Major challenges and opportunities in the current state of the industry
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Profiting in a time of change

The payment cards processing industry is being fundamentally reshaped. From the Americas to Asia to Europe, business models are being revamped to take account of changing industry economics and – in some markets – major regulatory change.

Economies of scale and rationalisation are the orders of the day in this industry, which up to a number of years ago was mainly national in character. No longer. Issuing and acquiring processing have become global businesses and the major players in the sector see the future going increasingly cross-border.

The industry is also being helped by the irreversible trend away from cash toward electronic payments – a far more secure and cost-effective means of payment. Indeed, Troy Wood, president and chief operating officer of TSYS, noted in an analysts’ presentation earlier this year that 62 percent of transactions in the United States and Europe are now electronic. In addition, the trend of increased credit card spending in other regions is also growing rapidly.

For the industry’s major players, cards processing is a hugely profitable business. In 2004 First Data reported a 14 percent increase in revenues to $2.4 billion, while profits rose 64 percent over 2003.

One of the major trends in the payments processing industry has been the increasing rate of cross-border acquisitions, especially by US players in Europe. As well as the companies mentioned above, other players such as the subsidiaries of US Bancorp – NOVA and euroConex – are making inroads into the European processing markets.

Regulation is another driver of industry change. For example, the European Commission has been at the forefront of driving the introduction of an internal payments market in the European Union. Allied to the ongoing industry restructuring, the arrival of the Single Euro Payments Area will in effect remove national boundaries for payments in the eurozone and lead to the end of existing national processing monopolies, especially on the debit side of the business.

This supplement features updates on the current state of the industry as well as perspectives from both MasterCard and Visa on what they see as the major challenges and opportunities facing the industry.

Gerard Lysaght
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MasterCard processing: efficient, borderless commerce

Cards are vital to our economic health, and at no time in history has the commercial life of families and businesses so easily transcended political and geographic borders.

Cards are vital to our economic health. A family in the Netherlands has long been able to find a hotel, pay for lunch, and fill the car with gasoline and tour the continent with little more than a Maestro®-branded card in hand. A business owner in Germany can conduct business in new markets around the world, with no investment in brick and mortar, because it accepts card payments. A student from Spain can study in Japan using her family’s card to purchase all of life’s necessities, planned and unplanned.

At no time in history has the commercial life of families and businesses so easily transcended political and geographic borders. Never before have individuals and businesses had the power of instant access to deposit accounts and credit lines, regardless of the service area of a bank, the day of the week or the time of the day.

The foundation for this phenomenon was laid decades ago when European banks chose the debit scheme that would rapidly grow into the unquestioned pan-European leader. Consumers and businesses came to understand the inefficiencies in terms of time and cost for cash and cheques, as they saw first-hand how Maestro and MasterCard could move them from an outdated model of economic exchange.

With the indisputable leadership of Maestro, the scheme has built into its offerings a consistent experience for the cardholder and merchant. In addition, it has built a platform based on a network with unsurpassed speed and reliability, efficiencies based on scale that cannot be matched locally, and a depth of fraud and risk management tools that provide protection for all players in the payments chain: issuers, acquirers, merchants and cardholders.

Today, when Europeans are asked for their preferred debit card, 70% of the time they will pull out a Maestro-branded card. The MasterCard Europe payments foundation is already in place, tested and preferred.

MasterCard worked with European financial institutions to build a payments foundation that was in alignment with SEPA before SEPA was articulated. Its vision is that payments could be made by anyone, anywhere, anytime. This is a promise that the board of MasterCard Europe makes to European cardholders, merchants and financial institutions, and a requirement that the European staff delivers on everyday.

The promise is made real because of MasterCard’s investment in technology. Since 2003 MasterCard has invested more than US$87 million in payment systems in Europe.

This technology offers advanced capability to ensure that transactions on Maestro and MasterCard payment cards offer value for each party involved in a payment: the issuer, the merchant, the acquirer, and, of course, the cardholder.

At the centre of MasterCard Europe’s technology and infrastructure is its processing platform – a secure and proven platform for processing both domestic and international debit and credit transactions. It is the industry’s only truly globally integrated platform, yet it is highly customisable for Europe, allowing it to be regionally sensitive and locally efficient. The platform is continuously evolving to offer new products and other enhancements, while development costs are shared by banks worldwide.

With MasterCard, financial institutions can use the platform to process their own payments in their own time zones, at the end of their business days and where relevant, in their choice of currency. Currently, through its technology centre in Waterloo, Belgium, MasterCard links to a global platform that enables the processing of transactions in 42 countries in Europe, as well as 160 currencies from 210 countries worldwide.

MasterCard’s systems can be customised by European banks desiring to meet specific local-market needs or respond to local governance requirements. In essence, MasterCard helps banks differentiate themselves by helping them tailor processing to fit their individual business requirements.

In addition, the platform offers a single interface to the power and efficiencies offered only by a globally-integrated model. In other words, a bank can tap into a truly global system through a single relationship, a single format, a single point of delivery, and a single contact.

