Developing Europe's Third Scheme:

Leveraging ATM's to Create a Competitive Environment for European Debit Card Schemes

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The ECB’s fifth progress report encouraged Europe to establish a third card scheme to “stimulate competition and ensure the close involvement of European banks in the governance of the scheme”

Is there an opportunity to use Europe’s ATM networks to develop such a scheme?

Introduction

Does Europe really need its own debit card scheme? This is the question currently being asked by major bankers and key stakeholders in the euro-area's payments business. The issue of European sovereignty of card schemes has often been debated since the demise of the eurocheque in the 1990's. Europay, then owned 15% by MasterCard, was perceived as a European creation with potential to unify Europe's fragmented debit card schemes. However in pre-SEPA (Single Euro Payments Area) day's country boundaries were more closely defended and the 'edc' brand failed to take off. Eventually Maestro became the dominant cross border brand but in domestic markets only displaced schemes in Austria and Switzerland.

It is believed that the concept of creating a totally new European debit scheme was seriously considered during the development of the SEPA Cards Framework (SCF). However the European Payments Council (EPC) correctly recognised the difficulties in agreeing a debit card scheme rule book able to embrace 10+ very different debit card schemes as well as the very high cost of building scheme governance and promoting a new European brand. But there was an optimistic assumption that one way or another, the scheme "adaptation" changes mandated by the SCF would create an environment within which competing European card schemes would emerge and flourish. It is now increasingly clear that this is not happening on the scale expected.

All SEPA stakeholders (the European Central Bank (ECB), the European Commission (EC) and the EPC) almost certainly failed to anticipate the powerful forces that the SCF would unleash within the 12 euro-area countries and the rest of Europe. Markets are already moving in anticipation of SCF implementation. Two national debit schemes already have plans to migrate to International Card Scheme (ICS) brands although no commitments have yet been made. In several countries individual banks and bank groups are also expected to make similar choices. Consolidation and change is accelerating across the EU with many interbank schemes and processors commercialising, merging, or being sold to Third Party Processors (TPP). Market rationalisation already assumes a rapid move to a harmonised and common EU payments landscape.

"Markets are already moving in anticipation of SCF implementation"

But will this landscape be dominated by Visa and MasterCard, solid European players but with roots in the USA? Both these organisations have established EU brands (V Pay/Maestro), EU and worldwide reach, sophisticated networks and highly persuasive propositions. The SEPA stakeholders have a view that a possible outcome could be a duopoly, where card related decisions could be taken outside the EU.

However the hope that the SCF would lay the foundations on which to create new schemes has not been a failure. The beacon of European debit card scheme sovereignty is being upheld by the Euro Alliance of Payment Schemes (EAPS). The initial concept of a simple network (the Berlin Group) has advanced to that of almost a card scheme expected to be launched by end 2007.

EAPS has recently won support from the ECB who now realise that the EU card payment harmonisation project (see Eurosystems Review of a SEPA for Cards, November 2006) could reduce competition and potentially limit its ability to manage an orderly card payments market. Also the ECB now regularly points out that Japan has JCB, China has CUP, the US has Visa, MasterCard, American Express and Diners Club, but the EU lacks its own card scheme. In addition, the ECB recognises that ICS brands have the potential to significantly increase Merchant Service Charges (MSCs) in the low/no interchange nations of Belgium, Netherlands and Finland and thus raise merchant and consumer concerns.

> "the ECB now regularly points out that … the EU lacks its own card scheme"

However EAPS is still a developing scheme. It took the ICS over 40 years to establish themselves worldwide. Even within national markets, debit schemes took a minimum of five years to gain traction. In addition, EAPS operates in a commercial market place. It has no mandate to insist banks join. The scheme has to sell itself by "knocking on every door on every floor" of Europe's banks and domestic card schemes. Despite its modest resources, it will undoubtedly win members but it is unlikely to match the offers, networks and reach of the two major ICS brands. The outcome could be a successful scheme with limited reach in terms of both geography and member bank types.

So where do we go from here? The ECB and other stakeholders wish a European debit scheme to flourish and complete with the ICS. Major EU banks have recently been meeting to consider the issue. Is it too late to start again and build a new framework within which competitive European card schemes can emerge? This paper proposes that Europe is not in a cul de sac and that now is a time for review. It may not be too late to put in place the key components and enablers to make it happen.

Potentially there are four strategies or options that the stakeholders (ECB, EC, EPC) can consider:

Option 1 – Let Market Forces Prevail.

