

## **Nonbanks in the Payments System: Innovation, Competition, and Risk**

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Panelist Remarks

Moderator: Ken Howes, Director, Edgar, Dunn & Company

Panelist: David Yates, President, Europe, Middle East, and Africa, First Data International

**Mr. Yates:**

Good afternoon. My name is David Yates. I am the President of First Data in Europe, Middle East and Africa. I would like to take a few minutes to talk about the topic of horizontal integration in the context of what is going on in the SEPA environment in Europe.

About four years ago, before I joined First Data in Europe, First Data had been in Europe for about 12 years, having acquired a national credit card processing company in the UK and, in the intervening eight years, had made no progress in getting into the rest of the Europe at all. As I stand here today in 2007, First Data in Europe is actually an extremely local company within the European Union and the nearby surrounding countries. We are no longer just a pure credit card processor. We are a company that does debit card processing, Islamic banking products, acquiring point-of-sale deployment, point-of-sale financing, switching, ATM driving-switching, etc. Having taken ourselves from being a very Anglo-Saxon model—a very U.S.-British

model—we have moved into Europe. We now have 7,000 people on the ground.

Without horizontal integration, the ability for us to do this simply would not be there at all. What happened on the ground to make all of this possible? There are several different things. Probably first and foremost amongst these is a groundswell of demand amongst the European banking community. If you take a look at what has happened since the Iron Curtain came down and analyze the ownership of the banks in Europe, what you suddenly find is that, throughout most of Central and Eastern Europe, the ownerships of the banks have completely changed hands.

The Italians, the Austrians, the French, the Dutch, everybody has piled into the new EU countries, changing the ownership structure of the banks within those countries and creating, if you like, a set of operations which are very highly profitable right now, but in many cases subscale. If you think about a Scandinavian bank moving into Latvia, it is very exciting to have a profitable new market, but – as the market conditions rationalize – what they find is they become a subscale provider within that market and end up looking to an organization like ours that can consolidate multiple volumes in Latvia under a central platform that we run Europe-wide.

First of all, the banks have consolidated their operations. Secondly, you have the same phenomenon going on with the retailers.

If you look at Tesco, Carrefour, McDonalds, and Burger King, there is a ubiquity of retailers across Europe asking for coherent and sensible acquiring solutions in all these countries from a single supplier, if possible, where they can negotiate decent terms of conditions and have a rational structure that fits in with their point of sale and the back-office systems and the treasury systems and not just a patchwork quilt of completely incompatible systems across the entirety of Europe.

So, from a banker's perspective and from a merchant perspective, that is what is going on. Consumers, of course, have traveled much more extensively. The exchange of people backward and forward across borders in Europe is huge. There is a massive travel from, let's say, Latvia, Lithuania, to my country, Ireland, where I would say about a quarter of the cars in Dublin now are registered from Baltic countries and not from Irish drivers at all. The same thing has happened in the UK, France, and Spain—just a huge interchange of people. So, banks, retailers, and people are all moving around. And last but not least comes on top of this the whole SEPA program.

What is SEPA? SEPA, in my mind, is the political will to create a united Europe—United States of Europe—from a payments' point of view. It already is a reality in two senses. It is a reality from the point of view of physical cash, so we have the euro in our pockets. And the exchangeability and convertibility or usability of our cash is extremely

easy everywhere we are in euro land. The people in the countries like that.

That same ease of use does not apply to electronic systems, and the only place where it sort of applies is within credit cards, where Visa and MasterCard created de facto interchangeability of credit card payments, but it did not happen within the debit space at all. So in debit, there is just no compatibility in Europe, none whatsoever, completely walled garden-variety networks of little national debit systems that are awfully incompatible from one country to the next country.

When you look at that as a backdrop and ask what is SEPA really, it is the political embodiment of a will to create a united Europe, and payments systems is one instrument to making that happen.

Actually, I had a presentation a little while ago from McKinsey, where the guy did a little trick around what the definition of SEPA was. They looked on Google and came up several. Some of them were things like these: Scottish Environmental Protection Agency, another one was the Southeast Power Administration of the United States, or southeastern Pennsylvania. Lots of definitions, but there are a couple of rather cynical ones that have come up quite recently. These are from Central European bankers, very senior folks, who like to indulge in these kinds of redefinitions of words. One of them defines SEPA as a Seriously Expensive Payments Architecture. In a

sense, if we do not have cross-border horizontal integration, that is exactly what it would end up being. We see ourselves at First Data as prime movers bringing this thing together and achieving the good kind of synergy and cost savings that makes mergers actually worthwhile.

