



PAYSYS REPORT

Issue 5 – October 2021

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1. European Payments Initiative (EPI): German savings banks plan to put some money on the table

According to press reports, the German savings banks have made a decision to invest in the European Payments Initiative (EPI). This is an important step for EPI. But the question is whether the other initiators of this initiative are willing to follow. Another question is whether the envisioned total amount of €1.5 b will be enough.

2. EPI, the end of Maestro and the co-badging issue

Mastercard has announced that starting June 2023, Maestro will no longer be supported. Already in 2019 Visa had made a similar decision with respect to V Pay. The move is not a big surprise because the number of Maestro cards has been steadily declining in recent years and Mastercard has been actively promoting its new debit product, Debit Mastercard – just like Visa has done with Visa Debit. The issuing banks, and also the European Payments Initiative (EPI), now have to ponder how to react. One obvious solution would be co-badging, either domestic debit cards or EPI cards, with Debit Mastercard or Visa Debit. However, the problem for domestic schemes or EPI would be that customers might find the new debit products of the international schemes so convenient that they become the preferred method of payment for all transactions.

European Payments Initiative (EPI): German savings banks plan to put some money on the table

(mk) According to the German business newspaper "Handelsblatt", the German Association of Savings Banks (DSGV) has decided to invest €148 m in EPI.¹

The Handelsblatt also reports that banks are now estimating necessary investments of EPI of €1.5 b over the next 5 years.

Compared to earlier figures voiced in the market (€4-5 b), this is a relatively modest amount.

The Handelsblatt also reports that the banks are calculating a future business case on the basis of a 0.2% interchange fee (IF). Apparently, a scheme fee is also planned to fund the running costs.

Moreover, they are still hoping that public funds will be forthcoming to support the project.

EPI has been set up by 31 banks and 2 payment service providers from 7 European countries (Belgium, Finland, France, Germany, the Netherlands, Poland, and Spain).

These 7 countries account for roughly two thirds of European card transactions and also about two thirds of GDP. But while in some countries (Germany, France or Spain), the participating banks cover almost the entire market, in other countries coverage is only partial (for instance Poland or Belgium).

There are no indications yet that non debit cards (like cards with delayed debit or credit cards) will be issued under EPI. The EPI potential is thus limited to approx. 70% of the European card payments volume. See fig. 1.

Our Comment:

It certainly has been an important step that the DSGV is pledging money for EPI. Now it is up to the others to put some money on the table. But even the target of EUR 1.5 b is reached - will this be enough? The plans of the EPI are ambitious.

According to Martina Weimert, CEO of the EPI Interim Company, EPI "is both a card, an instant payments scheme and a wallet".²

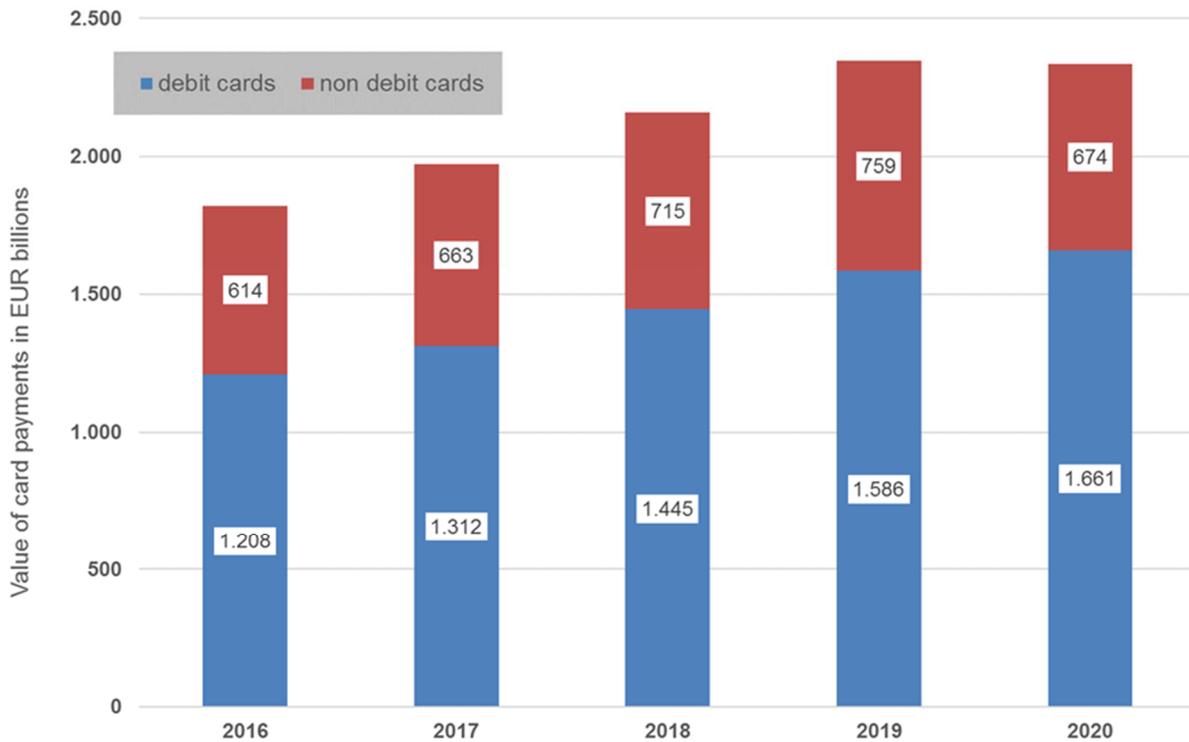
There are big plans for an EPI app: "The idea is to address point-of-sale payment, ecommerce, cash

