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1. Interchange in Holland: Clarification and extension

In our July edition we reported on the domestic fall-back Maestro interchange fee in Holland. At the time we wrote the article, the domestic Maestro rate for a Chip & PIN transaction was 0.40% + 0.05 EUR. This rate has been reduced considerably. The current interchange table as published by MasterCard in August looks as follows:

Table 1: Dutch National Maestro Interchange Rates[1]

Group	Fee Tier
PayPass	0.034 EUR
Chip & PIN	0.034 EUR
Base	0.034 EUR
Secure e- & m-commerce	1.05% + 0.05 EUR

These rates are substantially lower than the rates initially published. However, they are still higher than the rates agreed bilaterally. Thus a handicap remains for third-party acquirers – albeit a much smaller one than before.

Meanwhile, Visa Europe also has been publishing its domestic interchange rates. The published rates do not include V PAY, however, because Visa Europe has not set specific domestic rates for V PAY.

Table 2: Intra-EU x-border interchange rates for V PAY debit cards[2]

Group	Fee Tier
V PAY - Contactless Low Value Payment	0.06 EUR
V PAY - EMV	0.15 EUR
V PAY - Electronic Commerce	0.15 EUR

[1] http://www.mastercard.com/us/company/en/whatwedo/interchange/Country.html
[2] http://www.visaeurope.com/aboutvisa/overview/fees/interchangefeelevels.jsp

Since there is no domestic rate, the intra-EU x-border rate is the fallback rate for the Netherlands (see Table 2). So, unless there is a bilateral agreement between issuer and acquirer, these are the rates that have to be applied.

Our comment:

First of all, we would like to stress that the interchange rates published by MasterCard are those rates that are set by MasterCard – not by the banks. So, as already noted in the last newsletter, the Dutch interchange rates were set by MasterCard and not by the Dutch banks. These rates have now been changed. Surprisingly, this happened only a few weeks after their initial publication (and only a few days after the publication of our newsletter).

Still, the basic problem remains: Since the domestic Maestro rate and the fallback V PAY rate are higher than the bilateral rates agreed between Dutch banks, any external acquirer (foreign or Dutch) has to approach all Dutch banks and negotiate bilateral deals. If one or more Dutch banks do not agree to bilateral deals on the same terms as between themselves, an acquirer from outside will have to offset the higher interchange by lower costs or higher merchant prices.

Of course we do not know what Dutch banks will do. As pointed out in our last newsletter, it does not seem in the commercial interest of a particular bank to provide the same terms to other net-acquirers. But when they do so, the bilateral rates would become a de facto multilateral interchange rate. Indeed the whole issue would not have come up if regulators had been less opposed to multilateral interchange fees.

It is important to stress that the current situation is not the result of a plot of the Dutch banks. It is the outcome of antitrust policy which is suspicious of multilateral interchange fees and of regulators following two goals that are difficult to reconcile:

- *achieve a common price level within SEPA*
- *maintain the low level of Dutch debit card fees*

The only way to reconcile these two goals is to move European fees to the Dutch level. Such a move would probably lead to open revolt of banks in a number of EU countries (France comes to mind). Thus, it seems impossible to reach both goals.

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2. EAPS: Connecting German and Italian ATM networks

On August 27, 2009 the Euro Alliance of Payment Schemes (EAPS) announced that Italy and Germany mutually opened their ATM networks to domestic debit cardholders from each country.[3] Consorzio Bancomat and Zentraler Kreditausschuss allow each other's cardholders to withdraw cash from ATM networks in Italy (Bancomat) and Germany (Girocard) respectively. It was also announced that cross border POS acceptance between the two card schemes would follow.

Our comment:

In 2007, ZKA signed contracts with a number of Italian banks about the mutual access to ATMs and POS terminals. These contracts have now been superseded by a contract with the Consorzio Bancomat which opens up the entire Italian Bancomat ATM system for German cards. Thus, those banks that initially have not been participating could be won over.

