PAYSYS REPORT

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SEPA for Cards: Completed or not? An inventory

In the context of a self-regulation procedure the European Payments Council (EPC) set the end-date for SEPA for Cards at the end of 2010 in its Framework (SEPA Cards Framework SCF Version 2.1 of 2009). SEPA issuers declared not to issue or distribute general purpose cards which are not SCF-compliant or from schemes which are non-SCF-compliant from January 2011 onwards. As a consequence, all relevant cards should be equipped with an EMV-chip. In its newsletter of October 2012 the EPC stated that Europe has nearly completed its migration to EMV payment technology. In the meantime nearly all the card schemes with activities in SEPA declared themselves as SEPA-and or SCF-compliant in self-assessments.

As a self-regulatory process, SEPA for Cards seems to be completed, but not all stakeholders seem to be satisfied. In recital 8 of the Interchange Fee Regulation (2015/751) the European Commission says, *"integration of the Union payment card market is far from complete as many payment solutions cannot develop beyond their national borders and new pan-Union players are prevented from entering the market. There is a need to remove obstacles to the efficient functioning of the card market…"*

Our Comment:

Which payment card solutions and systems has the Commission in mind? Which national card scheme cannot expand beyond the national border? Who are the new pan-Union card schemes, which are (not were!) prevented from entering the market? Monnet (2012) and EAPS (2015) are dead, payfair has announced new ambitions, EUFISERV is still there and Visa Europe will probably be sold to Visa Inc. (see our Report No. 3/2015). They were not prevented from entering the market. Has Monnet been resurrected or is there a new pan-Union player (the Commission even mentions more than one) knocking on the door? It will be headline news for the European card business. Is the Commission keeping it top secret? The answers are obviously no, so why has nobody in the legislative process of the IF-regulation questioned this dubious recital? The position of the external regulator seems to be clear. It is not satisfied but the reasons cited completely unconvincing. The self-regulation bodies seem to be more satisfied with the outcome with their efforts. Let´s see whether this judgement is better founded.

Card schemes and their general purpose cards have been recognized as SCF-compliant (and nobody has objected until now), SEPA for Cards is from an official point of view completed. The deadlines of the 2009-version of the SCF have all passed. Several self-regulated requirements of the SCF will be replaced, concretized or amended by external regulation, like the IF-Regulation and the proposed PSD II. It will be a logical step for the EPC to withdraw the document. Such a decision will probably be made at the end of September 2015.

In contrast to the SCF-requirements, the vision of SEPA for cards is less concrete, tangible and measurable. SEPA started with a White Paper agreed by 40 banks and 4 European Banking Associations (EBF, ESBG, EACB and EBA) in May 2002. The self-regulation initiative of the European banking community was a reaction to the threatening regulatory initiatives to create a single payment area by coercion as demonstrated in the price regulation 2560/2001 of the Commission. Regarding cards the White Paper[1] stated in 2002 the existence of *"standards and infrastructures for cards in place for seamless domestic and cross-border processing, but significant price differences between domestic and cross-border transactions".* Price differences was one of the main issues for action, although two months later the enacted price parity by the EU between domestic and cross-border card transactions came into force in Euroland (July 2002). Another card-related key recommendation of this group of SEPA banks was to *"explore options and develop platforms to put forward European interests in the context of global card networks, as well as launch specific initiatives regarding debit cards, ATM cash withdrawals and cash."* Well, as we know today, the efforts to set up a European (Debit) Card Scheme to break up the dominance of the "American" card schemes has actually failed.

In 2003 the newly created Cards Working Group of the EPC proclaimed its less concrete vision statement: *"Meeting customer (consumers and merchants) expectations and requirements for secure, convenient, transparent and value-priced card based payment solutions that foster widespread acceptance and can be used in the same way across the Single Euro Payment Area, will support an increasingly efficient economy based more and more on electronic forms of payment."* The first version of the SCF (version 1.0 of 2005) stressed the experience factor of the cardholder to use their cards throughout SEPA *"with the same ease and convenience"* as they do in their home country. SEPA for Cards should establish the conditions for eliminating the continuing differences in domestic and cross-border usage in order to establish a uniform *"customer experience"* across SEPA. But was this ever a real problem? From a cardholder point of view I could already use my co-badged debit card or single-badged credit card with the same ease, convenience and "customer experience" inside and outside my home country in the pre-SEPA-era. Co-badging was already a widespread phenomenon before 2002. Probably the SEPA-vision had more relevance on the card acceptance side.

