Horizontal Integration in the Payments Industry

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Senior Executive Vice President

2007 Payments Conference
Santa Fe, 3 May 2007
Content

- European landscape
- Restructuring of functions
- Impact of horizontal integration
- Cooperation model
- Conclusions
### EPC non-Eurozone members
(EU12+3) partly active in the Eurozone

<table>
<thead>
<tr>
<th>Country</th>
<th>National Associations</th>
<th>European Associations</th>
<th>Multi-Country Banks</th>
<th>Mono Country Banks</th>
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Europe today

- National / local solutions
- Different schemes, experiences, standards
- Consumer protection laws
- No interoperability of national schemes
- Cross-border complexity and risk

Different domestic brands
Content

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Our regulators’ expectation*

Vision: “An euro area in which all payments are domestic, where the current differentiation between national and cross-border payments no longer exists”

2008 deliverables for the Euro area (EU13):

- credit transfer available to customers from Jan. 2008 at the latest
- priority payment available for customers from Jan. 2008 at the latest
- direct debit available for customers from Jan. 2008 at the latest
- cards: elimination of all technical and contractual provisions, business practices and standards from Jan. 2008

2008: implementation

- NCB’s will facilitate implementation process
- public administrations should be first movers

2010: migration

- SEPA objectives implemented end of 2010
- NCB’s will facilitate migration process

Scope of the Payments Services Directive and of the Single Euro Payment Area

<table>
<thead>
<tr>
<th>PSD Compliance</th>
<th>Voluntary Adoption of PSD Provisions</th>
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<tbody>
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<td>EUR</td>
<td>Domestic payment instruments and infrastructure (EUR)</td>
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Source: EBA Association

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Competitive and cooperative space in SEPA (two side market)

- Competitive Space
  - Public Administrations
  - Corporates
  - SME’s
  - Merchants
  - Consumers

- Cooperative Space
  - Credit Transfer
  - Priority Payments
  - Direct Debit
  - Card POS Transaction
  - Card ATM Transaction

- Business Rules
- Standards
- Brands

Bank A

Bank B

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EPC Approach

• Unbundling the payment functions in three layers
  • Value propositions of banks
  • Scheme layer
    • Business Rules
    • Standards
    • Brands
  • Infrastructure layer

• Creation of:
  • Rulebooks with business rules and standards
  • Frameworks with principles
Positioning SEPA Payment Schemes

CUSTOMER CHOICE
Core and Value Added Services

COMPETITIVE

COOPERATIVE
Scheme Management
Business Rules & Practices
Standards

EPC

COOPERATIVE

EPC

COMPETITIVE

PRODUCT & SERVICE LAYER

End to End Standards and Data-Elements

SEPA Credit transfers Rulebook
SEPA Direct debits Rulebook

PRINCIPLES FOR SEPA COMPLIANT CLEARING & SETTLEMENT MECHANISMS (PE-ACH MODEL)

BANKS + CSM CHOICE
PARTLY COMPETITIVE
PARTLY COOPERATIVE

PE-ACH
SEPA-Scheme Compliant ACH
Bilateral/Multilateral/Decentralised
Intragroup
Pure Bilateral

PROCESSORS

NETWORKS
Scheme functions of card value chain
EPC Design Deliverables

Primary Deliverables*
- Credit Transfer
- Direct Debit
- Cards

Complementary Deliverables*
- Cash
- E-payments for web retailers
- M-payments

Value added service deliverables (out of scope of EPC Governance)
- EBA Association: Priority Payment Protocol
- EACT and EBA Association: E-invoicing
- Authentication services for e-government services

*EPC Roadmap December 2004 and EPC Declaration 17 March 2005
SEPA Cards Framework

- SEPA Card Framework (approved July 2006)

  Provides a single framework for the payment function of cards for
  - **Banks** e.g. Issue EMV cards with PIN from Jan 2008
  - **Card schemes** e.g. Unbundling scheme from processing functions
  - **Service providers** e.g. Unbundling scheme from processing functions

- Cards Standardisation in SEPA (approved December 2006):
  - 4 domains
    - card to terminal
    - terminal to acquirer
    - acquirer to issuer
    - certification process
  - Focus to create (adopt) **global standards**: ISO, EMVco, a.o.
Public Policy Provisions for SEPA for Cards

- **Governing Council** ECB (17 November 2006):
  - Emergence of a European card scheme
  - The interchange fee issue
  - Fostering competition
  - Acquiring and acceptance practices
  - Processing
  - Standardisation
  - Data protection
  - Fraud
  - Monitoring card payment prices
  - SEPA compliance

- **EPC response** on the ten recommendations of **SEPA for Cards** (April 2007)
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Impact for Customers

• Customers

  • Impact on:
    • Consumers
    • Mono Country Corporates, Merchants and SME’s
    • Multi Country Corporates, Merchants and SME’s
    • Public Administration

  • Impact on:
    • Service levels
    • Flexibility in choice of payment service provider
    • Costs
    • New services
Impact for Society

- **Regulators**
  - Economic Policy
    - Lisbon Agenda
    - Competitive Financial Sector
  - Central Banks view
    - For euro payment instruments with reachability to all bank accounts
    - Contribution to a more integrated financial sector
    - Support for Euro currency
  - Competition Authorities
    - Enhanced competition
    - Assurance of level playing field
    - Increased market transparency for both providers and users
Impact for Suppliers

- **Banks** (and payment institutions)
  - Business Model:
    - Delivery Model
    - Sourcing Model
  - Bank Type:
    - Mono Country Banks
    - Multi Country Banks

- **Schemes**
  - SEPA Card Framework compliant
  - Unbundling scheme functions and processing functions
  - Adapt or Die

- **Card Processors and Clearing Houses**
  - Volumes!

- **Vendors**
  - Opportunities and threats
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Cooperation model with SEPA stakeholders

EU Level
- Design
- Monitoring

National Level
- Implementation

Stakeholders
- Consumer Bodies
- Merchants
- Public Admins
- Corporate Associations

SEPA Implementation Coordinating Bodies
(national implementation and migration planning)
- National Governments
- National Central Banks
- National Banking Associations

Banks
- Consumers
- Merchants
- Corporates
- Public Admins
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Conclusions

- The European Council and the Governing Council of the ECB expect deliverables with concrete deadlines
- The approved Payment Services Directive (PSD) will harmonise the legal environment and will be transposed into the law systems of the EU27 countries before November 2009
- The EPC was able to create commitment for a vision, for an EPC Roadmap and for the creation of harmonised business rules and standards for the January 2008 SEPA deliverables
- All suppliers in the value chain of payment services (banks, schemes, service providers) are reviewing their business models
- Horizontal integration is taking place on the bank layer, on the scheme layer and on the service provider layer. In particular the manufacturing functions of the value chains will be restructured
- Customers of banks, schemes and service providers are expected to benefit from the harmonisation for and consolidation of the Euro(pean) payments markets