



Unbundled Pricing: Are Merchants Due for an Uncomfortable Surprise?

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- “Unbundled” or “Unblended” pricing has come under increasing attention by the EU Commission.
- Historically, acquirers tended to offer one merchant service charge for credit products (both Visa and MasterCard) and one MSC rate for debit cards (Visa Debit and Maestro).
- Whilst they were often reported separately, in practice the rates tended to be the same for the majority of merchants when agreed during the recruitment process.
- To stop this practice, the EU Commission has instructed the card schemes they must ensure that:
 - From 1st January 2010 that acquirers must have an offer of "unbundled" rates to merchants upon request.
 - By 31st December 2010 that all acquirers offer merchants "unbundled" rates by default except those merchants electing bundled pricing.
- The key driver for the changes was to provide merchants with improved transparency.
- The new regulation focused on ICS products only with national debit excluded however there has been an increase in new premium priced products e.g. MasterCard World Elite.



EU Merchant Service Charge Approach

Countries across the EU take a varied approach in the calculation of merchant service charge in which elements from part of the overall charge

Fees Charged for:	BE	DK	FR	DE	IT	NL	PT	SP	UK
Initial set up/application	Yes	Yes	Yes	No	N/Y	Yes	Yes	Yes	No
Annual/monthly service	No	No	Yes	No	No	No	No	Yes	No
Minimum monthly service	No	Yes	Yes	No	N/Y	Yes	Yes	Yes	No
Terminals	No	No	No	No	N/Y	No	Y/N	Yes	No
Terminal maintenance	No	No	No	No	N/Y	No	Y/N	Yes	No
Telecoms	No	No	No	No	No	No	No	Yes	No
Statements	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Consumables	No	No	Yes	No	No	No	Y/N	Yes	No
Voice Authorisation	Yes	Yes	Yes	No	Yes	n/a	Yes	Yes	No
Chargebacks	Yes	Yes	No	No	Yes	Yes	Yes	Yes	No
Excessive chargebacks	Yes	Yes	No	No	Yes	n/a	Yes	Yes	No
Paper transaction	No	Yes	n/a	No	Yes	No	No	n/a	Yes

Source: PSE Survey 2008

N/Y = a proportion; n/a = not available



- The approach to MSC calculation by acquirers varies across Europe with different elements include in the final calculation.
- In some markets, acquirers will charge for certain one of events e.g. extension of service or merely include this in the current blended MSC rate.
- Acquirers will begin to look at their service offering in light of the proposed changes being introduced and consider ways of full cost recovery.
- Previously, many acquirers have absorbed some of the price changes to remain competitive.
- ICS scheme fees have been increasing over the last two years as interchange rates have dropped with many acquirers coming under pressure to drop MSC Rates
- Whilst many market pricing practices may be difficult to change in the immediate term, the longer term approach will be to move to a full cost recovery model as MSC rates become more transparent.



Card Scheme Approach

Over 200 acquirers have registered with MasterCard committing to the mandated date of the end of 2010 with over 50 banks already offering unbundled pricing as the default pricing offer

MasterCard

- MasterCard has introduced a new rule prohibiting acquirers from mandating the **bundling** (unless requested by merchants) of:
 - MasterCard and/or Maestro and/or MasterCard Debit
 - Competing schemes' card transactions
 - MasterCard consumer and MasterCard commercial card transactions.
- By 1st October 2009 each acquirer had to declare to MasterCard when unbundling by default will be available.
- To ensure that acquirers meet the committed dates, MasterCard publishes a list of acquirers and their committed dates of when unblended pricing will be the default pricing. They will continue to do so until end 2010.
- Over 200 acquirers have already registered with MasterCard outlining their current plans to offer unblended pricing as default.
- To date over 50 acquirers have already implemented the solution

Visa Europe

- From 11th November 2010 Visa Europe has introduced a new Operating Regulation covering unblending .
- Acquirers will need to show separately from each other and from all other schemes:
 - number of transactions
 - total spend/value
 - total price charged by card type (i.e. VISA Credit, VISA Debit, VISA Electron, V PAY, VISA commercial)
- The regulation also states that all new merchant contracts contain a provision that Merchant Service Charges (MSCs) must follow similar rules with no blending of transactions.



