PAYSYS REPORT

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In this issue:

Fuel cards and PSD2: There is more than meets the eye

(written by our guest author Simon Lelieveldt)[1].

We invited Simon Lelieveldt as guest author. Simon is an independent regulatory consultant in payments active in the Dutch Banking and Payments sector. In his career, he has worked both as a supervisor and a banker in different roles, including project manager, consultant, senior policy-advisor and head of a department of professionals.

In the original Payment Services Directive (PSD), article 3k provided for a proportional application of the PSD1. Instruments with a limited geographical reach and scope, such as store cards and fuel cards were not subject to its provisions. The exemption 3k was thus called the limited network exemption.

In its proposal for the new version of the PSD, the Commission claimed the existence of payments systems, waivered as "limited networks" with massive volumes, which imply greater risk and no legal protection for payment users, as "*feedback from the market*". However, this feedback was not a result of the external analysis[2] on the economic impact of the PSD1.[3] What could be seen though is that the interpretations of local supervisors ranged from strict to very lenient, which distorted the playing field in Europe. In addition, some observers noted that there was a strong desire by supervisors to have stricter rules for in particular the fuel cards market.[4]

In the end, the net result was a very strict version of article 3k in the PSD2, to ensure that its future application would be for truly limited networks only. In addition, any organisation that uses this specific exemption has to notify the supervisor.

The impact of this stricter scope on the issuance of fuel cards is a very specific subject that so far has not received a lot of detailed attention. Most observers assume that the fuel card is a regular payment card, used in a specific niche. In reality however, the fuel card can be better qualified as a purchase device, which is used to purchase goods, but not to pay for them. Therefore, the application of the PSD2 to fuel cards is less straightforward than it seems. There is more than meets the eye here.

Our Comment:

1. On fuel cards and chain sales: understanding the mechanism

Let's first have a closer look at the workings of a fuel card and what it does in terms of business processes. Generally speaking, fuel cards are delivered by oil companies to corporate fleet owners, sometimes distributed via resellers or co-branding arrangements. They are effectively a tool that validates the legal competency of its holder to receive goods/services from service delivery stations.

The company to which the cards are provided takes full responsibility for all services/goods delivered to the users of the cards and receives a monthly overview of all purchases made with the cards. It can set usage levels per card, ensuring that no more than a certain amount of goods and services are to be delivered to the cardholder. It can also set the range of goods to be delivered from narrow (fuel only) to wide (fuel and shop goods).

Every month, the fleet owning company receives an invoice with an overview of all purchases made and the rebate applied (mostly volume based). This specifies the purchases made in the network of the oil company itself as well as those in other networks and by other service providers. These other networks of service stations may also deliver goods/services to the card holder. What happens in practice is that prior to the actual delivery, the cardholders' oil company buys the whole service/goods package that the card-holder wishes to take out at the selected other networks with whom the oil company has struck delivery and service agreements.

This results in a chain sale of goods/services from:

- the service station dealer to its country organisation,
- the service station country organisation to the oil company national organisation,
- the oil company in a country to the corporate client that distributed its cards to the employees.

While technically there may be many variations to this flow, it does serve to achieve an important effect in VAT terms. It allows the oil companies and networks involved to reclaim the relevant VAT from local authorities and thus lower the end fee to the corporate fleet owners.

Thus, if we summarise the commercial reality of the fuel card transactions we can see that in essence the oil company provides goods/services to the fleet owner. It takes a counterparty risk in doing so but eventually the fleet owner pays via direct debit. This simple structure is made somewhat more complex due to the fact that the oil company:

- may use a complex supply chain with its own services delivery as well as chain sales, catered for by a lot of distribution and delivery agreements,
- may have a number of reseller or co-branding arrangements in place, via which its cards or other purchase tools (like on-board computers) end up in the hands of the fleet owner,
- may instead of cards also use other devices, such as cellphones, apps, tablets and web applications to allow the holders of purchase tools to purchase goods/services.

2. Hey, it's a card and a PIN, but is it a payment instrument as well?

Under the first payment services directive, there have already been cases where a supervisor paid little attention to the actual value chain and the existence of chain sales. An approach was taken from the viewpoint that, from the outside, the shop experience looks so much like a payment card transaction that it would be treated as such. We see someone arriving at the service station, filling up the tank, using a plastic card and Pin code in a terminal, getting a receipt and then leaving. So that must be a payment then.

This similarity at face value is in my view however an insufficient argument to treat the two cards as a payment instrument and to label the two transactions as payment transactions. Let's have a closer look at the true difference between the two.

