



PAYSYS **REPORT**

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Recent trends in Italian card payments

(written by our guest author Marco Fava)

We invited **Marco Fava** as guest author to highlight the recent trends in the Italian card market.

Marco Fava is Managing Director of CleverAdvice, Italian Member of the European Payments Consulting Association (EPCA).



Marco has 20+ years of experience in payment cards and is helping a number of European issuers in increasing their presence in the commercial cards space.

Consumer cards

During 2014 the trend of steady growth in usage of cashless payment instruments in Italy was confirmed: both the value and number of transactions increased significantly more than the rate of inflation, which has been 0.2%. In particular, the number of card payments in Italy grew by 13% in 2014, similar to 2013 (+13.3%) while the value of transactions increased by 10.2%, a significant jump from the 6.2% growth rate of 2013.

The average payment transaction value (i.e. excluding cash withdrawals) decreased by 2.5% in 2014, which followed an even higher reduction of 6.2% during 2013. That implies that a growing number of individuals are using payment cards for smaller, everyday purchases and as such displacing a number of cash payments. We believe this trend has been experienced and will continue mostly due to three reasons:

1. An increasing number of cardholders are getting more familiar with using payment cards, valuing their convenience over and above cash.
2. The steady growth of prepaid cards, which are typically used for lower value payments.
3. An increasing penetration of POS terminals among smaller merchants and sole traders concerned about potentially losing sales of individuals willing to pay with their card, and stimulated by the increasing mPOS offerings.

Our comments above are also based on a number of researches that we have carried out among Italian cardholders and merchants in the last three years.

Trends in charge cards

The number of consumer charge (i.e. deferred debit) cards outstanding in Italy is declining (-3% during 2014) confirming the trend started in 2009 with the economic downturn. This is due to a number of cardholders rationalizing their charge card portfolio i.e. dropping cards they seldom use. The reduction in the number of charge cards also highlights the general risk aversion of Italians: many in fact prefer not to be continuously exposed financially (i.e. every month) and are concerned about losing control of their expenses.

However, it should be noted that cardholders that decided to keep their charge cards used them more on average than in the recent past: in 2014, the number of payment transactions grew by 9.6% and values rose by 6%.

Trends in credit cards

After several years where the number of credit cards was in decline, in 2014 the number of credit cards grew at just over 3%. This is due to an improved insurance and service offering in line with client needs as well as the issuance of an increased number of more cost attractive products. Credit card transaction value grew by 5.3% in 2014 and even more so during the first six months of 2015 (+14.7%), confirming the upward trend.

Trends in debit cards

The number of debit payment cards in Italy continues to grow: after a healthy growth of 11.4% in 2013, in 2014 the number grew by 6.4%. As mentioned earlier, this reflects the risk averseness of Italians who tend to prefer debit vs. charge or credit cards for their everyday expenses. The higher number of debit cards has been reflected in higher debit card usage, with a 13.4% increase in payment transactions and a 12.2% growth in transaction value during 2014.

Trends in prepaid cards

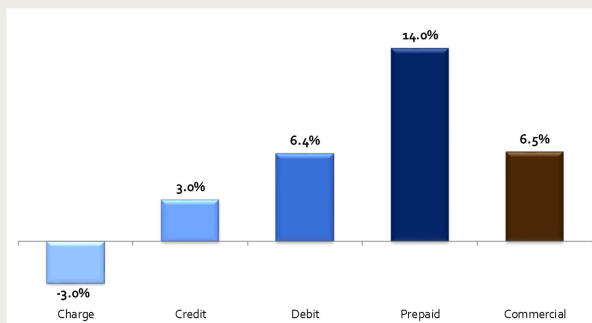
After a 5.5% increase in the number of cards in 2013, the number of open-loop, reloadable prepaid cards, experienced a further growth of nearly 14% during 2014. Italians confirmed their preference for prepaid payment instruments. Italy is the European nation that experienced the highest growth in the issuance of prepaid cards and with the highest transaction value. After approx. 12 years since their introduction, the number of prepaid cards is now approaching that of charge cards, introduced to the Italian market over 40 years ago. Usage of prepaid cards during 2014 grew even more strongly: +19.4% in the number of payment transactions, which resulted in +14.8% in transaction value.

