

Position Paper

Online Payments in Europe

Key issues and requirements of Web Merchants in Europe

“Improve conversion”

10 recommendations



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E-Payments Merchant Initiative (EMI) by:



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1 Introduction

This paper is the third and final version of the positioning paper in which major cross-border European web-retailers and their representative e-commerce member organizations have collaborated in the past months (E-Payments Merchants Initiative). A first draft of the paper was released on March 22, 2011. Since then it has been reviewed by web merchants, their representative member organizations and involved payment stakeholders. This third and final version of the positioning paper will be published June 15, 2011 at the European Banking Association Day in Madrid, having incorporated all input from previous reactions (since March 2011) and pre-conference e-payments in Barcelona of May 23, 2011. This positioning paper on e-payments will be further distributed among web merchants and their representative e-commerce associations for further endorsement and (inter)national engagement with all involved.

This position paper on online payments aims to:

1. list the key issues and requirements for web merchants in Europe
2. give direction to payment service providers and financial institutions in general for the development of payment services
3. be a constructive basis for discussion with stakeholders including consumer organizations
4. support national position paper(s) on online payments and call for action(s)

This position paper lists 10 issues, which have been discussed extensively in the past period. The foremost insight is that 6 out of the 10 issues can be improved strongly if better mechanisms for online authentication of -and authorization by- consumers were available. Such e-services would reduce card fraud, reduce usage barriers with consumers and, last but not least, enable new payment services based on the SEPA instruments (both credit transfer and direct debit). This finding is completely in line with 'key action 3' of Europe's Digital Agenda as published in 2010 (COM2010 245 final/2).

This underlines again that e-commerce is all about 'managing risks at a distance', both for the merchant and the consumer. The key message to the industry is to improve this missing e-identity component in a generic and customer friendly way: it will accelerate market growth, and thus lead to more transactions. A virtuous circle can be created.

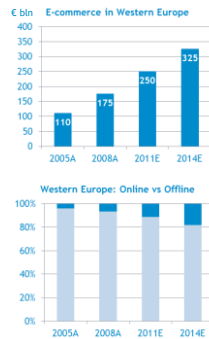
Reaction on this position paper are encouraged and should be addressed to wijnandjongen@thuiswinkel.org on behalf of all organisations mentioned.

2 Market outlook

In the past 15 years e-commerce has become a mature market and is still growing. This trend is expected to continue in the coming years due to the further proliferation of mobile devices (smartphones, tablets) and the customer need of 'being always online'.

E-commerce is serious business

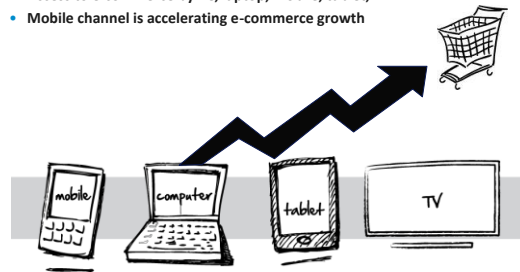
- Estimated EUR 250 bln revenue total in Europe in 2011
- Estimated double digit growth for the coming years
- Estimated to be around 11 % of retail sales in 2011, and still growing



Source: Innopay estimates
2 E-commerce payments: the next phase

Today e-commerce is all around us

- Access to e-commerce by PC, laptop, mobile, tablet, TV
- Mobile channel is accelerating e-commerce growth



Following this market success, e-commerce payments have become a major challenge in the past decade. The vibrancy and innovation of payments is resultant from imperfections in the European payments landscape. These imperfections bring opportunity to create new more efficient methods to consumers and merchants.

Many positive developments have taken place to optimize payments for the web. Innovation has seen traditional payment methods come under pressure as consumers and merchants migrate to more convenient and efficient and secure payment methods. However the journey is far from complete and does create operational issues for merchants who have to operate within this complex market. At the same time we see a strong regulatory pressure for harmonizing the payments landscape in Europe, both in terms of infrastructure (SEPA) and innovation (eSEPA). ECB and EC are having a similar agenda here.

Allowing free market forces, to drive the evolution in the European payments landscape is the best possible way of moving to a more perfect model. Part of the free market forces is the 'demand side', i.e. web merchants, who need to articulate their requirements and demands in a more clear, consistent and international fashion.

