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1. A SEPA strategy for ec cash / girocard

At a ZKA payments conference held in Berlin 21 April 2010, Wolfgang Adamiok, in charge of the card strategy of the German Savings Banks Association (DSGV), outlined his ideas for a new ZKA debit card strategy.[1] The aim is to make ec cash/girocard fit for SEPA. The approach Adamiok takes is interesting in many respects. The main idea is to split a debit card payment into separate services

- transaction processing (incl. card authentication and PIN verification)
- payment guarantee
- additional services (for instance card holder address information)

The idea is that there should be a common per transaction fee for the basic transaction service. The guarantee is priced separately <u>and individually</u> by each issuer. In order to provide transparency for merchants, merchants have to be supplied with the relevant fee before each transaction. Thus, they can decide on a transaction by transaction basis whether they want to buy a guarantee or not.

With this move, the guarantee part of payment pricing is taken out of the realm of multilateral price setting. Instead, there is unilateral price setting and competition with other providers of risk insurance. Therefore, Adamiok hopes that such a model will not come into conflict with anti-trust rules.

The model conflicts, however, with the SEPA Card Framework (SCF). The SCF defines SCF compliant card payments as guaranteed payments. The case of non-guaranteed SCF compliant card payments is not included. In addition, there is a second point in which Adamiok does not follow the line of the European Payments Council (EPC). He envisions that the new ec cash / girocard will be cleared via a "SEPA Card Clearing" (SCC). So far,

[1] All conference contributions can be downloaded under http://www.zka-online.de/uploads/media/Tagungsunterlagen.zip

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however, the EPC has resisted the demand to define a SCC based on SEPA Direct Debit (SDD).

Our Comment

The German savings banks, and potentially other banks or groups of banks within Germany, seem to be committed to transform the German scheme ec cash / girocard into a SEPA scheme. In order to move ahead, they have to comply with SEPA rules defined by the EPC, the ECB and the Europen Commission and with national and European anti-trust rules. Adamiok's strategy seems to be primarily geared at finding a pricing system that will not come into conflict with competition law. His idea of unbundeling may well please regulators who have frequently called for unbundeling. But it conflicts with the current version of the SEPA Cards Framework (SCF). Understandably, Adamiok sees anti-trust law as a harder constraint than EPC "frameworks". If the German savings banks get the confirmation that their pricing model complies with European (and German) anti-trust law, it will be difficult for the EPC to hang on to its current definition of a SCF compliant card transaction.

Processing of the new ec cash / girocard is described as being based on "European standards" – namely "Berlin Group authorisation" and "SEPA cards clearing" (plus SEPA FAST). So, the savings banks seem to be determiend to move ahead with a European infrastructure capable to clear card transactions. Such a system is a prerequisit for a truely European card scheme. Moreover, if implemented it will have to provide access also to other card systems. Thus, PayFair or Monnet could also use such a clearing system for their card transactions.[2]

2. Visa lowers its EU x-border debit card interchange to 0.2%

It has taken a little bit longer than anticipated but finally Visa Europe has given in to pressure from the European Commission and reduced its average debit card x-border interchange fee to a maximum of 0.2% - the same rate as the one the EU Commission had agreed with MasterCard in March 2009.[3] The reduction of interchange rates also applies in those countriesires of the EU where Visa Europe sets interchange rates: namely Greece, Hungary, Iceland, Ireland, Italy, Malta, Sweden, Luxembourg, and the Netherlands. In the other

[2] Such a cards clearing system might also help ELV to survive. However, there still would bet he need for a scheme defining business rules. Thus, the survival of ELV would by no means be guaranteed.

[3] See Visa Europe press release (http://www.visaeurope.com/en/newsroom/news/articles/2010/visa_interchange_fees_aid_sepa.aspx)

countries where domestic rates are set by domestic members, the agreed rate does not apply. It also does not apply to credit card transactions and prepaid transactions.

As the EU Commission points out,[4] the fee reduction is based on the application of the "merchant-indifference methodology". This methodology compares the costs of accepting cash payments with the copsts of accepting card payments.[5] The Commission expects new data on costs coming from European cost study.

