Title: **Regulation establishing technical requirements for credit transfers and direct debits in euros.**	**Impact Assessment (IA)**
Lead department or agency: HM Treasury	**IA No:** N/A
Other departments or agencies:	**Date:** 8/5/12
	Stage: Final
	Source of intervention: EU
	Type of measure: Secondary legislation
	Contact for enquiries: Michael Forrest. HM Treasury Tel: 020 7270 4779

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The Regulation is part of a project to create a Single Euro Payments Area (SEPA), so that cross border electronic payments in euros across Europe will be as easy to make as domestic payments. It does not apply to payments in non-euro currencies.

The Regulation will compel banks to phase-out old euro payment systems, and to adopt common standards for payment messages that will enable payments to be handled electronically from start to finish across the EEA. Without legislation, there is a high risk that the new standards will continue to operate alongside the old national standards. This would mean the expected benefits of SEPA would not be realised.

What are the policy objectives and the intended effects?

Standardising the format and computer language of payment messages for direct debits and credit transfers in euros will generate substantial economic benefits. It will:

(a) enable a payment instruction to be processed electronically from the point where a payment originates to the point where it is paid to a recipient anywhere within the European Economic Area;

(b) promote competition between payment service providers, and more innovation in the market

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

For the purposes of this impact assessment, the sole option considered is that of implementing the proposed Regulation.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 02/2017

What is the basis for this review? Duty to review. **If applicable, set sunset clause date:** Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

SELECT SIGNATORY Sign-off For final proposal stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: M Hl Date: 8.5.12

Summary: Analysis and Evidence

Policy Option 1

Description:

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1	High: 5.57	Best Estimate: **2.27**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	2.6	10	0.27	**5.88**
High	3.4		0.44	**7.68**
Best Estimate	3		0.36	**6.78**

Description and scale of key monetised costs by 'main affected groups'

The major investment cost comes from the prohibiting of banks to require the Bank Identifier Code (BIC), which is similar to a UK sort code, from those making a payment. Two possible solutions have been put forward so far to date; a pan-European database and a federation of national databases. Based on the cost of a similar database used by banks to relate miobile phone numbers to bank accounts, which in principle performs the same function we estimate the cost to UK banks will be £3 million.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	10	0.97	**4.85**
High	0		2.65	**13.25**
Best Estimate	0		1.81	**9.05**

Description and scale of key monetised benefits by 'main affected groups'

The regulation is expected to generate cost reductions as a result of harmonising euro credit transfer and direct debit formats. The benefits arise from the scale economies of being able to run common SEPA systems, (and phase out legacy systems and processes in other Member States), so that the cost of operating parallel systems are eliminated. Manual Processing of individual credit transfers will be largely eliminated.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5

This Assessment is based on data from an Impact Assessment carried out by the European Commission.

The impacts on business have been calculated according to data provided by the Payments Council.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: 0.42	Benefits: 1.81	Net: 1.39	No	NA

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			31/10/2016		
Which organisation(s) will enforce the policy?			FSA or Bank of England		
What is the annual change in enforcement cost (£m)?			0		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a		**Non-traded:** n/a
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**		**Benefits:** 100
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	13
Small firms Small Firms Impact Test guidance	Yes	9
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	10
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009
2	Commission staff working document: 1st implementation report on the SEPA Roadmap for 2009–2012. SEC(2010) 1585 final. 16/12/10.
3	Commission staff working document Summary of the impact assessment. SEC(2010) 1583 final. 16/12/10.
4	Commission staff working document Impact assessment. SEC(2010) 1584 final. 16/12/10.

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	3	0	0	0	0	0	0	0	0	0
Annual recurring cost	0	0.40	0.39	0.38	0.37	0.35	0.34	0.33	0.32	0.31
Total annual costs	3	0.40	0.39	0.38	0.37	0.35	0.34	0.33	0.32	0.31
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	0	0	0	0	0	1.52	1.47	1.42	1.37	1.32
Total annual benefits	0	0	0	0	0	1.52	1.47	1.42	1.37	1.32

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

1. Problem under consideration

At present, instructions to a bank to make a cross border payment in euros often have to be converted from one electronic format to another as the payment makes its way down the chain to the recipient. This is because banks use different national standards for processing payment instructions, and because clearing and settlement systems cannot process non-domestic payments, even in the same currency, if they are in an incompatible format or electronic language. Cross border payments therefore often require expensive, time consuming manual intervention by bank staff, when they cannot be handled electronically.