3 Consumer needs

E-commerce companies can not survive without answering to consumer needs. In the EU Commission's paper 'Digital Agenda' (COM2010 245 final/2) it is clearly stated (par 2.1.3) that the key barriers for online shopping are:

1. Lack of confidence in the online payment methods
2. Privacy concerns. For a consumer it is comprehensible that he should identify himself in order to enable delivery of goods or services online. However this should be able with providing the right set of personal data, affecting the consumer's privacy as little as possible
3. Lack of trust in the web merchant. Consumers expect fair agreements, conditions and delivery, whether or not supported by (international) trust marks.

It is in the interest of the e-commerce sector to eliminate these barriers. Regarding payments this means also consumers want more trust in online payment methods. This position paper addresses this issue, since better (cross border) e-authentication and e-authorisation service have direct positive impact on consumers.

4 Clustering of payment issues

Today's payment issues are numerous and it is not obvious to categorize them in a practical and meaningful way. Despite some overlap between the categories we have chosen for the following clusters (IS DAT ENGELS WOORD?)

1. Cards & Fraud: all issues surrounding cards, including 3D Secure implementation
2. Bank payment schemes: the rise and opportunity of (online) banking based payments such as credit transfers and direct debits
3. Non-bank payments: payment solutions developed specifically for the internet, so called wallet systems

On top of this we see the issue of SEPA migration, mobile payments and e-identity (incl. fraud) issues which affects all clusters. Another essential angle is one-off versus recurring payments. Each type of payment puts bespoke requirements on merchants in terms of usability, security and functionality.

5 Cards and fraud

5.1 Introduction

Cards are today's most important online payment methods in most European countries and will continue to be so for the foreseeable future. Merchants are worried about the SEPA cards framework because the outcome seems to be an oligopoly as only the major international card schemes remain and competition is not fostered.

However, cards have important product flaws when used for web transactions since 'cards were never designed for the web'. On the web the customer is not physically present with his card, therefore this is also known as Card Not Present (CNP) transactions. The main flaw is its vulnerability to fraud, which affects merchants and consumers strongly.

Fraud is caused on various levels. For consumer protection (because of the inability to authenticate the card user on the web), card schemes gave the buyer the ability to single side decide to reverse a transaction (chargeback) when he judges a transaction is not rightful. This ability is often misused by the consumer (except in the case of a fraudulent merchant) instead of going through the regular complaints and refund process. This phenomenon puts merchants on unnecessary costs for dispute handling, loss of goods and possible penalties. In the outer world (towards the consumer) there is the risk of reputational damage, the loss of consumer confidence in the merchant and payment brand which can culminate into the consumer's disappointment in the whole of the e-commerce process. This is clearly not beneficial for all stakeholders involved.

Another key weakness is the fact that credit card details represent monetary value, which implies that merchants have to think about and invest in security measures (e.g. PCI DSS compliancy) to protect them from card details theft or outsource them to 3rd party services such as payment service providers.

5.2 3D Secure needs improvement

3D Secure has been developed and introduced in the past years to protect merchants from a certain type of charge back ('it wasn't me'-type). The issues remaining are:

- 3D Secure does not protect against other charge backs and does not prevent charge backs happening in the first place.

- 3D Secure is an extra step in the checkout process where people have to give in an additional and dedicated password. This reduces order conversion, both because of the additional step and the loss of passwords.
- 3D Secure has a weak consumer experience which sometimes resembles a phishing site, which puts conversion under extra pressure.
- 3D Secure requires (additional) signup from every credit card holder. Sometimes the customer is forced to do this before he can proceed with the payment without knowing of the benefits of doing so. (resulting in lower conversion rates of visitors becoming buyers). A clear communication towards the consumer is missing.

Merchants recommend a revision of 3D Secure addressing these points. One way forward is to include authentication methods which people already have in use, such as bank passes, mobile phones and other secure tokens (**recommendation 1**).

5.3 Dispute management needs standardization

Disputes caused by chargebacks need a lot of handling today. Merchants need to communicate both with acquirers, PSPs and buyers, while often the right information is not complete or unavailable to the merchants. On top of this the communication process is not standardized amongst acquirers, PSPs and schemes. Therefore merchants want this process to be harmonized in order to improve speed and customer satisfaction (**recommendation 2**).

