In this issue:

IF Regulation and the Practice of Double Counting

The EU IF-Regulation (IFR 2015/751), which shall apply from 9 June 2016, also addresses the tricky issue of co-badging and choice of payment brand in card payments and will turn the traditional mostly peaceful co-existence of the co-badged domestic scheme and international card scheme (ICS) into an open competition, driven by the brand choice at the POS. If the cardholder is not sensitive with respect to the brand selection, the merchant will take over the driver's seat. After the brand choice (manually by the cardholder or by an automatic priority selection of the merchant) the transaction is routed to the acquirer and processed with the selected brand label of the payment scheme. The scheme licensed issuer and acquirer has to report this transaction to the scheme, depending on the brand selected. If applicable, transaction-based fees of the selected brand or scheme will be levied. The other (competing) scheme brands badged on the card will not record or charge any fees for this transaction. No double-counting will occur. In itself, it seems unnecessary to regulate this practice, but Article 8 (4) of the new IFR postulate it as a rule: *"Payment card schemes shall not impose reporting requirements, obligations to pay fees or similar obligations with the same object or effect on card issuing and acquiring payment service providers for transactions carried out with any device on which their payment brand is present in relation to transactions for which their scheme is not used."*

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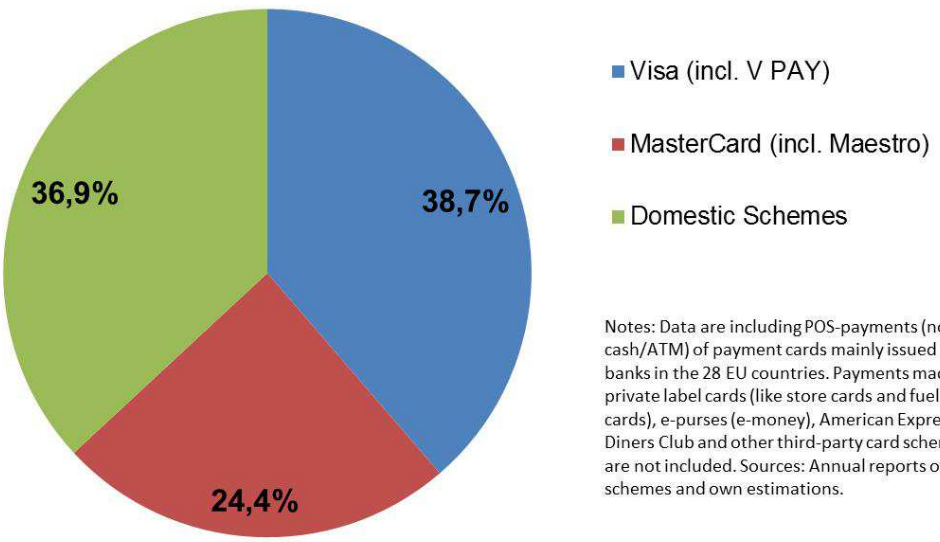
Our Comment:

The new rule may have some important statistical side-effects. Based on our research, card issuers in France and Spain are still reporting their domestic transactions made with the local brand of the domestic schemes (e.g. Servired or Cartes Bancaires) to the ICSs, co-badged on the card (Visa or MasterCard). The reasons for doing this reporting to Visa or MasterCard are historical. Some issuers have to pay a fee for these transactions based on their issuing license contract or they may benefit from a better tier within the fee structure or more voting power as shareholder by reporting additional volumes. Conforming with the accounting policy of the schemes, transactions can be registered as Visa or MasterCard transaction if some fee income – however small - is generated for the ICS, even if the transaction is a domestic scheme transaction. Anyway, we still have double counting of card transactions, but – and this is the good news - this practice is limited to Spain and France.
In our analysis of the market shares of the schemes in the EU (see our Report 2/2015) we took over the scheme statistics as the more trustfully statistics (perhaps somewhat premature?) compared to the ECB statistics which are based on data, reported by the PSPs to the national central banks within the EU. We assumed that each transaction with a co-badged card is registered only once, in the scheme statistics of the brand selected for this transaction and that for each card transaction the selected brand is unique, complying only with the rules and terms of the selected brand and scheme.

However, as result of this double counting practice in France and Spain we have to revise our analysis. Since we do not know the extent of this double counting, we should take the worst case by assuming that 100% of the transactions which were based on the local brands and generated within the domestic schemes in France and Spain were registered in the Visa and MasterCard-statistics too.

Total Card Payments in the EU 2013: 2,395 billions EUR



Notes: Data are including POS-payments (no cash/ATM) of payment cards mainly issued by banks in the 28 EU countries. Payments made by private label cards (like store cards and fuel cards), e-purses (e-money), American Express, Diners Club and other third-party card schemes are not included. Sources: Annual reports of the schemes and own estimations.