Since the agreement covers only debit card transactions, the EU Commission will continue its antitrust investigation of consumer credit and deferred debit card transactions. It also reserves the right to maintain proceeding against the "Honour All Cards Rule", MIFs for commercial card transactions, and Inter-Regional MIFs.

In its press statement, Visa Europe points out that the data on costs on which the current rate is based are still imcomplete and that better data may lead to a revision ot the agreed fee. Visa also stresses that the "merchant-indifference methodology" is more difficult to apply to credit cards because they may be used under circumstances where cash is not an option. Therefore, discussions on the credit card and charge card MIF are to be continued.

EuroCommerce has criticised the agreement as unacceptable and called it a “sell out” of retailers and consumers.[6]

Our Comment

As far as immediate debit cards go, Visa has acepted basically the same terms as MasterCards: an average fee of maximal 0.2%. Given the current fee of 15 cents the agreement implies a substantial reduction of fees. The EU Commission estimates that the agreement implies a 30% cut for cross-border transactions and an average lowering of 60% for the domestic rates concerned.

Both Visa and the Commission point to the importance of the "merchant-indifference methodology". This methodology sets the costs of cash payments as benchmark. Interchange fees have to be set in a way that card payments do not cost more than cash payments. So, for the future setting of rates a lot will depend on cost studies. One such study has been commissioned by the EU Commission in 2009. One does not need to be a prophet

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4 IP/10/462: Antitrust: Vice President Almunia welcomes Visa Europe's proposal to cut interbank fees for debit cards, Brussels, 26 April 2010.

5 Also known as “tourist test”. See our article ‘What the hell is a "tourist test"?’ in the June 2009 edition of this newsletter.

6 http://www.eurocommerce.be/content.aspx?PageId=41771

to predict that there will not be a single element in the results of this study that will remain uncontested – and, given the complexities of payment costs, probably rightly so.

At a more fundamental level, Visa does not seem to be convinced that the "merchant-indifference methodology" can be applied to credit cards because there are situations when cash is not a viable alternative to cards. Visa does not spell out what type of situation this should be. But obviously, e-commerce would be a good example. How should fees be set in this case – using the costs of cash upon delivery or direct debits?

More generally, the path taken by DG Competition is moving towards fairly detailed sector regulation. This will probably not only make card organisations and banks feel uneasy. Many anti-trust authorities are also likely to be unhappy with such a role.

3. Setting an end-date: the EU Commission vs. the EPC

On 15 March 2010, the EU Commission has published a discussion paper on the SEPA migration end-date.[7] In this paper, a number of options for setting an end-date are outlined:

a. Self-regulation
b. Non-binding Community instruments
c. Binding Community instruments
    i. Common schemes
    ii. Common standards
    iii. Definition of essential requirements

In addition, the Commission adresses a problem that may well prove difficult to solve in practise: the product specification for an end-date.

In section 1 of the document, the Commission looks at the pros and cons of the three principle instruments. When discussing self-regulation and a non-binding Community instruments, the Commission notes that these instruments cannot "*guarantee a concerted and synchronised effort by all stakeholders across all member states*" (p. 2). But the Commission also sees problems with the application of a binding Community instrument, noting that this would imply "*moving away from a purely market-driven SEPA project*" (p. 2).

In section 2, the Commission evalutes the three possible approaches to implement binding end-dates.

[7] European Commission: SEPA Migration End-Date" (PSMEG/002/10), 15 March 2010. http://www.europeanpaymentscouncil.eu/documents/PSMEG00210_EC%20Discussion%20Paper%20End%20Date.pdf

The first approach is to make EPC schemes (SCT and SDD) mandatory. This would be the step that brings harmonisation to the highest possible level. However, the Commission sees drawbacks, noting that this "*de facto grants a private moniopoly to the EPC*" raising questions of "sufficient transparency" and "stakeholder representation" (p. 3). Moreover it sees potential impediments to innovation and scheme improvements.

