

Processing Services in Europe: Interbanking infrastructures will be effective players

Von Nicola Cordone



Der italienische Kartenmarkt gleicht in mancher Hinsicht dem deutschen: Neben einem nach wie vor hohen Bargeldanteil hat sich das nationale Debitsystem Pago-Bancomat gut entwickelt. Die Verbreitung von Kreditkarten ist vergleichsweise gering und meist handelt es sich dabei um Charge-Karten. Nicht zuletzt durch Fusionen und den Markteintritt neuer Anbieter ist aber Bewegung in den Markt gekommen, und damit haben sich auch die Anforderungen der Banken verändert. Die frisch fusionierte SIA-SSB sieht sich für den neuen Wettbewerb in Italien und Europa bestens positioniert. Mit über 48 Millionen verarbeiteten Karten, drei Milliarden Transaktionen im Jahr und einer in neun Ländern eingesetzten Processingplattform darf sich das Unternehmen zu den größten europäischen Prozessoren zählen. Red.

In Europe for many years card payments processing has been perceived as one of those essential but routine activities irregularly debated across the table. Recently, however, Europeans' decision makers are more and more considering card processing the glue that holds together an infrastructure that handles over 30 billion transactions per year. Payments play a significant role in the life of European citi-

zens and every country still has a domestic market, with specific business models, products, infrastructures and rules. Cash payments still play a predominant role in many countries, with an over than 50 percent share.

Payments products, on aggregate, account for perhaps 40 to 60 percent of bank's total revenue. Payments margins coming from payments service of European banks are more than the 30 percent of total margins but not so many banks are accurately and continuously monitoring their payments performance.

Over the past two years the profile of processing has been raised across the EU. The European Banking system recognizes the needs to create a single market for payments in which everybody will be able to make any payment as easily, safely, efficiently and inexpensively as within national borders.

Cash remains the most popular, yet ranks amongst the most expensive, payment instrument to operate. In EU-15, there are about 360 billion cash transactions per 65 billion non-cash payment transac-

tions. About one out of four adults use cash as their only means payment when shopping. However, cost of cash for the economy in the EU-15 is 50 billion Euro per year, that is about 0.4 to 0.6 percent of GDP. Cash is also loss maker of 21 billion Euro for banks in 9 of EU-25 countries. A substantial part of cash is used in gray/black transaction and security of cash raises substantial additional costs for society.

Banks are looking for more than card processing services

Furthermore, the cash supply system in the Euro area is characterized by the co-existence of multiple national infrastructures. Central banks do not express any clear preference for cash, therefore the social cost of payments services could be reduced, if the share of electronic payments would be increased and use of expensive cash reduced. Prepaid programs adoption is growing at an astounding rate, despite the complexity of the environment, and is already reducing the number of cash-based transactions.

At the same time, the European Commission views Credit Card Issuing and Acquiring as a very profitable business, regardless on interchange fees existence. European card business players consolidation is accelerating and the current European landscape for ACHs and Card processors

Zur Autorin

Nicola Cordone ist Director des Geschäftsbereichs Payment Cards Business bei SIA-SSB, Mailand.

isn't completely disjointed. Some inter-banking infrastructures are operating as ACHs and Card Processors; their role and combination adds complexity in operations management, but allows larger scale economies and value chain proposition and revenues.

Across Europe, banks are getting more sophisticated and many are looking for advanced business, technical and operational solutions and not just basic card processing services. Outsourcing is and will become an essential part of banking strategy for retaining customers and expanding revenue opportunities.

The demands of corporations and financial institutions to outsource payment and treasury related business processes will drive business process outsourcing solutions from larger financial services providers. In embracing outsourcing for business transformation and long-term performance of their payments strategy banks mention economies of scale, network externalities, and sharing investments in central infrastructure as the main sources and drivers of value creation.

Boston Consulting Group foresees each large European bank will invest an average of 60-100 millions Euro up to 2010 to manage efficiently their payments systems. Large global banks that invested in payments are winning the costly battle for the business of the multinational corporation. Many of these banks are adapting to the changing payments landscape and investing in system that can be integrated with those of large corporation in order to maintain their payment business.

Italy is a late developer in terms of payment cards

Italy is a late developer in terms of payment cards and until recently was a nation of savers, and borrowing for consumption was not an accepted practice.

There has been rapid change in Italy in recent years. The banking industry has been reorganised, prompted by the emergence of the single European market and banks begin to focus on the retail sector. The number of institutions is declining as the small and medium-sized institutions either merge with each other or are swallowed up by larger banks. A welcome result is the creation of larger-scale players, i.e. the Unicredit activity in Europe, and the concentration of key skills within the more powerful resulting banks. The fragmentary nature of the banking industry, with a large number of small uncompetitive organisations lacking in technical and marketing expertise, has played a part however, as new products become available, the credit industry has experienced rapid growth.

