



SEPA – Can Banks Find New Opportunities for Growth and New Sources of Revenue?

Euroforum, Amsterdam

1st December 2010

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***“Success is like a science, if you have the right conditions
you get the result”***

Oscar Wilde, April 1883

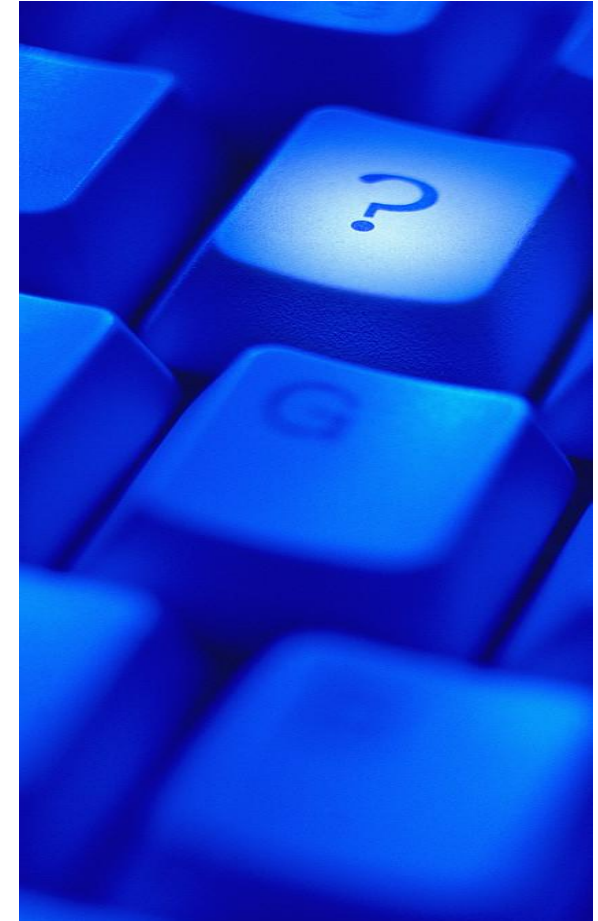


- Observations on SEPA, Cost Reduction or Revenue Generation
- SEPA Benefits through Improved Back Office Efficiency
- SEPA - Tomorrow's Vision versus 2010 Reality
- Potential Areas for Growth and Revenues
- Summary and Conclusions



SEPA Opportunities for Revenues – Some Observations

- SEPA, a semi-regulatory driven initiative – so business case and compelling proposition always difficult to build.
- Many SEPA benefits are intangible – not all show a definable return
- Many mandated changes – have to be integrated into existing products – fewer stand alone opportunities.
- SCF and new Standards for Cards evolutionary rather than new product and revenue generating
- Several studies show reductions in revenues as a result of increased competition and utility service provision
- Some argue SEPA's objective is to deliver cost reduction and improved efficiency.





Benefits Through Improved Back Office Efficiency

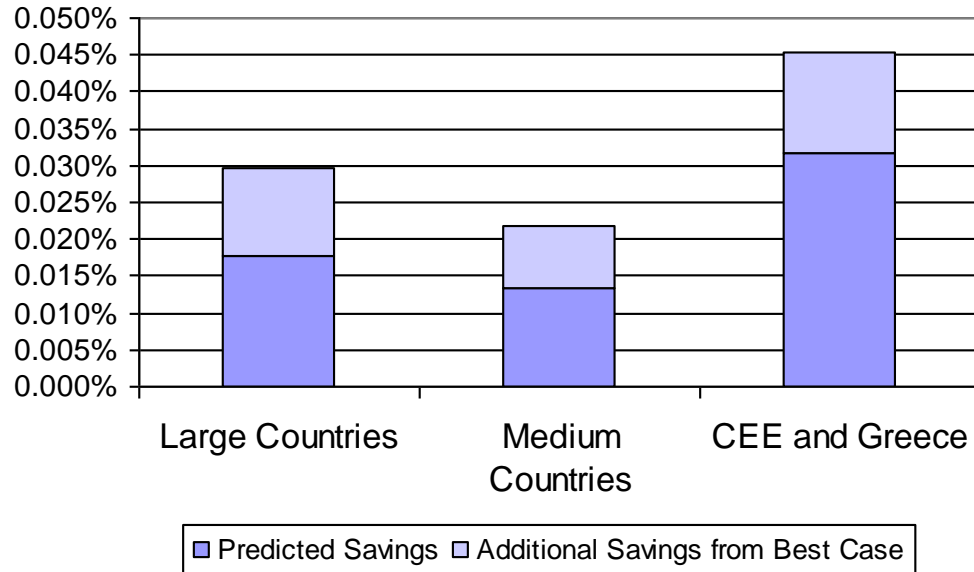
- Study commissioned on PSE by First Data to model the full effect of SEPA and the PSD on processing on all EU nations
- Assessed the impact on card schemes, banks, commercial and interbank processors, ACHs/CSMs, PSPs/NSPs and supplier sector
- Encompassed the costs of all forms of payment, electronic (SDD, SCT) cards, ATM, eCommerce by country
- Considered the impact of common process, harmonisation and standardisation on electronic and card payments
- Assessed the volume impact of M&A, demise of local ACHs and competitive impact of SEPA and the PSD
- Calculated base line case, predicted case and best case scenarios



