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1. PSD 2 and the battle over access to payment accounts

Third-party access to payment accounts has been controversial right from the start. Solutions offered by independent payment service providers (also known as “overlay services” or “third-party payment initiation services”) have been competing with bank-owned providers and banks have fought legal battles with the independent PSPs.[1] On the regulatory side, anti-trust authorities have taken a keen interest in the issue and have generally supported independent PSPs against the banks.

In its proposal for a revised PSD (the proposed PSD 2), the EU Commission has included provisions with respect to “third party access to accounts”. In recital 18 it states:

“third party providers (hereinafter “TPPs”) have evolved, offering so-called payment initiation services to consumers and merchants, … The TPPs offer a low-cost alternative to card payments for both merchants and consumers and provide consumers a possibility to shop online even if they do not possess credit cards”.

The Commission intends to regulate such TPPs as payment institutions and has defined two new types of payment services: payment initiation services and account information services. A TPP must ensure that customer data are safely stored and it has to “authenticate itself in an unequivocal manner toward the account servicing payment service provider” (Art. 58, 2)

The Council of the European Union broadly endorses the proposal of the EU Commission. However, the Council suggests to make a distinction between “reusable” and “non-reusable” personal credentials. Payment users should be allowed to disclose only non-reusable credentials to third parties, which would be in line with the proposed SecuRe Pay requirements of the ECB.

[1] See, for instance: „Overlay systems”: the view of German anti-trust authorities, in the April 2011 edition of this newsletter.

However, not everyone has been happy with the EU Commission's ideas. Banks and bank regulators have been vocal critics. Their main concern is security.

The European Central Bank (ECB) demands "*that customers are appropriately authenticated by relying on a strong customer authentication system. TPPs could ensure this through either redirecting the payer in a secure manner to their account servicing payment service provider or issuing their own personalised security features. Both options should form part of a standardised European interface for payment account access" (recital 2.7)*.[2]

The technical standards could be defined by EBA in close cooperation with the ECB. The main aspects of business rules (including a liability regime) should be clarified in the proposed Directive.

The European Payments Council (EPC) has once again put forward its resistance against any sharing of personal credentials with third parties.[3] It also rejects the idea of the Council that non-reusable credentials could be passed on. Rather, it endorses the proposal of the ECB and proposes a few more considerations: the TPP must be identifiable by the servicing PSP, no liability of account servicing PSPs for TPP's mistakes, strong limitation of the account information available to TPPs, an authorisation regime for TPPs. Moreover, the EPC criticises the Commission proposal because it obliges the banks to let TPPs use their infrastructure without providing a financial compensation.

In contrast to the banks, the payment institutions welcome the proposed legislation of payment initiation services. The European Payment Institutions Federation (epif) endorses the EU Commission's proposal to bring payment initiation services into the scope of the PSD.[4] It demands that the customer should have a right to share information with regulated payment institutions. However, it does not want TPPs to be required to enter a contractual relationship with payment servicing PSPs. Finally, epif complains that it has been difficult for

[2] ECB: OPINION OF THE EUROPEAN CENTRAL BANK of 5 February 2014 on a proposal for a directive of the European Parliament and of the Council on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC. See also: Josef Kokert, Markus Held: Payment Services Directive II: Risks and serious consequences for users and banks, BaFin Expert articles, 16 June 2014.
[3] Javier Santamaria: EPC Calls on EU Lawmakers to Maintain the Firewall Protecting Consumers Making Internet Payments. This Means: No Sharing of Any Personalised Security Credentials with Third Parties. Update on legislative process leading to the adoption of the revised Payment Services Directive, EPC Newsletter, 29.7.2014.
[4] EPIF POSITION PAPER ON PAYMENT INITIATION SERVICES (PIS), July 2013. http://www.paymentinstitutions.eu/documents/download/30/attachement/epif-if-position-paper-revised---final-april-website.pdf

some TPPs to open a bank account and that in a number of cases existing accounts have been closed. Therefore it demands a right to open and maintain a basic standard bank account.

Our Comment

At the moment it seems fairly open how third party access to accounts will be treated in the final version of the PSD 2. The EU Commission puts the focus on competition and innovation whereas banks and banking supervisors are more concerned about security. Both have a point. Overall, banks' joint ventures have not been a great success – with the notable exception of ideal in the Netherlands. In many markets, TPPs have moved much faster and have gained much more of the market. Moreover, even if the security concerns of regulators and banks may be well founded, up to now there do not seem to have been any noticeable incidents of fraud in connection with third party access to payment accounts. Still, the banks have a point. Security may well become an issue and they may ultimately be liable (if not legally they still have to consider the potential damage in their customer relationships). In addition, they can claim with some justice that the use of their infrastructure by third parties should be remunerated.