Impact of Interchange Fee regulation

IFR has been enforced in Italy since 9 December 2015. The impact on Italian issuers' revenue will be significant as average IFs for consumer credit, debit and prepaid cards will be cut 50-65% by the new regulation. To offset decreasing revenues, a number of issuers started to increase annual fees by charging monthly fees in lieu of annual fees and/or charge for services that used to be free such as monthly or quarterly transaction reports. This started to impact the composition of the card portfolios where there are signs of rationalization not seen before: the share of single-holders is increasing, while the number of multi-holders is decreasing as a consequence of consumers not seeing the value in paying annual/monthly fees on multiple payment cards.

General trends in card products

We believe that in the foreseeable future many aggressive issuers will focus on differentiating their card offering to gain a competitive advantage since portfolio rationalization is being considered by an increasing number of cardholders. In addition, our opinion is that they will focus on young customers and on-line payment and related services as they are both experiencing significant growth, which we expect to continue in the foreseeable future.



Cards outstanding: 2013-14 change

In spite of an increased share of charge and credit card products dedicated to younger customers (18-34 years old) – 21.3% in 2015, up from 8.7% in 2008 for charge cards, 17.7% in 2015, up from 10.8% in 2008 for credit cards – we believe that there will be a greater focus on prepaid cards. This is due to a number of reasons:

1. Prepaid cards are widely used to pay for online purchases: e-commerce is the fastest growing environment and our research shows that slightly over 50% of prepaid cardholders use their prepaid

cards mostly to pay online.

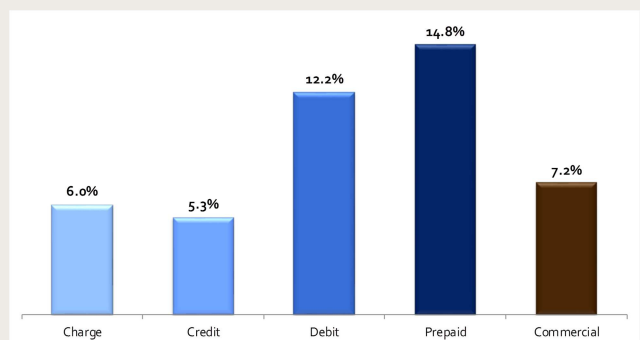
2. There is no need for them to provide a credit scoring, which eases customer acquisition and involves no risk for the issuer.
3. Prepaid cards require no bank account, which widens the potential customer base to include the unbanked.
4. There are opportunities to differentiate issuing with prepaid cards targeted to specific customers / industries (e.g. travel, currency, ...)

Impact of the Payment Account Directive for the Prepaid Card business

The implementation of the Payment Account Directive for the Prepaid Card business is likely to have marginal consequences on both banked and unbanked customers even in consideration of the high fees and duties levied on bank accounts in Italy. This is due to 2 reasons:

1. IBAN Prepaid cards (Prepaid cards that offer basic bank accounts) have been around for over 5 years and today make up 10-15% of all prepaid cards in Italy. IBAN Prepaid cards offer both attractive bank fees and are exempted from government duties.
2. Since 2012, Italian regulations require all issuers to offer basic bank accounts at very limited fees if the outstanding balance is kept below € 5,000. In addition these accounts are exempted from government duties.

IBAN Prepaid cards are popular not only due to lower fees but also because of their perceived convenience: a number of Italians realise they can combine all their banking and payment card services within a single product that they can hold in their hand, possibly a consequence of the high use of cash, still a king among Italian consumers.



Value of payment transactions: 2013-14 change

We expect the growth in prepaid cards in Italy will continue in the foreseeable future through offerings that will start to change significantly to include services addressed to specific customer segments and a higher number of highly focused, non-bank issuers entering the market that will find it easier to offer prepaid rather than debit/credit cards to consumers highly receptive to prepaid products.

Commercial cards

After a healthy 8% growth during 2013, the number of commercial cards in Italy grew by 6.5% in 2014. The value of commercial card payments (excluding cash withdrawals) was € 11.3bn, up 7.2% from 2013, which accounts for nearly 8% of overall card payments.

