

## THE HIDDEN PROCESSING SAVINGS SEPA MAY DELIVER

Over the past three years the costs of SEPA implementation have been variously estimated by consultants and research organisations at between EUR 8 to 13 billion. Without a clear business case SEPA is perceived by many banks as a mandated change which delivers little to the bottom line. The good news is that cumulative savings will be more than EUR 11 billion over the next ten years.

Payments professionals know that common standards, and a focus on efficiency improvement generally results in good savings. For example, back office costs for many payments instruments have fallen significantly over the past ten years (by up to 40% in some cases) as a result of improved technology and new processes.

Perhaps the full impact of SEPA is only now being realised. Consolidation and M&A has accelerated significantly and competition increased. Another positive message is market feedback. Interviews with banks and processors indicate that between 40% and 60% plan to use SEPA as a reason to replatform and replace legacy ageing systems with the latest technology. Those interviewed recognised that back office costs must radically fall. The key driver is pressure from the payments business to improve efficiency as their revenues decline.

### A HOLISTIC STUDY

In mid-2007 PSE Consulting were asked to conduct a research study analysing the likely productivity savings that SEPA may have on the EU's back office costs. The study was to be holistic in its design with a broad vision of SEPA geographic impact and scope. This objective was to model «the total SEPA effect».

### STUDY SCOPE AND METHODOLOGY

- Ten year forecast model (2007 to 2016) of 27 EU countries + Norway + Switzerland.
- Key efficiency change drivers used to assess back office savings were – M&A impact, standardisation and new systems, increased competition/innovation.
- Volume data covered credit transfers, direct debits, credit and debit cards, ATM, cheques, e-commerce, international payments and authorisation clearing and settlement (ACS).
- Banks assessed – large banks and collective groupings, medium and small banks.
- Processors reviewed – commercial, interbank, ACH, CSM's, ICS networks.
- Benefits calculated over and above improved efficiencies from the normal growth.
- Excluded cost of SEPA implementation, new systems and the cost of M&A.
- Uses analytical estimates/market knowledge (drawn from over 100 SEPA interviews with banks and processors during 2006 and 2007), plus European Payments Consulting Association member input.
- Separately reviewed internal to bank and external outsourced processing activities.
- Excludes efficiency savings by corporates and merchants.

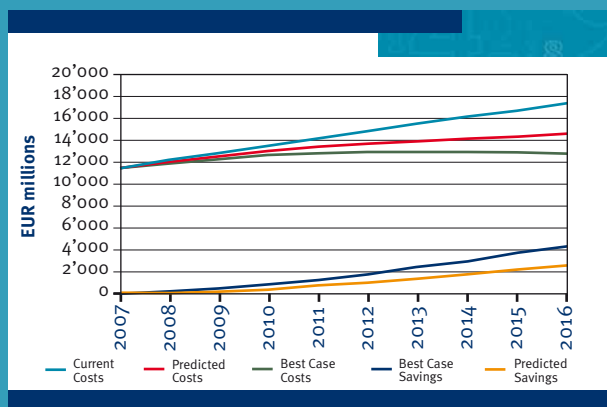
### TOTAL SAVINGS

The model estimates the current back office operational costs of processing EU payments at EUR 11 billion in 2007 and forecasts EUR 17 billion (at current prices) in 2016. These costs split approximately 60% internal to banks and 40% to commercial and interbank processors. Average current transaction costs are EUR 0.12 for the eight payment instruments modelled. Of these cards (debit, credit, ATM, e-commerce) represent 44%, electronic (credit transfers, direct debits, international payments) 49% and cheques 7%. »

