Excerpt from the World Payments Report 2011:

Key Regulatory and Industry Initiatives

World Payments REPORT 2011

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2 Regulatory and Industry Initiatives

HIGHLIGHTS

The payments industry is evolving due to a combination of exogenous and endogenous forces; that pressure has intensified even further since the financial crisis and the combined forces of **key regulatory and industry initiatives** (KRIIs) are now converging to drive change far into the future.

This Section outlines some of the many KRIIs now under way, and evaluates their impact on the payments landscape. Among the key findings:

- **KRIIs are at the heart of five main industry transformation trends** (ITTs), which together are reworking—or soon will—many aspects of the payments market and the positioning of participants. Those trends are:
  - **Systemic-risk reduction and control.** In the wake of the financial crisis, regulators are seeking to minimize systemic risk by imposing stricter requirements on capital and liquidity, but there is potential for unintended consequences, including in the way in which these standards can potentially change the economics of some business lines.
  - **Standardization** initiatives continue to improve efficiency, streamline processes and reduce costs. Some payments instruments and/or aspects of the value chain are becoming commoditized in the process, making it more difficult for banks to differentiate themselves in the market.
  - A drive for higher levels of **Transparency** is increasingly being seen in the payments industry. Several initiatives are focusing on making service fees to both corporate and retail clients more transparent, and this could have an impact on current business models.
  - **Convergence**. Developments in technology and evolving user and regulatory requirements are contributing to a gradual blurring of the lines between traditional payments activities supplied by infrastructure providers. There is more overlap, for example, between Low-Value (high-volume) ACH payments and High-Value (low-volume) RTGS payments. This type of convergence may increase competition between the RTGS and ACH systems for certain types of low-value payments.
  - **Innovation** remains one of the cornerstones of the payments industry. It allows players to specialize and to make use of emerging technologies and trends, such as mobile devices and contactless payments, to deliver state-of-the-art solutions. Non-bank PSPs—which tend not to be burdened by legacy infrastructures—may be better placed than many banks to leverage emerging technologies to satisfy user needs.
- **SEPA adoption levels reflect increased usage in the last year of SEPA Credit Transfers (SCTs).** On the other hand, SEPA Direct Debit (SDD) use is still extremely low. All stakeholders now agree on the need for a firm end-date for migration. The final text of the SEPA Migration Regulation looks likely to be agreed by the European Parliament and Council before the end of 2011 and potential end-date(s) of 2013-14 seem probable. Nevertheless, challenges and issues remain and discussions among stakeholders continue.
- **eGovernment initiatives are emerging as a key enabler of non-cash payments.** In countries where a mature eGovernment combines with developed non-cash payments infrastructure and behavior, conditions are especially ripe to trigger increases in overall non-cash payments usage.

NUMEROUS INITIATIVES ARE DRIVING CHANGE IN THE PAYMENTS LANDSCAPE

The payments system, as an integral part of the global economy, is continually subject to forces of change, but regulatory oversight has greatly intensified in the wake of the financial crisis, with implications for the operations and profitability of Financial Institutions (FIs). Initiatives such as Basel III and the U.S. Dodd-Frank Act are designed to reduce systemic risk and strengthen the ability of FIs to withstand systemic shocks. These initiatives are raising capital and liquidity requirements and, in turn, changing the economics of certain FI activities including payments, and potentially affecting the attractiveness of some business lines (see Trade Finance in Section 1, on p18 as an example).

At the same time, initiatives designed to improve transparency are targeting legacy fee and charging structures in relation to many payment instruments, most notably cards. The U.S. Durbin Amendment, for instance, was designed to give the government additional control over debit card "swipe fees" and the Canadian Code of Conduct for Cards assigns the Minister of Finance power to regulate the market conduct of cards networks.

In Europe, meanwhile, the Payment Services Directive (PSD) is now fully in force in all EU countries (with the exception of Poland at the time of writing), and the adoption of Single Euro Payments Area (SEPA) instruments, in particular the SCT, is starting to grow. The PSD and SEPA represent sweeping changes that seek to create a common legal framework and a standardized environment for euro payment services in the European Union (EU)—with a view to transforming the fragmented national payments markets of the Eurozone countries into a unified and highly competitive 'domestic' market.

Numerous other initiatives being formulated and implemented around the globe will also have an impact on payments. These measures, including examples such as the EU Digital Agenda (part of the Europe 2020 Strategy) and the International Payments Framework Association (IPFA) initiative to name but two, are further pushing the payments market toward increased levels of standardization, interoperability and de-fragmentation. (See Figure 2.1 for a Heat Map of some key regulatory industry initiatives on a global and regional level and the Sidebar for an overview of each initiative).

INITIATIVES ARE FUELING FIVE DISTINCT PAYMENTS INDUSTRY TRANSFORMATION TRENDS

The extent to which specific regulatory and industry initiatives have the potential to affect the payments industry is not always obvious at first sight. eGovernment initiatives, for example, are primarily civic schemes designed to enhance digital interaction between Public Administrations (PAs) and citizens and enterprises. However, the impact on payments could ultimately be substantial (also see Spotlight on eGovernment on p42) as public authorities are potentially powerful drivers of the move away from paper-based and cash instruments—a shift that will intensify competition between non-bank PSPs and traditional players.