Under this option the stakeholders leave the creation of European debit schemes to market forces, essentially the "as now" situation. Emerging schemes are given public encouragement and support, but in the end banks must choose. Currently there is only one EU owned scheme option in the market but with support and exhortation others might emerge. Some of the strengths and weaknesses of this strategy are summarised as follows:

Strengths	Weaknesses
• Stronger and more competitive schemes if they emerge • Low cost and low risk for the stakeholders • Schemes control and manage their own destiny • No meddling in markets by stakeholders • Potentially lower cost processing solutions than ICS, if successful	• Slow growth of reach, connectivity and traction • Eventual cost and complexity of building debit scheme rule book that matches those of the ICS • High interchange (to compete with ICS) • No mandate to join – many banks cautious - new scheme concepts • Insufficient resources, marketing, selling capability to compete • ICS offers - highly compelling, attractive to many banks • Divergent euro-area expectations by owners and countries (eg. 3 versus 4 party models) • Cost of network creation and brand promotion • High risk option – limited chances of success

Table 1: Option 1 - New Debit Schemes Market Forces

Under the "as now" option, a market forces solution could in the long run deliver competitive, lower processing costs. However such an outcome is highly uncertain. More likely EAPS has good but modest success as a north/south scheme with savings/co-operative bank issuers in Northern Europe and acquirers in Southern Europe.

Option 2 – Incentivised SEPA Scheme Development.

Under this option it is argued that, just like any developing industry, emerging card schemes need protection if they are to compete and survive. For these reasons the stakeholders (ECB and EC) adopt light touch regulation, allow developing new schemes to charge higher interchange (already evident for EAPS with POS rates at €0.27) during the first five years of development and national market variances to continue. These concessions would be on the basis that both issuers and acquirers contribute a proportion of any premium interchange to help build the new scheme brand, infrastructure, governance and administration. Some of the strengths and weaknesses of this option are summarised as follows:

Strengths	Weaknesses
• Competitive advantage through minimal regulation • Banks choose new brands with higher interchange • Funding to build scheme rule book and network • Potentially increased reach, connectivity and traction	• No mandate to join – banks will decide • Potential unintended consequences and collateral damage • Complaints from ICS that concessions are discriminatory • ICS increase interchange to match – competitive escalator develops – or …. • ICS have lower rates and gain merchant support • Stakeholders seen to be meddling in the market – no easy exit once begun • Merchants object to high fees – particularly nations where low or nil at present

Table 2: Option 2 - New Scheme Development Incentives

At face value, further incentives and concessions might encourage new schemes to emerge. The ECB has already proposed regulatory concessions for new schemes in a recent draft paper (Oversight Framework for Card Payment Schemes, April 2007). However as with all regulation the outcome could result in market distortions, increased interchange costs for low/nil countries and not work effectively.

Option 3 – Mandated Full Scheme Development to Compete with ICS.

Under this option the development of a full European debit scheme is mandated by the ECB and the EC designed to compete with the ICS. It argues that a third scheme is essential to enable the long term stability and control of Europe’s retail payments market. Broadly the mandate would oblige euro-area banks to co-operate to build a new card scheme with the EPC and the banking associations taking on this role. Some of the strengths and weaknesses of this option are as follows:

Strengths	Weaknesses
• Ensures a full European owned scheme develops • Compliments the SCF and logical extension • Enables full European control	• Already considered by banks in 2004 and dismissed as impractical • High cost and complexity of constructing a full debit card scheme, and limited grounds for agreement • No guarantee of solution for the low/nil interchange nations – merchant objections • Lack of a credible network able to handle debit volumes • Extended timeframe for development, ie. beyond current SEPA 2010 deadlines • Potentially limited reach/connectivity – key negatives • May require ongoing intervention to support

Table 3: Option 3 - Mandated Scheme Development

This option has its attractions. It takes the SCF to its logical conclusion converting its “adaptation” mandate into a formal scheme. The rule book could borrow best practice from existing schemes and could adopt some of EAPS’s thinking. The downside is the cost and complexity of building the new scheme, encouraging the development of a network and managing and promoting a new scheme brand. The EPC in its recent reply (11th April 2007) to the ECB’s November SEPA for Cards Paper has indicated it’s preference for a market forces driven solution.

Option 4 – Common ATM Scheme and Enabling Platform.