Using a purchase tool	Using a payment instrument
Used to instruct the retailer or service station to deliver goods/services	Used to instruct the bank to make a payment to a third party bank account
The amount to be paid is unknown. At the end of the month, rebates are applied and the reconstruction of what the actual equivalent price at this moment of sale would have been, is always a mathematical reconstruction	The amount to be paid is clear
Authentication of the card holder equals the right to receive goods/services up to a certain threshold	Authentication of the card holder equals the digital signature of the payment transfer
Positive response by oil company equals the formal sale of the services/goods from service station to oil company and the mandate to provide the services/goods to the card holder	Positive response equals the proper processing of the payment instruction
Holder of purchase instrument is not (by definition) authorised to give payment orders that relate to the billing account of the fleet owner	Holder of instrument is by design authorised to give payment orders from that account to the payee's account
Holder only receives proof of purchase / delivery but not proof of payment	Holder receives proof of payment and possibly also proof of purchase
No cashback possible	Cashback might be possible under the rules of the cards account
Oil company may design its own purchase, control and billing procedures, use its own set of purchase tools and may set its own acceptance and risk parameters. Inter-company delivery agreements will apply	Card is a payment instrument and payment transactions with it fall under legislation (PSD) and payment brand regulation, with bank specific acceptance and risk parameters
VAT recovered and rebate applied to purchases by all cardholders of the fleet owner	VAT-recovery not included
Aggregated invoice for goods and services delivered, sent to the corporate treasurer of the fleet owner, and paid for using the direct debit instrument	Periodic account statement for payments made or (as in the case of credit cards): aggregated invoice for total value of payments made, followed by direct debit.

As we can see, the commercial reality of a purchase with a tank card is pretty different from that of the same purchase with a bank card. Anyone using a fuel card:

- does not know the relevant monetary amount (which is determined later in the month),
- is not authorised in any way to debit the corporate account used for payment towards the oil company,
- only receives proof of delivery, but not proof of payment of a certain amount.

While the bank card ticks all the boxes, the fuel cards as outlined above do not qualify as payment instruments under the current PSD. There is no request being made to place, withdraw or transfer funds, hence there is no payment transaction, no payment order and no payment instrument.

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Fuel cards as outlined above do not qualify as payment instruments under the current PSD.

3. Regulatory approach for fuel cards and chain sales under PSD2

The current German draft law has a paragraph that discusses the topic of chain sales:

"If the service provider wants to avoid the qualification of its service as a payment service in an economic setting that looks like a payment triangle, it must always enter the purchase contract from the outset and without any ifs and buts as a seller" [5].

This phrase says that by taking over all obligations of the retailer (effectively becoming the seller) a company can avoid the payment services qualification for its activities. It is a clarification that creates a good distinction between purchase processes and payment configurations.

Unfortunately another paragraph in the explanatory memorandum seems to treat instruments such as fuel cards as payment instruments that might require an exception. It contains a new criterion that operationalises the viewpoint of the regulator with respect to limited networks and fuel cards. It says that if stuff paid for with a card moves the car, then it can be limited goods/services, but as soon as the stuff paid for is of a different nature (moving the consumer: drinks, food) the exclusion will no longer apply:

"For example, in the case of customer cards for private transport (fuel cards), the basic principle is that everything that moves the car (fuel, lubricants) is an exception, but not what moves people (shopware)." [6]

Using this basic notion to define limited services is in itself not so problematic. It is a smart operationalisation, as long as it is used within the context of the law. This means that the operationalisation only applies to fuel cards that qualify as payment instruments.

What strikes me however, is that the paragraph appears to rest on the assumption that customer cards and fuel cards are by definition limited network instruments and possibly full-swing payment instruments. The option that these cards could also be mere purchase tools that are out of scope is not explicitly mentioned and thereby creates confusion in the market.

So the main question is at which moment and based on which arguments the supervisor will decide that for fuel card A we have a payment situation that requires regulation and that for fuel card B there is a purchase situation which falls outside the PSD2 scope. When does the fuel card invoke the PSD2 and does it then by definition become a payment instrument?

4. Supervisory qualification on nature of goods or underlying legal construct?

When evaluating the possible regulatory approaches, we need to be aware of the possible legal qualifications of the fuel card in practice. In the fuel card arena we can witness different players with different business models and different terms and conditions.