6 Bank payment schemes

Bank payment schemes such as credit transfers and direct debits are core banking services since payments became digital more than fifty years ago. Over time, every country around the world has developed its own national standards and mechanisms. Since a few years we now have SEPA within the European Union, which aims to standardize these core banking payment services, including cards. The SEPA project (since 2002, banking self-regulation) led to the introduction of the SEPA Credit Transfer (SCT) in 2008 and introduction of the SEPA Direct Debit (SDD) in 2009. The uptake of these new services by market and public sector has been limited so far. Therefore an end-date will be mandated by the European Commission, which will probably be 1st January 2013.

It is with these core banking products (credit transfer, direct debit) where merchants see opportunity for new payment developments when they would be made suitable for use on the web.

6.1 SEPA Credit Transfer has no charge back risk

The SEPA Credit Transfer has no charge back risk for merchants because the buyer initiates the payment through his own bank. Since SCT is not designed for the web either, a new breed of payment method has come to market in various countries across the globe, which is called Online Banking ePayments (OBEP). With OBEP in the checkout process, the buyer is redirected from the merchant site to the site of his bank, where he authorizes the transaction with his online banking credentials. The merchants receive a real-time payment guarantee as a result of this authorization. Today OBEP services are not based on SEPA payments yet, but they can be made suitable for the SEPA payments requirements.

The OBEP category is leading in The Netherlands (iDEAL) where more than 90% of all online merchants accept this payment method. Similar systems can be found in e.g. Germany (giropay), Austria (eps), USA (Secure Vault Payments), Canada, Colombia and Poland. This is a fragmented and non-interoperable

landscape which is not beneficial for the proliferation of this type of payments. However, the proof of concept study on possibilities for interoperability between eps, giro pay and iDEAL is a very promising initiative from a technical point of view. However, proper pricing models are still a decisive factor as well for successful European proliferation of this category of payment services.

OBeP systems based on SCT are a viable alternative to cards because of the absence of charge back risks. Therefore merchants want more cross border OBeP payment options, including an international solution while reducing fragmentation and optimizing the buyer experience (**recommendation 3**). Buyers should be able to pay abroad with their online bank credentials.

6.2 SEPA direct debit has online potential

Direct debits are an attractive and cost effective way of paying in specific situations, such as recurring payments and situations where the risk is low or where the amount is not fully specified at the moment of ordering. The buyer's right to cancel credit entries eight weeks after the actual sale or the collection of the payment five days after its actual occurrence does not support one off e-commerce payments and can lead to the same situations we are experiencing currently with credit card chargebacks and fraud. Also the SDD was not 'designed for the web' and needs to be improved incorporating different payment scenarios.

Furthermore for direct debits a mandate is needed which can only be given on paper today. Merchants welcome therefore the e-mandate, because that enables the proper use of direct debit in the online world (**recommendation 4**). E-mandates should come with SEPA direct debit and/or with other local direct debit solutions and support one off payments as well as recurring.

For an optimal user experience the e-mandate should be given with credentials that the buyer already has, such as his online bank login or via his mobile phone hence creating a universal 'payment authentication experience' online.

7 Non-bank payment services

Non-bank payment services are often innovative services offered by non-banks. They have usually been developed specifically for e-commerce. Typically these services are regulated by the PSD. In this category we distinguish the following categories:

1. Wallet systems: they are used for both micro and macro payments. Buyers hold an account with the provider which is funded out of a bank account or credit card. Merchants face sometimes problems with charge back rules, which are not harmonized with connected PSPs or acquirers. Merchants request more harmonization and clarity in this area as well (**recommendation 5**).
2. Pre-paid solutions: this payment option is a way to use 'cash on the web', because cash is still strong in certain European economies. Buyers can (in physical stores) convert cash into prepaid balance and buy on the web. For merchants there are many prepaid options available and hardly any interoperability exists if not co-branded by the main international credit card schemes. Merchants call upon more standardization and interoperability in this field (**recommendation 6**).
3. Overlay services: these are new third party services that provide connectivity to online banking services. However, as they ask consumer to fill in their online banking credentials, there is a strong security debate going on. On the other hand web merchants encourage banks to 'open up their accounts' for third party merchant services, fostering innovation and competition, supporting recent investigation by competition authorities in Germany. Web merchants call upon clarity from

the industry and regulators on the status of these kind of new service providers to improve the consumer's confidence in their trustworthiness. (**recommendation 7**).

