Fact Sheet

What is SEPA?

Streamlining Payments in Europe

The Single Euro Payments Area (SEPA) is the area where citizens, companies and other economic players will be able to make and receive payments in euros (whether between or within national boundaries) under the same basic conditions, rights and obligations, regardless of their location. Every citizen, merchant, public administration and corporation with a banking relationship in the euro-area ultimately will be impacted by SEPA, as will everyone in the payments supply chain.

Geographic Scope
SEPA is being delivered as a key priority within the euro-area. Within Europe, outside the euro-area, there will be opportunities to participate in euro payment systems, and communities will be able to adopt SEPA standards and practices to contribute to the Single Market for payment services. Europe is currently defined to consist of the EU 25 member states plus the EFTA countries (Iceland, Liechtenstein, Norway and Switzerland).

Responsibility for SEPA
The SEPA programme is being led by the European Payments Council, which brings together the European banking community and is supported by the European Commission (EC) and the European Central Bank (ECB. It is a major public policy initiative to create a single integrated payments environment for the euro area, consistent with Economic and Monetary Union and the Lisbon agenda.

European Payments Council
The EPC is the industry body formed to implement a SEPA for Europe. Its Cards Working Group, has estimated that the annual cost of cash in the European economy is 50 billion euro. A disproportionate amount falls on retail banking – 32 billion euro. Significant cash replacement by more efficient payment instruments like debit cards, will substantially reduce this cost.

Key Drivers for SEPA
Today consumers can use euro notes and coins in all euro countries as easily as in their home country. However, debit card payments remain a fragmented experience within the Euro Zone. As most EU Member States have their own national debit card schemes with different brands, rules, standards, entry criteria and processing infrastructures, the consumer is faced with a number of plastic currencies. So by 2008, the European Central Bank wants a payments system in place that streamlines this and enables consumers to experience a Single Euro Payments Area (SEPA) when making payments within Euro-zone countries.

The introduction of Euro notes and coins in 2002 to complete monetary union was an important development for the EU and its economy. As electronic means of payment, debit cards have significantly contributed to the efficiency of payments, built consumer confidence and helped drive higher economic growth. The European Central Bank and the EU view it as essential that these payment instruments now move to full SEPA compliance as rapidly as possible. According to the SEPA implementation plan, banks and payment schemes are required to comply with the following timelines:

- **By 2008**: Issue cards that will enable consumers to make payments in the euro zone such as there will be no different experience between domestic and cross-border payments in terms of fees, security levels, fraud levels and merchant acceptance.
- **By 2010**: All payment cards and schemes must be SCF and SEPA compliant.

Current fragmentation into national debit schemes which operate on a local base only: Traditionally, most European countries have employed national debit card programmes and national processors, which are unable to process debit card transactions across borders. SEPA requires Europe to develop a more efficient infrastructure, especially for debit card transactions, which better manages the needs of the European banking community, merchants, consumers and other economic stakeholders.

The current numerous local debit card systems, with a multitude of brands and switching networks, different standards, technologies, levels of security and exposure to fraud, penetration of merchant acceptance and indeed different business models, do not help achieve a true SEPA for debit cards, as part of an integrated payment market in Europe. Indeed, the fragmentation into numerous national debit schemes represents a major obstacle to achieving SEPA for debit cards, and prevents all stakeholders from reaping major benefits from Pan-European debit card payment integration. For example:

- There are currently 16 different national debit schemes in Europe. Each delivers a different cardholder experience, as domestic debit cards are not necessarily accepted everywhere
- There is limited competition at national level, with many countries having only one acquirer or processor and very few terminal vendors

SEPA is not just about the 2% of transactions that are cross-border, but also about 98% of domestic transactions that are so far not open to competition

SEPA "Design Features"
In developing SEPA, two design approaches have been followed. For credit transfers and direct debits, a "replacement" strategy has been chosen, with new common credit transfer and direct debit schemes for the whole SEPA. For the highly complex cards business, the strategy has been to "adapt" existing schemes and their operator(s) to a new set of business and technical standards and processes.
A core feature of both approaches is the clear separation of scheme from infrastructure (a scheme is a set of rules, practices and standards agreed between providers of payment services. Infrastructure is the underlying delivery systems and processing platforms).

SEPA Cards Framework
On March 8, 2006, the European Payments Council (EPC) approved its "SEPA Cards Framework" (SCF), setting out the requirements for schemes and national banking communities to deliver on SEPA for card payments. The current SCF applies to the 12 countries of the Euro Zone, as well as to all euro payments in the EU. The SCF applies to "general purpose" cards - defined as all guaranteed payments (credit, charge and debit card) and cash withdrawals. The primary focus is on debit cards, as most major credit card schemes are largely SEPA compliant already. National-use only electronic purse and private label and bank proprietary cards are outside the scope of the Framework.