For example, player A operates from a middleman/aggregator perspective and has no service stations but merely buys up large quantities of oil from many different companies. They offer a tank card to cardholders (or corporates distributing those cards to their employees) with which one can pay for fuel as well as for shop goods. For the fuel part of a purchase, the aggregator card issuer is the provider of the fuel, but for the shop goods, it is the shop owner. One can find this covered in terms and conditions with a distinction between own business and third-party-business. Purchases at the service station thus lead to monthly payments to the aggregator, of which the part of third party services is channelled onwards to the third party business provider.

Now let's take player B, who issues fuel cards and

Some figures of the fuel card market

The turnover of fuel cards in Europe (including Turkey) is estimated at approx. 75 - 80 b€ by Datamonitor and other researchers. The largest market is probably Germany with a volume of 11.8 b€ (2015). About 27% of the total German fuel turnover is generated by fuel cards, dominated by fleet cards (issued by oil companies) and trucker cards (DKV, UTA and others). Of the total German card acquiring market (2015: 315 b€), fuel cards have a market share of 3.7%.

The fuel card market is relatively stable compared to other card markets with strong growth rates, like bank-issued debit and credit cards. The figures are strongly influenced by the volatile price level of fuel. In Germany the number of fuel cards issued is estimated at 5.7 m. (source of German figures: PaySys German Card Market Statistics 2006-2015).

operates or franchises their own service stations with a more encompassing chain sale construction as outlined in paragraph 2. All goods/services are taken from the service station and resold to the card issuer, who sells them to the company of the card holder. Effectively we can see sales and payments between the oil company and the corporate company that distributed the cards to its employees. This is a purely bilateral relationship where prior to the purchase both the oil and shop goods are owned by the oil company that issues the fuel card.

It would effectively turn the Payment Service Directive into a Purchase Services Directive

If we now consider a purchase at a service station where the card holder purchases both fuel and a can of coke, we can choose to:

1. disregard the legal structure and qualify both card A and card B as payment instruments, as the can of coke moves the customer rather than the car and it looks pretty much like a payment transaction with card and PIN,

2. disregard the appearances and scope of services bought and look at the legal underpinnings. We then qualify fuel card B as out of scope of the PSD2 and consider the process of payment forwarding of company A as a payment service, requiring supervision or exemption.

It is clear to me that option 1) doesn't work. It would require companies with a chain sale model (out of scope of the PSD2) to superimpose on their current payment processes a model which is the complete reverse, with card holders paying the full amount to the end of the distribution chain (the service station) and the service station being obliged to refund all other players in the value chain for their services delivered.[7] It would be an approach that would effectively turn the Payment Service Directive into a Purchase Services Directive.

The only sensible approach is to take a good look at the legal underpinnings and use a true functional approach, based on the actual business processes occurring.[8] As far as I know this is the approach favoured by the BaFin (German Financial Supervisory Authority). This means that if there is indeed a full chain sale model, than the fuel card is not in scope. But as soon as somewhere in the business model either company A or B is forwarding money to third party service providers, rather than fully buying and reselling their goods/services, the business model will involve payment services.

5. The devil is in the details...

It is important to note that it would be incorrect to immediately label fuel card A of the above example as a payment instrument. Whether or not fuel card A is a payment instrument depends on the exact nature of the terms and conditions. If the card is not used to instruct company A to make a specific payment of a specific amount to the account of the service station, it would not fulfil the definitions of the PSD2. It would serve to add shopping items to a purchase list, which will be paid by the end of the month in which situation the payment transaction (and payment instrument) is still the monthly direct debit rather than the purchase transaction with fuel card.

Having said that, the use of fuel card A may occur in a business process of a company to which the PSD2 now does apply. The reason for this applicability is that on a European level the Member States have chosen to no longer accept the reasoning that some payments processes may qualify as a relatively insignificant ancillary business, which is out of scope of the PSD. Under PSD2, it doesn't matter how small the payment stream is in relation to your general business: any company that effectively acts as a payment service provider will need to comply with the PSD2 rules.

Company A may now choose to solve its PSD2 problem by hiring a payment service provider to ensure PSD2 compliancy. This can be achieved by redefining the fuel card as a payment instrument under the PSD2. I can opt for the exemption under Article 3k by restricting the range of products and services. It is also possible to set up alternate models in which it is ensured that the payments leg of transactions are executed under PSD2 compliant legal and business agreements. In any case, the bottom line for company A is that a part of its business is now within the scope of the PSD2, while it wasn't under PSD1.

Whether or not a fuel card is a payment instrument depends on the exact nature of the terms and conditions.