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Based on this assumption, the total sales volume of cards issued in the EU (including three-party schemes) would be reduced to 2,481 bn Euro (2013) – due to the estimated double-counting in France and Spain of an estimated 478 bn Euro. Even in this "worst case", the ECB statistics are still about 325 bn Euro lower, for the EU area as a whole. This is equal to 13% of the total volume.

Another consequence of the exclusion of the double counting effect is the increased market share of the domestic schemes in the EU of 37% (instead of 30%) compared to Visa (39%) and MasterCard (24%). This should delight the EU Commission which is sceptical with respect to the dominance of the ICSs.

However, the ICSs will not be amused if they have to revise their figures for Europe downward as a consequence of Article 8 (4) of the IFR, which will come into force in summer 2016. The figures of 2016 could be referred to in a footnote like this: *"The data for Europe from 2016 onwards are not comparable to previous years due to regulatory requirements."* Will the shareholders of the ICSs understand and accept this reason for the sharp decline of the European figures? This challenge for the Board is surely not on the hidden agenda of the recently started initial talks between Visa Inc. and Visa Europe for selling Visa Europe to Visa Inc. (see next chapter).

Based on the methodology of using the data of the card schemes with activities in the EU, we intend to continue this market share analysis as soon as the 2014 data will be available. The results will be published in this report.

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Visa Europe for Sale: The End of a Vision?

Late on May 8th Bloomberg reported about initial discussions between Visa Inc. and Visa Europe. Visa Inc. intends to buy the shares of Visa Europe, incorporated in the UK. Based on a put option sale contract, Visa Europe would be able to sell itself to Visa Inc. The rumored price tag is between 15-20 bn US$. Two years ago (March 2013) the same item was discussed without concrete results, however, the discussed price was much lower (3 bn US$). Since 2004, Visa Europe has been independent of Visa Inc. One of the main reasons to set up Visa Europe was the SEPA-driven requirement for a real European scheme, owned and governed by European banks. As result of the Bloomberg report, the value of the Visa Inc. shares jumped to 4.36%

Our Comment:

Although Visa Europe fulfils the requirements of a "European scheme", the system tragically was almost never listed as candidate for the European Card Scheme, like Monnet, payfair, EUFISERV and EAPS. Regulators like the ECB and the European Commission are still postulating the existence respectively the risk of a duopoly of international (non-European) schemes by regarding Visa Europe as one of the two international duopolists.

Financial analysts of investment groups in the USA are telling us, that the time for the sale is well chosen, because Visa Europe is doing well, offering the best valuation to its members. They see a direct link to the upcoming regulatory environment as result of the IF-Regulation (IFR). The new business rules will improve the position of the merchants vis-á-vis the old domestic schemes. With the IFR in force, merchants may decide to which scheme they want to route transactions (choice of payment brand and application). Large domestic markets like France and Germany will be open up for competition of the ICSs. To gain market share, the ICSs need more financial resources for this competitive challenge. As worldwide scheme, MasterCard is better positioned compared to Visa Europe. A recent report by Evercore ISI suggests that *"the IFR favors global interoperability and scale, which puts Visa Europe at a competitive disadvantage versus MasterCard as the only globally interoperable payment network."* By selling the shares of Visa Europe, the shareholders will benefit from large revenues, which can be used for investments into the new technology (SecuRe Pay) and innovations in card business to compensate for the loss of IF-revenues. In particular, the British banks which hold approx. 25-30% of the Visa Europe shares would benefit.

This is surely not the European Commission's desired outcome. The Commission still expects a positive effect of the IFR by lowering the barriers for new pan-Union schemes with lower or no interchange fees at all (see recital 11 of the IFR). It was exactly this claim that the bank-independent card scheme payfair used to fire up the imagination of European policy makers when it was launched in 2007. The ECB is still mentioning this card scheme (beside EAPS and EUFISERV) as existing initiative for establishment of a new European card scheme in its SEPA-report of April 2014.[1] But payfair shifted its business ambitions to implement some local mobile payments projects in Eastern Europe and is providing a successful solution for an electronic lunch-voucher scheme called Monizze in Belgium.

