Half-Baked interoperability is not enough

Next steps needed for SEPA CSM interoperability

(Condensed version)

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Half-Baked interoperability is not enough; next steps needed for SEPA CSM interoperability.

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Interoperability between payment institutions, payment processors and clearing & settlement mechanism (CSM) - while not sufficient on its own - is essential for creating a competitive SEPA infrastructure. Operationally interoperability guarantees SEPA product qualities in case multiple parties are involved in a payment value chain.
While the Payments Services Directive, shared European oversight, Target2 and use of 20022 XML are accomplished, not all key elements to create SEPA CSM interoperability can be fully checked off:

- The banking community has underestimated the negative effect on interoperability of exceptions and optional choices to the SEPA Credit Transfer and SEPA Direct Debit rulebooks. As a consequence we see fragmentation in “mini SEPA’s” and differing message sets per payment processor causing substantial externalities to all participants in the SEPA. In hindsight we have not been ambitious enough in creating means to deviate while interoperability was effectively ensured.

- The ECB’s SEPA compliance framework for infrastructure and the EPC’s CSM framework, to realize full reachability ("all can reach all") by forming a multi-party PE-ACH are not fully effectuated.

- EACHA-like 'interoperability' to allow any payment institution or payment processor to use common technical conventions exchanging payments with each other is not widely implemented.

As acknowledged by the EPC at the ECB stakeholder meeting of April 2013 SEPA CSM interoperability is still “work in progress”.

**Initial choices limit interoperability.**

It was the European Commission’s strong intention that the SEPA payments standards would be shaped in the balanced interest of all stakeholders. The uneven distribution of knowledge and position in the process between the insiders - the banks - and the outsiders - the rest of society - has resulted in an outcome with limited interoperability which is arguably more in the interest of the banks than to the other stakeholders.

As early as 2006 the ECB recognized in its 4th Progress Report that SEPA CSM reachability and interoperability are critical requirements for a properly functioning SEPA infrastructure. The focus of the ECB has been to propagate interoperability only between the traditional CSMs, leaving the banks out of scope while they are performing the same functions in the payment value chain as CSMs.
The EPC first started to recognize the need for interoperability when the ECB and EACHA started to press for it. By then many decisions on the fabric of SEPA had been made already without taking the interoperability aspects into sufficient consideration. The EPC should have aimed much higher when deciding what should be standardized (i.e. the cooperative space) and what should be left to the competitive space.

EACHA - trying to become a partner in the EPC standardization process - left out some crucial elements of the EACHA Interoperability Framework guidelines, most notably: mandatory receiver capability, common legal contracts, and covering all inter-payment processor exchanges including bilateral exchanges.

**The payments world is moving on.**

Since the start of the creation of SEPA the playing field for payments has changed dramatically. New technologies and concepts have come up creating an interconnected reality that was just non-existent when the groundwork for SEPA was laid down which was only 6-8 years ago. The SEPA infrastructure should be able to adapt to these new developments by facilitating e.g.: high-speed payments, e-mandates, e-invoices, number portability, e-banking and payment account access services. Any effort in revitalizing interoperability will have to incorporate these developments if the SEPA infrastructure wants to remain relevant in the future.

If the SEPA infrastructure does not evolve it will become a hindrance for development of the EU economies and will create externalities for all the companies, citizens and financial institutions in Europe. The cost of the lack of SEPA interoperability to society - while not very visible to the average citizen - is high and will be getting higher when new developments in payments cannot be adequately adopted.

The SEPA infrastructure, as we know it today, is not a pleasant starting point to get this adaptation going. Unfortunately, if standardization is done ineffectively it is pretty hard to improve upon.

In the long run it is not in the interest of payment institutions either to be stuck with a legacy network that in comparison to emerging alternative approaches for payment exchanges will become less competitive and less adaptable over time.
SEPA needs a highly efficient and resilient infrastructure in terms of cost, safety, throughput time, and in adaptability. Interoperability, based on an open standard applicable for all payment institutions and payment processors and CSMs, is a prerequisite.

Only a true open standard covering technical and legal interoperability will help to create a competitive market for payments processing and CSMs by allowing payment institutions to be interoperable with any payment processor(s) that best meet their needs.

Next steps are needed.

The market has not been able to create interoperability so far; In my opinion the ECB is now having the ball in their part of the court:

- EBA Clearing does not allow other CSMs to link while their own direct participants are acting in exactly the same role within the EBA network based on Target2 Settlement. As long as this divide is not taken away SEPA CSM interoperability will not take off. It is important to create interoperability between existing players because the entry barrier for CSMs is prohibitive and alternatives from new entrants therefor not likely. The ECB should continue its pressure on EBA Clearing to take away the EBA/EACHA divide.

- A market led initiative would be optimal for realizing common SEPA CSM interoperability with all the stakeholders heard and listened to. For banks interoperability was - and in many cases still is - not a high priority or seen in their own or bank communities’ interests. For all other stakeholders interoperability is key to their interests. I expect the banks will be reluctant to take up the mantel again.

- The ECB should enforce interoperability with mandatory receiver capabilities for all payments processors with a mandatory open standard for interoperability applicable to all parties including “banks” with a CSM-role.
Biography

Jan Willem Mars has been involved in SEPA CSM Interoperability being the creator of the interoperability concept that was used as the starting point for the EACHA interoperability effort. He led the taskforce that created the EACHA interoperability framework. As a business developer he has been pioneering and establishing the inter-CSM connections of Equens that have built up to the EACHA network it is today.

Jan Willem Mars, owner of Leika Consult BV, has been an independent Strategy and Business Development consultant operating in a wide range of industries since 1999.

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