

# **Inclusion of commercial cards in the EU draft legislation capping the interchange fees level**

## **Impact study**

**October 2014**

**Impact study for MasterCard**

## PART 1: Market analysis

# Agenda – Market Analysis

## 1. Context

1. EU regulatory context
2. Commercial cards overview
3. European market overview

## 2. Domestic markets analysis

1. UK
2. France
3. Germany
4. Italy
5. Poland
6. Sweden
7. Comparative analysis

# Context of the study

- In July 2013, the European Commission published a proposal to cap interchange fees for consumer cards only:
  - 0,3% for credit cards
  - 0,2% for debit cards with a cap of 0,07€
- On February 2014, the European Parliament proposal reverses the exemption concerning commercial cards by amending the proposal



- The amended regulation includes four party models scheme (MasterCard, Visa, ...) and does not concern three party model schemes (Amex, Diner's Club, ...)

➤ The objective of this study is to assess the consequences of the potential regulation on the commercial card ecosystem

# Commercial cards – Products

## Commercial cards

**Business cards** are credit or debit cards commonly used for a variety of expenses types such as goods, services or travel. They are generally issued to small businesses with less than 50 accounts.

**Corporate cards** or Travel cards are used essentially for travel and entertainment expenses. They offer some additional benefits such as travel insurance or currency facilities and are generally issued to company that have a lot of expenses in Travel and Entertainment.

**Purchasing cards** are used for business purchases of goods and services (stationery, IT equipment,...). They are generally issued to large corporates or public sector bodies and administration, in order to cut down on paperwork and cover the need for purchase orders.

# Commercial cards – Types

## Commercial cards

**Charge cards** allow the cardholder to make purchases and to withdraw cash on ATMs, up to a pre-arranged credit limit. The terms include the obligation to pay the account in full at the end of a specified period, usually monthly. Cardholders are normally charged an annual fee.

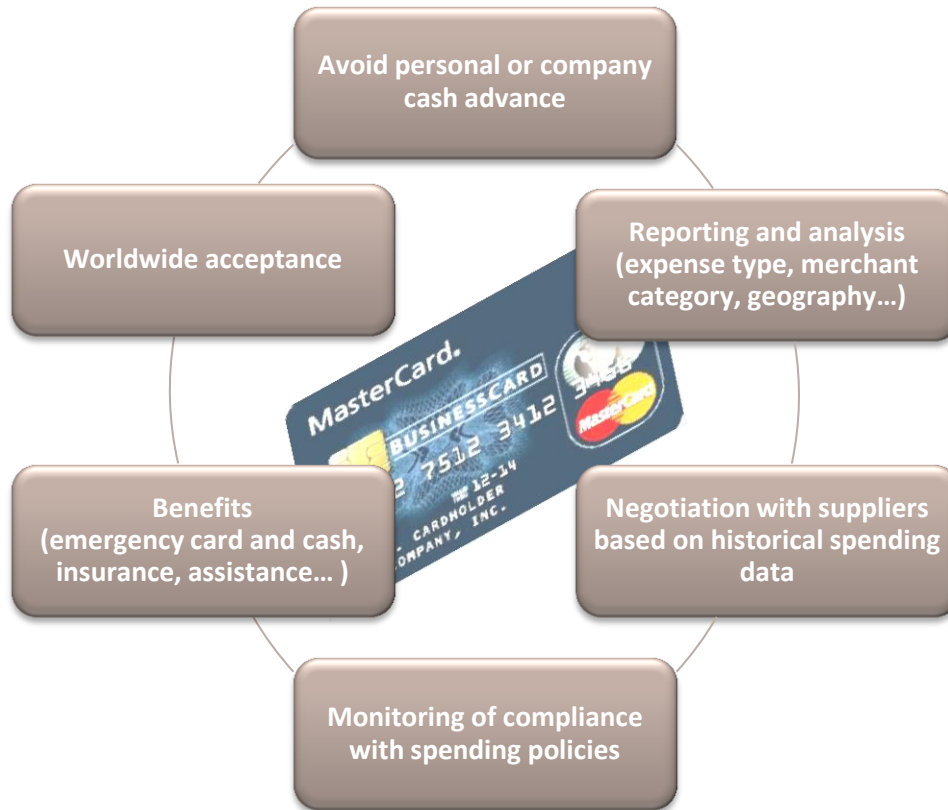
**Debit cards** are issued in conjunction with a business current account. Payments are deducted immediately from the account and the spending is limited to the funds available, offering a greater degree of control but lacking of flexibility.

**Credit card** enables the card holder to make purchases and to withdraw cash up to a pre-arranged floor limit. The credit granted can be settled in full by the end of a specified period or can be settled through several installments, in which case interest is normally charged.

**Prepaid cards** are debit based cards. Transaction amounts are deducted from a funded account. There are different types of prepaid cards such as pre-loaded card with a certain amount and also re-loadable cards that can be topped-up.

# Commercial cards, a highly specialized market

- Commercial cards are issued to companies as an easy way to manage business expenses and purchases

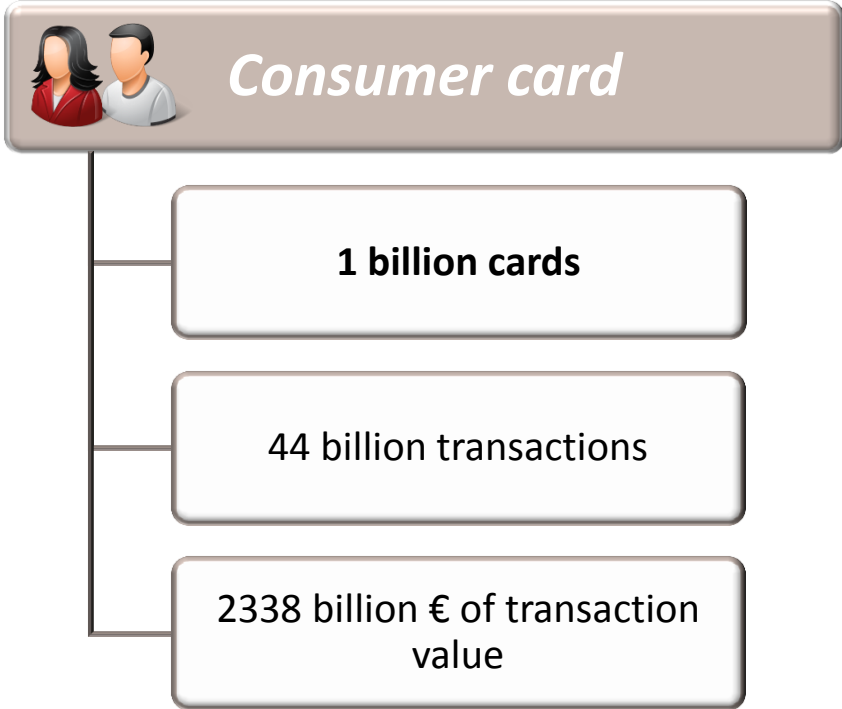
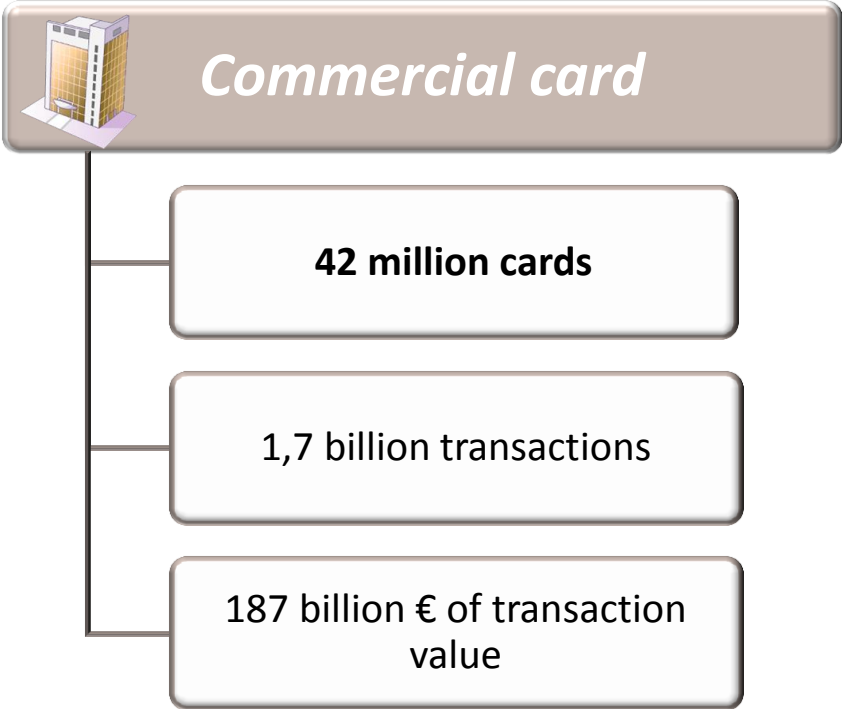


*Commercial card rationale*

- Commercial cards market is seen as specific and distinct from the consumer cards world:
  - High quality of service required by companies and cardholders
  - Wider range of added-value services and features
  - Customer requirements imply a specific approach in order to cover all businesses and corporate needs

# Commercial cards / consumer cards

- Figures in Europe:

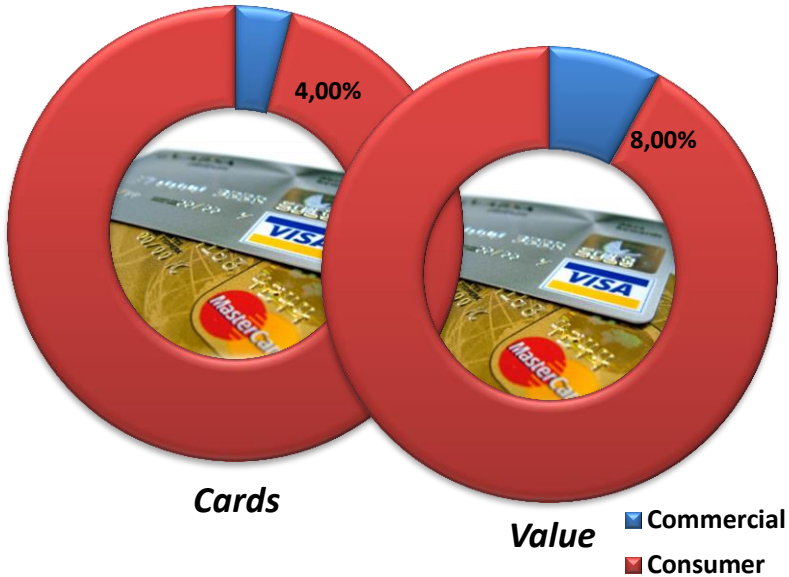


Commercial card is seen as a niche market



# Commercial cards / consumer cards

• Figures in Europe:

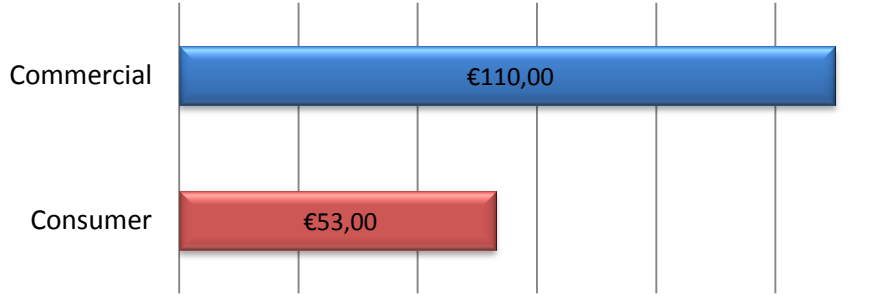


In Europe, commercial cards accounts

- for 4% of all cards
- for 8% of the total transactions value

Commercial cards have an average transaction value (ATV) two times higher than consumer cards

Average Transaction Value

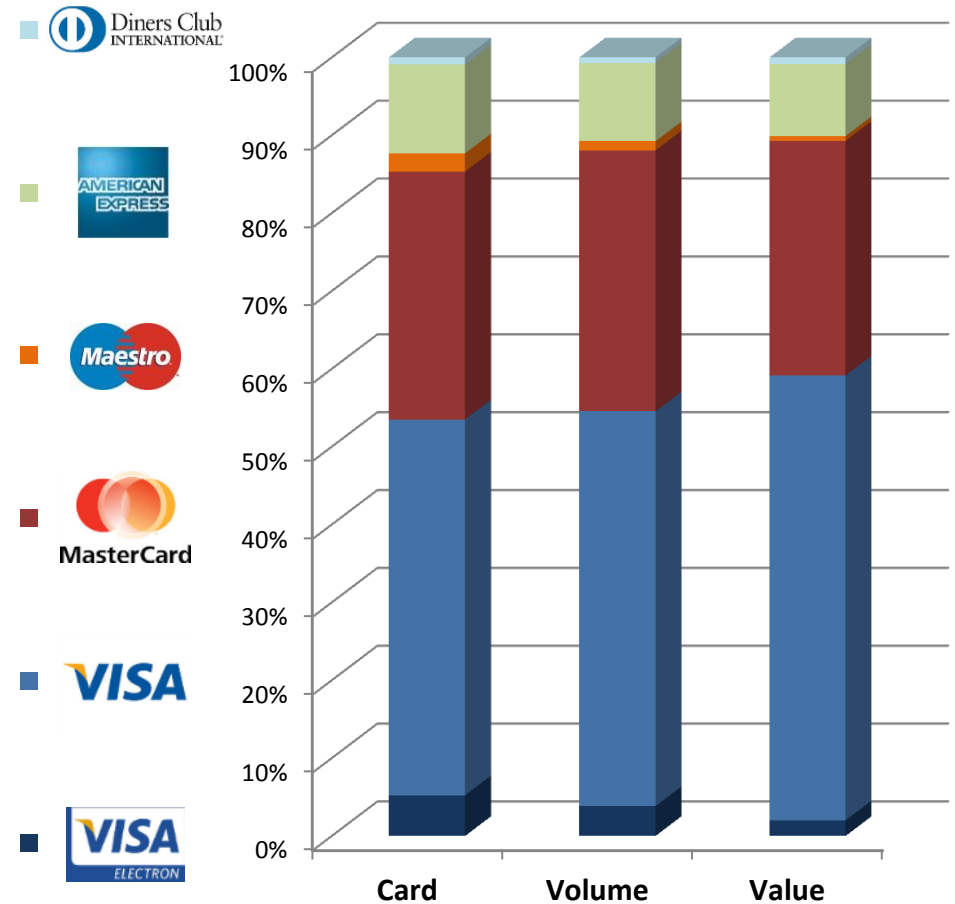


# European market – Schemes



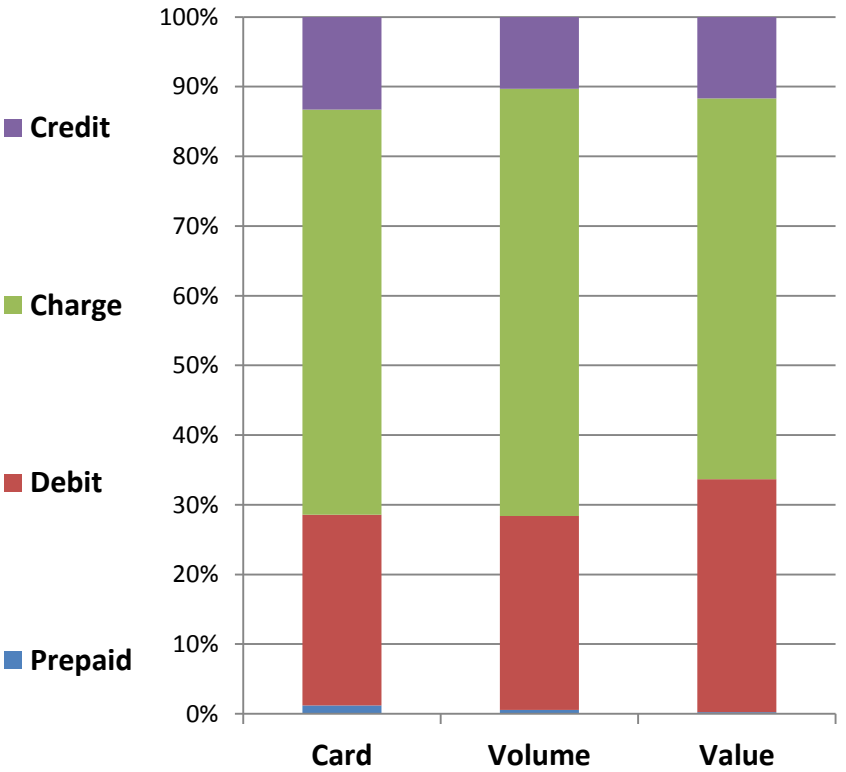
## • Commercial card market by scheme:

- **Visa** leads the French, Italian, Spanish, Turkish and British markets
- **MasterCard** prevails in Belgium, Denmark, Finland, Germany, Netherland, Norway, Poland, Sweden and Switzerland
- **American Express** has a strong presence within the multinational companies segment
- Private label **fuel cards** are out of the regulation scope and have a specific acceptance network and therefore are excluded from the figures presented here
- Private label fuel cards represents 42% of European commercial cards and 16% of the transactions value



2012 market shares within 15 EU countries.  
Commercial card products only. Consumer cards issued to businesses excluded.  
Private label fuel cards excluded.  
Source: RBR London, "Commercial cards in Europe 2013".

