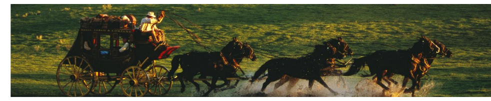
WELLS FARGO

A U.S. PERSPECTIVE ON SEPA

A Treasury Management White Paper



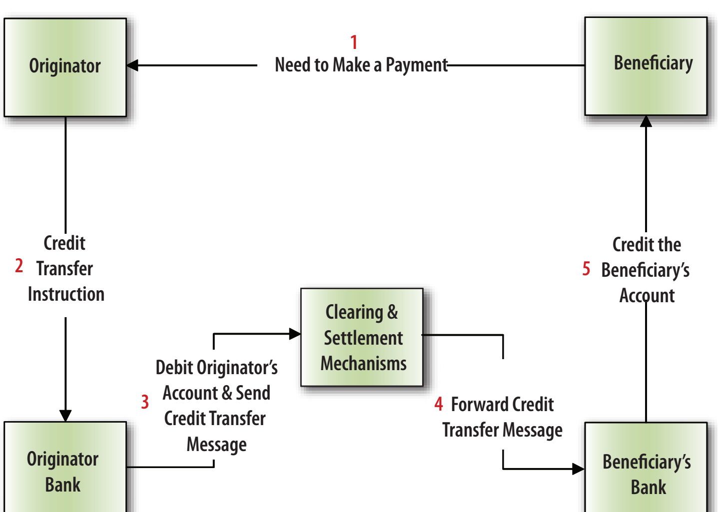
WINDS OF CHANGE IN EUROPE

SEPA, the Single Euro Payment Area, is both a place and a program. As a place, it encompasses the 27 EU member states (including new members Bulgaria and Romania), the three European Economic Area (EEA) states – Iceland, Liechtenstein, and Norway – and Switzerland. As a program, its aim is to create a “harmonised” payment system under which all electronic euro payments within or between European countries are treated as domestic rather than cross-border payments.

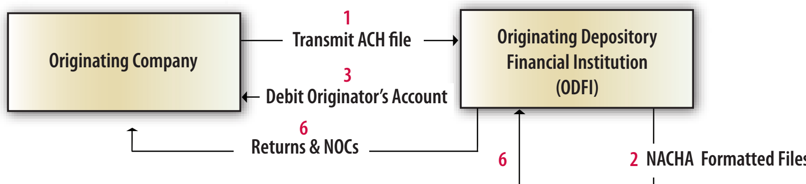
The European Payments Council (EPC), the decision-making and coordination body of the European banking industry in relation to payments, is managing the initiative and the conversion schedule. However, the European Parliament and European Council – both political bodies – are driving the SEPA endeavor with the objective of increasing continental credibility and competitiveness. Politicians rightly believe that both a single currency and single payment system are required as the price of entry for Europe to be viewed as a single market by the rest of the world.

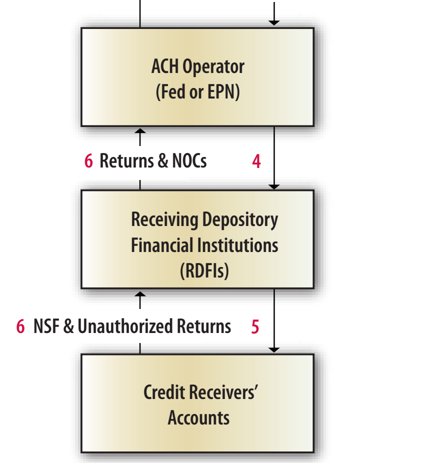
SEPA gets a lot of press. Google it, and you’ll find 1.2 million links to articles and websites. The gtnews.com website alone publishes several SEPA-related articles weekly. There’s good reason for all this attention. If it works as intended, SEPA will unite a continent in ways that Napoleon and the euro could not. It will bring electronic payments in up to 31 countries under a single flag. It will revolutionize the way European consumers pay their bills and European corporations collect their payments.

SEPA ACH Credit Transfer Flow



US ACH Credit Payment Flow





SEPA is a very big deal—in Europe. But what does it mean to U.S.-based companies? Is it the greatest thing since sliced bread or just another way to slice a baguette? This paper looks at SEPA from a U.S. perspective to determine what it will mean to companies with offices, operations, employees, vendors, and/or customers in the SEPA zone.