To achieve SCF compliance, banks need to decide whether to invest in making the national-use only scheme SCF compliant by - for example - opening membership outside of the home country, and standardizing terminal and processing platforms around international standards, co-branding, or migrating to another, SEPA-compliant, scheme by end 2010.

Impact on the payments market: SEPA represents a logical evolution of the payments market rather than a revolution. For the past 15 years, MasterCard has helped domestic schemes in the UK and Switzerland migrate to an international scheme. It will apply this extensive experience with the first full SEPA migration implementation plans in Belgium.

SEPA is not only about improving the efficiency of the modest volumes of cross-border euro payments. It is also a major restructuring and harmonizing project that will usher in common business rules and technical standards. All electronic payments will be impacted and core credit transfers, direct debits and card payments will migrate to interoperable formats and processes. At the same time, national market features and practices will be phased out.

Impact on the EU economy and consumers: SEPA will open up competition in the payment services market. It will also generate, through harmonization, more efficient payment systems that will deliver tangible economic and social benefits. The euro currency will be systemically strengthened by being underpinned with an integrated payments environment. It will:

- Provide cardholders in each participating country with a payment card they can use across Europe with the same convenience as in their home country
- Increase competition and transparency in the payments industry
- Lower barriers to entry for acquirers, issuers and equipment providers
- Deliver benefits to citizens of participating countries by reducing the overall cost of payments (one of the objectives of the Lisbon agenda)

In addition, industry research reveals that a phased move to replace cash with plastic could improve the European economy by up to € 50 Billion through lower costs and increased consumer spending.

Impact on Competition: The business architecture of the SEPA is based on several different layers of activity: (1) the competitive bank layer in which banks provide SEPA products and services for customer use; (2) SEPA scheme co-operation, which defines the basis on which banks may co-operate to provide standards, rules and interoperability and (3) the processing infrastructure, which is primarily competitive between various channels, although communities of banks can and do co-operate to meet common needs.

SEPA Compliance

Three general objectives for SEPA compliance as far as payment cards have been defined:

a. **SEPA for consumers:** By 1 January 2008, banks need to offer SCF- and SEPA-compliant cards so that cardholders can use their debit cards within the SEPA the same way as these are used nationally.
b. **SEPA for payment service providers:** the same market access and treatment for payment service providers, enabling them to compete at all points along the payment value chain.
c. **SEPA for infrastructure:** taking advantage of the full potential for economies of scale and scope arising from a competitive, pan-European infrastructure by 2010.

MasterCard's SEPA offering

MasterCard Europe believes strongly that SEPA is critical to Europe's competitiveness and that it will also create a new dynamic for banks and all other players in the payments sector to guarantee competitiveness into the future. In fact, MasterCard Europe has already announced critical initiatives on pricing, processing, products and now interchange that will enable European banks to deliver the Single Euro Payments Area for a 1 January 2008 commencement. MasterCard will be 100% SEPA Cards Framework (SCF) compliant from 1 January 2007, one year ahead of the official deadline.

In brief:

- **Products**: All products are MasterCard and Maestro SCF compliant
- **Acceptance**: Maestro is the most widely accepted SEPA compliant scheme, with over 90% debit card merchants accepting Maestro in the EU.
- **Pricing**: MasterCard already applies a single, harmonized and transparent set of prices for both intra-SEPA and national transactions. There is a clear separation between brand and processing, aligning customer value to price and enabling banks to achieve substantial economies of scale.
- **Business Mode**l: MasterCard is the first SEPA scheme to publicly announce a coherent, sustainable and straightforward SEPA 4 party Business Model.
- **Processing**: The result of MasterCard's €75 million investment in European processing is a SEPA-ready solution with switching, standardization and value-added capabilities. MasterCard began SEPA compliance testing for its existing members in September 2006 and this will be completed by the end of 2007.
- **Next generation products**: Examples include a breakthrough low value payments solution that is currently being trialed by Royal Bank of Scotland Group (Maestro® *PayPass*™*)*, which leverages MasterCard's EMV investment and new contactless technology to dramatically reduce transaction costs for merchants, add speed and drive acceptance in the previously untapped low value payment category. This technology makes payments with Maestro *PayPass* faster than cash, benefiting merchants whose transaction speed is crucial - and can also save them the cost of handling cash. Cardholders also benefit as they are no longer dependent on ATMs.

