

The SEPA Regulation: The Clock is Ticking

Introduction

The Regulation establishing technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009 (the “**SEPA Regulation**”) will be the fourth major regulatory intervention within a decade designed to achieve a harmonised euro payments market.¹ The SEPA Regulation will apply to credit transfer and direct debit transactions denominated in euros within the EU where both the payer’s and the payee’s payment service provider (“**PSP**”) is located in the EU, or where the sole PSP in the payment transaction is located in the EU. Certain payment transactions listed in the SEPA Regulation will be exempt from the requirements.

According to the Commission, self-regulatory efforts of the European banking sector through the Single European Payments Area (“**SEPA**”) initiative “have not proven sufficient to drive forward concerted migration to Union-wide schemes for credit transfers and direct debits on both the supply and demand sides”, neglecting consumer and other user interests and lacking transparency.

The SEPA Regulation will set 1 February 2014 as the migration deadline for credit transfers and for most direct debits, with a view to eliminating the high costs of simultaneously running multiple payment schemes and maximising the benefits of harmonisation, standardisation and simplification of payment processes. The deadline for migration applicable to non-euro countries will be 31 October 2016.

Standardising technical requirements

The technical standards applying to PSPs fall under three main categories:

- payment account identifier and message format requirements applying to credit transfers and direct debits;
- data element requirements applicable to credit transfers; and
- data element requirements applicable to direct debits.

In carrying out euro credit transfers and direct debits, PSPs must use IBANs to identify payment accounts regardless of the location of the relevant PSP. They must also use the ISO 20022 XML standard message format (i) when transmitting payment transactions to another PSP via a retail payment system and (ii) where a PSU that is not a consumer or a micro-enterprise initiates or receives individual payments that are bundled together for transmission.

Specific data elements are prescribed for each instruction stage of a credit transfer and direct debit respectively (i.e. between the two PSPs and between these and the payer/payee), allowing key information to pass along the payment chain in a standard format without being changed.

A payee under a credit transfer will have to inform the payer of its IBAN (and, if not identifiable from this, the BIC of its PSP) each time it requests a payment. As the European Banking Association (“**EBA**”) has pointed out, this means that in

Highlights

- The SEPA Regulation will set 1 February 2014 as the migration deadline for credit transfers and for most direct debits (subject to legacy mandate provisions)
- The use of IBANs will be universalised and message format and data element requirements on credit transfers and direct debits will be introduced
- Payers will be given new rights to instruct PSPs to impose certain restrictions on direct debits and PSPs will be subject to new checking obligations
- Multilateral interchange fees will be phased out for euro direct debits, subject to limited exceptions
- Payment schemes will have to become interoperable and payee accounts will have to be reachable via an EU-wide credit transfer and/or direct debit scheme
- The Commission will be given the power to amend the technical requirements through “delegated acts”

practice all corporates will need to include such details on their invoices. For direct debits, the payer will have to communicate the same details to payees before the first transaction takes place.

¹ The SEPA Regulation has not yet been published in the Official Journal of the EU. It will only take effect once it has been so published. All references to articles and recitals in this client briefing are to articles and recitals in the European Council’s draft of 16 December 2011 (2010/0373 (COD)).

Standardising message formats and universalising the use of IBANs are undoubtedly seen by the EU legislators as essential to the development of SEPA. The recitals to the SEPA Regulation state that as the BIC is only required in a very small, residual number of cases “[i]t seems unjustified and excessively burdensome to oblige all payers and payees throughout the Union always to provide BIC in addition to IBAN” and that “[a] much simpler approach would be for PSPs and other parties to solve and eliminate those cases where a payment account cannot be uniquely identified by a given IBAN”. However, in an uneasy compromise between uniformity and flexibility, the recitals also state that PSPs may agree, bilaterally or multilaterally, on “expansion of the basic Latin character set to support regional variations of SEPA standard messages”.

Other technical requirements that will impact upon PSPs include:

- a prohibition on setting a minimum amount per transaction;
- the mandatory provision of fully automated electronic processing in all process stages throughout the payment chain (although in cases of exceptional handling of credit transfers and direct debits, this requirement will apply “whenever possible”); and
- a requirement that the remittance data field must allow for 140 characters.

Empowering payers

In addition to developing common standards, the SEPA Regulation grants payers the right to instruct their PSPs to:

- limit a direct debit collection to a certain amount and/or frequency;

- block direct debits to a payer’s account, or specify a “black list” or “white list” of payees whose direct debits are to be blocked from or accepted into (respectively) a payer’s account; and
- in cases where the parties have agreed to exclude the right to a refund, verify each direct debit transaction before debiting the payer’s account, by checking whether the amount of the submitted transaction equals the amount agreed in the mandate.

The recitals to the SEPA Regulation explain that the above provisions are aimed at strengthening “the confidence of payment service users in the use of such services, especially for direct debits”. The rights in question do not apply to the European Payments Council (“EPC”) business to business scheme.