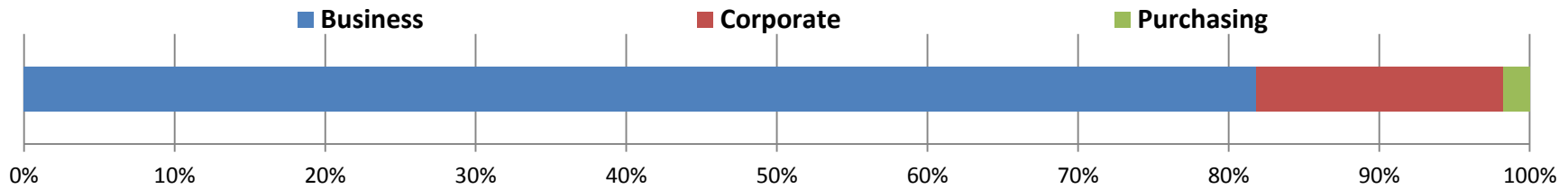
# European market – Products



Charge cards are widely used across Europe

Debit and prepaid cards are more often used by SMEs and sole traders because of their spending control capabilities

Business cards owns the largest share, as Corporate cards are issued only to very large companies and Purchasing card is a niche market

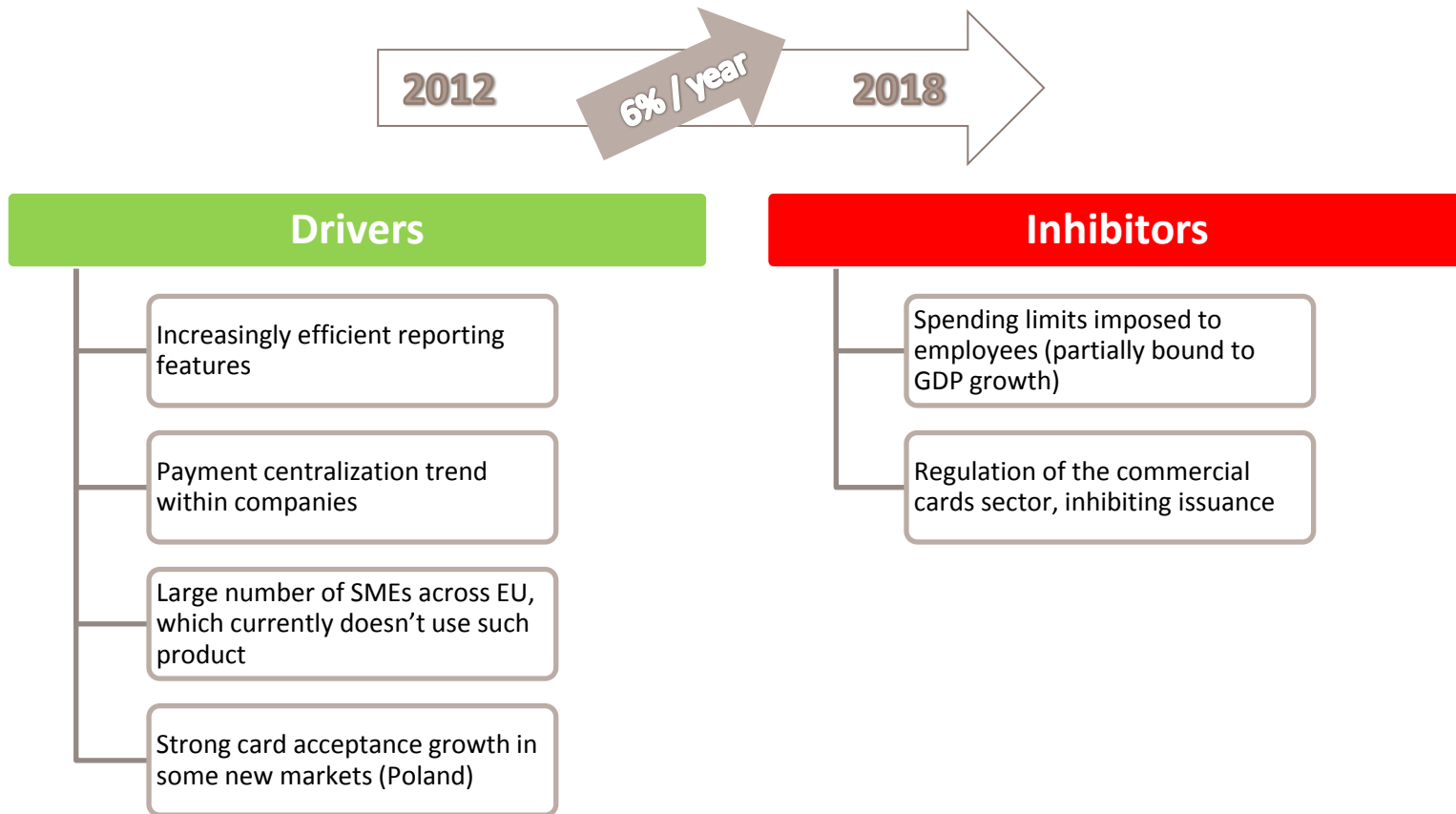


2012 market shares within 15 EU countries.  
 Commercial card products only. Consumer cards issued to businesses excluded.  
 Private label fuel cards excluded.  
 Source: RBR London, "Commercial cards in Europe 2013".

# European market – Forecast



- Commercial cards transactions value are expected to maintain a 6% CAGR\* between 2012 and 2018, and to be close to 260 billion € in 2018, compared to 187 billion € in 2012



\* : Compound Annual Growth Rate

# Agenda

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2. Commercial cards overview
3. European market overview

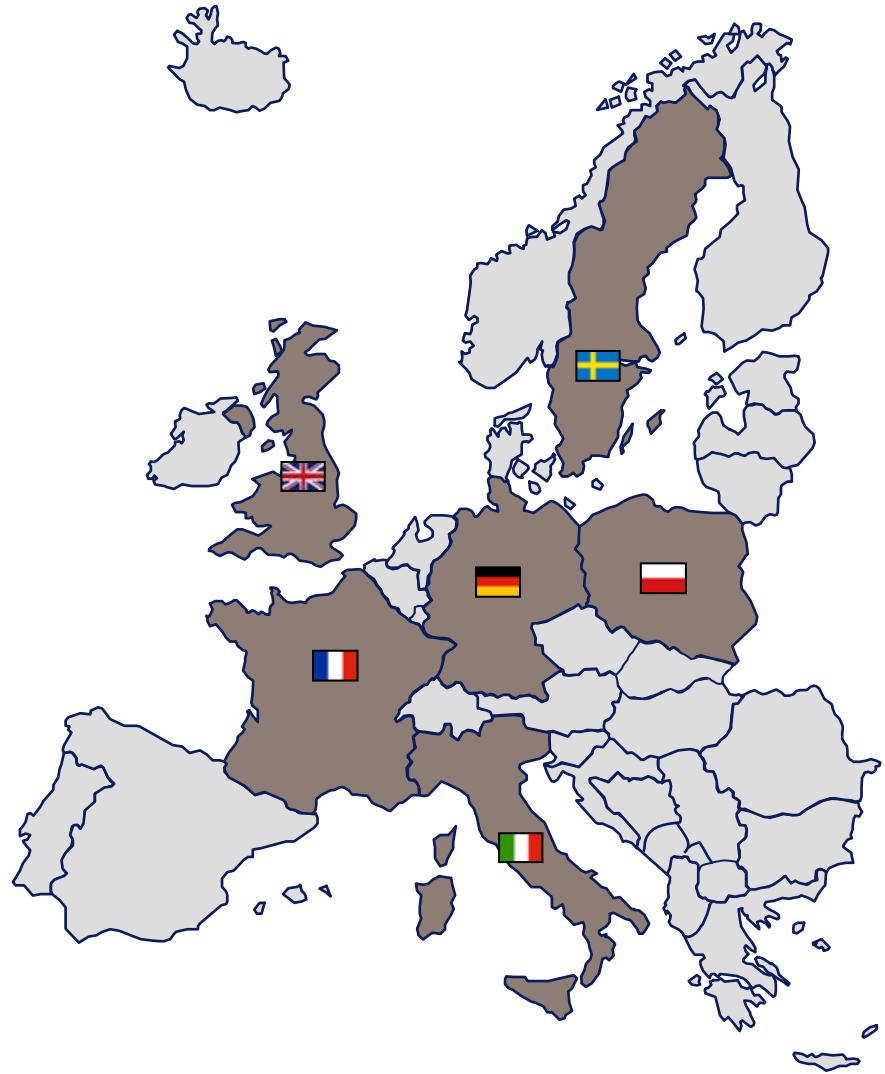
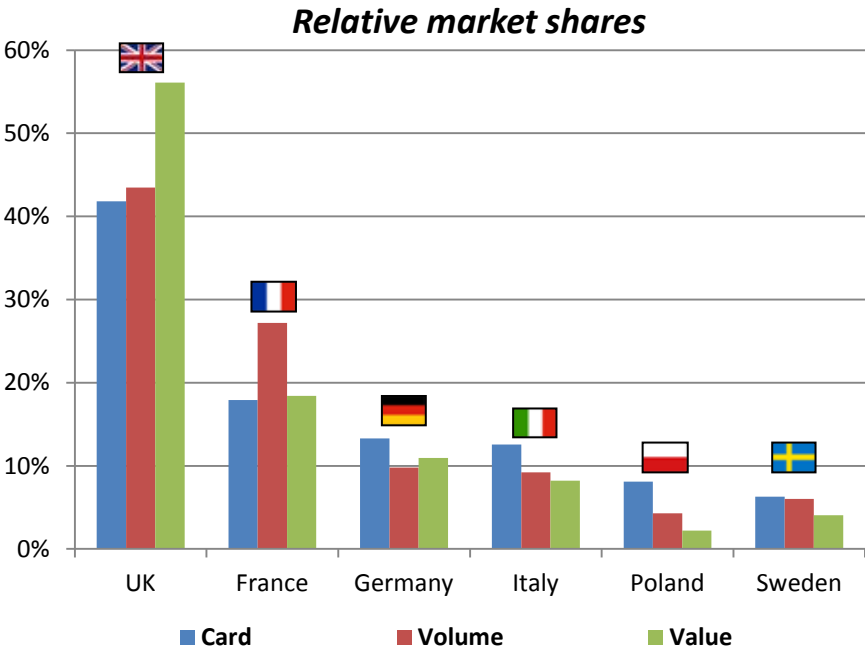
## 2. Domestic markets analysis

1. UK
2. France
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# Market analysis

• Focus on 6 major markets (80% of EU cards) :

- UK
- France
- Germany
- Italy
- Poland
- Sweden

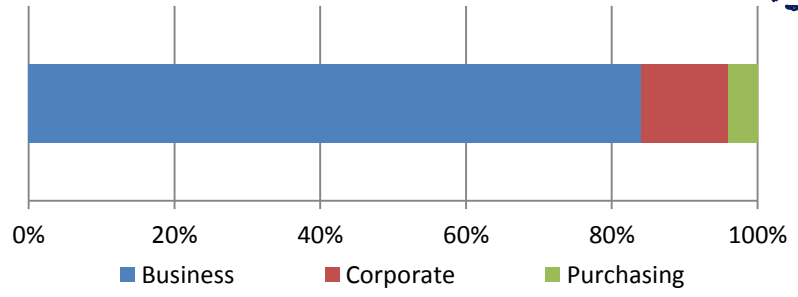
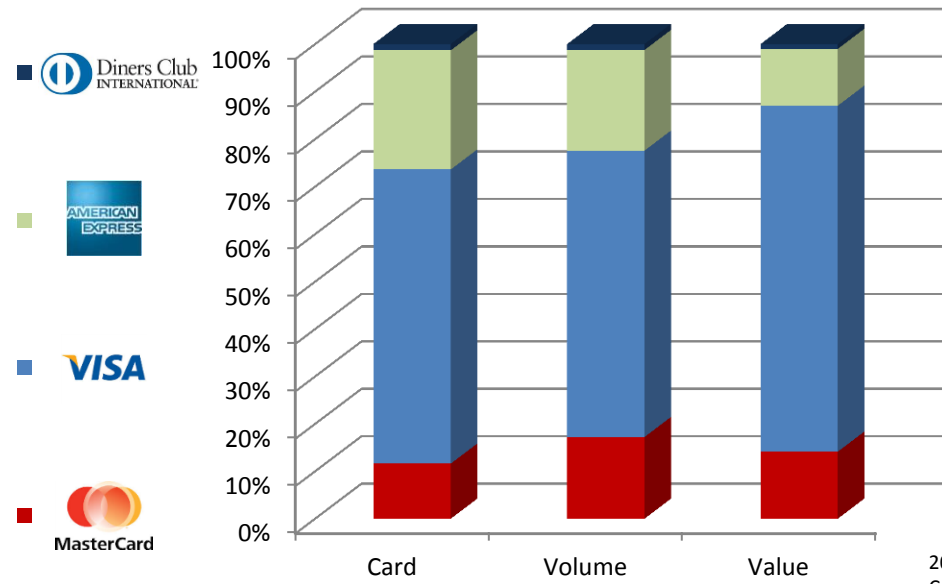


# British market



- **Figures in UK:**
  - 7 million commercial cards
  - 406 million transactions
  - 67 billion € of transactions value

• **Largest commercial cards market in EU, accounts for a third of EU's commercial cards payments**



- The majority of commercial cards are Business cards. Large businesses and corporations tend to use Corporate card
- Visa holds the largest market share, AMEX issues Business, Corporate and Purchasing cards
- Purchasing cards are often issued to public sector

2012 market shares within 15 EU countries. Commercial card products only. Consumer cards issued to businesses excluded. Private label fuel cards excluded. Source: RBR London, "Commercial cards in Europe 2013".



- **Major card issuers:**

- Lloyds Banking Group
- Barclays
- HSBC
- RBS Group
- MBNA

- Lodge and virtual card are already quite issued on the market

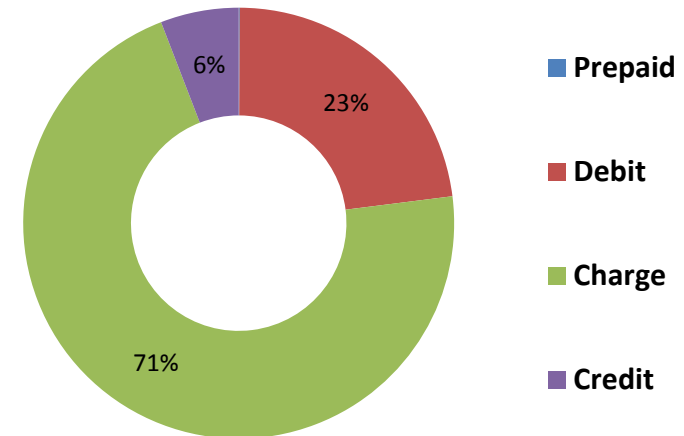
- Investment on simplified web-based tool for SMEs are been done. Including features like real time expenses tracking, virtual cards, control and alerts

- Several technological improvement have been added to enhance corporate purchasing

- Otherwise, fuel cards accounts for 38% of commercials cards issued

Majority of commercial cards issued are charge card.

Debit cards are mainly issued to SMEs

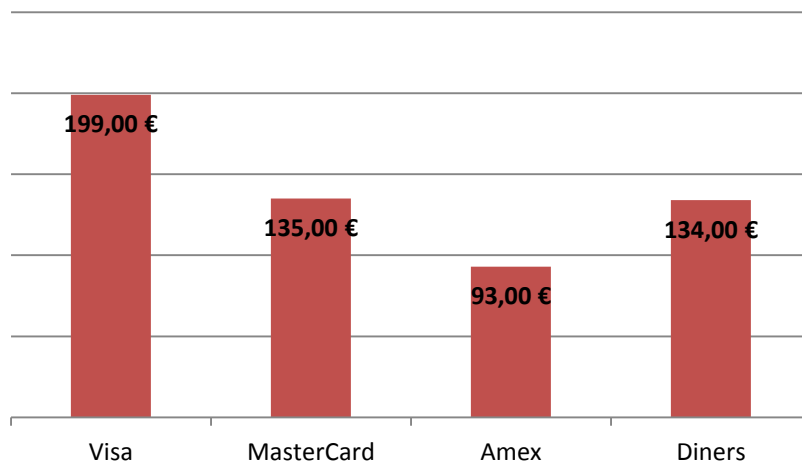


- Usually, commercial card issued in the UK have corporate liability, excepted for some small businesses





- The Average Transaction Value shows a particularly high value compared to EU, as well as the less "exclusive" position of Amex:



- Main acquirers on the UK market are WorldPay, Global Payments and Barclaycard Business
- MSC applied by acquirers is around 1.5% + additional POS terminal costs
- Interchange+ is widely applied in UK. More and more merchant are moving to this model
- Interchange level in UK is subject to a high level of regulation both from UK and EU authorities

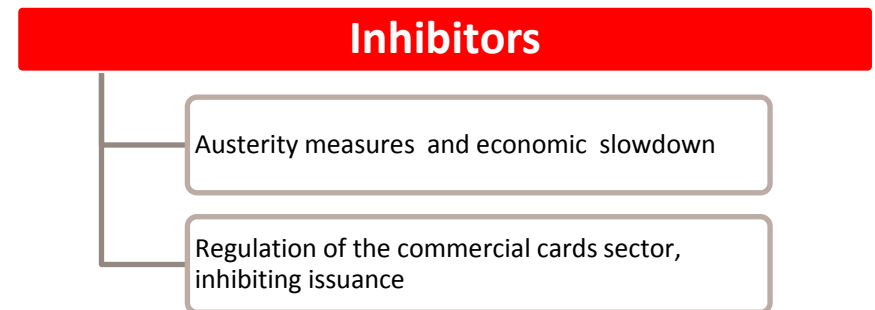
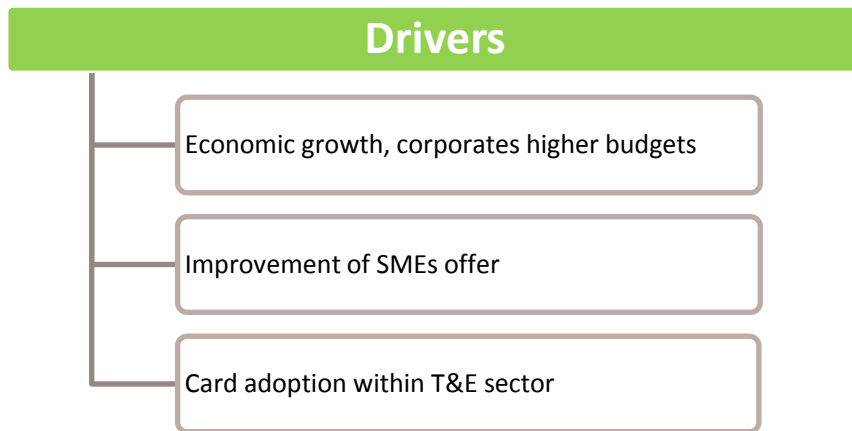
# British market - Forecast