Successful growth of the national debit scheme

Although Italy remains one of Europe's most cash-dependent countries, the successful growth of the national debit scheme Bancomat/Pago Bancomat (a well known brand with a large number of cards – over 20 million – controlled by a national organisation and governed by domestic rules), has been seen as instrumental in reducing the overwhelming dominance of cheques and cash payments.

Acceptance of the Pago Bancomat card has jumped from under 200,000 terminals in the mid-1990s to almost 1,000,000 by the end of 2006. One of the

main reasons for the success of the Pago Bancomat scheme has been the low costs incurred by retailers in promoting the card, especially in larger outlet chains. Most banks recognise that merchant acquisition is not a profitable activity in itself, but feel that they have to be involved in it to protect their everyday business relationships with retailers.

Changes on the market of credit cards

Credit cards have a very low penetration in Italy, and in fact most credit cards act as deferred debit cards. However, Consumer Credit companies, such as Findomestic, and new entrants into the market, such as Barclaycard, are shaking up that model as they position their credit cards as a borrowing tool and promote revolving credit.

Until recently, credit cards were not a very competitive product with little differentiation among issuers. New benefits, loyalty programs, some price competition and new entrants have changed the market and issuers are now competing on their product offerings.

The card infrastructure has matured

Italy's card infrastructure has matured considerably over the past decade, with significant potential for future growth. The number of acquirers is small and banks tend to provide terminals, technical support and usually pay for all POS equip-

The Italian Payment Cards Market (million)

Payment Cards in Italy	2005	2006	Delta
Credit Cards	28,90	31,27	8 per cent
Transactions	463,55	475,35	3 per cent
Value	46.732	49.213	5 per cent
Debit Cards	31,44	37,10	18 per cent
Transactions	1.422,66	1.501,23	6 per cent
Value	176.734	193.769	10 per cent
Prepaid cards	3,29	4,46	36 per cent
Transactions	20,45	35,44	73 per cent
Value	1.280	2.370	85 per cent

ment. Some banks also cover communication charges and the retailer normally pays a rental charge.

There are several different POS networks in Italy, which are managed by bank-owned companies known as Gestori Terminale (G.Ts). The G.Ts – which number over 30 in Italy – act effectively as co-operatives providing a shared POS network. In certain cases, the G.Ts may also assume additional roles and provide extra technical and IT support to banks.

Prepaid cards had a surprising success

The prepaid market in Italy is already large, and still growing, with an estimated 2007 open-loop total market of 7 millions cards, 50 millions transactions and 4.5 billions of Euros value (more than 35 issuers) and outsourcing is widely used as a key option to enable cost reductions and improve business effectiveness and flexibility. Prepaid cards had a surprising success in Italy, as they currently account for around 10 percent of total number of cards, and Poste-Pay, a general-use prepaid card issued by the banking division

of Poste Italiane, has captured the imagination of Italian people and a dominant share of the European prepaid market with more than three million cards issued.

Sepa: an opportunity to offer new payment products

Bankers have formed the European Payment Council with a brief to develop a common payment architecture and standard processes for Europe. The European Commission and the European Central Bank are pressing for rapid change and implementation of a common highway, in order to create an integrated payment featured by a level playing field and enhanced competition between payment service providers, greater consumer protection and improved transparency and a potential for improved efficiency.

A consistent legal framework forms the basis for consolidation and modernisation of the payment infrastructure, better integration of payment systems and the development of Pan-European applications.

The Single European Payments Area (Sepa) initiative may offer banks the opportu-

nity to create new payment/loan products which combine the features of deferred debit cards and revolving credit. SCF (Sepa Cards Framework) defines high level principles and rules for banks and card schemes in Sepa as defined in SCF. The SCF spells out high level principles and rules which – when implemented by banks, schemes, and other stakeholders – will enable European customers to use general purpose cards to make payments and cash withdrawals in Euro throughout the Sepa area with the same ease and convenience than they do in their home country.

Sepa is transforming the European card transaction landscape and banks are in the driver seat for implementing sepa for card transactions. Main topics still to be fully addressed are:

- Separation of card scheme governance, processing and other functions;
- Schemes Rules requirements on membership, licensing, open business model, transparent pricing structures (“scheme fees”) – not bundled;
- principles for Interchange fees between participating banks for schemes;
- commitment to a cross schemes anti fraud data-base;
- principles for interoperability for Cardholder, Merchants and Standardisation.

Changes in the roles of the International Card Schemes and processors?

