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SEPA 2.0: Opportunities and challenges after the end-date

by Luca Poletto, BNP Paribas

Five years after the go-live date of the first Single Euro Payments Area (SEPA) instrument, we are in the last sprint of the SEPA migration (Exhibit 1). Europe can now be considered as a domestic market. The integration of SEPA has been done with multiple efforts, both on the banks and corporate side, which will now open the gates to a range of new possibilities and opportunities to optimise the treasury landscape within Europe. To take advantage of these opportunities and create competitive advantage, treasurers and finance managers should assess their payment, collection and liquidity needs in Europe in relation to the new environment.

SEPA as a driver for streamlining receivables

'A sale is not a sale until it is paid for'. This simple statement may seem obvious, but transforming a sale into cash is one of the biggest challenges of every credit controller and is identified as one of the major drivers of working capital management. SEPA has transformed Europe into a domestic market, and the SEPA Direct Debit (SDD) product in particular enables creditors to collect on a pan-European scale in a uniform way, enabling a lot of new opportunities in improving accounts receivable management.

Working capital needs and exposure to debtor defaults can be significantly decreased by lowering the average number of days that a company takes to collect revenue after a sale has been made (a measure commonly referred to as days sales outstanding (DSO)). This explains why this topic is so high on the priority list of most companies.

Managing accounts receivable is two-fold: on the one hand there is a strong cultural and human aspect involved, and on the other hand it concerns the optimisation of internal processes. The switch to collecting via SDD offers improvement possibilities on both aspects.

The most common challenge that hinders the management of accounts receivables are linked either to the

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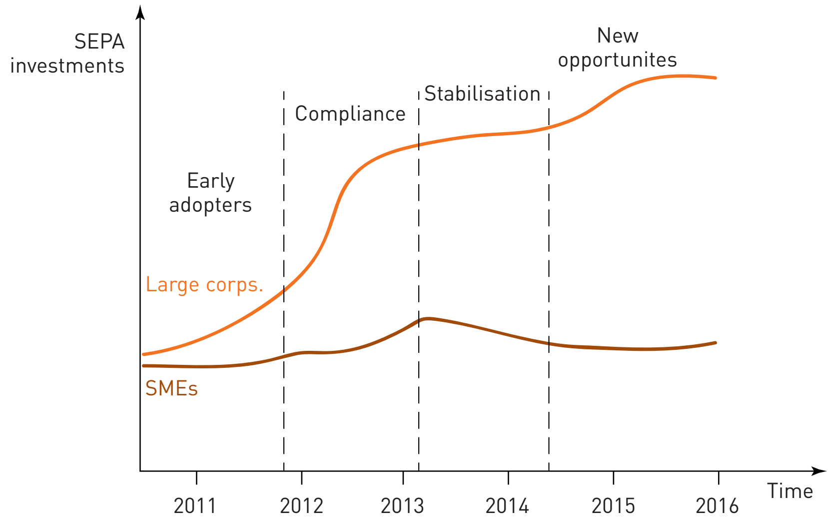
Visualisation of SEPA investments made over time* **Exhibit 1**



*Feedback from European customers

Source: BNP Paribas

reconciliation process or treasury forecasting. Accounts receivable reconciliation is a key concern for corporations collecting from corporate clients. Incorrect or missing remittance information is very common if the debtor is often responsible for initiating the payment. Another debtor related challenge is to account for partly paid or disputed invoices. On top of that, debtors can use a vast number of different payment methods, each with their own timelines and specific properties. Debtor initiated collections are also challenging in terms of treasury forecasting.

Implementing collections via SDD whenever possible provides a solution for both these issues. It introduces one uniform format that can be used to collect across all the European countries.

Some multinationals go beyond the standardisation allowed by SDD. They centralise the accounts payable operations in shared service centres, sometimes outsourced to third parties. In certain cases, they also centralise all the collection accounts in a single SEPA country. This type of account structures offer unparalleled harmonisation of both collection processes and cycles, sometimes referred to as collection factories.

Leveraging SDD

SDDs provide a uniform, standardised method of collecting domestically and cross-border, which was not possible in the local collection schemes. It removes the need to maintain accounts in every country, reduces the costs and improves efficiency. As the creditor is in charge of the initiation, he can avoid the common human errors such as wrong or incomplete remittance information. The debtors are no longer responsible for initiating the payment, which decreases the error rate.

There are some challenges related to the implementation of SDDs. First of all there is the human aspect again. Although the Payment Services Directive introduced strict consumer protection rules several years ago, a lot of debtors are still reluctant to give a mandate to a third party in order to debit their account.

The technical challenges of implementing SDDs are also slowing down the uptake of the product. Migrating from the local collection schemes to an SDD scheme requires a lot of expertise and has a serious impact on the payment processes and IT infrastructure. SEPA has introduced new requirements such as the usage of the International Bank Account Number (IBAN) in order to identify debtors unambiguously throughout Europe. Another major change that has been introduced by SEPA, compared to old legacy direct debit schemes, is the creditor-driven mandate flow (CMF). This means that the creditor (instead of the banks) is now in charge of managing the mandate life cycle.