- Commercial cards transaction values are expected to maintain a 1,9% CAGR\* between 2012 and 2018, and to be close to 74,9 billion € in 2018

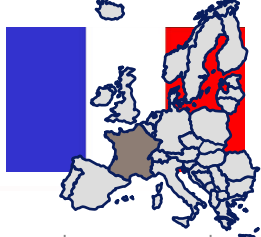


- Purchasing cards are considered to have a good growth potential within B2B payments
- It appears that several investments in reporting tools may be reconsidered



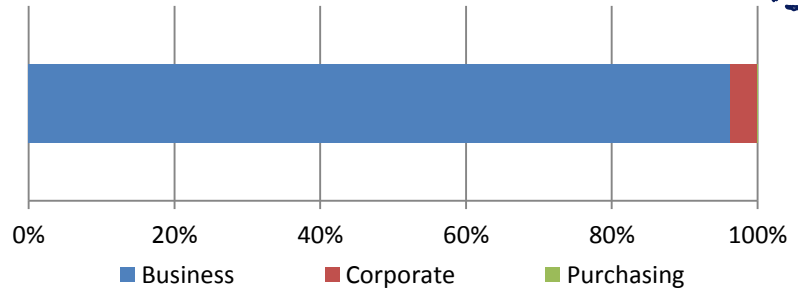
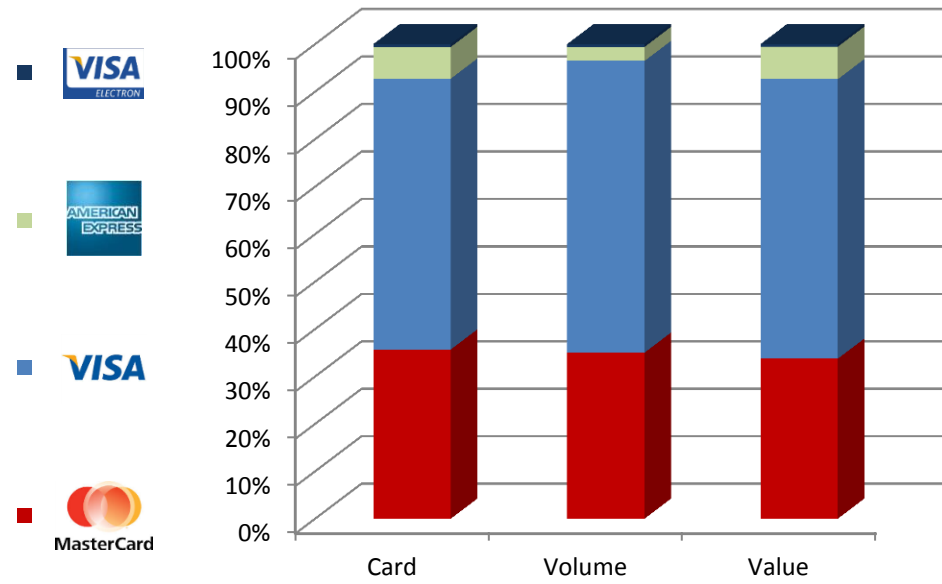
\* : Compound Annual Growth Rate

# French market



- **Figures in France:**
  - 3 million commercial cards
  - 254 million transactions
  - 22 billion € of transactions value

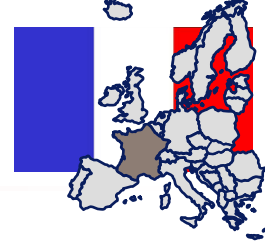
- **Most of MasterCard and Visa cards are co-badged with the domestic scheme CB**



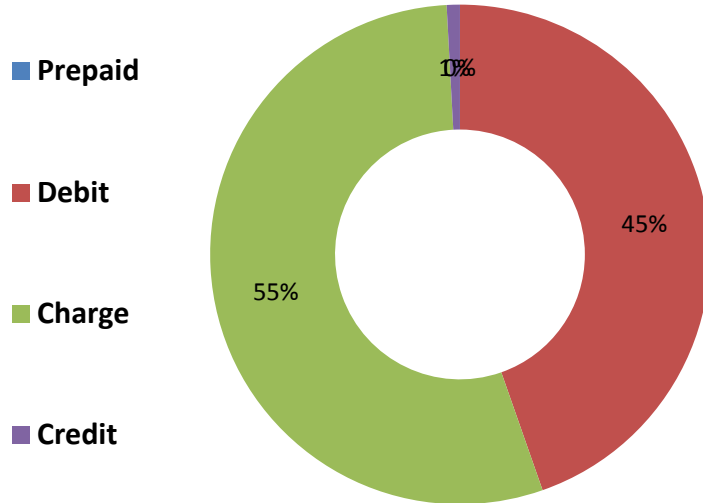
- **The vast majority of commercial cards are Business cards**
- **Visa still holds the largest market share**
- **A large number of SMEs are still underequipped**

2012 market shares within 15 EU countries. Commercial card products only. Consumer cards issued to businesses excluded. Private label fuel cards excluded. Source: RBR London, "Commercial cards in Europe 2013".

# French market - Insights



- **Type of commercial cards issued on the market:**



- **Major Issuers:**

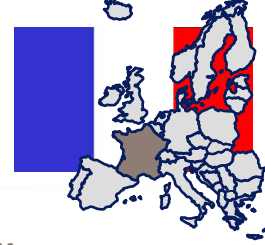
- BNP Paribas
- Société Générale
- Crédit Industriel et Commercial (CIC)
- Crédit Mutuel
- Banques Populaires Caisses d'Epargne (BPCE)

Charge card are preferred thanks to the flexibility they offer while debit card are chosen for their level of control

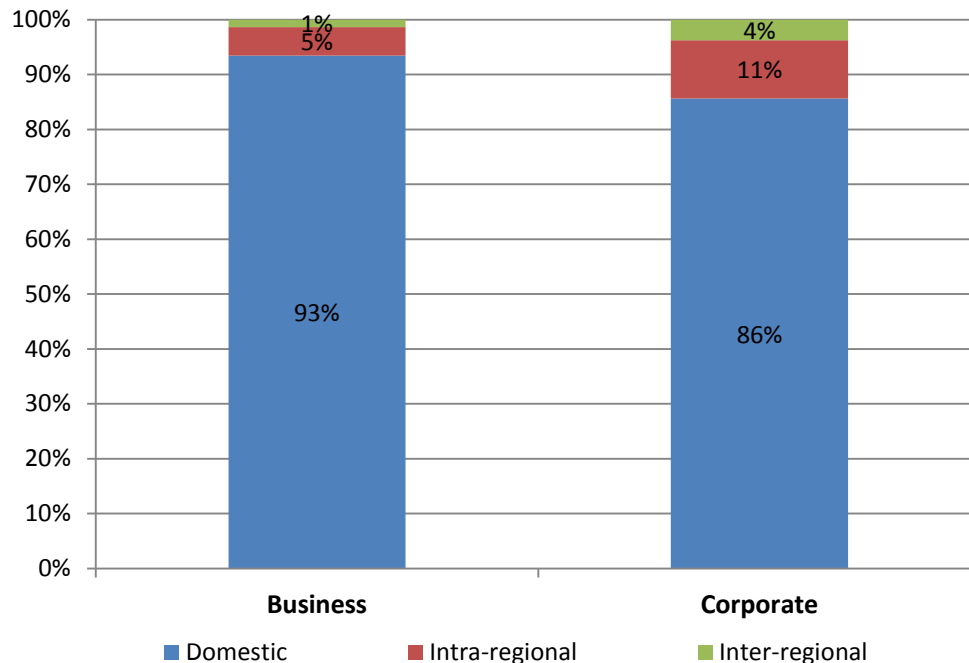
MasterCard issues proportionally more debit card than other schemes

- For a long time, spending reporting (paper, internet) has been part of the business card features which are sized to companies needs (VAT tools, advanced fraud control features...)
- Most of the commercial card are used with individual liability even if corporate liability is also offered

# French market - Insights



- Commercial cards are mostly used on the domestic market, even if a wider cross-border usage is observed on corporate cards :



- **Domestic interchange fees:**
  - **Visa Business** : 1,30%
  - **Visa Corporate** : 1,35%
  - **MasterCard Business** : 1,25%
  - **MasterCard Business Debit** : 0,03€+0,50%
  - **MasterCard Corporate** : 1,50%
- **CB: 0,28%** applicable from 1<sup>st</sup> October 2011
- **Originally, domestic interchange level was calculated by taking account of:**
  - Processing costs
  - Investment in collective security measures
  - The payment guarantee provided by the Issuer

- Almost all Merchant Service Charge (MSC) paid by French merchants are “blended”. Only very large acceptors negotiate specific MSCs.

# French market - Forecast



- Commercial cards transaction values are expected to maintain a 5% CAGR\* between 2012 and 2018, and to be close to 28,1 billion € in 2018



- Good potential within SMEs and large companies
- Virtual commercial cards are expected to experiment accelerated growth rate

## Drivers

Universal acceptance / Ease of use

Need of payment centralization expressed by companies

SMEs adoption

Additional features on Management Information System

## Inhibitors

Feeling that card do not provide enough control on irresponsible spending by the employees

Regulation of the commercial cards sector, inhibiting issuance

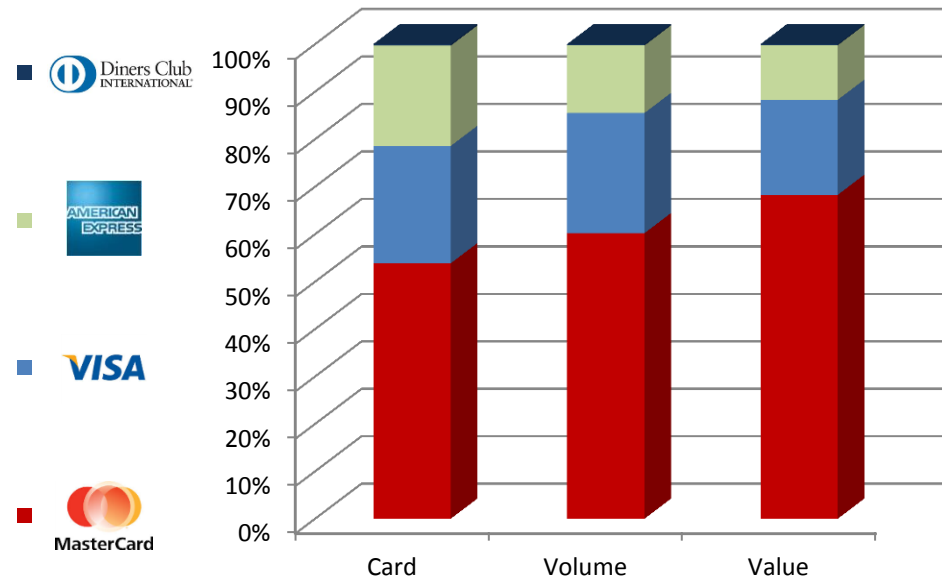
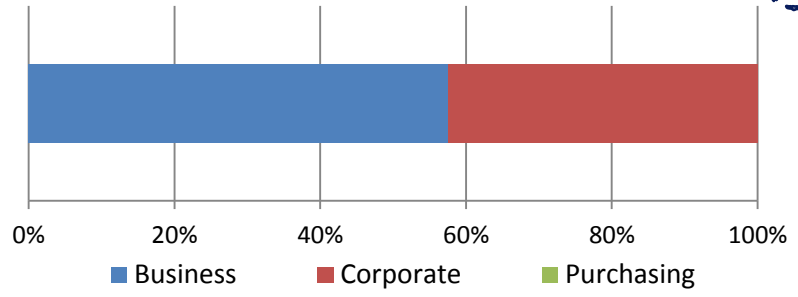
\* : Compound Annual Growth Rate

# German market



- **Figures in Germany:**
  - 2,2 million commercial cards
  - 91 million transactions
  - 13 billion € of transactions value

• **German market is highly underpenetrated with 10 million business travelers\* and 2,2 million cards**



• **AMEX has leadership on multinationals and strong presence in large companies, on the corporate card segment**

• **Fuel card schemes account for 66% of the German commercial cards base**

\* : VDR business travel report Germany, 2013

2012 market shares within 15 EU countries. Commercial card products only. Consumer cards issued to businesses excluded. Private label fuel cards excluded. Source: RBR London, "Commercial cards in Europe 2013".



# German market - Insights

- **Major Business card issuers:**

- Deutsche Bank
- Deutsche Kreditbank
- Commerzbank
- Savings Banks Group
- Targo Bank

- **Major Corporate card issuers:**

- AirPlus
- Degussa Bank
- Amex
- Commerzbank
- Citibank, Wells Fargo (deals outside of GE)

- **Almost all commercial cards issued are charge card**

- **Purchase cards are not issued**

- **2 major trends regarding companies policy, depending on business :**

- Centralized (lodge card: AirPlus)
- Distributed (one business cards per employee: Degussa, Amex)

- **Some consumer cards are issued to businesses but this practice is declining**

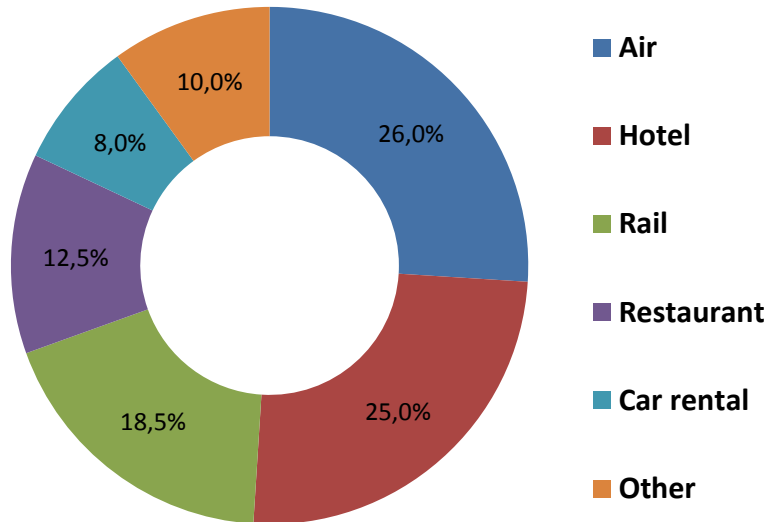
- **Tax law stipulates that commercial cards should only be used for business expenses**



# German market - Insights



- Card usage by merchant category (value):



- Commercial cards are usually used on a national level:

- 80% of transactions are domestic
- 15% intra-regional
- 5% inter-regional

- Domestic interchange are applied

- Average IC is around 1,5%
- ~ 1,45% for airlines / 0,68% for fuel station



- Acquirers structure their Merchant Service Charge (MSC):

- Blended model
- Interchange+ model, more likely for big companies

# German market - Forecast

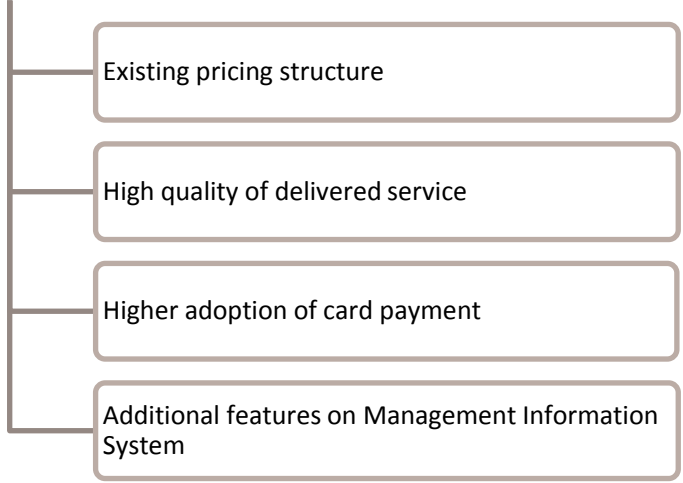


- Commercial cards transaction values are expected to maintain a 4,4% CAGR\* between 2012 and 2018, and to be close to 16,8 billion € in 2018

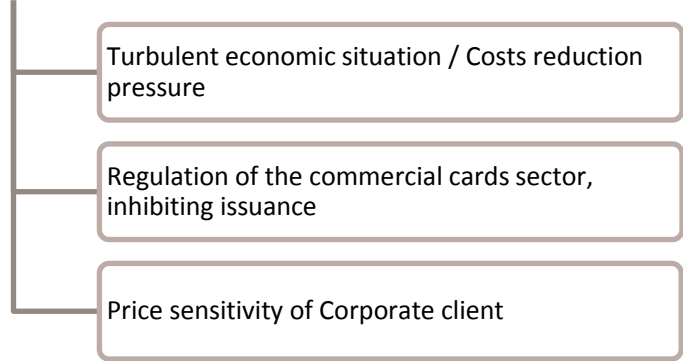


- Opportunities:**
  - from mid-market to large market
  - around alternative payment solutions such as virtual card, B2B payments
  - for new players (commercial/fleet card convergence)