MasterCard Ready Now to Help Banks Become SEPA-Compliant
MasterCard already meets or exceeds all of the core criteria outlined in the Cards Framework for SEPA-compliant payment schemes. In terms of helping banks and merchants become SEPA-compliant, MasterCard has drawn together expert project teams to support implementation.

MasterCard is negotiating with individual banks the migration of national use only cards and schemes to the MasterCard and Maestro brands. For banks wishing to maintain national use only schemes by making these schemes SCF compliant, MasterCard is offering a "co-brand" arrangement allowing banks to leverage Maestro's pan-European and global reach.

As the first country to announce its plans to migrate to Maestro to achieve SCF and SEPA compliance, a major joint MasterCard and bank project is now underway in Belgium. The unique experience achieved from this first migration will be leveraged in the implementation plans elsewhere. With agreements being finalized across the SEPA zone with individual banks, MasterCard is putting in place plans, structures and resources to implement Maestro as a domestic SEPA scheme from January 1, 2008.

MasterCard's SEPA Compliant Schemes
Banks need to deliver SCF-compliant card products to their customers with the required reach in terms of pan-European acceptance. Therefore "SEPA compliance" equals SCF compliance plus SEPA acceptance coverage. Banks have 3 options (or a combination) to reach "SEPA-compliance":

Option 1: Migration to International schemes - Select one (or more) of the international schemes to replace the current national scheme(s)

Option 2: Evolve national use only scheme(s) to SEPA compliance - so that they become SEPA-compliant; amongst other implementation options, national-based schemes, once they have become SCF-compliant

Option 3: Co-Branding - Co-brand its cards with both a national and a SEPA scheme – provided the latter has become SCF compliant.

Today, MasterCard is one of the Schemes in Europe with generally full card acceptance penetration for our primary SEPA debit card product, Maestro. Already, virtually all ATMs accepting non-proprietary cards across the EU also accept MasterCard, Maestro and Cirrus. On the POS side, over 90% of merchants accepting debit cards already accept Maestro in the EU 25 countries. In addition, over 56 million cards are already committed to Maestro and MasterCard as their SCF Scheme.

** *** **

About MasterCard Europe

MasterCard Europe is the entity responsible for managing MasterCard Worldwide's business in Europe - for Europe. With headquarters in Waterloo, Belgium, MasterCard Europe works with 51 European countries organized administratively into three customer areas, incorporating the Single Euro Payments Area (SEPA), mature markets and the developing markets of Europe, stretching as far afield as the eastern border of Russia. Through its network of local offices, MasterCard Europe can understand and meet the diverse needs of members in the very different types of markets throughout Europe, enabling people to do business in their own way in their own language.

Through MasterCard Worldwide, MasterCard Europe offers its European customers and consumers access to leading payment services throughout the world. MasterCard advances global commerce by providing a critical economic link among financial institutions, businesses, cardholders and merchants worldwide. As a franchisor, processor and advisor, MasterCard develops and markets payment solutions, processes approximately 14 billion transactions each year, and provides industry-leading analysis and consulting services to financial institution customers and merchants. Through its family of brands, including MasterCard®, Maestro® and Cirrus®, MasterCard Worldwide serves consumers and businesses in more than 210 countries and territories. For more information go to www.mastercardworldwide.com.

Contacts:
Louise Herbert, Tel. +32 (0)2 352 5647
Louise_herbert@mastercard.com

The SEPA 4-party business model: Bringing increased merchant and consumer choice and fostering convenience and competition in the Single Euro Payments Area

To support the goals and help achieve the benefits to merchants, cardholders and others of a truly competitive Single Euro Payments Area (SEPA), MasterCard will implement the four-party business model in the Euro Zone. This added-value model - its success already proven around the globe in countries like the US, the UK, South Africa, Japan, China and India - will help drive innovation, investment, evolution, and competition at a European level. The increased competition at all levels of the value chain created by this model will create opportunities for players to enter new markets, which in turn creates considerable opportunities and benefits for merchants and consumers.

