Topics of this issue:

1. Will PSD bring deferred settlements by merchant acquirer to an end?

(by Dr. Richard Reimer[1])

Merchant acquirers (**Acquirer**) effectively delay settlements to merchants by a number of days by pooling the funds sent by the issuing banks in internal settlement accounts before forwarding the funds to the merchant's bank accounts. This was and still is common practice in Germany and most European countries. This practice is now affected by the Payment Service Directive 2007/64/EC of 13 November 2007 (**PSD**) as it provides that funds must be made available immediately.

Comment:

Payment instrument acquisition is a payment service pursuant to the third definition in Art. 4 PSD. Any person providing acquiring services must therefore be an authorised payment institution and must comply with PSD's conduct of business rules. The rule in Art. 73 Para. 2 PSD provides that payment service providers shall ensure that the amount of the payment transaction is at the payee's disposal immediately after that amount is credited to the payment service provider's account. The key question is whether Art. 73 PSD applies to an Acquirer. This raises the questions whether settlement accounts are 'payment accounts' and whether merchant agreements are 'framework contracts' under the PSD. There are no clear answers to these questions and the acquiring business bears the risk that the lucrative deferred settlement may be ended by a court decision or regulator. Due to the full

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harmonisation of PSD in all European countries each legislation should extend the view to its neighbour for arguing with its national authorities.

GERMANY

*In Germany, PSD was implemented by two different acts. The first deals with all regulatory issues (German Payment Services Supervisory Act (**PSSA**)) and the second with the conduct of business rules (Act for the Implementation of the Civil Law Aspects of PSD and CDD, German Civil Code, **GCC**).*

*No German legislation has been introduced that specifically deals with the application of the PSD to merchant acquisition. In addition, the German Federal Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, **BaFin**) has not provided any specific guidance on the application of the PSD to merchant acquisition. BaFin is not competent to review any conduct of business rules. Therefore, any guidance on the civil law level may only be provided from the (i) legislator's grounds of the GCC, (ii) jurisdiction or (iii) literature. So far, no literature or legislation on merchant acquisition matters have been issued and published, respectively.*

The obligation in Art. 73 Para. 2 PSD to make funds available immediately has been implemented unchanged in Sec. 675f Para. 1 GCC which, in principle, also applies to merchant acquiring transactions. Nevertheless, the majority of the German Acquirers did not change their business model and thus continue to practice deferred payments.

There are different possible ways to argue in favour of deferred settlements:

- ***Assignment of merchants' claims***

In the legislation process the government and the interested public agreed on the view that if the merchant "acquires" by way of assignment claims of the merchant against cardholders and the merchant pays (as consideration) a price for this acquisition, the payment of this price is to be qualified as the fulfilment of an own obligation of the Acquirer vis-à-vis the merchant. This payment obligation needs to be considered apart from the payment order of the cardholder. Therefore, Sec. 675t GCC (implementing Article 73 of the PSD) does not apply.

The legislator (in particular the ministry of justice) published the aforementioned view in the latest grounds of the German implementation act in the paragraph "miscellaneous". The exact wording of the legislator was:

"To the extent that a card accepting merchant as payee assigns his receivables against the credit card owner under a credit card transaction to the credit card acquirer in return for a contractual payment claim against the credit card acquirer, it is questionable whether Section 675t Para. 1 BGB-E applies.
The performance of a separate contractual payment obligation of the credit card acquirer vis-à-vis the credit card accepting merchant, which is independent of the card owner's payment order, will (in any case) not be governed by § 675t Para. 1 BGB-E."

- ***Settlement agreement***

Furthermore, it is possible to argue that the obligation of the Acquirer - to ensure that the amount of the payment transaction is at the payee's (i.e. the merchant's) disposal immediately after that amount is credited to the payee's payment service provider's (i.e. the Acquirer's) account - is fulfilled by informing the payee that a payment amount to his benefit has been credited to the payment account of the payee's payment service provider account and that the payee may dispose of the respective funds immediately.
At the same time, the Acquirer as the payee's payment service provider and the payee may contractually agree on how to settle the amounts which have been made available to the payee immediately. In such a settlement agreement, the payee may grant the right to the Acquirer to retain the funds which have been made available immediately for a specific time period (e.g. a week or a month).

