PaySys SEPA Newsletter
Aug 2007

Topics of this issue:

1. **Interchange in Singapore: A Blueprint for SEPA?**
2. **SEPA for Cards: So far mainly "Wait and see"**
3. **The ECB's new "Impact Study"**
4. **MasterCard stops plan to introduce ad valorem debit fee in UK**

1. Interchange in Singapore: A Blueprint for SEPA?

In June 2007, NETS (Network for Electronic Transfers Singapore), the operator of the EFTPOS and ATM system in Singapore announced a massive increase in EFTPOS fees: from 0.30 to 0.55 per cent to up to 1.8 per cent from July 2007 to September 2007.[1] To justify this move, NETS pointed to the competition of international debit cards which lured banks with high interchange fees. The announced increase of fees was sharply criticised by the Consumer Association of Singapore (CASE).[2] CASE also complained on the matter to the Competition Commission of Singapore (CCS).[3] The CCS however, did not see any reason for regulatory action.

Our comment:

Some commentators have suggested that the developments in Singapore may be for-shadowing future developments in SEPA. These commentators mainly come from the US where interchange fees have been going up for almost 10 years. In the US, competition between schemes mainly was a "competition for issuers". In order to attract issuers, a scheme had to increase interchange. The same mechanism seems to be at work in Singapore. NETS justified its increase of fees with the need to offer issuing banks higher fees. Otherwise, these issuers would switch to international schemes which offer higher interchange rates.

No doubt, SEPA will bring competition to debit cards in Europe. However, it is by no means clear that this implies that Europe will follow the US model. After all, there are two sides to the card market, the issuing side and the acquiring side. Whether or not competition leads to higher interchange rates depends on the relative strengths of both sides. One element that clearly differs from the US is the prevalence of cash in many European countries. Schemes

[1] See www.nets.com.sg.
[2] See www.**case**.org.sg
[3] See www.ccs.gov.sg

and issuers have to face the fact that many retailers may indeed stop accepting cards if fees go up. This definitely limits the power to increase rates.

Another point that differs between the US and Europe is regulation. Whereas US regulators have refrained, so far, from regulating interchange, in Europe there is strong pressure to lower interchange. Whether such regulation is justified is a matter of controversy. In Singapore, the Competition Commission flatly points out that there is competition between different payment systems and that the price increase of NETS is therefore not an "abuse of market power". The CCS also points out that it is not its task to "review or regulate pricing decisions". Maybe, in this respect, Singapore could provide a role model for SEPA.

2. SEPA for Cards: So far mainly "Wait and see"

On the ECB's website there is a page on the implementation of SEPA which provides an overview of national SEPA plans.[4] Looking through these migrations plans, it becomes evident that there is still a high level of uncertainty regarding debit card strategy within SEPA. Some countries, have chosen the option to implement SEPA via the introduction of an international debit card scheme (for example Austria or Finland). As commentated in this newsletter, Belgian banks had planned the introduction of Maestro but have postponed a decision for now. German banks have decided to offer the German scheme ec cash outside Germany and to attempt to build a European debit partnership. So far, some other European schemes have joined, but for the moment it is still uncertain whether the banks in these countries will also back this move. In some crucial markets, however, no real decisions have yet been taken:

- Netherlands:[5] "Currence has decided that PIN will be made SCF compliant. However, individual debit card issuers will have to decide which SCF compliant brand(s) will be on their debit cards. PIN will not grow into an independent European product, for that the Dutch payment industry is too small. PIN will continue to be marketed until there is a sufficiency of competing and widely accepted European alternatives available that will remove the need for a national debit card. In this situation, every bank will decide for itself whether to continue its PIN licence. The PIN product will continue to exist until all banks have cancelled their licences." (page 13)

[4] http://www.ecb.int/paym/sepa/about/timeline/html/index.en.html#implement
[5] http://www.ecb.int/paym/sepa/about/timeline/pdf/Netherlands_SEPA_migration_plan_en.pdf

- Spain:[6] “Card schemes[7] have decided to opt for maintaining co-branding with the international schemes as a way of complying with the SCF requirements, although other paths may be followed in the future.” What remains to be done is EMV migration, adoption of other standards to be agreed within the EPC and adoption of internal bylaws, rules and regulations.