Obviously, the agreement is a big success for EAPS. But it should not be overrated. One important motive of Italian banks may have been to keep as many options open as possible.

Meanwhile, the German savings banks have reaffirmed their commitment to EAPS. At a Bundesbank conference, Bernd M. Fieseler, member of the board of the German Savings Banks' Association (DSGV), stated that EAPS is an integral part of the savings banks' cards strategy for SEPA. Moreover, he voiced support for the Berlin Groups' activities to develop a cards clearing system based on SDD. Thus, one important sector of the German banking system, with a card market share of about 50%, stands behind EAPS.

3. Self assessment of card schemes: "We are all SEPA compliant"

On March 4, 2009 the Eurosystem published its TERMS OF REFERENCE FOR THE SEPA COMPLIANCE OF CARD SCHEMES.[4] It contains a list of questions that card schemes are supposed to answer and to publish the findings on their websites by end-June 2009. So far,

[3] http://www.card-alliance.eu/assets/2009-08-27-Bancomat-and-girocard-connected.pdf
[4] http://www.ecb.int/paym/sepa/pdf/ToR_SEPA_compliant_card_schemes.pdf?fabf093dbe168154e4a3b254f030bf3f

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the finding cannot be found on the website of the ECB (unlike the Clearing house self-assessments) but some internet research helped us to find at least 5 self-assessments:

- Consorzio Bancomat (Bancomat, PagoBancomat - Italy)
- Multibanco (Portugal)
- Sistema 4B (Spain)
- ServiRed (Spain)
- Zentraler Kreditausschuß (German ATM System, electronic cash - Germany)

The result of the self assessment is straight-forward. All schemes see themselves as SEPA-compliant. In case of non-fulfilment of SEPA criteria, the schemes could usually point out that change is under way.

Comment

For anyone expecting an interesting read, the self assessments (at least some of them) may be a disappointment. Two schemes basically managed to answer all questions with the help of two words "Yes" and "Confidential". But whatever the particular form of answering the ECB's questions, the result is the same: all schemes see themselves as SEPA compliant.

This could be interpreted as good news for the supporters of SEPA. And indeed, progress has been made. Scheme and ownership have been separated, access has been (or will be) opened to payment institutions and foreign institutions, EMV implementation is well under way, etc., etc.

On second thoughts, however, change seems to herald the cementation of the status quo. Clearly, the idea of SEPA for cards is one of a few Europe-wide schemes competing in the market. Underlying this vision is the death of most of the old national schemes and the complete transformation of a few schemes to truly European schemes. However, this does not seem to happen. Rather, most national schemes are doing whatever is necessary to survive. As SEPA compliant schemes, they have the option to provide European coverage via co-badging with MasterCard/Visa or participation in EAPS. So far, none of the national schemes has shown big ambitions to venture across borders. GiroCard (electronic cash) can be found here and there outside Germany – however only on a very modest scale.

It will be interesting to see the results of the self assessments of the other schemes. But it would not be a surprise of these schemes also came out as SEPA compliant.

The EU Commission and the ECB have always asked for "at least one European scheme". In the end, they might get a dozen. Will they be happy?

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4. The ECB keeps up the pressure on banks

On 9 September 2009, Gertrude Tumpel-Gugerell (member of the Executive Board of the ECB) gave a speech at the EFMA conference.[5] The speech consisted of a long list of „to dos" for the European banks. Inter alia, she highlighted the following points:

- a more elaborate SEPA Cards Framework – possibly including a transaction processing framework,
- elimination of barriers to competition, such as anti-competitive charging and reporting rules, priority rules and interchange rules regarding cross-border acquiring
- adoption of technical standards by the EPC
- a certification framework
- possibly, membership of the EPC in EMVCo and PCI SSC
- a new European card scheme

Mrs. Tumpel-Gugerell also addressed the topic of interchange regulation, arguing that more regulatory clarity has been provided by DG Competition. She urged banks not to expect more because DG Competition has a mandate only to „act on specific cases and not to define rules". She also stressed that falling interchange fees may imply higher earnings because of the „volume effect".

