

Transaction Matters

Issue two – Spring 2009



Introduction

Welcome to your second issue of Transaction Matters – our quarterly newsletter. Firstly thank you for the overwhelmingly positive feedback on the launch edition and ideas on specific business issues that would be of interest e.g. the SEPA challenge, more customer case studies and articles on trends in the banking industry to name but a few. In response to this feedback we have incorporated many of your ideas in this issue and have profiled two European banks – WestLB and BAWAG P.S.K, which we believe you will find insightful and valuable. Both clients discuss how they are embracing the SEPA opportunity whilst managing costs and mitigating risk.

Clearly the banking sector is facing many challenges. The need to move forward and maintain shareholder confidence coupled with a real and significant pressure to cut costs. Add to this a strong media campaign championing a ‘back to basics’ strategy for banks and it would be all too easy to adopt a stand still and do nothing approach for the time being. There is compelling evidence to suggest that organisations who continue to invest, move forward and innovate, are likely to engender confidence and create market value earlier than their competitors.

SEPA Direct Debit (SDD) is one such area for innovation. In our discussions with clients it is clear there is an abundance of opportunity to package value added services for your corporate customers that will lead to new and potentially substantial incremental revenue streams. In addition we have been hugely encouraged by the response to our series of SEPA European briefings and the number of you who are seeking ‘first mover’ advantage in your markets with the introduction of a SEPA compliant offering. If you would like to attend or find out more about these events then please visit: [European briefings](#). We will be adding new dates and venues over the next few months.

If your focus is on improving working capital management and cash flow then Heather McKenzie offers an independent view of how banks can help their corporate customers put their cash to work.

In any event I hope you enjoy this issue of Transaction Matters and find it interesting and thought provoking. If you would like to contribute to a future edition or indeed have any feedback or ideas then please do let me know as I would love to hear from you.

Best wishes

Helen Ritchie
Marketing Director

p.s. on 26 March 2009 our groundbreaking alliance with BGC helped Vocalink win the [FST award](#) for ‘best outsourcing partnership’. BGC was profiled in the last edition of [Transaction Matters](#). Vocalink also won the award for ‘best payment system deployment’ for the UK Faster Payments Service as well as ‘overall winner’.

Market overview – back to basics

Edith Rigler is Senior Director of Business Development. She joined VocaLink in January 2009 and has over 25 years' experience in transaction banking, working in senior roles at HSBC, Deutsche Bank and Citibank.



The global credit crunch has dominated the news headlines for the last six months. A quick search on Google returns 9 million articles so there's certainly no shortage of information around. Much of this seeks a single explanation for the collapse of world banking, and many protagonists blame the US sub-prime mortgage failure as the principle cause. Does this help? Only in that it shows that the crux of the crisis lies in wholesale banking markets. This is cold comfort to those in retail banking and associated services, for in practice there is mutual dependence. The real concern for all in banking must be where we go from here. Back to basics seems the likely direction but the journey will still be hard. A quick look back gives a better view forward.

SEPA – a catalyst for change

In the heat of the current crisis, it is all too easy to forget that banking was poised for change long before the crisis began. The arrival of SEPA was bound to change the composition of European banking. Indeed, the spirit of the SEPA agenda was—and is—to introduce new, cheaper payment services through competition and innovation. Outmoded or protected payment practices would be swept away by a gale of creative innovation that prevailed in bank customers' favour. But, with many banks now in partial state ownership, has the competitive ardour cooled?

The SEPA agenda knows no sentiment, after all it is given regulatory enforcement in the PSD. So, crisis or no crisis, banks must offer SEPA-compliant products and services on time and to specification. But banks face the daunting prospect of SEPA compliance with greatly reduced budgets, new shareholders and little indication of the commercial upside. Is there a choice?

In our recent experience, banks are focusing on non-strategic investment in efficiency and automation. This is back to basics in practice. VocaLink is engaged in many discussions regarding the outsourcing of payments and related services, including processing, mandate management and ATM-managed services. The current market conditions appear to be changing what constitutes a core banking function. Why?