Banks will be likely to try to replace individual billing charge/credit cards with prepaid cards to benefit from the uncapped interchange fees

This is mostly due to three reasons:

1. A larger share of Italian companies are realizing that using cards not just for travel-related services but also to pay for some procurement expenses provides more benefits than some traditional payment tools such as checks, which are still used but significantly less than in the recent past.
2. A higher understanding of the benefits provided by expense reporting.
3. The increasing share of company online purchases that are easily payable via a payment card but not with a number of other payment tools.

The large majority of remaining commercial cards are still charge/credit cards, but also prepaid cards and more recently debit cards are gaining momentum due to a wider offer and the familiarity of Italians with such payment card types.

In particular, a number of banks have started issuing commercial prepaid cards in the last 3-5 years while more recently a few large issuers have introduced commercial debit cards, in part due to a significant push by Visa Europe, following successful results with commercial debit products in both UK and France.

We believe in the foreseeable future Italian issuers will focus additional effort in the commercial cards space, diversifying prepaid offers with products targeted to specific segments, which will include cards designed to meet the needs of larger companies unwilling to provide charge/credit cards to a number of their employees. Also banks will be likely to try to replace individual billing charge/credit cards with prepaid cards to benefit from the uncapped interchange fees of the latter without increasing a company's financial exposure.

The EBA's Discussion Paper on „Regulatory Technical Standards“

(mk) The PSD2 has mandated the European Banking Authority (EBA) to develop a number of technical standards and guidelines. In order to carry out this task, the EBA has invited market participants to comment on a number of issues. On December 8th, 2015, it published a Discussion paper on "Regulatory Technical Standards" applicable to payment services.¹ Market participants were invited to comment by 8 February 2016.

In the discussion paper the EBA highlights the background to its assignment and then moves on to discuss particular issues:

- Strong customer authentication,
- Exemptions from strong customer authentication,

- Protection of personalised security credentials,
- Secure open standards of communication,
- Possible synergies with the e-IDAS regulation².

Subsequent to the discussion of each of the topics, the EBA asks a number of questions it would like respondents to answer. The submission deadline has now expired and it will be interesting to see how market participants have responded and how the EBA will react. But one thing is already clear: the regulations of the EBA will be of utmost importance for the market as a whole and for the competitive position of different groups of market players.

Our Comment:

The PSD2 is an ambitious piece of legislation. Regulators want to foster competition, innovation, standardisation, security, consumer protection, etc., etc. Not all of these goals are in harmony and when reading the text of the PSD2 one cannot escape the impression that in many difficult cases regulators happily decided to leave it to someone else - in this case the EBA - to make crucial decisions. In fact, when reading the Discussion Paper, one cannot help feeling that the EBA is not particularly happy with the task it has been required to carry out. Of course, as a good and faithful regulator, the EBA does not openly say so. But the paper is a testimony to its realisation that the task is huge.

The EBA is required to set six technical standards and five sets of guidelines.³ In particular, specifying technical standards will be a huge challenge

- because technology is evolving fast in this field and
- because lawmakers have not always been careful to address potential conflicts between the desired goals.

Thus, there are sound reasons for doubting that it is wise to fix particular security measures in a regulation. What is deemed secure today may be insecure tomorrow. Market participants must be able to act quickly.

Unfortunately, the PSD2 is formulated in a way that leaves little room for interpretation

But sticking close to the provisions of the PSD2 may well lead to trouble. And who will be made responsible in the end, European law-makers or the EBA?

For instance, in recital 95 they want to *"reduce, to the maximum extent possible, the risk of fraud."* But in recital 96 they introduce a caveat: *"The security measures should be compatible with the level of risk involved in the payment service."* Thus, costs and convenience should also not be forgotten.

The EBA seems well aware that that there are many trade-offs that have to be considered (p. 9):

- Security versus innovation,
- Security versus convenience,
- Standardisation (allowing competition via easy entry) versus innovations.

But how can a regulatory body deal with such trade-offs? One thing seems to be sure: the more detailed the regulatory technical standards are meant to be, the more difficult it will be to deal with these conflicting objectives. More general, more results-based regulations would allow regulators to take trade-offs into account. It would also allow market participants to react with a sufficient amount of flexibility if new security challenges should arise.

Unfortunately, the PSD2 is formulated in a way that leaves little room for interpretation. A strong regulator with decades of experience and an established high reputation might still be prepared to bend the rules a bit. But for a fairly new institution like the EBA this would require an enormous amount of courage. But sticking close to the provisions of the PSD2 may well lead to trouble. And who will be made responsible in the end, European law-makers or the EBA?