There are some unique advantages to the SEPA schemes. Creditors that organise their collections via the business-to-business (B2B) scheme can debit non-consumers without a risk of refund. This is possible because the debtor has to confirm the first transaction of the mandate to his bank, allowing the debtor's bank to ensure that the transaction is indeed authorised. This helps tremendously with treasury forecasting because it is no longer possible to experience a bounceback of the debit transactions.

SEPA has introduced a set of open, common payment standards, as well as rules and practices that should facilitate the development of new payment products. This wave of innovation has already started, with the creation of an SDD COR1 scheme currently used extensively in Austria, Germany and Spain (a variant of the SDD Core scheme, but with a shorter settlement cycle of a day) and the emerging of e-mandates and the concrete point of care (POC) – an electronic mandate that can be signed digitally.

Potential enhancements to XML formats

After implementing Extensible Markup Language (XML) formats for SEPA credit transfers and SDDs as well as getting to use new valuable fields such as end-to-end reference or remittance information, why not consider extending the usage of these formats to other payment methods?

This could be implemented along two angles:

- Customer to bank – extending the usage of XML formats to all payables and receivables outside the SEPA countries.
- Bank to customer – benefiting from the richness of the XML formats in your automated reconciliation processes.

Let us first examine the 'customer to bank' angle. This geographical and functional extension can be gradually improved, each time capitalising on the knowledge acquired with past experiences:

1. Extend in priority the XML formats to other types of payments in SEPA countries: cross-border, payrolls, tax payments, high-value payments. BNP Paribas is able to convert these operations into the formats required by the clearing mechanisms, i.e., MT103 for cross-border payments or MT101 for high-value payments.
2. Then deploy the XML formats for all types of payments in all geographies (non-SEPA European countries, Asia and America), making this format a universal standard for payables all over the world. BNP Paribas is in a position to convey and adapt these instructions to the different countries for local processing under local constraints.
3. Moreover, corporations can also choose to extend the XML formats to local collection methods (i.e., *Ricevuta Bancaria* (RIBA) in Italy, *Lettres de Change relevé* (LCR) in France). Common Global Initiative (CGI), driven both by corporates and banks, specified how to use XML ISO 20022 for these specific local payment methods. BNP Paribas strongly supports this initiative and actively participates in these enhancements, bringing along the experience acquired locally in its main markets.

On the reporting side, the same step by step implementation process can be managed with expected benefits:

1. The XML reporting format for the account statement (CAMT053) allows the receipt of valuable reporting data. BNP Paribas is able to provide corporations with the richest information in SEPA countries on SCT and SDD but also on other payment methods and in other countries, providing you populate your issued orders with all the data you need to maximise your automated reconciliation rate. This service is offered through a global storage and enrichment mechanism which also aims at harmonising the reporting across the geographies.
2. An interesting option is the customisation of reporting: using XML formats for payables and receivables allows you to handle more commercial data than current legacy formats of most countries do which would then increase the possibility for customisation. Take this advantage of richer data to design your own reporting formats, therefore helping you produce your analysis reports in an easier way.
3. With the trend towards centralisation, the end-to-end traceability of your orders is also of high importance to bring you the proper visibility on the whole processing chain, from rejects to positive processing. BNP Paribas offers you a sophisticated and flexible traceability service which can be tailor-made to your requirements: you choose your own set-up in terms of levels of reporting, nature of operations, formats, etc.

E-mandates

The rule book published by the European Payments Council (EPC) defined the rules and obligations of the SDD scheme, as well as the underlying technical standards. This has set a harmonised direct debit product for the entire European market, which replaces the existing legacy schemes for all euro-based transactions. To be able to use the SDD scheme, debtors and creditors have to sign a paper mandate.

A direct debit mandate is in fact a dual consent from the debtor to his creditor and to his bank to be debited on his account. Under the SDD scheme, direct debit mandates are stored by the creditor. Rather than arranging for physical signature by the debtor and archive of mandates, e-mandates are paperless mandates that are completed and signed electronically by the debtor.

The objective of the e-mandates is to replace the paper in the Mandate Flow, allowing the debtors to issue, amend and cancel a Direct Debit Mandate through electronic means, while the collection process stays the same as in the existing SDD scheme.