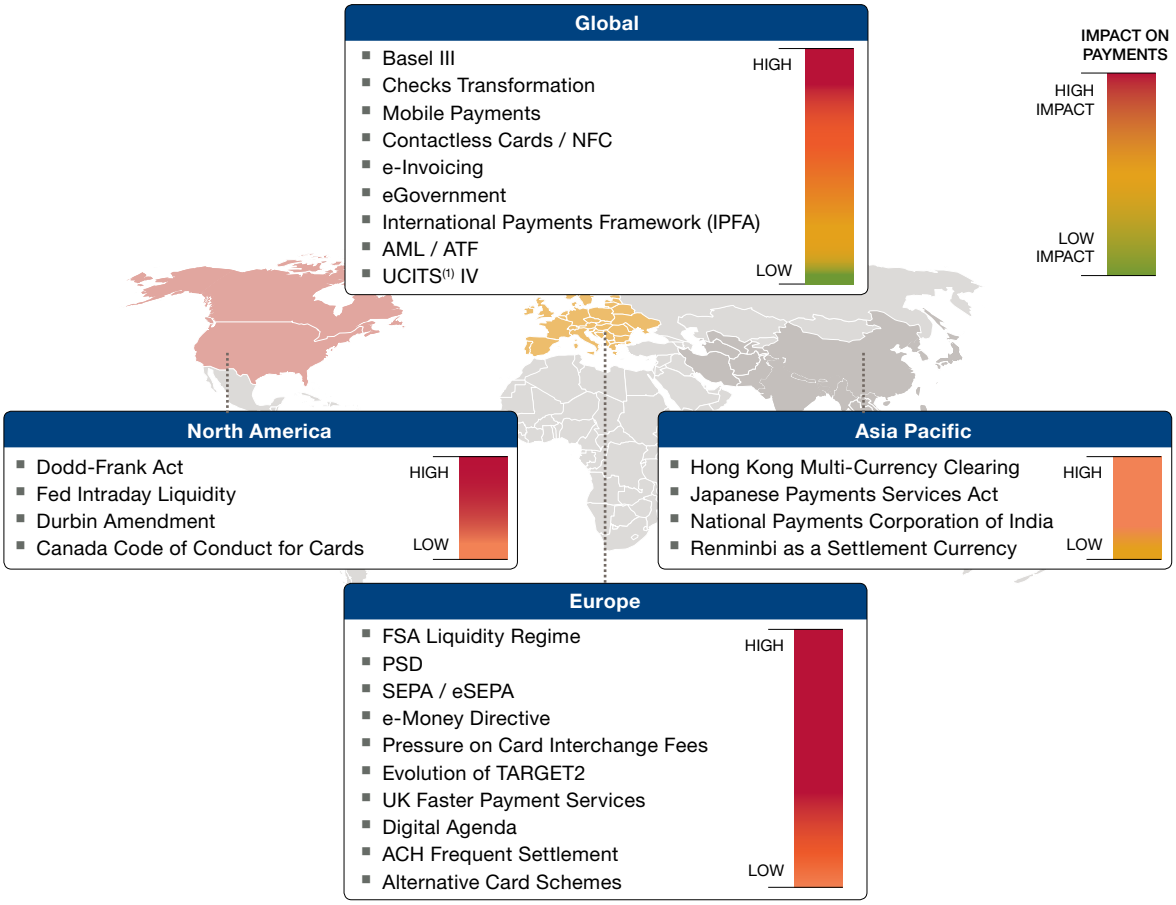
The objectives and scope of a number of initiatives have been evaluated on a heat map (see Figure 2.1) to show the impact on payments. Analysis shows that various initiatives are complementary in nature, and can together be expected to trigger an evolutionary path of transformation for the payments market and the behavior and attitudes of its participants.

Figure 2.2 maps each initiative into one of five major Industry Transformation Trends (ITTs)—with each initiative categorized by the single trend that best reflects its primary nature. In reality, some initiatives will also have a secondary and sometimes tertiary aspect.

This analysis helps to show how emergent trends have exerted regulatory and/or competitive pressure on banks and other PSPs in recent years, forcing them to adapt.[18] It also provides insight into which transformation trends are likely to predominate in the next 5-10 years—prompting further adaptation.

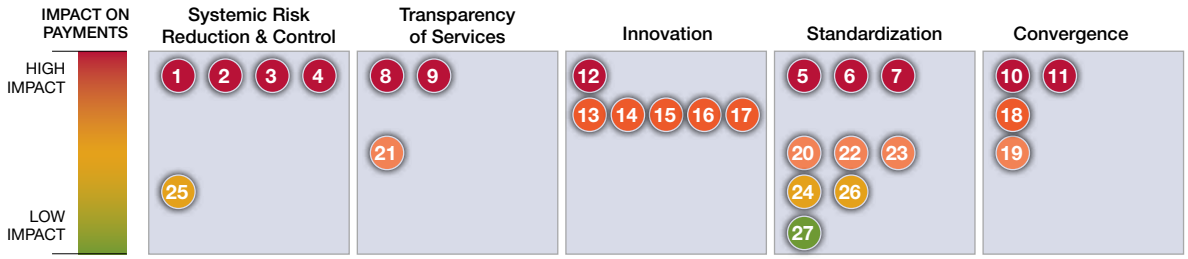
[18] For more detail on industry responses, see Section 3 of the WPR 2010, specifically references to the "Revenue-focused and Cost-focused" paths open to banks.

Figure 2.1 Heat Map of Key Regulatory and Industry Initiatives at a Global and Regional Level, 2010



Note: Red denotes the regulation or initiative will have an impact in the near-term or the potential impact on payments business models, competition, and the industry is high. Green indicates the impact is either further in the future or its impact will be indirect or less significant.
[1] Undertakings Collective Investment in Transferable Securities
Source: Capgemini analysis, 2011

Figure 2.2 Five Industry Transformation Trends Driven by KRIIs



KRII

1. Basel III
2. FSA Liquidity Regime
3. Dodd-Frank Act
4. Fed Intraday Liquidity
5. PSD
6. SEPA / eSEPA
7. e-Money Directive
8. Pressure on Card Interchange Fees
9. Durbin Amendment
10. Evolution of TARGET2
11. U.K. Faster Payment Services
12. Checks Transformation
13. Mobile Payments
14. Contactless Cards / NFC
15. e-Invoicing
16. eGovernment
17. Digital Agenda
18. ACH Frequent Settlement
19. Hong Kong Multi-Currency Clearing
20. Alternative Card Schemes
21. Canada Code of Conduct for cards
22. Japanese Payment Services Act
23. National Payments Corporation of India
24. International Payments Framework Association (IPFA)
25. AML / ATF
26. Renminbi as a Settlement Currency
27. UCITS(1) IV Directive

[1] Undertakings Collective Investment in Transferable Securities
Source: Capgemini analysis, 2011

These ITTs may be developing alone or in conjunction with others, but each is a major change driver within the payments landscape.

SYSTEMIC RISK REDUCTION AND CONTROL

Since the financial crisis, regulators around the world have been in the process of increasing capital requirements and setting more stringent liquidity regimes for FIs. As a result of the Basel III proposals, the cost of capital and liquidity will increase. This includes implications for the cost and availability of intra-day liquidity in a payments context, which will see banks managing their positions and those of their customers in a real-time and more granular way in the future—and may reach a point at which some banks might need to reconsider their participation in certain business lines. FIs will also be increasingly focused on securing more stable sources of liquidity, such as retail deposits and prepaid cards, and may, in some cases, need to reshape aspects of their business models to acquire them. Conversely, liquidity and the increasingly sophisticated management of intra-day liquidity could become a differentiating and competitive edge for some banks.

