



EUROPEAN PAYMENTS COUNCIL

Towards our Single Payment Area

Doc EPC-0303/03
(Vers. 1.0)

18.07.2003
RIG

CARDS WORKING GROUP

Summary of Findings & Recommendations



EUROPEAN BANKING FEDERATION



EUROPEAN SAVINGS BANKS GROUP



EUROPEAN ASSOCIATION OF
CO-OPERATIVE BANKS

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IMPORTANT NOTE: It is not the objective, and it may not be construed as being the objective of this Working Group, nor of this document, to discuss customer fees, or merchant service charges.

1. INTRODUCTION

Cards are an important payment instrument for the European citizen and their usage may grow even further in coming years, as cash and paper-based instruments are gradually substituted: card-based transactions account already for about one third of all non-cash transactions conducted in the EU and for 83% of all cross-border non-cash transactions. Nevertheless, the rather heterogeneous legacy situation, irrespective of the quality and efficiency of the service delivered by the various participants, should be noted - a situation further compounded, from 2002, by the impact of the introduction of the physical euro and the implementation of Regulation 2560/2001/EC on cross-border payments in euro¹. This was the reason for rather different views and future strategy orientations expressed at that time by countries and banks that have had, or face the above experience.

The European Payments Council (EPC) - created last June 2002 by 50 representatives of European banks and banking associations - tasked five Working Groups to deliver towards the objectives defined in the Single Euro Payment Area (SEPA) “White Paper” of May 2002². In this context, the ‘Cards Working Group’ was constituted early September 2002, with the mission to formulate a long term vision on the positioning of cards and electronic means of payment³ in the context of SEPA and to conduct research and articulate recommendations to implement this vision. The Cards Working Group further established two Task Forces to address the areas most instrumental in removing the obstacles that had been identified: a ‘Card Fraud Prevention’ Task Force and a ‘Business Model’ Task Force. The *Findings and Recommendations* resulting from this work have been unanimously approved at the fourth Plenary of the EPC⁴ in June 2003.

2. BACKGROUND: THE EUROPEAN CARD MARKET TODAY

Cards are the most convenient payment instrument to use anywhere, anytime. 62% of the European population holds at least one card. Furthermore, the whole infrastructure for card payments has been well established, functioning - in the current environment - to the satisfaction of all stakeholders, i.e. consumers and merchants, issuing and acquiring banks, and processors.

One may highlight the following features in cards’ usage across Europe:

- ✓ ***Cards outrank any other payment instrument in the EU:*** According to the ECB *Blue Book* (2002), card based transactions account for some 33% of all (national and cross-border) non-cash transactions conducted in the EU, and have been enjoying a p.a. growth of no less than 15%. Admittedly, in 40% of these transactions cards are however only used to withdraw cash from ATMs.
- ✓ ***The overwhelming majority of cards transactions are national:*** As a consequence the volume of card usage at country level and the type of cards used differ (sometimes widely) from country to country, as a result of different customer habits, product practices, and legacy pricing structures or

¹ It introduced the “principle of equal charges” for cross-border electronic payment transactions in euro, which applied as from 1 July 2003 (except for credit transfers, which benefited from a “transitional period” until 1 July 2003).

² A summary of the White Paper as well as the details to order an electronic copy of the full document may be found at the following address: <http://www.europeanpaymentscouncil.org>.

³ During its first meeting, the Cards WG clarified that in an initial phase it would not deal with issues related to either electronic purse or P2P transactions.

⁴ Cf. Cards Working Group ‘Findings and Recommendations’ Paper (DOC EPC-089/02 Version 1.0, June 2003)

obligations. In the same manner, the infrastructure(s), market participants, and market organisation(s) that support card transactions differ by country and by product, although some infrastructures support cross-border transactions and some same brands are used (nationally) in several countries.

- ✓ *Cards represent the most used instrument for “cross-border”⁵ payments in the EU*, accounting for 83% of cross-border non-cash transactions (in 90% of the cases at POS), although it should be stressed that the cross-border market is very small: less than 1% of total payment transactions in the EU. These transactions are generally governed by rules set by the international schemes.

3. THE BANKING INDUSTRY VISION: A SINGLE EUROPEAN CARD MARKET

The SEPA is a new dimension for all stakeholders, including banks and their customers (a dialogue with the latter being formally initiated through e.g. BEUC). In the dialogue with the authorities and the public at large, banks thus needed to chart out the space for which they claim responsibility in the field of cards. In this context, the European banking industry reached consensus on the following vision statement:

“Meeting customer (consumers and merchants) expectations and requirements for secure, convenient, transparent and value-priced card-based payment solutions that foster widespread acceptance and can be used in the same way across the Single Euro Payment Area⁶, will support an increasingly efficient economy based more and more on electronic forms of payment.