- ***Price model***

Another way to circumvent the impact of Article 73 PSD is to ask merchants (by ticking respective boxes on the application form) whether they would like to have payments on a daily, weekly, bi-weekly or monthly basis and to structure the price scheme accordingly, i.e. the fees are higher when the merchant chooses payments on a daily basis. Due to the costs for each money transfer and the administrative costs involved it is likely that the majority of merchants will opt for bi-weekly or monthly payment rhythms. If the merchants agree on a deferred settlement because such settlement is from a practical and/or economical point of view to their personal benefit, this could be seen as not derogating the payment service user's position (i.e. the merchant) as provided by Sec. 675e Para. 1 GCC.

UNITED KINGDOM

There are two relationship models for acquiring payment transactions in the UK:

- ***The execution model***

Under this model the merchant and the Acquirer enter into an agreement under which the Acquirer executes payment transactions for the merchant and to collect the payments from the card issuer on the merchant's behalf.
Under the execution model, the settlement account maintained by the Acquirer recording payments from issuers to the benefit of merchants is a 'payment account' of the merchant. The merchant gives future dated payment instructions to the Acquirer for payments from that account to its own bank account.
The Acquirer agrees to execute payment transactions for the merchant. The agreement is therefore a framework contract.

- ***The acquisition model***

Under this model the merchant and the Acquirer enter into an agreement under which the Acquirer acquires payment transactions from the merchant and pays the merchant for them at times agreed.
Under the acquisition model, monies received by the Acquirer from the card scheme are for its own account because the Acquirer has a separate obligation to pay merchants for transactions it has acquired from it. Receipt of those monies therefore does not trigger any obligation under Art. 73 PSD.
As the agreement does not serve the execution of payments but the acquisition of payments, it does not qualify as a framework contract.

SOLUTIONS AND ACTION REQUIRED

Currently, it is unclear how the settlement accounts of Acquirers are to be qualified accurately. Consequently, the industry bears the risk of law suits by merchants claiming for any damage, which could be seen in the lack of interest earnings due to the delayed availability of the funds. Furthermore, it cannot be excluded that competitors or any merchant associations may sue the Acquirer for injunctive relief (Unterlassungsklage).

The aforementioned solutions and models should be discussed with the EU Commission in order to find a solution appropriate for the merchant acquisition participants. In the meantime,

the industry should incorporate one or several of the aforementioned models in order to mitigate the legal risks involved.

2. PayFair moves ahead

In November 2009 PayFair, one of the three initiatives aiming to create a European card scheme, went live in Belgium. A Colruyt supermarket near Brussels started to accept payments via the PayFair card. Atos Wordline is delivering the terminal infrastructure. The Colruyt Group is a major Belgian retailer, operating more than 320 integrated stores in Belgium, France and Luxemburg. PayFair iscurrently in discussion with other merchants and with potential issuers.

Our comment:

Not long ago, PayFair did not seem to be more than a nice blueprint, exiting only on paper. But the initiative has gained traction and has finally gone live. Now it will be important to see whether PayFair can spread in its home base, Belgium. Even more important will be an expansion across borders. In Germany, PayFair co-operates with easycash, a PSP with a large merchant base and a long track record as debit card processor and quasi scheme operator. Clearly, a scheme like PayFair must be appealing for merchants but the big challenge is the issuing side.

In our November newsletter, we discussed the topic of separating the fee for a a payment guarantee from the other merchant fees. The PayFair pricing model does include such a separation. For the issuing side of the market there are two fees, an "incentive fee" that goes to the card issuer and a guarantee fee that goes to the bank of the cardholder's current account. The bank where the account resides may also be the issuer ("normal" debit card model) or it may be some other institution. The later case has come to be known as "decoupled debit". Merchants may decide whether they want a guaranteed or non-guaranteed payment.

PayFair's Decoupled Pricing Model

	Decoupled debit card	„Normal" debit card
Incentive fee	Card issuer	Card issuer
Guarantee fee	Bank	= Bank

From the point of view of banks, it may be hard to accept that other institutions may be the debit card issuer for their retail clients. But such a trend is already in the making – witness the PayBack Maestro Card issued by WestLB. The PayFair model has the advantage, that the banks may still earn a guarantee fee – even if they are not the issuer of the card. Thus, PayFair may well find some support in the banking community.

