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1. Access to payment schemes: An opinion from the ECB

One of the key elements of the Payment Services Directive (PSD) is the introduction of the "payment institution". This new type of institution has been created to foster competition in the world of European payments. However, given the existence of strong network effects in payment systems, newcomers may not pose much of a competitive threat to incumbents if they cannot access existing payment systems. Therefore, the PSD rules that payment institutions must be able to access payment systems on reasonable terms. Article 28 (1) of the PSD ("Access to payment systems") states: "*Member States shall ensure that the rules on access of authorised or registered payment service providers that are legal persons to payment systems shall be objective, non-discriminatory and proportionate and that those rules do not inhibit access more than is necessary to safeguard against specific risks such as settlement risk, operational risk and business risk and to protect the financial and operational stability of the payment system.*"

In order to be able to interpret this paragraph, one has to know what a "payment system" is and what the term "access" means. Article 4(6) of the PSD defines "payment systems" as follows: " *'payment system' means a funds transfer system with formal and standardised arrangements and common rules for the processing, clearing and/or settlement of payment transactions*". This is a useful definition is in line with common intuition. But what is meant by "access"? Using a debit card payment system as example, "access" may mean the right of a payment institution to become a participant and issue its own cards or acquire merchants on its own behalf. This would be a somewhat narrow interpretation of "access". The wider interpretation would be that the payment institution can also issue cards and "access" the bank account of the card holder – in the sense of getting information on the current account status or getting an authorisation. This would be like the German ELV coupled with an authorisation of the bank of the card holder. Which definition is going to prevail looks

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uncertain. But the ECB's G. Tumpel-Gugerell (member of the Executive Board) has clearly come out in favour of the wider definition. In her EFMA speech from September 2008, she stresses the need to remove obstacles for newcomers. In particular, she states: "*Finally, for non-bank driven initiatives to be developed, direct access to the current account for payment institutions, at reasonable price is an essential element.*"[1]

Our Comment

Banks have never been enthusiastic to see new, lightly regulated competitors emerge. These new players, the payment institutions, have the right to offer a wide array of payment services, many of which were confined to banks, so far. However, one thing clearly sets bank apart from the other players: they can offer a current or "giro" account. Since the current account is the centre piece of personal and corporate payment management, banks still remain in a strong position – even after PSD implementation.

However, if access rights are defined as suggested by Ms. Tumpel-Gugerell, payment institutions will be able to use the current account and current account information almost as if they themselves were providing the account. Thus, in the case of card payments, a third party providing card payment services always runs the risk of insufficient funds because it cannot authorise against the current account. Examples are specialised issuers of credit cards or providers of ELV payments in Germany. However, if these payment providers can get account information or even an authorisation, they will be able to provide guaranteed card payments and to compete head-on with bank-based payment schemes. Non-bank players like PayFair would find it much easier to set up an European scheme and ELV providers would find it much easier to expand across borders.

Obviously, the only thing that could make access less attractive would be a high price. Banks and payment institutions (plus merchants) may have different ideas about what a "reasonable" price should be. So, if the wide definition of "access" prevails, we may see the next conflict over banking fees. DG Competition should expect more work.

[1] SEPA for cards. Speech by Gertrude Tumpel-Gugerell, Member of the Executive Board of the ECB, EFMA Conference on Cards and Payments, Paris, 9 September 2008 (http://www.ecb.int/press/key/date/2008/html/sp080909.en.html)

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2. What the hell is a “tourist test”?

In its recent agreement with MasterCard,[2] the EU Commission has accepted an “avoided-cost test” or “tourist test” methodology to calculate interchange rates.[3] Suppose you are on a holiday in Italy. On the last day you go to a nice restaurant. Contemplating your working days in a cold and rainy city somewhere further north you run up a high bill. When you finally want to pay the bill and hand over your card the owner of the restaurant is very sorry to tell you that his card terminal is not functioning. So, you have to see whether you find either enough cash in your wallet or an ATM somewhere close by, in order to pay your bill.

Now the crucial point is that the card terminal may actually have worked just fine. But the restaurant owner who learned that you will go home and therefore are unlikely to come back to his restaurant simply chose to force you to pay with a less costly (for him) means of payment, cash in this case. If merchant service charges had been lower, he might have been willing to accept payment by card. This is the idea behind the “tourist test”. Will merchants be willing to accept card payments from a one-time customer under the assumption that the customer is able to pay with cash as well?

This may sound complicated. But in essence it boils down to whether cards are more expensive then cash (or some other alternative means of payment) or not. So, the EU Commission has basically used the costs of cash as a benchmark. Interchange rates should be set in such a way that cards costs are not higher than cash costs for merchants.[4]

Our comment:

The EU Commission has decided to accept the “avoided cost” or “tourist test” methodology for calculating interchange rates. Based on this methodology, MasterCard has come up with two different rates: 0.3% for credit cards and 0.2% for debit cards. This result is surprising because the avoided costs of cash should be the same – no matter whether the payment was made with a credit or a debit card. However, upon request, the EU Commission has pointed out that average costs of all merchants accepting debit cards and average costs of all merchants accepting credit cards have been used to set the two rates.