Modern international standards for making payments have been developed to help make banks' systems interoperable, so that payments can be processed electronically from start to finish, and to enable value added services (like electronic invoicing) that older systems cannot provide. The European Payments Council, an industry body, has developed the frameworks for a common form of direct debit and credit transfer designed for the Single Euro Payments Area (SEPA).

2. Rationale for intervention

The Regulation applies to payments in euros made through a direct debit or credit transfer. It does not apply to payments in sterling, or to other forms of payment such as cash, cheques and credit cards.

The majority of banks and users are still using old standards, processed through old systems, for direct debits and credit transfers. In 2010, there were still 20 different national processing infrastructures and schemes for euro payments. As of April 2012, 4,459 European banks have subscribed to the SEPA credit transfer scheme, 3,923 to the core direct debit scheme, and 3,944 to the business to business direct debit scheme. They can now receive SEPA transfers. However, a much smaller subset can initiate a SEPA payment, and the majority of users (public authorities and large firms) are not yet geared up to take advantage of the SEPA schemes. The degree of readiness varies from country to country. As a result, by February 2012, across all EU Member States, only 24.8% of eligible credit transfers were via the SEPA standard, and the percentage of SEPA direct debits was less than 0.5%. There is therefore a risk that the old and new standards will continue to operate side by side, nullifying the benefits of investing in SEPA and producing a sub-optimal outcome for both banks and users.

It is not practical for users who make regular payments to recipients in Europe to do so via SEPA until all the recipients' banks are capable of receiving a SEPA transfer. Otherwise users (or their banks on their behalf) would need to prepare payment instructions for SEPA and non-SEPA accounts in different formats. If European banks and users continue to operate both the old and new standards in parallel, the ECB estimates transaction costs passed on to users will be 46% higher than they would be if the old schemes were phased out.

In December 2009, Ecofin invited the Commission and ECB to assess whether legislation was needed to set binding completion dates for switching to the SEPA standards, and come up with a legislative proposal if there was a case for it. The assessment found that legislation was necessary.

The Regulation (EU) No 260/2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009 has been finalised and entered into force on 1 April 2012. The Regulation;

a) Defines 1 February 2014 as the deadline in the euro area for compliance with the core provisions of this Regulation. In non-euro countries, the deadline will be 31 October 2016.

b) Requires banks to execute credit transfers and direct debit services using SEPA standards..

c) Requires euro payment schemes for direct debits and credit transfers to be interoperable.

d) Sets the minimum technical requirements and conduct rules.

3. Policy objective

The aim is to integrate the European payments market for euro credit transfers and direct debits, and eliminate complexity and duplication resulting from running multiple payment platforms. This will:

(a) Increase the efficiency and competitiveness of the EU payments market by realising economies of scale and operational synergies on both the supply and demand side.

(b) Create an open and level playing field for competition in the payment service market at European level and facilitate downward price convergence for payment services.

(c) Establish a pan-European platform from which innovative and value-adding payment services and products can be launched.

4. Description of options considered (including do nothing)

The sole option is to implement the Regulation as required by European law.

The proposed approach to implementation is on a copy out basis, complying with the minimum requirements and no gold-plating.

5. Data – UK adherence to the new SEPA standards for direct debits and credit transfers

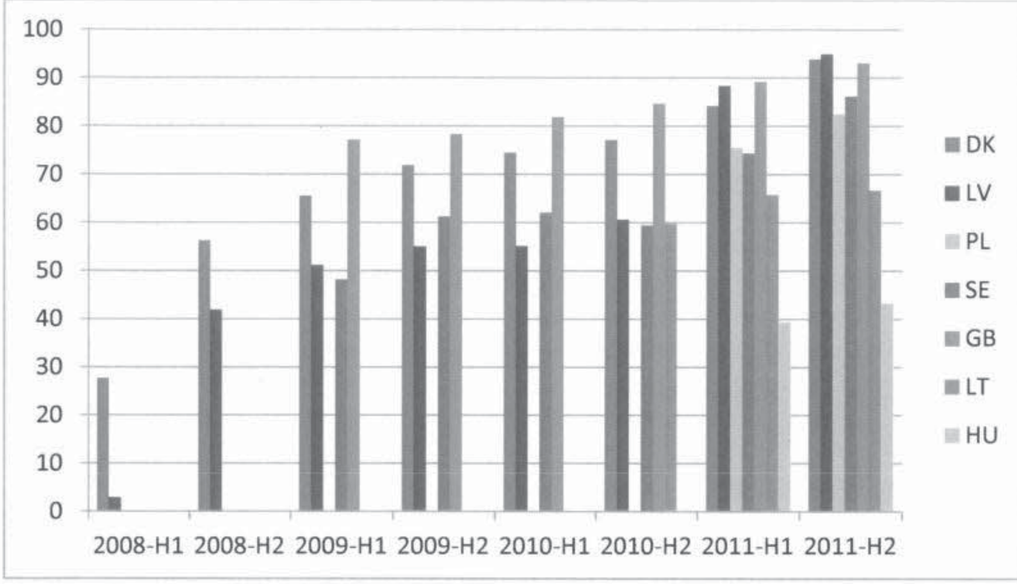
The UK banks that handle euro payments are already almost entirely compliant with the new standards and will be 100% compliant before the end of 2013 – well ahead of the compliance deadline for non-euro Member States of 31 October 2016.