withdrawals and P2P, and value-added services such as digital identity or instant financing." In addition, the solution will "contain currency conversion" (Weimert).

Putting all of this together may not come cheap. Moreover, as Weimert herself points out, for the moment, the existing domestic schemes in Europe do not require large investments beyond "maintenance and regulatory investments".

That does not make it easy for banks when it comes to deciding about large investments in a new

Fig. 1: Value of card payments with cards issued by resident PSPs in EU (27).



Notes: The low volumes of hybrid cards with a debit and/or delayed debit function are counted as "non debit cards". Due to the pandemic, the previously stable share of debit card sales has risen from approx. 66-68% (2016-2019) to 71% in 2020. A detailed analysis for specific countries shows that the increased preference for the debit card payments since the outbreak of the pandemic has been caused by the effects of the lockdown of certain market segments in which credit and charge cards are preferred (Travel & Entertainment). In those sectors that have not been affected by the lockdown, there has been no increased consumer affinity for debit cards.

Source: ECB Payment Statistics

scheme.

We find it hard to believe that the banks will receive public funds.

While German savings banks have made a decision, they still seem to hesitate. According to a report published in a financial newsletter, the Spanish and

Dutch participants still do not see a convincing story why EPI should succeed.³

If some banks should drop out of the initiative, the financial burden for the others would become heavier. In times of rising capital requirements this may be particularly unwelcome.

Will the EU assist financially? The German savings banks seem to think so. We find it hard to believe that the banks will receive public funds. But you never know.

Maybe some of the money collected via issuance of "green bonds" will find its way towards financing EPI? The EPI initiators might consider to choose a green logo for EPI.

EPI, the end of Maestro and the co-badging issue

(mk) At first, there were rumours in the financial press. But market participants did not have to wait for long. On October 19, 2021 Mastercard announced its decision to phase out Maestro.⁴