In the end, the result may be some form of compromise with mandated European technical standards and guidelines as to business rules. This may not be so bad – but there is a caveat. Standardisation at the European level takes time – sometimes a lot of time. In fact, one of the authors of this newsletter has been organising a conference on this topic way back in 2006.[5] Thus, the topic is by no means new. Meanwhile, however, other contenders such as PayPal have emerged and it is not clear whether European players will have time to think a couple of more years about standardisation. Some market participants seem to have noticed this problem and have started "pre-emptively" to think about standardisation ahead of the passing of the final version of the PSD 2. In May 2014 the "Open Transaction Alliance" had its kick-off to discuss the future of an access to account system.[6]

[5] "Online Banking as a European Internet Payment System", University of Karlsruhe, Thursday, March 23, 2006.

[6] http://innopay.com/system/files/140505%20OTA%20write-up%20meeting%20%25231%20April%208%20Brussels.pdf

2. Domestic card schemes: the ghosts that haunt SEPA for Cards

One of the three European co-legislators, the Council of the European Union ("the Council"; the others are the EP and the Commission) still has to come up with an opinion regarding the proposed regulation of interchange fees. The Council represents the governments of the member states. What is known, so far, is, that some member states try to protect their national card schemes.

The Danish government, for example, argues that domestic schemes should be exempted from the regulation as a whole if they operate with lower average interchange fees than the proposed interchange caps.[7] The Danish government criticizes the definition of the interchange caps in terms of a percentage of the transaction value. Rather a fixed fee per transaction should be used. In addition, it is argued that separation of scheme and processing may lead to higher processing costs if transaction volumes are split between various processors. Finally, the Danish government points out that co-badging and application choice of the card holder may lead to an increased use of more expensive international brands.

The German position also seems to support the notion that domestic schemes and domestic rules should be protected. In Germany, the anti-trust authority has insisted on a change towards a bi-lateral setting of interchange fees for the German ec cash system (girocard). According to the German government, such bi-lateral interchange setting should not fall under the interchange regulation.

Generally, it can be expected that countries with large domestic schemes will try to protect these schemes whereas countries that have dis-continued domestic schemes will push for more SEPA in the card world. We expect the Council to come up with an opinion soon and will take up the issue again in the next edition of this newsletter.

Our comment

For many years the EU Commission has worked hard to get SEPA going. In the field of card payments this has proved to be difficult. Nevertheless, the aim of single payments area seemed to have broad political support. And SEPA means that there are no longer any

[7] Ministry of Business and Growth Denmark: Non-paper. Interchange fee regulation and domestic debit card schemes, 2 June 2014. http://www.eu-oplysningen.dk/upload/application/pdf/ca7ff3c0/201305502.pdf?download=1

domestic schemes. Indeed, for direct debits and credit transfers, it has been mandated to shut-off all domestic schemes (Regulation 260/2012). For card schemes the end-date was 31 December 2010, set by the EPC as self-regulator. After this date all schemes should be compliant to the SEPA Cards Framework (SCF). From a regulatory point of view there are no longer any "domestic schemes", even if the users of the former domestic schemes (cardholders and merchants) remain geographically restricted by national borders. Thus it comes as a surprise that some governments vigorously defend the existence of domestic schemes in the Euro/SEPA-zone. Given this lack of political will to push for European card schemes, the future of SEPA for cards looks ever more cloudy.

Maybe, it is time for European institutions to review their current policy stance on cards. They have always maintained that they want competing card schemes while stubbornly clinging to the old domestic schemes as role model. However, most of the domestic schemes were monopoly solutions. The Danish comments on the proposed MIF regulation can be read as an endorsing the treatment of card payments (or debit card payments?) as an essential infrastructure with strong economies of scale that should be run as a regulated monopoly.

3. Presidency draft compromise on regulation of interchange fees

The Italian presidency of the Council proposed a compromise text[8] on the Commission proposal for regulation of interchange fees to be discussed at the 9 September Working party meeting. The compromise text draws on the initial proposal of the Commission, so it is an interesting exercise to compare the three versions of the Commission, the Parliament and the Council (see Table 1). We will focus on the proposed amendments of the Council, discussing those aspects which we consider of particular importance.

