Topics of this issue:

1. EU Commission publishes Green Paper on Payments

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On January 11, 2012 the EU Commission has published a Green Paper with the title "Towards an integrated European market for card, internet and mobile payments".[1] The paper describes the current payment landscape and its shortfalls, sets out the vision of the EU Commission for e/m-payments and cards and then delves into a number of issues – with the aim to "foster and accelerate market integration". In this latter part, the EU Commission frequently poses questions (no less than 32) and invites market participants to comment on these questions until 11 April 2012.

In the introduction, the EU Commission points out that a lot has already been achieved on the way to a fully integrated SEPA. It sees these achievements as a sound basis for a strong European position in the field of e/m-payments. In order for this to happen the EU Commission demands an integrated European approach. According to the Commission, market integration will foster competition, choice and transparency for consumers, innovation as well as security and trust.

When assessing the status quo (ch. 2), the Commission stresses that things are running well with credit transfers and direct debit. Once in place, the end-date regulation will lead to complete integration with respect to these two instruments. Once this has been achieved, market integration can proceed to other segments of the payment market such as cards and e/m-payments.

In the field of cards, the Commission still sees a lot of short-comings such as low market integration, high costs and high fraud risks in certain segments e.g. card-not-present.

The Commission sees e-payments as fragmented and often dominated by non-European players. states that this is due to lack of regulatory framework. Overall, it fears that lack of

[1] European Commission, GREEN PAPER. Towards an integrated European market for card, internet and mobile payments, COM(2011) 941 final, Brussels, 11.1.2012 (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0941:FIN:EN:PDF)

suitable payment instruments may severely damage the growth opportunities of electronic commerce.

Like many others the Commission expects m-commerce and m-payments to grow substantially over the coming years. However, for the moment, it sees the most promising m-payment initiatives coming from non-European players such as Apple, Google and Visa. In order to overcome the market fragmentation, the Commission demands more efforts towards standardization and interoperability.

The vision of the Commission (ch.3) can be summarized as follows: Consumers can make all payments anywhere in Europe from a single bank account. Businesses can centralize their financial operations and benefit from standardization. Merchants can profit from more competition and lower costs. PSPs can benefit from economies of scale. Technology providers can innovate on the basis of common payment standards.

In chapter 4, the Commission stresses the "Need to foster and accelerate market integration". For the Commission, market integration really is the "conditio sine qua non" for a more efficient payment system. Under the heading of market integration 5 issues are addressed:

1. Market fragmentation, market access and market entry across border

   Under this heading the Commission deals with "evergreens" that have been discussed for years: interchange fees, x-border acquiring, co-badging, separation of scheme and processing, access to settlement systems, the SEPA Cards Framework and access to bank account balance information ("information on availability of funds").

2. Transparent and cost-effective pricing

   Topics discussed are, inter alia, surcharging, non discrimination rules, honour all cards rules and blending practices.

3. Standardisation
4. Interoperability
5. Security

Finally in chapter 5 the Commission looks at a strategy for implementing its vision and at questions of governance. It raises the important question whether EU institutions should become more active in the SEPA governance.

Our comment

A detailed discussion of each topic would go beyond the scope of this newsletter. Therefore, below, we will first try to provide a general assessment of the Green Paper. After that, we are taking up a few selected topics.

“Market integration” is the central term in the Green Paper of the EU Commission. It is seen as the key driver for more competition, more choice, more innovation and more security. Unfortunately, it remains unclear what exactly “market integration” means. Equally opaque is the use of the term “competition”. The same is true for two other concepts that are highly valued by the Commission: “interoperability” and “standardization”.

If our interpretation of the Green Paper is correct, the EU Commission wants to achieve market integration AND competition with the help of interoperable products and standardized technologies. What type of payment system would fit this vision? Unfortunately, the Green Paper remains too vague and too abstract to answer this question. So we have to try to explain more specifically what the EU Commission actually means.

In our reading, the Commission wants to apply the model used for credit transfers and direct debits also for cards and e/m-payments. As it states in its Green Paper:

“Credit transfers and direct debits are the only payment instruments for which specific pan-European payment schemes exist, namely the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) rulebooks developed by the European Payments Council (EPC) for payments in Euro. In December 2010, the Commission presented a proposal for a Regulation setting obligatory deadlines for migrating national payment schemes to pan-European schemes. Reaching this essential milestone will lay the foundation for further market integration for the payment instruments and channels described below.” (Green Paper, p. 4)

Admittedly, the Commission doesn’t explicitly say that it wants a SEPA Card Payment (SCP), SEPA E-Payment (SEP) and SEPA M-Payment (SMP). However, the paragraphs dealing with reachability and interoperability seem to suggest just that.

“*To ensure that any payment can reach any beneficiary without detriment to the actors and intermediaries involved, a higher level of coordination is desirable in the form of full interoperability. In line with the Commission’s proposal for credit transfers and direct debits, the principle of interoperability could be applied in the cards market.”* (Green Paper, p. 17)

What does this imply? All parties should sit together and agree on a common scheme – as in the case of direct debits and credit transfers. In line with this is question 20, in which the Commission asks whether the European Committee for Standardisation (Comité européen de normalisation, CEN) or the European Telecommunications Standards Institute (ETSI) should play a more active role in payment standardization.