UK euro credit transfers

The SEPA credit transfer scheme was launched in January 2008. As of March 2012, 39 UK banks have signed up as participants to the SEPA credit transfer scheme. They represent around 85% of the UK payments market by volume. In addition, around 60 other institutions operating in the UK are covered by adherence via another Member State. A list of participating banks is at: http://epc.cbnet.info/content/adherence_database

The volume of UK domestic and cross border credit transfers in euros that are eligible for handling through SEPA was 5.4m in 2011 99.71% were processed in a SEPA format by December 2012.

This is illustrated by the chart below, which compares the performance of non-euro Member States.



Source: ECB

The UK banks that handle euro credit transfers are therefore almost entirely SEPA-compliant already and are expected to be fully compliant before the end of 2013.

UK euro direct debits

The SEPA core and business-to-business direct debit schemes were launched in November 2009.

20 UK banks are participating in the SEPA core direct debit scheme.
13 UK banks are participating in the SEPA business to business direct debit scheme.

A list of participating banks is at: http://epc.cbnet.info/content/adherence_database

The volume of euro direct debits in the UK is insignificant – just 509 transactions in 2011. All these were made in a SEPA form, as there has never been a euro direct debit scheme in the UK before. It is expected that all future UK euro direct debits will be in SEPA form. Therefore, UK payment service providers that handle euro direct debit transfers are now and will continue to be SEPA compliant.

Euro payment systems

There are no euro payment systems in the UK, The UK is therefore not impacted by the interoperability obligations for euro payment systems.

6. Costs and benefits of each option (including administrative burden);

(a) Transition costs

Banks costs: the UK banks that handle domestic and cross border euro payments have already made the necessary infrastructure investments to fully deploy the new SEPA direct debit and credit transfer payment instruments. The infrastructure costs vary significantly from bank to bank and depend on the geographical extent of their operations, the nature of each bank's business (eg corporate vs retail); their group structure; the complexity and configuration of their infrastructure platforms and internal processing systems and the degree to which changes are needed; and whether related payments or systems developments have also been incorporated:

(i) Sunk costs: Advice from industry participants suggest that the level of investment ranges from £1.1m for a smaller player to £50m for a pan-EU institution. The average figure is £2m for smaller banks and £25m for larger banks. These are predominantly fixed or sunk costs, represented mainly by project costs that will be depreciated over a number of years.

The total value of sunk costs is estimated to be around £185 million (5 x £25m for larger banks) plus (30 x £2m for smaller banks). These costs have already been incurred and cannot therefore be attributed to the proposed Regulation.

(ii) Variable costs: these are mainly operational back-office staff costs, IT processing costs and client support costs. These are harder to estimate. However, they would be incurred independently of whether payments business is handled via SEPA or a legacy payment scheme. In other words, they would be incurred in any event. They cannot therefore be attributed to the proposed Regulation.

(iii) Additional investment costs:

The Regulation provides that customers will no longer need to provide the European equivalent of a Sort Code (the Bank Identifier Code (BIC)) when sending a payment instruction to their bank. The Sort Code or BIC is the address of the bank branch that holds the payee's account. Customers will be able to make a payment instruction using the payee's International Bank Account Number (IBAN) only.

The implementation dates for this measure are:

Euro Member States	1 February 2014 for national payment transactions 1 February 2016 for cross border transactions
Non-euro Member States	31 October 2016

This measure will require banks to identify the address of the payee's branch in order to route a payment to the right address. In order to comply, it will be necessary for banks to look up the address, using the payee's IBAN. As there is currently no reliable and up to date means of looking up a payee's address, a database of IBAN and BIC numbers will be required.