Major Implications of Unbundling Pricing

System Changes

- Changes to split out card types and fee programmes.

Merchant Contracts

- Changes to existing/new merchant agreements

Application Form

- New fields on merchant applications

Operational Processes

- New processes to capture new data
- Merchant support training on new structure

Statements/Online/Reporting

- Unbundled card products - details on all statements
- Online merchant reporting to reflect more detail

Merchant Support Material

- Updated to reflect new pricing structure

Communication

- Communications programme for merchants and staff

Ongoing Compliance

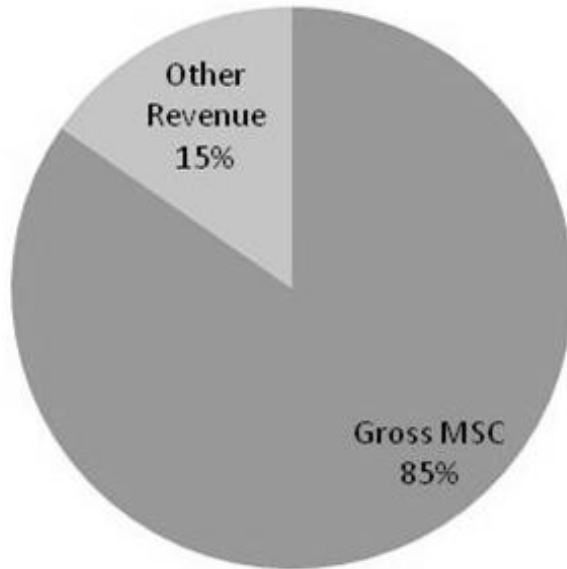
- Processes to ensure interchange rates updated and communicated



Revenue Analysis

In the US acquiring market, a greater share of revenue is generated from non transactional based services

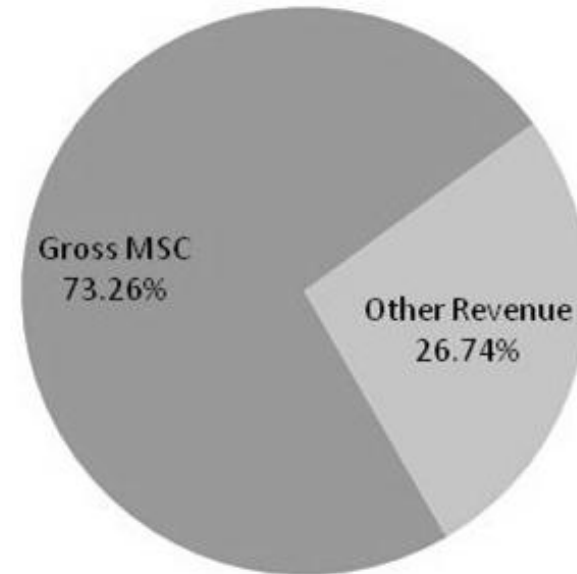
UK Acquirer – Total Revenue Analysis



Source: PSE Analysis

- With bundled pricing, UK acquirers will cover all their costs and include their profit margin as part of the blended MSC rate.
- In the UK, other revenue e.g. minimum monthly fees, PO rental etc, as a proportion of total gross MSC is far smaller than the US market.