STANDARDIZATION

Standardization is a powerful trend fueled primarily by the combination of:

- Regulatory initiatives that are aimed at increasing competition and improving consumer transparency and protection.
- Industry initiatives aimed at improving efficiency, reducing costs and streamlining the most automated elements of the payments value chain (i.e., the processing segments).

Standardization also results from initiatives developed individually or jointly by banks, Automated Clearing Houses (ACHs) and other PSPs seeking to boost transaction volumes and scale to expand existing businesses and generate additional revenues or facilitate new business models.

TRANSPARENCY OF SERVICES

In a payments context, transparency initiatives mostly focus on making service fees transparent to clients (particularly consumers). In the EU, for example, the PSD has a strong focus on enhancing the level of transparency, particularly in relation to charging. More generally, of all the instruments affected by this trend, cards are arguably feeling the most impact. Banks and other PSPs generate revenues from various card fees, including debit-card 'swipe' fees and interchange fees. These fees are integral to the economics of the card business, so mandated changes will have a significant impact on current business models.

CONVERGENCE

There is an increasing blurring of a number of traditional distinctions between different types of payment systems, for example, between Low-Value (high-volume) ACH payments and High-Value (low-volume) RTGS payments. The Faster Payments System (FPS) in the U.K., a good example of this trend, is increasingly attracting volumes from both BACS and CHAPS.[19] ACHs generally are shortening their clearing cycles in the process, sometimes making their services more attractive for Treasurers than those provided by the more costly RTGS systems, even for more urgent transactions. However, in the second half of 2010, more than 60% of payments in TARGET2 (the European Central Bank RTGS) were for amounts that it considers to be "retail payments" (less than €50,000), showing that while RTGS is designed for high-value payments, it also handles many low-value payments. As a result, RTGS is starting to compete with ACHs for certain types of low-value payments.

INNOVATION

Innovation, which fuels transformation, is currently being driven by several different and sometimes opposing forces, including:

- **Client needs**, with Corporate and Retail clients expecting ever more advanced and efficient solutions.
- **Technology**, which has been embraced by non-bank PSPs and leveraged by banks to bring speedy solutions and associated information to the market.
- **Competition.** An increasing level of competition from existing and emerging non-bank PSPs, which are often not burdened by legacy infrastructure, creates potential for agility in designing new solutions in the B2B, Business-to-Consumer (B2C) and P2P domains in the modern payments Industry.[20]
- **Government initiatives,** including eGovernment programs all over the world and the Digital Agenda in the EU. (See the Spotlight on eGovernment on p42)
- **Industry initiatives** to keep costs low while competing for new revenue sources.

[19] BACS (Bankers' Automated Clearing Services) is the electronic system that processes financial transactions (direct debits, direct credits and standing orders) for U.K. banks and in which clearing takes two working days. CHAPS (Clearing House Automated Payment System) is an RTGS system that offers same-day sterling fund transfers.

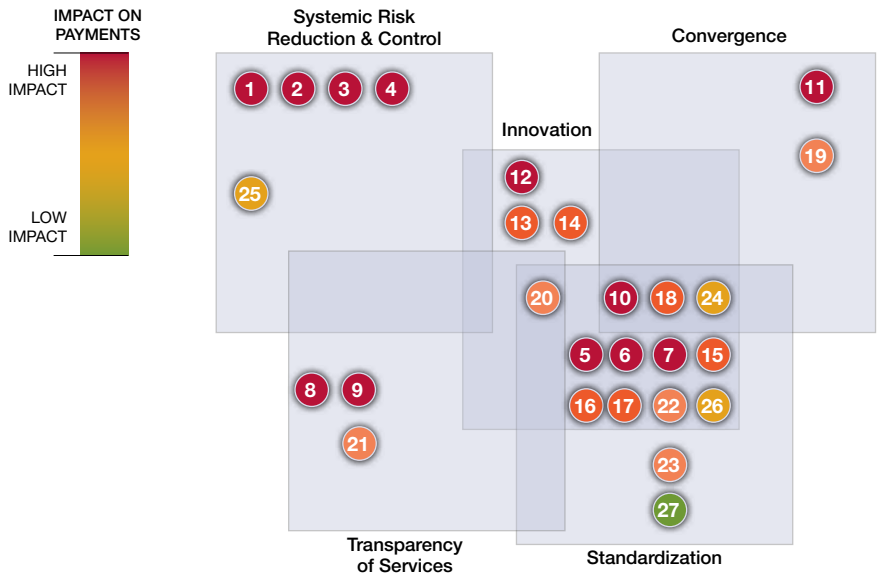
[20] For more detail, see Section 3, Chapter 1 of WPR 2010: "How the Payments Industry is Evolving".

INNOVATION IS BEING DRIVEN BY MANY REGULATORY AND INDUSTRY INITIATIVES

While it is helpful to isolate the primary impact of each KRII on each of the five discrete ITTs, the reality is that many initiatives have aspects or drivers that relate to more than one industry trend. Figure 2.3 provides a more dynamic view of the compounded effects of the KRIIs on the interconnected world of payments—in which many trends overlap.

In this dynamic structure, the diverse nature of initiatives such as ACH Frequent Settlement (#18) becomes more evident. The essence of this particular initiative lies in the blurring line between High-Value (low volume) RTGS payment systems and the Low-Value (high volume) ACH payment systems. It thus appears in the "convergence" cluster in Figure 2.2. More broadly, however, this trend could also be classified within the "innovation" cluster as only with the advancement of new technologies is it possible for ACHs to intensify settlement frequency. Ultimately, in looking at the overall payments landscape, this behavior is resulting in a de facto standard, and so it also appears in the "standardization" cluster in Figure 2.3.