The EPC's contemporary vision for cards[2] has added the merchants´ perspective: *"It also enables European merchants to choose which SEPA compliant card acceptance brand and product they wish to accept and with which acquirer(s) (i.e. a payment service provider that services card-accepting merchants) they wish to contract, without this choice being artificially constrained by legal, technical, or procedural issues."*

Probably the SEPA-vision had more relevance on the card acceptance side

There will be no reason for a merchant not to accept all SEPA-cards at its terminal assuming it has enough space for all the brand stickers

Somebody (ECB, European Commission?) introduced the often misunderstood, but catchy slogan for the SEPA card vision: *"Any Card at Any Terminal"*, which does not mean that the issuers should offer cards which are accepted at any terminal in SEPA nor that merchants should accept all cards with brands of SCF-compliant schemes.

In contrast to the full reachability obligation for PSPs to accept the SEPA products SCT and SDD, acquirers (and their merchants) should be able to accept the cards of the SEPA-schemes without legal, technical or procedural obstacles. The requirement "any card at any terminal" has already been implemented, although only a handful of merchants (most of them are retailers in ecommerce and border areas) are actually accepting card brands of a "domestic" scheme from outside of their country. Cross-border card transactions at the POS are still dominated by the "American" card schemes and their brands as result of a market driven process. Why is a German merchant not accepting the French CB-brand and vice versa the French merchant not accepting the German domestic scheme "ec cash"? Both schemes are SCF-compliant and willing (or forced?) to license foreign acquirers. Beside price/interchange differences, the main obstacle would be the certification procedure for the acquirer and the terminals based on proprietary standards of the schemes. Would the SEPA card standardization efforts of the EPC and the Cards Stakeholders Group (CSG) for harmonized, interoperable free standards pave the way? After the price regulation via the new interchange caps, price differences will not be a serious hurdle anymore. At the end of the day, every acquirer in SEPA could offer without big efforts all brands of the SCF-compliant schemes (former domestic and "American") to their merchants and all terminals could process the card transactions by a simple software download. There will be no reason for a merchant not to accept all SEPA-cards at its terminal assuming it has enough space for all the brand stickers.

How should the market effects induced by SEPA for Cards be measured?

The ECB is compiling two **indicators** based on the data-input of 23 card-acquiring processors and one central bank[3]:

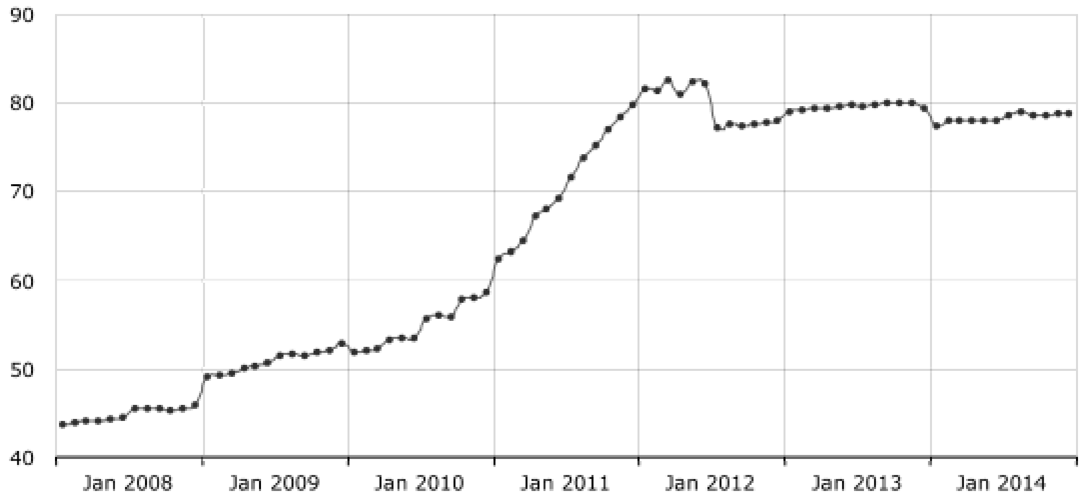
- Share of EMV transactions at POS-terminals
- Cross-border usage of cards

Are these indicators appropriate?