SEPA FRAMEWORK AND TIMEFRAME

In American English, “scheme” means a crafty, even nefarious, plot. In Europe, a scheme is simply a plan or, in the case of SEPA, a set of rules, practices and standards. There is a SEPA Credit Transfer Scheme for wire transfers and ACH-type payments and a Direct Debit Scheme for ACH-type withdrawals. There is also a SEPA Cards Framework for payment cards.

SEPA Credit Transfer and Direct Debit Schemes originally were to take effect in January 2008. However, the Payment Services Directive (PSD), which provides the legal framework for SEPA payment instruments, still must be ratified by the European Parliament and passed into national law in each EU state. No one knows how long that will take. The consensus opinion among Wells Fargo and its European partner banks is that the SEPA Credit Transfer Scheme will be ready in 2008, but migration to all three schemes will stretch beyond 2010.

“The biggest challenge is the pan-euro direct debit scheme,” says a major EU bank officer. “Cross-border credit transfers we’ve all been doing for a long time, but a pan-euro direct debit scheme no one has done before. So, that is quite a challenge.” Even bigger than the challenge of the SEPA schemes is the SEPA scope.

It encompasses 300 million consumers, 16 to18 million corporations, 7,000 to 8,000 banks, 4.5 million points of sale, and 240,000 ATMs in the euro area alone. "They're turning a big ship," says Laura Lee Orcutt, Wells Fargo Senior VP of electronic payment products, "They're turning it in the right direction, but it's going to take time."

THE CHANGING PAYMENTS LANDSCAPE

The current payments landscape across Europe includes at least 50 different electronic payment systems, each with its own rules, formats, clearing cycles and costs to the customer. SEPA will reshape this landscape and bring it more in line with the U.S. model. A representative of a global bank says, "An argument people used for launching SEPA goes, 'Why should it cost me more to make payments from Berlin to Barcelona when I can transfer funds from New York to New Mexico and there's no difference?' The comparison being drawn was between what is going on in the U.S. as a single market supported by a single currency and with a similar population versus what was going on in Europe."

ACH Payments

The new landscape will improve all types of electronic payments within Europe, but the changes that may benefit U.S.-based companies most are those affecting ACH-type payments.

International ACH is an underutilized payment mechanism. A Global Concepts Special Report issued in June 2006 on the use of international Treasury Management services by middle market companies found that cross-border or international ACH from a U.S. account is used by only 13% of firms who buy from foreign suppliers. SEPA could be the catalyst that launches international ACH payments on a fast growth track.

The U.S. has one ACH rule-making body, NACHA, and two settlement networks – the Federal Reserve and Electronic Payments Network (EPN). In Europe under SEPA, the PSD sets the rules, specifically the payment format and settlement timeframes. The 50+ electronic payment clearing networks will be reduced to a few pan-European ACHs (PE-ACHs). Europe will then have consistent standards underpinned by a uniform legal framework and a common customer experience, similar to what the U.S. has today.

Corporate treasury departments looking for ways to centralize payment processes and reduce payment costs already are looking at international ACH. The assistant treasurer of a large U.S.-based oil and gas drilling company with offices around the world says, "We want to get our overseas payroll largely rolled into the low-value (ACH-type) networks. If we can do that with the UK, France, Australia, and New Zealand, we're going to resolve three-fourths of our payment issues."

Wells Fargo offers ACH transactions to those countries today. When asked what will change under SEPA, Orcutt names two things: the legal framework and the formatting. "Our strategy all along has been to shield our customers from the different formatting requirements, but we've never been able to simplify the legal framework for them. SEPA will standardize both, and standardization should improve speed, cost, and reliability across Europe," she says.

Standardization is crucial to international ACH debits to Europe. In the U.S. and Canada, ACH debits settle with finality within a specified time frame. In the rest of the world, it's a different story. In the UK, for example, there currently is no limit to the time in which ACH debits can be returned. Payments collected from customers in England this month could be returned in 2010. A standard 42-day time limit to request returns for direct debits is being considered along with the SEPA Direct Debit Scheme.