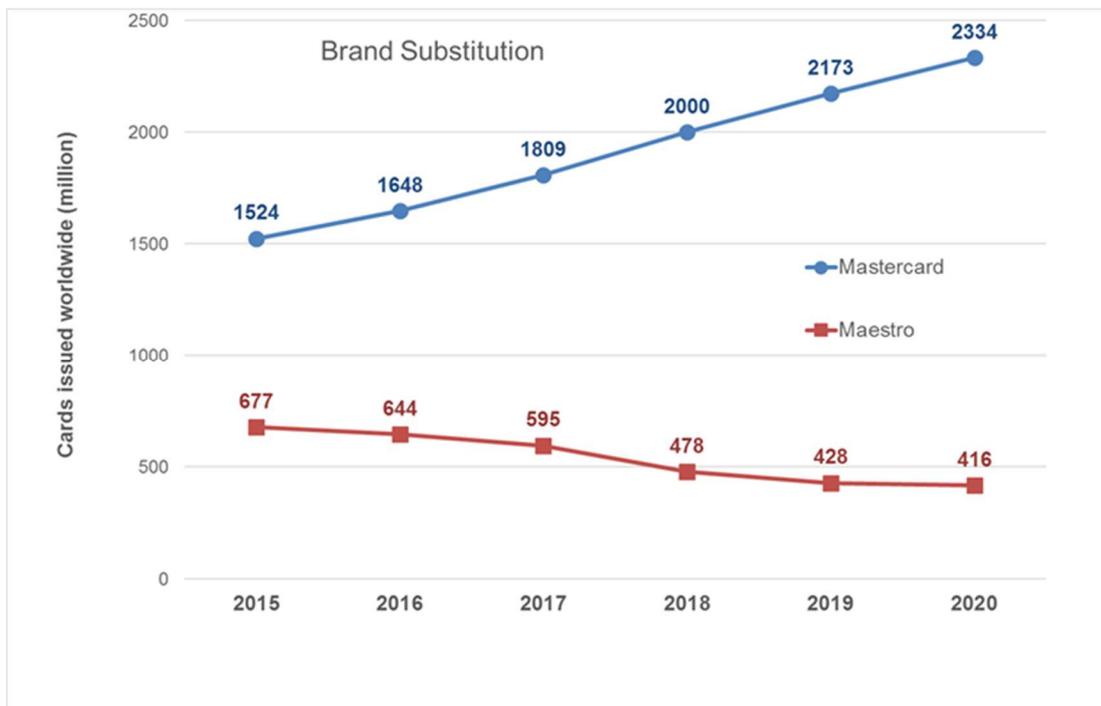
Starting July 1, 2023 Maestro cards will no longer be issued. So, after more than 30 years a brand that was widely used as a second brand on co-badged cards will become history.

Maestro was successful, to some extent. In the words of a Mastercard blog: *“Maestro effectively became the only pan-European debit brand accepted almost everywhere*

across Europe. There are now more than 400 million in circulation worldwide.”

But as Bob Dylan said *“the times they are a changin’ ”* and Mastercard has decided to move on: *“It’s time to adapt the smart, safe and seamless experience that people have learned to appreciate when using their debit card in the physical world to today’s digital lifestyles.”*

Fig. 2: Brand Substitution Mastercard versus Maestro (2015-2020).



Source: Mastercard

Our Comment:

The number of cards carrying the Maestro brand has declined in recent years. See fig. 2. But Maestro is still important in a few European countries (like Germany, Italy and Belgium; see diagram 2) as a co-badge next to a domestic debit brand. So, in these countries, quite a few banks will have to ponder their card issuing options over the coming months.

Visa has already announced since the beginning of 2019 that the European brand "V PAY" will be steadily replaced by "Visa Debit" over the next few years. In contrast to Maestro, an end date has not yet been publicly communicated.

Figures for V PAY have not been published for a long time. In Visa's annual reports, the term V PAY (like the insignificant brand "Electron") only appears in footnotes since 2014. In the latest publication citing V PAY data, Visa reported only 30 million V PAY-branded cards in 2013 (!), 90% of which were issued in Germany.

What are the implications for the European Payments Initiative (EPI)? One could argue that the end of Maestro does not affect EPI. After all, co-badging will still be possible, not with Maestro but with Debit Mastercard.

But Mastercard's move is affecting the dynamics of the market. With Maestro heading for the exit, issuing banks may start already before June 2023 to replace Maestro co-badges with Debit Mastercard co-badges.

So, Mastercard's move may already accelerate the uptake of Debit Mastercard and Visa Debit in 2022.

As Mastercard correctly points out, Debit Mastercard gives users much more options than Maestro. Of course, the same applies to Visa Debit. So, it will be difficult for EPI to argue that they can offer a significantly better product.

The case for EPI would rest on questions of European governance and the fear of rising scheme fees. Maybe from the point of view of the European banking sector as a whole, this may still be sufficient grounds for supporting EPI.

But from the point of view of an individual bank, using the international card schemes (ICS) and playing "wait and see" may be more promising.

If EPI initiative succeeds in establishing a European

Diagram 1: The potential future European card landscape

	EPI		domestic schemes (DS)		no EPI & DC
acceptance	no co-badge	co-badged	no co-badge	co-badged	
domestic	EPI	EPI or ICS	DS	DS or ICS	ICS
intra-Europe	EPI*	EPI or ICS	option: DS ***	ICS or common brand***	ICS
outside Europe	option: EPI**	ICS	na	ICS	ICS

*: May not apply to all EU countries (as long as EU-coverage is less than 100%)

** Assumption: EPI succeeds in establishing acceptance worldwide through cooperation with acquirers (similar to JCB and UnionPay).