The share of EMV transactions has been stagnating since January 2012 at 80% of all card transactions at POS terminals. This is surprising. The comparable figure of EMVCO for Europe[4] is 96.6% (2014), including the figures for MasterCard, Visa, JCB, Discover, Amex and JCB. Domestic schemes are missing. If both numbers are correct, some domestic schemes must be not full EMV compliant, taking into account the strong market share of the international schemes in Europe (see or Newsletter No. 3/2015). The ECB reports three reasons for not reaching the 100% level:

- Non-EMV compliant transactions by cards issued outside the EU,
- Direct debits generated by the mag stripe on cards (ELV in Germany),
- One country which is still using non-EMV compliant acceptance technology.

The share of transactions made by cards issued outside the EU is about 1-2% and can be ignored. In the Euro-zone the market share of ELV is about 4-5%. Thus, if one country–or more precisely one domestic scheme–is not EMV compliant, it must be a huge scheme, representing about 15% of the transactions in the Euro zone. The existence of such a scheme is unlikely. However, there is another reason, not mentioned by the ECB, for the stagnating share of EMV transactions. Beside the traditional bank issued credit and debit cards, terminals are also used for store cards, fuel cards, prepaid cards and other private label cards. In Germany, for example, the share of these private label cards is about 4-5% of the transactions processed by German card-acquiring processors. Anyway, this indicator expected to stagnate at 80% in the future and is therefore of little use as an indicator for SEPA for Cards.



EMV transactions in the Euro area
as a percentage of total transactions at POS terminals (Source: ECB)

Cross-border card transactions in the Euro area
as a percentage of total transactions at POS terminals (Source ECB)

The second indicator used by the ECB is the share of cross-border transactions in Euro as a percentage of the total transactions at POS-terminals. The data is delivered by the same processors as the EMV-figures above. The rationale behind this indicator is the assumption that SEPA for Cards will stimulate XB-usage of cards. The ECB says, *"a move to a significantly higher level would indicate that SEPA had been successful in changing the card industry, the card acceptance practices of merchants and/or the payment behavior of cardholders."* In the pre-SEPA-area people apparently hesitated to use their cards (which were already fully enabled for worldwide use), because the "customer experience" for domestic payments differs from XB-usage. It is difficult to find hard facts which would support this impalpable assumption.

The peaks in August of every year (except 2012) show the strong impact of XB-travel by tourism (intra-European and inbound tourism from outside the Union) for XB-card payments, which is not surprising. Researchers on XB-Tourism in Europe identify a bundle of driving factors, like reduced border controls, reduced rates for roaming, international sport events, medical assistance abroad, prices for travelling by plane and last but not least the exchange rate of the Euro (tourism from outside the Euro-zone). In our Report of February 2013 we already stressed the strong effects of the Interchange Fee regulation on the XB-percentage of card payments in ecommerce caused by the IF-arbitrage by huge ecommerce-merchants (Amazon, PayPal etc.). SEPA for Cards is obviously not a dominating factor for more XB-border card payments, otherwise the conclusion based on the ECB indicator should be a stagnating SCF-development or even a failure.

Let us have a closer look at the figures. In the period 2009-2010 the XB-rate actually increased, crashed in 2012 and has stagnated since then. The ECB does not comment on this unexpected curve. The crash in 2012 could be a result of the continuous rising exchange rate of the Euro in relationship to the most important currencies, like Dollar, Yen, Renminbi and Pound Sterling in the second part of 2012, making travelling from outside into the Euro-zone less attractive. By the way, it is remarkable to see the tipping point for both ECB-indicators (EMV and XB-rate) in the second and third quarter of 2012.