All change...

These uncertain times are redefining banking: over time, the service portfolios offered by banks will be determined, not by the SEPA agenda, but by market forces. Outsourcing and partnership offer a 'soft' route to market with minimal investment and hassle. Banks also achieve instant and ongoing legislative compliance and incur costs in line with revenues. This mitigates commercial and operational risk, which also pleases shareholders.

SEPA – the search for first principles

Few would doubt that the SEPA agenda is progressing slower than many had hoped, but more positively than some had feared. This partly reflects the recession and an associated decline in overall transaction levels. We estimate the monthly growth rate of the SEPA Credit Transfer is around 0.8%. It is too early to say when this rate will accelerate or whether it vindicates the gloomy predictions of the Boston Consulting Group report, *Weathering the Storm*. Our view is more optimistic: SEPA will happen but the migration from legacy products will take place more slowly than predicted. However, legislation mandating a SEPA end date would speed up progress.

The European Commission, the European Central Bank and the European Payments Council have called for a clearly defined SEPA migration end date to be agreed this year. An end date would accelerate migration to SEPA payment instruments and remove the need for banks to support fragmented payment systems over the long term. Most banks will benefit from a standardised payments landscape though this is unlikely to be complete before 2014. On the bright side, the Euro Banking Association reports that 97% of all banks in 31 SEPA countries are now SEPA ready. This represents 99% of European payment volumes and more than 4,000 banks are participating in the SEPA credit transfer scheme.

The case for accelerating SEPA

The economic slowdown has dampened the progress of SEPA. For many in banking, SEPA remains a complex initiative; a necessary evil that increases the short-term cost of doing business in Europe. Couple this with the need to comply with the Payment Services Directive and it is understandable that bank appetite for SEPA implementation is low. Nevertheless, it is important not to lose sight of the economic benefits of SEPA.

Longer-term, the harmonisation of payments reduces the cost of doing business throughout Europe. Studies have shown that payment efficiency can be an engine of economic growth. Fast, efficient payments increase the velocity of circulation of money, which leads to an overall increase in GDP. The current structure of national automated clearing houses was designed to service national payment instruments most of which moved around domestic economies. The European ACH structure reflects this too: the model is complex, overburdened with national legislation, legacy systems and antiquated operating structures. All of these factors inhibit the growth of international business, so the case for SEPA is strongly commercial.

We believe that the current economic conditions make the case for SEPA even stronger. Just as retail businesses cut prices to stimulate demand, a cheaper payments infrastructure will do likewise. SEPA provides the right impetus to drive cheaper payment services. But banks are wary of change and mindful of costs. For the moment, most banks remain focused on surviving the storm. But, survival also means getting close to customers to meet their evolving needs. Banks that are bold enough to invest in SEPA products will create competitive advantage when the upturn begins. An end-date for migration is imperative.

BAWAG P.S.K. banks on SEPA

Austria's BAWAG P.S.K believes early deployment of SEPA Direct Debits will give it a competitive edge. Annette Gleisner, Senior Payments Manager at BAWAG P.S.K., talks to Heather McKenzie. During an economic crisis, banks should look to increase efficiency, return to core services and reduce risks, says Annette Gleisner, senior manager payments at BAWAG P.S.K., one of Austria's leading banks. BAWAG P.S.K. is doing just this, identifying payments as a core activity and embracing the Single Euro Payments Area (SEPA) through its involvement in a SEPA Direct Debit (SDD) pilot with VocaLink.



BAWAG P.S.K. is the largest retail bank in Austria, with 1.2 million private customers and more than 60,000 business customers. The bank also services payments to and from the public sector. While the Austrian Government has mandated that all public authorities in Austria must be SEPA compliant, in general SEPA Credit Transfer volumes remain very low, says Ms Gleisner. "The government is trying to set a good example by using SEPA applications, but at the moment there is no reason for Austrian banks to switch to XML payment formats." The only reason this would change, she adds, is if wider regulations are imposed or if an end-date for domestic payments instruments is set.

