

Whitepaper

PSD and SEPA -  
Supportive or divergent?



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## Executive Summary

### Payments Services Directive dynamics to date

In March and April 2008, Logica and the IBOS Association - the international cash management banking alliance - collaborated to research the progress made by banks on the implementation of the Payments Services Directive (PSD). Twenty bank entities over eighteen countries across the EU and EEA participated in the survey.

In conjunction with Logica's work within the payments business at clients across Europe, this detailed study has provided some thought provoking conclusions for the payments industry.

Whilst the focus of the survey was the PSD and the banks' projects to support implementation by November 2009, we can also draw conclusions about the impact on the implementation of SEPA and on the likely consequences for the payments industry.

The PSD is the legal basis for the SEPA. Although the SEPA Credit Transfer scheme was launched in January, the Direct Debit scheme required harmonisation of legal frameworks. The survey showed, however, that the process for **transposition**, with opportunities for derogation from certain articles of the PSD, introduces a real risk of national divergence, rather than the convergence that is implicit in the SEPA vision. The proximity of the national derogation decisions to the PSD deadline of November 2009, and the national lobby groups' natural affinity for local customs and practices, creates a high risk that PSD implementation will not be uniform. Diversity between national domains undermines the business case for corporates and consumers to migrate to the new SEPA Schemes. If they cannot deliver a uniform customer experience, then what added value do they provide? An inconsistent service with national diversity poses **a direct threat to the full SEPA vision.**

A collaborative approach between legislators and lobby groups is required to resolve inconsistencies arising from transposition, to ensure fitness for national migration, and to communicate clearly and rapidly, in order to reduce implementation risk and cost. The balance of country and pan European drivers needs to be managed, carefully. Work underway within the European Commission and pan European banking communities is aimed to mitigate this risk. However, the current level of detail available to bank project teams appears insufficient to support effective budget and implementation planning. The key missing element for the success of SEPA migration seems to be the choice and imposition of **clear, published and coordinated end dates** for national schemes. This is already under discussion at European level. Early conclusions and clear plans from this process would enable banks and their clients to undertake effective business and implementation planning.



The results of the survey raise issues as to how PSD transposition can support the achievement of SEPA implementation and migration without consistency. Inevitably this puts additional emphasis on the significance of the Payment Services Directive Transposition Group led by the European Commission.





Possible PSD disparities across countries could risk reinforcing national payments markets. A combination of variations in PSD implementation and national community-defined Additional Optional Services (AOS) for SEPA could ultimately undermine the development of a single payments market – the opposite of the original SEPA vision.



In the area of **individual bank strategy and options**, each bank has a unique set of strategy and implementation options to consider. Variations in country legislation and in their timing, added to existing issues of payments business strategy choice, profitability focus, and access to investment budgets, have made matters more complex. The survey shows an appreciation amongst respondents of the width and scale of the impact of PSD on bank services, applications and existing projects. The high number of banks with special cross-departmental project leadership for PSD, and the acknowledgement of the numbers of product/channel/country variants to be analysed and made compliant, show a pragmatic realisation of the challenge. But the survey responses on key project milestones and dependencies show a serious risk, with availability of detailed requirements lagging behind investment and development deadlines. There is a risk that some banks will find they are unable to implement the changes demanded by PSD before the November 2009 deadline. Uncertainty over interpretation of national transposition of the PSD, combined with lack of effective communication to the consumer, may encourage brinkmanship in banks that have competing priorities for investment and implementation resources.

The conclusion that Logica draws from the findings of the survey and from our current experience with banks in the payments industry, is that economic and compliance drivers continue to encourage banks towards consolidation of their payments operations. The debate on consolidation has dominated the industry agenda for several years and, in Europe, consolidation appears increasingly likely to be the result of current industry changes. The complex impact of the PSD on multi country, and multi product, banking groups, is likely to result in **acceleration of the process of consolidation and industrialisation** of the back office.

As banks face these changes, those with an agreed strategic view of the role of payments within their business may be able to exploit specific changes in the market for commercial gain. But the pressure points are already clear. In addition to the straightforward commoditisation of payments processing, changes are imminent in the:

- Requirements for payments processing businesses to provide transparent pricing and clear business SLAs both to clients and service users within the bank
- Changes to clearing and settlement options and models enabling new choices for banks with the necessary infrastructure flexibility
- Emerging competitive and supply models for payments processing services both from within and outside the banking industry.

In conclusion, banks and their clients face a period of continued uncertainty around the clarity and details surrounding implementation of legislative change across the European payments business. With wider strategic options available in the current climate than in previous times, forward thinking banks have the ability to exploit industry and market change for long term commercial gain.

In the context of today's current pressures on the banking industry, payments remain a potentially profitable, fee earning service that attracts cash balances. Furthermore, where efficiency and flexibility is built into compliance programmes, changes can generate improved returns for banks that are able to model the impact on their business, operations and technology. Logica's established understanding of these issues, and ability to deliver change programmes, can enable our clients to define and deliver effective strategies in the delivery of operational change across multiple countries in Europe.

#### **Logica's PSD survey**

The survey covered eighteen PSD jurisdictions (Portugal, Belgium, France, Hungary, the Netherlands, Italy, Slovenia, Denmark, Estonia, Finland, Latvia, Lithuania, Norway, Sweden, UK, Spain, Austria, and Germany) providing an insight into the current developments and emerging trends on managing the process on pan-European and national levels. Twenty two surveys were issued to IBOS member-banks; 20 surveys were completed.

Eight major banking groups participated in the survey and included many responses from subsidiaries operating in different national jurisdictions. It is worth noting, therefore, that some opinions presented in this research may reflect a mixture of the local national position on PSD, with a banking group approach towards implementation and governance.

The survey was sponsored by the IBOS Board; Logica conducted the survey by distribution and collection of electronic questionnaires from the member-banks. The findings and conclusions in this document are supported by the statistics from the survey.

### **Detailed Report on Findings**

#### **PSD transposition timeline - variances between jurisdictions**

The timing and effect of national transposition is not clear across the EU. Though some countries have published dates, the detailed clarity and the dates for many are not yet in place. This frustrates the establishment of pan-European terms and conditions for payments. Additionally it hinders both SEPA migration and the consolidation of payment operations for banks and corporates. National variations of PSD could put SEPA into reverse.

