



*Is the SEPA  
End Date the end,  
the beginning  
of the end or the end  
of the beginning?*

### Highlights

- Migration end-date is likely to be end-January 2014
- While there are many 'knowns' there are still many areas of uncertainty
- Smart decision making will focus on areas that are likely to remain stable
- A wait and see approach won't work!
- Seeking a partner to consult on possible solutions could bear fruit

## Will the SEPA End Date really change the game?

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"Now this is not the end. It is not even the beginning of the end, but it is, perhaps, the end of the beginning."  
.....

Winston Churchill, 10 November 1942

### Executive summary

There is no doubt that regulation is a driving force in the payments industry and will be so for the foreseeable future. The Payment Services Directive, the E-Money Directive, Basel III, Anti-Money Laundering and Know Your Customer rules, along with the SEPA End Date regulation, will continue to consume a sizeable amount of available IT budget at financial institutions.

It is the Single Euro Payments Area (SEPA) End Date regulation, however, on which many minds are focused at present.

Formally known as the European Commission's proposal for a regulation establishing technical requirements for Credit Transfers and Direct Debits in Euros and amending Regulation (EC) No 924/2009, the SEPA End Date regulation promises to deliver a clear deadline for migrating domestic payments instruments on to SEPA standards.

This deadline is important because current migration rates are far from matching set expectations, with only 20.5% migration for SEPA Credit Transfers (SCTs) and a very limited 0.1% for SEPA Direct Debits (SDDs) having taken place so far.

The proposal cites an "increasing recognition by all categories of stakeholders that a legally binding end-date may be necessary to achieve successful [SEPA] project completion".<sup>1</sup>

Full integration of the payment market will be achieved only once Union-wide payment instruments (SCTs and SDDs) replace completely national legacy instruments. "In order to achieve this goal, migration end dates for Credit Transfers and Direct Debits in euro are set up through this regulation," says the proposal.

In the latest available official proposal, full migration to SCTs will occur 12 months after the regulation goes into force and for SDDs, 24 months after enforcement. Member States are permitted to set earlier dates than those outlined in the proposal. Since the proposal was published and debate has taken place at the EU Parliament, most observers now believe a single migration End Date will be imposed, probably for the end of January 2014 for both SCT and SDD migration, that is 24 months after the regulation is voted upon.

There is therefore not much time for reflection on next steps.

The self-regulatory efforts of the European banking sector through SEPA have not proved sufficient to drive forward concerted migration to Union-wide schemes for credit transfers and direct debits on both the supply and demand sides, says the proposal. In fact, most corporate customers and banks do not believe the business case to switch over to the new payments instruments and formats in itself to be compelling, considering that most of their payments remain local.

There seems to be very little conviction around the SDD specifically, since the proposed business model does not match current local practices. In the end, migration may well be driven purely by economics, since the cost of maintaining dual processes will be higher than switching.

The EC also believes that the slow uptake of SEPA instruments could in part be due to a the self-regulatory nature of SEPA. "Only rapid and comprehensive migration to Union-wide credit transfers and direct debits will generate the full benefits of an integrated payments market, so that the high costs of running both legacy and SEPA products in parallel can be eliminated," the proposal states.

Whatever the scepticism that exists regarding the importance and/or timeliness of the SEPA push as compared to other developments such as the euro crisis, the fact remains that the EU is determined to move forward with this regulation. Therefore it is more important than ever to prepare for what is certain, and ensure contingency plans for areas where the impact remains uncertain.

## Obstacles on the path to SEPA

While the current focus is on the bank to bank retail space, there is more at stake than retail clearing between banks. As discussed further in this paper, other issues will compete for attention in the years ahead, including:

- The extra burdens placed on debtor banks;
- Corporate (particularly SME) and public authority migration to SEPA instruments;

- The short term inclusion of niche payment products in the SEPA universe; and
- The often underestimated volumes of large value retail and wholesale payments made via other channels such as correspondent banking.

These issues, which today appear to be "under the radar" of most institutions and industry groups, could act as roadblocks on the path to a fully compliant SEPA environment.

### Debtor banks

The End Date Regulation imposes extra burdens on debtor banks and goes far beyond what is proposed in the European Payments Council's (EPC's) rulebooks. For example, it stipulates extra checks (such as permitting different return periods depending on whether the SDD is a first in a series or subsequent, validity of the mandate information and status, et cetera) that have been considered optional by the EPC thus far.

