

SEPA: Where to now ?

Introduction

Since the publication of the SEPA Cards Framework (SCF) document by the European Payments Council (EPC) on March 8 2006, payment industry players throughout Europe have been trying to parse and analyse statements emanating variously from the European Commission, the European Central Bank (ECB) and the EPC, to gauge their position against the latest SEPA (Single Euro Payments Area) announcements. More specifically, as to the 3 options for SEPA migration set out in the SCF document, the industry has been in continual debate as to where each of these alternatives might lead vis-à-vis the objective of "true" SEPA compliance. To jog the reader's memory; in summary; the 3 options set out by the EPC are as follows:

- Option 1: Select one (or more) of the international schemes to replace the current national scheme(s) – once the former have become SCF compliant
- Option 2: Act in such a way as to evolve one or several national schemes so that they become SCF compliant by extending their operations to the entire SEPA (Single Euro Payments Area)
- Option 3: Co-brand its cards with both a national and an international scheme – provided both have become SCF compliant

In this document Hubert O'Donoghue, Manager Partner, O-C Group tries to interpret the latest pronouncements on this critical development for the Cards Industry.

What they said.....

The last quarter of 2006 has seen some very important contributions to the SEPA discussion. First there was a speech made by the European Commissioner for the Internal Market and Services, Mr McCreevy to the SEPA congress held in Frankfurt on November 13th. The title of this speech was not surprisingly "Time to deliver on SEPA". In the course of this speech the commissioner gave some important pointers as to where the commission stands on SEPA.

- Whilst warmly praising the progress made on SEPA by the EPC in particular, he acknowledged that "cards is an area where we need more detail".
- The commissioner committed to working more closely with the ECB and the EPC to "align external communications and develop a consistent and persuasive information campaign"
- Specifically in the cards market he expressed his enthusiasm for an "any card, any terminal" approach but gave a clear warning that in achieving "SEPA compliant" products "if there is any abuse in the cards market then we (the commission) have the instruments to intervene and we shall not hesitate to make use of our powers."
- In the area of standards he provided the clearest signal yet that mandatory standards will apply stating "Payments are a network business par excellence and standards are absolutely key"

So from the Commissioner's speech where, you might ask, can we find more clarity as to what SEPA compliance means? Whilst; as you would expect, a speech by a Commissioner to such a forum is never going to get down to the "nuts and bolts" of SEPA compliance, there are key indicators given here which are further reinforced by the ECB in their most recent contribution.

In keeping with Mr McCreevy's commitment to a more joined up approach between the Commission, the EBC and the EPC, within a week of his speech, the ECB published a substantive statement on SEPA entitled "The Eurosystem's view of a SEPA for Cards". This

document took up most of the issues raised in Mr McCreevy's speech and made a number of significant calls, supportive of the views expressed by the him.

.....on standards

One of the biggest frustrations for the cards industry has been the lack of specifics contained in the SEPA Cards Framework Document. At all levels in the industry, from brand strategy to compliance and from IT application management to card operations, matters vital to the cards industry have been identified on which the ultimate outcome of the SEPA discussion will have a bearing.

In this regard the ECB makes a welcome acknowledgement as to the short comings of the SCF stating, "the Eurosystem however considers that the SCF is rather general and leaves too much room for interpretation concerning practical implementation."

This view prompted the ECB to set out a clear position to the EPC as to a number of areas which are within its area of responsibility and which need to be addressed in order to provide more clarity as to what "SEPA compliance" means. One area on which the ECB places particular emphasis is the area of standards. Recognising how domestic, proprietary and national standards have been used as a very effective anti-competitive barrier to entry in the past, the ECB states "It is important that all stakeholders are free to participate in the definition of standards, which should be neutral, future-oriented and not nationally biased, with the aim of guaranteeing universal adoption and avoiding placing particular infrastructure/service providers in a better starting positions." It goes on "standards should cover every phase of the transaction chain (cardholder-to-terminal, terminal-to-acquirer, acquirer to issuer), as well as the security evaluation and certification of technical devices". The ECB calls on the EPC to "investigate how the objectives of the SCF, especially interoperability, could be ensured by the card standards which are currently being developed."

A literal interpretation of these statements might lead one to conclude that those who opted for Option 1 (Select one or more of the international schemes to replace the current national scheme) or, Option 3 (Co-brand its cards with both a national and an international scheme – provided both have become SCF complaint), in the hopes that new technical impacts might be minimal, may have been wrong. Those early adopters of Options 1 or 3 would have factored in as a consideration that leveraging Mastercard/Visa products (and thereby interfaces) which they already have to support, would be the simplest, cheapest most synergistic route to SEPA compliance. If the ECB's position is to be maintained as to "neutrality" and "avoiding placing particular infrastructure/service provider in a better starting position", then all players, even those who would see themselves as "interoperable" across the whole SEPA today, will have to embrace some degree of change (and cost) in supporting new common standards.