ACH COMPARISON

	EUROPE		U.S.
	TODAY	**SEPA**	
Systems	50+	4-5 PE-ACHs (estimated)	Fed, EPN
Formats	50+	XML ISO20022	NACHA
Payment Routing	International routing code + account number	BIC + IBAN	RTN + AN
Credit Settlement	D+1* (Germany) D+4-5 (Spain)	D+3 Maximum D+1 by 2012	D+1
Direct Debit Latest Settlement of Returns (NSF, Acct Close, Stop Payment)	Varies by country, not defined by a rule book	D+5	D+2
Direct Debit Latest Date for Refund	UK: no end date for return as unauthorized	D+42 (Requests)	D+60 (Unauthorized)
Notification of reason for return	Varies by bank	Unspecified rules for rejects and returns	NACHA return codes R01, R02, R03, R04, R06, R08, R09
Notifications of Change	Occasionally provided by UK banks	Not covered in SEPA documents	NACHA NOC codes C01, C04, C13

* D+1 equals specified date payment must be received + (plus) one transit day

"Customers want assurance that their ACH collections will settle within a certain timeframe and be returnable within a certain timeframe across the board," says Orcutt, "SEPA will give them that assurance."

Wires Transfers

Wire transfers will continue to be the preferred mechanism for large dollar payments requiring speed and finality. The SEPA Credit Transfer Scheme makes one major improvement to the European wires system: the elimination of "bene deduct."

> Europe is moving toward an electronic payments system that is universal and predictable.

Bene deduct, short for beneficiary deduction, is the embedded practice of European receiving banks "lifting" a fee from the value of an incoming wire prior to posting. Its effect is to reduce the amount of the payment to the beneficiary's account. A $10,000 payment wired to a European vendor may post to the vendor's account as a $9,875 credit.

SEPA rules do not apply to payments coming into Europe from other parts of the world. Whether or not wires coming from the U.S. will be subject to lifting fees is something to be negotiated between initiating and receiving banks outside of SEPA.

Also outside of SEPA is the European Banking Association-sponsored priority payments initiative, often referred to as "pri-euro." Some European banks soon will begin offering same-day availability for incoming electronic payments through this optional, voluntary service. Depending on the speed of a country's ACH system, pri-euro processing may be available on wire transfers only or on both wires and ACH payments.

Because there is no value limit on payments through the SEPA credit transfer process, experts expect a shift away from differentiating payments between high-value and low-value to differentiating between urgent and non-urgent.

Card Payments

Of all electronic payment instruments, cards will change the least under SEPA. The aim of the SEPA Cards Framework is to remove the technical, legal, and commercial barriers to pan-European card acceptance.

Today, international cards such as Visa®, MasterCard, Diners Club, and American Express are accepted throughout the euro zone, but national cards often cannot cross borders. Beginning in January 2008, European banks that issue cards or act as acquirers must offer SEPA compliant cards, and merchants must be able to accept these cards. All cards in circulation must be SEPA compliant by the end of 2010.

SEPA is expected to bring consistency to the settlement of card transactions in Europe and to reduce cross-border interchange rates. When card payments become more efficient and cost-effective, more U.S. companies may consider issuing cards to employees working in Europe for payroll or expense reimbursement.

BENEFITING FROM BANK CONSOLIDATION

A major investment in technology is required for European banks to become SEPA compliant. In return for making this investment, most banks will lose rather than gain revenue by having to reduce the fees they charge for electronic payments. Expect this scenario to drive a new wave of bank consolidation in Europe.

Some banks may merge, and many may get out of the payments business altogether. Large, SEPA-compliant banks plan to become payment "factories" serving their own customers plus those of correspondent banks. This, too, resembles the U.S. model where in 2006, according to NACHA, the top five originating banks accounted for 58.1 percent of all ACH origination activity.

International ACH is a highly cost efficient payment method today with the price of a transaction generally 50% to 75% less than that of a wire transfer. Under SEPA, when higher volumes of ACH transactions are pushed through fewer European banks maximizing straight-through processing, prices may drop further.

"Once we're in a single domestic payment area, customers will start to realize they can pick and choose their payments bank. So, banks will more than likely start to offer cut-price payments figuring to make up the revenue reduction on volume and value-add services," states a UK bank representative.