A possible end-date of 2011-2012 would increase SEPA payments volumes, but as yet there is little agreement in the Austrian, and wider European payments industry about the end date. In the meantime, BAWAG P.S.K is pressing ahead with its SDD project, which it considers to be of competitive advantage.

A SDD business-to-business pilot, which was successfully completed earlier this year, was conducted with two of BAWAG P.S.K's corporate clients, and was part of a wider VocaLink project that involved ABN, The Royal Bank of Scotland Group plc and some of their corporate clients. BAWAG P.S.K is planning a further pilot this summer, and is hoping to bring on board more corporate clients.

The SDD pilot enabled BAWAG and its corporate clients to test a broad range of SDD services in advance of the scheme launch on 1 November this year. The pilot has enabled the bank and its corporate customers to test workflows and ensure that services can be delivered once SDDs are launched. "We are very confident we will be ready for the launch of SDDs in November and will be able to offer our corporate customers new, Europe-wide services," says Ms Gleisner. "Austria is a small market and I don't think corporates here should wait until 2011-2012 before they take advantage of the single European market. Using SDDs from their launch, corporates will be able to expand their businesses across Europe more easily."

At present, awareness and understanding of SEPA among Austrian corporates is not high, says Ms Gleisner. However, she believes the SDD pilot will help raise awareness and provide a good entry point for discussions with corporate customers about the advantages of SEPA Credit Transfers and Direct Debits.

Further down the line, there are other value added SEPA-related services that will prove valuable for both banks and corporates. These include payments capture, validation, mandate management, exceptions management, debtor and creditor services and Faster Payment type services. BAWAG P.S.K. believes involvement in the SDD pilot will demonstrate to its corporate customers that the bank is ahead of the market in delivering the SEPA vision through SDDs.

“Banks have to offer services that their business customers and consumers want,” says Ms Gleisner. “Value added services like mandate management will enable corporates to convert to SEPA instruments without increasing their expenditure.”

The mandate management service centralises critical mandate information on behalf of the bank and its clients, dematerialising paper mandates and minimising BAWAG P.S.K.’s infrastructure and development costs.

“Because we see payments as a core business, involvement in SEPA is very important to us. The launch of SDDs will bring about a major change in the market and will enable us to deliver new products to our clients. I think this will give BAWAG P.S.K. a significant competitive advantage over other Austrian banks,” says Ms Gleisner.

If you would like to discuss taking part in VocaLink’s next SEPA DD pilot, contact us now by emailing us at info@vocalink.com or calling us on +44 (0)1582 813 204.

SEPA – one year on

Transaction Matters talks to Steffen Kowalski, Member of the Divisional Board, Transaction Banking, and Head of Transaction Services at WestLB. WestLB is a major international bank, employing 5,700 people in 35 locations worldwide. It operates in wholesale and retail markets and is committed to offering its customers quality SEPA services throughout Europe. As part of its SEPA strategy, WestLB is a reach partner and client of the VocaLink Euro CSM. Steffen recounts his experience of SEPA, one year on.



TM. What has been the response to SEPA from your perspective? **SK.** WestLB was an early adopter of SEPA services. Volumes of traffic have fallen short of expectations, partly due to the economic slowdown, but they are beginning to grow. At present we process around 40,000 transactions per month and, since December 2008, payments can be processed in both directions. WestLB has reach to almost all banks in Europe.

Most payments are from private individuals, but the arrival of the SEPA Direct Debit (SDD) will accelerate volumes. Germany is the largest user of direct debits in Europe and automatic mandate migration will be a major driver of the SDD.

TM. Are you surprised by the slow uptake of SEPA?

SK. No. We never believed that SEPA was going to be a big bang. To be successful, SEPA instruments must be of equal or greater value to the market than the existing instruments. We are all still learning and it was always going to take time to achieve harmony throughout such a large area. The introduction of the SEPA Credit Transfer(SCT) was the first stepping stone and

a massive achievement. There are only a few complexities to resolve at a technical level – the real challenge now is to encourage mass migration to the new instruments. Mass adoption will give SEPA the commercial impetus to succeed.