..... on pricing and practices

But the matter of harmonisation and convergence does not end there. Leaving aside the need for shared standards, there is also the matter of "acquiring and acceptance practices" across Europe. This is an even thornier subject as it broaches the matter of interchange fees and merchant service charges; the manner in which they are set and the manner in which they have been used to inhibit competition in the past. In this matter the ECB in its statement invited the commission to announce, "as soon as possible", its policy with regard to interchange fees and to "clarify its position with regard to acquiring and acceptance practices". In this area the main issues on which it seeks clarity are:

- Interchange fees. The ECB point to the recent Commission Sector Inquiry Report highlighting that it gave the general impression that interchange fees might be abolished altogether. Given the enormous ramifications of such a move for the industry it's not surprising the ECB expresses the sense of urgency it does.
- Fee related restrictions to cross border acquiring. This is another complex area which is central to the commercial dynamic of domestic and cross border acquiring. Here again, a levelling of the commercial playing pitch in support of the SEPA open borders approach goes to the core of the business and will have widespread commercial implications for industry participants. And, as I will discuss later when we come on to talk about the commission's view of the role of Visa, Mastercard in the competitive environment, there can be no hiding behind an international brand as a means to protect revenues (options 1)
- Fee blending – the practice of acquirers applying a “bundled” rate to merchants for all card products.
- The prohibition on merchants to surcharge card payments if they are more costly than other instruments
- The application of an “honour all cards” rule.

The ECB document states that the removal of these barriers is “intrinsic to the emergence of a SEPA for cards; these barriers should be eliminated by 1 January 2008.”

The first thing to be said in this regard is that resolving the issues lying beneath the areas of interchange and acquiring practices is a “tall order” for achievement by 1 Jan 2008. Any body trying to adjudicate fairly on pricing to balance the rights of consumers on the one hand and the commercial interests of merchants, acquirers, schemes and processors, on the other, will have to take an enormous range of factors into account, not least of which is the need to ensure the viability of acquiring and processing SEPA compliant products.

On the matter of pricing and competition the ECB comes out with what are perhaps it's strongest statements. Those who thought that SEPA might only involve placing a Visa or Mastercard logo on the piece of plastic either beside or in replacement of the national logo might want to think again.

..... on competition

On competition the ECB states that it is “deeply concerned about a possible evolution whereby the two international card schemes progressively become the only providers of card payment services offered by banks in the euro area”. Its concern is borne out of its view that both schemes operate very similar business models with high costs and interchange fees. Clearly, as the ECB sees it, this would not lead to the kind of competitive environment it envisages and would in fact lead to price hikes which will in the first instance be borne by merchants. They in turn can be expected to pass these increases on to consumers in the form of higher prices generally. The ECB believes that the emergence of at least one European card scheme would lessen the risk of price increases. Moreover, option 3 (co-branding) is viewed by the ECB as the least favourable approach as “it would merely perpetuate the present situation, whereby a multiplicity of schemes are protected from competition by national borders”.

..... to the International card schemes

Having made these blunt statements to the International card schemes concerning it's view of their approach to pricing and competition the commission calls on them to “define their SEPA compliance plans by mid 2007” So what does this mean ? Well clearly the ECB does not consider that the International card schemes are yet “SEPA” ready, due to concerns around standards, pricing, practices all of which gives rise to their concerns about competition and the emergence of a “level playing pitch”. Going back to the 3

options for SEPA migration remember that the important caveat is that the chosen international scheme must have become "SCF compliant". Following the statement of the ECB we are now starting to understand a little more, the detail of what that means.

Option 2 anyone ?

And finally, a few remarks about Option 2. You would think from all I said that there was no interest in evolving "one or several national schemes so that they become SEPA compliant." Wrong, "EAPS" the Euro Alliance of Payment Schemes is starting to gather critical mass, now comprising Electronic Cash and Deutsch Geldautomaten Systeme (Germany), COGEBAN (Italy), Eufiserv (Belgium), Link (UK's ATM Switch), Euro6000 (Spain) and Multibanco (Portugal). These are expected to be joined by InterPay in the (Netherlands) Laser (the Irish debit card brand) and Activa (Slovenia). Some in the industry are dismissing this development as making little sense, involving as it would some major work to create a seamless infrastructure on which each participant could interoperate. These players may well see opportunities for more control and greater returns than they might enjoy pursuing the other 2 options.

Conclusions

Well, it's still too early to say what the eventual outcome will be but at least the ECB statement has helped to underline the core issues and identify owners and actions for them:

- The commission must clarify its policy on interchange fees and acquiring and acceptance practices "as soon as possible". All the signs from the commission (through Commissioners McCreevy and Kroes) are that this will happen.
- The EPC must come up with common end-to-end standards for transaction processing which will be open and neutral as between all players. These are being worked on.
- The cards schemes must define their SEPA compliance plans by mid 2007. In the case of Visa, it's CEO spoke hot on the heels of the commission statement offering re-assurance that Visa is fully committed to the spirit of SEPA and does not plan to "challenge the jurisdiction of the regulators"

If in the coming months, progress can be made on these points the technical and regulatory detail around SEPA should be a lot clearer.