The SEPA Effect - Benefits More Substantial than Revenues?

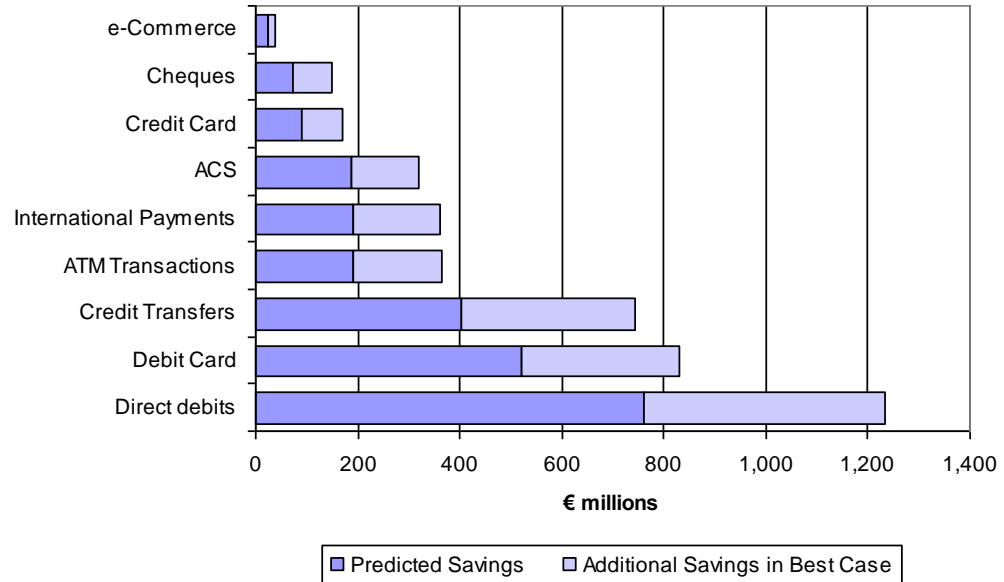
Beyond 2016 study showed annual savings for card schemes, banks, processors and ACHs of €3 bn to €4.5 bn; 0.02% to 0.03% of EU GDP

Annual Savings as a Percentage of GDP – 2016 and Beyond



Greatest impact on the five largest countries (68%) but significant savings in the CEE as volumes increase

Annual Savings by Payment Instrument – 2016 and Beyond

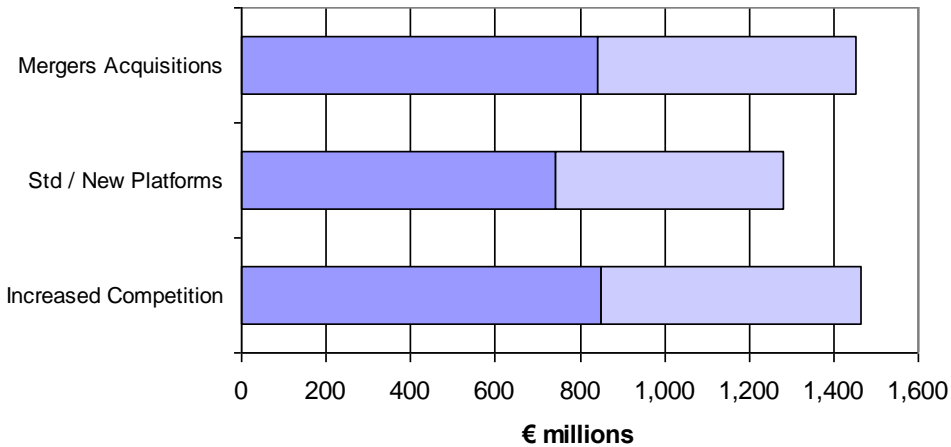


Highest savings from SDD, SCT and debit cards, reflecting CSM consolidation and declining processing fees – 0.01% by 2016