TM. What is the feedback from your customers regarding SEPA?

SK. The general view from customers is that the potential is untapped. There is still a need for clarity around various customer propositions. Standardisation will benefit all, but only if there is widespread agreement and adoption. Business has still to harness the real potential of SEPA, but it will happen. Initiatives such as e-invoicing and centralised treasury management will help business make savings and improve efficiency. But success requires collaboration between all parties and across geographic areas.

TM. What is the business case for SEPA from WestLB's perspective?

SK. There are many. The most obvious is probably our ability to reduce the number of market connections and the associated costs. SEPA is the largest free-trade area in the world. The proliferation of the web and e-commerce means that consumers no longer think along the lines of geographic markets. The persistence of domestic payment systems was the last barrier to true free trade throughout Europe. SEPA is ultimately about customer empowerment. As a bank we exist only to serve customer needs and SEPA gives us the opportunity to grow the business – our pool of prospects is immediately enlarged. When we emerge from the downturn, WestLB will be in good shape to expand even further.

TM. What are the immediate opportunities for WestLB?

SK. We can reduce our dependency on non-domestic payment platforms. WestLB has adopted an open approach to SEPA - we have formed several alliances to ensure we offer customers excellent service throughout SEPA and beyond. Our partnership with Vocalink has allowed us to overhaul operating costs while mitigating risk. WestLB must gain a competitive advantage by offering quality products and not through technical projects such as payments. In this way we can fulfill our SEPA obligations and deliver on everything that is promised by the WestLB brand.

TM. What is the role of market infrastructures?

SK. To date, infrastructures have been of greatest value where they provide robust clearing and settlement facilities. Going forward, given current market conditions and the cost pressures within the industry, all banks realise that they need to reconsider and evaluate the cost of delivering and running their own payment infrastructures. We believe that market infrastructures can share that burden and the risk.

TM. What convinced you to work with Vocalink?

SK. WestLB was already a customer and sponsor of EBA Clearing, which offers a singular channel for pan-European clearing. But we must leverage all potential relationships to manage our costs and provide excellent customer services and we try to channel as much as possible incoming payments via WestLB as a hub for the savings banks. Vocalink offers instant access to new avenues for European clearing. Additionally, in the future we will also benefit from value-added services from Vocalink. We are committed to harnessing as many relationships as necessary to support the emerging needs of our customers throughout Europe and beyond.

TM. Thank you.

Threats and opportunities for the ATM industry

Warren Buffet famously remarked, “Be fearful when others are greedy and be greedy when others are fearful.” These troubled times have certainly created great fear and uncertainty and this manifests itself in both spending and savings patterns. Despite interest rates being at a record low level, the savings ratio in the UK continues to increase as people opt to save an increasing percentage of their incomes.

In parallel with this shift from spending to saving, people are also changing the way they pay for goods and services. Many are switching to cash as a payment mechanism in preference to credit cards. It’s not hard to see why – cash offers real-time payment and balances can easily be checked at an ATM. Although this goes against the established trend of increased credit card usage, cash has always been king in times of increased uncertainty. Over recent months, ATM traffic has been high. This creates threats and opportunities for the ATM industry.

The spate of forced mergers and acquisitions within the banking industry has distorted the conventional rules. Mergers that would previously have been blocked by competition authorities have been encouraged. The takeover of Halifax/Bank of Scotland by Lloyds Banking Group would have been unthinkable until recently. But we are repeatedly told that we are living in exceptional times, and that this calls for exceptional measures. These measures may be expedient in the short term, but what about the long-term effects?

With the emergence of a few dominant, multinational banking organisations, there is less of a requirement for national and international card schemes. Card schemes could instead be run through a series of bilateral agreements between the few, large banks. This is intuitively unappealing as it goes against the grain of competition and consumer choice. But, as the rulebook is rewritten, it may also produce opportunities for service providers within the ATM service chain.

