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1. The thorny issue of separation of scheme and processing

The European Switches Forum (ESF+)[1] has circulated a paper that takes up the issue of separation of scheme and processing – one of the key principles of the SEPA Cards Framework (SCF). The ESF+ complains that this separation is still far from perfect in many card payment schemes and makes a number of recommendations.[2]

The list of complaints highlights three types of practises that constitute a linkage of scheme and processing and that are likely to inhibit effective competition:

- pricing and fee assessments
- business rules and practices
- the use of technical and information standards.

In the area of pricing the ESF+ points to cross subsidies, bundled pricing favouring the use of scheme processors and assessment fees that are also based on volumes processed by third-party processors.

As far as business rules and practices are concerned, the ESF+ mentions excessive reporting requirements, mandated routing on international transactions, unequal access to test and certification systems and limitation of settlement guarantee to transactions processed by scheme processors.

Finally, it is pointed out that technical and information standards are applied in a discriminative way. This applies to PCI DSS and safe harbour rules.

Based on the analysis of the status quo, the ESF+ comes up with 5 recommendations:

1. Financial separation: The finances of scheme and processor should be separated and there should be no bundled pricing of scheme and processor services.

[1] ESF+ (European Switches Forum) is an informal think-tank comprising experts from the European payments card world, including ATOS WORLDLINE, AUTOMATIA PANKKIAUTOMAATIT, BBS, BKM, BORICA, CB, EDB, EQUENS, EUFISERV, EURO6000, FIRST DATA, IPSO, LINK, NETS, PBS, SECETI, SERVIRED, SIA-SSB, SIBS, SISTEMA 4B,SIX-TELEKURS, TRIONIS, and VOCALINK.

[2] The document can be obtained from David Stephenson: david-stephenson@cartes-bancaires.com

2. Payment scheme rules should not prescribe the use of a particular processor (for any transaction that originates and/or terminates in Europe).
3. Equal access to payment scheme services and information – including dispute resolution services, black lists, settlement guarantee and advance notice of changes.
4. Uniform compliance of all processors with standards such as PCI DSS and data protection requirements.
5. No additional information requirements that provide confidential commercial information to schemes (such as transactions processed under rules of a different scheme).

The paper does not blame any particular schemes but ESF+ members have made it clear that this type of anti-competitive practices are carried out by national as well as international schemes.

The ESF+ is determined to press its points with the authorities and has talked already with the ECB and the European Commission about current practices in the market and potential remedies.

Our Comment

The separation of scheme and processing is a recurrent theme in official publications on SEPA. It can be found in the SEPA incentives paper[3] of the EU Commission, in the SEPA Cards Framework (SCF) and in the ECB's "Terms of reference for the SEPA compliance of card schemes"[4]. However, so far, the authorities have been rather vague when trying to define what this actually means. Therefore, it does not come as a surprise that schemes with own processors have used their rule-making power to favour own processors.

In a time in which national schemes are trying to defend their turf (including their processing activities) while international schemes are extending their processing capabilities, the issue is of utmost importance.

The issue has been well known for some time already. However, now a group of players has been pushing the case with the regulatory bodies to define in more detail what "separation of scheme and processing" actually means and to enforce this rule correspondingly. Representatives of ESF+ have had the opportunity to present their case and have met regulators that were eager to listen. Now, it will be interesting to see how regulators will

[3] http://ec.europa.eu/internal_market/payments/docs/sepa/sepa-2006_02_13_en.pdf
[4] Published on 4 March 2009. See http://www.ecb.int/paym/sepa/pdf/ToR_SEPA_compliant_card_schemes.pdf?66b40da6119f3718721a251e7557a215

react. A minimum requirement seems to be the provision of a more concrete and detailed definition of “separation of scheme and processing”. For such a definition, the ESF+ proposal is a good starting point. Such a definition should go hand in hand with a list of functions that schemes are permitted to carry out on a centralised basis.

Once this has been achieved, it would be worthwhile to also be more explicit in defining what constitutes a “scheme” and what type of scheme falls under the provisions of the SCF. The discussion about the appropriate treatment of 3-party schemes shows that clarification is still needed: Are Amex and Diners schemes? What about the Aurora card or Payback Plus? Equal questions would arise outside of the card world, for instance with respect to internet payments: Are PayPal, Moneybookers or the PaySafeCard schemes?

2. Interchange in Holland: multilateral or bilateral?

In line with its agreement with the EU Commission, MasterCard has published not only its X-border interchange fees but also the national interchange fees (if set by MasterCard). One of the most interesting cases is Holland. The national Maestro interchange fee structure for Holland is as follows:

Dutch National Maestro Interchange Rates[5]

Group	Fee Tier
PayPass	0.40% + 0.05 EUR
Chip & PIN	0.40% + 0.05 EUR
Base	0.50% + 0.05 EUR
Secure e- & m-commerce	1.05% + 0.05 EUR

Maestro Intra-EU X-Border Interchange Fees[6]

Fee Tier	Maestro, Maestro Prepaid Consumer	Maestro Prepaid Commercial
Chip	0.11% + 0.05 €	0.40% + 0.05 €
Chip - Late Presentment	0.17% + 0.05 €	0.75% + 0.05 €
PIN-verified	0.15% + 0.05 €	0.50% + 0.05 €
Signature verified	0.17% + 0.05 €	0.75% + 0.05 €
Secure e- & m-commerce	0.26% + 0.03 €	1.05% + 0.05 €
PayPass	0.15% + 0.03 €	0.45% + 0.03 €

[5] http://www.mastercard.com/us/company/en/whatwedo/interchange/Country.html
[6] http://www.mastercard.com/us/company/en/whatwedo/interchange/Intra-EEA.html

Thus, the Dutch rates are higher than the European X-border rates which are also the fall-back rates for those countries that do not have national rates.

