Topics of this issue:

1. **Co-badging issues yet again**
2. **The New European Debit Card Scheme**
3. **War on Cash**

1. Co-badging issues yet again

According to industry sources the EPC discusses the issue of brand selection when a co-branded card is used at a terminal that accepts both brands. The outcome of the discussion may lead to a revision of the SEPA Cards Framework (SCF) and EMV specifications.

Our comment:

The issue of brand selection at the POS is a thorny issue because it touches upon various important aspects:

- *the strategic position of issuing and acquiring side (Who selects the brand?)*
- *practical issues (Is selection by customers practical?)*
- *regulation (Would issuer pre-selection be acceptable to regulators?)*

When it comes to 'who selects the brand', the interest of issuers and merchants are clearly opposing. Issuers wish to select the brand with higher interchange and merchants wish to select the brand with lower interchange. Whoever gets to chose is in a strong position. One way to resolve this conflict would be to let customers decide. However, for many market practitioners it sounds crazy to let customers decide at the POS which of two card brands they want to use. They expect confusion of both, customer and cashier. But there are examples in Europe where such a system seems to work. Finland is one such example. Finish domestic debit cards are often co-badged with Visa/MC credit cards. When presenting such a card at the POS, customers are routinely asked whether they want to pay with debit or credit card. So, in principle, it seems feasible, to have two competing brands on the card and let the customers decide. However, in countries where such a selection has not been in use, so far, its introduction may lead to a period of learning and confusion, particularly when the cardholder - contrary to the Finish example - does not experience a functional distinction between the brands. So, the question arises whether banks and merchants are prepared to shoulder these costs of consumer education. It seems likely that merchants in particular would not be enthusiastic.

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Another possibility to solve the issue is pre-selection. The issuer could prioritise brands on the card. Or the issuer could let the customer decide about a priority. It is difficult, however, to predict, how regulators would view such an option.[1]

One way to avoid all of these problems all together is to issue single brand cards. This seems to be at the moment the direction the German banks are heading. The new brand Girocard[2] *is SEPA compliant and can be issued on a stand-alone basis. It will be complemented by partnerships with other brands under the EAPS umbrella. Of course, acceptance outside Germany is patchy (depending on Girocard acceptance outside Germany and the number of EAPS partners). But this does not matter to many customers.*[3] *And those customers who want better acceptance can either pay for an extra brand on their card (Maestro, V Pay) or get a credit card. For customers, such a strategy implies fewer functions for the same price as before or the same set of functions for a higher price. One cannot help thinking that such a solution must also appeal to banks in other countries with relatively low debit fees. We also wonder whether such an outcome is conforming with the initial ideas of the SEPA project.*

Thus, for the moment, there may be some space for co-badging. If, however, a successful European brand emerges, it becomes highly unlikely that co-badging of competing brands will be a viable option (see next section).

2. The New European Debit Card Scheme

In its 5th Progress Report[4] the Eurosystem strongly recommended the set-up of at least one additional European debit card scheme. The arguments listed are: to enhance competition, to maintain the efficiency of current national schemes, to safeguard the control of card business by European banks and the political objective to fill in the gap of a missing scheme originated in Europe.

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[1] The ECB, for instance, states: “The use of national brands should therefore not be favoured by a pre-assignment priority at the POS (point-of-sale) terminal, but the choice of brand in a payment transaction should be left to the merchant and/or the cardholder.” See: ECB: SEPA: from concept to reality. 5th progress report, July 2007. p. 13. http://www.ecb.int/pub/pdf/other/singleeuropaymentsarea200707en.pdf

[2] “Girocard” will be replacing the German “ec cash” debit brand.

[3] For instance, only 15% of the holders of co-operative bank ec cards are using their cards for POS transactions outside Germany. See Michael Siegers: Wettbewerb im Debitmarkt – Wege zur Produktsegmentierung, Bankkarten-Forum 2007.