#### **Findings**

In the majority of communities such as Spain, the regulators have still to create and identify their transposition schedule and law making activities. Predictably, 67% of respondents answered that they know only approximately the time/date when PSD goes into the local statute books; in the majority of cases the date was given in the responses as 1 November 2009, i.e. the actual date when PSD comes into force internationally.

Banks from the UK, Germany and Hungary stated that the PSD will become a law in their jurisdictions by the end of Q4 2008. Banks in Slovenia and Sweden will have PSD in the local law at the end of Q2 2009. Here are the transposition schedules for the UK and Germany:

Planned PSD Transposition Schedule	
<b>UK</b>	<p>July 2006 - HM Treasury 1st consultation document and an initial Regulatory Impact Assessment (RIA)</p> <p>March 2008 - HM Treasury 2nd consultation</p> <p>Draft UK implementation legislation will be published by summer 2008</p> <p>Final legislation will be laid before Parliament by end-2008</p>
<b>Germany</b>	<p>May 2008: First draft for German law</p> <p>July 2008: Draft by government to Bundesrat</p> <p>Sept 2008: First reading by Bundestag,</p> <p>Dec 2008: Bundestag: 2./3. Reading; Bundesrat: Approval</p> <p>Nov 2009: Legal force</p>
Note: the timelines were derived from various sources in public domain and survey responses	



The discrepancies in the timings and details of legislation across European countries threaten consistent transposition of PSD by November 2009. Each country can choose between a “Mini-PSD” (including all opt-outs) and a “Maxi-PSD” (with no opt-outs). There is a danger that this creates national variations in payments services and does not support pan-European consistency.



The opt-outs offered by the PSD to countries and the ability to exceed minimum service levels means there are opportunities to adapt the PSD to national requirements during transposition. Decisions on which will apply in which countries have not yet been made. With the lack of clarity on dates for transposition, this makes detailed planning very difficult and again threatens the interoperability of European payments: will banks and their clients be able to exploit a Single Market across the EU? In essence, a “mini-PSD” – where countries utilise all the opt-outs - would make implementation of a “maxi-SEPA” extremely difficult!

#### Conclusions

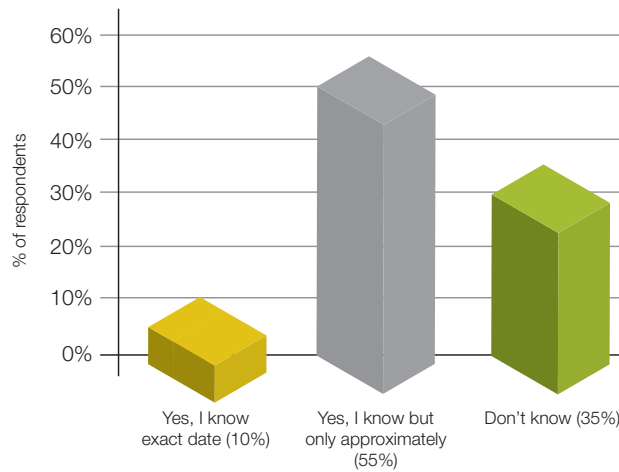
Banks have defined plans to implement PSD provisions, however in the majority of jurisdictions there is a lack of defined timelines and plans for the transposition of the PSD into the national legislation. Banks may progress with their change programmes using the EU version of PSD, but for the full implementation, especially on the level of legal and commercial compliance, banks will need explicit decisions from their lawmaking authorities, on the derogations from PSD provisions on both levels:

- (a) National community level, that applies to the whole financial industry of the jurisdiction
- (b) On the level of service and contractual obligations between the payment service provider (bank) and payment service user (customer).

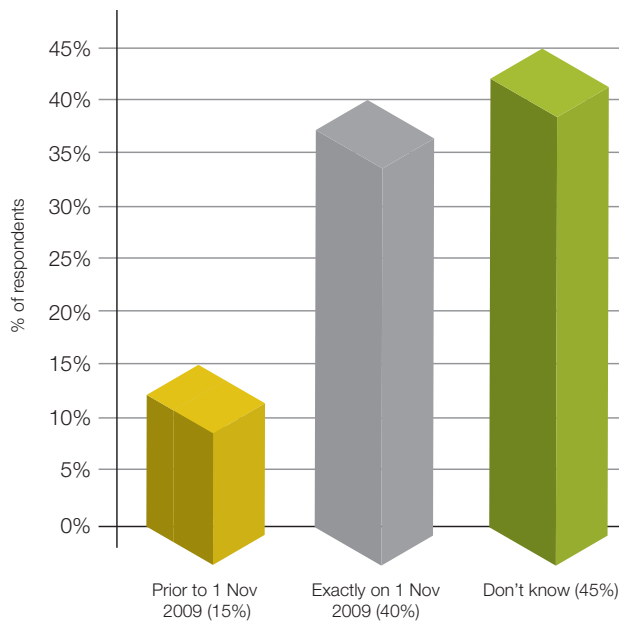
Consequently, this delay on the legislative level impacts the overall implementation in individual jurisdictions, and consistent and timely implementation on the EU level will be impaired.

Banks need to carry out a requirements definition and impact analysis to commence with their PSD programmes. If the legislation schedule is delayed or shifted too far into 2009, the ability of multinational banks to have smooth and timely implementation (and testing) of the PSD programme is compromised.

When will PSD go into the local statute book of your jurisdiction(s)?



What is the effective date of the PSD provisions in your jurisdiction?



**Focus on a community – PSD activities in national communities**

The research shows that in all jurisdictions, the ‘National Banking Association’ and the ‘Central Bank’ are the major organisations driving the consultation and lawmaking activities around the transposition of the PSD into local legislation.