SEPA for Cards is obviously not a dominating factor for more XB-border card payments

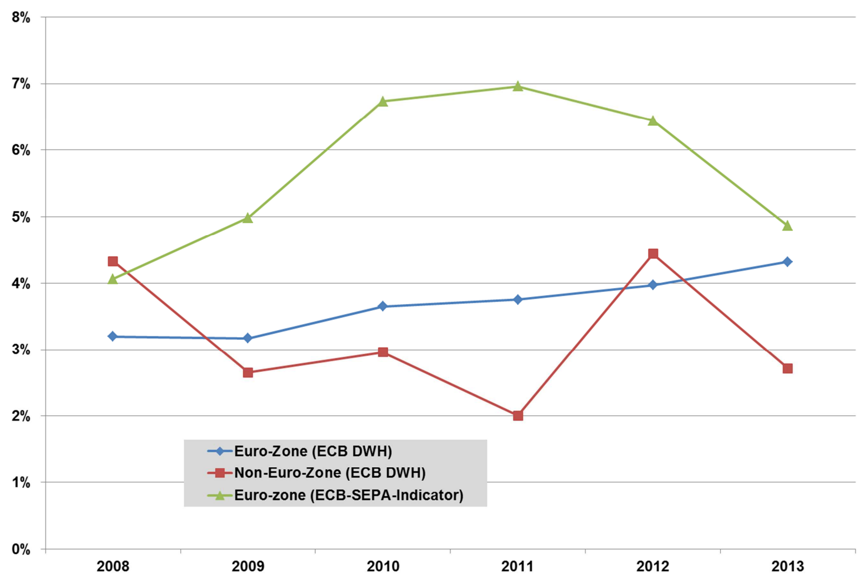
If we compare the indicator (based on the data input of card-acquiring processors) with the country-data of the ECB´s Data Warehouse (DWH) the outcome for the Euro-zone is not consistent.[5] The share of the XB-transactions at POS in the Euro-zone has slightly grown from 3.2% (2008) to 4.3% (2013) without disruption in 2012. However, the figures from the non-Euro-zone are volatile without a clear trend, confirming our surmise, that cross-border card transactions are determined by a variety of factors, of which SCF could be one.

The European Commission launched an ecommerce sector inquiry[6] for the EU in May 2015, which will analyze the obstacles to XB-ecommerce. Although 50% of the EU-population has shopped online, only 15% of the consumers have shopped from a merchant or service provider based in another Member State. But is this due to problems related to XB-use of cards? Survey data of the period 2010-2012 show a different picture: only 6% of complaints are related to difficulties in securing payment from customers resident in other Member States (e.g. geo-blocking of foreign cards by merchants).[7] This indicates that the obstacle to more XB-trade is not an inadequate single market for card payments.

Taking into account the low predictive value of the existing ECB-indicators regarding the progress of the shared objectives and the vision of SEPA for Cards, we suggest using other indicators, like:

- Number of card-accepting merchants, who accept brands of schemes from other Member States (former "domestic" schemes),
- Share of XB-transactions as percentage of the total transactions of former domestic schemes,
- Number of domestic transactions as percentage of the total transactions of the "international" schemes,
- Number of cards in a member state issued with a license agreement of a scheme from another Member State.

The rationale behind the self-regulation of SEPA for Cards was the existence of former domestic card schemes in SEPA, in which "domestic" should be an anachronism. In a pre-SEPA environment of only international schemes, SEPA for Cards made no sense. From a formal point of view, SCF has been fully implemented – but only from a formal point of view. If we want to measure the market effects of a truly integrated SEPA cards' market we need new indicators.



Cross-border card transactions in the Euro area
as a percentage of total transactions at POS terminals (Source ECB)

What could be the consequences of this SEPA vision for cards with full operability and reciprocity between the domestic schemes? The international schemes would lose their USP as a brand for cross-border transactions inside SEPA (however, not for transactions outside of SEPA). Domestic schemes would be able to counter-attack the "American" schemes in their XB-business. Within SEPA, the same level playing field would be created implying competition between all of the schemes. A logical step of the issuers would be the termination of co-badging. Another option could be the brand-migration by the issuer from the domestic scheme of their home country to a foreign domestic scheme, which is more innovative, offering advanced technology etc.

