crisis on SEPA Implementation,* p. 2-4;

line faster than the gross domestic product (GDP), which obviously meant that they were taking far more risks and looking at more complex products, both of which have come undone in the current dip.

In the light of the present financial turmoil, the market analysis has led to the following:

- A central management structure is needed-there is s a necessity for strong central structure for managing and governing the SEPA and the PSD migration. In September 2008, SEPA Credit Transfer achieved the market share of only 1.65[5] of the overall community's credit transfer volume. If the sluggish trend continues and SEPA Direct Debit migration follows the same pattern, the perceived SEPA benefits won't be achieved over 6-10 years.
- There is a necessity for the review of the investments and cost aspects of SEPA and PSD migration due to changed economic conditions. These factors, and especially the decline in IT spend, negatively affect SEPA solutions and systems.
- Changes in capital markets-the role, origin and cost of capital have significantly changed the allocation of investment and distribution of benefits for SEPA and PSD business case. According to Morgan Stanley, the cost of equity for banks has risen to about 12.5%, while future returns at the end of the crisis may be no higher than 13%.

B. The business case both SEPA and PSD must be reviewed because it evolved under the changing economic conditions. The deterioration in the European and world economy and decline in financial services market can endanger the timeline and level of investment in SEPA and PSD. The regulatory changes from SEPA and PSD present banks with many new compliance requirements, but also offer a series of opportunities, including the chance to: re-asses business models and consolidate payments infrastructure; rationalize legal entity structure if they operate on a pan-European basis; design and tailor new products to enable the capture of new markets; create efficiency savings by applying the standards in the PSD to operations outside of Europe.

Following the postulates of the game theory (Nash equilibrium-prisoner's dilemma) a combination of choices and implementation strategies on the supply side and the implementation/investment choices on the demand side would create a series of economic outcomes for the project. As parts of possible outcomes are the following: adherence to the provisions of PSD, meeting estimated benefits; implementing within the European Commission' timeframe; staying on the level of original planned investment; reaching the required levels of penetration within all stakeholder groups; staying on the level of original planned investment.

Given the current economic conditions and the precarious financial situation some banks have found themselves in, is now really the best time to be forcing banks to invest in SEPA? Having earned money off the *status quo* for some time, banks are finding hard to come to terms wit the new world of

[5] McCreevy, Charlie, (2009), *Financial Crisis-SEPA can be Part of the Solution*, p. 3;

payments that the PSD beckons it. And the credit crunch is only likely to widen the gap between customers' expectations and banks' ability to deliver new payment services and products.

The Institute of International Finance (IIF) calculated the damaging consequences of the credit crunch: up to June 2008, banks internationally made 476billion USD[6] (373bn EUR or 294bn GBP) in credit write downs and also raised 354bn USD (278bn EUR or 234bn GBP) in capital. By the end of September 2008, the re-capitalization figures further increased to 554bn USD (435.2bn EUR or 342bn GBP) with 338bn USD for the US, 55bn for the UK and 96.1bn EUR for European banks. Morgan Stanley predicted that Europe's banks might need an additional 83bn EUR (105bn USD) capital injection. Although participation of individual payment services providers is very important for the successful implementation of SEPA (31 national payment systems), the cooperation and coherent actions of 29[7] national communities, which are subject to PSD, is also important. Therefore the current systemic crises in general, and failure of the whole national economies such as Iceland (not subject to the PSD) and Hungary in particular, are major negative factors and impediments to the successful implementation of these initiatives and legislation

C. Today, SEPA is "lost in conversation", because a more important conversation is happening-the one about survival. Some banks have done a little to make the changes needed for SEPA implementation, but most haven't done enough. Despite the financial buffeting that is happening, it is extremely important that a clear and constant focus is kept on SEPA and its benefits. The credit crisis has undoubtedly changed the banking landscape forever; it has also called into doubt the vision of a Single Euro Payments Area. As SEPA migration in some countries looks like it may be lapsing due to economic conditions we can outline four main areas that need to be addressed to help the project regain some momentum: the European Payments Council must bring together all stakeholders in order to move SEPA to the next critical stage; an end date must be set for the retirement of the legacy payments instruments; it must be found a way so that the basic SEPA product can be enhanced without creating market fragmentation; bank need to collaborate with each other more if SEPA is to be a success.

SEPA is at a crossroads. The current financial current financial market turmoil and related economic decline constitute a less than ideal background for a project that has a far strong policy that business case dimension. But a demonstration now by policy makers and regulators that "better regulation" is more than a motto could still allow European society to reap the benefits of this project in medium term. For the thousand of people heavily involved in creating the new payments landscape in Europe, the journey can sometimes be rough. Faced with this, perhaps some inspiration from our predecessor's hard work with innovation can add further motivation for all of us. Back in the 18th

[6] Macknight, Joy, (2009), *SEPA-Lost in transposition?,* pp.4-6;
[7] ***European Commision, (2009), *Transposition of PSD,* pp.12-16;

century, the diesel engine was invented by Christian Karl Diesel, but the one that took this great innovation through major improvements some years later was Charles F. Kettering, a US electrical engineer. Kettering stated: ”A problem well started is a problem half solved”. A bright and innovative career also made him conclude: ”Every great improvement has come after repeated failure. Virtually nothing comes out right the first time. Failures, repeated failures, are the posts on the road to achievement.” This could be something to bear in order to keep a strong focus, even during periods where implementation may seem fraught with difficulties. SEPA is a common effort for the future. It is an important journey that demands courage, motivation and execution from all parties.

Conclusion

Despite the significant challenges and hurdles that still exist - including, of course, the unsettling impact of general market events over recent months - the foundations nevertheless continue to be put into place for an unprecedented joint initiative between the payment industry, the regulators and the user community with a view to realizing the significant benefits on offer to all stakeholders by taking the SEPA project to its national conclusion.

The changes in macroeconomic market conditions, significant changes and shifts of power in the capital markets and vulnerability of all participants require more regulatory supervision and control. The EC, ECB and national regulator’s strategies need to be changed to secure the benefits and manage risks. Economic incentives have to be created for the collaborative and standardization solutions. The question facing the industry now is: would regulators be able to pick up the reigns of power and maintain the pace and benefits of migration for SEPA and PSD?

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