Figure 2.3 Overlap of Industry Transformation Trends Driven by KRIIs



KRII

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13. Mobile Payments
14. Contactless Cards / NFC
15. e-Invoicing
16. eGovernment
17. Digital Agenda
18. ACH Frequent Settlement
19. Hong Kong Multi-Currency Clearing
20. Alternative Card Schemes
21. Canada Code of Conduct for Cards
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25. AML / ATF
26. Renminbi as a Settlement Currency
27. UCITS[1] IV Directive

[1] Undertakings Collective Investment in Transferable Securities
Source: Capgemini analysis, 2011

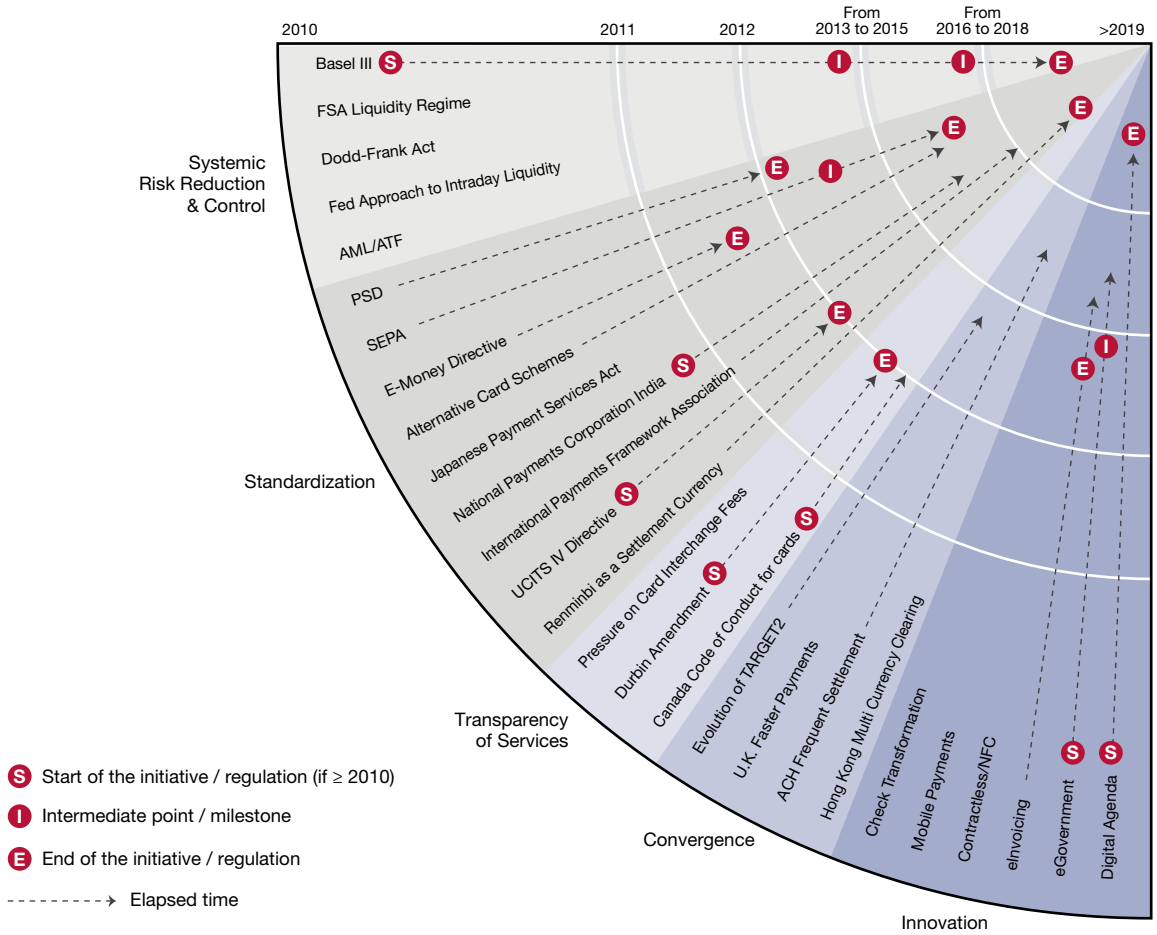
THE INDUSTRY TRANSFORMATION MAP

The pressure exerted by KRIIs will increase over time. As product/service margins decrease and bank liquidity and capital costs increase, industry players will need to gauge the effects and reshape their business models accordingly—if, that is, they want to continue providing the same services to their clients efficiently and effectively. Moreover, as the trends of standardization and convergence increase international competition and potentially reduce margins for banks and non-banks, innovation and emerging technologies could be expected to deliver competitive advantage to certain market players.

Figure 2.4 provides an Industry Transformation Map that shows a high-level picture of how the KRIIs identified herein may evolve in the next decade. This perspective illustrates the complexity of the global transformation of the payments industry—and shows just how many factors, events and conditions industry players, including PSPs, have to deal with in the evolving landscape.

Not all of the KRIIs included in the Transformation Map contain a distinct start, intermediate, and end marker, since some are market-driven initiatives whose lifecycles are difficult to determine. (Time markers specified on the figure are largely indicative of events within the lifecycle of each KRII.)

Figure 2.4 Payments Industry Transformation Map, 2010–2019



Source: Capgemini analysis, 2011

CONCLUSION: TRANSFORMATION PRESSURES EXTEND FAR INTO THE FUTURE

When discussing global or regional regulatory initiatives like Basel III or the PSD, it might seem that the regulations will create a level playing field for all players in all impacted countries, but this may not always be the case. The potential for differing domestic interpretations presents particular challenges for those banks and corporates that operate in multiple jurisdictions.

Additionally, while individual regulatory and industry initiatives have finite parameters and goals, few involve a "Big Bang" revolution. Most involve a series of component measures that are phased in over time—often creating an impact at the same time as other related or unrelated initiatives. Even analyzing and extrapolating just those initiatives identified in this Report, it is clear that payments transformation will be extensive throughout the coming 10 years—presenting banks and other PSPs with multiple factors and scenarios to consider as they plan future strategies.

Not only will industry players need to continue to identify, assess and select market opportunities, they must do so while simultaneously managing growing compliance and liquidity costs, and anticipating how other parts of the industry and market will react (e.g., the strategies and ambitions of competitors and partners and evolving client needs). Moreover, internal decision-making will increasingly need to accommodate a greater number of factors and perspectives, requiring closer interaction, for example, with the Risk Management and Treasury functions.

