

ABELIAN VIEW



Highlight of the Week

Implications for Payment Processing from the Capital One/Discover Merger

- While Capital One’s acquisition of Discover would create the 6th largest bank in the US, the deal’s more significant impact may be disruption of the credit card payment processing market. Discover operates its own payments network, which Capital One will acquire if the merger is approved.
- The payment processing space is currently dominated by Visa and Mastercard, which control 84% of the market volume in the US. Trailing this duopoly are American Express with 11% of the US market and Discover with less than 5%. Capital One currently uses the Visa and Mastercard networks.
- The new Capital One/Discover entity will be the largest credit card issuer in the US with potential to vertically integrate onto the Discover payment processing network:
 - Users: Capital One plans to move all debit cards and select credit cards to Discover’s network starting in Q2 of 2025, which will inject a significant number of new users into Discover’s network. This tectonic shift likely *creates a third major player in the payments network market, challenging Visa and Mastercard’s prominence*. One analysis suggests that if every Capital One customer eventually flips to the Discover network, Mastercard would lose 25% of its processing volume and Visa would lose roughly 10%.
 - Merchants: Capital One is also likely to expand the number of merchants that use the Discover network, potentially offering lower swipe fees as a competitive tool to penetrate the market.
- The emergence of a third major credit card payment processor should be viewed favorably under antitrust regulations, hopefully balancing competition in the network space and limiting credit card swipe fees charged to merchants. However, it is unclear whether the added diversification will be enough to convince banking regulators to approve a deal that would create the 6th largest bank in the US. If approved, the deal will close later this year or early 2025.

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