This is a key issue for organizations wishing to grow cross-border, and to extend their markets to other regions of the world. MasterCard takes the concept of efficiency and delivers it several ways: through a favourable operating model, a single interface, and by using the same procedures for all MasterCard brands and domestic (including on-us) and international transactions, as well as for issuer and acquirer traffic.

To accomplish all of this, MasterCard continually makes significant investments in technology that result in unparalleled speed, reliability and security. MasterCard offers a streamlined and proven means to process payment transactions efficiently, as well as a platform that uses technology and innovation to meet the demands of a new era of commerce.
Want to unlock the potential of multi-product processing?

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Card Tech Limited (CTL) is a UK-based software provider with offices in London, Nicosia, Moscow, Dubai and Kuala Lumpur. CTL has clients in over 70 countries licensing its systems and using its processing services.
innovation to offer new revenue streams (loyalty programme management, SecureCode for e-commerce transactions, OneSMART PayPass, MoneySend, M/Chip 4).

A better network
MasterCard has been consistently delivering better response times and performance for many years, and its strategic implementation choices have led to significant advantages in customer service, speed and reliability. MasterCard’s average roundtrip transport network response time is 120 milliseconds, leading the industry.

Some organizations choose to continue with a centralized network architecture which relies on an assortment of unsophisticated devices and tools to send a payment request to a central site for processing. As a result, information can be lost on the edges on the network.

When a problem occurs in this system, a bank must recognize the error, make a diagnosis and take action to recover it. This process can result in lost transactions, operational inefficiencies and expensive trouble shooting for the bank.

In contrast, MasterCard’s peer-to-peer network architecture can avoid these scenarios. In MasterCard’s network, a transaction is passed from a bank’s system directly to our locally distributed payments processing application. The local system can send transactions over alternate routes, and attempt multiple times if a network problem occurs. Even in the extreme case of a major network outage, MasterCard can respond on behalf of a bank to ensure that the transaction is not lost.

The sophistication of the peer-to-peer design allows virtually every transaction to be routed directly between financial institutions for decision-making. This design helps issuers better manage risk by understanding consumer purchasing and reducing “open to buy” limits. This design also streamlines access to the network to deliver rapid response to acquirers. When acquirers are not available, MasterCard “stands in” for them to ensure cardholders can use their cards anywhere, anytime, and every time.

A better partner
MasterCard is a true partner with financial institutions. It gives banks control of their card business through the MasterCard Europe board. Multiple advisory boards ensure broad input into direction and a direct link to results.

In addition, MasterCard is organized to work cross-regionally with global banks. This infrastructure enables MasterCard to partner effectively and deliver solutions that are tailored to local needs. With MasterCard, there is no need to navigate through a fragmented organizational structure that can be different in each region. There is one team to assist members with all their needs, backed by a local team of specialized staff.

MasterCard also can help European banks optimize their portfolios, become more efficient, improve payment economics and assist in their strategic growth. For example, MasterCard Europe expertise in rewards and security protection can be leveraged to improve customer loyalty through cardholder loyalty programs. In addition, MasterCard can leverage its platform to help European banks improve activation through automated promotions, prescreening accounts and prepaid services.

Unparalleled migration experience
Migration from national to international debit schemes can be daunting for some banks. MasterCard Europe has unparalleled and direct experience in migration. With more than 30 domestic processing arrangements pre-defined in its Global Clearing Management System, MasterCard can move quickly to determine the appropriate path that best minimizes impact on European institutions and their cardholders.

MasterCard Europe is a trusted partner and experienced in helping banks navigate through the challenges associated with migration from a closed domestic debit scheme to a pan-European solution. Consider for example, MasterCard Europe’s recent successes in the UK and Sweden.

In the U.K., MasterCard is converting 20 million Switch-branded cards to Maestro, resulting in 1.3 billion additional annual transactions switched, and cleared and settled via MasterCard, using domestic formats developed by MasterCard Europe.

In 2001, Swedish banks desired a solution through a single partner, single interface and single set of procedures for all transactions. They chose to partner with MasterCard Europe to gain flexibility and reliability, and now MasterCard is clearing and settling approximately 100 million transactions per year. In 2005 MasterCard began switching authorizations in an international format supporting new features, such as ATM Watermark and local characters.

MasterCard’s strength in infrastructure, brand and innovation, and its expertise in migration, combine to make MasterCard the best partner with whom to navigate the challenges of SEPA.

Always-on operations
MasterCard Europe’s network practically defines the phrase “always on.” Its track record of virtually 100 percent availability reflects the company’s investment in technology and a strong business continuity program. MasterCard runs one of the world’s most sophisticated processing platforms, which annually processes more than $1 trillion in payment transactions for nearly 25,000 member financial institutions and more than 24 million merchant locations.

Business continuity – the ability to sustain operations without interruption or downtime – is critical to ensuring that Maestro and MasterCard-branded transactions cards work every time. MasterCard Europe is an industry

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leader in this area and has integrated business continuity planning into its business strategy for more than a decade.