As a consequence of Sepa many also anticipate radical changes in the roles of the International Card Schemes (ICS) and the major commercial processors (third party processors (TPPs)). Europe has over 80 major processing companies and the majority interbank owned. Many expect these structure to change as the EPC plans evolve and as the interbank sector redevelops its ageing processing infrastructure.

Prepaid Cards: a huge potential

From Gianluigi Rocca, SIA-SSB Head of Strategic Marketing Cards – Any time you offer a product that make people’s life easier you’re paving your way to success, and prepaid solutions are one of those. Prepaid card products represent an area of much interest and innovation within the payments industry. The prepaid market has expanded rapidly in the US and is now becoming a primary focus for product development within Europe. The diversity of products and functions currently being labelled as “prepaid” has challenged analysts and product developers to identify areas of greatest opportunity and then to build compelling proposi-

tions. The UK, France, Germany and Italy all emerge as relatively attractive markets to pursue across the prepaid product spectrum – supporting sufficient value and volume to attract even large scale banks and processors.

Although the next five years will see a rapid expansion in prepaid turnover, card base and transaction volume, the majority of the addressable market is set to remain untapped: prepaid cards are then expected to account for around five percent of European credit and debit card payments and three percent of transaction volume.

SIA-SSB Key Figures (2002)

total transactions debit and credit card operations payment and collection operations	7.3 billion of which 3.2 billion 4.1 billion
Payment Cards	
Total cards managed credit cards debit cards	48.5 million of which 16.6 million 31.9 million
Merchants managed	990,000
POS terminals managed	147,000

In the European banking sector, mergers and acquisitions continue apace; clearly part of the business rationale is to achieve more scale and scope, optimize the cost base, and eliminate duplicate infrastructures. Pan-European banks are focusing on the concept of developing common product that can be sold to customers via common delivery channels in each country. Most of them believe that major savings can be made through the centralization of product development and marketing and the phased replacement of each country's domestic systems. To be effective, this concept needs common delivery platform and processing infrastructures.

Market evolution forces a fast and coherent redefinition of market infrastructures roles and the direction is toward process simplification and entities aggregation. ACH and Card Processors European landscape is diversified in terms of cards managed, transaction phases management, Added Value services and shareholders and target markets but Sepa is accelerating internal and external change drivers towards a new market equilibrium within Europe: interbanking infrastructures, when backed by owners, will be effective players in this new environment.

Uncertainty about interchange fees delays Sepa-related decisions

At the same time processors need to evolve their offering and every cross-border opportunity is a very exciting opportunity,

to give customers additional benefits and values along with cost reductions across processing value chain extended coverage.

The current uncertainty with respect to how interchange fees will evolve in the future is one of the main factors delaying Sepa-related decisions. Any significant change will have large impacts on market structure and processors evolution.

SIA-SSB Group: prepared to the Sepa-market

The SIA-SSB Group as a processor is addressing goals important to maximize value of shareholders' assets and enable efficient processing for customers by means of:

- Single European IT Platform and Infrastructure (already running in nine countries) for debit and credit processing with world-class features, managed by a "migration specialist".
- Reduced "processing costs" due to a double quantum leap of economies of scale.
- Reduced total "servicing costs" that enables standardization, optimization and automation of operations across countries in a reduced time frame.
- Faster time-to-market across countries, developing products once for all the

countries, thanks to the single and centralized IT platform.

■ Excellent and consistent service level through operations streamlined leveraging the common IT platform and the SIA-SSB knowledge.

With over 48 million payment cards issued, more than three billion transactions managed in 2006 and operations in nine countries, the SIA-SSB Group is one of the leading processors in Europe for all major debit and credit cards and domestic and international prepaid payment cards. Thanks to its professional competences and experience, the Group delivers modular, flexible card Issuing and Acquiring services customizable for the processing of domestic payment cards (Bancomat and PagoBancomat), international cards (Visa, Visa Electron, MasterCard, Cirrus) and private-label cards, with the highest service levels on the market.

Within the Cards Issuing services, the Group can handle requests for new cards both on paper and electronic format, as well as requests for data archive updating, risk detection systems and customized solutions, with services covering all possible needs related to cards issuing.

As to the acquiring services, the SIA-SSB Group is one of the few processors qualified to manage payments made with credit, debit and prepaid cards at subscribing merchants, banks and the national and international circuits. Top services offered include management of cardholder archives for merchants that accept debit card payments as well as management of accounting service, management of all the maintenance activities (POS terminals and EFT Servers), transactions on international circuits through clearing procedures; and in conclusion, operational management of security activities, dispute handling, credit recovery, customer care and system applications maintenance.