Until now the structural market effects of SEPA for cards has been limited to the reduction of the number of schemes (termination of several domestic schemes) and an initial and cautious competition between domestic and international schemes for domestic transactions in some markets. That´s all. Without more substantial effects, SEPA for Cards is more or less a European standardization program with efficiency-only effects for all players as outcome.

Apple Pay: difficult expansion outside the US

In July, Apple Pay was launched in the UK. Thus, the UK has become the first country after the US where Apple managed to strike a deal with card issuing banks. According to the Financial Times, UK banks will pay considerably lower transaction fees ("only a few pence per £100 transaction") than US banks.[8]

Apple is also negotiating with Canadian and Australian banks but there still is no official launch date. According to press releases, fees have been a problematic issue in both countries.[9] Given the low level of interchange fees in the UK (max. of 0.3% after European interchange regulation came into force) and in Australia (about 0.5%), it has always been clear that banks would not be willing to pay as much as 0.15% for Apple Pay. It is interesting, however, that even in Canada with its relatively high rates (about 1.5%), banks are reluctant to strike a deal.

Our Comment:

Obviously, fees are always a contentious issue, but the question why and how much issuers should pay Apple raises the broader question how Apple fits into the standard 4-party model.

To be sure, the standard 4-party model (with card holder, issuer, acquirer and merchant) has always comprised more than 4 parties. First of all, there is the card scheme as 5th party and then there are numerous payment service providers (PSPs) that provide ancillary services: issuing and acquiring processors, network operators, terminal service providers, etc. Customers of these service providers are issuers, acquirers and merchants.

On the acquiring side, merchants pay for payment services provided by acquirers and other PSPs. They buy the product "payments". As buyers they are interested in costs and quality of service and it does not matter much which acquirer and which PSP offers these services.
On the issuing side, services required by card holders are usually provided by issuers (produced inhouse or on an outsourcing basis). From the point of view of the card holder, it does not matter which particular PSP provides such services. In fact, most of the time, the customer does not even know which service providers are involved because they act on behalf of issuers.

So, on both sides of the market, PSPs are competing with each other and no single provider has a privileged position. However, in the field of m-payments this may be different.

Apple may pose quite a threat to the profitability of card issuers

Because in this field payment is about to be merged with communication and other non-payment services (or should we say “lifestyle”?). “Card users” do care whether the m-payment service is carried out with the assistance of Apple or some other some other provider (say Samsung with an Android phone). An issuer who does not strike a deal with Apple and who tells his customers that they may well use an Android phone to carry out contactless payments at the POS may find that some of his/her customers will terminate their card contract and move on to some other issuer who does support Apple Pay.

So, if the desire to use a phone (rather than a plastic card) is substantial and if there is a strong preference for Apple, issuers basically have to pay Apple for access to the Apple customer base. If there is competition between issuers, Apple may raise the price as high as the surplus issuers are earning from card holders. Thus, depending on the two “ifs”, Apple may pose quite a threat to the profitability of card issuers. This effect is limited, however, by Apple’s limited share of the smart phone market.

Fraud with Australian NFC cards alarms regulators

According to Australian police reports, there has been a significant amount of card fraud using low-value contactless transactions ("Tap and Go").

"The increasing use of new card technology such as 'Tap and Go' and the removal of PINs and signatures provides motivation for offenders to physically steal credit cards to commit multiple transactions with little risk of being caught or challenged for identification."[10]

In Australia, "Tap and Go" can be used up to a threshold of 100 AUD (63 EUR). The police are complaining about the resulting extra work and call on card issuers to let customers decide whether they want to enable contactless transactions (via an "opt-in option").

The Australian parliament has taken up the issue: At the moment, it does not see any serious fraud risks but it supports the critique of the police that the financial industry should discuss security issues more closely with the law enforcement agencies and that there should be an opt-in function.

"The committee recommends that financial institutions which issue debit and credit cards create an 'opt in' function that requires customers to consent to contactless payment technology features being activated on their cards." (Recommendation 12)[11].