For MasterCard, an important part of continuity is making sure that the network is scalable and can handle large numbers of transactions during peak times. MasterCard can quickly scale up to handle large-volume increases because its virtual private network offers “bandwidth on demand.” Its network is 40 percent faster than its competitors.

MasterCard technology can handle virtually any type of transaction, in any volume, from any source, any day of the year, and any time of the day. From micropayments to RFID, the network can support any payment format with an extremely high level of reliability.

Delivering business value through technology

MasterCard’s new Global Clearing Management System (implemented for the European market in June) was built to manage the complexities of clearing and deliver additional value through a standardized yet flexible architecture. The system is configurable, so issuers can develop promotions rapidly for new market segments without expensive system development and testing. It also allows customized business rules, enabling issuers to establish relationships with merchants or manufacturers, to help increase the number or size of transactions, and to activate cards.

MasterCard Europe’s processing platform also delivers improved time to market for new projects. For example, MasterCard was able to roll out a new, tiered interchange program in months due to its flexible design. Interchange rates can be defined between acquirer and issuers for specific merchant or transaction types, which can be used to design card promotions linked to specific merchants.

The benefits to European businesses help expand the current vision of payments into the future. Consider the benefits of sending credit applications for new cardholders from a partner merchant to the issuer for instant approval at the point of sale. Consider the benefits of sending credit applications for new cardholders between the issuer and partner merchant for faster approval.

Processing in Europe

Europe is one of the most technologically advanced regions in the world when it comes to payments processing. But it also has some of the lowest interchange rates in the world, which has put pressure on card issuers to find new ways to compete. The challenge is to find a balance between profitability and competitiveness.

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“MasterCard’s European platform allows members to tailor processing to suit their individual needs, and exploit this powerful platform to deliver the payments experience SEPA is demanding”

European platform, resulting in unequalled speed, efficiency and reliability. No platform has more uptime; with more than 200 distributed endpoints in Europe, and more than 700 worldwide, along with multiple levels of redundancy, MasterCard can ensure that transactions always go through.

When it comes to payments processing, one size doesn’t fit all. MasterCard’s European platform allows members to tailor processing to suit their individual needs, and exploit this powerful platform to deliver the payments experience SEPA is demanding. A major component of MasterCard’s flexibility in Europe is that it is brand-neutral. Its network can therefore process in-country branded transactions as well as those initiated using in-store private-label cards.

MasterCard offers the European market an opportunity to streamline many facets of processing payment transactions.

MasterCard offers a complete SEPA-ready platform that is deployed around the globe. Maestro was introduced in 1991, and has been in use for more than a decade. The European message format (VS) and network have been in place for years. MasterCard’s customized European functionality and network are tested and proven, and processes all domestic authorization activity right in Europe.

The right choice

MasterCard enables members to select from best-in-class card programs and technology tools to find the right mix for customers in each specific market. Whether the answer is EMV chip, contactless chip, new forms of deferred debit, or new risk management tools, member banks can choose from the best options on the market today. A domestic technology provider is unlikely to have a global view of all options. Similarly, domestic providers are unlikely to have the research and development funds to bring the best products to the market.

MasterCard has found that a collaborative approach brings workable, practical solutions to the industry: ISO messaging standards, EMVCo for global chip interoperability, and the Maestro brand. With MasterCard Europe, banks have quick access to the best thinking in the global market – the thinking that has laid the foundation for the future in Europe.
Control the Cards Race

Issuers, acquirers and processors worldwide are leading the pack with CSC’s CAMS II™ Card & Merchant System.

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Euronet Worldwide, Inc. (Nasdaq: EEFT) is an industry leader in processing secure electronic financial transactions. The company offers ATM, POS, and Card Outsourcing services, integrated EFT software, network gateways, and electronic prepaid top-up services to financial institutions, mobile operators and retailers. Euronet is EMEA’s EFT processing leader, operates the largest independent pan-European ATM network, and is the world leader for electronic processing of prepaid mobile airtime.

The company’s processing centers in the U.S., Europe, Asia, and the Middle East jointly process transactions for 175,000 point-of-sale terminals across 85,000 retailers.

With corporate headquarters in Kansas, U.S.A. and EMEA headquarters in Budapest, Hungary, Euronet Worldwide serves clients in 70 countries from its 23 offices around the world.
The emerging European processing landscape

Jonathan Vaux, Senior Vice President, Product and Partnership Management, Visa Europe gives an outlook on the future of processing and the convergence trends across the payments and banking sectors.

Our perspective

It should be noted from the outset that we are not a single entity, rather the Visa organisation, like our peers, is an international association of banks, uniting more than 3,000 banks in Europe, and 21,000 worldwide. In Europe, these member banks have issued 280 million Visa cards which, in the year to March 2005, were used to conduct 1 trillion euros worth of transactions, representing close to ten percent of personal consumer expenditure across Europe. Member banks also sign up merchants to accept Visa, or other cards issued by our peers, in order to benefit from fast, efficient, guaranteed cashless payments.