Both rates are far above the rate Dutch banks are charging retailers for all Maestro, V Pay and PIN transactions - about 0.05 EUR per transaction. Such a charge is sustainable only because interchange rates agreed bilaterally between Dutch banks are substantially lower - about 0.02 EUR per transaction.

Our comment:

We have to apologize for making the Dutch card market once more the subject of an article. But since it is one of the least cost debit card markets in Europe it provides a particularly interesting case study. The EU Commission wants SEPA and ultimately as part of SEPA a Pan-European price model. At the same time it wants low prices. Both goals can be achieved only if prices are lowered to the lowest level in the European Union. However, with its agreement with MasterCard this spring, the EU Commission has hinted that it may live with an average rate of 0.2%. This level lies far above the Dutch interchange level.

Given the strong position of Dutch retailers and the political support for the currently existing low level of debit card fees in the Netherlands, the banks agreed to extend current PIN rates to Maestro and V Pay.

The interesting point is that this has not been made possible by lowering the national Dutch fall-back Maestro rate. Indeed, this rate lies above the intra-EU X-border fall-back rate. The low charges are made possible by low bilaterally agreed rates.

This procedure has a nice side-effect. Any acquirer wanting to enter the Dutch market would face the national interchange rate. However, this interchange lies far above current merchant service charges (MSCs). Thus, such an acquirer would be able to offer competitive pricing only if he could strike bilateral deals with the Dutch banks. However, the Dutch banks would have little incentives to agree to such a deal. Thus, competition on the acquiring side could be completely stifled.

Theoretically, on the issuing side things are the other way round. An outside issuer could decline to make bilateral agreements and thus receive the national interchange rate. However, at least with respect to debit cards, it would be difficult and costly to enter the Dutch market only with a view of profiting from higher interchange rates. Small banks that are already in the market could try such a strategy. However, given that they somehow depend on co-operation with the large banks, such a move might no be recommendable for them.

3. The EU interchange decision: Suisse ripples

The Suisse anti-trust authority (Weko) has opened an investigation into credit card interchange fees.[7] Currently, Swiss credit card interchange rates amount to 1.3%. This rate goes back to December 2005 when issuers, acquirers and merchants agreed on the current rate. The agreement was cleared by the Weko and ends in December 2009. Since the end of the agreed period is approaching and since the EU Commission and MasterCard agreed on a rate for intra EU X-border transactions of 0.3%, the Weko has taken up the case again and is launching its investigation.

Our comment:

It is somewhat ironic that the first effect of the EU Commission / MasterCard deal on other anti-trust authorities can be witnessed in Switzerland. This shows that the regulation of interchange fees has become an international issue and that anti-trust authorities are closely watching what their peers in other jurisdictions are doing. They are not the only ones watching. Obviously, for retailers the rates agreed between Brussels and MasterCard can be seen as a kind of benchmark. Where-ever rates are higher, retailers will lobby for an adoption of the EU rates.

4. German parliament against end date for national direct debits

In July 2009 the German parliament has passed a law containing the parts of the PSD that, so far, had not been transposed into German law. This law also contains a resolution of the German parliament that calls for the government to make sure that the German direct debit will not be terminated by an act of regulation.[8] *"At the present moment, the German parliament is not convinced of the necessity to support the introduction of SEPA direct debit by a legally prescribed migration date. The introduction of SEPA direct debit should follow ... a market driven approach. At the current moment the acceptance of important end user groups seems questionable."* (page 4)

[7] See http://www.news-service.admin.ch/NSBSubscriber/message/de/28128
[8] Deutscher Bundestag: Entwurfs eines Gesetzes zur Umsetzung der Verbraucherkreditrichtlinie, des zivilrechtlichen Teils der Zahlungsdiensterichtlinie sowie zur Neuordnung der Vorschriften über das Widerrufs- und Rückgaberecht. Beschlussempfehlung und Bericht des Rechtsausschusses (6. Ausschuss), Drucksache 16/11643.

Our comment:

Payment service users in Germany, in particular large corporates and the retail sector, continue to lobby successfully for the current German direct debit. Thus the German parliament sides with the ministry of finance that also has voiced opposition against a compulsory shut-off of national direct debit systems.[9] This comes at a time where the Bundesbank is clearly favouring an end date. The Bundesbank is supported by the co-operative banks whereas the savings banks strongly favour a market driven approach.[10]

The fate of the German direct debit is also important for the card payment world because the German direct debit is used for clearing ec cash transactions, ELV transactions[11] and ATM transactions. If an end date is set either banks will have to find a new way of clearing these transactions or they will have to continue supporting the former direct debit system as cards clearing system.

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[9] See „German conflict over direct debit" in our May 2008 newsletter edition.

[10] See speeches by Hans-Georg Fabritius (Bundesbank), Bernd M. Fieseler (savings banks) and Andreas Martin (co-opertaive banks) at the recent payment symposium of the Bundesbank (http://www.bundesbank.de/zahlungsverkehr/zahlungsverkehr_veranstaltungen_symposium.php)

[11] Non guaranteed, signature-based transactions.