The banks are considering two options for building a BIC-IBAN database: (i) a European-wide database; or (ii) a collection of linked national databases. Discussions are under way, but no decisions have yet been reached. A database offering a round the clock service will be expensive to build and maintain, and decisions will need to be taken on who would be responsible for building and maintaining it, how costs and usage charges night be met, and other legal issues.

The UK Payments Council is currently working with the banks to find a solution, and this impact assessment therefore looks at other examples of the costs of creating and running a database on the same principles as a BIC-IBAN database in the UK. There are two recent models:

(i) The Sort Code Validation Accreditation Scheme was introduced by UK banks in 2010 to help businesses reduce the risk of using incorrect or out-of-date sort code data. This required the building of a database to match the correct sort code to the correct account. The Payment Council's estimate is that the costs were less than £1 million.

(ii) A mobile phone payments database is currently under construction. The database will link mobile phone numbers to a customer's bank account number and sort code. The database is budgeted to cost £2.7 million in year 1 and a further £1m pa over 4 years.

Both these projects have been run and are funded by the Payments Council. Based on their costs, this impact assessment conservatively assumes that the transitional one-off cost of building a national UK BIC-IBAN database is likely to be around £3 million. It assumes that the cost of subscribing to the alternative option of a central European database will be similar.

The running costs are less clear. Based on the costs of populating the mobile phone database and the charges to the business end user for the Sort Code Validation database, it is estimated that the aggregate cost to UK banks of subscribing to a BIC-IBAN database are likely to be of the order of £200,000 to £400,000 pa (mid-point of £300,000 used in summary table). The costs of running the mobile phone database are not comparable, as the banks own and control BIC codes, whilst they are reliant on external input from customers on mobile phone data

End users costs: the end users are the banks' customers (public sector bodies, corporates, SMEs and consumers). The regulation lays three obligations on end-users:

(i) Bundled payments: Users who make or receive a large volume of direct debits or credit transfers that are bundled together in batch files will be required to adopt formats based on the ISO 20022 XML international standards.

Small firms do not make bundled euro payments in large batch files, so they will not be affected. Large corporates already use bank systems (e.g. "Enterprise Resource Processing Systems") which are or will soon be SEPA-compatible. They will therefore able to comply with this requirement at no extra cost. A few mid-size firms that do not use SEPA compatible systems may be affected if they are required to make IT changes to convert payment instructions to a new format. It is expected that these firm's banks and existing outsourced service providers will educate and help them to adopt the new standards, for example by offering conversion programmes that convert payment instructions from one format to another. The transition period for firms to adopt the new standards has been extended to four years. This means that they will be able to schedule a conversion to SEPA standards to take place during routine maintenance or planned upgrades of their systems. For these reasons, the potential cost to firms is likely to be negligible or zero.

(ii) International bank account numbers: all users will be required to provide international bank account numbers (IBAN) only to identify payment accounts for both domestic and cross border euro transactions and the bank will hold full responsibility for ascertaining the correct Bank Identifier Code (BIC) to enable the correct execution of the payment transaction.

An IBAN uses existing sort codes and account numbers from the payer's domestic bank account, with some extra characters added. In the UK, the customer's IBAN is printed on their bank statements.

As customers are already in possession of their IBAN code, this measure is expected to introduce no new costs.

(iii) Payment accessibility: Users will not be allowed to discriminate against payment service providers in another Member State. This is a qualitative single market measure which imposes no costs.

Interchange fees for direct debit transactions: multilateral interchange fees for direct debits will be banned. These are interbank fees for handling direct debits, which may be passed onto customers. Currently, the banking systems in six Member States (Spain, France, Sweden, Belgium, Portugal and Italy) apply these fees in which the bank of the payee (eg a utility company) pays the bank of the payer (eg a consumer) a per-transaction fee. An exception to the ban on these fees will be made for transactions that cannot be executed and must be rejected or reversed ("R-transactions"). Banks will be able to charge interchange fees for R-transactions, provided that there is no alternative, and that fees are strictly cost based and do not exceed the costs incurred by the most efficient payment service provider that is a party to the fee arrangement.