# HIGHLIGHTS

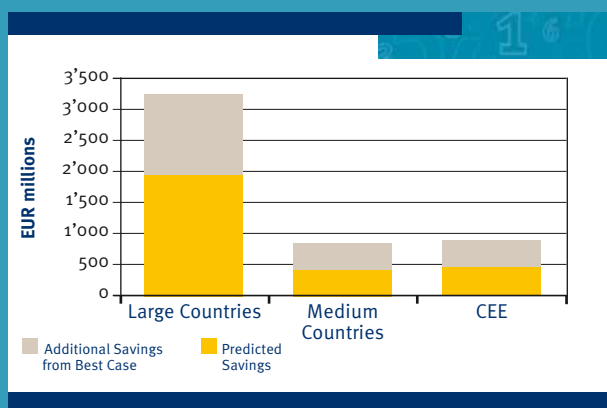
The study shows that over the ten years from 2007 through to 2016 the potential cumulative savings as a result of the SEPA effect could be EUR 10.7 billion (or more). Year-on-year savings are estimated at between EUR 2.7 billion and EUR 4.5 billion over current costs. As a result average transaction costs for the eight payment instruments are predicted to fall to between EUR 0.08 (best case) and EUR 0.10 (predicted case) over and above normal productivity savings.

## CUMULATIVE SAVINGS OVER TEN YEARS – 2007 TO 2016



The greatest «SEPA Effect» savings is predicted to be within the largest five countries (70%) Germany, UK, France, Italy and Spain, partly reflecting their market share, but also their ability to achieve significant economies of scale. Medium sized countries like Switzerland are generally more efficient but lack volume to achieve major economies of scale. M&A and increased competition mean these countries win 15% of the total savings.

## ANNUAL SAVINGS BY COUNTRY 2016 AND BEYOND

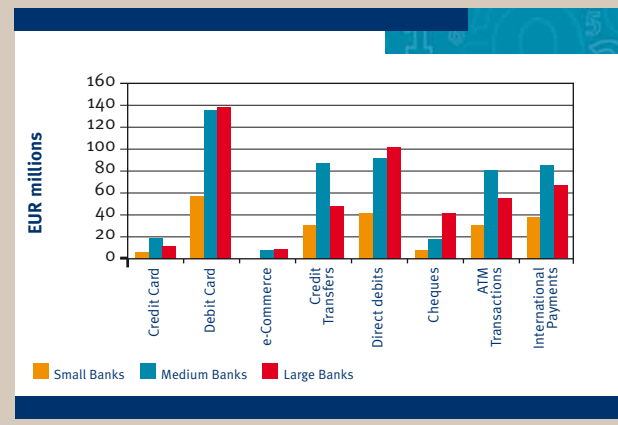


## SAVINGS POTENTIAL FOR PAYMENT INSTRUMENTS AND BANKS

The vast majority will be derived from improvements in processing of direct debits, debit cards and credit transfers. This is true in almost all the markets surveyed, partly because they are the dominant methods of payment but also because these will benefit most from bank consolidation and the creation of very large scale integrated ACH and card commercial/interbank processing companies.

In addition, the underlying processing platforms (particularly at banks) are often old and replacement platforms are expected to have a very significant impact on efficiency. Large banks are predicted to generate annual cost savings of between EUR 500m to EUR 800m after 2016. However, significant gains are made by medium sized banks, where between EUR 525m to EUR 900m in cost efficiencies are generated.

## PREDICTED ANNUAL SAVINGS BY SIZE OF BANK AND PAYMENT INSTRUMENT – 2016 AND BEYOND



## CONCLUSIONS

When the full consequences of «the SEPA effect» are calculated costs are predicted to gradually decline over the next ten years and show cumulative savings of EUR 11 billion (and more), sufficient to pay back some or all of the costs of implementing SEPA. M&A by both banks and processors is expected to generate 35% of the efficiency savings, with harmonisation, standards, new platforms and increased competition contributing 65%. The highest proportion of back office savings result from improved processing of direct debits, credit transfers and debit cards. Finally, the total 2016 annual savings (banks + processors) could be between EUR 2.7 billion and EUR 4.5 billion, representing 0.03% of the 29 European countries' GDP. ■

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