Swish – Sweden's blueprint for a European real-time P2P system?

In late 2015, one was virtually bombarded with headlines such as *"In Sweden, a Cash-Free Future Nears"* (New York Times)⁴ or *"Sweden is on track to become the world's first cashless society"* (sciencealert)⁵. Such headlines were not only driven by the declining share of cash in day-to-day payments. What particularly caught journalists' attention was the success of Swish, the Swedish mobile real-time P2P payment system. Many commentators drew on the work of the Swedish economist Niklas Arvidsson who recently analysed the development and implementation of Swish.⁶ Arvidsson sees Swish as an important payments innovation that will speed up the move away from cash in Sweden.

"In 2015 we see a rapid decline in the use of cash as innovative payment services – such as Swish – have become a direct substitute to cash payments in situations where cash historically used to be the only alternative, e.g. payments between friends or in situations where electronic payment services did not function." (Arvidsson 2015, p. 203)

Indeed, Swish seems to be taking off and is receiving a lot of attention in the media. The success of Swish comes at a time when European policy makers are also thinking about developing some kind of real-time payment system. The European Retail Payments Board (ERPB) chaired by the ECB is pushing for an "instant" version of the SEPA Credit Transfer (SCT^{inst}).⁷

Our Comment:

(mk) To be sure, Sweden has come a long way on the road towards cashlessness. Card usage is high and rising and both the stock of cash and the value of cash withdrawn at ATMs are declining.

So, the move away from cash has mainly been a "card success story". So far, Swish has not played a significant role. But Swish may be entering payment segments such as P2P that have not been served by cards. Moreover, Swish has gained a large customer base within two years and usage figures are rising

fast. Thus, it does not seem unlikely that Swish will have a significant impact.

So what is Swish? It is a P2P/P2B system developed by Swedish banks – jointly with the Swedish bank clearing house Bankgirot and the Bank of Sweden. At the moment, Swish is accessible to customers of the following banks: Danske Bank, Handelsbanken, ICA Banken, Länsförsäkringar, Nordea, SEB, Skandia, Sparbanken Syd, Swedbank och Sparbankerna.

	2010	2011	2012	2013	2014
Card payments per person	206	210	230	250	270
Card payments (SEK billions)	783	796	849	900	981
ATM cash withdrawals (SEK billions)	214	206	183	218	208
POS payments (SEK billions)	544	573	626	666	690
Bank notes in circulation (SEK billions)	98	94	89	83	75
SEK/EUR (yearly average)	9.53	9.03	8.70	8.65	9.10

Cash and cards in Sweden

Sources: BIS, Red Book data, Sveriges Riksbank and own calculations.

The Swish payment system consists of the following elements:

- a Swish app on smart phones,
- an ID stored on the phone (“Mobile BankID” an electronic personal identification system for mobile phones and pads used by various service providers),⁸
- a payment message broker that routes messages between participants,
- the real-time settlement system BIR (connected to the Swedish Central Bank’s settlement system RIX).

Connected customers may use their mobile phones to make instant transfers to other customers or to an increasing number of companies and organizations that are connected on a “payee only” basis.

Arvidsson portrays the success of Swish as the result of a disruptive technological innovation that has been implemented in a cooperative effort of the Swedish banks, the Swedish Central Bank and the Swedish clearing company Bankgirot. So, basically, this is another example of the successful application of the “co-opetition” model that has been frequently used in payments. The most successful application was the introduction of cashless wage payments in Sweden and many other “giro-countries”.

An important question is whether the Swedish approach can be scaled up to the European Union as a

whole. First of all, the very fact that there is a Swedish approach and now a Swedish system up and running gives food for thought. Are we not living in SEPA? Why is it that there are still so many national “go-it alone” approaches?

SDD and SCT have taken a long time to be designed, agreed and implemented. In the end, success required regulations to force everyone on board. Moreover, it should not be forgotten that in many parts of the market new products are evolving fast and there may be little time.

Experience teaches us that it is a huge challenge to change the backbone of payment systems and that it takes an enormous amount of time. Apart from SDD and SCT, EMV comes to mind. Europay, MasterCard and Visa started this project back in the 1990s. Today, in 2016, more than 20 years later, the US is getting close to implementation. But 100% still seems to be far off.⁹ So, before proceeding, one should always look at the question of whether it is really necessary to touch the backbone. In many cases, using the existing backbone in novel ways may do.