For company B, nothing changes under the PSD2 as long as it operates its fuel card under the full chain sale construct. This means that, under the proposed German interpretation, it also needs to take liability for all goods/services purchased with the card. Furthermore, company B needs to ensure that its current use of the fuel card does not involve some residual third party services streams that have over time been added to the chain sale model. Some local implementations may have been introduced over time that may now turn out to be PSD2 relevant.

The final consequence of the above approach is that - for good reasons – the situation may occur that even when using two very similar fuel cards, the purchase of the can of coke with fuel card A leads to PSD2 applicability, while the same purchase with fuel card B doesn't.

6. Why does the fuel card exemption discussion matter so much?

The fuel card exemption discussion under PSD2 is not just relevant in the regulatory context or for the fuel card market only. It's relevant for all European retailers and business partners in value chains, because there is no analytical difference between the fuel card and PIN mentioned above and the user ID/password combination that is in use by retail customers who are shopping at websites. Both tools serve to identify the user and agree to the delivery/purchase of services. Payments are organised via a separate procedure via a regular bank or payment institution.

The fuel card example stresses the importance of a truly functional approach, based on the legal qualifications used in commerce. This avoids the emergence of an arbitrary 'similarity argument'. Such similarity arguments may lead supervisors to incorrectly view some technical purchase tools in the market as payment instruments, with the consequence that the Payments Services Directive turns into a Purchase Services Directive and all merchant purchase buttons and websites become payment instruments.

We should not cross that Rubicon and avoid transforming the PSD2 into a Purchase Services Directive. By sticking to a true definition-based functional approach, we will be able to preserve the goals of the PSD2 regulation: a technology neutral application of legal texts. This requires supervisors to look through the technological appearance but not through the essence of the commercial transactions and functions at hand.

Let commerce be commerce and payments be payments.

DCC coming under regulatory scrutiny

(mk) Dynamic Currency Conversion (DCC) is one of the payment services that is regulated by the PSD2. Article 59 states:

"1. Payments shall be made in the currency agreed between the parties.

2. Where a currency conversion service is offered prior to the initiation of the payment transaction and where that currency conversion service is offered at an ATM, at the point of sale or by the payee, the party offering the currency conversion service to the payer shall disclose to the payer all charges as well as the exchange rate to be used for converting the payment transaction.

The payer shall agree to the currency conversion service on that basis."

Even though the deadline for incorporation into national law (13 January 2018) has still not been reached, the EU Commission is already contemplating further action with respect to DCC. In March, it published a „Consumer Financial Services Action Plan"[9]. In this document the Commission stresses that "*only 7% of consumers have purchased a financial service from another EU Member State*" (p. 3). In order to make the market for consumer financial services more European the Commission wants to (p. 4):

- "*Increase consumer trust and empower consumers …;*
- *Reduce legal and regulatory obstacles affecting businesses …; and*
- *Support the development of an innovative digital world*"

DCC is one of the topics that may stand in the way of "*consumer trust and empowerment*" (pp. 5-6).[10] The Commission is not opposed to DCC in principle. As it points out, DCC "*could stimulate competition in currency conversion*" (p. 6). However, for lack of transparency the Commission doubts that consumers would be able to take advantage of such competition. New rules in PSD2 might improve transparency. However, the Commission seems to be sceptical and is contemplating further action. In order to decide the issue it will undertake a study to better understand DCC.

Just for the record: the Commission also highlights the fact that fees may make intra-EU payments fairly expensive if non-euro currencies are involved. As it points out "*an extension of the Regulation [on cross-border payments] to all currencies in the EU would bring down the costs of cross-border transactions in all Member States.*" (p. 5)

Our Comment:

There are many ways in which DCC can be judged

- a useful service for card holders,
- a cardholder rip-off,
- an instrument to divert revenues from the issuing side to the acquiring side.

It is probably a mixture of all of these elements. For consumers, it may indeed be reassuring to know the price they are paying expressed in their own currency. For business travellers who have to recover expenses, DCC makes life easier because all expenses are expressed in the home currency.

For card holders, DCC also seems attractive because use of DCC implies that no issuer currency conversion fees will be applied. However, few card holders will be able to check how high the exchange rate mark-up is they are paying. This provides the acquiring side with a lot of leeway when deciding on the "proper" mark-up. In fact, the DCC mark-up may be costlier than the issuer mark-up plus the currency conversion fee.