Key dates

- **February 2012** – European Parliament expected to adopt SEPA Regulation
- **1 November 2012** – MIFs to be phased out for cross-border payment transactions
- **1 February 2014** – Migration deadline for credit transfers and direct debits in euro
- **1 February 2016** – Migration of niche products to be completed
- **31 October 2016** – Migration deadline for non-euro countries
- **1 February 2017** – MIFs to be phased out for national payment transactions



Contrary to these provisions, the EPC is more in favour of enabling scheme participants to offer features in response to market demand - although arguably seeking to enhance consumer protection, the above-mentioned mandate features are not necessarily aligned with the practical requirements of the relevant users and might inadvertently result in an increase in the complexity and cost of direct debits across the EU. Moreover, there is a risk that these new obligations will result in PSPs having to bear significant costs to upgrade their systems, implement additional functionalities and train their staff; these costs will most probably be passed on to consumers. According to the EBA, PSPs may need to assess how best to support payers in managing and changing direct debit restrictions that they have defined for their payment accounts.

Tightening the grip on MIFs

The SEPA Regulation will seek to tackle the highly controversial issue of Multilateral Interchange Fees (“MIFs”), with a view to “provid[ing] legal certainty to the payments industry on business models for direct debits” and to creating neutral conditions of competition in the market. MIFs, which currently apply to direct debit transactions in certain member states, are to be phased out by 1 February 2017 for national payments and by 1 November 2012 for cross-border transactions. The SEPA Regulation will allow for the continued application of interchange fees in the context of transactions which cannot be properly executed by the PSP or which result in exception processing (R-Transactions) in certain circumstances

and under strict conditions. Interestingly, the Commission has drawn a distinction between the analysis of MIFs in the context of direct debits and of payment card transactions. The recitals clarify that the SEPA Regulation will leave the door open for the Commission to monitor R-Transaction fees across member states, ensuring that these converge over time.

Eliminating fragmentation

The SEPA Regulation will require all payee accounts that are reachable for national credit transfers and/or direct debits to also be reachable via an EU-wide credit transfer and/or direct debit scheme respectively. The direct debit reachability obligation will be confined to direct debits that are available to consumers as payers under the scheme and, as stated in the recitals to the SEPA Regulation, is aimed at “encourag[ing] the successful take-up of Union-wide credit transfer and direct debit services”. In the interests of transparency, this obligation will be consolidated with the corresponding direct debit obligation contained in Regulation (EC) 924/2009.

Payment schemes will also have to be interoperable. The original proposal of the Commission mandating interoperability between multiple EU-wide payment schemes for credit transfer and direct debits² has been replaced with a requirement for payment schemes to have a single set of rules that will apply to national and cross-border transactions. In addition, payment schemes will have to consist of participants from a majority of EU member states that also represent a majority of PSPs in those states.

PSPs may need to consider:

- Redrafting documentation so that it meets the new technical standards prescribed by the SEPA Regulation
- Aligning terms and conditions with the EPC SEPA Scheme Rulebook provisions
- Ensuring documentation grants payers the rights dictated by the SEPA Regulation
- Checking pricing information contained in customer documentation

According to the EBA, these criteria will only be met by the EPC SEPA schemes and therefore all PSPs offering euro credit transfers and/or direct debits in or between SEPA countries will most probably have to stop using current national schemes for regular credit transfers and direct debits and become compliant with the relevant EPC SEPA scheme. Although conducive to overcoming fragmentation in the euro payments market, given the timeframe for the changes and the significant impact they are likely to have on PSPs’ payment processing operations, this exercise is likely to be challenging.

Legacy hangover

EU legislators have tried to find an appropriate balance between the long term cost of continuing to cater for legacy

² Enunciated in its draft proposal dated December 2010.

products and the immediate challenges associated with abandoning them.

Any valid payee authorisation to collect recurring direct debits in a legacy scheme prior to 1 February 2014 will continue to remain valid after that date. Such authorisations will also be deemed to represent the payee's consent to the payer's PSP to execute recurring direct debits collected by that payee in compliance with the SEPA Regulation. The relevant mandates must allow for unconditional refunds and refunds backdated to the date of the refunded payment, where such refunds have been provided for within the framework of the existing mandate.

EU member states will be permitted to increase transition periods for certain niche legacy credit transfer and direct debit services. Therefore, national banking communities may be forced to continue to run legacy systems in parallel with their SEPA equivalents.

Shifting sands

The SEPA Regulation will grant powers to the Commission to amend the details of the technical requirements through "delegated acts". Such powers are delegated for an initial period of five years which is extendable by a further five years subject to objection by the European Parliament or Council.

This will effectively give the Commission the power to determine key features of the EPC SEPA schemes. When adopting such acts, the Commission has promised to consult experts appointed by EU governments in its preparatory work. However, the extent to which the Commission will consult other SEPA stakeholders remains uncertain. One possible qualification that might assuage

the concerns of market participants is the statement contained in the recitals to the SEPA Regulation that "technical requirements should not restrict flexibility and innovation but should be open to and neutral towards potential new developments and improvements in the payments market".

The rationale for this significant extension of the Commission's standard setting mandate is that the possibility of technological and market developments make it likely that the technical requirements under the SEPA Regulation will need to be updated at a pace not readily achievable under normal EU legislative processes involving the European Parliament and Council.



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