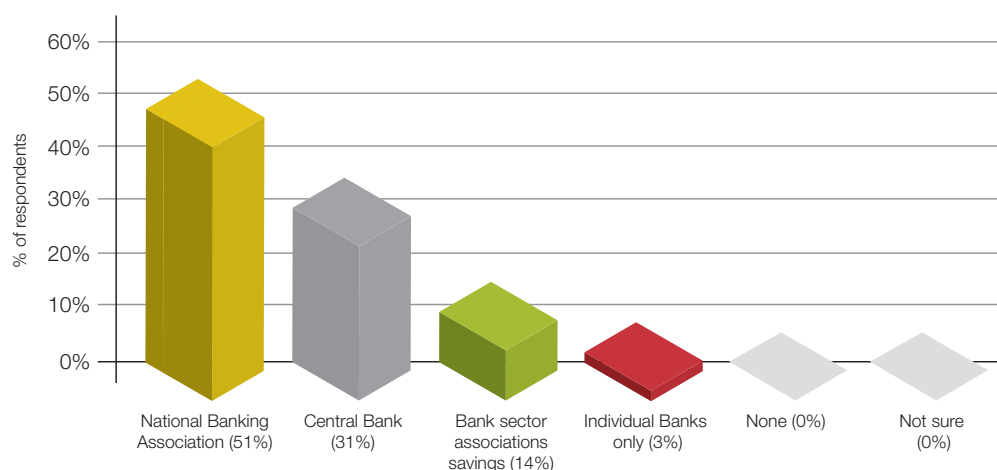
Whilst the banks are clear who owns the banks’ representations to national governments in each country: either the National Banking Association or the central bank, it is not clear how consistency of the final version of the laws enacting PSD can be achieved across countries. This is especially when the implementation process has a national perspective, as in the

case of SEPA migration. Variations in PSD taken together with possible community-defined variations in the SEPA Schemes would entrench national differences – the opposite of SEPA.

The research indicates that banks are well informed, and are empowered to lobby the banking community interests and are close to the transposition process. The remaining question is whether the banks can facilitate or influence the speed of the transposition of the PSD into their local law?

The role and activities of the Payment Services Directive Transposition Group led by the European Commission are still gaining momentum and require greater emphasis on comprehensive communication.

**Which, if any, lobbying organisations exist in your jurisdiction for banks towards the legal process of PSD implementation?**



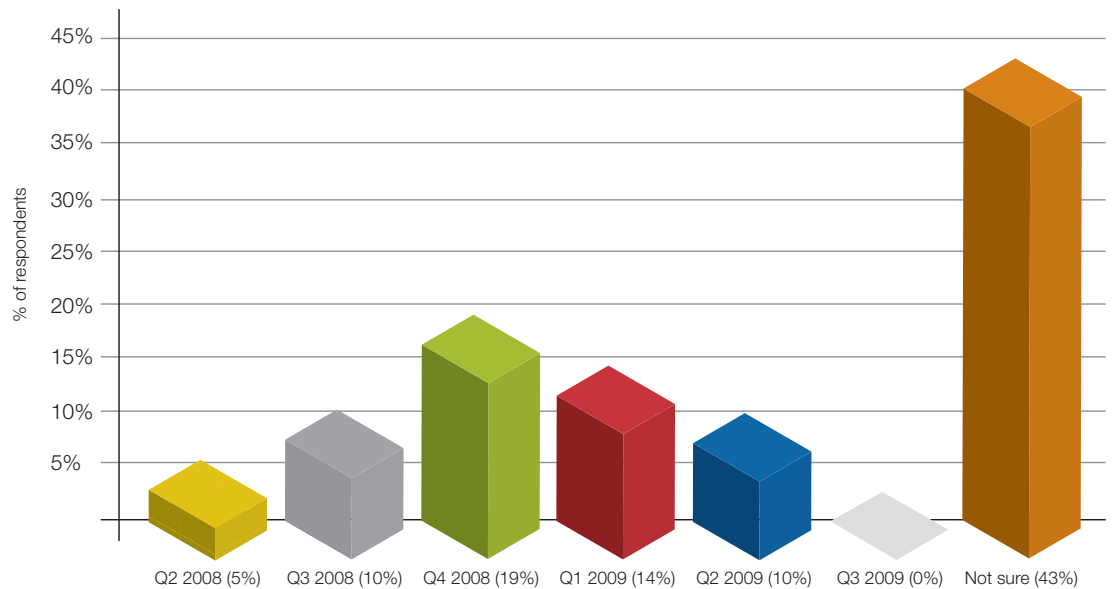
### Communities' approach and timing for derogations in PSD

The evidence from the market shows that the status of applying derogations in the national jurisdictions is still at the consultation stage. However these will be crystallised in the final law by the end of 2008 in several national communities including the UK, Finland, Germany and Hungary. The derogations will only take a clear form and direction in the final drafts of legislation which will be presented for the ratification of the appropriate parliaments.

We can already see a pattern emerging, where national law makers try to take advantage of an opt-out clause for the government controlled payment service providers to be exempt from the provisions of the PSD. Our opinion around the opt-out from the provisions of Title 2 is that such an approach is fully justifiable (with respect to capital requirements and financial obligations such institutions are 100% backed by the government/tax payer). However, if these government-controlled payment services providers are exempt from complying with the provisions of Titles 3 and 4, such a

decision may seriously impact payments activities of these jurisdictions, for example, in the compliance with D+1 execution time, full amount, charges and other provisions.

When do you expect to know with reasonable certainty which of the opt-outs (i.e. rights of derogation) will be taken up by your jurisdiction?