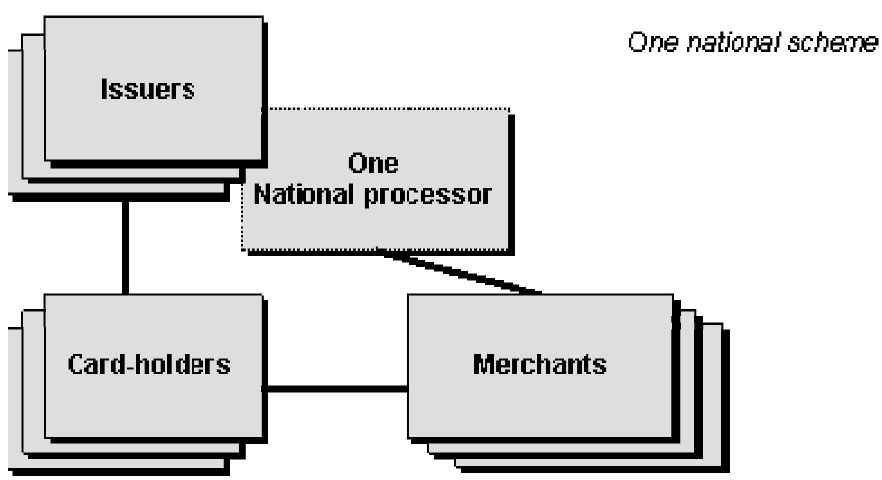
The current situation

The current payments market in Europe is fragmented:

- There are 16 national debit schemes.
- Not all cardholders can use their cards throughout the whole of the Euro Zone.
- There is a limited choice available to merchants as many national markets only have one acquirer or processor and a few terminal vendors.

Some domestic schemes in Europe are based on a three-party model where a single national processor is responsible for both the issuing and acquiring of card transactions. In other markets, the processor/acquirer is owned by the issuing banks. As a consequence there is a lack of choice for merchants.

Figure 1: The three-party business model

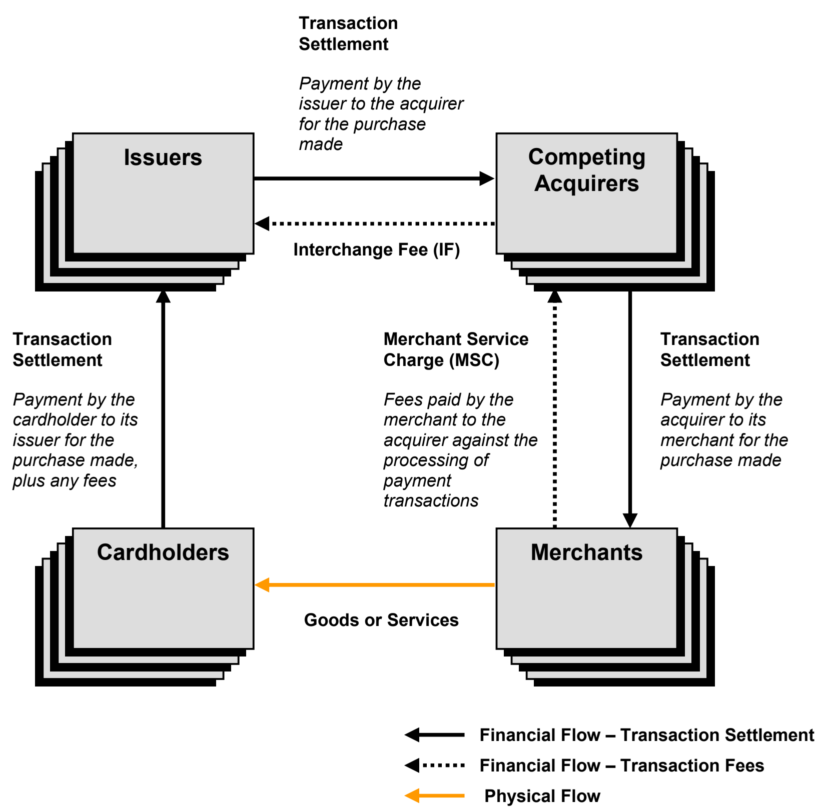


SEPA: an opportunity to introduce a transparent and competitive four-party model

SEPA provides the opportunity to introduce a four-party business model that will help increase transparency, provide more choice for merchants and cardholders and strengthen competition. With the four-party model:

- Barriers for issuing banks to enter new markets and offer debit cards and services cross-border will be lowered.
- Barriers to acquire cross-border will also be removed, thereby opening up the market to competition. In Europe alone there are over 180 Maestro acquiring service providers. As markets open up to competition, indications are pointing to 10 to 15 active service providers per national market; as is currently the case in the UK.
- The market will open up to multiple competing international schemes.
- Merchants and cardholders will have the possibility to accept or make payments internationally.

Figure 2: The 4-party business model



What is interchange?

Interchange refers to the fee typically paid from the acquirer to the issuer for each point of sale transaction. The level of interchange is determined by many different factors according to the way the transaction occurred and the type of card used. Interchange, helps issuers cover the costs of security, fraud, credit losses, technological development, developing new payment innovations, and billing and administering millions of card accounts. Interchange ensures that the payment card scheme is economically viable on an ongoing, long-term basis, benefiting every participant in the system – cardholders, financial institutions, and merchants.