EPC Members fully acknowledge that cards are a very important business for banks. They are committed to lead the realisation of this vision through the deployment of profitable customer value propositions, whilst taking advantage as much as possible of present international schemes that provide global acceptance.

This Single European Card Market is made possible and strengthened, by concerted actions on non-competitive issues, at card industry level, including the global card schemes, as well as domestic card schemes, and through the ECB/Eurosystem, EC and governments, and also card acceptors, regarding especially:

- ✓ **Preventing and combating fraud**,
- ✓ **An open, competitive market for cards** that promotes widespread usage,
- ✓ **Coherent legislation and regulation** responding to proposals from European institutions for legislation and regulation, with a preference for self regulation,
- ✓ **Deeper standardisation** (i.e. authorization interfaces, clearing interfaces, smart card and accepting devices specifications), **and stronger cooperation**, especially on chip migration.

EPC Members should support this vision by working within the existing governance structures of card schemes.

The promotion of the above general SEPA objectives is not to be pursued at the expense of free competition“

⁵ The EPC considers the EU as a “domestic” (hence “borderless”) payments area.

⁶ For the purpose of this document the Single Euro Payment Area (SEPA) is defined as the countries and territories subject to EC Directives, Regulations, and Recommendations. As of May 2003 the scope thus is the existing EU 15 Member States, the acceding countries (10 countries), as well as the 3 European Economic Area (EEA) countries.

4. STRATEGY FOR A SINGLE EUROPEAN CARD MARKET

A. Strategic issues to address

From a high-level yet relevant perspective, and following an extensive inventory of the current market situation, the following issues seem to affect at one stage or another every bank willing to participate in building SEPA for cards:

- Upholding the banks' payment franchise: In the face of current developments, banks are increasingly considering their participation in the payments business from a holistic perspective, spanning all payment instruments and channels, in order to maximise their opportunities to deliver on customer requirements in a cost effective and profitable manner.
- Ensuring card schemes remain aligned with banks' business objectives: Banks have entrusted (both national and international) card schemes with as main business objective: *building a cost effective, interoperable infrastructure*. Capitalising on this primary objective card schemes offer other functions and services to their members, such as processing, and value added products. In the evolving SEPA environment, it is however essential that card schemes remain well aligned with the overall payment business objectives of their member banks.
- Removing borders, at every level: The EPC will promote a *borderless* European payments area. For the obvious reason the European card landscape bears at every level the imprint of the many national environments. In order to reassert its claim on the payment franchise, the banking industry (including card schemes) will have to consciously and willingly overcome these differences, establish a framework for the future, and move towards its implementation in a credible manner.
- Acknowledging processing as an independent business: Across SEPA the different components of the card business chain, and in particular processing, should be able to benefit from market opportunities, and meet the objectives set by their shareholders.
- Defining and implementing standards: Banks will be tested by the capability of their co-operative organisations not only to define standards, but also to implement them on time and at cost on a scale that satisfies both customers and regulators. In particular EMV⁷ implementation across SEPA should be completed by all stakeholders involved as scheduled.
- Maintaining the global interoperability of the card infrastructure: Through industry-owned international schemes, banks have established a high level of interoperability and service promise for their customers. Whilst on one side the requirements of coping with the pressing realities of the SEPA must be acknowledged, it is essential that interoperability is not compromised, as it responds to customer requirements in terms notably of convenience and reach.
- Coping with the challenge of e-commerce and mobile payments: Up to now cards have been instruments of choice for emerging electronic and mobile payments, though fraud and dispute levels related to these transactions may seem comparatively very high. Looking forward, banks have to keep developing customer friendly solutions that also meet banks' profitability objectives, in overall coherence with their payment product portfolio.

⁷ An international standard for smart card jointly developed by Europay MasterCard and Visa (EMV)

B. Strategy for implementing the Single European Card Area vision:

The banking industry should consider the following 8 pillars:

⇒ **PILLAR 1: Fighting Card Fraud across Europe**

An essential, if not paramount, ingredient needed to build the Single Euro Payment Area is the degree of *trust and confidence* perceived by all the parties involved in a card transaction. In fact, the negative impact of fraud in terms of image and its effect on customer trust and confidence, added to the cost of fighting fraud, is often higher than the cost of the fraud itself.