European banks were the first non-Ameri- can participants in Visa. They were also the first to regard it, not as a credit card system, but a generic payment mechanism. Accordingly, they were the first to issue Visa debit cards, and the vast majority of our European cards continue to be debit. Since these debit cards are the dominant payment means and the pivotal point of the banking relationship, they tend to have real strategic significance for any retail bank. Accordingly, effective governance and control of the payment system is a top priority for European banks, and a highly pertinent issue for European regulators. It is, therefore, worth admitting to a vested interest – by acknowledging that Visa has a very big stake in the way the European payments industry evolves. And, on behalf of our member banks, we are working hard to influence that evolution.

Convergence across banking and payments

Before looking at the specifics of the Euro- pean retail payments sector, it is perhaps worth considering the broader context and the multiple convergence trends across the banking and payments sectors. The mergers and acquisitions continue apace. Clearly, part of the business rationale is to achieve more scale and scope – optimising the cost base, and eliminating duplicate infrastructures.

Pan-European banks are, therefore, focusing on the concept of developing common products that can be sold to customers via common delivery channels in each country. Most pan-European banks believe that major savings can be made through the centralisation of product development and marketing and the phased replacement of each country’s domestic systems. To be effective, this concept needs common delivery platforms and processing infrastructures.

Constructing multi-country cross border processing solutions are undeniably high risk, high cost and for possible limited rewards. The small number of processors which have built, or are building, solutions have incurred project over-runs, primarily because of the complex interfaces and country specific features that have to be developed to link into legacy systems in each country.

Everyone agrees that Europe cannot support a parallel infrastructure in every single country, so these incumbents are actively hunting for a new remit. Coinciding with this we have the emergence of the new legal framework for payments, the Commission’s scheme to harmonise the legislative context for all payments, not just across the euro-zone, but all E.U. countries. Covering transparency and liability, security and fraud prevention, and revocability and refunds, it will create a level playing field across the continent.

Looking more closely at our own sector, card payments, there is the European migration to EMV chip technology. This is significant for many reasons but in this context it is the first time that Europe is uniting around a single card standard. The casual observer may think of the card market as highly standard- ised. But, scratch below the surface and you see a mass of national idiosyncrasies. EMV represents a big step towards convergence.

Now we seem, finally, to have reached the moment of truth and the mindset of the industry does appear to be shifting. Even so, we are still at the start of a very long, difficult process, and there are some very complex, emotive issues to resolve.

The future of processing study

Against this background, Visa Europe commissioned Payment Systems Europe to under-
take a major research study among European banks and processors. We asked for their opinions on today’s card processing market and how they thought it may evolve.

In terms of the big picture, there are probably not too many surprises. Yes, everyone agrees that SEPA is a worthy aim. And yes, everyone agrees that it makes sense to move towards a common payments architecture. In other words, there is complete consensus on what and why. Where it gets more tricky is when we discuss who, how, when, and where.

But the important thing to acknowledge is this – no one is happy with the status quo. Not the banks, not the commercial processors, and not even the inter-bank processors. Even if SEPA were not on the agenda, there would be real pressure to change, and to move towards more openness, transparency, standardisation, and competition. Indeed the study shows us that it is not even SEPA that is the biggest force for change. Nor is it the Commission’s competition intervention. Instead it is the needs and demands of the big pan-European banks which is regarded as the primary change driver.

These banks say they are frustrated by the lack of choice and flexibility, they do not like to be dominated by inter-bank processors, and they are not impressed with what is on offer from the third-party processors either. Yes, they have got an element of choice when it comes to their credit card processing, but, for banks in mainland Europe, the priority is invariably debit.

But how do they break the deadlock? Again, it is agreed by the survey respondents that the larger banks will be the ones to decide. On balance these big banks say that, yes, they would like to see closed domestic markets opened up to competition. They are in a situation where they are supporting a different inter-bank scheme in every country where they operate, and each scheme is presenting them with a big bill to replace an aging delivery platform.

But there are not any easy exit strategies. One option could be to renew their support for these incumbents, helping them to pursue pan-European strategies, to win cross-border volumes and thereby drive down sales. Alternatively, they would orchestrate the sale of these inter-bank processors, dismantling local defensive barriers. Both strategies have definite drawbacks, so the more likely scenario is gradual, market-by-market liberalisation, as history, and the fact that the debit card is so simple be exported across Europe. Given the EMV chip technology right across the region, the pan-European banks really need is multi-country solutions for issuing, acquiring, and ATMs. Today, few if any processors could offer a credible service.

So, how about the processors themselves? These organisations fall into two broad camps, the commercial processors, or TPPs, many of which are owned and/or operated by large American multinationals, and the mutually owned inter-bank processors.

"So long as it adapts to the realities of a larger, more uniform European market, the inter-bank cooperation model is alive and well"

The survey suggests that the inter-bank processors may be facing an uncertain future. There was some criticism over the quality of service and the costs of redevelopment. However, no one should underestimate the level of support they retain. Several banks believe there is definitely a future for cooperative platform development and shared services. The conclusion is clear, so long as it adapts to the realities of a larger, more uniform European market, the inter-bank cooperation model is alive and well. It should also be noted that many of the processors, irrespective of whether they are third parties or inter-bank consortia, face an impossibly difficult situation. They say that the banks have a new-found preoccupation with costs and efficiencies, often at the expense of revenue generation and profitability. Consequently, all they want from the processors is vanilla-style commodity services.