*** The intra-European acceptance can be realised through acceptance of the domestic brands (as already partly in card-not-present ecommerce) or via a common brand.

scheme, issuers will have quite a few options: EPI with or without co-badge with the brand of an ICS, a domestic brand (if applicable) with or without co-badge or an ICS-brand (Debit Mastercard or Visa Debit).

Such an end date regulation may also be required to provide EPI with the necessary scale.

Will the establishment of EPI lead to the end of domestic schemes? This is the idea of the EPI initiators. As Martina Weimert, CEO of the EPI Interim Company, put it: *"We're not doing a merger, but a transfer of domestic transactions into EPI, which ultimately could result in de-commissioning domestic card schemes."*⁵

But it cannot be taken for granted that this will happen. At least for a certain period, there may well be a co-existence of domestic schemes and EPI.

That could be a co-existence of single-brand domestic cards with EPI cards or co-badged cards (domestic plus a common brand as interim stage of EPI).

Something comparable happened when SCT and SDD were established. In the end, the EU Commission terminated this parallelism of domestic and European schemes via an end date regulation.

Such an end date regulation may also be required to provide EPI with the necessary scale. But to get there, it must first be up and running and that requires the financial backing of its initiators (see article above in this Report).

Just as the domestic schemes, EPI would depend on the ICS for international acceptance. Moreover, as not all EU countries may be covered, initially, it may also depend on the international schemes in some parts of Europe. Indeed, that seems to be the plan.

As Weimert says: *"we could go for co-badging agreements with Visa and Mastercard, mainly for international acceptance. The co-badging will be up to the decision of each bank, each issuer."*

From the point of view of the issuing banks a European debit card, usable only in Europe might not be so bad. They could market credit cards to all of their clients who need to pay outside Europe. Already today, cardholders prefer their credit cards (ICS-only cards) to their co-badged debit cards for XB payments. But it is not clear that such a solution would persist.

The European banking sector is not a monolithic block. Should bank customers wish to own an internationally usable debit card, some banks are sure to oblige. This would put other banks under competitive pressure to do the same.

In such a case, there could be substantial substitutions of debit cards branded with ICS for EPI cards.

Needless to mention that it is likely that Mastercard and Visa would use their substantial financial firepower to support such a trend. Thus, it is not clear whether such a nice division – debit cards with an EPI brand / credit cards with an international brand – would be feasible in the long run.

Co-badging is a double-edged sword.

So, co-badging may be the preferable solution. European law makers have made sure that such a solution cannot be prevented. Art. 8(1) of the Interchange Fee Regulation (Regulation (EU) 2015/751) prohibits scheme rules that *"hinder or prevent"* co-badging.⁶

Thus, co-badging would make it possible for banks issuing EPI-cards to offer a card that is accepted outside Europe. But co-badging is a double-edged sword. In one respect, it would make life easier for EPI. But in another aspect, things might get more difficult.

Co-badging would imply that all, or most, debit cards would carry two brands. Both of them would be usable domestically.