3. Setting end-dates: An opinion from the Council of Ministers

At its meeting on December 2, 2009, the Council adopted a number of conclusions regarding SEPA.[2] Many of these conclusions are fairly general and of limited significance. But the Council also makes some specific comments on the topic of setting end-dates for legacy instruments. The Council broadly endorses setting end-dates because they provide clarity and help to avoid "the high costs of running both legacy and SEPA products in parallel". The Council cautions, however, that

- "each SEPA product shall be assessed separately"
- "specific preconditions of Member States also have to be taken into account"
- "specific needs and interests of end consumers have to be considered" and
- "different possibilities for setting an end-date shall be demonstrated"

The Council calls on the EU Commission "to carry out a thorough assessment of whether legislation is needed to set binding end-dates for SDD and SCT" (together with the ECB and in close cooperation with all actors concerned).

Another topic addressed is governance within SEPA. The Council sees room for improvement and proposes "to establish, as soon as possible and before mid-2010, a SEPA governance and monitoring structure at EU level bringing together the supply and demand sides on an equal footing under a neutral Chair."

Comment

In its "conclusions on SEPA", the Council of Ministers enorses the setting of end-dates. But this endorsement comes with a lot of qualifications. The condition that each product should be assessed separately seems logical. SCT, SDD and SEPA for cards are at different states of completion. More difficult to interpret is the condition that specific preconditions of Member States and of end consumers should be taken into account. This statement may well reflect

[2] Council of the European Union: Council conclusions on SEPA, 2981st ECONOMIC and FINANCIAL AFFAIRS, Brussels, 2 December 2009.

differences of opinion between member states. Such a statement allows those states that are unhappy with the design of current SEPA products to delay implementation and/or demand modification. It does not seem far fetched to speculate that this wording reflects, in particular, concerns of countries beingunhappy with SDD. All in all, the Council of Ministers does not seem to be willing to rush things too much. This is underlined by the demand of the Council that the Commission should undertake a "thorough assessment" of whether there is a need to set an end-date or not. Not long ago, the Commission has carried out such an assessment. The Council apparently requires another assessment. In the same direction works the demand to changer SEPA governance. If the banks have to share responsibility with other players, decision making is likely to take longer. But the advantage may well be better acceptance of SEPA products.

4. Surcharging: Ryanair loses in German court

For quite some time, Ryanair has infuriated its customers with a surcharge on online payments. The Federation of German Consumer Organisations went to court to stop this practise and has scored a preliminary victory.[3] A Berlin court (Kammergericht Berlin) ruled that this practice violates provisions in the German civil code. The judges argued that it was impossible for customers to discharge their obligation to make a payment without extra cost. The court acknowledged that customers can pay with a Visa electron card. But since the electron card is not widely used, the court is not viewing it as a well established means of payment. Rather, the typical customer would be forced to either pay the surcharge or acquire an electron card which implies an additional burden. The court hinted that the decision might be different if a payment system like direct debit would be offered free of charge. For the moment, the ruling is not binding. Ryanair announced that they will take the case to a higher court. For the time being, the company continues with its surcharging policy. The only modifications are that debit is no longer offered and that in addition to the electron card, MasterCard Prepaid is also free of charge. For other card payments, there is a charge of 10 EUR.

Our comment

The ruling of the German court is not directed against surcharging per se. Rather, the judges are stressing that a surcharge can only be levied for a special service. At the POS this could

[3] http://www.telegraph.co.uk/travel/travelnews/5796025/Ryanair-loses-handling-charges-case.html
www.spiegel.de/reise/aktuell/0,1518,630705,00.html

be card acceptance on top of accepting cash. But as the judges argue, on the internet, cash is not a viable alternative. If the main sales' channnel is the internet – even if there are also POS sales – a seller has to offer one of the widely used internet payment instruments for free.

The case shows that non-surcharge rules are not just means of card schemes to make life hard for merchants. Surcharging can be used to make pricing less transparent. Public regulation may be one way to prevent this. On top of that, payment schemes should be allowed to formulate their own surcharging rules. In such a way, the interests of merchants to protect themselves against high fees and the interest of issuers to protect their clients (the card holders) could be balanced.

Should you have any questions or comments please contact

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