Clearly, it is not at all easy for any processor to excel in these circumstances, particularly when you have to upgrade your systems, the market is highly oversupplied, and there are barriers to international growth. The banks and processors agree that the market has to shrink substantially, and the consensus was that there may only be room for 20 to 30 players by 2012.

Other cross-border retail payments

It should be stressed that what we have been discussing so far is the payment card market and payment card processing. This is a payments market which is commonly perceived as the most uniform, the one that is closest to the SEPA ideals, and has the fewest adjustments to make. So what about the prospects for other types of payment?

Visa has also spent some time analysing the ACH market. Specifically, we conducted some very detailed, structured discussions with our members, and also with the national ACHs. Our aim was not to define how Visa could replace existing infrastructures and market players, rather, we wanted to examine whether our processing capabilities could enhance the capabilities of incumbent players – perhaps by providing complementary, value-added processing services, which could result in reduced costs and increased revenues for banks.

Again, the findings are extremely interesting. Firstly, it was thought inevitable that pan-European clearing infrastructures will emerge to replace the existing, local ACHs. Moreover, it was recognised that the scale and the functionality of VisaNet could add value to banks and the processing infrastructures they are using today. Consequently, most banks had accepted that, yes, they would have to invest – at some stage.

Finally, we asked these large banks about the environment ten years from now. They all agreed on two points. Firstly, they all agreed that, ten years from now, there would not be more than 4 to 5 wholesale payment clearers. And, secondly, all 12 processors we spoke to agreed that they would be one of the four or five survivors!

Where to from here?

Even if we are to confine our considerations to the payment card sector, it is clear that Europe’s banks have some difficult choices to make. Let us look at some of the criteria that will be important in the decision-making process.

Grasping the EMV opportunity

There is definite consistency in the way that the European credit card market functions, and this also extends to charge cards and some types of debit card. This, however, is not the case for a large chunk of the debit market, particularly in central Europe. Indeed, there are 15 different domestic card implementations, each of which has its own particular rules, regulations, and processing infrastructures. The casual observer could suggest that the credit card model should simply be exported across Europe. Given the history, and the fact that the debit card is so very pivotal in the banking relationship, the industry insider would label such a suggestion as naïve.

However, with the implementations of EMV chip technology right across the region, there is an historic opportunity to unite, and possibly even converge, around a com-
The Prepaid Cards Revolution

By David Cavell FCIB

The Prepaid Cards Revolution presents an authoritative review of the development of a product that may well challenge the Internet in its potential, rate of growth and implications for the global payment systems, and provides you with the knowledge and guidance to ensure success in the creation, development and implementation of your prepaid cards programme.

This unique research reviews more than 20 organisations, including both issuers and service providers. It considers both established players and the very latest examples of the use of the card, and examines the capabilities that are available to support both new and existing issuers. In particular, it also looks at the nature of the prepaid product range, in a marketplace where much still remains to be done in product definition, understanding consumer usage, and clarifying the regulatory and legal framework in which the product operates, including its use in sectors such as:

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- Health
- Internet payments
- Transport
- Travel money; and
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mon platform. What we are talking about here is the creation of a new Always Chip – Always PIN debit product for Europe. In a few years, Europe will be a mature chip market – indeed, more than 90% of terminals and cards will be EMV. In other words, the environment will accommodate fully secure cards, debit cards in particular – for which consumers’ security expectations are not fully met today, especially when they travel outside of Europe. To the extent that there is a consensus, it appears to be that Europe’s banks should aim for a fully secure debit solution, which at the point-of-sale will be chip and PIN only.

With no exception items, no skimming of the magstripe, minimal fraud, and the opportunity to operate off-line in selected environments, such a product would result in lower unit costs for all participants, which would in turn lead to increased merchant and consumer confidence. Our own proposal is for a product, V PAY, that is fully owned and controlled by Europe’s banks, and which operates under its own acceptance mark. It is able to coexist with domestic debit schemes, as long as the banks who own these schemes find it appropriate. Of course, it is also an ideal point-of-convergence for these schemes across Europe. Although there are differing views about the timing for such convergence, within and among countries, no one is arguing with the fact that it will and must happen at some point. At Visa Europe, we are, therefore, working with many of our members to see how such a product can help them evolve towards a more secure, more convenient, and most cost-effective European debit scheme, topped up by a European-only governance structure.

In June 2005, the first live V PAY transactions took place in Greece and France, followed by Germany, Luxembourgh, Norway and Turkey making V PAY a full-blown product. The decaling of merchants across Europe has started in September with the first V PAY cards being issued in 2006.

The response from the industry has been extremely positive. For example, V PAY won a 2005 Excellence in Payments Innovation Award from the European Payments Consulting Association (EPCA) and European Card Review (ECR). The judges named it as “the most innovative payment solution that has added to the development of SEPA”.