The second approach considered is the mandatory use of certain standards such as IBAN and ISO 20022. According to the Commission, such an approach would leave more room for "*development and innovation of payment instruments*". However, since business rules would not be addressed, there would this would still allow for different implementations of payment products.

The final approach discussed is the "essential requirements" approach.[8] This approach would only rely on the definition of essential requirements. All products fulfilling these requirements could be offered in the market. So, for instance, there could be competing credit transfers. Such an approach would leave room for competition and innovation but its harmonisation effect is somewhat unclear.

In section 3 of the discussion paper, the Commission loooks at the tricky issue of defining which products should fall under the regulation and which not. In particular, the question is raised whether "niche products" with some special functionalities should be aso be phased out. Again, the Commission considers three options:

- Phasing out all products at the defined end-date
- Providing a permanent exception for specific niche products
- Providing a transition period for niche products

As the title of the Commission paper says, it is meant to be a paper starting the discussion on how to send an end-date. It invites all stakeholders to comment on these three questions:

- Which instruments should be used to set an end-date?
- Does SEPA require common schemes, common standards or essential requirements?
- How should niche products be treated?

Our Comment

The discussion paper includes some points that have been made many times before, e.g. the the pros and cons of self regulation vs. a mandated end-date. What comes as a complete

[8] This approach has been applied, for instance, in the case of phasing out the use of non-efficient light bulbs.

surprise – almost a sensation - is the discussion of possible ways to set a mandatory end-date. It was our understanding that a "mandatory end-date" meant that all other products would have to be shut-off and that the EPC's products SDD and SCT would remain as the only offering in the market. Apparently, this was also the understanding of the EPC which now has to read that such an approach would have the drawback of granting a "monopoly" to the EPC. Surprisingly, the Commission now contemplates two alternative approaches, "common standards" and "essential requirements".

Understandably, the EPC has not been "amused". In the latest EPC Newsletter, there is long article by the EPC's Gerard Hartsink expressing his frustration with the new line of the Commission as outlined in the discussion paper.[9] *Hartsink forcefully makes the argument for a "*mandatory migration to the SEPA Schemes developed by the EPC*" (p. 7). At length, he quotes statements of EU policy makers that support his case that SEPA has always been about making SEPA schemes mandatory. As he rightly points out:* "If the EPC is a monopoly, then the regulators established this monopoly.*" (p.3)*

In a way, both the Commission and the EPC have a point. The Commission, at long last, wakes up to the fact that "market led" standardisation - carried out with a lot of political pushing - basically leads to cartel solutions. The EPC did what it did, because of political pressure. Its members have heavily invested in the project and now find that the political masters suddenly seem to have second thoughts.

In a way, at his crucual point where a decision has to be made whether the project requires the coercive power of the state, contradictions are surfacing that have been neglected for a long time. Consider the different approaches taken with respect to cards, on the one hand, and credit transfers/direct debits, on the other.

For direct debits and credit transfers, there was a common agreement from the start that there should be one European product for each of the two instruments.[10] *The goal was 100% standardisation – or in today's words of the Commission – monopoly solutions ("single scheme model"). With respect to card payments, one has taken a completely different path: the EPC defined high level requirements (in the SEPA Cards Framework) and regulators expressed a desire to have competition between at least three card schemes (one of them European) ("competition model"). But why this different treatment? Why should there be*

[9] Gerard Hartsink: On SEPA and US Health Care Reform. The EC paper 'SEPA Migration End-Date': a commentary, EPC Newsletter, 29.04.10
http://www.europeanpaymentscouncil.eu/pdf/EPC_Article_111.pdf
[10] In fact, for direct debit, finally two products were defined.

competing card schemes and no competition between direct debit schemes or credit transfer schemes? This has never really been discussed (at least not in public).

In this respect it is notworthy that regulators sometimes tried to push the EPC to consider an own card scheme.[11] This would imply moving towards the single scheme model also in the field of cards. At the same time, the Commission now considers the essential requirements model for credit transfers and direct debits. This comes down to miving away from the single scheme model. In a way, one could interpret the SEPA Cards Framework as a definition of "essential requirements" for card schemes. Thus, the Commission suddenly contemplates the "competition model" - so far only apllied to cards – also for credit transfers and direct debit.

