# Re-engineering Debit: The Missing SEPA Blueprint

ARTICLE

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As the plan for a Single Euro(pean) Payments Area (SEPA) emerges, Europe's banks and interbank organisations will need to decide how to re-engineer Europe's patchwork of domestic debit schemes.

How should a SEPA blueprint for a new Unified Debit Card Scheme be developed?

**Background**

Over the past six months the European Central Bank (ECB) has made it abundantly clear that it expects the payments card business, via the European Payments Council (EPC), to move rapidly towards a single payments area for Europe. In September 2004, during an EPC address, they stated "a pan-European solution (for debit) is lacking …. we are still far from having a SEPA"; and in December 2004, in its third review of EPC's progress, the ECB stated again that "this [SEPA for cards] will require a transformation strategy for both national and international card schemes to respond to the creation of the new domestic payments area". Whilst the ECB strongly supports voluntary change, and the development of many competing SEPA solutions, it has made it clear that if the EPC fails to deliver SEPA by 2010 then it will consider mandating a common solution. Similarly Charlie McCreevy, the EU Commissioner for Internal Markets and Services has stated recently ($10^{th}$ March 2005) "We cannot continue to sit on our hands forever … if necessary the Commission will make some agreed industry standards mandatory … industry has to understand that the time has come to move forward"

Many question why SEPA has become such a strategic issue for the Commission/ ECB. Three very important factors appear to drive the Commission/ ECB's rationale. First, citizen Europe needs to be able to access their current account anywhere in Europe, not just in their domestic market. Second, that the full benefits of the euro zone single market cannot be achieved until all payments (credit transfers, direct debits/credits and payment cards) are accepted and processed in a common manner. Third, a common current account, processing and settlement framework will facilitate much needed cross-border banking sector consolidation by reducing the high cost of adapting systems to each local market.

So what does the ECB's increasingly prescriptive approach mean for Europe's plastic card business? Most observers agree that International Card Scheme (ICS) branded credit cards have successfully pioneered a single European credit card framework over the past 20 years. These cards are now almost universally accepted across Europe, and the world, and are now a vital part of any traveler's luggage; in many ways credit could already be described as "SEPA compliant". However the same cannot be said for Europe's highly fragmented debit card market.

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Even a cursory investigation of today's Europe debit landscape reveals more than 15 non-compatible schemes. Conceived and implemented in the mid to late 1980s, well before a common euro wide business and technology vision, these ageing and complex schemes have successfully served their local markets, but now need to face the challenges of modernisation and offer common acceptance across the whole of Europe.

So, like it or not, Europe's bankers and their old, complex, domestic card schemes are now the primary focus of the ECB in extending their SEPA vision for re-engineering Europe's payment systems. The following table summarises the current euro zone schemes and also attempts to assess their complexity.

| Country | Domestic Scheme | No Cards (m) [1] | No Txns (m) [1] | Complexity Score |
|---|---|---|---|---|
| Austria | Maestro/Bankomat | 9 | 176 | Medium |
| Belgium/Luxembourg | MrCash/Bankcontact | 13 | 606 | High |
| Finland | Pankkikoritti | 4 | 387 | Medium |
| France | CB | 45 | 4,751 | High |
| Germany [2] | ecCash | 100 | 780 | High |
| Greece | Electron/Maestro | 6 | 3 | Medium |
| Ireland | Laser | 1 | 69 | Low |
| Italy | Bancomat | 29 | 641 | High |
| Netherlands | PIN | 22 | 1,143 | High |
| Portugal | Multibanco/Electron | 11 | 696 | Very High |
| Spain | 4B, CECA, ServiRed | 57 | 710 | Very High |
| **Total euro zone** | | **297** | **9,962** | |

[1] PSEL 2003 Projection

[2] Excludes ELV

**Table 1 Current Euro-Zone Domestic Card Schemes**

As the 2004 Visa Europe/Payment Systems Europe (PSE) “Future of EU Card Processing” survey showed, many of these domestic debit card schemes have, for reasons of security and ease of processing, used ways of working that currently restrict market entry. Of particular criticism has been the lack of transparency between the scheme rules and operational processes of dominant domestic interbank processors. Although some progress has already been made towards openness (in Denmark and the Netherlands) many believe further significant change is still required.