Maintaining European ownership and control
What some observers fail to appreciate is that ownership and control of the card payment system is a highly emotive subject for European banks. Thinking back to chip cards, for example, the EMV specification itself was hammered out in Europe, and Europe is the clear world leader in implementing it. The nature of the cards issued here in Europe is very different from elsewhere in the world, and their usage patterns are also quite unique. Additionally, no other banks face the challenge of migrating from separate, multi-country infrastructures to a more unified regional infrastructure. The recent constitutional changes at Visa Europe are a reflection of this situation. Traditionally, we operated as a branch of Visa International. But, as of July 2004, we created a separate incorporated company called Visa Europe. In effect, this means that Europe’s banks are the joint-owners of a distinct European payments business, and to reflect their proprietary interest each one holds a nominal, non-transferable share in the company. Yet, to maintain our internationalism, Visa Europe exists as a group member – and co-owner – of Visa International.

In business terms, incorporation means that we can accelerate our European development work. It also means that we can develop more technology services and have the freedom and opportunity to enter into commercial partnerships and joint ventures. Incorporation also has profound symbolic significance.

It demonstrates that Europe’s banks are the exclusive owner-operators of their own regional payment system. With an unambiguous European focus, and pan-European representation, we can express their views and represent their interest more forcefully with European associations, regulatory bodies, and forums. In particular, we want regulators, industry bodies, and working groups to regard us as a welcome and authoritative partner.

The issues of ownership and control also extends to the processing infrastructure which ties together the various participants. Our various surveys suggest that Europe’s banks are unwilling to cede control to third-party technology companies. Perhaps they have glanced across the Atlantic and seen the weight of influence which such companies have on the terms and the costs of the entire payment market.

Europe’s banks have a deep and enduring appreciation of the strategic significance of electronic payments. Companies or organisations which seek to represent or serve these banks should maintain a healthy degree of respect for these instincts.
Profiting from Debit Cards

The key to maximising account revenue

by Dr Anthony Gandy FCIB

Profiting from Debit Cards – the key to maximising account revenue explores developments in the global market for debit card schemes and how the banking industry can best respond to the changing payment requirements of its customers.

This latest research from Cards International considers the impact of key changes such as SEPA on the retail payments environment, the changing requirements of consumers and merchants, the potential for new charging models that will enable debit cards to compete for online and high street micro-payments, and the role of the debit card in accessing new sectors and markets.

Research covers

- Current debit card schemes – structures and models
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- The role of the debit card as the access device to banking services
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Consolidation and outsourcing dominate the processing landscape

Like the banking sector that it serves, Europe’s card processing industry is facing major consolidation. As banks continue to outsource processing requirements to third parties, the industry has a huge role to play in shaping the future of the continent’s payments space.

The acquisition of EuroProcessing International by First Data Corporation on 10 June is the latest example of the consolidation trend in Europe’s card processing industry. There are likely to be more before the end of the year, as at least two former national processing companies in Central Europe are reputedly on the market.

“There are a number of drivers in the processing business,” said Ken Howes, director at Edgar Dunn & Company. “You can put the whole business under one umbrella, but it’s more complex than that. There is a difference between issuing and acquiring processing, between credit and debit processing. Does the authorisation of debit card transactions go into a bank’s host system or to a central processor? There’s a difference between that and then playing in the credit card issuing business.”

According to Howes, the large number of domestic debit programmes in Europe results in high barriers to entry in some markets.

He said: “We mustn’t forget that there’s a lot of in-house processing going on. In the future we may see the rationalisation of the broader processing business and the positioning of in-house processors to the extent that they may wish to extend their processing capability. On the acquiring side you may even get some involvement of the payment schemes in processing arrangements. At the high level, the drivers encouraging cross-border processing are economies of scale and the fact that volume is very important. There is a grab for processing volumes.”

Visa International agrees that the processing industry is going through major changes. “It’s safe to say that more and more banks are looking at the costs of processing,” said Jonathan Vaux, senior vice-president of payment processing services at Visa Europe.

Major consolidation is on the cards, according to Vaux, and the inter-bank processing market is one of the major areas of any rationalisation. “We are consciously processor-agnostic,” said Vaux. “We manage the processing side of the business through our members and work with them to help them implement the processing solution that they choose.”

Of course, national requirements are only one element of a processor’s capability set – cross-border processing is a growth opportunity for the continent’s processors. “On an implementation standpoint we enable anyone who wants to go into a new market,” said Vaux. “Anyone who wants to go cross-border or be a pan-global player is going to have to build connectivity.”

“The challenge is to manage each individual [national processing] business in its transition from being well protected to being fully exposed to competition”

Johan Reinsli, EuroProcessing

Expansion overseas

Across Europe, rationalisation is the order of the day. The acquisition of Oslo-headquartered EuroProcessing International is the third major purchase by First Data in the past 18 months. In 2004 it acquired Cashcard in Australia and Delta Singular (later rebranded First Data Hellas) in Greece.