Cross-border fraud is approximately 20 times higher than domestic fraud. This means that SEPA card systems must not only be efficient, cost effective and meet the needs of consumers, merchants, card issuers and card transaction acquirers alike, but there must also be a clearly defined and coherent policy regarding the fight against abuse and fraud. In addition, there should be an effort towards a more uniform level of equipment in the different zones of SEPA, so that any cardholder who wishes to pay with a card is provided with the same facility, and the same level of security, in each of the different Member States, and also of the acceding countries.

The following table outlines a suggested breakdown of the work to be done:

Objective	Address card fraud (in SEPA) to fight against organised crime	<input type="checkbox"/> Sharing card fraud prevention tools <input type="checkbox"/> Developing tactical initiatives to fight fraud through a continuing process of: <i>Identification / Prediction / Prevention / Resolution / Innovation</i>
Role	Promotion (and not: co-ordination)	<input type="checkbox"/> By agreeing on short term cross border (intra EU) initiatives <input type="checkbox"/> By promoting anti-fraud solutions (such as chip, authorization systems, merchant monitoring, legislation)
Tasks	<input type="checkbox"/> Formulate an EPC view on security issues <input type="checkbox"/> Disclose fraud and fraud prevention related issues and trends <input type="checkbox"/> Identify all of the possible “effective” fraud prevention solutions (including migration to EMV) and prioritise them <input type="checkbox"/> Examine legal premises for detecting and fighting fraud <input type="checkbox"/> Determine best practice for fighting fraud	
Distribution of information	Information and Task Force deliverables: on line to all Task Force members and other appropriate bodies	

In order to push forward with the above actions, the EPC set up a dedicated structure to address card fraud and assist chip migration: the ‘European Card Fraud Prevention Task Force’. It is composed of various bodies operational in combating fraud in the different European countries, including (national and international) card schemes, banking associations, Police forces, the European Central Bank and the European Commission - some of which are participating on a case-by-case basis.

⇒ **PILLAR 2: Implementing SEPA-wide licensing**

Existing card schemes (be they domestic, or international) must make sure that their licensing rules fully acknowledge the objectives of SEPA.

In particular banks will seek to achieve the following changes:

- ✓ Banks must be able to offer products and/or services throughout SEPA on the basis of a single license for any given brand.
- ✓ Throughout SEPA, banks must be able to compete openly in issuing cards and/or acquiring transactions.
- ✓ Card scheme rules should not treat banks' and banking groups' "on us"⁸ cross-border transactions within SEPA differently from domestic "on us" transactions.
- ✓ Issuing banks must have control of the space on the chip that is not required to ensure interoperability and security, and of the chip applications (both payment and non-payment).

It is recognised that the changes to be achieved are also of a legal and/or regulatory nature. Nevertheless, possible scheme obstacles must be addressed as a matter of priority.

Moreover, this should not prevent individual banks or banking groups to continue and position themselves as providers only on a regional or restricted basis.

⇒ **PILLAR 3: Achieving a deeper SEPA-wide standardisation**

Significant opportunities for reaping economies of scale and lowering costs may and should be pursued by banks through deeper SEPA-wide standardisation. Removing technical barriers to issuing and acquiring card operations in a country will indeed lead to greater interoperability and convenience for customers, hence an increased competition for vendors. In particular, the issuer must be in a position to clearly identify the type of card usage in any situation throughout the whole processing chain.

Standards should be managed and maintained through *existing bodies*, with appropriate input from banks and card schemes.

⇒ **PILLAR 4: Promoting card payments and safe card usage**

Across SEPA, cards have the potential to be positioned as the preferred retail payment method. This can be enabled by decisively building customer confidence, and enabling customers to use their cards everywhere in the same manner (still allowing for value-added functionalities).

Banks and banking groups must be able to develop "on us" vs. "off us" strategies, and of course to continue to differentiate services offered, in line with the card schemes' rules. As a consequence the governance of (national and international) card schemes must be, and remain, fully aligned with the banks' business objectives within SEPA. European banks will work in particular with the respective domestic and international schemes to achieve this.

It must be acknowledged that different segmentation models may emerge: as banks will issue general-purpose payment cards, they will co-exist with "closed schemes" cards issued for a specific usage (e.g. supermarket, or petrol chain, or regional only).

⁸ "On us" is defined as to be where a bank or banking group services the acquiring and issuing parties at the same time, through its specific in-house or outsourced processing centre, or processing partners.

⇒ **PILLAR 5: Opening the market for Processing**

The principle that, within SEPA, issuing, acquiring and processing are to be considered as a *business* (or businesses), which is (are) carried out on *commercial* and *competitive* terms, is confirmed. An open processing market (including possibilities for processing “per function, cross border” within SEPA) must be created, to allow banks to make business decisions.