Comment

Most of the topics addressed by Mrs. Tumpel-Gugerell are not new. However, the tone seems to become more and more urgent. Moreover, the list of to dos seems to become larger rather than smaller. In particular, in her speech she refers to anti-competitive practices about which many payment service providers have complained in the recent past (see our July newsletter). In addition, she has adopted a point raised by retailers, namely that always the interchange of the country of the merchant applies - even in the case of cross-border acquiring. It is understandable that merchants criticise this practise. But the question is whether there are any viable alternatives. First, one should also note that the description of the current status quo is not completely correct. For a particular merchant, there are at least two interchange fees that apply within the EU: the domestic and the x-border rate. Currently,

[5] A single market for cards: the missing piece in the SEPA puzzle. Speech by Gertrude Tumpel-Gugerell, Member of the Executive Board of the ECB, EFMA Conference on Cards & Payments, Paris, 9 September 2009.

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domestic means that the merchant and the issuer are in the same country (see "Status quo" in Table 3).

Table 3: Applicable interchange under three different regimes

Merchant	*Acquirer*	*Issuer*	*Applicable MIF Status quo*	*Applicable MIF Rule 1*	*Applicable MIF Rule 2*
FR	FR	FR	domestic	FR MIF	domestic
FR	DE	FR	domestic	DE MIF	x-border
FR	FR	DE	x-border	FR MIF	x-border
FR	DE	DE	x-border	DE MIF	domestic

What are the alternatives? If the French merchant is acquired by a foreign acquirer, say from Germany, which MIF should apply, always the German MIF (Rule 1), or a MIF based on the nationality on the residency of the acquirer and the issuer (Rule 2 – which would correspond to the interpretation of the EU Commission with respect to direct debit interchange fees)?[6] In the latter case, a domestic MIF would apply if the acquirer and the issuer reside in the same country.

If interchange is based on Rule 1 in the EU, all acquirers will migrate to the country with the lowest interchange fee within the EU. Thus, one could also set one uniform interchange fee for the entire EU. If interchange is based on Rule 2 the effect would depend on the relative level of interchange fees. If the Intra MIF is relatively low, it would provide an incentive for merchants to contract with a foreign (-based) acquirer. In this case, the Intra MIF would also become the de facto domestic MIF. If the local rate is lower, it would be better for merchants to remain with local acquirers. Thus, for the area as a whole, the Intra MIF would provide a ceiling.[7] On the whole, the same effect could be produced with a binding SEPA MIF or a SEPA maximum MIF. Thus, the proposition that the new system would be more competitive is dubious.

Another noteworthy point is the approach taken to standardisation. The ECB, and the EU Commission, urge banks to go ahead with standardisation. This urging comes without a single foot note or reservation. This is puzzling because joint standardisation is a bit like central planning and as such the exact opposite of competition. Regulators, however, often

[6] See "The meaning of 'cross-border': A clarification of the ECB" in our Nov./Dec. 2008 newsletter

[7] This finding basically mirriors the result of our analysis of direct debit interchange fees in the September 2008 newsletter. See „The proposed SDD interchange fee and the meaning of ‚x-border'".

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seem to exclusively interpret „competition“ as „price competition“. But competition can also be understood as a discovery procedure to find new and better solutions. Such solutions are unlikely to emerge in long and protracted negotiations within the EPC (representing more or less the entire banking sector in the EU). They will be introduced by small groups of banks or payment service providers or individual institutions with a view of gaining temporarily relief from competitive pressures and earning super normal profits. This is the essence of „dynamic competition“. By mandating EU wide standardisation, such dynamic competition is brought to a halt. If the aim is to make „the European Union (EU) the most competitive economy in the world“ (Lisbon Agenda) stifling dynamic competition seems to be the wrong strategy.

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- 250 EUR per year (single user license)
- 500 EUR per year (company license)

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