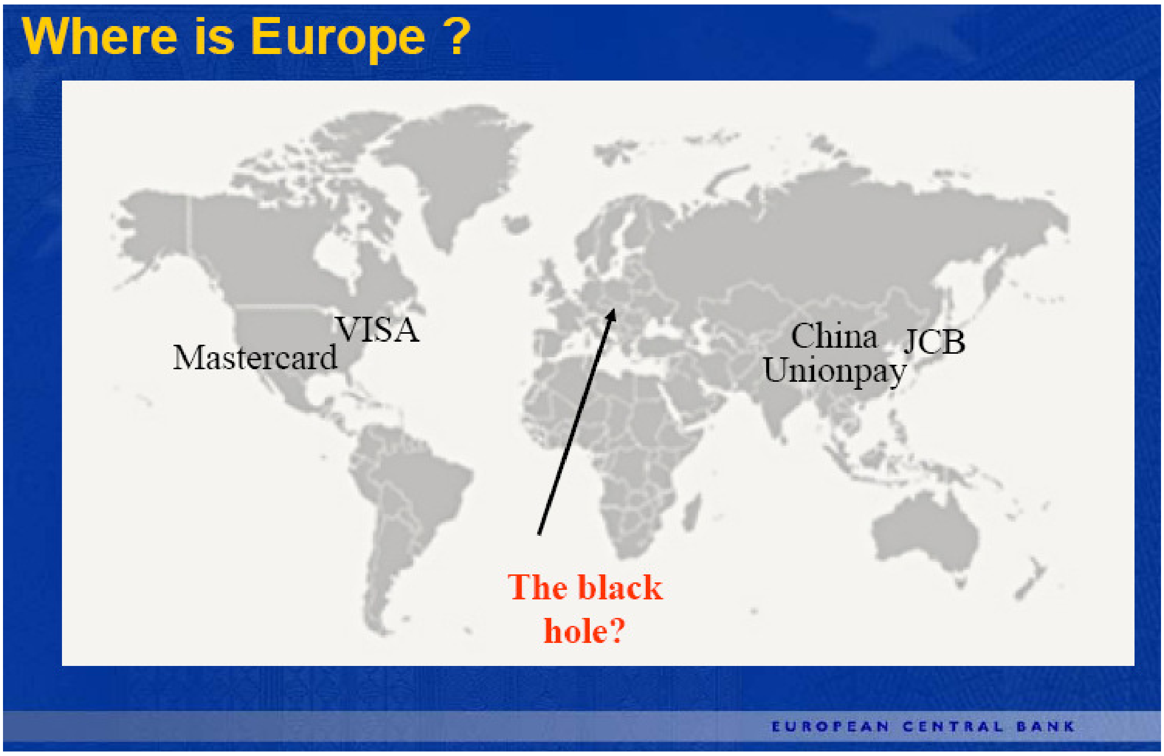
[4] ECB, Single Euro Payments Area (SEPA) from Concept to Reality, July 2007.

Our Comment:

This recommendation raises a few questions:

1. *Is the hole still black?*
2. *How can a European scheme reach worldwide acceptance like the other worldwide card schemes?*
3. *What does the adjective "European" exactly mean?*

Sometimes a single picture can say more than 1000 words. Wiebe Ruttenberg of the ECB presented this suggestive chart during his presentation at the conference of the Dutch schemeholder Currence[5] a few months ago:



A black hole appears on the world map. The USA have Visa and MasterCard, Japan its JCB card scheme, China its Unionpay, but there is no Europe-originated card scheme for Europe as a whole – even though the SEPA deadline is approaching fast. Politicians and regulators decided to end the successful national schemes within Europe, but no real European scheme is emerging to fill the black hole of this continent. Players outside Europe could take

[5] Wiebe Ruttenberg, Presentation on Currence Conference, Amsterdam May 31th 2007 (download at www.currence.nl)

control of the payments of European citizens, sensitive data could be processed outside Europe without being subject to European data protection standards, etc. This is a strong appeal to patriotic sentiments. No doubt, all members of the European Parliament would vote for the rise of a European scheme as a political objective with high priority after presentation of this chart.

But let us have a closer look. First of all, there are already two European schemes on the pinboard: V PAY and EAPS, both direct reactions of the market to the SEPA regulation. Peter Ayliffe, President and CEO of Visa Europe, stated in its recent EFMA-speech[6] in Paris on September 18, that V PAY is fulfilling all the requirements of the Eurosystem for a new European debit card scheme "equivalent to the scheme originated in the US, Japan or China". V PAY was "conceived in Europe, by Europe, for Europe". Banks are invited to share as issuing or acquiring member and therefore to take an active role in scheme governance and ownership.

(By the way, both ECB and Visa are stating, that European banks should have the governance of a new European scheme. Did they miss the Article 23 of the Payment Services Directive which invites non-banks to become issuers and acquirers of the SEPA compliant payment systems, who cannot restrict access of these new players anymore after November 2009?)

The Eurosystem states that a global reach of the new European debit card scheme is not considered to be necessary. To deliver euro area-wide acceptance co-badging (ECB is here using the expression "co-branding") could be the medium-term option, allowed and preferred by the Eurosystem also after January 2011. Global reach outside the SEPA could be provided by the issuers via co-badging too. This would be a long-term solution because no planned or already existing SEPA compliant card scheme (excepted Maestro) would be a world-wide accepted brand. It is explicitly not intended to make V PAY a world-wide accepted brand. But this is exactly the reason why neither the V PAY-piece nor the EAPS-piece will fit into the 'world map puzzle' presented by the Eurosystem. The cited schemes originated in the USA, China or Japan are world-wide accepted schemes without co-badging! You will not see a JCB-card co-badged with Visa or MasterCard. Each scheme delivers a world-wide acceptance to the cardholder through its own brand. The reason is simple but important and has far-reaching consequences: these brands are competing brands! We already discussed this consequence for the national schemes becoming SEPA-compliant (like the German ec

