

Topics of this issue:

1. **BKM (Turkey) joins Berlin-Group**
2. **German cooperative banks sign V Pay agreement**
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## 1. BKM (Turkey) joins Berlin-Group

BKM, the Interbank Card Center of 28 banks and financial institutions in Turkey, has confirmed its active participation in the work of the Berlin Group.

### **Our comment:**

*The Berlin Group keeps growing. With its new member it is even expanding beyond current SEPA territory. Still, it is not clear how significant the growth of this club of payment schemes is. Ultimately, the decisions will be made by issuers and acquirers. Thus what counts is whether the EuroAlliance can find more support within the European Banking community.*

## 2. German cooperative banks sign V Pay agreement

DZ BANK, WGZ BANK and the National association of German cooperative banks (BVR) sign co-branding deal with Visa on the issuance of V PAY co-branded ec debit cards. The IT providers of the cooperative sector, CardProcess, DG VERLAG, GAD and FIDUCIA IT will adapt their systems accordingly. Once this has been completed, more than 1200 cooperative banks (with almost 16 million clients) will be able to choose between maestro and V Pay.

### **Our comment:**

*Visa has hailed the contract as “a truly historic decision for payments in Germany and in Europe”. However, from the point of view of the card schemes, the co-branding option does not seem very attractive. If the EuroAlliance should flourish, the volume of co-branded transactions would be small. Moreover, whereas, in many countries, maestro used to be the exclusive co-branding partner, in the future, there will be competition between the brands. In the case of the cooperative sector in Germany, it will be up to the member banks to decide whether they want to offer a V Pay co-brand, a maestro co-brand or both. Thus, the term “truly historic” is going too far. What really would be “truly historic” is the switch from electronic cash to V Pay of a large German issuer.*

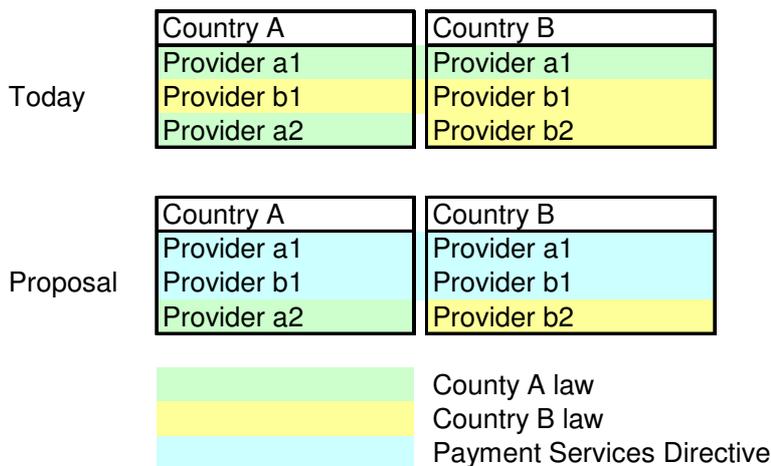
### 3. Update: Payment Services Directive

Given the agreed 2008 deadline for the introduction of SEPA products, the Council of Ministers seems to contemplate a compromise solution regarding the applicability of the PSD (Payment Services Directive). The most important element of this compromise would be a waiver for payment institutions that do not do any cross-border business and that fall under a certain threshold. These institutions could be regulated according to national laws, just as today. Thus, the provisions of the PSD (including capital requirements) would only be relevant for very large institutions and all of those institutions that do cross-border business. If this compromise is accepted, it is hoped that other issues can be solved as well so that the Directive could be passed in 2007.

**Our comment:**

*Given the huge political pressure that has been put on the banking industry to come up with SEPA solutions within a fairly tight time frame it would be more than just a little embarrassing if governments and the Commission would not be able to make their homework, on time. However, when it comes to making rules and regulations quick compromises may be far from optimal. The proposed compromise is a case in point.*

**Figure 1: Implications of proposed compromise**



*At first, the proposal looks like an example of sensible pragmatism. But on close reflection, the results are quite curious. If accepted, the proposal would create a level playing field between x-border payment institutions (provider a1 and b1). But it would skew the playing field between national and x-border institutions.*

*Today, in country A and B, national institutions are regulated in a uniform manner and foreign institutions face a different regulatory regime. According to the proposed changes, cross-*

*border institutions (provider a 1 and b1 in Figure 1) are regulated alike within the EU, and small or mid-sized national institutions (without cross-border business, provider a2 and b2 in Figure 1) are regulated according to national laws. This implies that in countries with a light regulatory touch (which may include no regulation at all for certain types of business) business would be fairly difficult for foreign institutions and for local institutions doing cross-border business.*

*An open question that remains is the definition of the threshold for the waiver. Is size defined in absolute terms or in relation to the size of the national market? Another question is the definition of "cross-border" business. If a German acquirer has a subsidiary in Holland, do the activities of this subsidiary constitute cross-border business?*

#### **4. Decision on Interchange Fees in Poland**

The Polish Office of Competition and Consumer Protection found 20 banks, Visa Europe, Visa International, MasterCard Europe and the Polish Bank Association guilty of restricting competition in the market for acquiring services by means of the joint setting of interchange fees.<sup>1</sup> The practise of setting interchange fees was prohibited with immediate effect. According to the Office of Competition and Consumer Protection, non-cash transactions can be settled at par value, without deducting the interchange fee.

The banks were fined a total fine of 164 million Polish Zloty (roughly €42 million). By comparison, estimated interchange fee income in 2005 amounts to 400 million Polish Zloty (about €100). The decision of the Office of Competition and Consumer Protection is open to appeal by the banks concerned.

Pointing to the example of Denmark, Norway and Holland, the president of the Office rejects the argument that joint interchange fee setting is indispensable within 4-party systems. Similarly, the Office was not convinced that interchange fee is an instrument of the optimal distribution of costs among the participants of the four-party payment card system, which leads to maximisation of the system's size. Using the results of the EU Commissions Sector Inquiry, the Office also rejects the claim that benefits from interchange are passed on to customers (citing evidence that interchange is not related to card holder fees). Finally, the Office was not prepared to accept the cost studies presented by Polish banks as a basis for the calculation of interchange.

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<sup>1</sup> [www.uokik.gov.pl/en](http://www.uokik.gov.pl/en)

#### **Our comment:**

*For years, multilateral interchange has been an issue. Little by little there seemed to be emerging a consensus between competition watchdogs. Most of them see interchange as an infringement of competition law. But they also mostly agree that some kind of multilateral interchange is necessary. So, most competition authorities followed the example of the EU and mandated a cost-based interchange. The Polish competition authority has not followed this pattern. Arguing that cost-studies are not sound enough to form the basis for a regulated interchange fee, they abolished interchange altogether. It remains to be seen whether this decision remains an “outlier” or whether competition authorities in other countries will follow. As for Poland, it seems probable that the banks will appeal. Thus, the ultimate outcome is not yet known. If the appeal should be unsuccessful, the question is what will replace the current system. Will there be a zero interchange or will there be bi-lateral agreements? To what extent are cross-border transactions affected?*

#### **Should you have any questions or comments please contact**

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