Our comment

The debate seems to focus on effective dates for interchange caps and the question whether an intermediate period for caps on domestic card transactions is needed. Parliament and Council both agree that an intermediate period could lead to market distortions when cross-border acquirers are in a substantially better competitive position than local acquirers. The

[8] http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2012912%202014%20INIT

ECB in its opinion[9] emphasized the same issue. Meanwhile the "European payment users Alliance", an alliance of various merchant organizations urged in a position paper[10] for swift implementation of interchange caps, within two months for cross-border transactions and six months for domestic payments i.e. an intermediate period of four months.

Table 1: Comparison of the three proposals

Article	Commission proposal	Parliament first reading	Council compromise
Art 1 para 3 IF caps for commercial cards and three party	Out of scope	In scope	No amendment proposed
Art 2 point 6 Definition of commercial card	Card issued to undertaking	No amendment proposed	Card issued to undertaking ***and*** payments charged to the account of the undertaking
Art 3 Intermediate period between introduction of IF caps for cross-border and domestic payments	Intermediate period of 22 months	No intermediate period	No intermediate period
Art 3 Effective date for IF caps	2 / 22 months after entry into force for cross-border / domestic	12 months after entry into force	Not specified
Art 3 IF caps for immediate debit cards	0.2%	0.2%, 7ct max	To be discussed: 0.2%, 7ct max 0.1% for transactions below 20 EUR
Art 6a	n/a	For cross-border transactions, the interchange fee applicable shall be that of the country of the acquirer	n/a
Art 7 para 1 Effective date for separation of payment card schemes and processing entities	immediately	No amendment proposed	Phased approach
Art 9 para 2 Unblending of merchant service charges	Interchange ***plus plus*** model Acquirers shall provide interchange fee, scheme fees and service fee separately	No amendment proposed	Interchange ***plus*** model Acquirers shall provide interchange fee, and service fee separately

[9] http://www.ecb.europa.eu/ecb/legal/pdf/celex_52014ab0010_en_txt.pdf
[10] http://ueapme.com/IMG/pdf/Stakeholder_Alliance_joint_position_paper_MIFF.pdf

Obviously merchants have a strong interest in the lowering of interchange fees. However as interchange fees for cross border transactions (in the classical sense where merchant and cardholder are from different countries) are already low[11] compared to domestic interchange fees we are wondering whether merchants really will gain a substantial benefit from a phased implementation of interchange caps. In addition, we doubt that any large merchant would contract with a foreign acquirer only to gain a better interchange rate for a period of four months. Accordingly in our interpretation the core message in the merchant's position paper is that they would accept a period of six months for implementation of interchange caps rather than the statement that they insist on the two months period for cross-border transactions. Delegates of the Commission, as well, explained that they favor a short implementation period for all transactions over a phased approach. So, the positions of all stakeholders (with the exception of card issuers, of course) are not far away from each other. Moreover, beginning 1.1.2015, Visa domestic interchange fees will be under pressure due to the Visa commitments[12] and issuers already need to prepare for substantially decreasing revenue from interchange fee. In addition, these commitments allow cross-border acquirers to apply capped interchange rates to domestic transactions. So from the 1.1.2015 on, foreign acquirers of Visa are put in an advanced competitive position against local acquirers and the outcome is very much the same as the result of a phased introduction of caps on cross-border and domestic interchange rates. A quick legal process would help to protect the level playing field and to bring market forces back into balance.

Another important issue is the formulation of the caps. The Commission has proposed straight percentage caps. However, the Parliament would like to introduce a "double-cap" for debit card payments 0.2% or 7 cents – whatever is lower. The Council endorses the Commission proposal. However, it is pointed out that it is open for discussion about a "double cap" as proposed by the Parliament. Moreover, it also suggests that 0.1% for transactions below 20 EUR may be an option.

The "double cap" would imply that large value transactions would fall under the 7 cents cap and small value transactions would fall under the 0.2% cap. For a transaction of 5 EUR the interchange fee would be 1 cent – if the suggestion of the Council is taken up it would only be half a cent. It seems at least questionable that such a low interchange would allow issuers

[11] Due to various competition cases.
[12] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0516%2801%29&from=EN

to recover the substantial investments carried out to make low-value payments fast and convenient. Future investments into small value payments might be capped.

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