David Yates, president of First Data International’s EMEA region, said that First Data Hellas is a microcosm of First Data on a global level. “They’ve got banks [as customers] in Greece, Albania, Romania, Serbia, Bosnia, Cyprus, United Arab Emirates and Saudi Arabia. First Data Hellas is almost a hub for the Balkans,” Yates said.

He continued: “We’ve got some very well-skilled people in Athens and the company operates at a good price point. It’s a European centre of expertise and we’re looking at creating a set of these centres.”

First Data says that the EuroProcessing acquisition will give it “an important foothold in Eastern Europe and the Nordic region, while enabling delivery of an enhanced service offering to EuroProcessing International’s banking clients”. It offers ATM and POS transaction processing services, rental and maintenance, debit and credit card management, card personalisation, and electronic top-up of prepaid mobile airtime through POS, ATM and GSM messages.

First Data plans to establish a single entity for debit and credit issuer and acquirer processing across the Nordic region, reflecting its “commitment to being a significant participant in the European debit market”. It will also offer credit card consultancy in Central and Eastern Europe as banks in the region become more aware of the revenue opportunities of revolving credit.

EuroProcessing International’s management team in Oslo will continue to lead First Data’s operations in the Nordic markets, offering the full First Data issuing and acquiring services portfolio to banks across the region.

Yates said that he views Central and Eastern Europe – especially Hungary, the Czech Republic, Slovakia and Poland – as “places where we want to be”.

Yates said that FDI aimed to be active in a range of activities, including issuing, full back-office processing, locally deployed solutions, merchant acquiring joint ventures, and switching. “We’re not constrained by financing issues. The constraint is more operational.”

With that in mind, the international reach of EuroProcessing’s international network will be especially attractive. The company has offices or representatives in Slovakia, Lithuania, Latvia, Serbia & Montenegro, Russia and Hungary – all markets where First Data sees major growth opportunities.

EuroProcessing, set up in 2000 to invest in domestic transaction processing companies in the region, has subsidiaries in Central and Eastern Europe including Mokejimo korteliu sistemos (MKS) in Lithuania, Transacty in Slovakia, BankServiss in Latvia and Transacty in Serbia & Montenegro.
Yates foresees more consolidation across the processing industry. “I would imagine that there will be fairly significant consolidation in processing,” he said. “We have to have some realism about the state of development in each of the markets. Europe is more likely to consolidate more rapidly. I equally think that having a foothold in China and India is important.”

He continued: “You can start to consolidate some of the systems because some are transportable internationally, such as credit card issuing and acquiring and switching. However, there are some components of national debit that are specific.”

Outsourcing in the processing industry

FDI estimates that some 30 percent of its outsourcing clients make up 70 percent of revenues. “We see two competing trends,” Yates said. “What you see in brand new marketplaces is banks looking for an in-house solution that is implemented quickly and effectively. However, at the top end even some of the world’s biggest players have given up writing their own card management systems.”

For companies between both extremes, some form of outsourcing is probably under consideration. “The question for banks and processing companies is whether the organisation that they’re outsourcing to has the right dimensions to invest in a business where regulation and competition keeps pushing the cost of compliance and upgrades still higher,” said Yates.

“We feel that we should be pragmatic in developing local capability in the debit as well as credit space so we could integrate local capability or participate in some international standard.”

In its most recent cards and payments outsourcing link-up, First Data Corporation announced on 3 June that it had signed a seven-year technology outsourcing agreement with Australian bank Suncorp to manage its portfolio of over 6,000 credit card merchants using First Data’s OmniPay Merchant Processing platform. The company’s OmniPay technology platform will support Suncorp’s merchant payments processing requirements.

Outsourcing in the ‘New Europe’

While banks in the Baltic region have been among the most innovative banks in the world when it comes to using IT, they are also among the slowest to outsource, preferring to keep most technology development in-house.

Indeed, up to 2003, Hansabank – the largest bank by assets in Estonia, Latvia and Lithuania – had more software programmers in its IT department than the largest software development company in the whole Baltic region.

The cards business in Estonia and Lithuania follows the standard Central European model of a national processor. Pankade Kaardikeskus (PKK) in Estonia, MKS and BankServiss in Latvia manage both issuing and acquiring transaction processing in their own country.

According to Johan Reinsli, chief executive of EuroProcessing: “The challenge is to manage each individual [national processing] business in its transition from being well protected to being fully exposed to competition – from banks’ own in-house operations as well as from other cross-border players. The previous owners of the domestic processing centres – the banks – want, quite justifiably, the shift to happen more or less overnight. Keeping up with that sort of pace certainly focuses minds on doing the right things right, at the right time.”

MKS processes for all but two of the country’s major banks, including nationally owned organisations and foreign subsidiaries.
Industry. "Visa looks on Europe from the periphery. 'The Blyff would have on the European processing of SEPA, but there are forces for change.'

According to Aleksandras Sosnovskis, senior project manager in the company’s business development department, MKS processes 2 million cards for switching transactions and manages 500,000 card accounts. "Lower implementation, certification and maintenance costs, higher service quality and security levels are all among the advantages of using a central processor," he said.