PSE recently conducted a high level research study focussing on the most common debit card scheme barriers that exist within Europe. Table 2 below provides a summary of the ten most important business and technical inhibitors that apply to card acquiring. This represents just a proportion of the more than 40 barriers identified.

| Card Acquiring Barriers / Practices | Occurrence |
|---|---|
| **Business** | |
| 1. Lack of transparency - combined scheme/processor | **Medium** |
| 2. Complex membership rules with many exclusions | **Medium / High** |
| 3. Mandated use of single acquirer/processor/network | **Medium / High** |
| 4. Lack of cardholder redress/disputes processes | **Medium / High** |
| 5. Complex risk management processes difficult to replicate | **Medium** |
| **Technical** | |
| 6. Lack of common terminal application standards | **High** |
| 7. Complex and different authorisation, clearing, settlement interfaces | **High** |
| 8. Multiple terminals at merchant sites reflecting different standards | **Medium** |
| 9. Complex terminal and network security standards | **Medium** |
| 10. Non conformance to international card numbering standards | **Low** |

**Table 2 Summary of Most Common Debit Scheme Barriers**

Many in the processing and acquiring sectors believe that achieving a SEPA vision requires domestic schemes to dismantle these barriers - effectively opening up their markets to increased competition over the next few years. There is now a pressing need to re-engineer and build a strategy to develop the missing blueprint for SEPA debit.

It is within this context of complexity the ECB has now given the EPC (through the Cards Working Group) the very difficult task of defining the scope of SEPA for debit and identifying and prioritising the changes required to achieve initial and longer term compliance. The ICS (Visa and MasterCard) also face similar challenges with their EU debit schemes. Similarly, the member banks who own Europe's debit card schemes and interbank processors face major obstacles and difficult choices. What solutions are open to these players? Does Europe now need to engineer a Unified Debit Card Scheme (UDCS)?

When examining this issue four possible scenarios emerge for developing and implementing the SEPA debit blueprint, each of which is briefly analysed in the following sections.

**Scenario 1: Simple Framework**

Scenario 1 occurs if the EPC decides the best way to achieve SEPA by 2010 is to minimise changes to current schemes and processing structures (a task made easier by the fact that cross border debit usage is very low). In this scenario the EPC limits its SEPA debit scope to encouraging basic bilateral and reciprocal agreements between the 12 euro country's domestic schemes and their interbank processing companies (a similar concept to that originally developed by Banksys in the early 1990s). This basic framework would enable domestic card acceptance in any country using the EMV technical umbrella. These rules would ensure that all intra-European card transactions must be accepted on the basis of the commercial terms set by the local debit card scheme (ie. ecCash would be accepted in Belgium to MrCash/Bankcontact rules, in the Netherlands to PIN rules, in Ireland Laser rules, etc). By this means the current difficulties relating to different domestic scheme inter-operability and interbank fees will be minimised and SEPA compliance achieved. A common technical interface could also be specified by the EPC but it would then be up to each domestic scheme (or groups of schemes) to choose network providers clearing and settlement methods. Ultimately this framework concept could evolve towards common rules and governance standards for all schemes.