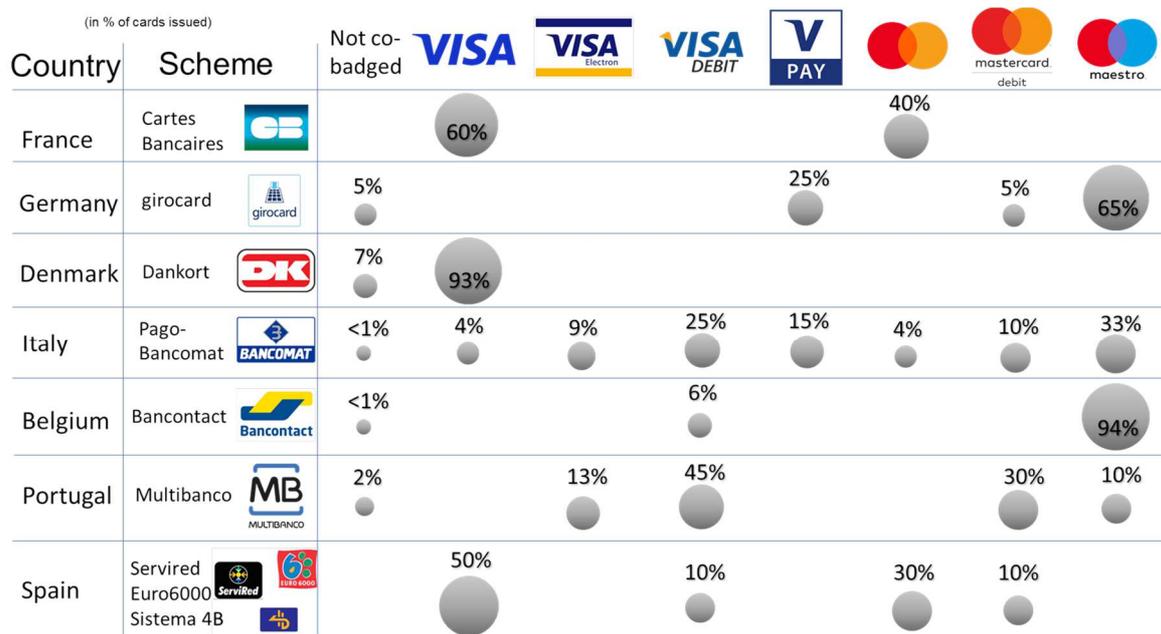
Having a competitor on each card may prove quite a headache. In the old pre-SEPA days, things were easy. "Co-badging" (or co-branding" as it usually was called then) meant that the domestic brand was always used domestically and the international brand only x-border.⁷

So, there was no competition between the brands. But

SEPA changed all this. Regulators wanted scheme competition and they prohibited agreements which effectively divided the market. The main beneficiaries were the international schemes. But they were somewhat timid to use the new clout. In particular, with high interchange fees, the acceptance network in most countries remained limited.

At this point, European regulators became active. Interchange fees were capped and the costs of acceptance of international cards were slashed. As a

Diagram 2: Co-badging practice in domestic schemes (EU)



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Source: PaySys market research

consequence, acceptance widened. International cards also became convenient products for domestic use. So the question is, do you really want to have such a co-badging "partner" on your card?

Competition would be fierce and Mastercard and Visa would do everything in their power to make their brands the first choice of cardholders and/or merchants.

What could regulators do in order to help the goal of a European scheme? They could go back to the rules before SEPA, i.e. allow restrictive agreements that divide markets. Will they do that? Probably not. Thus, co-badging should be carefully considered by the EPI.

Notes

- 1 E. Atzler and A. Kröner: Etappenziel für europäisches Bezahlsystem erreicht, Handelsblatt, 29.9.2021.
- 2 Exclusive interview with Martina Weimert, CEO of the EPI Interim Company, The Paypers, Monday 30 August 2021. (<https://thepayers.com/interviews/exclusive-interview-with-martina-weimert-ceo-of-the-epi-interim-company-1251230>)
- 3 Heinz-Roger Dohms und Christian Kirchner: EPI steht auf der Kippe – Spanier und Holländer zögern bei Funding, <https://finanzszene.de/payments/bangen-um-european-payments-initiative-spanier-und-hollaender-zoegern>, 21. October 2021.
- 4 Valerie Nowak: Why this Maestro is retiring after 30 years, October 19, 2021. <https://www.mastercard.com/news/europe/en/perspectives/en/2021/blog-from-valerie-nowak-why-this-maestro-is-retiring-after-30-years/>
- 5 Exclusive interview with Martina Weimert, CEO of the EPI Interim Company, The Paypers, Monday 30 August 2021. (<https://thepayers.com/interviews/exclusive-interview-with-martina-weimert-ceo-of-the-epi-interim-company-1251230>)
- 6 In the US, as well, co-badging has been regulated. See: Meanwhile in the US, PaySys SEPA Newsletter, September/October 2013. (https://paysys.de/wp-content/uploads/2019/09/2013_8newslettersep_oct13.pdf)
- 7 On the implications of rule changes with respect to co-badging see: Co-badging issues, PaySys SEPA Newsletter May 2007. (<https://paysys.de/wp-content/uploads/2019/06/sepamai07.pdf>)

Thanks to Scott McInnes of Bird&Bird for helpful comments.

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PAYSYS REPORT

Oktober 2021

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