As more initiatives converge in the future, industry transformation will intensify. As product/service margins decrease and bank liquidity and capital costs increase, industry players will need to gauge the effects and reshape their business (and delivery) models accordingly to keep pace with clients' expectations while also providing services in an ever more efficient and effective way.

The trends of standardization and convergence (and transparency, to a certain extent) will increase the level of competition and accelerate the commoditization of payments, making it more difficult for individual banks and non-bank PSPs to differentiate and prove their value. Innovation, emerging technologies, and partnerships can, however, help them to differentiate their services and achieve competitive advantage.

It is likely that in future, banks will find it harder to operate on a standalone basis in relation to all aspects of the payments value chain, and the majority might have to specialize in certain segments over time, as we will explore further in Section 3.

Key Regulatory and Industry Initiatives

Key #	Key regulatory and industry initiatives (KRIIs)	Description
1	Basel III	The Basel Committee issued the text of Basel III rules on bank capital adequacy and liquidity in December 2010. Endorsed by the G20, "Basel III" aims to raise capital levels and quality standards and promote the build-up of capital buffers, enhance risk calculations and coverage, cap leverage ratios, and additionally plans two liquidity ratios—the Liquidity Coverage Ratio (LCR, to be met by 2015) and Net Stable Funding Ratio (NSFR, to be met by 2018)—to address short and longer-term liquidity needs.
2	U.K. FSA Liquidity Regime	The U.K. Financial Services Authority (FSA) overhauled liquidity regulation for U.K. banks with effect from October 2009. Among the changes, the FSA has set new quantitative requirements on liquidity and tightened the definition of liquid assets; stipulated the principles for self-sufficiency and adequacy of liquid resources; enhanced systems and controls requirements; and demanded more frequent reporting requirements. The FSA is phasing in tougher quantitative standards in stages.
3	U.S. Dodd-Frank Act	The Dodd-Frank Act, law since July 2010, contains a set of reforms on a wide range of regulatory and supervisory topics, with provisions relating to capital, liquidity, and risk requirements for U.S. financial institutions. Dodd-Frank and Basel III have similar objectives but not all standards and implementation schedules are the same.
4	U.S. Fed Intraday Liquidity	The U.S. Federal Reserve amended its Payment System Risk (PSR) policy in March 2011. Most notably, the revisions encourage institutions to voluntarily pledge collateral to cover daylight overdrafts by providing such overdrafts at a zero fee while raising fees for uncollateralized daylight overdrafts. Any depository institution with regular access to the discount window may incur daylight overdrafts, with specific rules and caps.
5	EU Payment Services Directive (PSD)	Designed to create a common legal framework for payment services in the EU, increase international competition and harmonize rights and obligations for PSPs, the PSD was transposed into the national law of most EU Members during 2009-10. The PSD has an impact on all payment services in the EU, including changes to charging options (the move to shared ('SHA')), reductions in maximum execution cycles and the removal of 'incoming float'. To increase competition, PSD removed legal obstacles and entry barriers so that new non-bank PSPs (Payment Institutions) can offer payment services.
6	SEPA / eSEPA	SEPA, a self-regulatory response to a political vision, seeks to provide harmonized payment services (credit transfers, direct debits, cards) where € payments within the EU will be treated as domestic payments with the aim of eliminating cross-border barriers and increasing competition across Europe (also see SEPA Update on p40). SEPA will continue to impact payments pricing, standardizing processes and streamlining the Industry. eSEPA commonly refers to innovations in payments and other areas which are expected to emerge on the back of the delivery of the core SEPA infrastructure (SCT/SDD), providing various retail payment services electronically so as to offer easier access, better functionality and an enhanced user experience.
7	EU E-Money Directive (EMD)	Electronic money is a digital equivalent of cash, stored on a device, server, mobile phone, electronic purse. etc. The new E-Money Directive (2009/110/EC) aims to enable innovative and secure e-money services, provide market access to new companies, foster effective competition, and bring the regime for e-money institutions into line with the PSD requirements for Payment Institutions. The EMD rules were required to be in force in all EU countries by April 30, 2011.
8	Pressure on Card Interchange Fees	Regulators in the EU and elsewhere are currently putting pressure on Multilateral Interchange Fees for cards (See #9 and #21 below). These include industry-wide regulations on swipe fees, direct rulings on specific competitors, and improved guidelines on transparency and competition.

Key #	Key regulatory and industry initiatives (KRIIs)	Description
9	U.S. Durbin Amendment	This is a provision in the Dodd-Frank Act, section 1075, allowing the Fed to control the swipe fees on debit cards with a cap that results in an approximately 50% decrease in current fees that will come into effect in October 2011. The goal is to aid merchants and (indirectly) consumers with lower interchange fees.
10	Evolution of TARGET2	TARGET2 is the European Real Time Gross Settlement (RTGS) system, and it was set up to settle euro Large-value transactions in real time. The ECB and Eurosystem are planning for its further evolution, including eventually adopting XML ISO 20022 standards.
11	U.K. Faster Payment Services	The Faster Payment Service, launched in 2008 in the U.K., is a banking initiative that allows for retail payment transactions to be exchanged between scheme participants in near real-time. The participant banks make up 95% of payments traffic in the U.K.
12	Checks Transformation	There is a major trend in the payments industry leading to a general decrease in the use of checks in favor of more efficient instruments. This trend is also a result of active initiatives carried out by governments and/or banking communities. There are two prevalent approaches: moves towards further check reduction and potential decommissioning (as in Sweden) and check digitalization (as in the U.S.). See Checks Spotlight on p22.
13	Mobile Payments	M-payments (payments for goods and services using mobile devices) have been growing quickly for several years. Emerging markets are now larger than developed markets in terms of m-payments value, and continue to grow at a faster rate. Non-bank providers of m-payments are gaining market share and currently growing twice as fast as traditional banks in this area.
14	Contactless Cards / NFC	NFC is a short-range wireless technology, increasingly popular for micropayments and POS transactions. Contactless cards should allow banks to potentially shift small payments from cash to non-cash. Interac has carried out a series of contactless POS debit transactions in Canada. VISA Paywave and MasterCard PayPass are contactless credit cards that are widespread in the U.S. and U.K., as well as present in APAC and the EU.
15	e-Invoicing	e-Invoicing is a global trend. In the EU, Invoicing Directive 2010/45/EU aims to harmonize invoicing rules allowing tax authorities to accept electronic invoices as if they were paper. In the U.S., 2001 Code Title 10, Section 2227 states that "all invoices to the Department of Defense must be electronic". In Brazil, the "Nota Fiscal Eletronica" (NF-e) is legally replacing the conventional bill of lading.
16	eGovernment	eGovernment involves the use by governments of Information and Communication Technology (ICT) to inform and render services to citizens and businesses. Payments means are affected as eGovernment extends into eProcurement, e-Invoicing, and ePayments—see Spotlight on eGovernment on p42.
17	Digital Agenda	The Digital Agenda for Europe is one of the seven flagship initiatives of the "Europe 2020 Strategy". It aims to: maximize the social and economic potential of ICT (most notably the Internet); create a single EU digital market by harmonizing technical, regulatory, and legal frameworks; and promote interoperability between Member States' eGovernment programs.
18	ACH Frequent Settlement	Nowadays, most of the largest worldwide ACHs (such as STET, VocaLink, EQUENS, JGB) are performing more and more frequent settlement and clearing cycles. For example, EQUENS currently performs a settlement cycle every half hour on each TARGET day (between 09:00 and 16:00 CET), with extra cycles at 16:15 and 16:45 CET. This offers the advantage of low settlement account balances, and lower liquidity risk.
19	Hong Kong Multi-Currency Clearing	Due to its capacity to settle transactions in multiple global currencies, Hong Kong could become the payments and settlement hub for Asia-Pacific. If an FI in Asia-Pacific wishes to carry out an FX transaction involving local currency and the USD, the local currency leg can be settled in the home country and the USD leg in Hong Kong, effectively reducing counterparty risk (so-called Herstatt risk).