UK banks do not currently apply multilateral interchange fees to direct debits. The UK direct debit system was designed more than 40 years ago, when there was no concept of interchange fees. It was intended to provide an alternative payment option to cheques and the banks did not want to create any obstacles to the take up of the new service. The scheme operates successfully without an Interchange fee because it is indemnified by the firms who benefit from it. Firms gain much greater control and certainty over their collection of cash flows, and are able to offer discounts to incentivise their clients to sign up to direct debits, in preference to other forms of payment. The UK scheme has also been able to amortise its cost of infrastructure development over a long period. As a result, the unit cost of operating the UK direct debit scheme is around 1penny per direct debit, which is lower than most other forms of payment.

As a multilateral interchange fee structure does not hold in the UK, <u>this measure will have no cost impact</u> in the UK. It is not known whether UK banks will pass onto customers the costs of rejected or R-transactions for euro direct debits that may be levied by European banks. As the number of R-transactions is insignificant, and is likely to remain so in future, the potential costs to UK customers who make cross border payments in euros are negligible.

<u>Out of court complaint and redress procedures:</u> effective procedures will be put in place to settle disputes arising under the regulation. Payment service providers in the UK already fall within the jurisdiction of the Financial Ombudsman Service. This is because they are already subject to a similar requirement under the terms of the Payment Services Directive (2007/64/ec). Given the small fraction of cross border payments in euros as a proportion of all payments, it is expected that any breaches the regulation will generate <u>no significant increase in the volume of complaints</u> to the Financial Ombudsman Service.

<u>Penalties:</u> the regulation mandates the creation of new penalties for non-compliance. These will be principally fines for non-compliance with the regulation. It is not therefore expected that this will generate any workload for the courts, given the current experience of compliance with existing legislation by payment service providers, which has not generated an increase in the workload of the courts. However, the Treasury is consulting the Ministry of Justice about this and will complete a justice impact test.

<u>Other costs:</u> This assessment is confined to UK costs. However, many UK banks and some firms have a broad European footprint, operating in many Member States. They may incur compliance costs of operating in those countries. This assessment does not attempt to assess the costs of compliance in other Member States.

Transition costs summary
The preliminary assessment is that the Regulation will impose £3 million in additional transition costs in the UK.

(b) <u>Ongoing costs</u>

There are currently some 2,100 regulated firms carrying out payment services in the UK. Of these, 99 participate in the payments methods affected by these Regulations (there are 99 banks in the UK participating in the SEPA credit transfer scheme).

<u>Banks compliance costs</u>:

Based on advice from the FSA, there will be some additional reporting to the regulator to demonstrate compliance.

For larger banks this is expected to involve 5 hours of work per month. 4 hours will involve a member of junior management preparing returns and a further hour for an employee at mid-management level.

1 junior manager = £40 x 4 hours per month x 10 banks = £1,920 pa
1 for mid level manager = £75 x 1 hour per month x 10 banks = £ 9000 pa

For smaller banks this is expected to involve 1 hour of work per month for a mid level manager to prepare the data for the competent authority.

Yearly costs for smaller bank = £75 x 1 hour per month x 89 banks = £80,100 pa

Regulatory costs

Given that UK banks are expected to achieve full compliance in 2013, before the Regulation takes effect in the UK in October 2016, the regulator's cost are expected to be minimal.

This may involve one associate in two days per month to collect, monitor and report on data received from the banks. Using Information from the "Real Assurance Risk Management Report on the Estimation of FSA Administration Burden", June 2006 – the daily rate is c. £315.

1 associate x £315 x 24 days x 99 banks = £31,185 pa

Based on the bank record of compliance under past legislation in the payments field, it is assumed that the regulator will not need to take any enforcement action. There is also a requirement to provide access to a redress mechanism. Based on advice from the Financial Ombudsman Service, the level of complaints to the Ombudsman about credit transfers and direct debits is around 1,200 per year. This is an extremely low level of complaints relative to the volume of transactions (xx billion in 2011). Given the small fraction of cross border payments in euros as a proportion of all payments (less than 0.1% of retail payments in the UK are in euros),it is expected that the regulation will generate no measurable increase in the volume of complaints to the Ombudsman.

Ongoing costs summary
The Regulation will impose £1,122,205 p.a in additional ongoing firm and regulatory costs in the UK.

