EU Capped Interchange:
Who's making a success of the new rules?

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The Rules Of The Game Are Changing...

....But Don’t PANIC!

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Interchange Fee Regulation Have Been Coming For Some Time...

- **2013**: Proposal for a regulation on interchange fees for card-based payment transactions (MIF Regulation)
- **2014**: Working party discussions – further amendments proposed
- **2015**: Regulation adopted by Council
- **2016**: MIF Regulation enters into force
- **2017**: 9th December
  - Interchange fee caps came into force
- **2018**: December
  - June 2016
    - Unblended, co-badging, application selection and honour all products rule abolished
  - December 2018
    - Three party schemes no longer exempted and review of the MIF regulations
What Does It Mean?

Key elements within the scope of MIF Regulation:

- Fee caps: 0.2% for consumer debit cards; 0.3% for consumer credit cards
- Caps apply to both cross-border and domestic card-based payments
- Applicable to card transactions at POS, on the Internet and on mobile
- Four-party payment schemes are within the scope of this MIF regulation
- Three party schemes working with external issuer/acquirer will be considered four-party and subject to IC caps
- Removal of Honor all Products element from Honor all Cards rule

Key elements out of scope of MIF Regulation:

- ATM withdrawal transactions
- Some commercial cards are not subject to IC caps (employer vs. employee settlement)
- Three party payment schemes (e.g. American Express)
- Limited network – specific instruments used in a limited way (limited goods and services)
There Are Different Scenarios For Different Players

Issuer banks look for ways to “offset” the loss of revenues, such as cutting loyalty programs or increasing cardholder fees.

Microeconomic impact in how cardholders behave, e.g. cardholder turn to less expensive payment methods such as debit cards or cash.

There is room for “windfall” profits as acquirers might not pass full reductions to merchants immediately. In the long term margins will be squeezed due to lower MSCs and higher pricing transparency. Scale will become even more critical.

Macroeconomic impact in how the market reacts, e.g. smaller issuers look to exit to market.

Reduced cost of acceptance and changing requirements in payment acceptance, i.e. more selective of card types! “HACR” plus no surcharging for regulated products.
Has It Happened Before?

The lesson from Australia...
15 Years Ago In Australia

**Before regulation**
- Australian issuers’ interchange revenue: AUS$ 23.52/per card/quarter

**After regulation**
- Australian issuers earning in interchange revenue: AUS$ 9.30-10.30/per card/quarter (in 2007)

**40%-42% decrease in interchange revenue**

Issuers increased credit card related fees following the regulation as a way to counter balance the losses in interchange revenues

**Other initiatives:**
- Fewer rewards benefits
- Companion cards (Amex, DC)
- Sub-segmentation
- Additional interchange categories (wider spread)

Source: EDC Analysis (2013); Reserve Bank of Australia (2013); Mercator Advisory Group (2007)
The Qantas Approach

Qantas expanded its banking and merchant partners increasing the earn and burn locations.

New Strategy ➔ Multi Partner Open Model

- Qantas revamped its frequent flyer program, giving members the opportunity to book "Any Seat" on Qantas and Jetstar flights.

- In 2008, Qantas partnered with several issuers for direct earn cards including ANZ Australia and New Zealand cards, Earth Australia, Diners Club Australia and American Express Australia.

- Frequent flyers previously could only earn points by producing a separate Qantas Frequent Flyer Card each time they made a purchase.

20 Card Partners
Capped IC will dramatically impact the co-brand economics.

The co-brand product proposition has been diluted.

- Customer acquisition costs will increase.
- Operational costs have to decrease.
- Co-brand revenues will decrease.
- Sale of air miles will go down.
Before the IC caps the co-branding model was established and worked.

1. **Customer** signs up for account.
2. **Customer** enrolls in loyalty program.
3. **Airline** participates.
4. **Issuer/Banks** pay for program management and for new accounts.

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Miles and rewards flowed around the model

- **Bank pays partner for currency**
- **Bank earns interchange on transaction spend**
- **Customer spends €£$ on partner cards**
- **Partner provides customer rewards**
- **Earns miles/rewards for €£$ spend**

**Issuer Banks**

**Airline**
IC caps put the traditional co-brand model into jeopardy

- Bank pays partner for currency
- Bank earns interchange on transaction spend
- Earns miles/rewards for €£$ spend
- Partner provides customer rewards
- Customer spends €£$ on partner cards

Airline

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Impact

Decrease in co-brand interchange earnings will squeeze program margin and erode airline and issuer bank earnings dramatically

• 3 party co-brand systems are affected in many countries as well;
• Commercial card out of scope, but defined more rigorously
• Both will be reviewed in 2018

Customer proposition will erode

• Mile earning ratios will have to be lowered
• Price per mile will decrease
• Bank card fees will be increased on all positions

Card schemes likely to support but will not make up the difference
Must assess the payments system holistically – 360º

1. Reposition the co-brand card program and loyalty programs
2. Open up new distribution channels
3. Re-evaluate “exclusivities”
4. Work with issuers to re-price

Issuer
Banks

Acceptance
Issuance

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Refine and optimised the acceptance strategy

1. Reward customers for using certain payment methods

Incentivise "high-yielding" transactions

Surcharging Policy

2. Review miles/reward earn policy for disloyal transactions

Issuer Banks

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Q&A
Thank you

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