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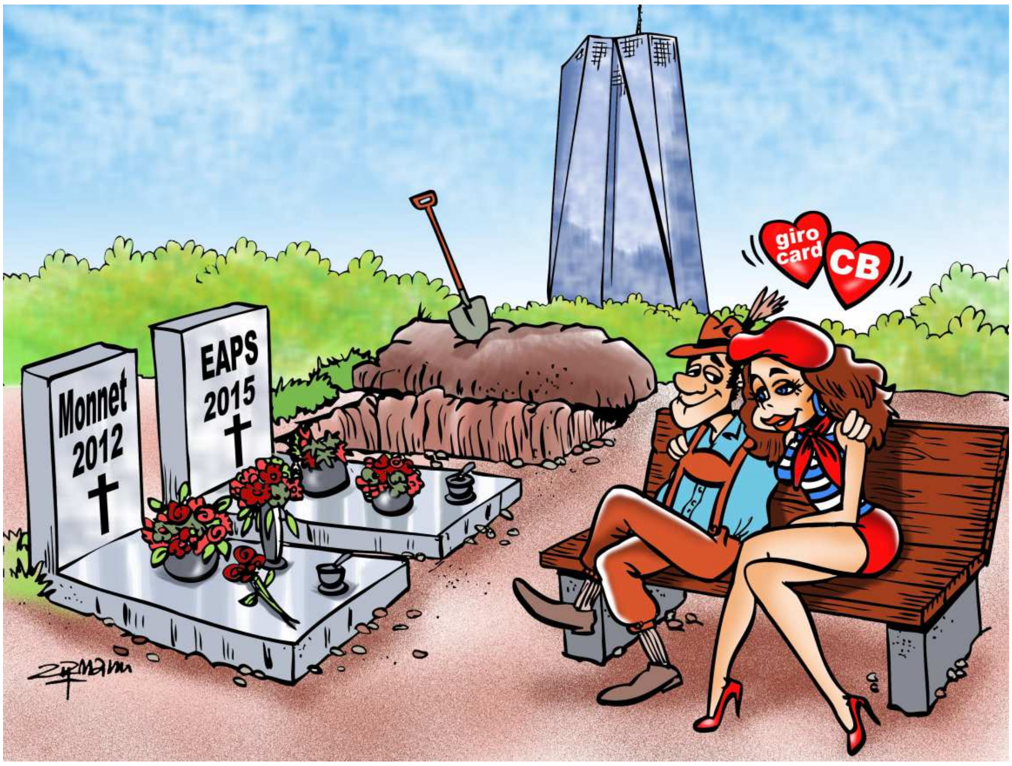
Nevertheless, payfair-CEO Stephan Becker stated at the end of 2013, *"payfair is back in the pole position to become the new "SEPA" scheme"*.[2]

We don´t see such an optimistic life expectancy at the second candidate, EAPS (Euro Alliance of Payment Schemes) where LINK (UK) and Bancomat (Italy) terminated their memberships. This must be seen as the death blow for EAPS, which is likely to be buried alongside Monnet (✞ 2012) within the next months.

Who is left? EUFISERV, dominated by savings banks in Europe, announced in October 2011 the launch of the POS functionality (beside ATM) in order to become a fully SEPA-compliant four party card scheme. The new scheme would be opened for all banks (not only savings banks) to issue EUFISERV-branded cards. As a first step, debit cards co-badged with EUFISERV (like the SparkassenCard of the German Savings Banks) are accepted at Spanish POS-terminals (acquired by EURO6000). It actually works, but after 4 years, the POS-volumes of the new scheme are still not significant.[3] In its annual report, EURO6000 is listing the acquired transactions labelled according to the differing brands, but EUFISERV is still missing in this list. Despite financial attractiveness for issuers and acquirers (no scheme fees!), the main obstacle is the network effect of a two-sided market. Additionally, the scheme-owners are more focusing on cross-border transactions in order to avoid competition with their own domestic schemes.



Has this been a beauty contest without genuine candidates? Contrary to the Commission´s assessment, IFR will probably not encourage domestic schemes to come on stage. If Visa Europe was sold, the contest would be over for the time being.

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However, we see some silver lining, as most births start with a flirt. In April 2015 the two largest domestic card schemes in Europe, the French CB and the German girocard started a co-operation for providing common functional certification requirements for POS-terminals and acquiring systems.[4] Good news for terminal vendors to pass through the certification for both schemes in a single act.

The next step could be a bilateral acceptance agreement of both domestic brands to bypass Maestro and V PAY. There may be some hiccups on the way, if, for instance German banks start CB-branded cards (or vice versa). But at the end of the (long) day a naturally grown French-German scheme as a torso of a European Card Scheme could probably have a better chance of survival as a top-down constructed Monnet-scheme.

Don´t stop dreaming!

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Brexit: The winners are moving companies and lawyers

Prime minister David Cameron and his Conservative Party won the recent elections in the UK on May 7th. He promised a referendum on UK membership in the European Union before the end of 2017. The possibility of an exit of the UK from the EU ("Brexit") as indirect consequence of the election brings a lot of uncertainty to the British industry, but also to its counterpart on the continent. Within the EU, London is still the centre of the financial industry. About 8% of the British GNP is generated by this sector.