## Drivers

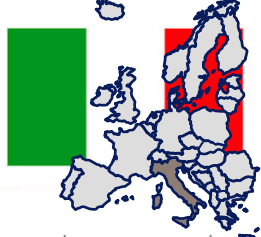


## Inhibitors



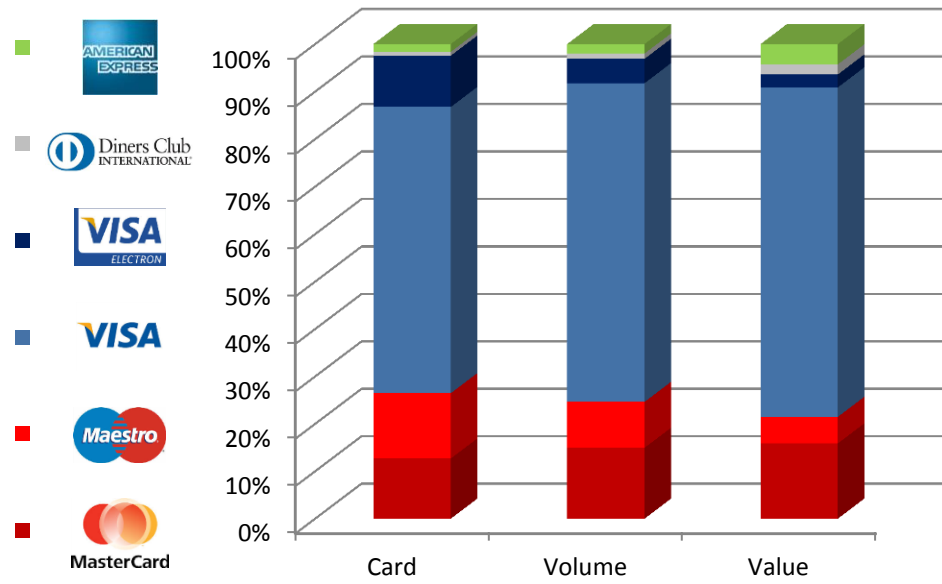
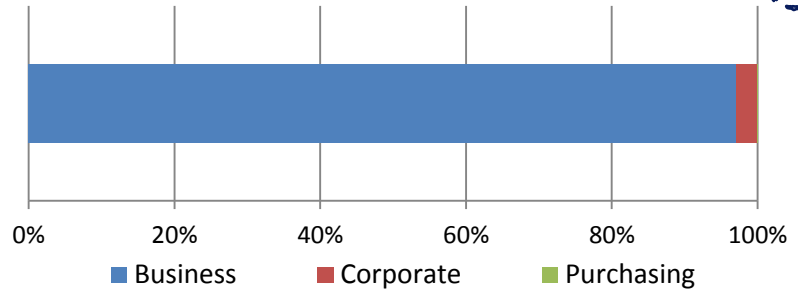
\* : Compound Annual Growth Rate

# Italian market



- **Figures in Italy:**
  - 2 million commercial cards
  - 86,2 million transactions
  - 9,8 billion € of transactions value

• **Business card is the leading product since the market is mainly composed by small companies**



- **Visa is the historical player on the commercial card market**
- **MasterCard has launched several new products in the last years**
- **T&E cards, Amex and Diners, represent roughly 2% of the segment**

2012 market shares within 15 EU countries.  
 Commercial card products only. Consumer cards issued to businesses excluded.  
 Private label fuel cards excluded.  
 Source: RBR London, "Commercial cards in Europe 2013".

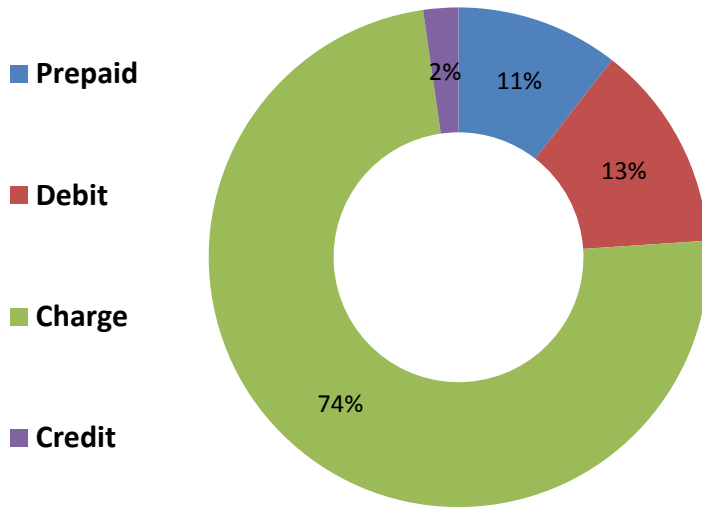
# Italian market - Insights



- Major issuers:

- CartaSi
- Banco Posta
- Gruppo UniCredit
- Gruppo Intesa Sanpaolo
- Gruppo MPS

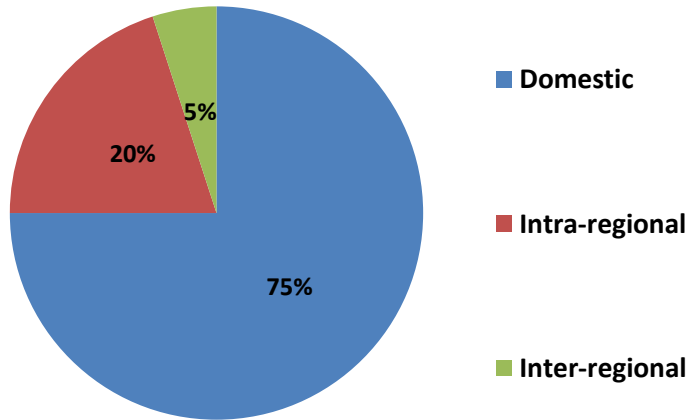
- The market has declined over the last 2 years due to the fall of demand within the small business segment
- Due to the economic crisis, restrictive Credit scoring rules have a major impact on the issuance of charge products



- Charge cards are mainly issued

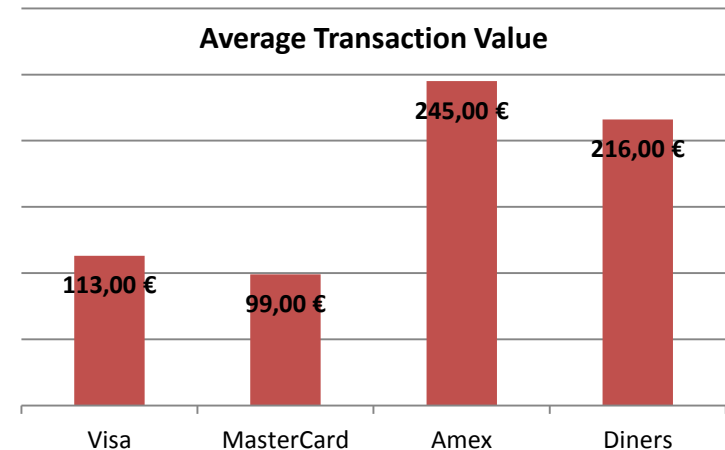
- Personal cards are often used for business purpose

# Italian market - Insights



- Important issuers are also acquirers, enabling a large share of On-U's transaction
- Some bilateral agreement on MIF are also in place on this market

Amex and Diners average transaction value confirm their exclusive positioning which is also bound to a limited market share within small businesses



# Italian market - Forecast



- Commercial cards transaction values are expected to maintain a 3% CAGR\* between 2012 and 2018, and to be close to 11,8 billion € in 2018



- Opportunities:**

- Around prepaid and debit product
- Convert small businesses using personal cards to commercial cards

## Drivers

Use of Debit / Prepaid product to reach small business ineligible to credit

Perception of the value added by commercial card

Additional features on Management Information System

## Inhibitors

Credit scoring rules

Regulation of the commercial cards sector, inhibiting issuance

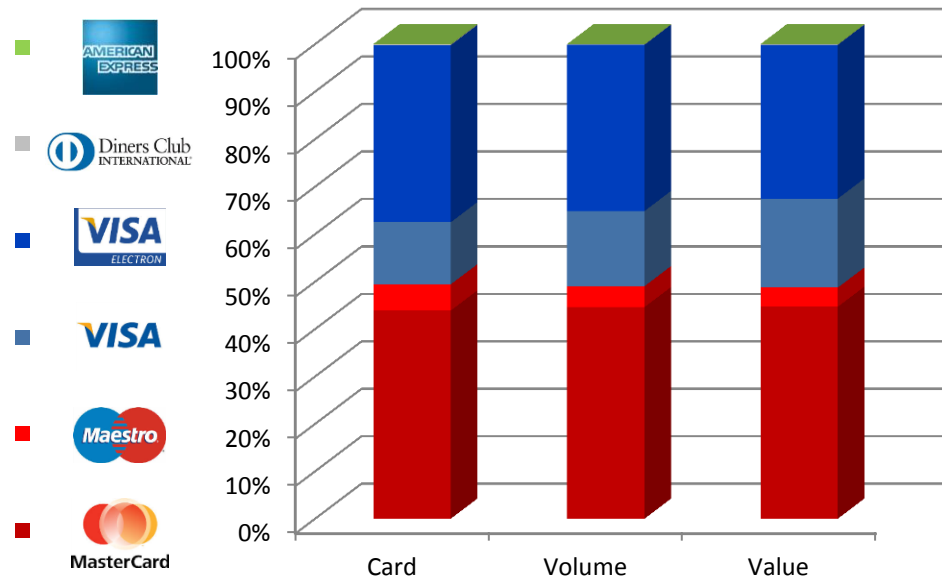
\* : Compound Annual Growth Rate

# Polish market

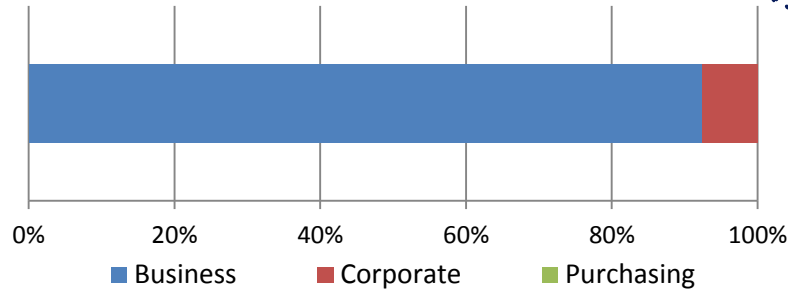


- **Figures in Poland:**
  - 1,4 million commercial cards
  - 40,2 million transactions
  - 2,6 billion € of transactions value

• AMEX and Diners have a limited presence on this market



2012 market shares within 15 EU countries.  
 Commercial card products only. Consumer cards issued to businesses excluded.  
 Private label fuel cards excluded.  
 Source: RBR London, "Commercial cards in Europe 2013".



• Visa and MasterCard own roughly the same market share

• A relatively small and immature market, nevertheless very promising with already a lot of commercial cards issued (compared to the global transactions value)

# Polish market - Insights



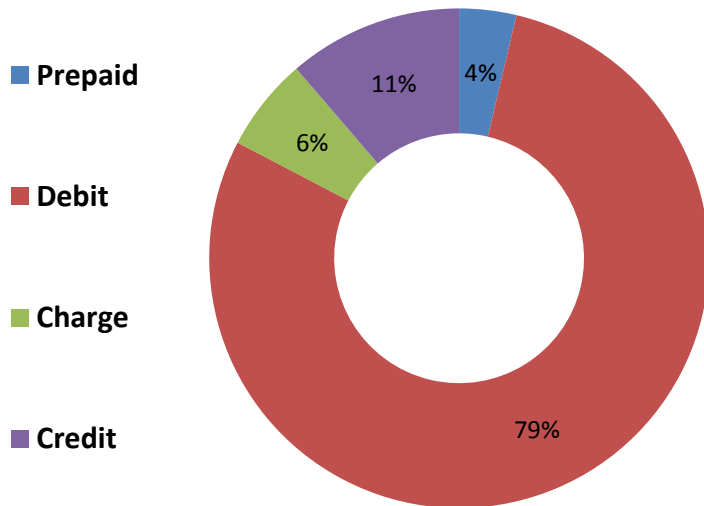
- Major issuers:

- PKO BP
- BRE/multibank/mbank
- Bank Pekao
- ING Bank Slaski
- BZWBK

- Services around business travels and insurances are currently being developed

- Debit cards are mostly issued to SMEs which represent the majority of the market:

- Innovative products as virtual cards or advanced reporting tools are also available





# Polish market - Insights



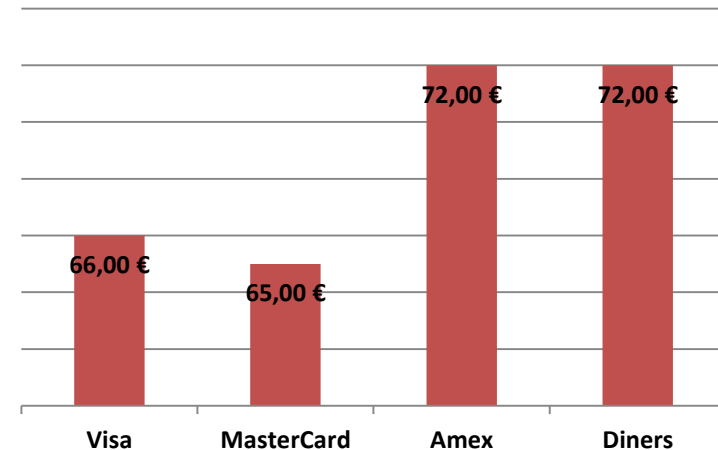
- Since 1<sup>st</sup> July 2014, a maximum interchange fee have been introduced on all Polish payment cards



- From 2,0% to 0,5% for corporate cards
- From 1,9% to 0,5% for business cards
- Special rate of 0,3% for « large merchants »

- Acquirer negotiate with their customers to maintain the MSC level
- Merchants are more concerned by the level of the POS renting fee than the MSC
- Merchants do not anticipate to pass interchange reduction savings to their customers\*
- The regulation have been anticipated by Issuers, which start to reduce some benefits (loyalty cashback, free cash withdrawal...)

Average Transaction Value is expected to decrease while the acceptance network expands



\* : IPSOS Study, Poland: Attitudes to Interchange Fees, 2014

# Polish market - Forecast



- Commercial cards transaction values are expected to maintain a 12% CAGR\* between 2012 and 2018, and to be close to 5,2 billion € in 2018



- Opportunities:**

- For large European cross-border acquirers
- For card issuer as the market quickly expands
- Prepaid card product are expected to gain a larger market share

## Drivers

Rise of SME number

Wider adoption of card payment

Companies demand for expenses control tools

## Inhibitors

Regulation of the commercial cards sector, inhibiting issuance

Corporate uses of consumer product

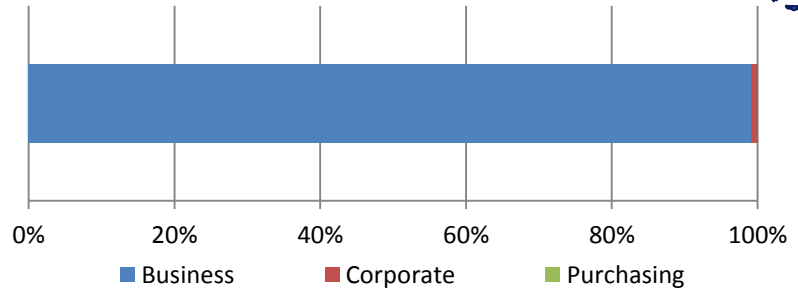
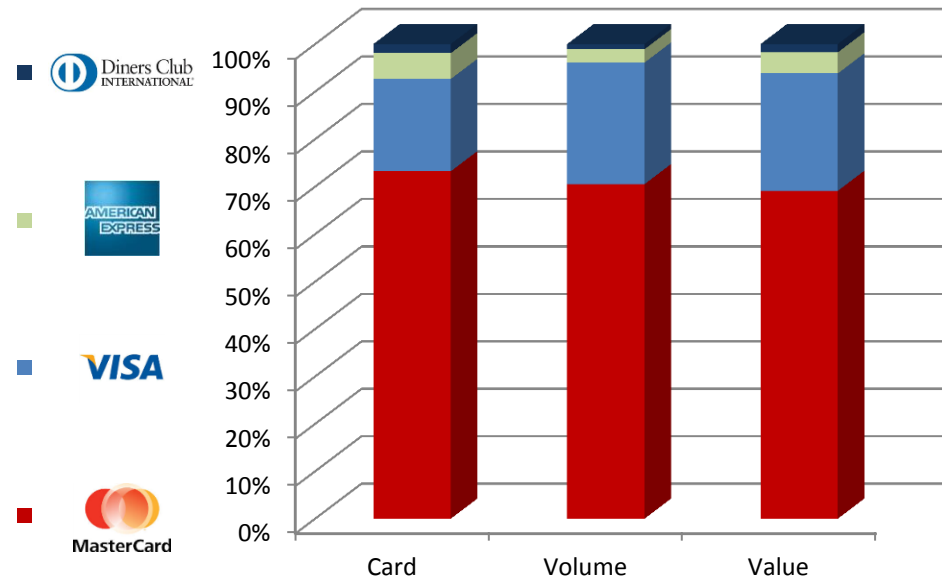
\* : Compound Annual Growth Rate

# Swedish market



- **Figures in Sweden (2012):**
  - 1 million commercial cards
  - 56 million transactions
  - 4,8 billion € of transactions value

- **MasterCard is the leader with a market share of 70%**



- **Fuel cards account for 76% of the commercial cards on this market with about 3,2 million cards issued in 2012**
- **Business cards are mainly issued to SMEs and large businesses but the multinational segment is costly and too specialized for local issuers**

2012 market shares within 15 EU countries. Commercial card products only. Consumer cards issued to businesses excluded. Private label fuel cards excluded. Source: RBR London, "Commercial cards in Europe 2013".