On 6 June the Estonian subsidiary of Swedish banking group SEB – Eesti Uhishpank – announced an agreement with TietoEnator Support OÜ to outsource some of its on-site support services, including those for cards and payments processing.

"It’s only IT support that’s being outsourced," said Avo Kask, managing director, TietoEnator Support OÜ. "No business function is involved, just on-site support for IT equipment."

The deal, which is due to be signed on 31 October, will include the transfer of ten to 20 of SEB Eesti Uhishpank’s current on-site services staff to TietoEnator Support OÜ. However, Eesti Uhishpank will continue to process its cards through PKK. Incidentally, TietoEnator also provides IT solutions to MKS.

SEB runs 680 branch offices in Sweden, Germany, the Baltic countries, Poland and Ukraine. It has more than 5 million customers, of whom 1.9 million use the internet for their banking transactions.

Managing the migration

The three Baltic nations were among the eight Central and East European countries that joined the European Union in May 2004. They were automatically migrated from Visa’s Central Europe Middle East and Africa (CEMEA) region to Visa Europe (previously Visa EU). Vaux believes that processors in these countries face similar challenges to many of the longer-established markets in Visa Europe.

"The economics of every market are different," Vaux said. "Bearing in mind the development of credit and the inter-bank processing arrangements in these markets, it all makes for different dynamics. Those markets are at a different state of opportunity, but there are forces for change."

Vaux said that it remained to be seen what impact the Single Euro Payment Area (SEPA) would have on the European processing industry. "Visa looks on Europe from the perspective of being a Europe-wide organisation. Our role is to look at SEPA and provide cost-effective solutions to bring around the SEPA vision. We are making sure that people realise that payments is a business, not a utility.”

Howes at Edgar Dunn agrees that SEPA could have a major impact on the processing industry. "One of the major questions is 'what does cross-border processing mean in a SEPA environment?'. This will clearly be a consideration for domestic processors. With the exception of one of two players, they will all find that they don’t have a business unless they change their business model."

However, Howes says that there may be other revenue opportunities for processors.

"There is no ruling that says processors should be running a below-cost or commodity business," he said.

"When you get a commodity business you don’t have lots and lots of players. Processors are in the payments value chain. If you’re in the credit business you’re also in the supply of credit value chain. There’s a point at which these value chains come together. We may find processors being more innovative in where they find incremental revenues."

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Ken Howes, Edgar Dunn & Company

Consolidation and co-operation

Outsourcing link-ups involving major European players are happening in other parts of the world, too.

Barclaycard, the largest card issuer in the United Kingdom, is active in 28 African countries. This extensive network was a major factor in American Express’s recent decision that Barclaycard would acquire and process Amex card transactions in nine African markets.

Having started in Kenya on 1 May, the service is now being rolled out to Botswana, Zambia, Ghana, Malawi, Seychelles, Tanzania, Uganda and Zambia, with a completion date of the end of August. However, Barclaycard will not issue American Express cards in any of the nine countries covered under this deal.

“This partnership will provide Barclaycard Merchant Services with a sustainable competitive advantage as no other bank will be allowed to offer this exclusive service," said American Express in a statement. “Merchant customers will also benefit from a single acquiring relationship that will offer services with major card schemes including American Express, full local customer market servicing and support available by calling a local phone number, 24-hour card authorisations locally from Barclaycard, and potential to improve their target customer base to include inbound American Express corporate and consumer cardmembers.”

GZS looks to the future

One of the organisations that best typifies the changing European processing landscape is Gesellschaft für Zahlungssysteme (GZS). For many years the exclusive Eurocard processor in Germany, GZS now processes both Visa and MasterCard transactions for around 2,200 banks, retailers and industrial companies. In addition, the company processes transactions for some 350,000 card-accepting merchants.

However, in recent years change has been the only constant at GZS, as the company seeks to reduce its cost base, expand internationally and refocus on its core competencies.

In 2003 GZS replaced its entire acquiring processing platform and upgraded most of its card processing systems. It posted losses in 2003 and 2004, but expects to return to profit in 2005.

"Our successful restructuring should position GZS to play an active role in the card market’s consolidation process,” the company said.

As part of its restructuring, GZS cut 25 percent of its workforce, making a provision of €17 million ($20.5 million) to cover the cost of the redundancies. The company hopes that the restructuring will result in a 20 percent reduction in costs.

Things have got better, but the company is still loss-making. On 18 February GZS reported operating losses for 2004 of €4 million, a considerable improvement on the €26.9 million loss in the previous year. The company posted revenues of €124.2 million and expenses of €128.3 million. It processed a total of 948.3 million cards transactions (922.4 million in 2003) with a sales volume of €72.6 billion in 2004.

At the release of the company’s results, Norbert Pawlowski, chairman of the GZS board of directors since November 2004, said: “GZS has re-established a firm, economic basis and taken the first step towards playing an active role in the card market’s consolidation process. GZS is presently partaking in a systematic fitness programme to boost its long-term competitiveness.

“Over the coming months, we will not only continue to roll out the restructuring process, but put even more effort into customer-centricity and sales activities as drivers for further growth.”
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