Does real-time towards the customer also imply real-time in settlement? Card systems seem to do fairly well, providing a sort of “real-time” for their customers with the use of a guarantee. Settlement, however, is postponed. The same is true for direct debit payments when merchants buy a guarantee or insurance from a PSP.

Real time settlement is important when two conditions are fulfilled:

- Need for immediacy (the transaction needs to be carried out right away)
- Relatively high risks (due to high value or risky counterparty)

When looking at the use-cases of systems like Swish (or m-payments more broadly) one of the recurrent themes is that you are out with friends and need to split the bill. Well, unless you do not trust your friends there is neither a need for immediacy nor is there a high risk.

Ultimately, decisions about investments into new payments infrastructure depend on the business case. New products must help market players to earn a reasonable return – either by opening up new revenue streams or by helping to defend existing revenue streams against competitors. Unfortunately, a European system does not look promising in this respect. When it comes to creating new revenue streams, the Swedish example with Swish provides reasons for caution. The Swedish banks had planned to charge customers a transaction fee. However, as Arvidsson notes: *“In the fall of 2015, none of the banks have introduced transaction fees for consumers when they use Swish. The users are deemed to still not be ready for such a disruptive feature.”* (p. 206).

When it comes to defending bank’s turf against competitors, things look even less promising. The PSD2 grants other PSPs access rights to the banks’ infrastructure. Of course, access per se need not be a big

problem. If banks could charge a reasonable price for such access, it might still be interesting to invest. But given the current stance of European anti-trust policy that is a big “if”.

Does real-time towards the customer also imply real-time in settlement?

Meanwhile, in Sweden, economists are already pondering the question of how to handle the declining market share of cash. In a very comprehensive and thoughtful article, Segendorf and Wretman address the challenges ahead.¹⁰ As they point out, even in Sweden, not everyone wants to go cashless. Moreover, not everyone may be capable of going cashless. Thus, there is a public policy issue in how to aid these people. Another issue is the quality of the infrastructure. Of course, Sweden has a high-class infrastructure. But there are gaps. If one wants to phase out cash, such gaps seem unacceptable.

Users in November 2015 (millions)	3.7
Users in November 2014 (millions)	1.9
Transaction value in June 2015 (million EUR)	388
Number of transactions in June 2015 (millions)	6.4
Number of companies and organizations as payees	45 000

Swish at a glance

Source: www.getswish.com and own calculations.

Notes

- 1 EBA: Discussion Paper on future Draft Regulatory Technical Standards on strong customer authentication and secure communication under the revised Payment Services Directive (PSD2), EBA/DP/2015/03, 8 December 2015.
- 2 Regulation (EU) N 910/2014 on electronic identification and trust services for electronic transactions in the internal market.
- 3 In addition, the Interchange Regulation requires the EBA to define how to separate payment card schemes and processing entities.
- 4 Liz Alderman: In Sweden, a Cash-Free Future Nears, New York Times, web edition, Dec 26, 2015
http://www.nytimes.com/2015/12/27/business/international/in-sweden-a-cash-free-future-nears.html?_r=0
- 5 Bec Crew: Sweden is on track to become the world's first cashless society, 16 October 2015.
<http://www.sciencealert.com/sweden-is-on-track-to-become-the-world-s-first-cashless-society>
- 6 Niklas Arvidsson: Emergence of an ICT-based disruptive mobile payment service, in: Eric Giertz, Annika Rickne & Petri Rouvinen (eds): Small and beautiful. The ICT success of Finland & Sweden, Vinnova Analysis VA, October 2015, p. 200 - 208.
- 7 ERPB Secretariat: Review of the EPC proposal for the design of an instant SEPA Credit Transfer scheme, 11 November 2015.
- 8 The BankID website provides some (limited) information in English (www.bankid.com).
- 9 Stephen Kiene: EMV Activity Rising Slowly but Steadily in the U.S., First Annapolis Navigator, January 2016.
- 10 Björn Segendorf and Anna-Lena Wretman: The Swedish payment market in transformation, sveriges riksbank economic review 2015:3.

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