**Focus on a payment services provider**

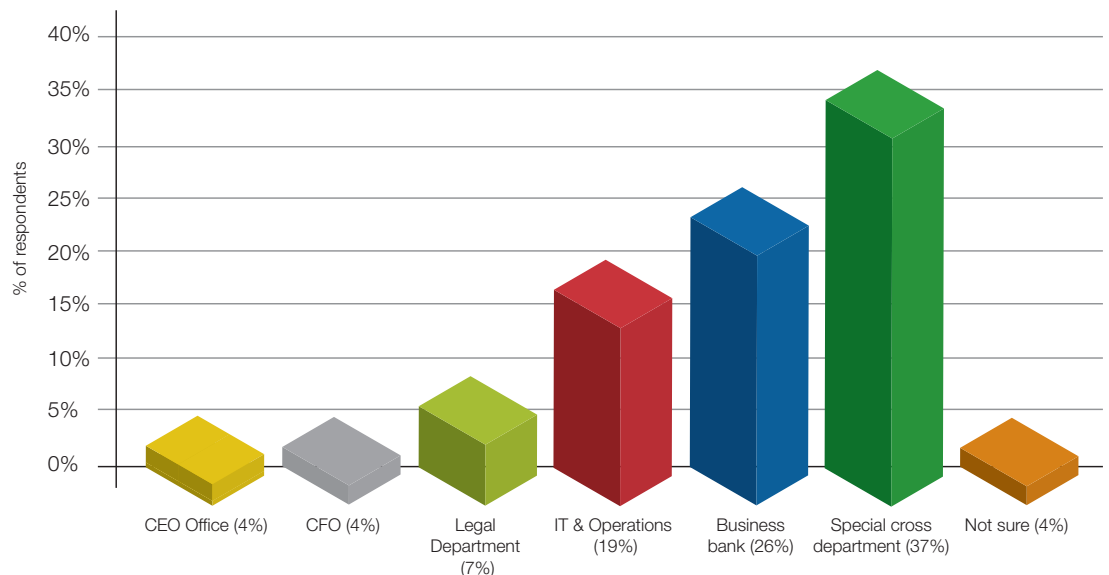
It is true that for every significant programme in the financial industry, executive ownership is one of the key considerations. PSD implementation is not an exception. Not only is it important for a payment services provider to decide which senior executive is leading the PSD programme, but also to carefully choose the team that will take the financial institution into the new regulatory reality and hopefully find a way to derive some benefits to offset the investment. From the governance point of view for PSD implementation, a cross departmental Programme Board is a 'must' to ensure representation of all stakeholders and avoidance of 'you didn't tell us' post-implementation finger-pointing.

There is a view in the market that the SEPA DD and CT business cases are complex despite the fact that only two EUR payment schemes are considered over a dozen or so delivery channels. In contrast, PSD covers all currencies of the eligible national communities, embraces all SEPA requirements, and has impact on **every** 'product-channel-country' cluster of a bank's payments business. The survey provides some insights and alerts to the fact that activities such as 'impact analysis' and 'requirements definition', needless to mention the 'allocation of budget', need immediate attention.

### Bank's division responsible for PSD

A significant result highlighted that nearly all respondents identified a division in their bank which has a responsibility for PSD activities, i.e. the number of 'not sure' responses was very low. The research established that 'IT & Operations' (19%) and 'Business Bank' (26%) were the dominant divisions in a bank which are responsible for PSD programme, but more importantly, that 'Special cross-departmental Programme Board' (37%) is the leading body for running the PSD activities in banks.

### Which part of your organisation is responsible for running the PSD programme?



Nearly all the surveyed banks reported the existence of PSD programmes and identified a primary department responsible for assessing the impact and for implementation.



### Bank's Senior Officer responsible for PSD

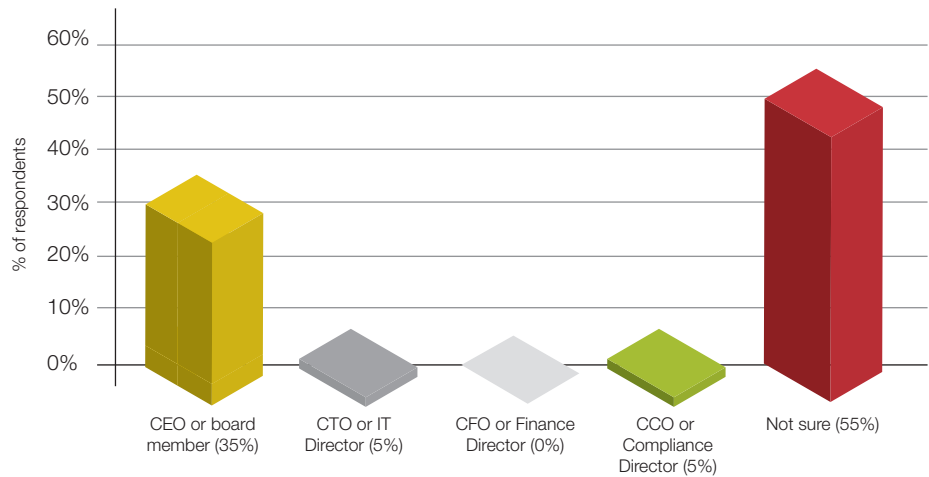
The results from the question above were compared to the answers of a senior officer responsible for the PSD programme, i.e. the management ownership of budgets and responsibility for the delivery and results. It revealed an even split between 'CEO or Board Member' (35%) and 'Not sure' (55%). 'CTO or IT Director' and 'CCO or Compliance Director' each scored 5%. None of the respondents identified 'CFO or Finance Director' as being responsible for the PSD programme.



PSD programmes seem to be in existence and of a certain level of maturity in banks. Significantly what is lacking is ownership for the budget and outcomes.



Which Senior Officer of your bank is ultimately responsible for the implementation of PSD compliance and/or related change programme?



**Conclusions**

PSD programmes seem to be in existence and of certain level of maturity in banks. What is lacking (44% ‘not sure’ responses) is significantly the ownership for the budget and outcomes. With 44% of the programmes being run by a ‘Cross-departmental Programme Board,’ lack of leadership and accountability for the outcomes may lead to the overall failure for PSD compliance. This will also impact consistent implementation across both national and EU communities.