The requirement for additional checking will translate into extra costs that will ultimately have to be passed on to end users. Combined with the now confirmed ban on Direct Debit multilateral interchange fees (MIFs) as from the migration end-date for SEPA Direct Debits this puts the business model of SDDs into question and could eventually undermine the attractiveness of SDDs to creditors and debtors alike. This could possibly provoke an adverse reaction towards the new payment scheme from both users and financial institutions.

### Corporate and public authority migration to SEPA instruments

Progress on corporate and public authority migration to SEPA instruments was presented by members of the EU Forum of national SEPA Coordination Committees, which met in May 2011.

The Austrian Payments Council, for example, reported that corporate "big billers", such as insurance companies and telecoms operators, had launched SCT migration projects. In the public sector, domestic mass payments have been made in SCTs since June 2009, with 70% of federal government payments migrated by the end of 2010 and 100% planned for 2011.<sup>2</sup>

In France, 48% of corporate treasurers

plan to migrate to SCTs during 2011, 46% during 2012 and the remainder after 2012.<sup>3</sup> French state payments account for 45% of current French SCT volumes. Public administrations use SCTs for 80% of their credit transfers and the social sector is scheduled to end its migration to SCTs by the end of 2011.

The French National SEPA Committee Secretariat cites figures from the Association Française des Trésoriers d'Entreprise that 17% of corporate treasurers will launch SDDs in 2011, with others following after 2012. The migration of some important billers (which generate between 3-4 million SDDs per month) is under way and should be finalised by the beginning of 2012.

Finland, one of the most advanced European countries when it comes to SEPA migration, will cease to transmit domestic Credit Transfers through its domestic payment system from 1 January 2012.<sup>4</sup> By the end of April 2011, the share of SCT payments in Finland was 68.7% of the domestic credit transfer volume. The report did state that SMEs have moved slowly. SDD mass migration is not expected in Finland as DDs represent only a 5% share of electronic payments.

Details of all the submissions presented at the meeting can be found at: [http://ec.europa.eu/internal\\_market/payments/sepa](http://ec.europa.eu/internal_market/payments/sepa).

### Niche payment products

Niche products are certain legacy payments instruments that have specific characteristics preventing them from being immediately defined as Credit Transfers or Direct Debits under the SEPA umbrella. Such products include dematerialised bills of exchange, promissory notes and other products that are tailored for specific users groups.

The definition of the SEPA End Date needs to specify whether such niche products are in the scope of the legacy SCT and SDD instrument phase-out. The European Commission envisages that Member States might exempt niche products fulfilling certain conditions, such as specific purely domestic transactions (for example bills of exchange in use in some countries), or market share below a particular threshold, for a period of time – 36 months at present – after which all legacy products would have to be phased out.<sup>5</sup>

In a study of responses to the European Commission's Working Paper on SEPA Migration End-Date, Capco found a majority wanted to retain niche products as long as their volumes were below 10%. Some respondents indicated that niche products should be handled by the national banking committees, which should decide whether to retain niche products or to phase them out.<sup>6</sup>

### High value payments

The SEPA End Date proposal does not cover payment transactions processed and/or settled through high value payment systems for which both the original initiator and the final recipient of the payment is a payment service provider as well as whenever the customer explicitly requests its transactions to be channelled over these systems.

However a simpler result could have been achieved if the regulators had adopted the same approach here as is already in place for corporates. Segregation of what needs to be migrated to SEPA and what does not require migration could be based on the simple fact that the instructions are processed individually versus bulked in files, including for the bank to bank space.

### Choices

The SEPA project will benefit from the clarity that the End Date regulation will achieve. However, several issues remain for financial institutions, infrastructures and corporates alike. Individual organisations in each of these sectors will be faced with choices: stay in business or outsource to a third party.

Financial institutions will have to make SEPA choices that take into account the numerous and sometimes conflicting roles they have in the clearing business:

- As users of clearing platforms;
- As shareholders of the platforms; and
- As players in this business in their own right.

In its research, Capco found that the large multinational banks have no apparent need to outsource SEPA services, but rather could provide insourcing services to smaller banks and other groups.

Capco's report states: "Overcapacity of SEPA insourcing services in the market will lead to competition among insourcing banks, as soon as a mandatory end-date

is finally set. Existing sourcing contracts could have to be reassessed. Yet in spite of impending issues, banks that could be potential outsourcing candidates have not yet made any serious approaches."