Optimisation of efficiency will be facilitated by a set of industry developed and monitored *best practices* for issuing and acquiring processing (i.e. authorisation, clearing, and settlement), which will further foster certainty in service levels.

⇒ **PILLAR 6: Maintaining the interchange structure⁹**

Interchange structures are essential to the effective operation and development of the card business, and for the sound co-operation between banks. Without interchange, co-operation between competitor banks would prove impossible. These principles will not change with the SEPA for cards. Co-operation between banks for the development of card use within SEPA thus *needs* an interchange structure.

⇒ **PILLAR 7: Aligning card payment schemes with banks’ objectives within SEPA**

Card payment schemes within SEPA, be they domestic, or international, will be encouraged to evolve in order to fully support the banks’ objectives within SEPA. To that end banks operating within SEPA must obtain access to domestic card payment schemes on the same conditions as in-country banks, and international schemes must develop attractive business propositions.

Today the majority of volumes are represented by national transactions. The challenge for the banking industry will thus be to devise incentives for a technical migration that will make a convergence process possible, and allow banks to harness the potential economies of scale promised by SEPA.

The card payment system architecture of the future could consist of any of the following components:

- ✓ Bilateral, or multilateral arrangements,
- ✓ Linking of systems (and eventually a linking between “clusters of systems”),
- ✓ Development of international schemes to handle national, SEPA and other cross-border transactions.

The EPC recommends the *international scheme model*, since it is seen as the most efficient way to ensure comprehensive interoperability at European and global level. However plurality of market providers is essential to ensuring a competitive market. Furthermore, it is noted that the two major schemes differ significantly when it comes to detailed implementation, and that bilateral agreements or linked systems could continue to exist or be allowed to emerge.

Going forward, greater *transparency* will be expected by European banks as regards scheme member fees, in order to allow them to make better decisions on the basis of business cases.

⁹ **Disclaimer:** *this section is not intended to address card fees nor MSCs, or any other customer fee.*

⇒ **PILLAR 8: Establishing a coherent and consistent set of rights and obligations**

A coherent and consistent set of rights and obligations that apply in the same manner to every party in the chain, irrespective of location should be established, in order to create a SEPA for cards: achieving and maintaining a competitive playing field is indeed a core objective of the Single Market. Furthermore, card related services should only be provided by professional providers committed to this set of rights and obligations, and in particular to the same oversight and regulatory framework as required in function of the activity(ies) undertaken.

Under the aegis of the EPC, the banking industry (including card schemes) has therefore begun making specific proposals for items to be addressed by the regulators/legislators. While it must be noted that the banking industry generally favours *self-regulation* in order to progress, occasional support from legislators and/or regulators will indeed be required in a number of areas. It is nevertheless recommended at this stage that the way forward to truly advance SEPA be evaluated and decided on a *case-by-case* basis, in order to allow for the principle of self-regulation to apply and to maximize efficiency. From this perspective, legislation/regulation is considered from 3 angles¹⁰:

a. ***Areas which are best served by a banking industry self-regulation approach:***

Customer information requirements (with a code of conduct), Alternative Dispute Resolution (ADR) mechanisms, notification procedure in case of loss or theft

b. ***Areas where from a banking industry perspective support from authorities may be required:***

- In the context of the introduction of EMV, support from the regulators may be needed to achieve a more secure environment for consumers, merchants, and banks.
- Customer responsibilities: customers must be fully aware of their responsibilities, and of the consequences of not coping with their contractual and legal obligations. As new payment channels emerge, these responsibilities must be reinforced accordingly and explicitly.
- Legal responsibility in case of breakdown of a payment network: no additional onus should be put on the banking sector alone: other parties (i.e. suppliers and sub-contractors) should also be responsible as is common practice in network arrangements.
- Addressing the harmonization of legislation related to data protection in order to enable the real time collection and distribution of fraud related information.

c. ***Areas where a distinct risk of over-regulation exists, and that are best addressed by self-regulation approaches:***

Revocability/cancellation of a payment instruction, sanctions and penalties, digital certification services in the payment sector (a deeper understanding of the issues is necessary before progressing in this field), the payment provider's liability to refund in customer/merchant disputes, burden of proof, consequential damage, obligations and liabilities of contractual parties, and price regulation.

¹⁰ The lists below are just illustrative and do not intend to be exhaustive.