Key #	Key regulatory and industry initiatives (KRIIs)	Description
20	Alternative Card Schemes	Monnet, a European cards scheme project to compete with Visa and MasterCard networks, was launched by several German and French banks in 2008. Several more EU banks joined in 2010. PayFair, founded in 2007, is a retailer-driven initiative set up as a neutral alternative between banks and merchants, respecting the SEPA philosophy of unbundling the scheme and its processing. EAPS (Euro alliance of payment schemes), established in 2007, aims to create an interconnected network of independent card schemes, banks, acquirers and PIs from Italy, Germany, Spain, Portugal and the U.K.
21	Canada Code of Conduct for Cards	With the Payment Card Network Act, the Canadian Minister of Finance has the power to regulate the market conduct of credit and debit card networks. The goal is to promote competition and fair business practices that translate into lower costs for merchants and lower prices to the consumer. This can reduce industry revenues, with increased competition and lower profit margins, and reduced usage (in favor of other payment methods).
22	Japanese Payment Services Act	Prior to April 2010, only banks and certain other Financial Institutions were permitted to engage in fund transfer services in Japan. Now the Payment Services Act has allowed non-bank entities to conduct fund transfer services in Japan provided that they are registered as "fund transfer business operators"; and that the amount of funds to be transferred per customer request does not exceed ¥1m (€10,000 or the foreign currency equivalent).
23	National Payments Corporation India (NPCI)	NPCI is an umbrella institution for all retail payment systems in India. It aims to integrate multiple systems into nationwide, uniform and standard business processes. NPCI will function as a hub for all electronic retail payment systems. It now manages: the National Financial Switch (NFS), an interbank network of ATMs; check truncation services in key cities; and the Interbank Mobile Payment Service (IMPS), an instant interbank electronic fund transfer service through mobile phones. Another goal for NPCI is to establish a national card scheme like China UnionPay (CUP).
24	International Payments Framework Association (IPFA)	IPFA is an association that aims to simplify and standardize international non-urgent payment systems through the use of global standards. On October 2010, initial live traffic between two IPFA members, the Federal Reserve Banks in the U.S. and EQUENS in Europe began; extensions are planned to Canada, Mexico, Brazil and South Africa in 2011. IPFA is aiming for greater levels of standardization and easier international flows. Other consequences could include a higher degree of commoditization and also specialization (see Section 3).
25	Anti-money laundering / anti-terrorism financing (AML/ ATF)	Section 314(b) of the USA PATRIOT Act, which aims to fight anti-money laundering (AML) and anti-terrorism financing (ATF), requires FIs to conduct due diligence on new and existing customers and maintain complete records of all transactions. This makes payments more costly and slows down straight-through processing (STP). The positive for PSPs is that they gather more information about their clients to help improve services.
26	Renminbi as a Settlement Currency	In December 2008, China started using the yuan as a settlement currency on foreign deals with neighboring economies. Cross-border yuan trade settlement is expected to grow from Rmb 506 billion (US$77 billion) in 2010 to Rmb 2 trillion (US$300 billion) in ten years. This initiative is likely to draw a market distinction between banks that are able or not to trade in yuan. The growing importance of the yuan will also accentuate the value of Hong Kong as a multi-currency clearing and settlement hub (see #19).
27	EU UCITS IV Directive	The fourth modification to Directive 85/611/EEC (Undertakings for Collective Investments in Transferable Securities) aims to achieve higher integration and efficiency of EU markets, allowing more mobility in managing international funds, remote establishment and-cross border management of UCITS funds and centralization of asset management. Member states were expected to transpose the Directive into national legislation by July 2011. Due to easier mobility and international funds management, higher international payments flows are expected, but also higher competition due to lower barriers in EU.

SEPA at a Glance

The Single Euro Payments Area (SEPA) has 32 European country members to date (the 27 members of the European Economic Area, together with Iceland, Liechtenstein, Norway, Monaco and Switzerland), enabling more than 458 million citizens to execute SEPA payments. The SEPA initiative is supported by the Payment Services Directive (PSD), which provides the legal foundation for creating a single market for payments across the European Union (EU), establishing a modern and comprehensive set of rules applicable to all payment services in the EU. New entities, formally known as Payment Institutions, are starting to operate in the market. What has been missing until now has been clear end-dates for migration to the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) schemes. However, a draft EU Regulation to bring the necessary level of certainty on dates was published by the EU in December 2010. Definitive end-dates should help ensure that the benefits of SEPA can be achieved and that the high costs of running both legacy and SEPA products can be eliminated, thus achieving a single market and improving efficiency and competition in the process.