The payments industry is to a certain extent waiting to see what Europe's payment infrastructures will bring to the SEPA environment. Some early indications of infrastructures' approaches were evident at the International Payments Summit (IPS) in London during March 2011. IPS delegates this year noted that some automated clearing houses would provide processing services across many countries, while others would be limited in the number of countries they could serve because of the many differences in market practice and regulations between countries, exacerbated by a lack of standards.

The initial view was that standards would drive competition, enabling banks to break away from national allegiances and shop around in the SEPA landscape. In the absence of such a competitive market, the European Automated Clearing House Association (EACHA) is promoting the connection of national blocks via intelligent links. This interoperability of clearing houses is expected to help further adoption of SEPA instruments, although it remains rather limited in scope and volumes at the moment.

One of the issues in creating new infrastructures for SEPA is meeting or exceeding the functionality in many domestic systems on a pan-European basis. Some countries have very mature ACHs that offer value-added services such as account switching or mandate management. Users of infrastructures in these countries will be concerned that deteriorations in service will arise from a move to a pan-European model.

The SEPA End Date Regulation will set out a definite date, but there is a risk that over time the benefits of a published end-date in driving SEPA adoption may be diluted as relative dates, governance and compliance oversight are left to domestic financial regulators.

The first set of end-dates, therefore, is just a beginning. It is important that payments industry stakeholders and participants make smart choices that will not be challenged in the future when the various phases of the SEPA migration materialise. This can be done by focusing on elements

that are likely to remain stable over time, particularly in light of the current instability in the financial industry and the global economy.

### Context

The context in which financial institutions, corporates and infrastructures make choices about SEPA should not be overlooked. The global economic recovery is faltering and as outlined above many issues remain to be solved regarding the details of SEPA.

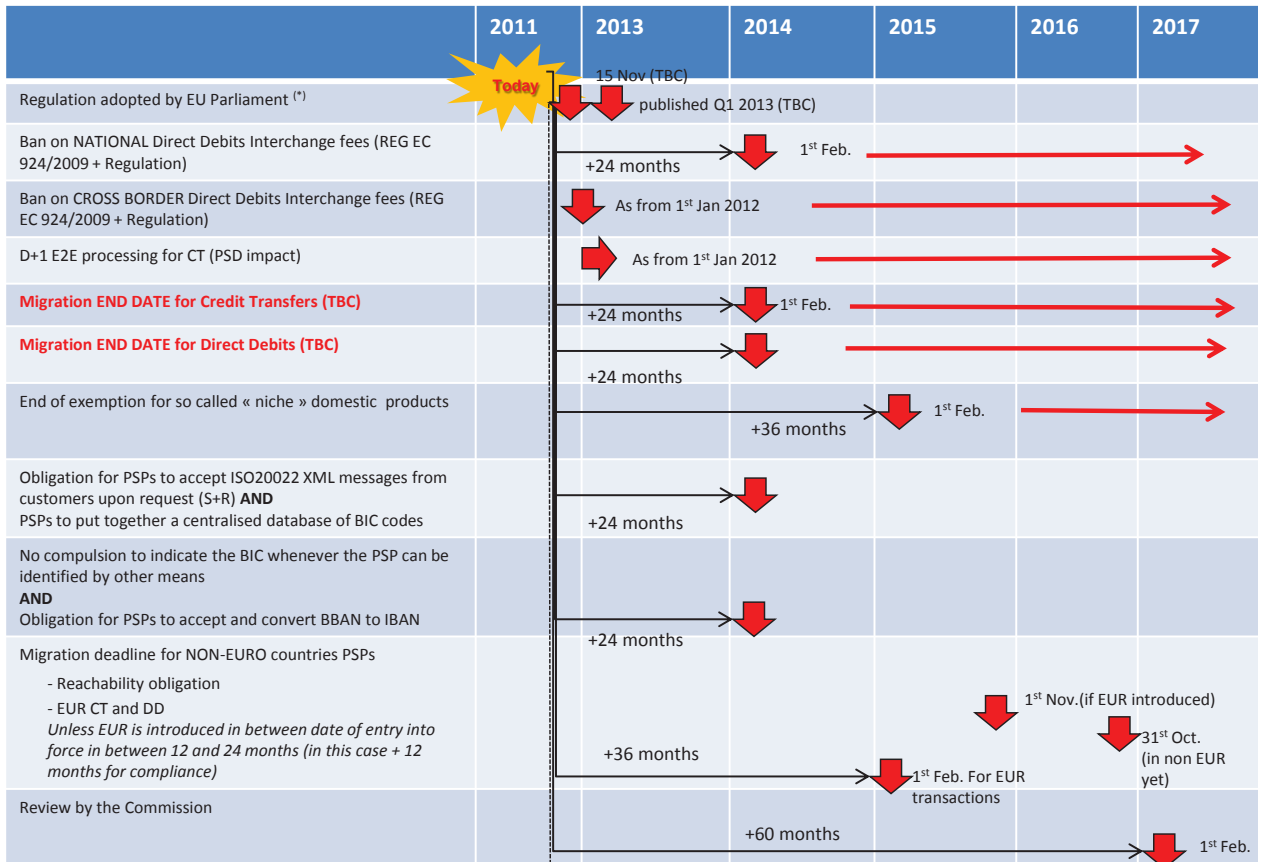
One of the foremost concerns today is the future of the euro currency itself. The sovereign debt problems in Portugal, Ireland, Greece and Spain, along with recent concerns expressed about France and Italy, have cast doubts on the long-term survival of the euro.