US Acquirer – Total Revenue Analysis



Source: PSE Analysis

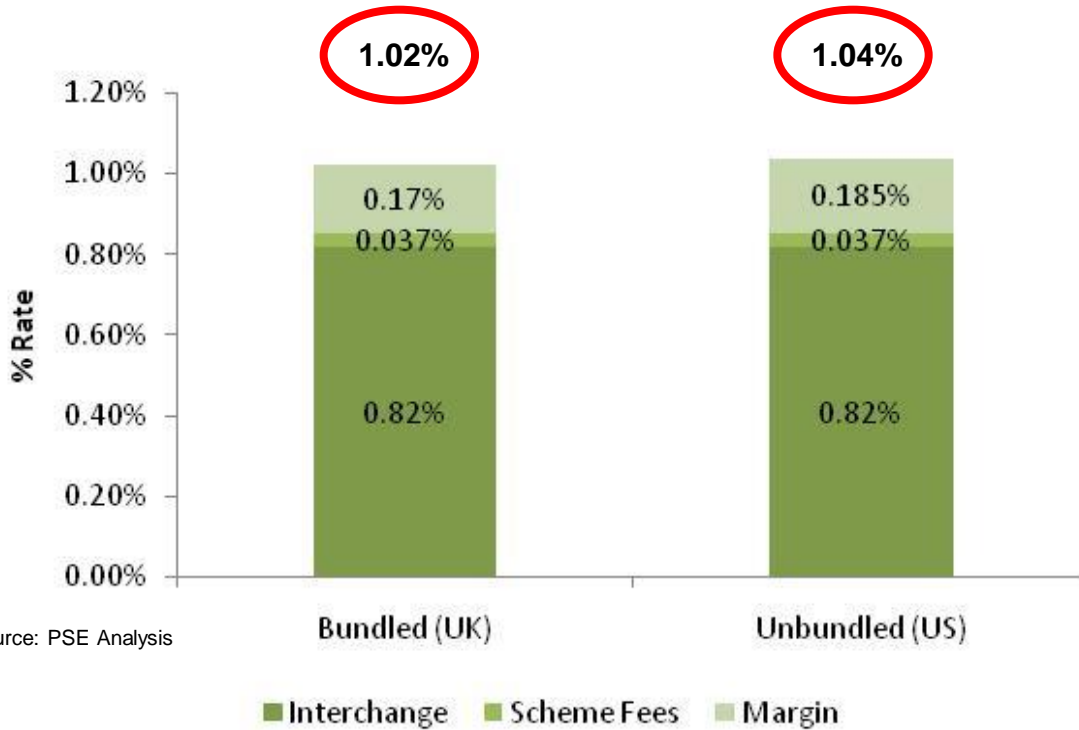
- Typically with unbundled pricing (interchange plus charging) US acquirers charge for all services provided.
- Other revenue will include a variety of services which are billed e.g. statement fees, ACH payments, processing costs, etc.



Unbundling - "True" Merchant Service Charge

Unbundling of card products was designed to reduce MSC rates potentially the reverse is possible as acquirers begin to charge merchants for all services

Actual MSC Rates: Bundled versus Unbundled



Comments

- With acquirers forced to unbundle card products, acquirers will need to charge merchants separately for the cost of processing transactions.
- Acquirers have to cover all their costs through their Net Margin (Gross MSC minus Interchange plus Assessment fees).
- When comparing the US market, US acquirers typically make more revenue as a proportion of total revenue from processing transactions.
- After combining these additional costs, the actual MSC rate that a merchant would be charged is potentially higher under unbundled pricing than bundled pricing.
- This is contrary to what the EU Commission is attempting to achieve but does open opportunities for acquirers to increase margin by charging for all services.
- Processing fees will become the area of competition for acquirers going forward.

Source: PSE Analysis

Assumptions

- Credit Card analysis only -£250K pa
- MSC Rate charged at 1%
- Face to Face merchants – EMV using UK Interchange rates and US margin



Fee Examples

There are a range of fee based services that can be used to charge merchants following the unbundling of fees but it needs to be positioned in a way that is easily understood by merchants

- Transaction Processing fees
- Statement fees
- Termination fees
- Minimum Processing fess
- ACH Payments
- ACH Rejects
- Chargeback fees
- Refund Processing fees
- Retrieval Request fees
- Cash Advance fees
- Terminal Rental fees
- Authorisation fees
- Joining fees
- Annual fees
- Terminal Management fees
- Batch Processing fees
- Non Bank Card Settlement
- Operational Support



Unbundled Pricing - Opportunities?