This option argues that an all embracing debit card scheme is not necessary to stimulate the growth of competitive European schemes. What is needed are the key enablers of harmonised interbank scheme rule book and an agreement to support the creation of a network with strong connectivity and reach. Such a network could involve starting with the euro-area’s ATM schemes. The ATM domain has similarities with those of direct debits and direct credits for which the SEPA scheme/rule books have already been developed. They are bank to bank and are inherently much simpler in their structure than POS scheme rules. All national market ATM schemes could be harmonised within the framework of one single rule book and longer term could be based on IBAN and BIC account codes. All banks would be members and connected. Once developed and implemented, the common ATM scheme would then provide a platform on which future competitive debit card schemes could be constructed. Some of the strengths and weaknesses this option are as follows:

> “The ATM domain … [is] inherently much simpler in [its] structure than POS scheme rules”

Strengths	Weaknesses
• Simpler to construct, not impacted by complex POS rules, interbank only, similar models exist • Part of the SEPA voluntary mandate – so all banks participate – common euro-area acceptance brand – substantial reach and connectivity • Low cost and risk to implement, little change needed – current ATM schemes work • Greater commonality of existing interchange so harmonised ATM MIF could be achieved • ATM network available from EUFISERV/ICS with existing API and others (First Data) • Multiple ATM schemes replaced by one new common rule book • Common ATM scheme clearing and settlement - CSM options available	• First stage towards a full debit scheme – more costs to follow • Bridges needed between ATM and POS systems in several countries • Potential to delay SCF implementation – a diversion • Availability of resources to develop ATM scheme rule book • Commitment to the concept by all the stakeholders • Cost of creating/extending networks to enable all ATM schemes to integrate • No immediate solution for the low/nil interchange nations

Table 4: Option 4 – Common ATM Scheme and Enabling Platform

Using an ATM card scheme to provide the platform for new debit card schemes is supported by history. Many (six/seven) of the euro-areas debit card schemes were originally ATM which then added debit in the early 1990’s. A simple ATM scheme would only focus on interbank activity (typically cash withdrawal and balance) and would leave national markets to add their own additional optional service and national product solutions. In addition, because Europe’s 20+ ATM schemes already operate successfully, they require less change than a full debit scheme where over 4.5m POS devices would be impacted. A common ATM scheme would also deliver many benefits to the EU payments sector, including common scheme governance and open membership, lower cost software through standard applications, common ATM/host/issuer standards, as well as the potential to enable the ATM initiation of SEPA transactions (SDD and SCT) for remittances and transfers.

“A common ATM scheme would also deliver many benefits including lower cost software through standard applications”

However of greatest importance would be that a common ATM scheme would be an investment in the future and eventually the building and promotion of European card brands. Many of the core components would be in place to enable the competitive development of debit card schemes, including a common network, connectivity, wide euro-area reach, common interface standards and common EU based clearing and settlement.

The primary disadvantages would be the need to build bridges between ATM and POS networks in those countries where ATM schemes are separate. In addition, such an initiative would have the potential to impact SEPA plans already in the pipeline, as would the availability of skilled resources to build the rule book. Encouraging network construction would be complex but an ATM network already exists through EUFISERV and if Visa and MasterCard networks were to become brand agnostic, they could also offer solutions. Finally obtaining the commitment by all the stakeholders to build yet another scheme will not be easy.

Conclusions

How do these options compare? It is suggested that each needs to be evaluated on the basis of reach/connectivity, credibility, feasibility, low cost, acceptability to the key stakeholders and a solution for low/nil interchange nations. The table below summarises the results of a simple evaluation:

Option	Reach Conne ctivity	Credibility	Feasibility	Low Cost	Low Risk	Acceptability to Stakeholders	Solution to the Nil/Low Interchange	Ranking
Option 1: Leave to Market Forces	◔	◑	◕	◕	◑	◔	○	**2**
Option 2: Incentivised Development	◑	◔	◔	◔	◑	◔	○	**3**
Option 3: Mandated Development	◑	◔	◔	◔	◔	◔	○	**4**
Option 4: Common ATM Scheme	◑	◑	◕	◑	◑	◕	◔	**1**

Table 5: Analysis of Strategic Options

As this analysis suggests the most advantageous options are to leave new scheme development to market forces or to put in place a common ATM scheme as an enabling platform.

Obviously this paper presents a high level analysis of the options. More work is required to examine each in detail. However, the common ATM scheme route might enable a way forward which is relatively low cost and low risk. If the concept proves workable, new debit schemes (large or small) could "knock on every door on every floor" armed with a common enabling platform and network which will substantially increase their chances of success.

About PSE Consulting

PSE Consulting is a leading European payment business and technology consulting organisation. The company was founded in 1991 by Peter Jones and operates from offices in London.

PSE Consulting is a founder member of the European Payments Consulting Association (EPCA), an association of like consultancies operating in six European nations.

PSE Consulting provides independent advice to many of the European institutions mentioned within this article and to many other players who are currently shaping the European debit market place.

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