Summary of Costs		
	Transitional Costs (£000)	Ongoing Annual Costs(£000)
Bank Compliance Costs	3,000	390
Regulators Costs	30	30
Total	3,030	420

BENEFITS

Transition and ongoing benefits

The Regulation is expected to generate significant structural cost reductions as a result of harmonising euro credit transfer and direct debit formats. The benefits arise from the scale economies of being able to run common SEPA systems, and from phasing out legacy systems and processes in each Member State so that the cost of operating parallel systems are eliminated. For the largest players, it will also create opportunities to maximise their investments by extending their capabilities to accommodate global payments traffic. In other words, there will be significant efficiency gains and increased competition for payments business. The banks' customers will benefit through faster payments, lower prices and the introduction, over time, of value added services, like electronic invoicing.

The wholesale price of payment transactions is expected to fall as a result of prices converging on the level of the lowest, as economies of scale are realised and competition increases.

The European Commission's impact assessment suggests that the reduction in banks' costs of processing, clearing and settlement will amount to 20% over six years, and that given growing payment volumes, the wholesale operating cost reduction per transaction might reach 54%. It therefore suggests that the average wholesale price of a payment transaction might fall from €1 to around €0.40. In the absence of other costs data, this assessment takes the projected reduction in the wholesale price (of between 20% and 54%) as a proxy for the projected reduction in operating costs.

Applied to the current level of UK euro credit transfers (5.4m in 2011), without factoring in any growth in volumes, the European Commission's assessment of a 54% cost reduction over 6 years (£0.90 – 54% = £0.41p) would yield the following cost reduction:

Current cost of 5.4m transactions x £0.90p = £4.86 million

Upper estimate (53% cost reduction) 5.4m x £0.41p = £2.21 million

Lower estimate (20% cost reduction) 5.4m x £0.72p = £3.89 million

Projected savings
Upper bound (£4.86m - £2.21m) = £2,65m
Lower bound (£4.86m - £3.89m) = £0.97m
Midpoint = 1.81m

The projected operating cost reductions per year therefore range from £0.97 million to £2.65 million (mid-point £1.81 million), without factoring in any growth in the volume of payments. These annual reductions are conservatively assumed to be generated at the end of 5 years and not during years 1-5.

The banks are also expected to benefit through an increasing volume of payments business. Volume growth is expected to offset any bank revenue loss. In the UK, the Payments Council forecasts sterling automated credits to grow by an average rate of 3.8% between 2012 and 2019.If the same rate of growth is applied to SEPA transactions, this would see the volume of SEPA credit transfers rise from 4.9m in 2011 to 6.85m by 2020.

Year	Payment Volumes	Range of projected cost Reductions (m)		Mid Point
2011	4.90	0	0	0
2012	5.08	0	0	0
2013	5.28	0	0	0
2014	5.48	0	0	0
2015	5.69	0	0	0
2016	5.90	0	0	0
2017	6.13	2.65	0.97	1.81
2018	6.36	2.75	1.01	1.88
2019	6.60	2.85	1.04	1.95
2020	6.85	2.96	1.08	2.02
2021	7.11	3.1	1.12	2.22
		14.31	5.22	9.88

Taking into account an annual growth rate of 3.8% in the volume of payments, the projected operating cost reductions per year range from £5.22 million to £14.31 million over ten years.

Impact on Competition

Currently, any bank planning to enter a foreign market for payment services needs to fulfil a number of national requirements. In particular, different payment scheme stipulations need to be implemented which can take as long as 12 months. Restricted market entry and mobility for foreign banks place a limit competition. The SEPA Regulation will harmonise the procedures for handling euro payments via direct debits and credit transfers. This will remove the need for banks to implement national requirements allowing easier entry and mobility for banks into foreign markets.

The opening of a payment account in another Member State today is often refused by banks on the mere basis that the consumer is not a resident or a national of the Member State concerned. Furthermore, as European payment users and consumers become increasingly mobile, there is a growing need for them to be able to open a payment account on a cross-border basis. The SEPA Regulation will enable payments to flow electronically from one account to another anywhere in the EU. This will allow higher customer mobility across borders for increased customer mobility, fuelling further demand and leading to more rigorous competition.

Multilateral Interchange Fees (MIFs) for direct debits will be banned. These are interbank fees for handling direct debits, which may be passed onto customers. Currently, the banking systems in six Member States apply these fees in which the bank of the payee pays the bank of the payer a per-transaction fee. Such an arrangement distorts the competition between payee banks by setting a floor for the fees that payee banks charge to their corporate customers. Companies will have to pass on these inflated fees to their consumers through their own bills. By banning MIFs the Regulation will remove this barrier of competition between payee banks and therefore costs will not be passed on to their consumers.