Historically, credit transfers and direct debits have usually been commodity services provided on a monopoly platform. Card payments have been either more a commodity – many European debit card systems can be used as example – or a product provided by competing schemes. So the questions that need to be adressed are:

- *What are the pros and cons of each model?*
- *Which model do we want for SEPA?*

Related with these questions is the problem of European diversity. If one commodity product is enough for a single country (with its historically grown payment habits) is the same true for the EU as a whole? At least one European regulator has been contemplating the possibility that Europe is big enough "for both economies of scale and competition."[12]Thus, under an essential requirements approach, there could be, for instance, room for two types of direct debits, one more French style and one more German style.

A very remarkable point of the discussion paper is also the treatment of niche products. This is related to the general question: If a binding end-date is chosen – which products have to be phased out? As the discussion paper shows, this is a tricky point. Shutting down all of these products would certainly offend many users. Leaving them in place would slow down standardisation and might provide a back-road for national schemes.

Closely connected with this question is another problem: What about new products? To take an example: Suppose we are in SEPA after the end-date and VocaLink wanted to offer a

[11] An example can be found in the ECB's progress report: "the EPC could reconsider the position it has taken with regard to the SEPA for Cards, i.e. its choice not to create a SEPA scheme for card payments", ECB: Sixth SEPA Progess Report, November 2008, p. 25. The point has been taken up, again, by G. Tumpel-Gugerell in her speech at the Monnet Symposion in Madrid, May 5, 2010.

[12] Jean-Michel Godeffroy (ECB), Strategien für den kartengestützten Zahlungsverkehr der Zukunft, ZKA-Informationsveranstaltung, Berlin, 15.01.2008.

"FasterPayment EU"[13] *product to European banks. Would it be allowed to do so? Under what conditions? Would VocaLink have to get permission from the EPC? If its competitors are part of the EPC stakeholder group, would they be allowed to vote on the proposal?*

4. Monnet Symposium in Madrid

On 5 May 2010, 30 banks from 10 European countries gathered in Madrid to discuss the prospects of building a third card scheme.[14] The project, called "Monnet", is driven by a number of French and German banks: BNP Paribas, BPCE, Crédit Agricole, Crédit Mutuel, La Banque Postale, Société Générale, Deutsche Bank, DZ BANK and Postbank. These banks tried to drum up support of the banks in the other countries. Both, the European Commission and the ECB support the project.[15]

Each participating bank will have to decide by the end of 2010 whether it wants to participate in the creation of Monnet. In the meantime, it is planned to carry out further studies at a European level, regarding the business case and other issues.

Our Comment

Monnet has made one step forward. However, just how big this step is, is still difficult to evaluate. The information about the meeting has been confined, so far, to a brief press release of the French Banking Association.

The EU Commission and the ECB strongly support the project. But as the ECB's G. Tumpel-Gugerell notes "there are still many issues to be resolved – finding a proper financing model being probably the most important one from the point of view of banks".[16] *Referring to the recent agreement between Visa and the EU Commission (0.2% for debit card transactions; see topic 2 of this newsletter), she points out that there is more clarity on interchange fees, now. But it seems questionable that this is the kind of clarity that will push the banks into the direction of building a European card scheme. In particular, why should French banks give up an interchange fee of approx. 0.45% in order to move to a European scheme that might offer only 0.2%? Thus, it is stil highly uncertain what will become of Monnet.*

[13] FasterPayment is a service that allows an almost real-time credit transfer between most banks in the UK.

[14] See the press release of the French Banking Federation „About twenty European banks plan to create a new card scheme for Europe", Paris, May 6, 2010. (www.fbf.fr).

[15] The speech of the ECB's G. Tumpel-Gugerell has been published on the ECB's website: http://www.ecb.int/press/key/date/2010/html/sp100505.en.html

[16] Source: See footnote above.

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