It is important to note that interchange is not the same as the fee that acquiring banks charge merchants, called the merchant service charge, which also exists within three-party systems. The merchant service charge covers the bank's cost of providing services to merchants.

Interchange fees are important in balancing costs between issuing banks and acquiring banks. If issuers could not recover some of their costs through interchange from acquirers, those costs would eventually become unsustainable, and issuers would be forced to reduce cardholder services, resulting in the shrinkage of the scheme. Cardholders and merchants would have fewer payment choices, the marketplace would be less competitive, the cost of both using and accepting cards would increase, and issuers would be forced to reduce cardholder services. In card systems that do not involve issuing banks or interchange – for example American Express and other proprietary debits – merchant fees tend to be considerably higher and/or their cards are accepted at far fewer merchant locations worldwide.

How the four-party model enhances competition

The SEPA four-party business model aims at creating added-value for all parties involved in the Single Euro Payments Area:

- Under the 4 party model, there is intra-scheme competition on both the issuing and acquiring side. This model opens up markets and creates new opportunities for acquiring banks, terminal vendors, and processors to enter all markets in Europe.

- Today, acquiring has an essentially national focus. Only a handful of acquirers have successfully expanded outside their national borders. Cross-border growth for acquirers in Europe has traditionally been restrained due to their incapacity to offer acquiring services for domestic debit transactions. The cost of supporting local debit card schemes with their specific requirements makes it very difficult to compete with established players.

  A SEPA based on a 4-party model will make it easier for European acquirers to gain access to new markets to offer merchants in those countries a greater choice of acquirers. With the increased choice of acquirers, merchants will have an increased choice of acquiring offerings, including terminals, leading to better service and lower prices

- Merchants benefit from the 4 party model through increased choice and increased transparency. The 4 party model facilitates cross-border acquiring, helps lower infrastructure costs, and encourages more cross-border transactions due to greater convenience and ease of use for cardholders to use their debit and credit cards outside their home country.
- Cardholders benefit by being able to more easily use their debit or credit cards at merchant locations outside their home market. This also means greater convenience for consumers who hold Maestro cards, which already enjoy over 90% acceptance in the Euro Zone
- Society overall benefits from interchange and the 4 party model, as these - over time - lower the costs of payments through increased competition, increased scale and encouraging greater innovation in payment cards and services
- Interchange is a vital component of the 4-party model in helping balance costs between issuers and acquirers

- Larger international corporations will benefit from the standardization being created across Europe in the front and back office. Corporations will be able to cover the whole European area with the same payment instruments, same terminals, same standards and same systems. They will be able to make use of pan-European acquiring services for all their payments thereby simplifying the back office.

- Cross-border hurdles for small and medium size enterprises (SMEs) will be reduced. Faster settlement and simplified processing will improve cash flow and reduce costs, as well as enabling the receiving or the making of euro-payments anywhere in SEPA.

Maestro: the SEPA-compliant solution of choice
With over 279 million Maestro branded cards in Europe, Maestro is a strong European brand and offers a ready-made platform for SEPA debit cards, which adheres to the competitive 4-party business model. Already over 90% of merchants in Europe currently accepting debit cards also accept Maestro. With Maestro, continuity for merchants and cardholders will be ensured based on a solid future: same card, same convenience.

** *** **

About MasterCard Europe

MasterCard Europe is the entity responsible for managing MasterCard Worldwide's business in Europe - for Europe. With headquarters in Waterloo, Belgium, MasterCard Europe works with 51 European countries organized administratively into three customer areas, incorporating the Single Euro Payments Area (SEPA), mature markets and the developing markets of Europe, stretching as far afield as the eastern border of Russia. Through its network of local offices, MasterCard Europe can understand and meet the diverse needs of members in the very different types of markets throughout Europe, enabling people to do business in their own way in their own language.

Through MasterCard Worldwide, MasterCard Europe offers its European customers and consumers access to leading payment services throughout the world. MasterCard advances global commerce by providing a critical economic link among financial institutions, businesses, cardholders and merchants worldwide. As a franchisor, processor and advisor, MasterCard develops and markets payment solutions, processes approximately 14 billion transactions each year, and provides industry-leading analysis and consulting services to financial institution customers and merchants. Through its family of brands, including MasterCard®, Maestro® and Cirrus®, MasterCard Worldwide serves consumers and businesses in more than 210 countries and territories. For more information go to www.mastercardworldwide.com.

Contacts:
Louise Herbert, Tel. +32 (0)2 352 5647
Louise_herbert@mastercard.com