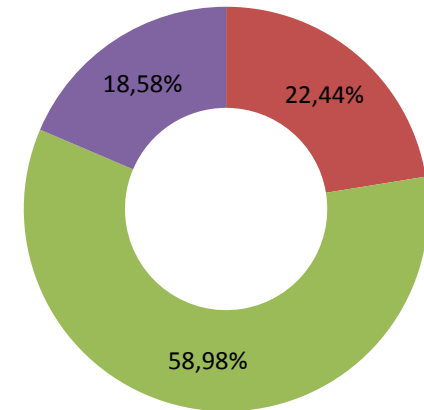


# Swedish market - Insights

- **Major issuers:**

- Nordea
- Swedbank
- Handelsbanken
- EnterCard
- American Express

- Debit
- Charge
- Credit



*Types of commercial cards*

- **Pricing structure is negotiated with regards to**

- the number of card pool
- the payment term
- the other features required by businesses
- Card yearly fee : from 50-60EUR per card

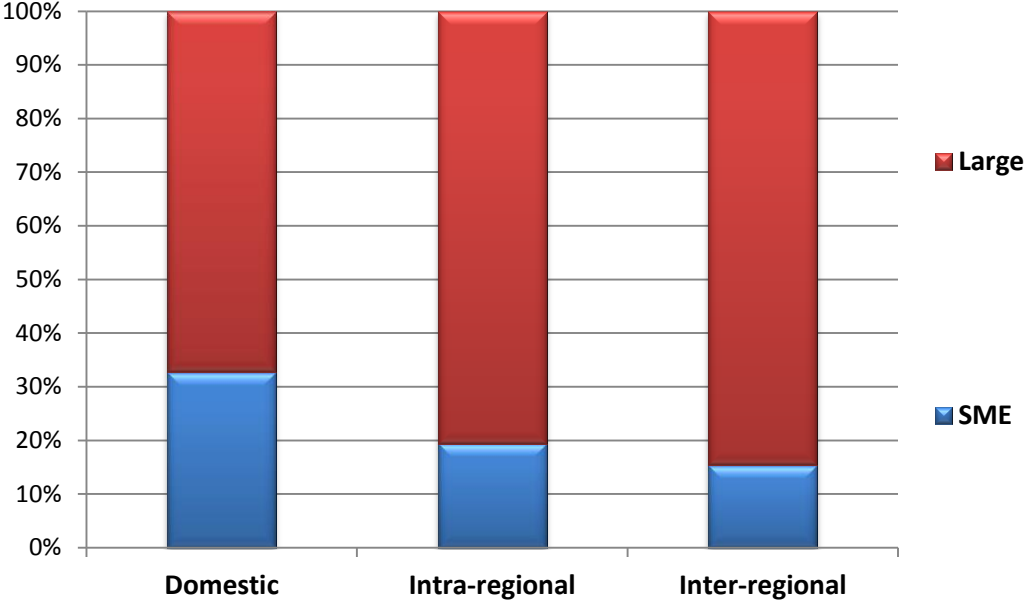
- **Lodge cards are common on the market and usually distributed by travel agencies**

- **Purchasing cards are not currently offered on the market but will be soon introduced**

# Swedish market - Insights



**Commercial card volume**



Large businesses owns the largest share of transaction volume and also have an increased presence on intra- and inter- regional transactions compared to SMEs

- Bankgirotcentralen (BCG) and PlusGiro (formerly Postgirot) are the 2 predominant invoice acquirer for Giro payment which is largely used by companies
- MasterCard’s Average Transaction Value (85€) is slightly higher than Visa (83€) thanks to its presence in the Corporate card segment. AMEX and Diners have an ATV around 140€.

# Swedish market - Forecast

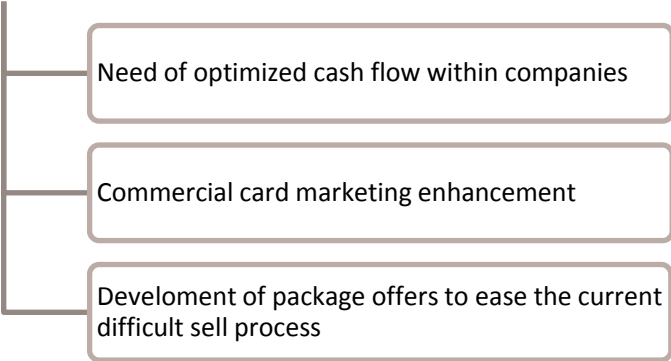


- Commercial cards transaction values are expected to maintain a 2,8% CAGR\* between 2012 and 2018, and to be close to 5,7 billion € in 2018

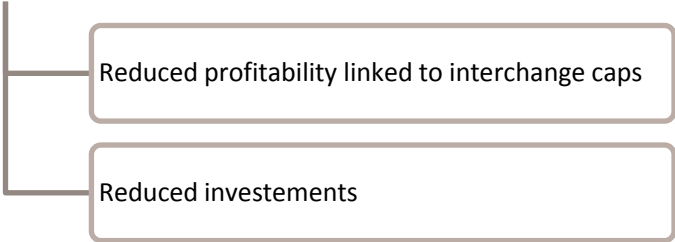


- Opportunities:
  - Purchase card solutions, where transactions are currently paid with an invoice
  - SME segment migration to card payments

## Drivers

































## Inhibitors



\* : Compound Annual Growth Rate

# Market comparative analysis



	Size	Growth Potential	Card usage	Debit product
UK 				
France 				
Germany 				
Italy 				
Poland 				
Sweden 				

# Market comparative analysis highlights



<b>UK</b> 	<ul style="list-style-type: none"><li>• <b>First market in EU</b></li><li>• <b>Low growth potential</b></li></ul>
<b>France</b> 	<ul style="list-style-type: none"><li>• <b>High level of card usage: 85 transactions per card per year</b></li><li>• <b>Co-badging of commercial cards with “CB” local scheme and “CB” interchange level already apply to all “CB” domestic transactions (0,28% on average)</b></li></ul>
<b>Germany</b> 	<ul style="list-style-type: none"><li>• <b>Very demanding customer (high quality expected and price sensitivity)</b></li><li>• <b>Underpenetrated market</b></li></ul>
<b>Italy</b> 	<ul style="list-style-type: none"><li>• <b>High risk of moving to consumer card and to alternative payment means</b></li><li>• <b>Low level of card usage</b></li></ul>
<b>Poland</b> 	<ul style="list-style-type: none"><li>• <b>High growth potential for commercial card</b></li><li>• <b>Strong presence of debit product</b></li></ul>
<b>Sweden</b> 	<ul style="list-style-type: none"><li>• <b>Small market with good level of card usage</b></li><li>• <b>Alternative payment mean mainly used (fuel cards, credit transfer)</b></li></ul>



## PART 2: Impact Assessment

# Agenda - Impact assessment

1. Objectives
2. Summary market analysis
3. Quantitative impacts assessment
  1. Interchange revenue
  2. Merchant Service Charge
  3. Card fees
  4. Impacts on the value chain
4. Qualitative analysis
  1. Business consequences
  2. Prospective analysis
  3. By country
5. Conclusion

# Impact assessment

## Objectives of the impacts assessment

- **Quantitative analysis of the potential impact (scope = 6 countries)**
  - Give a presentation of profit and loss for the market stakeholders per country
    - MIF
    - Merchant Service Charge (MSC)
    - Cards fees
  - Provide an overview of impacts and cost transfers on the 4-party value chain
- **Qualitative analysis and business consequences**
  - Highlight the possible slow-down and decline of the diffusion of commercial cards
  - Assess the potential effects on the current card value proposition addressed to SME's
  - General effect on the payment landscape for professionals (review of expenses management required within the SME'S)
  - SWOT analysis, including the rational and inherent value of commercial cards
    - Corporate
    - Merchant
    - Issuer/Acquirer
- **Qualitative analysis of the MIF capping impact per country**
- **Summary of main findings and conclusion**

## 1. Objectives

## 2. Summary market analysis

## 3. Quantitative impacts assessment

1. Interchange revenue
2. Merchant Service Charge
3. Card fees
4. Impacts on the value chain

## 4. Qualitative analysis

1. Business consequences
2. Prospective analysis
3. By country

## 5. Conclusion

# Impact assessment

## Summary of market analysis

### • Market analysis key points

- Market analysis scope: UK, France, Germany, Italy, Sweden and Poland
- Sustainable annual growth in FR, GE, IT and PL, thanks to the benefits that commercial cards offer and the underpenetrated market particularly for SME client
- Different market profiles per country due to different payment methods usage, card product features
  - Relative low level of card usage in several markets
  - Predominance of credit products (except for Poland)
  - High proportion of fuel cards transactions volumes in Sweden, Germany and UK
- Leading national card scheme (“CB” in France) with majority of co-badged products issued and low domestic MIF level
- Poland market has just been regulated with a 0,5% interchange cap
- Heterogeneity of the maturity level and the card adoption rate on the markets

### • European market perspectives

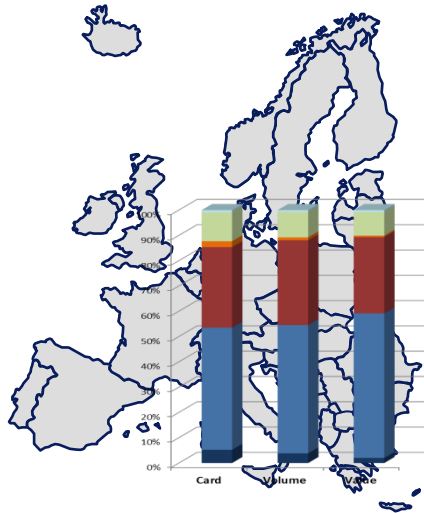
- New strategies on issuer side
  - Promotion and development of new solutions: lodge card and virtual account numbers, mobile applications, comprehensive reporting systems...
  - Share of debit and prepaid products will increase thanks to their greater control capabilities on expense
  - Purchasing card is considered to have a strong growth potential
  - Generalization of “only” brand card (MasterCard and Visa) by issuers (France)
- Fuel cards are already declining for the benefit of general purpose commercial cards

**Overall, market players have a negative perception on the European Parliament (E.P.) proposal to cap commercial cards interchange (April 2014), except Acquirers that are considered as the winners.**

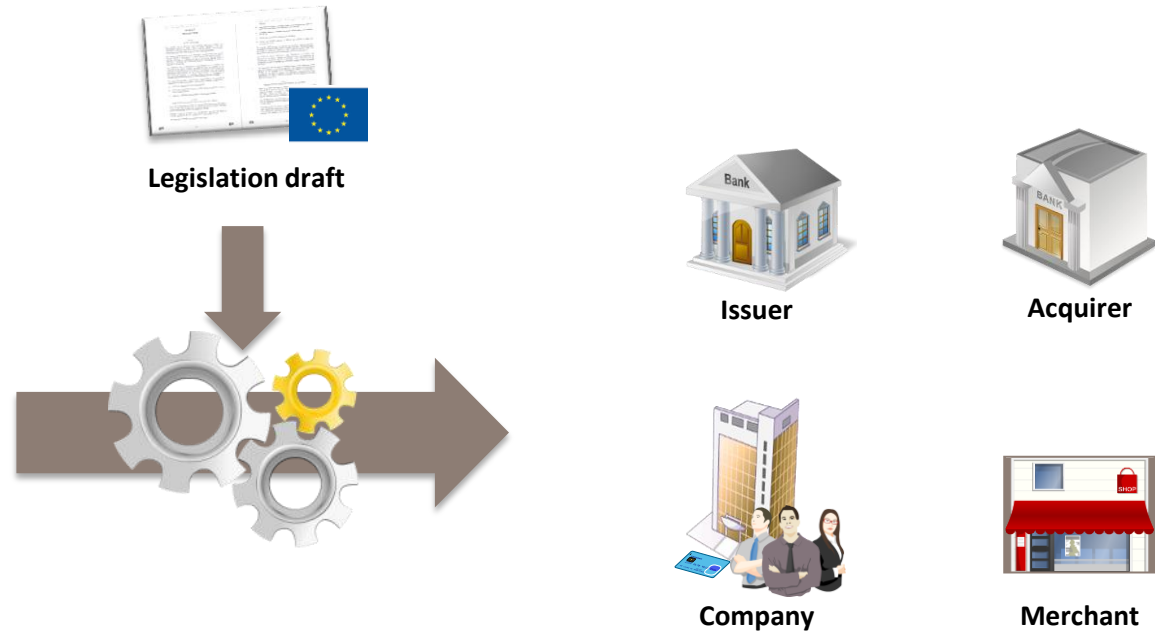
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# Impact assessment

## Quantitative impacts assessment



Market analysis



- Legislation (based on E.P. proposal) could directly impact the following players:
  - **Issuers**, regarding their interchange revenue loss (and the symmetrical gain for **Acquirers**)
  - **Merchants**, which might benefit from acquirers interchange gain through a MSC reduction
  - **Companies**, which may support card fees increase

- Methodology :



- Calculation inputs were assessed during the market analysis and where applied
  - on the current interchange rates
  - on the interchange rates in the legislation draft
- Calculation is performed on 2012 figures
- Results have been cross-checked using a Galitt proprietary tool used by several financial institutions to elaborate their card business model

### Key assumptions:

#### Current interchange revenue calculation inputs:

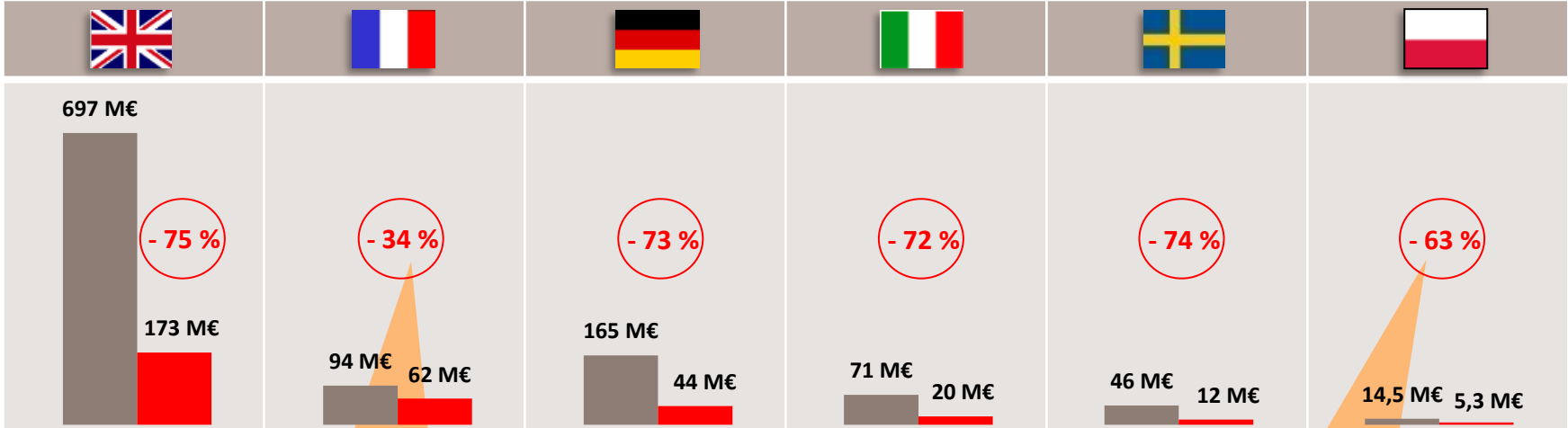
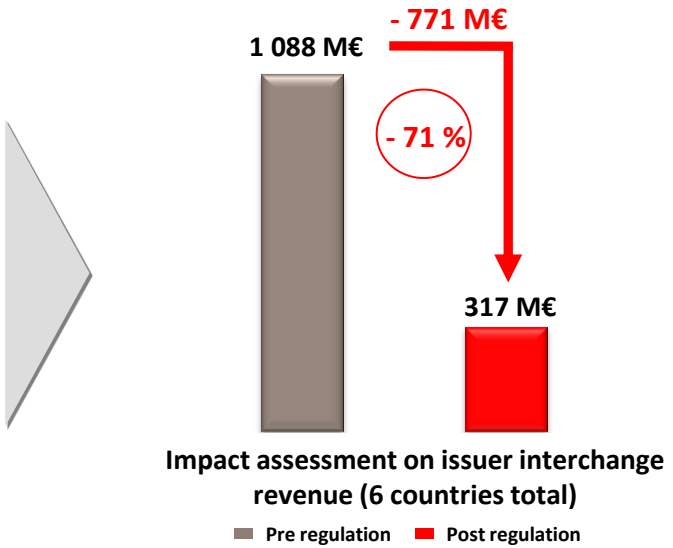
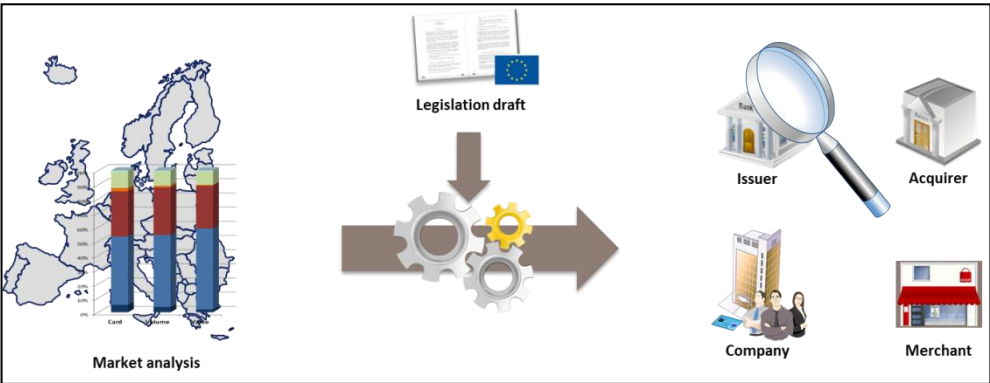
- Interchange rate
  - defined by each card scheme
  - depends on the following transaction parameters:
    - Domestic / intra-EU / inter-regional
    - Credit / Debit
    - Business / Corporate / Purchasing
  - is applied on the related transaction value
- « On-Us » transaction rate: estimation of the number of transaction where the Acquirer is the Issuer (varies by country)
- Local scheme co-badging: 90% of the domestic transactions in France are processed by the « CB » scheme. CB interchange level applies (approx. 0,28%)



# Impact assessment

## Quantitative impacts assessment – Interchange (2/2)

- Focus on Issuer interchange annual revenue loss:



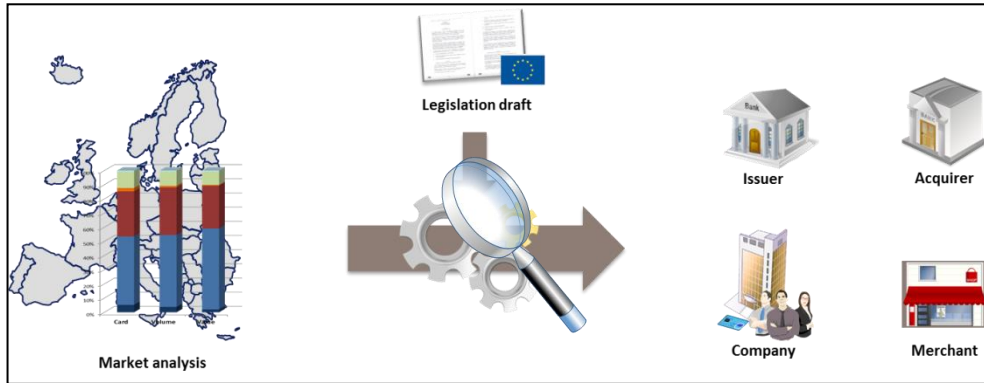
Domestic transactions processed with local scheme IC level

Interchange cap to 0,5% since 1 July 2014

# Impact assessment

## Quantitative impacts assessment – MSC (1/2)

- Methodology :



- Merchant Service Charge (MSC) reduction will be a case by case situation, however the trend will be that MSC reduction will mainly be negotiated by large retailers (having interchange+ model)
- Calculation is performed on 2012 figures
- Consequently, the assumption was made that the reduction will depend on
  - the lower interchange paid by the acquirer
  - interchange rates knowledge and negotiation ability of the retailer

### Key assumptions:

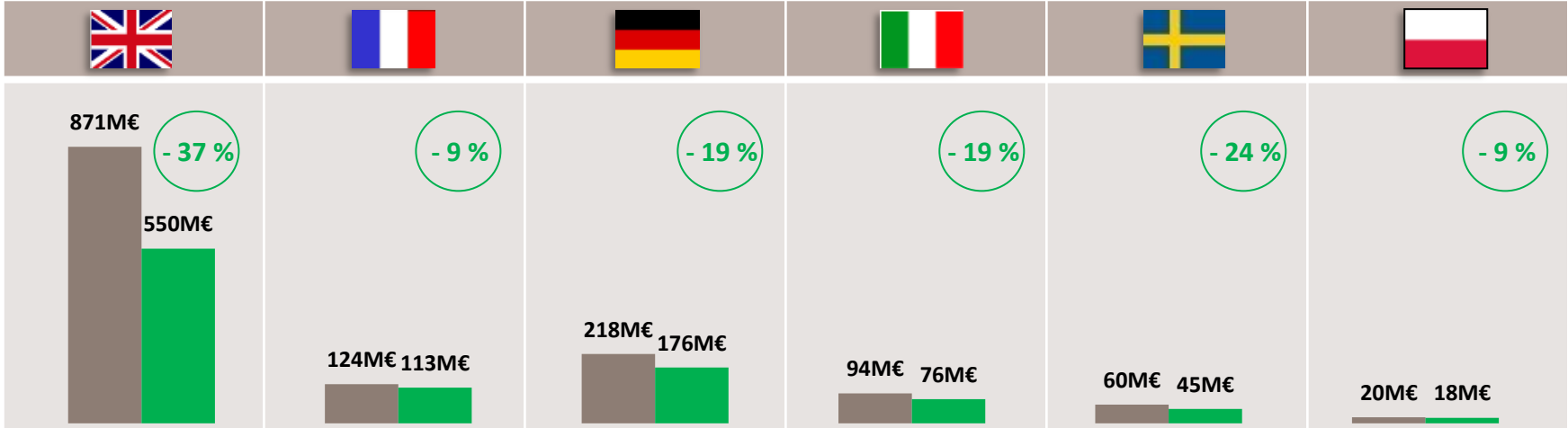
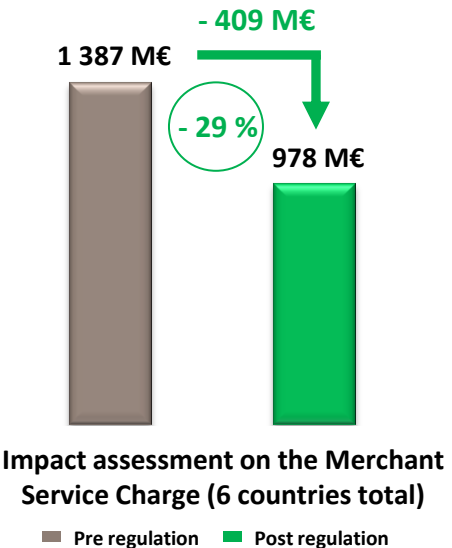
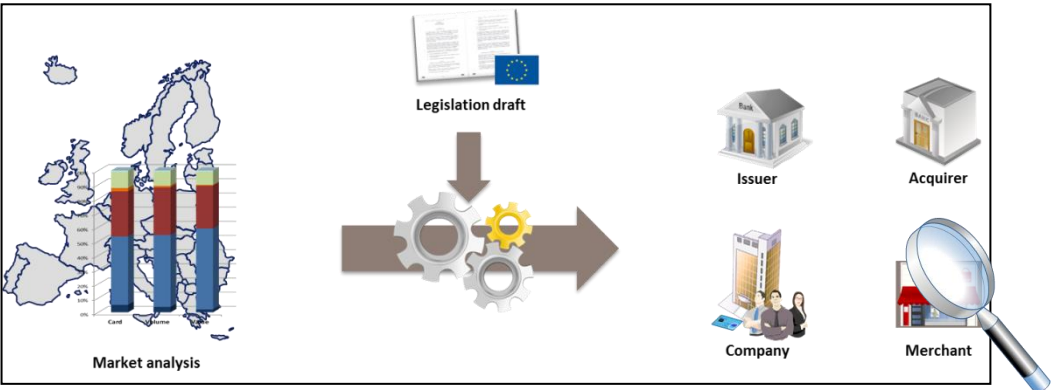
- **Retailer Segmentation**
  - For each country:
    - A. % of retailer with interchange+ MSC model
    - B. % of retailer with blended MSC model
- **Current MSC level**
  - Estimation for each
    - country
    - retailer segment (A) and (B)
- **MSC reduction *pass-through rates*\***
  - For each retailer segment
    - 80% for interchange+ segment (A)
    - 5% for blended segment (B)
- **MSC reduction**
  - Depending on each pass-through rate
  - Depending on the acquirer additional interchange profit

\* **Pass-through rate:** % of the Acquirer gain passed to the merchant

# Impact assessment

## Quantitative impacts assessment – MSC (2/2)

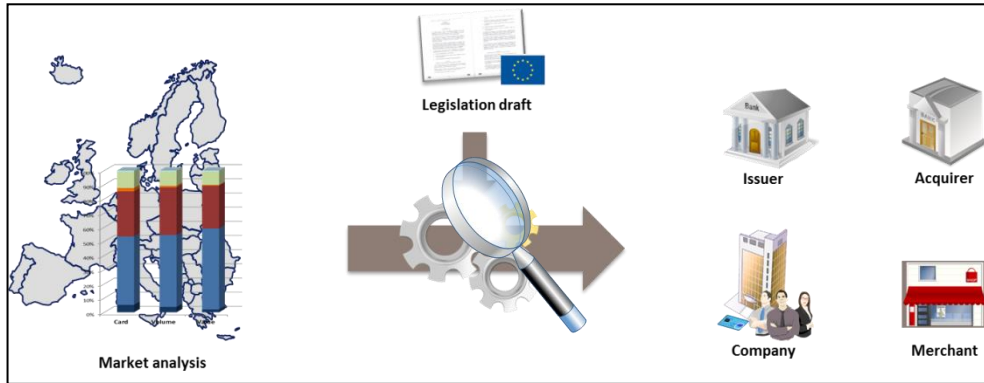
- Focus on Merchant Service Charge (MSC) reduction:



# Impact assessment

## Quantitative impacts assessment – Fees (1/3)

- Methodology :



- Impact assessment on card fees paid to the issuer was made through 3 calculations:

- An estimation of current fee level paid by companies on a card fee panel
- Scenario A: smooth card fee increase
- Scenario B: strong card fee increase

(Scenario A and scenario B: see next slide)

### Key assumptions:

- Card fee panel

- **Annual card fee**, estimation based on the market analysis data
- **Late payment**, estimation based on B2B late payment rate (for each country) in financial services
- **International fee**, estimation based on the market analysis data
- **Withdrawal fee**, estimation based on the market analysis data
- **Servicing fee**, including MIS, emergency card and cash, card replacement, re-issuing. The estimation is based on the market analysis.

- Companies segmentation

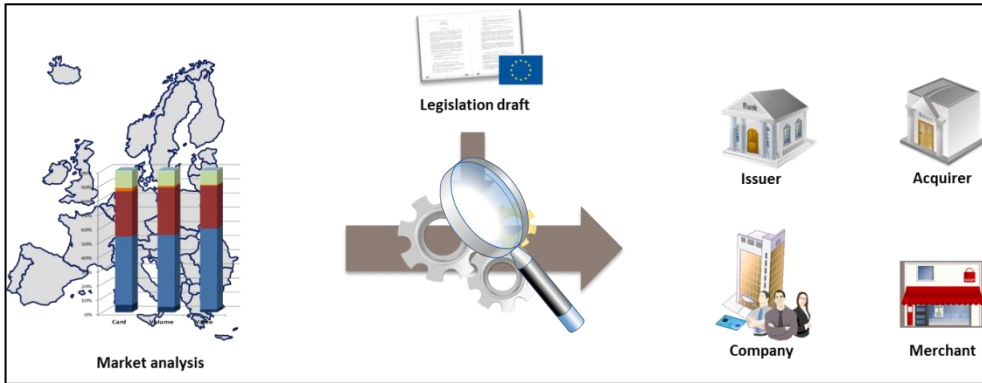
- SME (45-50%)
- Large (50%)
- Very large, multi-national, B2B (>5%)

- Based on the segmentation, the number of company paying for each fee have been estimated, large companies paying less than SMEs (usually they even do not pay annual card fee)

# Impact assessment

## Quantitative impacts assessment – Fees (2/3)

- Methodology :



### Scenario A:

- A uniform and very limited increase is expected on the card fee panel (assumption: 5%)
- Therefore, only a small part of the interchange loss is supported by SMEs and Issuers rather leverage on new revenue streams

### Scenario B:

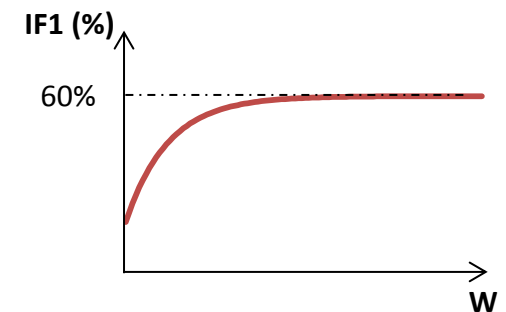
- A model has been set up to represent the fact that the increase of card fee (IF1) will be based on the weight (W) of the Interchange loss (ICL) compared to the current collected fee (F0) :

- W ratio calculation :  $W = \frac{ICL}{F0}$

- The relationship between the weight of the loss (W) and the card fee increase (IF1) is provided by a function  $f$  representing the simple fact that the increase quickly grows with the loss weight

- Assumptions:

- Maximum fee increase (commercially realistic) = 60%
- Transfer function shape

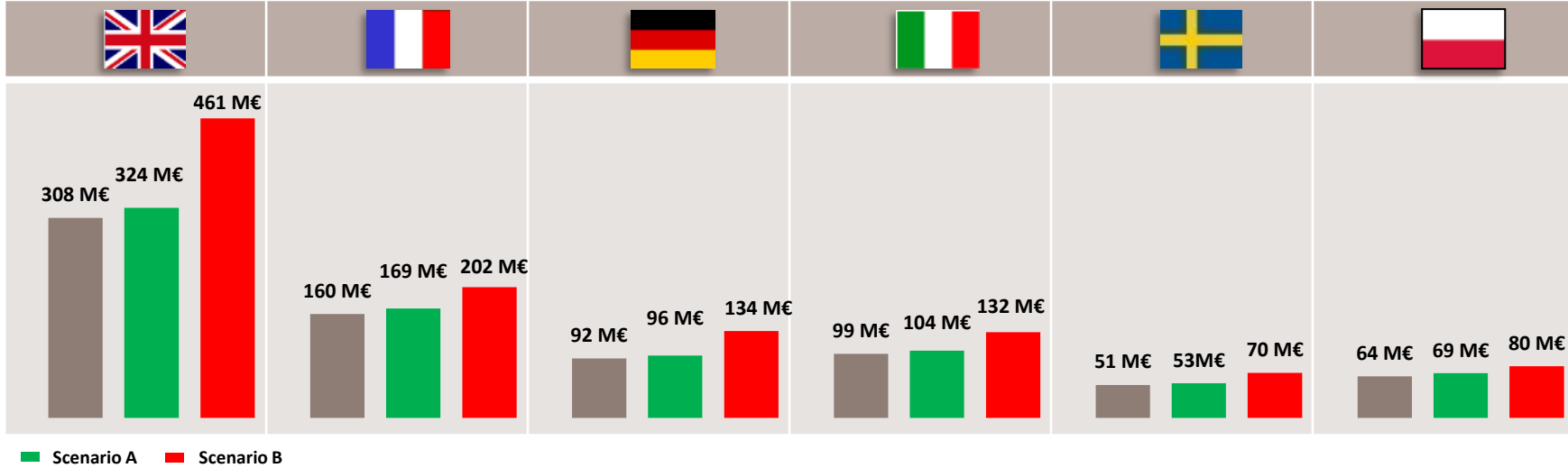
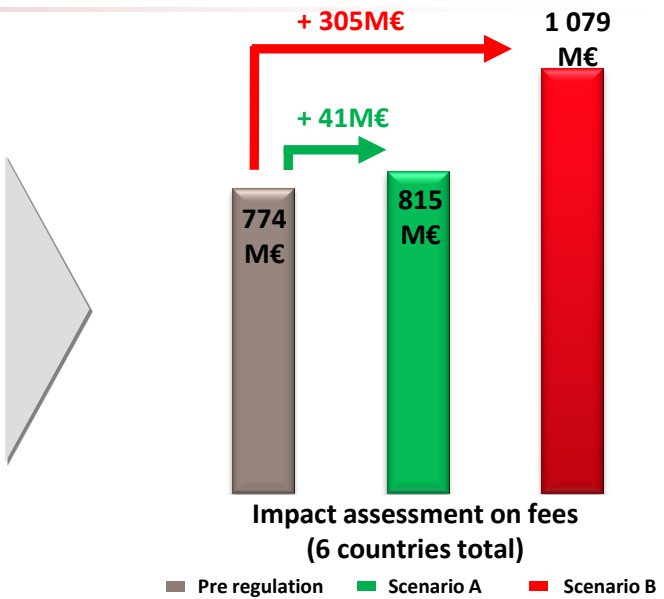
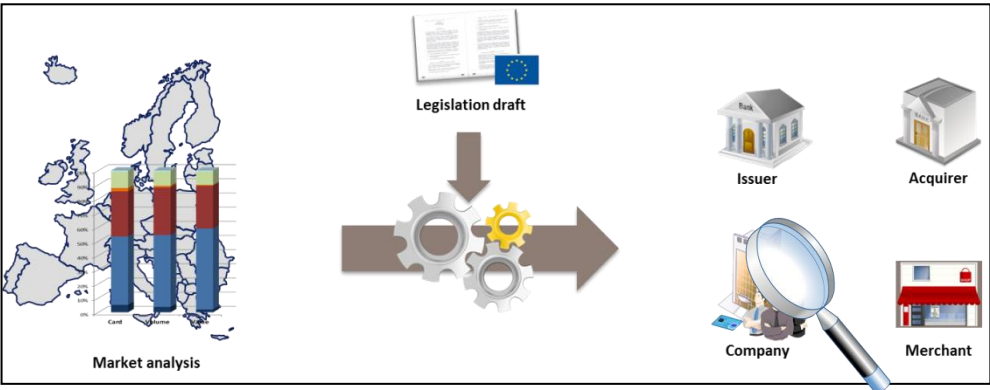


$$IF1 = f(W)$$

# Impact assessment

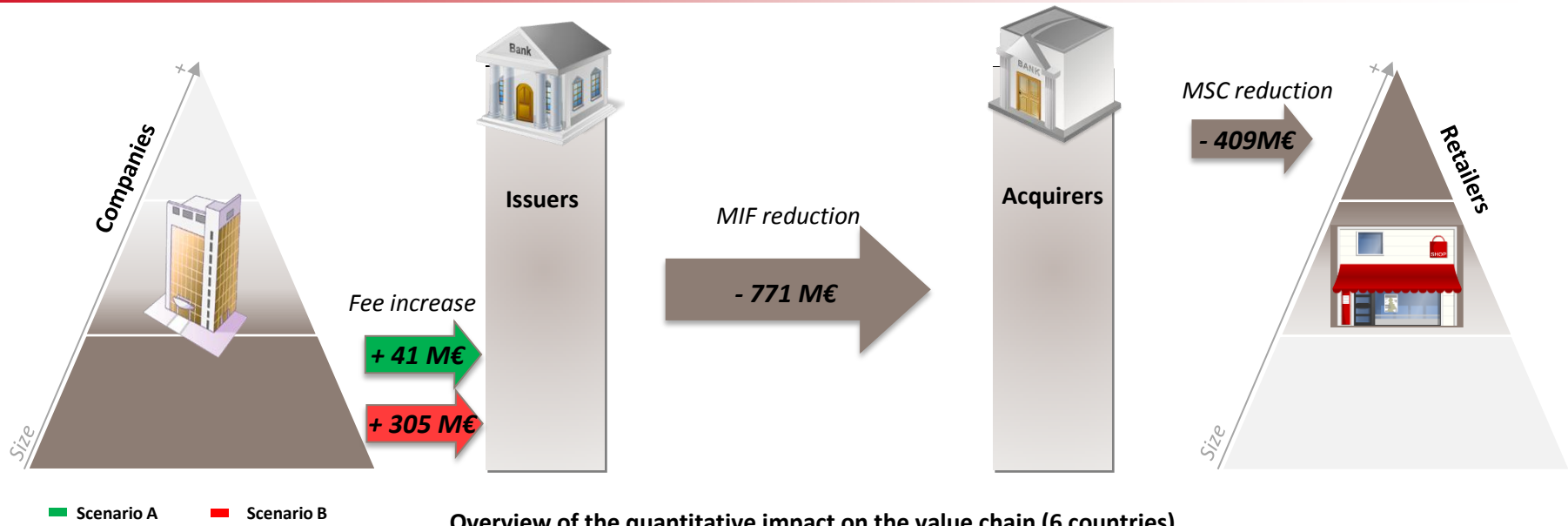
## Quantitative impacts assessment – Fees (3/3)