[6] The speech of Peter Ayliffe could be downloaded at: www.visaeurope.com/pressandmedia/reports

cash/Girocard) and co-badged with competing brands like V PAY or Maestro after January 2008[7]*. The options for the new European debit card scheme are:*

1. *staying infantile as Europe-only payment card or*
2. *the scheme must set-up its own worldwide acceptance or*
3. *a new (non-competing) brand should be found or created for acceptance outside Europe or*
4. *a new EU-regulation which should give European issuers the right to put competing worldwide brands (like Visa and/or MasterCard) on the same card.*

Within the same family V PAY could co-brand its cards with the VISA credit card brand, but this will destroy all the sophisticated brand strategies and is at the time not realistic. So, the new European scheme (if it will arise) will probably not become a player equivalent to the worldwide brands. The dream is over before it even started.

There is another reason why the suggestive chart of the Eurosystem does not fit. MasterCard is already a publicly quoted company, Visa (outside Europe) will become also stakeholders, who are not licence members (banks as issuers and acquirers). Wal-Mart, Google, Ebay or even Bill Gates could control MasterCard or Visa as main stakeholder. What about good old-economy player Siemens? Is MasterCard a German system, if Siemens would buy MasterCard-stocks? The ECB-chart is based on the origin of the worldwide payment schemes, which do not have relevance for the governance of a publicly quoted system anymore! Therefore, the easiest way to fill in the black hole is a swap of a part of the gold reserves held by the Eurosystem for 51% of the MasterCard or Visa stocks; a real patriotic act!

So what does the adjective "European" mean? Ownership, governance, origin, site of headquarters, political influence, democratically controlled by European citizens or under supervision of the ECB?

And why do we need a "European" debit card system in a global world? Vitale interests like military industry or employment policy reasons?

And why do we need only a European debit card and not a credit card scheme too? Do we need rather a European card scheme if the scheme difference between credit and debit will become obsolete in medium-term SEPA-perspective like in the French Cartes Bancaires scheme today?

[7] See the newsletter of May 2007

3. 3.1. War on Cash

The rhetorical "War on cash" continues. MasterCard and Visa hardly can make a statement about anything without pointing out that cash is the prime target of their endeavours. They argue that cash is expensive for society as a whole and that huge benefits can be reaped by intensifying the use of payment cards. Their arguments are echoed by some central banks, by the European Commission and by the EPC.

Our comment:

Even for a non-expert in the art of warfare it seems obvious that one of the most important pre-conditions for a successful war is knowledge of the enemy. If cash is the enemy and if the aim is to beat cash in terms of costs, a first pre-requisite is a sound knowledge of the costs of cash. However, when looking at some of the statements on this issue one is perplexed by the wide range of figures.

Perhaps the most widely cited figure is the EPC's estimate of EUR 50 billion (or 0,4 to 0,6% of GDP) costs of banks and merchants. Less often cited is the estimate of the number of transactions and the resulting costs per transaction. The EPC estimates that 360 billion cash transactions are carried out each year in the European Union. That comes down to an average cost per transaction of 15 cents. For an "all purpose" means of payment that does not strike us as terribly expensive. When MasterCard declared its "war on cash", however, it did seem to imply that by switching to cards, these costs could be reduced to almost zero: "Industry research has shown that a phased move to replace cash with plastic could improve the efficiency of the European economy by up to € 50 Billion through lower costs and increased spending by consumers."[8]

In a recent Visa presentation, the figures are even larger: 190-285 Mrd. EUR.[9] The European Commission, on the other hand, is more modest. In its "Incentives Paper"[10] it estimates potential savings of up to 5.3 billion EUR: "If, for example, the use of cash would be reduced to the level of countries with the lowest usage, this would generate a surplus of EUR 5.3 billion." (p. 41). In a footnote the Commission refers to a study by McKinsey. McKinsey did

[8] Master Card International: € 50 Billion Boost to Europe's Economy within Reach says MasterCard Europe, News Release, Waterloo, Geneva. March 11, 2005.
[9] Visa-Presentation at the VÖB-Fachtagung "Single European Payments Area - Kurz vor dem Start", 25.9.2007.
[10] EUROPEAN COMMISSION Internal Market and Services DG: Consultative paper on SEPA Incentives Brussels, 13 February 2006.

indeed derive an estimate of 5.3 billion EUR – however, this figure refers to increased profits of banks – not reduced costs.

So on the whole, there seems little agreement on the magnitude of the benefits of replacing cash. In addition, it does also not always seem clear whether the benefits consist of higher profits (which could also be due to higher earnings) or lower costs. We wonder whether one can really win a war on such shaky empirical basis. The current demise of electronic purse schemes is a reminder that ill-prepared ventures into unknown territory may end in failure.[11]

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[11] See also the recent announcement that Chipknip will no longer target the manned POS. http://www.currence.nl/currence/