In August, French President Nicolas Sarkozy and German Chancellor Angela Merkel announced a series of measures aimed at strengthening the euro's prospects, including a call for more economic co-ordination between Eurozone countries. However, some countries raised reservations about ceding control of tax and economic policies.<sup>7</sup>

Globally, moves have been made to strengthen financial system controls and monitoring in an attempt to avoid a repeat of the events of the 2007-2008 financial crisis. The imposition of "stress tests" on financial institutions has created a fairly charged atmosphere. In Europe, the European Banking Authority conducted tests of 91 banks in 23 countries, representing two-thirds of the asset base of the European Union's banking system (the US tests covered only 19 banks).<sup>8</sup>

After years of discussions, the financial industry has reached a general agreement on the necessity of establishing an end-date for migration to SEPA instruments. But the difficulty of reaching a consensus on this issue has been replaced with difficulty in reaching compromises on issues such as niche products and obligations for corporate customers. Factor in the shift in banks' priorities from the SEPA vision to ensuring stability of the financial system, and the prospects for implementation in the short term are not very promising.

The initial focus has been on end-dates for the bank to bank clearing space, but the End Date proposal also addresses



A moving target but a clear roadmap with many a date still to be confirmed

a number of relative dates that must be considered. These include the phasing out of niche products as already discussed, the mandatory use of ISO 20022 XML messages for customers' bulk transfers and the migration for non-Euro countries' Payment Services Providers. The bank to bank end dates will trigger milestones for other stakeholders and other business lines as shown on the following page.

While SEPA supports the overall European Union aim of a single financial services market, like many European projects it is subject to conflicting objectives even among EU regulators. Members of the European Parliament, policy makers at the European Commission and representatives of the payment systems' overseer – the European Central Bank – all have input into making European payments infrastructures more efficient and future oriented while securing the financial system and protecting end users. Balancing these goals is obviously very

difficult. Because these three groups sometimes have differing objectives, the resulting lack of clarity makes it difficult for banks and industry utilities to move forward.

A similar scenario exists when it comes to who is driving SEPA-related change. Myriad players have an input, including EU regulators, industry bodies and stakeholders. These include the European Banking Authority, SEPA Council, European Commission, EU Parliament, the ECB/Eurosystem, the European Association of Corporate Treasurers, representatives of consumers' organisations, the European Payments Council and individual banks.

Another complexity in the current scenario is who will take charge of compliance oversight. SEPA is a high-level EU dictat, but local financial regulators will need to cope with compliance issues and the inevitable variations in scope and time. This will make the migration to SEPA even more problematic for pan-European financial

institutions and corporates that will have to cope with a multi-speed SEPA roll-out.

It is not yet clear what will be the focus of individual regulators – to move the bulk of payment volumes on to SEPA instruments, or to achieve 100% migration to the new instruments.

Another factor influencing SEPA decisions is the perceived lack of a business case. Capco's research found that SEPA benefits to banks and customers are "mostly opaque". Of the banks the company surveyed, 78% said they believed SEPA would "slightly harmonise" the payment market, while 22% believed it would result in less harmonisation. Half of Capco's survey respondents said the introduction of SEPA would have a negative effect on their profit and loss accounts, due to the cost of migrating to SEPA and of running parallel systems until full migration. Says Capco: "No positive impact on revenue is expected; neither are new products and price structures."

One of the main aims of the End Date Regulation is to kick-start general migration to SCTs and SDDs which is currently low and very uneven across countries. As of June 2011, the number of SCTs as a global average percentage of total CT transactions in the Eurozone was 20.5%, with SDDs representing 0.1% of total DDs.<sup>9</sup> (The lower figure for SDDs is usually attributed to the more recent launch of these instruments in November 2009, 18 months after the launch of SCTs).