- Focus on fee increase (card fee panel):



# Impact assessment

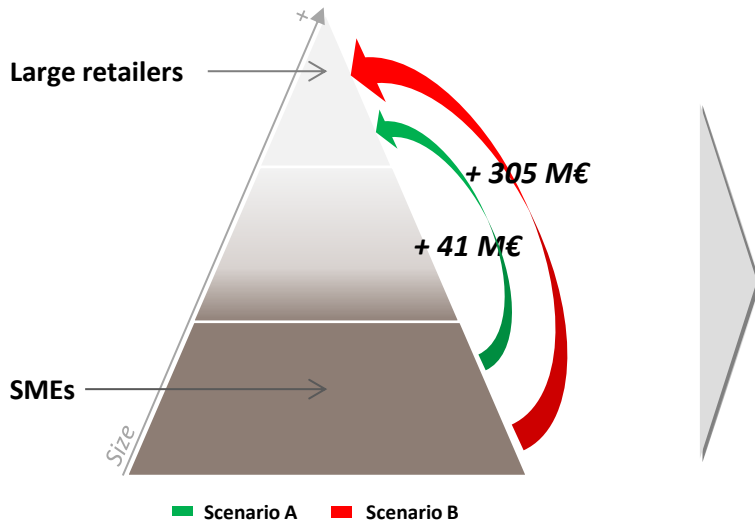
## Quantitative impacts assessment – Value chain



- Consequently to the massive transfer that will take place between Issuers and Acquirers, a counter balance is predictable at the boundaries of the chain, involving both retailers and companies:
  - On the Issuing side, large companies will likely be protected from the regulation side effects, while on the other hand small ones will have to contribute to this new equilibrium
  - Regarding the acquiring market, the same conclusion can be drawn, where only retailers with high negotiation power and interchange rates awareness will fully benefit from a MSC reduction

# Impact assessment

## Quantitative impacts assessment – Value chain



- Arbitrary cost transfer:

Applying the interchange cap on commercial cards will change the P&L profile of each player: it appears that a costs transfer will indirectly happen, from the SMEs using commercial cards to the large retailers

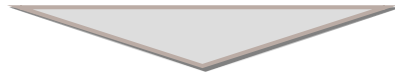
- Considering the heterogeneity of the European commercial card landscape, scenario A may prevail on a particular national market, while scenario B would be enforced on an other
- Quantitative evaluation shows that merchants may only partially benefit from the interchange cap and SMEs are more likely to contribute to mitigate it.
- Commercial card development within SMEs will be jeopardize while businesses clearly look for efficient solutions in expense management



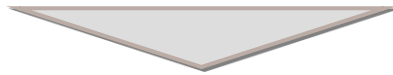
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# Business consequences for merchants

- **Quantitative analysis has presented an estimate of the benefits for merchants: MSC cost savings of 409M€, after the capping of interchange fees (in 6 countries: UK, FR, DE, IT, SE, PL)**
  - The benefit for merchants is subject to be reviewed if higher scheme fees are passed to merchants
- **Distribution of benefit for each merchant category in each country will not be equal**
  - Market profile different per country
  - Merchant billing practices not harmonised - Usage of Interchange + model underdeveloped in several market



- **The distribution of benefits will be very limited for small merchants**
  - Only large merchants from T&E sector will benefit from cost reduction, considering the knowledge on MIF level evolution and the capacity to negotiate they have
- **There is no evidence that this cost reduction for merchants will lead to lower prices at retail store**
  - No reason for merchant to pass through the cost reduction to retail prices



- **Considering the advantages of accepting card payment, principal risk for all merchants would be that many customers turn away from card efficient payment method**
  - Higher credit risk : with card payment, the credit risk is transferred to the card issuer
  - Longer payment terms : with card payment, the merchant can benefit from 2 to 5 days payments, improve cash flow management and optimize cost for payment data collection process
  - Make it more complex at the Point of Sale: less card payments, more paper, cash payments.., that is unrealistic considering the needs of T&E merchants and commercial cards users

# Business consequences on the offer

- Commercial card profitability decrease directly linked to the interchange cap: the quantitative analysis on 6 countries shows a loss of 771 M€ for commercial card issuers
- Players will react by restructuring their value offer
  - Building new product packages
  - Reduced standard travel assistance
    - Delayed flight, missed departure
    - Luggage
    - Hospital, medical expenses
  - Reduced standard business insurance
    - Related to electronic goods: phone, laptop, GPS...
    - Related to mobility: car, driving licence, keys
  - Leverage on new products to develop value added services
    - Virtual card
    - Lodge card
    - Expenses control
- Some issuer could leave the game due to the additional pressure on margin. This may lead to a competition slow-down on current products

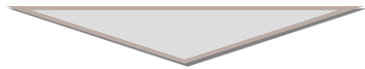


Benefits on commercial card packages may decrease, but for large companies, new products and services are likely to be developed

# Impact assessment

## Business consequences on SMEs

Payment card ecosystems are mainly based around interchange



As interchange is not paid by SMEs, capping it would clearly not decrease their contribution to the system



The post regulation situation would be unfavorable to SMEs and will likely hamper the commercial card development, by reducing the demand on commercial card products

- Commercial cards adoption will decelerate as issuer rebates will surely be drastically reduced to mitigate their profit loss
- SMEs adopting commercial payment products will be steered to reduced packages
- Credit benefits linked to commercial card usage may cruelly miss to small companies



SMEs may face benefits reductions on rebates and services and have not yet any credible alternative solution to commercial cards

# Impact assessment

## Specificity of commercial cards market

- **Commercial cards are very different from consumer debit or credit cards**
  - Merchant working with business customers have to deal with much more complicated procedures and information flows
    - Accounting, invoice processing
    - Tax paperwork
    - Payment term negotiation
    - Late payment and dispute handling
  - Therefore, costs and benefits, partially shared between players through interchange, have not the same structure compared to the consumer card ones
- **Commercial cards benefits for merchants also includes**
  - Wider access to customers who require high quality payment services
  - Improved services to customers who spend two times more, compared to consumer card users (110€/53€)
- **Some merchants further leverage on payment instruments dedicated to businesses by deciding to accept even costlier 3-party schemes**



Specificity of commercial cards should be taken into account while determining the corresponding MIF level

# Impact assessment

## Specificity of commercial cards market

- **MIF determination with MIT (Merchant Indifference Test)**

- Payment instruments: debit card, credit card, cash
- Costs survey perform on a merchant sample
- Evaluate the Marginal Cost (MC) of Payment Instrument (PI)

- The level of MIF is assessed for a Payment Instrument (PI) as follows:

- Marginal Cost of the PI =  $MC(PI) = (\text{cost per transaction}) + (\text{cost per unit of turnover}) \times (\text{Average Transaction Value of PI})$
- MIT MIF =  $MC(PI) - MC(Cash)$

Electronic Funds Transfer, Cheque and Paper invoices are also widely used in B2B transactions

On a business trip: Airline tickets, car hire and an hotel stay are not often paid in cash

As seen above, consumer and commercial cards costs and benefits structure cannot be compared

The Average Transaction Value (ATV) is two times higher compared to consumer cards

- **Trouble in using the same test parameters for commercial cards**

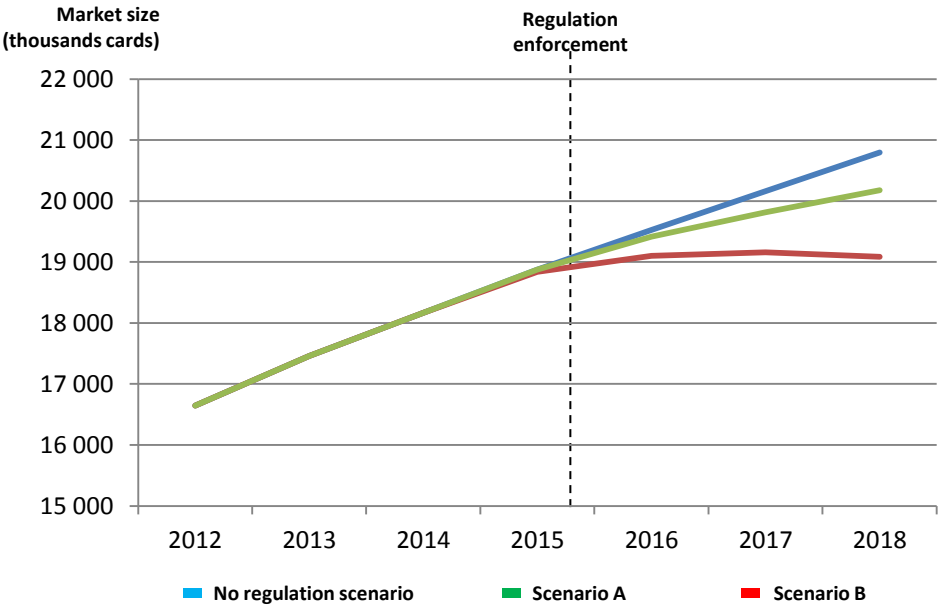
- Limited size of the commercial card market
- Card usage within specific and limited merchant categories, different from the MIT sample
- Indifference versus cash cannot be used

Commercial card and consumer card should be treated as two different payment instruments. Merchant Indifference Test (MIT) is not applicable.

# Impact assessment

## Prospective analysis

- Market size prospective analysis (2012 – 2018):









The regulation will have an impact on the commercial card market development and previous forecasts and business plans may be at stake

- Scenario A: assuming a limited fee increase and some package restructuring accepted by a majority of companies, the regulation would hamper the commercial card market anyway, mainly because of suppression of rebates and incentives for companies
- Scenario B: a strong fee increase together with a reduction of services provided on commercial cards would clearly put a quick stop to the commercial card sector growth in the EU

# Impact assessment







## By country

	Merchants	Acquirers	Schemes
<b>UK</b> 	Most of merchant will -at least partially- benefits from IC cap	Big players will benefit from the regulation and gain market shares	Large competitive advantage will be given to 3 party schemes
<b>France</b> 		Big players with high processing capabilities will be able to gain market shares	CB local scheme already applies an average interchange with a cap at 0,28%
<b>Germany</b> 	MIF reduction benefits unlikely to be passed to small retailers	Large acquirers are present on this market, will leverage on this new situation	3 party scheme competitors will be able to deeply benefit from the regulation on this high quality demanding market
<b>Italy</b> 		Large acquirer players are also issuers and may partially mitigate the MIF revenue loss	Some of the large issuers could reconsider their 4 party schemes card program and choose new 3 party schemes partnership program for commercial cards issuance
<b>Poland</b> 	Only a small proportion of merchant will benefit from the MIF cap through MSC reduction	Impact on acquiring side has already been noticed since national regulation on interchange has been enforced on July 2014	Strong growth of 3 party scheme market share in recent years (2013, 2014) will be fostered
<b>Sweden</b> 			4 party scheme already in a difficult position on this market will be strongly impacted



# Impact assessment

## By country

	Companies	Issuers	Card products
<b>UK</b> 	As card is widely used, the impact will be felt at national level	Will face the largest IC loss in the EU	Strong fee increase and products range restructuring are very likely
<b>France</b> 	SME's could reconsider the benefits of commercial cards if card fees and bank fees increase considerably.	Most of issuers also have an acquiring activity, which may mitigate IC loss and enable them to gain market share on other players	Some issuer will have to review their commercial cards' strategy: reduce the range of product and reconsider the different scheme issuing programs
<b>Germany</b> 	Large number of business travelers do not benefit from commercial card	Issuers will be strongly impacted as their do not have acquiring activities	Reduction of product range and offer by issuer will give a competitive advantage to some 3 party scheme products
<b>Italy</b> 	A lot of credit related benefits will be lost by SMEs: <ul style="list-style-type: none"> <li>➤ currently 75% credit/charge cards</li> <li>➤ high credit access needs within SMEs</li> </ul>	Market concentration on issuing side; middle-sized banks could choose to leave the commercial card market	Switch to consumer card expected in case of fee increase
<b>Poland</b> 	Impact will be heavily directed on SMEs as they account for a larger market share compared to other countries	Impact already noticed on issuing side: preventive increase of card and bank fees	Impact already noticed on products: reduction of benefits on new deals
<b>Sweden</b> 	Companies more likely to switch to other payment instruments (considering their expense management practices: currently not based on commercial card)	Current effort of card issuer to develop rich and easy-to-use alternative card solutions could be stopped by the new legislation	Threat on the existence of general purpose commercial cards

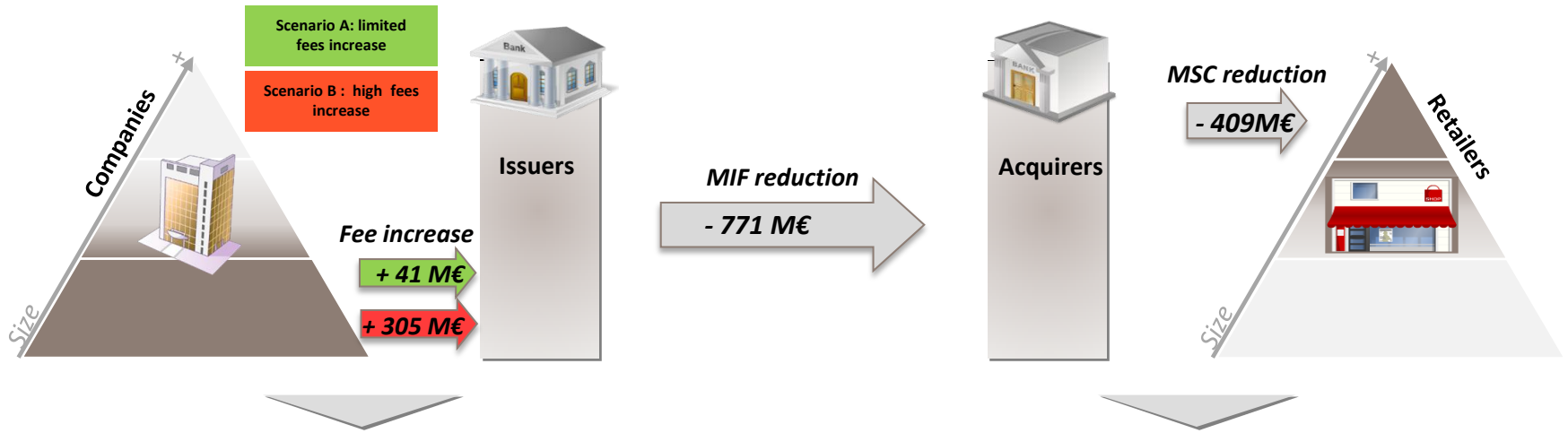
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# Impact assessment

## Conclusion

- ❑ Interchange fee is a mechanism used to distribute the cost of delivering the service between all parties that benefit from the card system.
- ❑ European Parliament position is to plan to cap the interchange fee level of all cards based transactions: for debit and credit cards and including commercial cards
- ❑ Therefore, the cost distribution will be reallocated:

Quantitative impact assessment of the MIF reduction in 6 leading European markets after interchange capping



Up to 45% (in average) of fee increase can be forecasted on some country, mainly concentrated on small players:  
 Therefore it can be up to 70% increase (more than +30€/card) for SMEs and sole traders

Large retailers will benefit from the MIF decrease:  
 It is assumed that less than 10% of the MSC reduction will go to medium and small retailers

- **Unfair reallocation of costs**
  - SMEs will support additional costs (up to 70% of increase on SMEs/sole traders fees) while large companies are more protected from price raising thanks to their size, negotiation power and strong relationship with their banks
  - Large T&E merchants will strongly benefit from MIF decrease, whereas small retail are unlikely to immediately renegotiate their contract
- **Less benefits for commercial card users (companies and retailers)**
  - As a result of MIF capping, card issuers will be forced to reduce their commercial card offer (e.g. less credit facilities, features to automate invoice processing...) to mitigate the MIF revenue losses
  - European SME's will face a difficult choice:
    - Either to give up the use of efficient commercial cards services:
      - All the associated credit benefits
      - automatic expenses statement management
      - internal expenses management facility
      - paperless invoice processing and reconciliation
    - or support strong card fee increase
    - Moreover, they will face the lack of existing and efficient alternative solution to commercial cards
- **Less competition and high risk for the development of electronic payment**
  - Price and margin reduction will lead some issuer to abandon their commercial card program
  - Corporate cards services will be provided by a limited number of large card issuer; they will compete on the market only for large deal to meet multinational companies demand
  - Innovation in payment services for European companies will be hampered by lack of investment

- **EU objective: market harmonization**

- Regarding the differences in market situation:
  - Markets where financial institution are both issuer and acquirer will more likely safeguard their commercial card products, unlike countries where acquiring is more specialized activity
  - Commercial card development in relatively immature markets will not benefit from the incentive of interchange to catch up mature ones level
  - Different level of competition on commercial card market will lead to divergent levels of card fees. Same on the acquiring side, MIF reduction pass-through will be various, leading to create competitive advantage to certain T&E merchants.
- Impact and consequences of the regulation will be very specific by country, and could even result on contradictory evolution
- We consider that the **new regulation will fail in harmonizing the commercial card market**

- **EU objective: fraud, traceability, treasury**

- Card based transactions are efficient to **fight against fraud** with a global approach through the promotion of the EMV standard and the associated liability rules imposed by card schemes
- Traceability is also a key asset within the use of card in B2B payments: the electronic recording of transaction is an effective tool against black market and **underground economy** especially concerning SMEs
- Hampering the commercial card market growth would be **counterproductive regarding EU objectives** on late payments, e-invoicing, electronic administration: commercial card solutions are designed to address these needs.