Acquirers have opportunities of generating new revenue sources provided the processing platform is designed in a way that items can be identified

Increase in Overall Margin/Cost Management:

- Acquirers may be able to **generate additional margin** from unbundled pricing by charging merchant for all processing related services – ACH payments, transaction processing, chargebacks, etc.
- Acquirers will be able to **cover all of their acquiring costs** by consolidating charges.

Charging Correctly for Transactions:

- Acquirers will be able to cover the **“true” cost** of acquiring all card transaction. For example, Commercial and international cards – traditionally accepted as a loss by acquirers.
- **New card products** that get rolled out globally 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. refund processing.
- Possible to charge merchant for an **operational based service**.

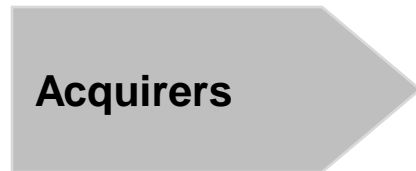
Regular Fee Income:

- Acquirers may be able to bundle all service costs into a **regular monthly fee** designed to generate healthy margins.



Unbundling – Impact to Acquirers and Merchants

The planned changes to unbundling of merchant service charge will have a significant impact to merchants and acquirers



Current – Bundled Pricing	Future – Unbundled Pricing
<ul style="list-style-type: none">• Easy reconciliation of both credit and debit cards• Simple process - all products accepted and processed• Easy for merchant’s staff to understand	<ul style="list-style-type: none">• Much more detail – differently priced products, complex reconciliation process• Potential to move to interchange plus with even more detail• Only process/accept card products configured• Complex for staff to identify high rate card types during sale• Potential to decline/surcharge for high priced products – BIN Blocking• Potential increase in overall MSC
<ul style="list-style-type: none">• Pricing assumptions cause unprofitable accounts• Increased revenue from bundling products under one rate• Simple operational processes - clear and concise offers to merchants• Easy to rollout new products designed to be processed under one card product	<ul style="list-style-type: none">• Externalisation of costs of each card product acquired/processed• Potential increase in overall MSC revenue• Increase in merchant communication and costs• New card products require updates to T&Cs• Major system changes to ensure full breakdown• Increase cost of operational processes, data capture documentation etc

- The new regulation **does provide transparency** of MSC pricing for merchants and will detailed the full cost of acquiring each transaction.
- However, the regulations does **create complex reporting** for the merchant to reconcile going forward the large number of different interchange rates across both schemes.
- Whilst this was not the intention of the regulations, it is likely to place **pressure on MSC rates to rise** as acquirers attempt to fully recover all costs.
- Acquirers are beginning to **fully pass** on the recent card scheme fee rises in the last two years along with passing on an additional charges for premium products e.g. Business Cards.
- The changes in full cost disclosure across all ICS products is the next natural step for acquirers to recover all costs and this **may increase MSC rates** when compared with the previous bundled rate.
- Many merchants are already looking at ways of not accepting some of the premium priced products through **proactive BIN blocking**.



- PSE Consulting intends to run a further MSC survey during 2011 across the following countries:
 - **Top EU markets:** France, Germany, Italy, Spain, UK
 - **Smaller Western Europe markets:** Austria, Belgium, Denmark, Finland, Greece, Ireland Luxembourg, Netherlands, Portugal, Sweden
 - **CEE markets:** Estonia, Latvia, Lithuania, Czech, Slovakia, Hungary, Poland, Bulgaria, Romania, Slovenia, Malta, Cyprus
 - **Non EU markets:** Norway, Switzerland, Turkey
- The following merchant sectors will be covered during the survey: hotels, restaurants, SME merchants, supermarkets, petrol, car rental, airlines, eCommerce, high street retail and professional services.
- This survey builds upon the previous five surveys that PSE has run between 1995 and 2007 and look at the overall impact recent regulation and competition has on MSC rates.
- PSE will issue the survey prospectus in Q1 2011.



Thank You

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