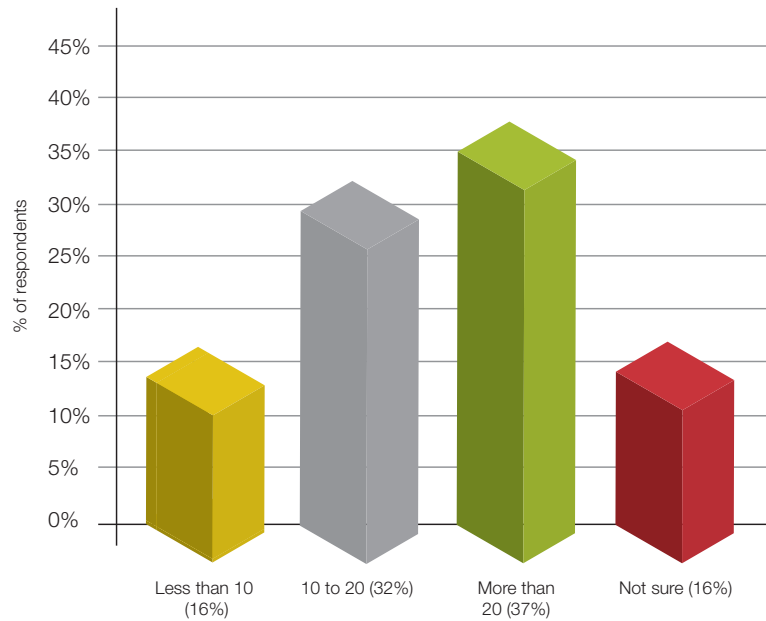
**Number of payment services and their number per customer initiation channel**

It is clear that the number of products offered by banks across each initiation channel is high. Compliance requirements will need to be assessed in those countries where banks operate. Banks may also find they are compelled to simplify and consolidate their channel/ product offerings, to reduce the compliance effort, cost and to improve the consistency of service.

**Payment services**

The majority of banks will have either ‘10 to 20’ or ‘more than 20’ payment services impacted by the PSD. Taking into account the fact that these services are rarely cross border, i.e. offered in more than one jurisdiction, the real approximate number of services at a multinational bank may be calculated as a multiple of all services impacted by the PSD for all countries of operation. So the real answer, may be ‘more than 60’ payment services impacted by the PSD.

**What is the number of ‘payment services’ supported by your bank that are impacted by PSD?**



More than half of the respondents run ‘five or more payments services per channel’. This presents banks with an n-factorial assessment and implementation challenge to apply national legislative requirements of each country to all existing and planned services.



**Payment services per initiation channel**

In the survey, Logica and IBOS looked at payment services per initiation channel, specifically from a PSD perspective, so we were not really thinking about bank ‘products’ which can number in the thousands. Instead, we considered basic payment services, overlaid with the underpinning clearing and settlement mechanisms.

The difficulty lies in that the banks bundle specific versions of such services with special terms and conditions, and each such bundle needs to be evaluated against the PSD. Such bundles originate in different countries and therefore inherit national law variants. Additionally, there is the potential for the service bundle to be delivered through more than one channel to customer.

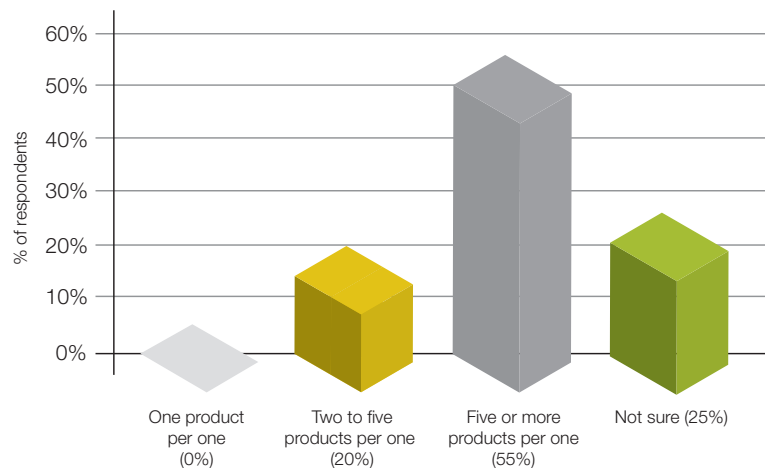
We identified that the majority of banks would run ‘five or more services per initiation channel’ (55%)’ and that ‘two to five services per initiation channel’ (20%) was the second choice from the participating banks. Interestingly, none of the respondents selected ‘one service per initiation channel’.



The depth of the impact within respondent banks was also made clear with over one third indicating that 'Special cross-departmental Programme Board' is responsible for the PSD programme. There is a risk if the programmes are not started in time and with appropriate lines of communication across the departments.



What is typical number of 'payment services' offered down a channel-to-customer at your bank?



The conclusion is that the proliferation rate and the number of clusters 'payment services per initiation channel' that are subject to PSD compliance can be calculated as 'service \* channel \* country'. In some of our simulated calculations, the number of 'service per channel' clusters can be up to 74 instances for Credit Transfer only.

#### Conclusions

Firstly, managing the product/service business has become very complicated because of the PSD, i.e. all individual and framework contracts for each 'service per channel' cluster must be reviewed and properly renewed with payment service users.

Secondly, implementation, management and proliferation of SEPA service/instruments will be impacted by the national versions of PSD (dictated by the choice of derogations and opt-outs).

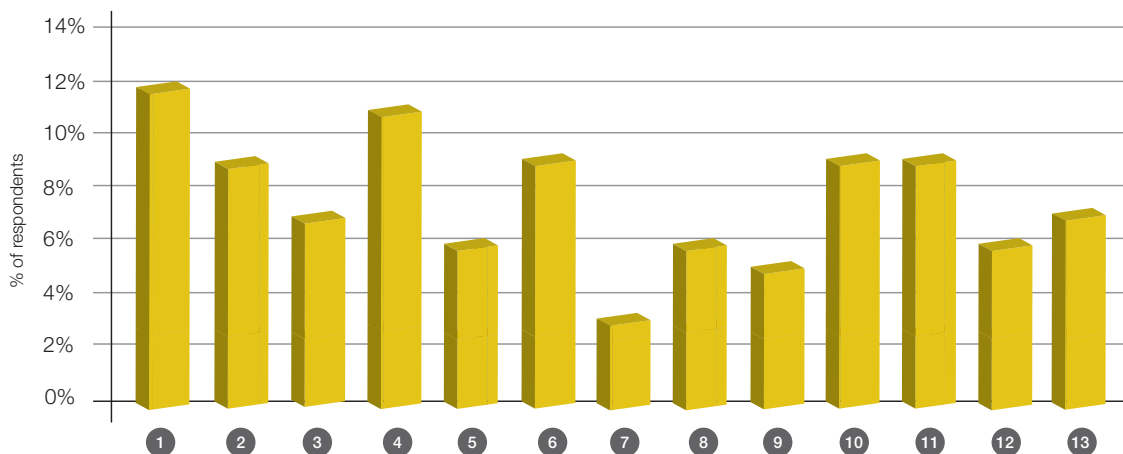
Finally, to minimise the cost of compliance and at least break even on the investment, banks need to find lean solutions for more efficient running of their products/services business and managing of the payments systems infrastructure.