Another one came up with a definition that quite annoyed me because he called it “Sending European Payments to America.” I thought it was having a little go at me. As an Irishman, that kind of irritates, grates every time. Actually, what this was about was a comment on concerns about the governance angle of this whole thing and a comment in particular on the hegemony of the two major schemes – Visa and MasterCard – where there is genuine concern among European bankers that, unless the European Central Bank and the Commission enforce the regulations they have been discussing, which are to separate the operation and governance of schemes from the choice of who processes those schemes, the banks will be tied to people who do not give them economic solutions.

The other piece of SEPA, which is extremely interesting, is the definition of the payments institution. What that does is it opens up the field to any player. In theory, if the economics of banks and processors like First Data and Equens, if we are unable to deliver the right economics, it opens the door to new plans like retailers to become a payments institution in their own right and would enable

them to participate in any scheme that gets developed—whether that is Visa, MasterCard, or something European.

What are we doing as we dismantle these national schemes, whether this is my friends at Equens or whether this is First Data, they looking after the ACH side, ourselves looking after the cards business? What we are doing is we are changing the business model completely. We are moving away from organizations that were not very market disciplined. They were allowed to operate on a full-cost-recovery basis or a nonprofit basis and forcing them to become economic providers of these services to banks. Understanding that, if we are not an economic provider to the banks and to our retailers and in the final analysis to consumers, then each of them has the choice to shop somewhere else and buy from a better economic provider. In that sense, what SEPA has created and the banking landscape has created is an environment in which there is real choice of supply and real choice of the economic model that we go with.

From our side, we view the consolidation processing into fewer fiercely competitive nonbank hands as something that is absolutely harmless. As I listened to the discussion today, I was fascinated to see the different perspectives that exist around the term “nonbank.” I am grateful to the meeting to have forced me to think about it because, from the regulator’s point of view, nonbank means everybody who is not a bank. But from a bank point of view, nonbank actually means

people like – well, they think about it simply differently. From the regulator's point of view, the issue is governance, and from the bank's point of view, the issue is, Will somebody cannibalize my business model? There, the real importance is a definition of what processors are doing, what part of the value chain they expect to take, and what schemes are doing, and what value the processing or what part of the value chain they want to take. This issue of governance will not go away, as we bring all of these different models together across Europe and then actually across the whole world, because there isn't such a thing as just a European processing scheme. We live in a global world. Europe is just making part of its infrastructure a little bit more accessible to all.

What we believe is there will be both horizontal and vertical integration of the European payment landscape. We think that is a good thing. We expect that to make the whole environment more competitive. We also agree that we will be down to probably no more than three to five organizations in the ACH business and probably about the same number in the cards business. There will be convergence between those two kinds of processing organizations, where each takes on the other's work. That will happen quite quickly within a period of probably the next 10 years.

From our side, just to summarize it, we are extremely excited about SEPA. We see it as a superb opportunity to provide real value

from horizontal integration from mergers, real synergy effects. What we do think is the governance issue does need to be sorted out and needs to be taken extremely seriously if all parties are to feel comfortable with the way this is moving ahead.

Thanks for your time.

**Mr. Howes:**

Thanks, David. Before we open up, can I just ask one question? You have mentioned the payment schemes there. How do you see the role of the payment schemes evolving in this new environment? Obviously, they have a lot to lose and a lot to gain potentially. How do you see that evolving?

**Mr. Yates:**

Ken, I really have no clear idea about how the payment schemes will evolve. As they change their ownership structures and become available to be purchased even by other organizations, that question is an open point. That is why the issuance of governance is of so critical importance to the banks. The only thing I would say is, whatever final form they take, it is very important to keep this logical separation of processing from scheme, so there is a freedom of choice effectively around the economics for all the participants, whether they are banks or merchants.



**Mr. Howes:** Gerard wants to...

**Mr. Hartsink:**

We should be very careful with the words “payment schemes,” because, from a European perspective, you have more the UK perspective for what the payment scheme is all about, that is old thinking. New thinking is an entity which manages business rules and standards for a scheme. It could be a card scheme. It could be a direct debit or a credit scheme. The owners are still today the banks in Europe. But the regulator was crystal clear, and the scheme management entity being the European Payment Council, will give a proper answer that also other stakeholders – being customers or vendors – should be also engaged in the decision making on the business rules and standards so that you create an open environment. And that is market reality in some of the markets in Europe. It is not at all market reality here in the United States or in other European countries. So, please be careful with the words.

**Mr. Howes:**

Thanks, Gerard.

Okay, we are going to open up for questions. There are three types of questions, it seems to me. There are questions that you might want

to ask of an individual panelist. There are questions that you might want everyone to respond to. And there might be questions you ask of an individual and then everyone else wants to respond to it as well. All of those are welcome. If, in fact, we have questions for the panel, I might take two or three together in the interest of time efficiency.

Who is first? There is one up the back.