2002
- **Setup of EPC and SEPA Project launch after the Lisbon Agenda 2000**

2007
- **Adoption of PSD as the legal basis for SEPA**

2008
- **Launch of SCTs**

2009
- **Launch of SDDs and deadline for transposition of the PSD into Member State Law**

2010
- **All accounts reachable for national DD must be reachable for SDD (Regulation 924/2009)**
- **Full EMV migration and certification framework for terminals**
- **Draft EU regulation issued, proposing technical requirements and end-dates for SCT and SDD**

2011
- **Legislative Path for the European Commission (EC) Proposal for SEPA migration end-date Regulation**
- **Framework for card transaction processing implementation**

2013–2014
- **Potential End-Dates for migration to SCT and SDD**

SEPA Update

The following provides a brief update on key SEPA developments since the comprehensive overview provided in the WPR 2010:

- **PSD implementation:** The vast majority of member states have transposed the PSD into national law. At the time of writing, Poland and Iceland are the only EU/EEA countries still to complete this task.
- **SCT and SDD usage:** In May 2011, SCTs accounted for 19.37% of all eligible bank credit transfers, up materially from 9.6% in October 2010, while the volume of transactions rose to over 109 million from 49 million. SDDs, by contrast, still accounted for only 0.11% of all eligible direct debits in May 2011, equivalent to 0.69 million transactions. While the use of SEPA instruments is clearly broadening (see public-sector use below), there is still a long way to go.
- **Public Administration (PA) usage of SEPA:** As of October 2010, the SCT migration rate among PAs for the first time exceeded the corresponding rate for the overall market (14.5% vs. 9.6%), with the most significant growth reported by Finland, Belgium, Austria, Spain, France and Germany. SDD migration so far remains marginal, partly as few PAs use DDs as a payment means. Notably, countries with the fastest rates of migration growth also predominate in eGovernment development (i.e., their services are highly sophisticated and accessible and have a low take-up gap). Finland is one of the few cases in which the government, users and banks are cooperating fully to adopt SCT within 2011.
- **eSEPA Models:** The EPC has been continuing with its work on various eSEPA initiatives, with ongoing work on e-Mandates, e-payments and m-payments. Additionally, the EC is also pushing on with its work on e-Invoicing. Nevertheless, all of these future-looking developments hinge first on the successful migration to SCT and SDD.

SEPA MIGRATION END-DATE

Given the slow rate of adoption and the significant benefits at stake, many stakeholders, including the ECB and the EPC, reached the conclusion during 2010 that targeted EU legislation was needed to establish end-dates for the replacement of the national legacy payment schemes by the harmonized SEPA schemes. EU legislation to support SEPA is not a new concept. The PSD had already provided initial support by providing a harmonized legal environment and EU Regulation 924/2009 went further by requiring that all banks offering domestic euro direct debit services within the Eurozone had to make themselves reachable for SDDs by November 1, 2010. But a clear end-date for the migration process was still missing.

Against this background, the most important SEPA development since our WPR 2010 update is the December 2010 publication by the EC of a proposal for an EU Regulation *'Establishing technical requirements for credit transfers and direct debits in euros and amending Regulation EC 924/2009'.* As published, some aspects of the proposed Regulation have proved to be controversial. The EPC and many other stakeholders had been hoping for a 'clean' approach simply requiring existing domestic euro retail payment schemes to migrate to the SEPA schemes. However, in practice, political and competition sensitivities resulted in a much more complex proposal, based on mandating a set of guiding principles on technical standards that all euro retail credit transfer and direct debit schemes would have to meet by certain end-dates. Those dates—12 months after the 'in force' date of the Regulation was proposed for credit transfers and 24 months for direct debits—potentially put those end-dates at end-2012 and end-2013 respectively, assuming the Regulation is finalized by the end of 2011.

Enshrining technical details in a legal text always entails challenges. One potential risk, for example, is that the Regulation might inadvertently allow for divergence and continuing variations to messaging formats at the national level—and potentially even the continued existence of national payment schemes alongside their SEPA equivalents. This would result in a 'mini SEPA' outcome, where different requirements and schemes continue to co-exist, forcing companies and their banks to maintain different processes and systems for different countries and significantly diluting the benefits of SEPA. Avoiding a mini-SEPA outcome will require the final wording of certain core definitions and principles in the Regulation (particularly the key concepts 'Reachability' and 'Interoperability') to be particularly carefully drafted.

Another specific issue that has provoked discussion is that, as published, the scope included customer payments made via 'Large Value Payment Systems' (such as TARGET2), not just via retail payment systems. Following widespread expressions of concern that this would have meant major additional and unexpected adjustments costs across the industry, all the key parties now seem to accept that transactions through these systems need to be excluded from the scope.

The topic of per-transaction Multilateral Interchange Fees (MIFs) for DDs continues to be a hotly debated issue. The EC proposal is to ban all per-transaction DD MIFs after a transition period, except in the case of 'R-transactions' (such as returned payments). The whole MIF issue is a very delicate one, especially because MIFs are a fundamental element of the business models within a number of EU countries, such as France and Italy, and finding an acceptable compromise is proving to be a challenge.

On all of these topics, the opportunity for changes still exists at the time of writing, as the Regulation is subject to the usual EU 'co-decision' process—meaning that before it can be formally adopted, it needs to be negotiated and formally agreed between three bodies—the European Parliament and Council as well as the Commission. So with this objective in mind, dialogue is continuing with the Regulatory community, particularly via key industry bodies, including the EPC and the European Banking Federation (EBF) via its Payment Regulatory Expert Group. At the moment, everything remains on track to finalize the Regulation by the end of 2011, but it is clear that the few months before that will be pivotal.

Once the SEPA Regulation is agreed and comes into force, and the adoption of SEPA instruments finally takes off, this will in turn drive the business case for further innovative developments, such as e-mandates and e-payment solutions, that are dependent on the success of the core SEPA migration. Similarly, efforts to make e-invoicing a reality—a bigger prize for many corporates than SEPA itself—are expected to accelerate as SEPA gains ground.

Separate discussions are continuing over how to optimize SEPA governance. As the SEPA schemes continue to evolve, it remains an issue how to balance the needs of European citizens, businesses and retailers. The SEPA Council has been established to represent both the demand and supply sides of the market in driving SEPA forward and would seem to have a major role to play here.