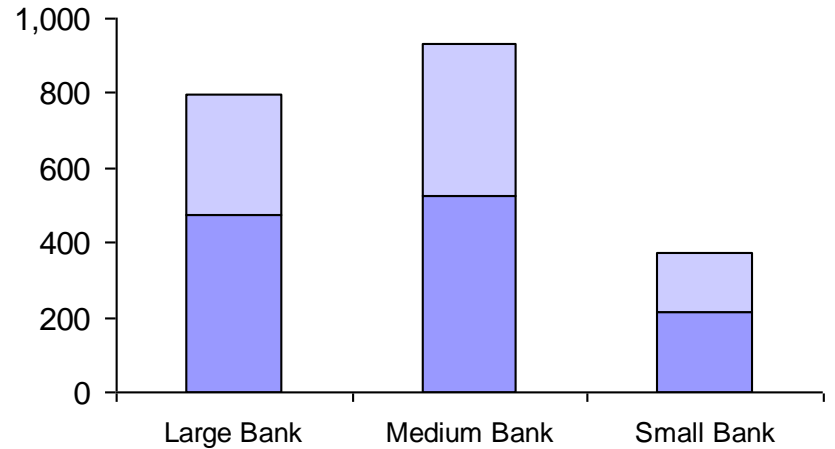


The SEPA Effect - Benefits More Substantial than Revenues?

Savings by Key Driver – 2016 and Beyond



Annual Savings by Size of Bank – 2016 and Beyond



■ Predicted Savings □ Additional Savings from Best Case

■ Predicted Savings □ Additional Savings from Best Case

M&A by commercial/interbank processors and banks expected to generate over 35% of savings with harmonisation, standards, new platforms and increased competition contributing 65%

Greatest savings are predicted amongst the small and medium size banks as unit costs fall through lower interbank and processor fees as a result of increased volumes



What do Consumers Want from SEPA?

“High quality, competitive payment services from their bank, with EU wide acceptance, delivered securely at reasonable prices in a timely manner within a simple, transparent, legal framework.”

but

- Not over concerned that national payments are harmonised
- Will perceive harmonised legal framework (PSD) delivers substantial benefits
- Very concerned if over priced – particularly cross border
- Expects EU wide card acceptance



What do Corporates Want from SEPA?

“Open, markets with competitive offers for electronic and card payments, common processes and standards, with multiple schemes, reach across the EU and services which easily utilise and interface with national market cards processing and CSM infrastructures.”

and to

- Remove country barriers to entry and processes that restrict competition
- Simplify and harmonise processes through standards
- Reduce internal headcount and costs through reduced exceptions
- Improved transparency, lower costs of acceptance and processing
- Enable multi country payments processing and reach for multi country corporates
- Integration with other financial data to improve efficiency



Was the Consumer Today/Tomorrow Vision Realistic?

Some of the “tomorrow’s visions” for mobile citizens, cross border home owners, students made in 2006

- “Common EU wide process for consumer redress”
- “Purchases made in any country with common legal framework for consumer protection and redress”
- “Full disclosure of charges, fees, exchange rates for payments”
- “Standard transfer time to home country account using common account codes”
- “On bank in home country accessible through SEPA”
- “Increased choice – new products and services with more competitive offerings”
- “Predictable SEPA wide transfer process for payments anywhere in Europe with common standards and processes”
- Ability to shop around for lowest cost or highest functionality accounts in SEPA countries

The PSD has delivered on many of the 2006 Consumer Vision



Was the Corporate/Merchant Today/Tomorrow Vision Realistic?