- France:[8] “In France, "CB" bank cards, which include cards requiring systematic authorisation (“zero floor limit cards”), are currently 95% "co-branded" with one of the two international schemes (VISA or MASTERCARD) and in their great majority comply with the EMV standard. The National SEPA Committee therefore takes note that most of the French "CB" bank cards should comply with the European framework for interoperability from 2008. A diversified offering of payment cards will be maintained and what will become of purely national bank cards remains to be considered.” (page 15)

“The EPC is currently working on the standardisation for the various phases of card payment processing and is expected to arrive at a solution by 2008. The timetable and procedure for adapting to these new standards will have to be specified in due time within the framework of the SEPA migration work, in consultation with the concerned stakeholders.” (page 34-5) With respect to Cartes Bancaires it is flatly stated: “GIE CB will have to comply with the principles of the EPC's SEPA card framework.” (page 35)

- Italy:[9] “Italy, through CO.GE.BAN (which manages the Bancomat debit card brand), favours the cobranding option (option3) as the best for the Italian system. CO.GE.BAN is also participating in the work on the “Pandomestic” Scheme (option 2), which will be called the ‘Euro Alliance of Payment Schemes’ (EAPS).” (page 14)

Our comment:

A clear pattern emerges. In those countries that have not decided to switch to Visa/Master Card, the banks plan to use a combination of EMV migration and co-branding with international schemes as the way the achieve compliance with the SEPA Cards Framework. Further decisions are postponed to some unspecified point in time. In particular, there is hardly anything on the crucial topic what will be eventually happening with the national debit schemes. After all, co-branding will not be accepted by European regulators as a long-run

[6] http://www.sepaesp.es/docs/Spanish_SEPA_MIGRATION_PLAN.pdf
[7] Euro6000, Sistema 4B, ServiRed
[8] http://www.ecb.int/paym/sepa/about/timeline/pdf/France_SEPA_migration_plan_en.pdf
[9] http://www.ecb.int/paym/sepa/about/timeline/pdf/Italy_SEPA_migration_plan_en.pdf

solution to achieve compliance with the SEPA Cards Framework. The only country where banks have spelled out a SEPA strategy for the local debit scheme is Germany.

3. The ECB's new "Impact Study"

In August, the ECB has published a study of the economic impact of SEPA.[10] The study summarises existing estimates of the costs of SEPA (between 0.5 and 12 billion EUR) and comes up with its own estimate of cost and revenue implications of SEPA. The estimate is based on a questionnaire sent to banks. Comparing the results for different scenarios with a baseline scenario, SEPA is expected to cause a decline in revenues between 7.6% to 9.9% and a fall in costs between 1.3% and 6.8%. For the time of co-existing systems (old systems and new SEPA systems) banks predict a fall in revenues of 4.4% and a rise in costs of 4.8%. On the whole, margins are expected to fall. Unfortunately, there is hardly anything on cards in the study – the only exception being a reference to higher costs of issuing SEPA-compliant cards.

Our comment:

The ECB's study basically conforms with other studies that predict lower revenues due to increased competition and lower costs due to economies of scale and scope. Indirectly, it also reflects the concern that SEPA may not really be such a formidable squeeze on costs. The expected cost decrease due to SEPA is modest (-1.3% for a fully completed SEPA). Larger cost reductions are expected from "e-SEPA".[11] This mirrors similar concerns by the EU Commission which presses for the adoption of EBPP. Finally, the study indirectly confirms the view that nobody knows with any degree of certainty what SEPA for cards will look like.

4. MasterCard stops plan to introduce ad valorem debit fee in UK

MasterCard announced that it abandoned plans to introduce a new debit card with a fixed fee of 3.5 pence and 0.15% ad valorem fee.[12] The announcement was made after stiff resistance of retailers against the new fee structure.

---

[10] http://www.ecb.int/pub/pdf/scpops/ecbocp71.pdf

[11] "'e-SEPA' the fourth scenario aims to go beyond SEPA. If the previous phases are successfully completed, this fourth scenario is one of a future payments world which is fully electronic, paperless and with less cash (but not cashless)." (p.12)

[12] See http://www.brc.org.uk/details04.asp?id=1220

Our comment:

MasterCard's decision is yet another example that shows how difficult it is to change long established pricing rules.

Should you have any questions or comments please contact

Dr. Hugo Godschalk (hgodschalk@paysys.de)
Dr. Malte Krueger (mkrueger@paysys.de)
Christoph Strauch (cstrauch@paysys.de)

PaySys Consultancy GmbH

Im Uhrig 7
60433 Frankfurt / Germany
Tel.: +49 (0) 69 / 95 11 77 0
Fax.: +49 (0) 69 / 52 10 90
e mail: info@paysys.de
www.paysys.de