To sign a mandate electronically, different approaches are currently investigated or even already existing on the market. As a bank, we can classify them into two categories:

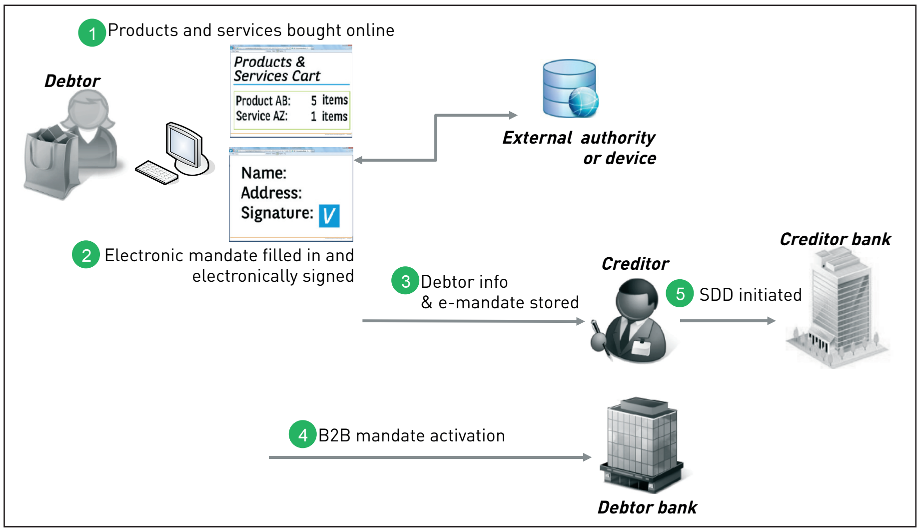
1. An e-mandate can be based on an electronic signature that is arranged directly between the debtor and the creditor without the involvement of the debtor bank. In this case, the identification of the debtor will require the usage of a third party which will act as a certifying body. It could also be realised by the usage of an already established identification system, such as electronic ID cards.
2. The second type of e-mandate is based on an electronic signature whereby the debtor uses its bank credentials to sign a mandate. In this instance, the debtor's bank is in a position to validate the debtor's identity as well as the account and the debtor's powers on the account.

In both cases, the e-mandate brings many advantages for all parties. First, the solution allows a fully automated end-to-end processing of mandates, including the issuing, amendment and cancellation of mandates, which facilitate the life of both debtors and creditors. Being paperless, it also allows a reduction in paper files and archiving.

A third advantage will also be appreciated by B2B organisations: after signature, the e-mandate can automatically be received and recorded by the debtor's bank which enhances the current manual process of mandate registration that slows down the activation of SDD B2B mandates.

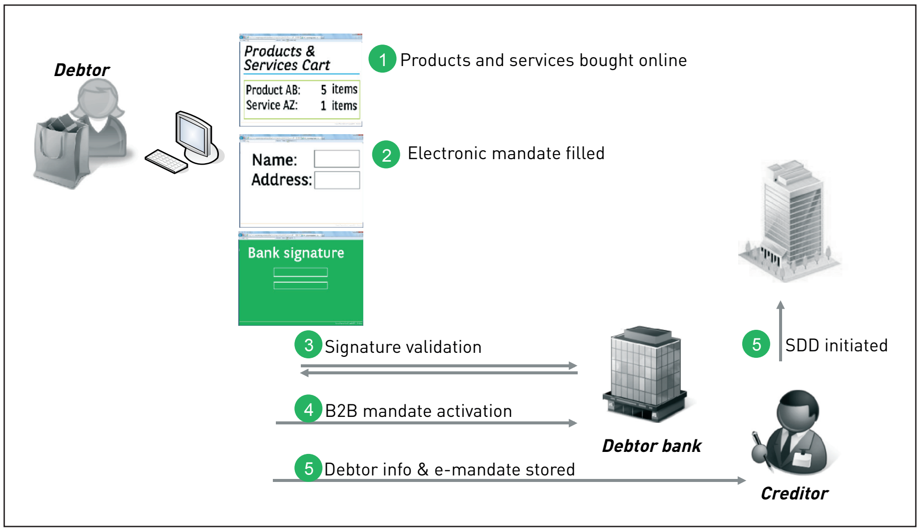
In its e-mandate implementation guidelines, the EPC

E-mandates arranged directly between debtor and creditor **Exhibit 2**



Source: BNP Paribas

E-mandates using bank credentials **Exhibit 3**



Source: BNP Paribas

introduced the technical background for creditors to use e-mandates in replacement of the paper ones. Today, the scheme presents a 'four-corner model', which means that the debtor, the creditor, a validation service (which could be the debtor's bank) and a routing service (to redirect the identification to the correct validation service) are involved in the process of e-mandate signatures. But in the market, we see various other models taking form today, launched by both payment solution providers and banking associations.

E-mandates will gradually become a reality, spreading through the countries. Being an optional measure to comply with for both debtor's and creditor's bank, it is driven by the needs expressed by the local consumers. As the different types of electronic signatures have to be supported legally by each state, the evolution of the respecting laws will also be a key factor. Finally the level of security and the quality of the e-mandate solutions that banks and providers will set in place will certainly change the local outcome as well.

Several initiatives are in a pilot or a design phase in some European countries (France, Belgium, Italy and the Netherlands). A pan-European initiative, called MYBANK and run by EBA Clearing, is in a first pilot phase and supports a global e-mandate scheme, empowered by bank validation of debtor's identity and his power on the account.