Our Comment:

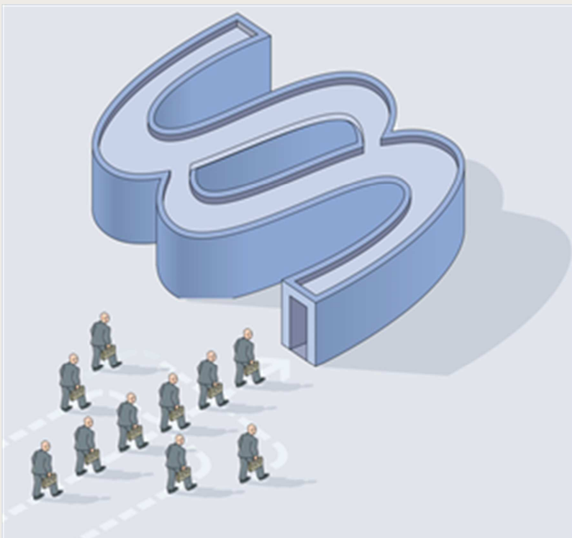
Freedom of establishment and freedom to provide services are the basics of the single market. Within the regulated financial industry these freedoms are applying to traditional banks as well as to the other service providers, like authorized payment institutions (PI) and e-money institutions (EMI). The so called "European Passport" offers the right to provide payment services all over in the EU if the service provider is authorized in the Member State where the provider is located. Most of the Payment Service Providers (PSP) are using the Passport by offering cross-border services, especially those who are located in small Member States, like Luxembourg, Malta or Gibraltar. Despite the requirement of offering these services in the home country too, most of the new PIs and EMIs are not choosing the location in the Member State of their main market. Obviously other reasons are decisive.

For PIs and EMIs the UK is definitely a favourite home country. In August 2012 almost 40% of the 586 authorized European PIs were located in this country.[5] Also the authorized EMIs are concentrated in the UK (March 2014: 40% of the 91 institutions[6]). Since these numbers were collected, 18 new EMIs have been authorized by the Financial Conduct Authority (raising the total by 50%). Most of them are licensed with European Passports. We don´t see such figures in any other Member State.

So why is the UK such attractive for non-bank PSPs?

Some company strategists claim that the regulation by the FCA is not as tough as in other Member States. But there are no hard and objective facts to confirm this statement.

The lemming-effect is more obvious: So many companies which chose the FCA as regulatory regime, cannot have done everything wrong…



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The third reason is probably the exemplary transparency of the regulation process of the FCA compared to most of the competent authorities in continental Member States. Let’s look at an example. On the FCA’s website an applicant for an e-money institute license will find about 1,000 pages of documents only related to e-money and e-money institutions. The whole process for application and the regulatory requirements are described in detail. All documents needed for application can be downloaded with sample forms and help texts. You will find a FAQ file, information about the FCA´s interpretation of the definition of e-money, agents, distributors, cross-border issuance, AML requirements etc. A clear, transparent and standardised application process is benefiting the applicant but also the regulator. Both save time and resources.

Compare the FCA-website, for example, with the website of the German regulator BaFin. Here, you only will find a few instruction leaflets (about 20 pages in total) of the interpretation of some e-money-related issues, like the specific German AML-rules for e-money. That´s it. The regulator´s case-by-case approach is time-consuming and the outcome is often not predictable. An application process can take a year or longer. Until today 6 EMIs based in Germany took this long and windy road (UK: 54). However, the lack of transparency and standardisation is a good business-driver for lawyers.

Finally, some regulators simply don´t like the additional workload of regulating non-banks as consequence of both Directives (PSD and EMD). They are practising a beggar-my-European-neighbour-policy by not paving the way for potential clients.

What would be the consequence of a Brexit? More than 50% of all European PIs and EMIs will lose their guaranteed entry right into the EU markets.

Observers say that the chance of a Brexit as a result of the referendum is about 50/50. What would be the consequence of a Brexit? More than 50% of all European PIs and EMIs will lose their guaranteed entry right into the EU markets. They have to shift their locations from the UK to the European continent, otherwise they will lose their passport rights. From today´s perspective, the favourite Member State could be Luxembourg. In the coming period of uncertainty, the high growth of authorized payment and e-money institutions in the UK will slow down.

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Notes

1 http://www.ecb.europa.eu/pub/pdf/other/cardpaymineu_renfoconsepaforcards201404en.pdf European Commission, Final results, 2015, p. 36.
2 http://payfair.nl/news
3 We don´t see any reporting of real POS-transactions by this new card scheme and the chapter "POS" at the EUFISERV-website (www.eufiserv.com) is still "under construction". An announcement says "coming soon!"
4 http://www.cartes-bancaires.com/IMG/pdf/PR_-_CB_and_Girocard_-_OSCar_and_Certification_-_Final_-_EN-2.pdf
5 See: http://ec.europa.eu/finance/payments/docs/framework/130724_study-impact-psd_en.pdf p. 36 (excluded small PIs which do not have a passport right).
6 Excluded small EMIs without passport rights.

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