The following table examines some of the advantages and disadvantages of this approach.

| For | Against |
|---|---|
| • SEPA compliant acceptance framework<br>• No need for major scheme development<br>• No common brand, so low marketing costs<br>• No initial over-arching card scheme rules<br>• Retention of domestic brands<br>• Potential to evolve into broader EU scheme<br>• Existing bodies retain national control | • Current debit barriers remain in place<br>• Country risk management cultures clash<br>• Issuers reject imposed acceptance terms<br>• No common governance/op regs (for disputes) and commercial framework<br>• Does not stimulate competition, interbank processing not opened up<br>• Cost of network delivery system<br>• Not ICS compliant, no worldwide acceptance<br>• No brand may confuse users and merchants |

**Table 3 Simple Framework - Analysis**

As the analysis shows, the simplicity of such an initial concept is attractive. There is no need for a major scheme or brand development project and interbank agreement should be relatively easily achieved. There is little change to the current infrastructures and the domestic schemes remain in place. The downsides are more strategic. Whilst this option is SEPA compliant from an acceptance perspective, the option does not improve competition nor remove barriers to entry. Also there will be no common governance framework processing rules and consumer redress practices. The overall conclusion is that this is a short term fix that would work, but only as part of a longer term broader plan.

### Scenario 2: EPC Unified Debit Card Scheme

Scenario 2 will occur if Europe's bankers believed they need to develop their own indigenous Unified Debit Card Scheme to compliment the single currency. Thus member banks commission the EPC to develop a new common debit card scheme to replace all current domestic schemes. This would have its own distinct brand, plus authorisation, clearing and settlement platform (initially euro zone, eventually the entire EU). Domestic boundaries and structures would therefore evaporate. There would be a common business framework and terms of acceptance, interchange, EMV implementation, terminal/host and settlement standards and common processes for consumer redress and disputes.

Table 4 below summaries the advantages and disadvantages of this UDCS option:

| For | Against |
|---|---|
| • Totally new, best of breed, European champion SEPA compliant scheme and brand<br>• European bank owned and controlled<br>• Common open governance structure<br>• Displaces domestic schemes and local barriers – cost savings/more competition<br>• Drives a single market for payments products | • EPC no experience of major scheme development<br>• High cost of scheme and infrastructure construction<br>• Complexity 12/28 country agreements<br>• No ICS standards for worldwide acceptance<br>• High cost of marketing and rebranding<br>• Long lead time and risk of failure to deliver |

**Table 4 EPC Unified Debit Card Scheme - Analysis**

Clearly a totally new scheme would deliver not only SEPA but also re-engineer the current domestic schemes and open up domestic payment markets. However, this would be a high-cost, high-risk strategy. Developing a new card scheme would be a complex task and to obtain worldwide acceptance would have to conform to ICS standards. In addition, the EPC have little or no experience of developing and implementing such a major product initiative. Agreement amongst members would be difficult with a significant potential for over-runs, even if an existing delivery system (for authorisation, clearing and settlement) were used. The overall conclusion is that this option whilst feasible is unlikely to meet the ECB's timeframe and EPC cost constraints, particularly given banks current difficulties in implementing EMV.

### Scenario 3: EPC Core Country Scheme

Scenario 3 argues that the EPC members are unlikely to agree and implement the terms of a full UDCS in all countries by 2010. The history of interbank developments shows that schemes and major infrastructural change are best implemented by a limited number of players who understand the issues and who can focus on rapid development and delivery. Thus under this scenario a group of core euro zone countries lead the rest of Europe and develop a version of UDCS using one member's scheme rules and infrastructure as a basis for SEPA compliance. Once implemented, the concept could then be rolled out to the rest of the euro zone and eventually across the whole EU. Table 5 below summarises points for and against this option.

| For | Against |
|---|---|
| • Faster implementation<br>• Based on existing tested scheme<br>• Focused core group delivers<br>• Lower cost and low risk than a full solution<br>• Eventual common governance structure | • Scheme unacceptable to new members<br>• Clash of risk management cultures<br>• Lack of EPC support – separate initiative<br>• May not meet ECB deadlines<br>• May continue barriers and restrictions<br>• Potential for fragmentation – geographic blocks<br>• No international inter-operability unless to ICS standards |

**Table 5 Core Country Scheme – Analysis**

This option is an attractive real world option that, because of its focus and small number of participants, should achieve its implementation objectives particularly if based on an existing tested scheme. However, there is a high risk that other groupings will disagree with the founding members' vision and risk management philosophies and business and technical frameworks. Thus alternative approaches would develop, duplicating the core country options. The result would be fragmentation and no common scheme for Europe.