SPOTLIGHT

eGovernment Efforts Could Help to Drive Non-Cash Adoption

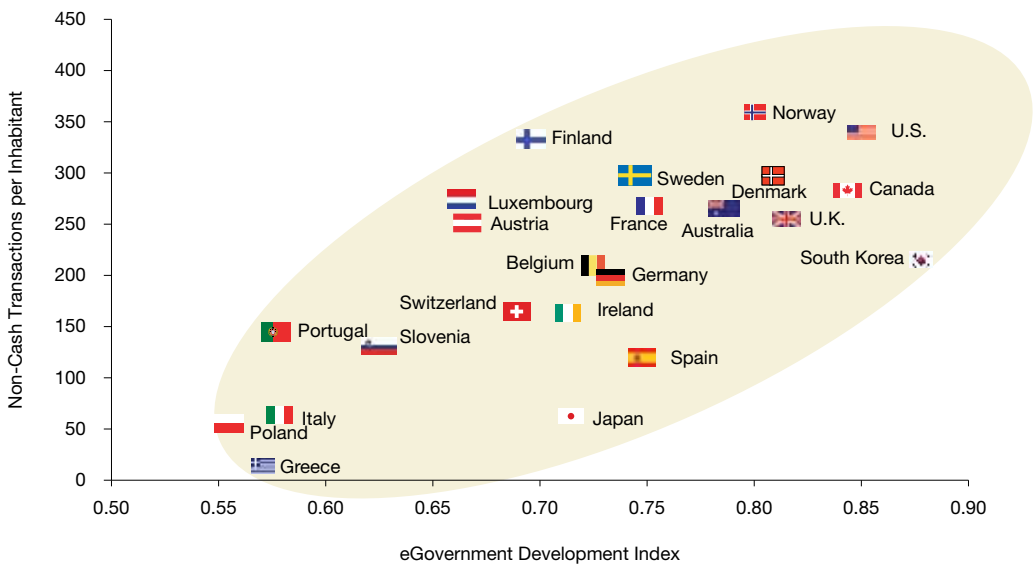
"eGovernment" in its broadest sense involves the use of Information and Communication Technology (ICT) by governments to inform and render services to citizens and businesses. In payments, eGovernment involves electronic procurement, invoicing and payments to and from citizens, businesses and government agencies.

eGovernment is potentially beneficial for all payments stakeholders. Electronic transactions—by Internet, mobile, wireless devices and other digital media—are generally quicker and more convenient, cost-effective and secure than paper-based predecessors such as cash and checks.

Many governments are now actively investing in eGovernment, and continued with those investments even during the financial crisis. According to a 2010 United Nations survey on eGovernment, [21]South Korea has the world's most developed eGovernment, followed by the U.S., Canada, and the Nordic EU countries. It is interesting to highlight (Figure 2.5) the relationship existing between the usage per inhabitant of non-cash payments instruments and the eGovernment index (also see Section I, Figure 1.4 for detail on growth of non-cash transactions usage per inhabitant).

In countries where a mature eGovernment combines with developed non-cash payments infrastructure and behavior, conditions are especially ripe for accelerating the move away from cash and paper-based payments instruments.

Figure 2.5 eGovernment Development Index and Non-Cash Transactions per Inhabitant



Source: Capgemini analysis, 2011; United Nations global eGovernment survey 2010

[21] "2010 United Nations e-Government Survey: Leveraging e-government at a time of financial and economic crisis," completed in December 2009, and launched in early-2010. The survey measures three indicators: online services, telecommunication infrastructure, and human capital.

The U.S. and Canada are actively pursuing eGovernment, and have well-developed portals and a wide spectrum of e-services for their citizens. Among their specific payments initiatives:

- The U.S. launched Pay.gov, a secure government-wide collection portal, in 2000. It offers a suite of online services that Federal agencies can use to meet their responsibilities toward the public. The web-based application allows client interaction and online payments to more than forty government agencies (including the Health, Defense and Justice departments) by ACH debit or credit card.
- The U.S. Treasury Department, as part of an ongoing campaign to increase ePayments,[22] has also started to shift its social security and Federal benefits payments from checks to ePayments (direct debit or prepaid cards). It hopes as a result to reduce government expenses by $1 billion over the next 10 years.[23]
- Canada, which has a robust national eGovernment portal, launched a new user-friendly procurement Website in 2010 (buyandsell.gc.ca). It provides Canadian businesses with an easy way to access information and execute business transactions with the government.

Europe also has many eGovernment initiatives under way. The European Commission's Digital Agenda calls for developing cross-border eGovernment services for citizens and businesses, regardless of their country of origin,—by promoting systems interoperability and key enablers such as e-payments, e-Signatures and e-Identification. Services accessible across the EU strengthen the single digital market and complement existing legislation in domains such as eIdentification, e-Procurement, e-Justice, e-Health, mobility and social security.

e-Procurement is one of the high-impact services representing a major portion of Europe's economy—some €1.3 trillion in public administration expenditure. In terms of cross-border e-Procurement in the EU, the main initiative is PEPPOL: Pan-European Public Procurement Online. The goal of this project is to set up a pan-EU solution that facilitates interoperable public e-Procurement. However, in the post-award phases of the e-Procurement process, the availability of e-Invoicing and e-payment services is somewhat problematic, suffering from legal and practical barriers.[24]

To help overcome these barriers, EU governments are working toward digitalization in payments and invoicing. In some member States, the public sector has launched or is preparing to launch initiatives to make eInvoices mandatory in public contracts. Denmark mandated eInvoicing for the public sector in 2005, Sweden in 2008, and Finland in 2010. Italy, Estonia, Spain, and France are likely to follow soon, and other countries such as Belgium and Austria are also considering it.

CONCLUSION

Governments can be a driving force in non-cash payments adoption because they affect such large economic segments. Some, for example, are already moving salary and social-benefit payments online, and many now allow and encourage online tax payments.

One of the goals of such initiatives is to capture efficiencies and cost-savings from substituting manual processes, but eGovernment requires the ability to initiate and accept a broad range of electronic transactions, so governments need to work closely with PSPs to facilitate a full suite of appropriate electronic-payments solutions.

[22] http://www.godirect.org/

[23] "U.S. Treasury prepares to retire checks", finextra.com.

[24] This problem will be easier to solve once SEPA has completely migrated on core products, allowing secondary products such as e-Invoicing (and eSEPA in general) to become a reality.