### European Parliament proposal to include commercial cards in the legislation implies to place these on the same level than consumer cards

#### **Commercial cards market is totally different from consumer cards market:**

- ✓ Limited in size
- ✓ Offer comprehensive solutions with many integrated services that benefit to all market stakeholders along the 4-party model: European companies (whatever their size), Merchants, Employees, T&E industry
- ✓ Card usage within specific and limited merchant categories, different from the MIT (Merchant Indifferent Test) retailer sample
- ✓ The MIT versus cash cannot be used as cash is not the alternative to commercial cards
- ✓ Globally, almost all parameters and assumptions used for MIT are different between the consumer and the commercial card market

**Commercial card and consumer card should be treated as two different payment instruments.**



**The specificity of commercial card solutions must be considered by regulators: a differentiated approach would be more efficient and preserve benefits delivered to all party involved.**

## PART 3: 3-party vs 4-party scheme issue

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1. Regulatory context
2. Presentation of 3-party system
  - General architecture
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4. Arguments for the inclusion of 3-party scheme in the regulation
5. Conclusion



# 3-party vs 4-party scheme issue

## Regulatory context

- E.U. project of regulation (amended version, *European Parliament, April 2014*)
  - *Inclusion of commercial cards in the capping of Interchange fees (article 1)*
  - *Exclusion of transactions with cards issued by three party payment cards schemes, except when their volume exceed a threshold set by the Commission*
  - *Acknowledgement of the existence of implicit interchange fees, when three party card scheme use service providers as issuers or acquirers*
- EU definitions:
  - **Three party payment card scheme**
    - a payment card scheme in which payments are made from a payment account held by the scheme on behalf of the **payer** to a payment account held by the scheme on behalf of the payee, and card based transactions based on the same structure.  
**When a three party payment card scheme licenses other payment service providers for the issuance and/or the acquiring of payment cards, or issues payment cards with a co-brand partner or through an agent, it is considered as a four party payment card scheme**
  - **Four party payment card scheme**
    - a payment card scheme in which payments are made from the payment account of a *payer* to the payment account of a payee through the intermediation of the scheme, a payment card issuing payment services provider (on *the payer's* side) and an acquiring payment services provider (on the payee's side), and *card based* transactions based on the same structure
  - **Interchange fee**
    - a payment card a fee paid for each transaction directly or indirectly (i.e. through a third party) between the payment service providers of the payer and of the payee involved in a payment card or a payment card-based transaction
    - “net compensation” considered for the calculation of the amount of interchange fee:  
Concept of net compensation: “total net amount of payments, rebates or incentives received by an issuing payment service provider from the payment card scheme, the acquirer or any intermediary related to the payment transaction or related activities”

# 3-party vs 4-party scheme issue

## Regulatory context

- Evolution of the project of regulation (Council of the European Union, October 2014)
  - Exclusion of commercial cards transactions in the capping of interchange fees, but following the new definition of commercial cards formulated by the EC (see the definition hereafter), not all cards transactions will be exempted
  - Exclusion of transactions with cards issued by three party payment cards schemes, except if:
    - the three party payment scheme is using payment service providers as issuers or acquirers
    - the three party payment scheme is working with licensees for the development of issuing or acquiring activities
- New definition of commercial card product:
  - “commercial card” means “**any card-based payment instrument** issued to undertakings or public sector entities or self-employed natural persons **which is limited in use for business expenses** where **the payments made with such cards are charged, directly or indirectly, to the account of the undertaking** or public sector entity or self-employed natural person”
  - This means, that all Business and Corporate cards transactions charged to the personal account of the employee won't be considered as commercial cards and as such, capped by a maximum interchange fee of 0,2% for debit card and 0,3% for credit card
- Clear distinction required between commercial and consumer cards, from a technical and a commercial point of view: under the responsibility of the PSP

# 3-party vs 4-party scheme issue

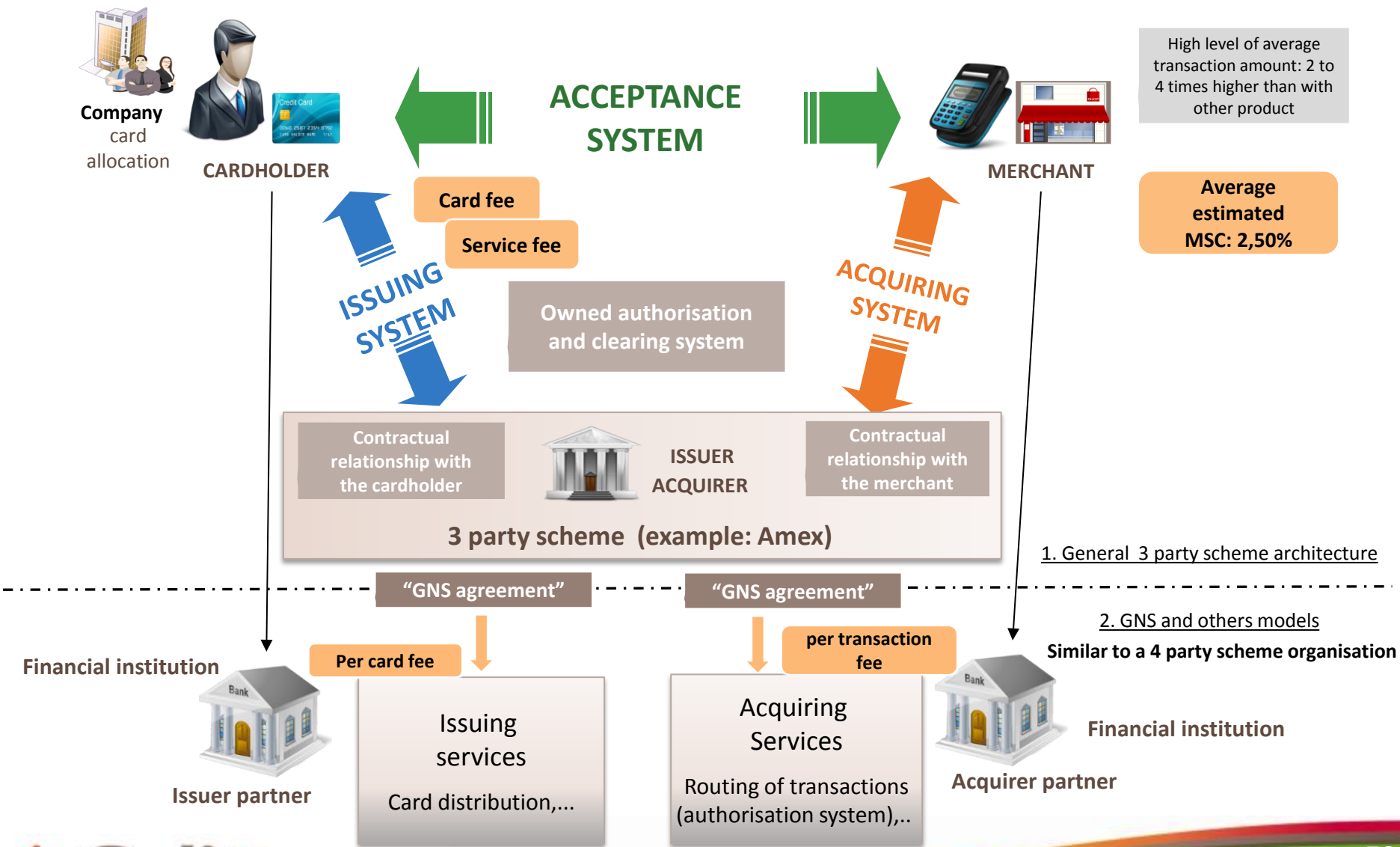
## Upcoming regulation – Scheme comparison

- Differentiation between 3-party and 4-party in the regulation

Issue	3-party scheme	4-party scheme	Remarks
<b>Capping of interchange fee</b> maximum of: - 0,2% for debit card transaction - 0,3% for credit card transaction	<b>Does not apply</b> (*)	<b>Apply,</b> if the total transaction amount is debited on the account of the employee (**)	(*) capping of interchange fee should apply in case the three party schemes works with issuer or acquirer PSP partners; it would be considered as 4 party scheme in this case  (**) <u>Does not apply</u> if the total transactions amount is charged on the company or on the public entity account (reference to the new definition of the commercial card proposed)
<b>Separation of payment card scheme and processing entities</b> (art.7)	<b>Does not apply</b>	<b>Apply</b>	The new rule will apply in 2 phases: Phase 1: after few months (to be defined), separation of accounting and organisation Phase 2: after 3 years (tbd), separation in terms of legal form and decision making process
Licensing	Apply	Apply	Any territorial restriction prohibited in the European Union for licensing agreement (issuing of payment card or acquiring card transactions)
Co-badging of card and processing rule	Apply	Apply	No restriction to co-badging on card imposed to issuer No restriction to processing of authorisation and clearing by different entities
Choice of application at the point of sale	Apply (but few co-badged product currently)	Apply	Choice determined by the payer (the customer) at the POS Prohibition of any mechanism that limit the choice of the payer at the POS (when using a co-badged payment instrument)
Unblending	Apply	Apply	Transparent pricing from the acquirer to the merchant with separate MIF level and fees by scheme, brand and product
“Honour all card rules” application	Apply	Apply	Acceptation by the merchant of all type of cards subject to a regulated interchange fee (e.g.: debit cards)

# 3-party vs 4-party scheme issue

## 3-party to 4-party – Evolution of "Closed-loop" model



# Global Network Services (GNS) and similar models

- GNS and others models type : wide range of different partnerships
  - Set-up of partnerships with financial institutions, dedicated to the development of the 3-party scheme through distribution agreement or other contractual agreements
  - Business case based on fees paid to the partner per card distributed or per signing merchant
  - Situation where 3-party schemes behave like 4-party schemes
- Four different models :
  - **Licensee model (= GNS)**: the 3-party schemes grant an issuing license to a bank to directly issue cards to their customers. For American Express, this model accounts for about 15% of Amex volumes
  - **Agency model**: the 3-party schemes issues the cards and recruits the banks as agents to promote and distribute Amex cards to their own customer base. The bank receives, from the 3-party schemes , an incentive which is similar to interchange
  - **Referral model**: the 3-party scheme remains the issuer, and it has a direct relationship with the cardholder. The partner (today usually a bank) refers / provides 3-party schemes access to its customers and, in return, receives a compensation similar to interchange
  - **Co-brand model**: Amex issues the cards and partners with a merchant which acts as agent to distribute card and provides Amex with privileged access to its customer's base. Co-brand partner is compensated through a lower merchant service charge and through additional incentives (e.g. acquisition of air miles). Co-brand portfolios account for about 23% of the cards and over 40% of the volumes (3-party schemes )

# Global Network Services (GNS) and similar models

- **Examples of services provided on the issuing side:**
  - Promotion of card products in the card offer of the financial institution
  - Signing of new corporates (for card allocation to employee) and cardholders
  - Distribution of 3-party scheme cards
- **Examples of services provided on the acquiring side:**
  - Promotion of 3-party scheme acceptance offer – co-branding agreement
  - Signing of new merchants
  - Provision of POS terminal, merchant customer service and technical assistance
  - Routing of the transaction to the Amex authorization system
- **American express strategy through the GNS and others models**
  - Various type of partnerships: Independent Operator (IO), Network Card License or J.V.
  - Flexible business model: possibility to tailor organisation and revenue stream to each market
  - Partners bring: local market knowledge, own brands and distribution networks,..
  - Presented as an attractive alternative to 4-party scheme value proposition since 2003 by American Express

# 3-party vs 4-party scheme issue

## Impact of the new regulation

- Implementation of “net compensation” for the calculation of the interchange
  - For all issuers, the net compensation concept will strongly limit the investment capacity for the development a new products and services dedicated to companies
- New definition of commercial cards
  - The regulation would refrain 4-party schemes and issuers to propose commercial cards products directly linked to the employee account (even if the risk management policy is based on such architecture on issuer side today), which represent the vast majority of cards issued
- 3-party vs 4-party scheme
  - Incentives given to 3-party model choice could benefit to leading 3-party scheme in Europe
  - Profitability of commercial cards will be strongly affected in 4-party model (e.g.: business cards for SME’s)
  - Some issuers could withdraw from the market (concentration of players and risk of less competition) or give-up the 4-party model

### American Express in European commercial cards market

- Estimated 12% market share in card issuing (all type of commercial cards)
- Stronger position considering the Corporate, purchasing and more generally the premium card market, where Amex has a leading position in most of the European markets
- High total transactions value for commercial cards, considering the average transaction amount, which is very high

# 3-party vs 4-party scheme issue

## Impact of the new regulation

- Unequal situation for 4-party card scheme vs 3-party
  - New regulation on interchange won't strongly impact 3-part scheme like American Express
    - Only few cases where GNS or others partnerships are concluded, will imply the capping of fees, rebates or incentives received by the Amex partner, since Amex seems to have a limited number of partners in Europe (Amex's announcement in 2013: total number of 27 partners)
    - In commercial card type where Amex has a leading position in Europe (Corporate, Purchasing and Premium cards), most of the cards are linked to the company's bank account; transactions with these cards would be excluded from the regulation
  - Transparency of the business case
    - New regulation will impose a complete transparency of the business case and a cost-based approach to 4-party scheme, while in most cases, 3-party scheme will set services prices without any control
    - 3-party scheme will continue to sign individual and bilateral licensing arrangements with partners
- Severe consequences for issuers in 4-party scheme model
  - Redistribution of costs imposed in the value chain of 4-party schemes only
  - Interchange capping targets mainly 4-party scheme while 3-party scheme could remain unregulated
  - Possibility for 3-party scheme to circumvent the new regulation and adapt GNS and similar models
  - Less possibility for issuers of 4-party scheme to invest in new products and solution even if:
    - The cardholder choice at the Point of sale will reinforce the necessity to invest in order to differentiate issuing products from the competitors
    - Issuer will have to incentive and give advantages to the cardholder to make their products used at the POS
    - Issuer shall invest in new partnerships with merchants and loyalty program partners



# 3-party vs 4-party scheme issue

## Impact of the new regulation: business perspectives

- **Impact on the commercial card offer**
  - Decrease of card profitability for 4-party scheme issuers will cause restructuring of their offer (reduced product packages and services)
  - Very limited decrease (or no impact at all) for the card profitability of 3-party scheme
  - Risk of new and non-consistent market segmentation for commercial cards, where only corporate and premium card products would benefit from new investments
    - Fierce competition on the market only for the issuance of premium product dedicated to large corporates
    - Reinforcement of the market leading position of Amex in this respect
    - Less investment predictable for products dedicated to SME's (vast majority of them, linked to employees account, will be regulated), where American Express is much less dominant
- **Impact for merchants**
  - The development of interchange + model forces the 4-party scheme to decrease MSC proportionally
  - 3-party scheme could face some pressure for price decrease, but will be free and will have the time to adapt their model accordingly
  - T&E merchants will continue to pay higher discount rate to capture high transactions value from corporate and premium cards, where Amex is predominant
    - No reason for merchants to terminate the acceptance of cards with very high transaction amounts
    - Merchants will be obliged to accept the cards chosen by the client (card solutions with enhanced expenses management solution and rich reward and loyalty programs)

## 3-party vs 4-party scheme issue

# Arguments for an equal treatment in the regulation

- **Necessity to guarantee the same legal conditions to market players in order to ensure a level playing field for all card schemes and financial institutions in Europe**
  - Bank partners could give a priority to 3-party scheme like Amex when launching a new card program, if the issuer can benefit from uncapped financial compensation
  - New situation will allow American express issuing partners to propose superior value proposition to cardholder thanks to the fees received by the scheme: rich rewards, incentives, special offer,..
    - Possibility to extend the reward program for co-branding card products
    - Capacity to fund marketing programs to encourage card spending
  - Transparency on fees, rebates, incentives should apply to all schemes and all market players
    - Amex 's merchant should be authorized to demand a detailed description of merchant discount by law
- **No justification for the differentiation between 3-party and 4-party model**
  - Similarities between 3-party using GNS and similar models and 4-party schemes are obvious
    - Since 2003, expanding strategy of American Express partly based on GNS business; today, more than 25% of Amex cards would be issued through GNS partnerships
  - The development of GNS and similar models partnerships will never be under the control of the authorities
- **No reason for giving a competitive edge to 3-party organisation**
  - 3-party schemes currently cover all the market demand for commercial cards, for merchants and companies of all sizes, with a wide range of cards and solutions

# 3-party vs 4-party scheme issue

## Conclusion

- **Competitive advantage for 3-party scheme organisations in the current legislative proposal on interchange**
  - Regulated framework with capped transactions will mainly impact 4-party scheme
  - No clear regulatory framework for 3-party schemes: uncertainty about how these schemes will be regulated
  - Transparency of schemes rules and pricing structure not guaranteed for 3-party scheme
- **New legislation could deeply impact market organization and market offer**
  - Incentives for the development of 3-party scheme model, with the risk of higher costs and higher prices on both side of the value chain, in contradiction the E.U. objectives
  - Redefinition of the investment strategy for issuers and acquirers in commercial card business
    - 4-party scheme issuers will have to invest a lot to remain competitive in premium card market
  - Amex will reinforce its leading position in corporate and premium cards market
- **Pending questions**
  - **Regarding the calculation of the interchange applied in 3-party scheme**
    - Definition of the regulated “area”, considering the situation where 3-party schemes can run a number of different 4-party models type, that could imply/or not imply MIF capping ?
    - Calculation of the “net compensation” (total amount of fees, rebates, incentives received by issuer or acquirer partners in GNS and similar models)?
  - **Regarding the application of the regulation itself**
    - How to control 3-party scheme model and practices mostly based on bilaterally and confidentially negotiated arrangements ?