From the point of view of card issuers, DCC is a costly affair. Usually, foreign exchange transactions are highly profitable for issuers. They receive a currency conversion fee and they earn the mark-up. In times of declining interchange fees such income is all the more important. If DCC is used, issuers neither earn a currency conversion fee nor a mark-up. The card schemes are also affected because they usually provide conversion services to issuers. Thus, DCC can be seen as an instrument that redirects income streams from the schemes and the issuing side to the acquiring side of the market.

So, on the one hand, there is a consumer protection issue. Consumers opting for DCC may get a bad deal, in fact many commentators use the term "rip-off". DCC providers are aware of this and have created the "DCC Forum" to improve the image of DCC in the public mind. Moreover, acquirers have started to introduce buyer protection schemes that promise to reimburse customers if by choosing DCC they end up at a disadvantage.[11]

Such actions may have been prompted by regulatory activities. As Article 59 of the PSD2 shows, regulators have started to act. The international schemes have taken these provisions on board and issued guidelines for DCC.[12] In fact, they would probably be willing to do more. But they have to tread carefully because DCC also has an anti-trust dimension. When it comes to currency conversion there is competition between acquirers (and DCC providers) on the one hand and the schemes together with card issuers on the other. Thus, scheme restrictions on DCC could be interpreted as restriction of competition. In fact, the Australian Competition & Consumer Commission has made exactly such a case against Visa.[13]

General rules adopted by card schemes should not simply be seen as a restriction of competition.

There is a sense of déjà vu. Anti-trust rules prohibit certain scheme rules because they are interpreted as a breach of competition law. Subsequently, consumer protectors reinstate these rules. It happened with respect to No-surcharge rules and it may happen again with DCC. Both surcharging and DCC can have positive economic effects. However, they are also prone to be misused. Therefore, general rules adopted by card schemes should not simply be seen as a restriction of competition. They also serve to protect cardholders. So, before contemplating further regulatory action it might be a good idea if payment regulators and consumer protectors liaised with anti-trust authorities.

Notes

1 I would like to thank Hugo Godschalk for the constructive discussions on this article and for the provision of background information on the fuel card market mechanics and the position of the German regulators.

2 Study on the impact of directive 2007/64/ec on payment services in the internal market and on the application of regulation (ec) no 924/2009 on cross-border payments in the community, Final report, Prepared by London Economics and iff in association with Pay-Sys, 24-07-2013.

3 See this Report of January 2014.

4 This suspicion was discussed, early on, in this report of March 2014.

5 Original text: „*Will der Dienstleister in einem wirtschaftlichen Setting, das wie ein Zahlungsdreieck aussieht, die Qualifikation seiner Dienstleistung als Zahlungsdienst vermeiden, muss er grundsätzlich von Anfang an und ohne Wenn und Aber als Verkäufer mit allen Pflichten in den Kaufvertrag eintreten.*“ Source: Gesetzentwurf der Bundesregierung Entwurf eines Gesetzes zur Umsetzung der Zweiten Zahlungsdiensterichtlinie, 2017-02-08.

6 Original text: „*Individualverkehr (Tankkarten), bei denen im Grundsatz gilt: Alles, was das Auto bewegt (Treibstoffe, Schmierstoffe) fällt unter die Ausnahme, nicht jedoch das, was den Menschen bewegt (Shopware)*“, p 134, Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur Umsetzung der Zweiten Zahlungsdiensterichtlinie.

7 I will not detail the reconstruction of the chain sale here, but suffice to state that this means that the company of the card holder will suddenly become the financier of the fuel value chain, payments must be made between parties without a contract in place and all entities in the fuel value chain will pass on money (at least for VAT purposes) and thus become payment service providers.

8 See more on using a functional approach in supervision in: Lelieveldt, Simon L. "How to Regulate Electronic Cash: An Overview of Regulatory Issues and Strategies." American University Law Review 46, no.4 (April 1997): 1163-1175.

9 European Commission: Consumer Financial Services Action Plan: Better products and more choice for European consumers, Brussels, 23 March 2017.
(http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017DC0139).

10 DCC had already been addressed in the EU Commission's GREEN PAPER on retail financial services. Better products, more choice, and greater opportunities for consumers and businesses, Brussels 10.12.2015, p. 15.

11 See, for instance, Barclays' "Best Rate Match" or Fexco's "Best Rate Guarantee".

12 See for instance Mastercard: Dynamic currency conversion compliance guide.

13 See Australian Competition & Consumer Commission: Visa ordered to pay $18 million penalty for anti-competitive conduct following ACCC action, 4 September 2015.
(https://www.accc.gov.au/media-release/visa-ordered-to-pay-18-million-penalty-for-anti-competitive-conduct-following-accc-action)

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