- “Separation of card schemes from processing”
- “Increased processor consolidation, larger operations/lower costs through economies of scale”
- “One common timeframe and Service Level Agreements (SLAs) for payments for all countries, resulting in improved cashflow”
- “Reduced costs through common SEPA credit/debit transfers and standards, opportunities for harmonised, secure guaranteed remittance data”
- “Mandated implementation of EMV chip on all cards and use of PIN”
- “Lower terminal and transaction costs from use of standard application software”
- “Lower operational costs through standard frameworks for exception items and for consumer redress”
- “One internal platform supports all SEPA countries”
- “One terminal able to serve all acquirers, substantially reducing footprint costs and operational complexity”
- “Opening up of markets for acquiring services, greater choice, new products”
- “Common standards for both card payments and for SEPA Direct Debits (SDD) and SEPA Credit Transfers (SCT) clearing and settlement”
- “Increased choice and ability to shop around for lowest cost accounts in any SEPA country”

For Corporates the SEPA Vision still has some way to go!



General SEPA – Growth and Revenues

Revenue Losses

- Reduced costs of automation of SCT and SDD passed on as a result of increased competition expected to reduce electronic payment revenues *
- Harmonised interchange already significantly reducing revenues to banks
- SEPA POS Standards will reduce terminal costs and acquirer rental revenues.
- New SDD has potential to deliver new services in countries with low DD usage and/or unsophisticated services – growth of direct debiting volumes and revenues.
- Development of e-invoicing and integrated treasury management services, large corporate offers - good revenue potential.
- Visa and MasterCard volumes and issuer revenues grow as several national debit schemes disappear (PKK, Laser, PIN, MC/BC).
- Removal of regulatory infringements – change shape and product components to generate new revenues.
- Join new card schemes and exploit new market opportunities.

Revenue Growth

Source: CSC Survey 2010



Growth in ACH Based Card Payments



- Significant potential for growth of card payments linked to ACH direct debits – national markets and pan-EU
- Major benefit is high credit card interchange, very low cost of settlement enabling merchants to deliver greater rewards on loyalty cards
- Concepts originally pioneered in Germany through ELV and by US debit card providers (Tempo and others)
- Examples are:
 - Decoupled cards – one for one transactions – as ELV
 - Deferred cards – 5, 10, 30 day settlement – Spanish market now 27m cards
- Payfair concept pilot launched in Belgium – moving forward
- Growth of eCommerce PSP ACH electronic payments in all EU countries – significant opportunities
- PayPal's settlement of choice is ACH direct debit payments – significant growth potential



Unbundled Card MSC Pricing - Opportunities?

Acquirers have opportunities of generating new revenues as a result of regulatory pressure on Visa and MasterCard to make MSCs more transparent

Externalisation of Cost - Margin/Cost Management

- Acquirers able to **recover all their acquiring costs** as a result of new detailed charging structures.
- Acquirers may be able to **generate additional margin** from unbundled pricing by charging merchants for product components currently free of charge – terminals, ACH payments, transaction processing, chargebacks etc

Charging MIF Correctly

- Acquirers will be able to cover the **“true” cost** of acquiring all card transactions. For example, commercial and international cards – traditionally accepted as a loss by acquirers.
- **New card products** which often attract high interchange rates can be charged correctly rather than be accepted at a loss.

Charging for Other Services

- Acquirers will be able to **charge merchants for other services** that were previously unseen by merchants e.g. onboarding, set up, minimum fees, termination fees.
- For largest, merchants can charge on the basis of **“interchange plus”** – ensuring full MIF cost recovery.



SEPA Winners and Losers

SEPA Winners

- Maintain a positive vision
- Accept SEPA delivery realities and build within
- Focus on back office cost reduction
- Ensure SCT/SDD integration and harmonisation
- Manage regulatory constraints
- Refurbish/relaunch old products
- Focus on larger corporates/merchant requirements – electronic/cards
- Build work-arounds until SEPA fully delivers
- Join Visa, MasterCard or new card schemes

SEPA Losers

- Assume SEPA will have no impact
- Fail to maintain SEPA momentum within organisation
- Over optimistic about scope of SEPA opportunities
- Fail to recognise impact of harmonisation and the impact of utility on offers competition and revenues
- Fail to reduce internal costs of payments processing



So Where Do We Go From Here SEPA Growth and Revenues for Banks?

- Recognise that SEPA may reduce bank's revenues
- Accept that in the immediate future growth and revenue opportunities are modest and will not offset losses
- Recognise limited scope for innovation until SEPA is widely implemented
- Accept that major SEPA benefits delivered from improved back office efficiency – offsets some revenue losses
- Press SEPA stakeholders to refocus on improving processes and the removal of national market blockages
- Build new offers that manage regulation and maintain revenue streams



“You can only predict things after they have happened”

Eugeno Ionesco, *Le Rinoceros*, 1959



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