Banks that have historically chosen to retain ATM operations in-house may now be more open to outsourcing. This is sensible as it reintroduces competition to the ATM service chain and has the potential to reduce costs for banks and charges for their customers.

The ATM market has traditionally been fragmented, with oversupply in some areas and shortage in others. The new market dynamics and increasing demand for ATM services should bring real market forces into play. With fewer banks vying for brand promotion on ATM sites, a considered, commercial approach becomes both sensible and likely. Banks will explore new business models including outsourcing and strategic alliances to meet an overall increased demand for ATM services. This should produce significant opportunities for ATM processors, switches and banks alike.

VocaLink is a sponsor of the [European ATMs Conference](#) (11-12 May 2009) and will be exhibiting. Craig Broom, Cards Service Line Director of VocaLink is presenting on alternative models for ATM operations.



Putting cash to work

As external sources of liquidity become scarce, corporates are looking to improve their working capital management to free-up trapped cash. Banks are more than willing to help, writes Heather McKenzie*

In economic downturns, cash is definitely king for corporates. Traditional sources of liquidity and working capital, both on a short-term and long-term basis, are drying up. This creates significant liquidity risk in the supply chain as suppliers and distributors struggle to find sources of operational cash flow. Large corporates need to know the financial soundness of their key suppliers and distributors. The collapse of even a small components supplier could have dire repercussions for manufacturers, for example.



The squeeze on external sources of funding have led corporates to look at internal liquidity and how they can improve working capital management. Simon Bailey, director of payments at Logica, says corporates need to manage working capital “closer to the wire. If corporates actively manage working capital they can know what cash they need five or ten days out. If they have a good knowledge of their inflows and outflows, they can optimise returns in cash balances and draw down on debit balances, paying less and earning more interest.”

There are significant rewards for corporates that more closely manage their working capital. According to working capital surveys, there is €550 billion of trapped liquidity in the top 1000 companies in Europe alone. For the top 1000 US companies, this figure is more than \$750 billion. Freeing up this trapped liquidity will ensure greater stability of the supply chain.

Banks have started to see the area of supply chain finance and working capital management as an important differentiator during the downturn. Those financial institutions that can make their payments systems and related services such as electronic invoicing more efficient will gain considerable competitive advantage.

Electronic invoicing (e-invoicing) is considered a strategic initiative at The Royal Bank of Scotland Group plc. Ian Watkinson, their Head of Product Innovation, Global Transaction Services, says: “For our customers we see e-invoicing as a fast-track to saving time and money. In addition to eliminating paper and automating manual processes, users of the service will quickly benefit from real-time document management, faster settlements and better working capital optimisation.” In June last year, they entered into an e-invoicing agreement with Accountis, a developer of secure financial document exchange and payment systems and will offer a white labelled VAT-compliant e-invoicing service to their corporate customers.

E-invoicing holds promise for corporates because the earlier an invoice is delivered, the earlier a payment can be made. If corporates can combine e-invoicing with real-time, irrevocable payments they stand to gain huge advantages. Real-time payments enable all parties to a payment to understand the fate of each payment transaction immediately. The whole area of successful supply chain finance is reliant on getting information sooner, and ideally in real time. If corporates know when money is moving along the supply chain and why, and exactly when a payment has been made, they will be better able to plan and optimise their use of liquidity. That greater control will free them from reliance on the traditional sources of liquidity

that have dried up and will help them to identify potential problems in their supply chains. The corporates that can use information effectively are likely to have far fewer problems during the downturn than those corporates that do not.

The manufacturing industry has long adhered to the concept of 'just in time' manufacturing, where equipment, resources and labour are available only in the amount required and at the time required to do the job. As the economic downturn continues, and the technology exists to track payments inflows and outflows, the concept of just in time liquidity is gaining ground.

*Heather McKenzie, editor of International Payments is a well respected journalist in the financial industry with an excellent knowledge of the payments market.