4. Cash on delivery: in the Central and Eastern European countries cash on delivery is the most popular payment method. However, also here the landscape is very scattered and cross border payments are hardly possible. Merchants require cross border cash on delivery methods (**recommendation 8**).

8 Mobile channel

Only recently the mobile device (phone, tablet) has become a serious alternative for the PC when it comes to e-commerce. However, because of the different user settings and screen sizes as well as the uncertainty of security risks, not every online payment method is applicable for a mobile device. Therefore merchants require payment methods which are optimized for mobile devices and which can be offered in a competitive fashion. This goes beyond the native payment options of the app stores offered by the major platforms (Apple, Android, Blackberry etc.) and the keying in of credit card details on a mobile device. E-commerce via mobile devices will also benefit of generic e-authentication solutions: consumers can then re-use profile data stored elsewhere to reduce input on the device itself. This will improve the shopping experience, hence increase conversion. (**recommendation 9**)

9 Online identity and authentication

Consumers have more and more online identities of various natures. They vary from verified credentials (e.g. bank passes) to unverified credentials with stored preferences (e.g. social media credentials). Merchants welcome initiatives towards re-using these identities in the e-commerce process. There are many benefits, including:

1. Secure payment: online identity solutions will improve the security of cards, credit transfers and direct debits (see recommendation 1,3 and 4). By using a similar international online identity solution for all payment types, the buyer experience becomes harmonized. This leads to a better experience, more trust and therefore more sales if implemented in such a way that the consumer's privacy is warranted. Also the mobile channel should be included in this effort (**recommendation 10**).
2. Profile information: buyers can store profile information (address, name etc.) and disclose them to merchants of their choice. This gives a merchant more certainty and leads to a better buyer experience (more conversion).
3. Improve the mobile shopping experience: mobile screens are small and have small keyboards. Using already stored online identity profiles will reduce the need for input by buyers and will therefore make the mobile channel easier to use.
4. Reduce fraud: with better e-identity services merchants can prevent fraudulent transactions.

Today there are many online identity and authentication options, but none of them are interoperable so far. Also here merchants call upon the industry to come up with interoperable solutions. Solutions that avoid merchants having to connect to a myriad of not interoperable online authentication services in order to meet their business needs

10 Summary of recommendations

The above recommendations are summarized in the table below, according to three categories, in random order of priority:

A Improvement of existing products	
Recommendation 1	Improvement of user experience of 3D Secure
Recommendation 2	Harmonize charge back and dispute processes of credit cards
Recommendation 5	More clarity on charge back rules with wallet systems
B Development of new products	
Recommendation 3	An international and interoperable OBeP solutions based on (SEPA) Credit Transfers
Recommendation 4	SDD: introduction of e-mandate for (SEPA) Direct Debits and improvement of one off direct debit rules
Recommendation 6	Interoperable pre-paid solutions
Recommendation 8	Cross border cash-on-delivery solutions
Recommendation 9	Payment methods dedicated for phones and tablet, including e-authentication options for ease of use (less input of data on the device)
Recommendation 10	Use e-authentication solutions to fight fraud and improve the buyer experience of credit transfers, direct debit and credit cards, including for the mobile channel
C Regulatory issues	
Recommendation 7	Clarity on the status of online banking overlay services and required standards

Additional remarks:

1. Recommendation 1, 3, 4 7, 9 and 10 have a strong link to the aforementioned generic e-identity solution. A consumer adopted generic solution can solve many of these topics. All mentioned recommendations are in need of collective actions by merchants and the financial industry.
2. Leading action holders, merchants to be involved:
 - a. Category A ('existing products') : card schemes, issuing and acquiring banks
 - b. Category B ('new products') : banks and other payment providers
 - c. Category C ('regulation') : public authorities

Web merchant are open to any stakeholder to work on the all issues mentioned in this position paper, in order to bring forward the digital economy in Europe.