Finally, on top of all the interoperability and security requirements, the Commission proposes certain obligations that usually apply to essential (or "critical") infrastructures. Thus, based on the observation that card payments are the preferred non-cash payment instrument, the Commission discusses the introduction of a kind of "obligation to contract" on the acquiring side of the market (Green Paper, p. 12).[2] Similarly, in the section dealing with security, the Commission is suggesting that "*PSPs could be required to refuse executing financial transactions on websites which have previously been identified as illegal*" (Green Paper, p. 19).

We have repeatedly asked why the Commission and the ECB want competition in the world of cards (at least three competing card schemes) although they are content with just one direct debit scheme and one credit transfer scheme. This question has still not been answered but the Commission seems be inclined to treat both worlds more equal. If our interpretation is correct, it wants one common SEPA scheme also for card payments and e/m-payments (possibly with smaller competitors on the fringes). If this is the case, the Commission should clearly say so. Moreover, it should admit that such an approach may also hamper competition, in particular competition between schemes and standards. Full reachability and full interoperability based on common standards basically implies one common system. Finally, the Commission should seriously ask itself whether this approach really is a suitable strategy to beat the likes as Google, PayPal or MasterCard/Visa.

The Commission looks at a number of issues in more detail an invites readers to comment. Some of these topics are discussed below.

Interchange and x-border acquiring are yet again discussed. In particular, the Commission wants to know whether there should be "a cross-border MIF […] applicable to cross-border acquiring" (Green Paper, Question 5, p. 9). It also points out that high MIF may be a particular problem in connection with commercial cards. Finally, there is a remark that could

2 "the question arises whether it is in the public interest to define objective rules describing the circumstances and procedures under which card payment schemes may unilaterally refuse acceptance." (Green Paper, p. 12)

be read as an implicit critique of DG Competition: "*Furthermore for both e- and m-payments, (potential) market participants seem reluctant to invest as long as the legal situation regarding scope for applying collective fee arrangements, such as for payment cards, has not been settled*" (Green Paper, p. 6)

According to the interpretation of the EU Commission the SEPA Cards Framework (SCF) implies that all non-complying schemes have to be shut off – including all non-guaranteed schemes. So, according to this interpretation, the SCF would imply that ELV has to be shut off.

The Commission also discusses the issue whether PSPs should have the right to access information regarding the availability of funds on clients' bank accounts. Here it sees security and competition as conflicting issues. An issue which is not addressed is whether service providers that are not payment institutions (as defined in the PSD) should also have such a right of access.

Once more it comes up with the costs of micro payments (Green Paper, p. 12). Claiming that these are "excessive". If the Commission really thinks so and the ECB agrees, they might contemplate setting up their own scheme. Let's see if they are able to undercut existing schemes.

Another evergreen is the hypothesis of e-payments being a bottleneck for e-commerce. This argument is about as old as e-commerce itself. In spite of an overwhelming lack of empirical evidence, it has survived to the present day. Undisturbed, the Commission is repeating it again, citing one of its studies in support. However, a reader bothering to have a look at the study will find the following conclusion: "*there was no general consensus on whether payment problems exist. 57% of consumer associations and many businesses agreed that problems do exist, but 11% of private individuals and some industry federations stated the opposite.*"[3]

[3] European Commission, Summary of the results of the Public Consultation on the future of electronic commerce in the Internal Market and the implementation of the Directive on electronic commerce (2000/31/EC), 2010 (http://ec.europa.eu/internal_market/consultations/docs/2010/e-commerce/summary_report_en.pdf). The results of a survey conducted regularly in Germany also suggest that payments are not a big problem for e-shoppers. See Krueger, Malte und Kay Leibold: Internet Payment Systems: The Consumers' View. Results of the Online-Survey IZV7, Karlsruhe 2004 (http://www.fh-frankfurt.de/de/.media/~krueger/izv7_en.pdf).

In the field of card payments, the Commission wants to apply the principle of separation of scheme and processing also to clearing. Moreover, it wants clearing to be interoperable (Green Paper, p.15).

Although the Commission sees progress on the road to SEPA there also seems to be a lot of dissatisfaction with the current state of affairs. Therefore, it does not come as a surprise that the Commission is contemplating a more active involvement: "*a more prominent role for the legislative and regulatory oversight through, for example, the ECB, the Commission or the European Banking Authority (EBA) could be considered*" (Green Paper, p. 20). Well, looking back, the Commission and the ECB already have been very active. Thus "more prominent role" could only mean to bring the payment system even more under public control. As already mentioned above, this looks a lot like payments becoming an essential infrastructure – just like electricity or postal services.

Finally, we have to express our surprise when reading the following statement:
"However, the payment instrument chosen by the consumer may not be optimal in terms of the full cost to the economy. Merchants typically include their transaction costs in the prices of goods and services they offer. The end result is that all consumers pay more for their purchases in order to cover the real cost of more expensive payment methods used by some." (Green Paper, p. 12-13)

For a long time, the Commission seemed to be convinced that cash is the most expensive means of payment and that it should be replaced by other payment instruments such as cards. Has the Commission changed its mind?

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