There are doubts, however, as to whether the credit transfer and direct debit transactions that are SEPA eligible represent a majority of payment instruments in all cases in some countries. In its submission to the EU Forum of SEPA committees, the French Secretariat pointed out that the ban on MIFs threatened the migration to SDDs in France and could lead to consumers returning to the use of cheques. Whether SCTs and SDDs represent a majority of payment instruments brings into question where the savings expected from not running legacy and SEPA channels together are, if only a fraction of instruments can be migrated.

## The known and the unknown

When considering what actions to take regarding SEPA, it is right to bear in mind what we do know about the End Date Regulation, but also what we don't yet know. What we do know about the impact of End Date Regulation on different types of market participant is outlined below.

### Financial institutions

The retail payments business is back on the "C level" agenda as it represents stable revenues, albeit as a very low margin business (and becoming lower). The shrinking margins necessitate a repositioning, or at least a confirmation, that the financial institution wants to stay in this particular business. Also to be taken into consideration is whether the institution is a shareholder and/or user of a payments system. Where domestic banks own infrastructures, they may take a more defensive approach to SEPA in terms of opening up their markets to competition. Such factors may not

always direct institutions to the most economically sensible choices.

### Infrastructures

Various strategies to make a living out of clearing or value-added services (going into channels or the insourcing business) are open to this group. Most industry observers believe SEPA will be a "critical mass game", forcing infrastructures to remodel their value propositions or find other business models in order to survive or outsourcing processing to another service provider.

### Large corporates

SEPA may act to accelerate concentration in payments factories, but SEPA projects should have already started. There is, however, a risk of hesitation given the complexity of some payment instruments and the fact that domestic communities are adopting variants, which will affect how efficiently corporates can operate instruments that have a large European footprint. For purely domestic corporations in Europe, SEPA presents little in the way of a business case.

There are also a number of issues which remain clouded in uncertainty.

### New schemes and payments innovations

The emergence of mobile and electronic payments has attracted plenty of interest but it is uncertain whether their existence is linked to SEPA. Are these developments actually payments instruments or simply new acquisition/distribution channels? Most e- and m-payments are based on a "classic" payment instrument. Will these innovations act as a distraction from the main goal of harmonised payments processing or justify the whole exercise?

There is also more to come with new technologies that will improve the end customer's payments experience, but these will again be niche markets or experiments that will take some time before maturing and falling into the "cooperation zone".

### Competition

In maturing businesses such as e- and m-payments, competition is still very high and players are not really seeking to co-operate. Indeed, some may resist harmonisation, as evidenced by recent competition cases on e-payments. Only the mature payments areas can be truly addressed by SEPA, but arguably these are not the critical ones.

EBA Clearing's MyBank initiative, launched in June 2011, is based on a collaborative approach between banks, consumers and online merchants. The e-payment service for online shopping transactions will enable buyers and sellers from all over Europe to exchange trusted payment orders and e-mandates directly through their online banking portals.<sup>10</sup> The service is scheduled to go live in mid-2012. The solution will be open to banks and licensed payment institutions, in line with the Payment Services Directive and the relevant regulatory requirements.

EBA Clearing believes that offering a SEPA-wide solution based on a pan-European interbank payment infrastructure will provide both banks and their customers with the opportunity to expand their business prospects in the e-commerce area.

### Business models

For certain payment instruments, the business model may well change under SEPA. The European Parliament plans to ban MIFs on DD transactions over time. MIFs, which are a collectively agreed fee to be paid by the Payment Service Provider of the payee to the Payment Service Provider of the payer for each DD transaction, are considered to be a restriction of competition. Such an arrangement, some Members of the European Parliament argue, sets a collectively agreed floor for the fees that payee banks charge to their corporate customers, which in turn will have to be passed on to their consumers through bills.<sup>11</sup>

To incentivise banks, in particular the ones that receive high MIFs, to migrate towards SDD the cross-border payments Regulation (EC) No 924/2009 contains a transition regime with respect to the acceptability of MIFs as a financing model for direct debit transactions, in force until 31 October 2012. Under this transition regime, per-transaction MIFs applied for national direct debits can be maintained,

unless competition proceedings at national level would lead to these MIFs being decreased, in which case this lower level would apply. A transitional default MIF of maximum 8.8 euro cents for cross-border SDDs has also been set.