Our Comment:

When contactless payments were rolled out, initial concerns were that sophisticated fraudsters might generate contactless transactions without card holders noticing it. In reality, it seems to be "traditional" card theft that may pose a problem for contactless payments. As the Victoria police notes, cards are stolen from "handbags, wallets, ... from motor vehicles and mail boxes". Tap and Go allows thieves to conduct a number of small-value transactions with very little risk of being detected. Since Australian issuers provide card holders with zero liability, there are no losses for card holders and since the transactions are of limited size, the loss for issuers is bearable. Thus, issuers are not too concerned. But the police are - because of the extra work.

In Australia, cards may be particularly interesting for thieves because of the relatively high limit for transactions without PIN or signature (100 AUD, 63 EUR) and because issuers do not seem to have imposed a fixed number of transactions after which PIN or signature becomes mandatory. Thus, according to press reports, thieves could make a large number of relatively small purchases totalling up to 2,000 AUD (1,260 EUR)[12]. In other parts of the world, there is a lower threshold and the card has to be inserted into a terminal at certain intervals (or at random).

In reality, it seems to be "traditional" card theft that may pose a problem for contactless payments

Moreover, there may be cumulative maximum amounts for contactless payments. German issuers, for instance, have imposed a maximum in the range of 200-300 EUR. Given these restrictions, contactless cards are less interesting for thieves. They are, however, also less convenient for card holders.

It remains to be seen whether the problems reported by the Victoria police will also come up in other places. But the case shows how difficult it is to design a product that is meant to replace cash. Liberal offline-limits and zero liability policies for customers may make contactless cards popular but pose a challenge for issuers and police. Strict limits and/or full liability for card holders may reduce uptake by consumers.

Notes

1 http://www.europeanpaymentscouncil.eu/index.cfm/knowledge-bank/epc-documents/euroland-our-single-payment-area/sepa-whitepaper-0520021pdf/
2 http://www.europeanpaymentscouncil.eu/index.cfm/sepa-vision-for-cards/sepa-vision-for-cards/
3 https://www.ecb.europa.eu/paym/retpaym/paymint/indicators/html/migration_card_payments.en.html
4 Figures for Europe Zone 1 with are including the SEPA countries (euro and non-euro-area)See the Sept./Oct. 2013 edition of this newsletter.
5 Without the country data, which are missing or not consistent in the ECB DWH, like Germany, Austria, Ireland, Malta and Poland
6 http://europa.eu/rapid/press-release_IP-15-4921_en.htm
7 See: ECC-Net report "Enhanced Consumer Protection – the Services Directive 2006/123/EC, p. 29. http://ec.europa.eu/consumers/ecc/docs/ecc-services_directive_en.pdf
8 Martin Arnold, Andrea Felsted and Daniel Thomas: UK banks put squeeze on Apple Pay fees, Financial Times, July 14, 2015, http://www.ft.com/intl/cms/s/0/02287f44-2a3d-11e5-8613-e7aedbb7bdb7.html#axzz3l2EkkgCeIn some legislations within the EU, accounts at the card issuer related to a charge or credit card (not the current account linked to a debit card) and merchant accounts at the acquirer are not regarded as payment accounts according to the PSDI. Assuming a synchronization and harmonization of definitions between the PSDII and the IF regulation, these local interpretations could be controversial, because such accounts are definitely payment accounts according to the IF regulation.
9 James Eyers: $2b fee sticking point as Apple wrangles with Australia's big four banks, The Sydney Morning Herald, August 17, 2015, http://www.smh.com.au/business/banking-and-finance/apple-pay-being-repelled-by-big-banks-20150815-gizz6y.html and Daniel Tencer: Apple Pay Coming To Canada In Fall 2015: Will There Be A 'Collision' With The Banks?, The Huffington Post Canada, posted 17 April 2015, http://www.huffingtonpost.ca/2015/04/17/apple-pay-canada-launch-november-2015_n_7088810.html
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12 PHIL HICKEY: Perth's tap-and-go thieves use bank cards stolen from late-night drinkers, Perth Now, August 9, 2015 12:13pm. http://www.perthnow.com.au/news/western-australia/perths-tap-and-go-thieves-use-bank-cards-stolen-from-late-night-drinkers/story-fnhocxo3-1227476483717

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