U.S. companies that employ multiple European banks to gain access to national payment systems may be able to consolidate their accounts and banking relationships, reducing their banking costs and simplifying their payment systems. A Wells Fargo customer looking forward to the time when his company can use one bank to access 31 countries versus 31 different banks says, "That will reduce 31 setups and 31 maintenance fees and 31 security procedures to one."

U.S. banks, too, may consolidate their European banking relationships. Wells Fargo partners with best-in-country banks for routing customers' wire and ACH-type payments into Europe. When the reach of major European partner banks extends throughout the continent, we'll look to negotiate volume discounts for our customers by pushing higher payment volumes through fewer banks.

XML, IBANs, AND BICs

XML ISO20022 is the format that will be required for ACH payments and wire transfers made in euros within the SEPA zone. XML ISO20022 is also the worldwide SWIFT MX message standard.

SEPA MAP OF EUROPE

IBAN is the acronym for International Bank Account Number. BIC, which stands for Bank Identifier Code, is the SWIFT bank code or address of the beneficiary's bank. BICs and IBANs are required for ACH and wire payments in euros under SEPA. Since January 1, 2007, BICs and IBANs have been required for wire payments originating from within Europe in all currencies. They are not required for payments to Europe originating from the U.S.; however, Wells Fargo encourages customers to collect BICs and IBANs from their payees and begin including them with electronic payments to Europe as soon as possible.

Judd Holroyde, head of Global Product Management and Delivery for Wells Fargo, explains why: "We are beginning to see European banks rejecting payments or assessing surcharges or 'repair fees' for payments received without a BIC and IBAN. We've heard horror stories about repair fees of up to 16,000 euros. There is a lack of consistency in applying these repair fees, so it's best to avoid them entirely by always including the BIC and IBAN."

Bank codes and account numbers are relatively easy to obtain. The assistant treasurer of a company that sends approximately $2 million in wires per month to Europe says, "BICs and IBANs are usually included on invoices. We really haven't had any issues in getting them – I thought we would have more. All the vendors want to get paid, so it's in their interest to provide the information we need to pay them."

NON-EURO PAYMENTS

At least 70% of all non-cash payments in the EU-27 today are made in euros, according to the European Payments Council. The percentage of electronic payments made into Europe in euros by U.S.-based companies is significantly lower. A Wells Fargo customer with operations worldwide says, "We are overwhelmingly dollar-based. Almost all our revenue is dollar-based; almost all of our expenditures are dollar-based. The one exception is the UK where we go through a lot of pounds sterling."

What will SEPA mean to non-euro payments? It's reasonable to assume that national payments systems will continue to exist in countries where national currencies—British pounds, Swedish krona, Swiss francs, etc.—are in use. Even countries that have retired their national currencies are reluctant to replace their national payment infrastructures. A European partner bank says, "What we're hearing from corporates, public authorities, even central national banks is that the period of dual running [national payment systems running alongside SEPA systems] will extend far beyond 2010."

LOOKING FORWARD TO SEPA

With the countdown to SEPA speeding up, U.S.-based companies doing business in Europe have much to look forward to: standardized payment formats, consistent clearing and return timeframes, more favorable pricing, straight through processing, an electronic payments system that's more familiar than foreign. While, from a European perspective, the approval and implementation of SEPA are massive, complex tasks, from a U.S. corporate perspective, SEPA is all about simplification.

Wells Fargo is evaluating European bank partnerships and SEPA access alternatives in order to bring customers the best possible solutions. Through Wells Fargo, it should be as easy for companies to make a global payment as it is a domestic payment.

"What U.S.-based companies want from us is the ability to move money easily, and it's our job to streamline that for them," says Steve Ellis, head of Wells Fargo Wholesale Services. "We want to make it as easy to move money from the U.S. to Europe as it is to move money from coast to coast in the U.S.."

ABOUT WELLS FARGO

Wells Fargo originates more than 110 million ACH transactions per month on behalf of customers from one of the few in-house designed, built, and maintained ACH platforms in the nation. We are the second largest receiver and third largest originator of ACH payments in the U.S. and the only winner of three consecutive annual awards for ACH quality and leadership from NACHA, the governing body of the automated clearinghouse networks.