### E-invoicing

While this may represent the biggest incentive as regards savings for Europe<sup>12</sup> in the SEPA business case, e-invoicing remains a fragmented market and the bulk of initiatives are domestic. In a study for the European Commission<sup>13</sup>, Capgemini said SEPA would significantly reduce the complexity of implementing e-invoicing solutions and integrate them into the back offices of sellers and buyers, lowering the barrier of compatibility with internal systems. Financial institutions could create a potential extra revenue flow of €0.4 billion to €3.4 billion per year via e-invoicing, although additional investments would be required to achieve these revenues.

The biggest benefits according to Capgemini however are on the demand side, with potential maximum cost savings of 0.8% of GDP per year on invoice-related processes. Although clearly there are hard benefits for both supply and demand sides, the most important relationship between SEPA and e-invoicing is in relieving implementation barriers for e-invoicing: SEPA will standardise processing and simplify implementation and integration.

### Interoperability

The need for interoperability is obvious, but technical interoperability is at present the easiest step forward. Interoperability at a business level is key, but is more of a long-term project.

### Infrastructures

Which infrastructures are best placed to win the game of consolidation? Smaller, purely domestic ACHs are exiting the market, while others are gaining market share and rolling out value added services.

### Systems convergence

The same service levels can be achieved over a variety of channels, but the business models of these channels

need to be carefully examined. Unless financial institutions are ready to sponsor, subsidise or abandon some channels, consolidation is unlikely to take place. Smaller users and non-shareholding institutions may well gain the greater benefits of the convergence and consolidation of systems.

## Stay focused, act wisely

The SEPA landscape is far from clear, despite the End Date Regulation proposal. But there are steps that financial institutions and infrastructures can take now:

- Assess your position and critical success factors for own institution given the context outlined above.
- Assess your needs and ambitions in the retail space. This will be linked to whether your institution is pursuing a global, regional or local strategy and your position in the market. Finally, is your market competitive and what hopes do you have for the medium and longer term?
- Determine from where your retail payments are being generated – along which channels and systems? What are the trends in each channel and the volumes?
- Examine what has to be migrated and when. Construct a “heat map” and set priorities.
- Examine the payment behaviour of your corporate clients and what their requirements are.
- Examine the potential side-effects of SEPA on other systems that do not fall under the End Date regulation.
- Look “over the horizon” and assess the medium and longer term effects on other clearing channels and currencies.
- Go back to basics and capitalise on your strengths, including privilege reach and major clearing channels, and carefully assess the strategic need to maintain a presence on smaller channels locally or remotely. Do you need everything everywhere? By rationalising you can reduce costs (and to start with, connectivity costs). This also applies to corporate connectivity: think global and think of the future. Consider leveraging shareholding

positions in clearing channels or writing off if necessary.

- Assess opportunities, if any, in niche markets and businesses and in outsourcing or insourcing.
- Go for the “no-regret” messaging solution. Protect yourself from the side-effects of migration by selecting a messaging solution that is future proof and of which the price remains stable over time. Assess additional benefits such as tiering, negotiation power, specific pricing schemes et cetera. Make sure your choice of solution doesn’t have an impact on your migration plans and doesn’t prevent you from growing and acquiring market share. When choosing a solution, remember that cheaper is not necessarily better – select best in class only even if it is marginally more expensive. Ensure you have a pervasive presence on channels and in countries. Assess the level of commitment that is needed between your institution, provider(s), partner(s) and strategic partner(s).
- Plan ahead based on the known facts and draft out plans for alternative scenarios – plan for readiness and compliance and size levels of investment according to ambitions, comparing these with alternative solutions.
- Assess alternatives in case there is a need for “backward compatibility” or if the whole project derails because of external factors (for example, a severe Euro crisis interrupting or halting completely the SEPA vision).
- Get help if needed!

## Conclusion

The retail payments clearing business will without any doubt be deeply altered and the strongest – and best prepared - are likely to survive.

Identifying core strengths and weaknesses will help financial institutions, corporates and infrastructures to shape their responses to regulatory changes and determine the position they should take and the course of action they should follow.

With full SEPA migration only a couple of years away, “wait and see” cannot be an answer. There is no other choice than to build up a plan to achieve migration and stick to it going forward. Seeking a partner with whom to consult on strategies could prove to be a fruitful exercise. However, the longer you wait, the fewer partners of choice there will be. Although the SEPA path remains uncertain, moving forward in a collaborative way will be the key to success.

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