#### Banks' plans to manage the PSD programme

#### Impact of PSD on Programme portfolios

The pressure of PSD compliance has already been applied to the programme portfolios in banks. All respondents reported the PSD impact on their 'SEPA project/programme' (almost 100% of respondents and 12% in the overall poll out of 13 choices). Pressure on SEPA related programme is followed by increased focus on 'Product/Service definition and development'. Banks report pressure on 'Compliance programmes', 'Payments Operations redesign', 'SEPA clearing and settlement' and 'Domestic clearing and settlement'.

## Which activities/projects/programmes in your bank are impacted by the PSD?



Almost 100% of respondents expect increasing impact on ‘SEPA project/programme’ and ‘Product/Service definition and development’ that augment the pressure on cross-departmental, IT and business programme offices.

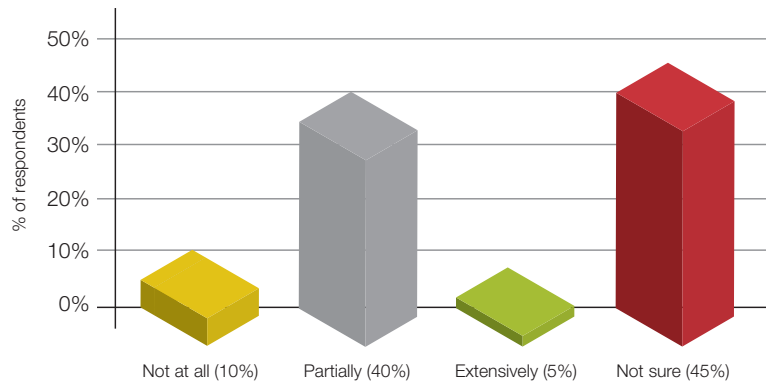


- 1 - SEPA project/programme (12%)
- 2 - Compliance activities/project (9%)
- 3 - Channel/instrument consolidation project/initiative (7%)
- 4 - Product/service definition and development (11%)
- 5 - Management of operational risk (6%)
- 6 - Payments operation redesign (9%)
- 7 - Supplier selection (3%)
- 8 - Payments services outsourcing (6%)
- 9 - Management of AML/KYC/Fraud/TCF\* activities (5%)
- 10 - SEPA clearing and settlement (9%)
- 11 - Domestic clearing and settlement (9%)
- 12 - Payments transportation (e.g. SWIFT) (6%)
- 13 - Reference data management/routing (7%)

#### Factoring of Operational Risk in PSD implementations

There is a certain lack of correlation between responses to which programmes are impacted by the PSD, e.g. almost all respondents identified the following projects as high on their agenda ‘Compliance activities / project’, ‘Management of operational’ and ‘Payments operations redesign’, and the question on Managing the Operational Risk. Only 45% identified the impact (40% ‘Partially’ and 5% ‘Extensively’). Ten percent think there is no operational risk factor in adopting the PSD. A worrying 45% are not sure – does this mean that provisioning and risk planning is overlooked?

To what extent would operational risk considerations drive your bank to use the PSD implementation in order to simplify current operational arrangements?

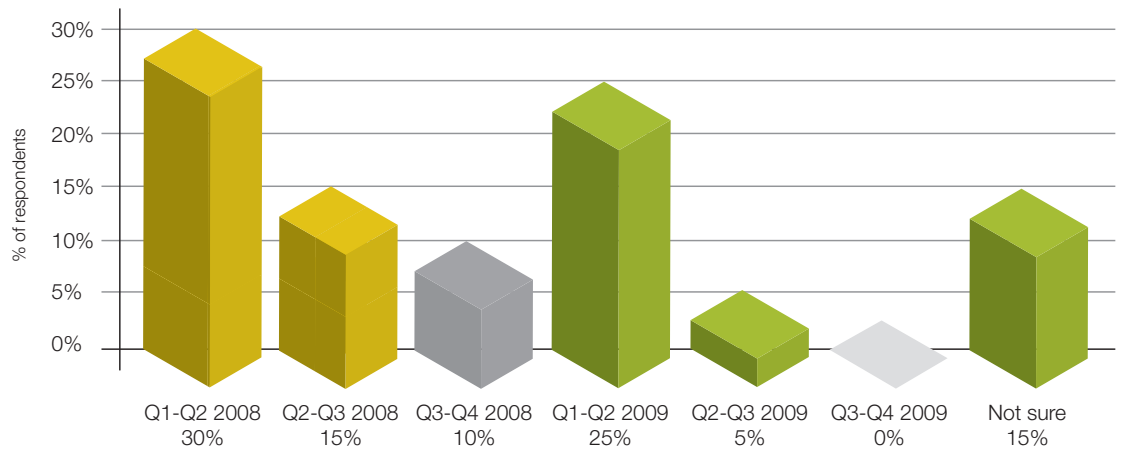


**Impact Analysis Phase of PSD Programme**

In the majority of banks the 'Impact analysis' has already started; in most cases it precedes or overlaps with the 'Requirements definition' phase of the PSD programme with the following distribution:

- 30% - Q1 – Q2 2008
- 15% - Q2 – Q3 2008
- 10% - Q3 – Q4 2008
- 25% - Q1 – Q2 2009
- 5% - Q2 –Q3 2009

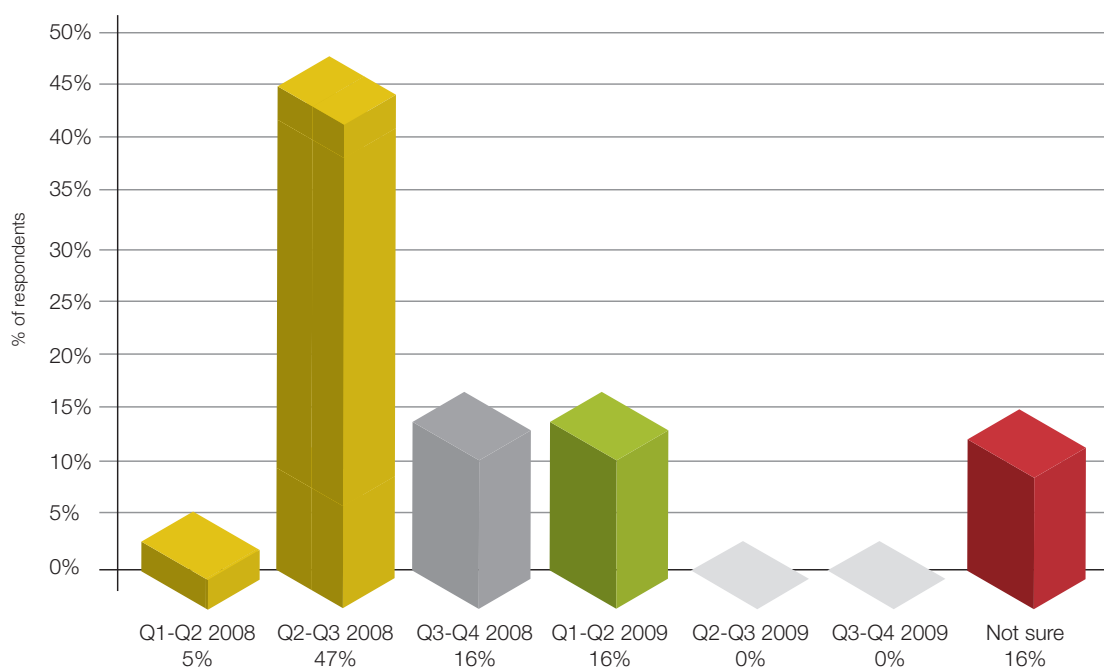
What is the planned date for 'perform impact analysis' phase of your PSD compliance programme?



### Requirements Definition Phase of PSD Programme

A large group of banks have already commenced 'Requirements definition' (5% in Q1-Q2 plus 47% in Q2-Q3). A smaller number of banks will only start 'Requirements definition' in Q3 – Q4 2008 and Q1 – Q2 2009. Such a late start to the PSD programme may be dictated by the delayed law-making activities and publication of derogations and opt-outs in certain national communities.

### What is the planned date for 'perform requirements definition' phase of your PSD compliance programme?



If Banks wish to gain benefits from the changes imposed by the PSD they simply cannot afford to wait until next year to begin implementation.



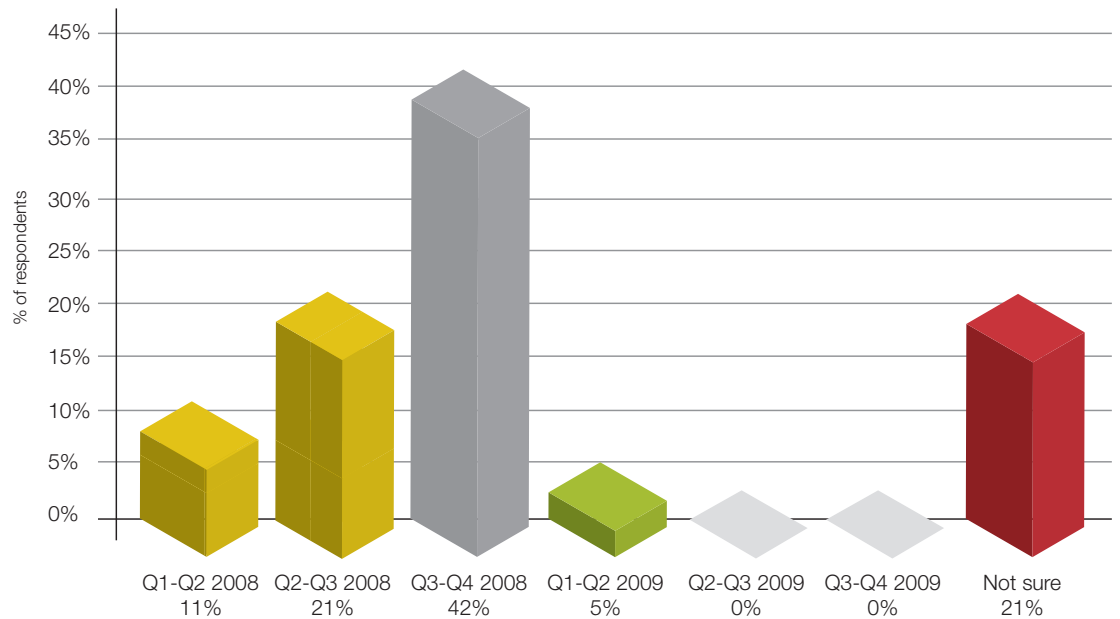
### Budget/Funding of PSD Programme

Not surprisingly, the timing for the allocation of 'Budget/Funding' has the following distribution:

- 11% - Q1 – Q2 2008
- 21% - Q2 – Q3 2008
- 42% - Q3 – Q4 2008
- 5% - Q1 – Q2 2009

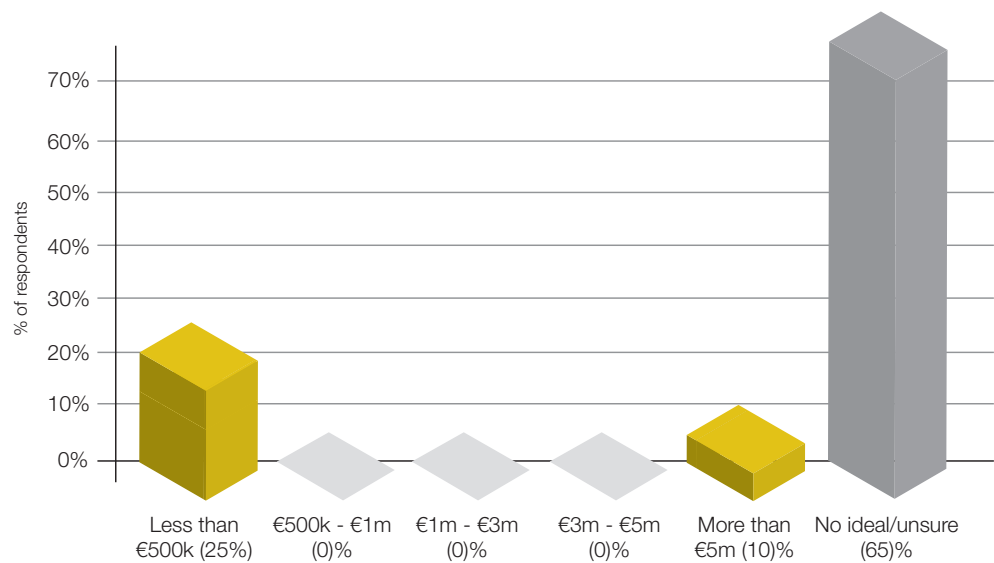
The effort, resource and money for PSD implementation is still not known but is likely to substantially affect other programmes. The short implementation timeframe, its scope and its mandatory legal nature require banks to prioritise PSD over new services; and to estimate its financial implications within the established budget process before the changes are clear. Banks may well choose to freeze all affected systems to non-PSD changes, and to bounce other developments until PSD-compliance has been achieved.

What is the planned date for the 'secure Budget/Funding' phase of your PSD compliance programme?



It is not clear whether banks are unsure or simply do not want to disclose the budget required for the implementation of the PSD programme. If 'unsure', then the danger of tripled and quadrupled budgets for the PSD / SDD / transformations programmes is very real.

Can you provide your best estimate of the cost/budget of PSD compliance at your bank?

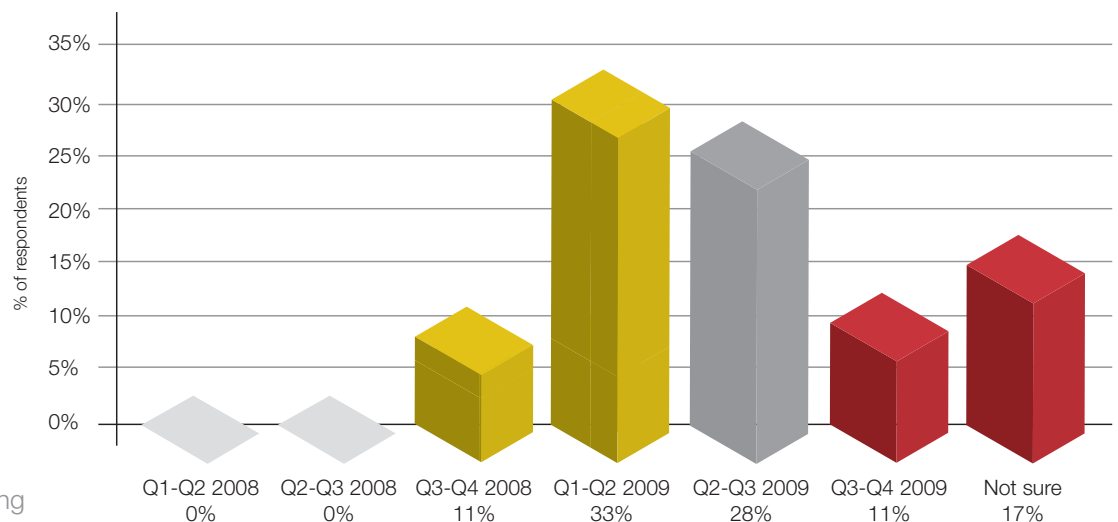


### Implementation Phase of PSD Programme

The 'Implementation' phase of the PSD programme has distribution of timelines as follows:

- 11% - Q3 – Q4 2008
- 33% - Q1 – Q2 2009
- 28% - Q2 –Q3 2009
- 11% - Q3 –Q4 2009

### What is the planned date for 'commerce implementation' phase of your PSD compliance programme?



“

It is evident that the banking industry is on track towards PSD readiness by 1 November 2009. The Payment Services Directive Transposition Group under the EC needs to step up its activities in managing the effect of national derogations and aligning timelines for the publication of national payments legislation. This will allow for timely and consistent delivery of individual PSD programmes in banks and national communities

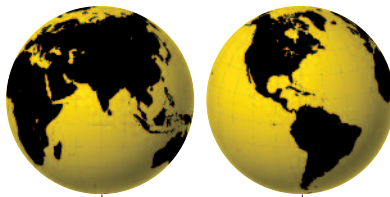
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### Conclusions

Largely, the preparation timeline highlights the overall dependency of the banks' programmes on the availability of the national versions of the PSD by the end of 2008 or early 2009.

Also worrying, is that the unavailability of definitive national PSD texts and the lack of decisive pan-European effort towards the harmonisation of the national versions, pushes the 'Impact Analysis' and 'Requirements Definitions phases of the PSD programme into Q2 of 2009. This finding combined with the uncertainty around the size, allocation and timing of PSD programme budgets, suggest that timely and cost efficient implementation of PSD is somewhat under threat.

Looking at the correlation of the impact on the 'SEPA Programme/project' and the PSD 'implementation' timeline, we can conclude that the implementation for SEPA (with community AOS) may take national flavours 'strengthened' by the derogations in local versions of PSD. If this happens it will further compartmentalise national payment systems and work against the concept of 'one SEPA'.



- |                |                      |
|----------------|----------------------|
| Australia      | Morocco              |
| Belgium        | Netherlands          |
| Brazil         | Norway               |
| Canada         | Philippines          |
| Czech Republic | Poland               |
| Denmark        | Portugal             |
| Egypt          | Russia               |
| Estonia        | Saudi Arabia         |
| Finland        | Singapore            |
| France         | Slovakia             |
| Germany        | Spain                |
| Hong Kong      | Sweden               |
| Hungary        | Switzerland          |
| India          | Taiwan               |
| Indonesia      | Ukraine              |
| Kuwait         | United Arab Emirates |
| Luxembourg     | United Kingdom       |
| Malaysia       | USA                  |

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