[2] See our SEPA newsletter from May 2009.
[3] See Jean-Charles Rochet and Jean Tirole, Must-Take Cards and the Tourist Test, DNB Working Paper 127, January 2007.
[4] Sometimes the costs of cash handling that can be avoided via card use are also referred to as „benefits“.

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Thus, there is an interchange difference because the merchant sectors that accept debit cards are not exactly like the merchant sectors that accept credit cards. For the latter, cash costs seem to be higher (on average). The question arises, why this should lead to an interchange fee that is differentiated according to the card used. After all, it is not even always clear to the merchant whether a customer pays by debit card or credit card. Take the example of Cartes Bancaires (CB). A CB card can be used in debit or credit mode. But this is decided between issuer and card holder. The card itself always looks the same. The avoided cash costs are the same. So why should costs differ?

If cash costs are different for different merchant sectors, one should have sector specific interchange rates. Alternatively, if merchant size is driving the size of cash costs, interchange rates should be made volume dependent. It is also quite possible that there are differences between regions or countries. So, in this case, should we have different national interchange fees within SEPA?

Apart from these considerations, there are huge practical problems. Estimating cash costs of merchants is a complex task and the results of cost studies are not always satisfactory.[5] *Moreover, since the payment costs of cash relative to cards are rising with the transaction amount, there is always a threshold level from which on cards are cheaper – even for very high interchange rates. Finally, it has to be taken into consideration that the price paid by merchants not only consists of interchange fees but also of acquirer fees. So, when setting interchange fees the average level of acquirer fees has to be known.*

3. Germany allows no-surcharging rules

On July 2nd, the German Parliament passed a law covering PSD implementation in the civil code (as opposed to other parts of the PSD that have become part of the banking code or put into a new law covering oversight of financial services). The big last minute surprise is the use of the option, granted by the PSD, to allow no-surcharge clauses. While initially, the draft had included a clause prohibiting “no surcharge rules”, a parliamentary commission finally removed it from the draft and

[5] See Krueger, Malte: Cash – the familiar stranger, European Card Review, September/October 2008, 30-32.

replaced it with the right of payment service users to grant rebates for the use of certain payment instruments.

Our comment:

The removal of the prohibition of no-surcharge clauses can be seen as a success of lobbying by some payment card systems. It remains to be seen, however, whether they will come to enjoy their success. For one thing, from a more academic economic perspective it does not seem to make a big difference whether merchants put a charge on relatively expensive means of payment or offer a rebate for the use of relatively cheap payment instruments. In practise, this may be a different matter. If, for instance, cash is widely used and merchants want to make cards more expensive they would have to rebate a large fraction of their sales. This may be inconvenient. So, it may actually matter quite a lot whether only rebates or also surcharges are allowed. Indeed, this must be the idea of those that have been lobbying for a replacement of the prohibition of no-surcharge clauses. But if this is the case, the fine success in lobbying German representatives may cause a hang-over, once anti-trust policy is coming into play. Principally, card schemes can make three arguments against anti-trust intervention in card markets:

- *low market share of cards (in Germany well below 50%)*
- *competition between card schemes (in Germany there is have ELV[6])*
- *surcharging or rebates*

The share of card payments increases and the survival of schemes like ELV cannot be taken for granted. So, in the end surcharging/rebates may be the only good argument left against intervention. However, regulators may see rebates as a bad substitute for surcharging – just as the lobbyists. Thus, they may come to regret the hasty last minute changes. But, since the law does not prohibit surcharges – it only allows no-surcharge clauses – schemes still have the option to voluntarily remove no-surcharge clauses from scheme rules.

[6] A non-guaranteed, signature based card payment.

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4. EuroCommerce lodges complaint against Visa

EuroCommerce has lodged an official complaint against Visa, arguing that its multi-lateral interchange fee violates European anti-trust law.[7] EuroCommerce argues that the measures taken so far by Visa do not go far enough. Pointing to studies that supposedly show that a payment transaction costs only one cent, EuroCommere argues that current price levels are still much too high.

Our comment:

For many years, EuroCommerce has been fighting interchange fees and it comes as no surprise that it is not content with the current level of Visa interchange fees. But since the proceedings of the EU Commission against Visa are already under way, the effects of this move are limited.

The claim that it costs only one cent to process a payment transaction sees brave. Moreover, EuroCommerce seems to overlook that the EU Commission has changed its methodology for setting interchange rates. It does not look at costs of production of payment service providers but it looks at opportunity costs of merchants (see article above on the "tourist test").

[7] See http://www.eurocommerce.be/content.aspx?pageId=41547.

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