**Scenario 4: Select an ICS Scheme**

The final Scenario 4 argues that to meet the ECB deadline, the EPC should encourage members to migrate to the two major ICS brands. Both have debit products that are widely used in domestic markets (Maestro and Electron). In addition, Visa has recently launched its new SEPA compliant product VPay. In this scenario the EPC specifically sets out to ensure both ICS compete to deliver European debit products that are fully owned and controlled by Europe's banks and processed in Europe. Each ICS must also commit to ensure that common governance, business and technical standards are implemented that remove many of the current domestic scheme blockages. Also, domestic schemes that choose an ICS brand must be able to rapidly migrate to the new product. Table 6 below summarises the arguments for and against this option.

| For | Against |
|---|---|
| • SEPA and EMV compliant plus EPC approved<br>• Pre-package scheme – minimum change<br>• Fast implementation – meets ECB deadline<br>• International acceptance<br>• Common governance/ commercial framework<br>• Devolved domestic membership<br>• Low risk and cost | • Not under direct European control<br>• Higher membership/ongoing fees<br>• Loss of local brand/need to re-brand<br>• Not all domestic barriers dismantled<br>• Loss of flexibility in debit product design |

**Table 6 Select an ICS Scheme - Analysis**

Both Visa and MasterCard can offer low risk and low cost prepackaged solutions that will be SEPA compliant, which are already available. VPay, for example, is specifically focused as an alternative to domestic debit as well as delivering EMV. The downsides for local bankers are a loss of control, submission to a larger international organisation, potentially higher membership fees, the need to rebrand their domestic product and phase out their old scheme.

**Conclusions**

In reality these options are likely to be pursued in parallel. The EPC is already believed to be reviewing a framework concept. Banks from Benelux, France and Germany are also debating the core countries initiative (similar to Scenario 3). The UK already operates two debit schemes, Spain three, so it is probable that in some countries SEPA compliant VPay, Maestro and domestic schemes will co-exist and compete.

In making their choices, the members of domestic debit card schemes have few benchmarks against which to measure these emergent options. For several countries the choice is more difficult because of the pressing need to also implement EMV. For others, the major factor is regulatory pressure to improve governance, transparency and open up markets. For these reasons, bankers will use different criteria to examine their options. However, key selection methods could include: a workable proven product, low development and ongoing costs, low risk implementation and migration, a commercial framework that can be adapted to local market conditions, and a reliable technology platform which will deliver EMV at the same time. Ideally all should be available by the end 2008 and operational by 2010.

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However, until the scope of debit SEPA standards has been researched and defined by the EPC the final size and scale of the changes required are unknown. The EPC faces perhaps the most complex standards task ever conducted by an interbank institution. Several commentators suggest that potentially SEPA implementation costs could be many times greater than EMV. Thus at this stage, scheme owners are unable to fully commence the assessment of the options.

Of the four scenarios which will be the most successful? It appears highly unlikely that the EPC will embark on UDCS development (Scenario 2) given their limited resources and the high risks and costs. The core country initiative (Scenario 3) has several attractions, but without a greater consensus and support may lead to fragmentation. A framework approach (Scenario 1) would meet the ECB's initial timescale and has the potential to be expanded later to common governance and commercial frameworks. However, it may fail to remove the debit card barriers and blockages. The ICS option will be very attractive to several countries because it could deliver "SEPA in a box" and offers a speedy low risk option but at the expense of cherished domestic brands and some loss of control.

So tough times ahead for Europe's debit card schemes, and few takers for the UDCS concept. Until the missing SEPA blueprint has been created, re-engineering Europe's debit infrastructure is still some years away.

**Peter Jones**

## 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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