5. RECOMMENDATIONS

- 1/ The banking industry should reinforce actions to prevent and combat fraud through active co-operation between banks, card schemes, retailers, the Eurosystem, the European Commission, law enforcement authorities, governments, and other stakeholders. Minimum security standards (including EMV chip) and a common approach for tackling fraud will be defined, and their implementation monitored.
- 2/ Domestic and international card schemes should present their scheme tariffs to member banks in a transparent manner fully consistent with the objectives of SEPA, in order to differentiate between the various functions provided and facilitate banks' business planning.
- 3/ Domestic and international card schemes should be encouraged to speedily complete amendments underway to their rules and conventions, in order to enable any bank or banking group to operate throughout SEPA.
- 4/ Whilst restating their preference for self regulation as expressed in the vision, banks should co-operate with legislators and regulators (including the Eurosystem and the European Commission) to identify and remove where necessary legislative and/or regulatory obstacles and discrepancies that prevent delivering the banking industry vision for card payments in SEPA.
- 5/ Collectively banks should ensure that with effective bank input they achieve greater levels of technical standardization that fully support the banks' business objectives defined in the vision statement. This effort will be undertaken within existing standardization (including card schemes) organizations.
- 6/ In order to implement the agreed vision, banks should ensure that they fully exert their responsibilities as stakeholders in domestic and international card schemes at all times.
- 7/ In order to effectively support the implementation of this industry vision, the banking industry and the Eurosystem should jointly define an aggregated high-level statistical data collection and distribution process that provides a timely view on the intra-SEPA market evolution. It will be implemented by the ECB (and enhance the process presently used for the production of the ECB Blue Book statistics). As much as possible existing data feeds will be used, new structures and costs minimized, and card schemes involved. This statistical data collection and distribution process should be implemented and managed in such a way as to fully respect data protection rules and business secrets principles.
- 8/ The banking industry should establish the Cards Working Group as the body under the auspices of the European Payments Council (in coordination with the appropriate banking bodies and schemes) with the specific mission to regularly and at least annually report to the EPC on the status of the above Recommendations, with propositions for action, and, when appropriate organise a debate on new issues, and make additional recommendations. The EPC Cards Working Group will meet as required to deliver these objectives. The Cards Working Group will also ensure continued liaison with authorities through existing structures as required.

6. CONCLUSION AND ROADMAP

Cards represent a significant business for the banking sector but there have been rising concerns about profitability in recent years: the proclaimed political and business ambition to build the SEPA could give another strong impetus to the natural growth of the card market.

The implementation of the banking industry vision for cards will however demand effective co-operation between a maximum number of stakeholders, including governments, the Eurosystem, the European Commission, retailers, consumer organizations, as well as law enforcement authorities. Cardholders should also be motivated through educational programmes. Of course genuine duplication of efforts with existing structures will be avoided.

The final implementation of all Recommendations is targeted to be in compliance with:

- The responses of national and international card schemes
- The necessary involvement of the European Commission and the European Central Bank.
- The necessary involvement of the accession countries

All Recommendations should be implemented **by 1st January 2006 at the latest**. It should be expected at this stage that the banking industry would take the lead in moving these Recommendations forward.

A (at this stage) tentative overview of the Cards Working Group Roadmap is provided hereafter:

Recommendation	Actions	Timeframe	Stakeholders
Recommendation 1	1) Pro-active anti-fraud activities 2) Analysis of existing and planned security of payment systems and equipment deployed	1) Programme to launch in 2003, 2) Report to be submitted 1Q2004	1) Banks, card schemes, Governments 2) EPC Cards WG, banks, card schemes
Recommendation 2	Presentation of card scheme tariffs to member banks in a manner consistent with the reality of SEPA	In time for 2004 budget planning	Card schemes
Recommendation 3	Amendment of card scheme rules and conventions	To be completed in 2004	Banks, card schemes
Recommendation 4	Identification and working towards removal of legislative and regulatory obstacles	Agree scope and process in 2003, to be completed in 2005	Banks, European Commission, ECB
Recommendation 5	Co-operative work on greater technical standardization	Key areas to agree in 2003, begin process in 2004	Banks, card schemes, existing standardization organizations
Recommendation 6	Banks to fully exert their responsibilities as shareholders in card schemes, in line with the EPC Cards WG vision statement	During 2003	Banks
Recommendation 7	Definition and implementation of a neutral data collection and distribution process	To be completed in 2004	Banks, Eurosystem, card schemes
Recommendation 8	Report with propositions for action to the EPC, organise debate on new issues as appropriate	2Q2003, then ongoing	EPC, Cards Working Group