Topics of this issue:

1. **Payment Services Directive (PSD)**
2. **Capital requirements of the PSD**
3. **Maestro: Set-Back in Belgium**

1. Payment Services Directive

Contrary to expectations, on March 27, the Council of Ministers has been able to reach a compromise on the Payment Services Directive (PSD). "The council's agreement is based on a proposal by the presidency involving a compromise on the following main issues.

– capital requirements for payment institutions;
– activities that payment institutions may undertake, in particular the granting of credit
– the possibility of waiving application of certain provisions for smaller payment institutions;
– the possibility of waiving application of certain provisions for certain instruments used primarily for the payment of small amounts (low-value payments)." [1]

If the PSD is passed by the European Parliament on April 25, 2007, member states have to introduce its provisions into national law until November 2009. With respect to information requirements, liability issues and consumer rights the PSD makes the important distinction between consumers and non-consumers. Other important provisions: Payment Institutions (PIs) may be involved in granting credit if this is closely connected with the payment business, they may also do other types of business, PIs should have access to clearing & settlement systems, PIs have to adhere to capital requirements (more on that in section 2).

Our Comment:

The PSD still has very much the look of a regulation originally designed for credit transfers. Often, the card business does not quite seem to fit into this framework. But for many service providers in the card world it may still be plus: they receive the EU passport and (probably) access to clearing & settlement systems. What the PSD will not provide, however, is a completely uniform European regulation. There are many issues where member states can

[1] http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/misc/93332.pdf

choose from a variety of options. This is particularly important with respect to ongoing capital where the options differ considerably with respect to the amount of capital required.

2. Capital requirements of the PSD

Capital requirements are stated in articles 5a (Own funds), 5b (Initial capital) and 5c (Ongoing capital) of the PSD. With regard to on-going capital, member states have the choice between three different methods:

Method A: 10% of fixed overheads

Method B: stepped percentage of Payment Volume (PV)

Method C: stepped percentage of net income from interest, commissions, fees and operation income.

The exact wording can be found in the draft document, which was made available through EPSM.

Our comment:

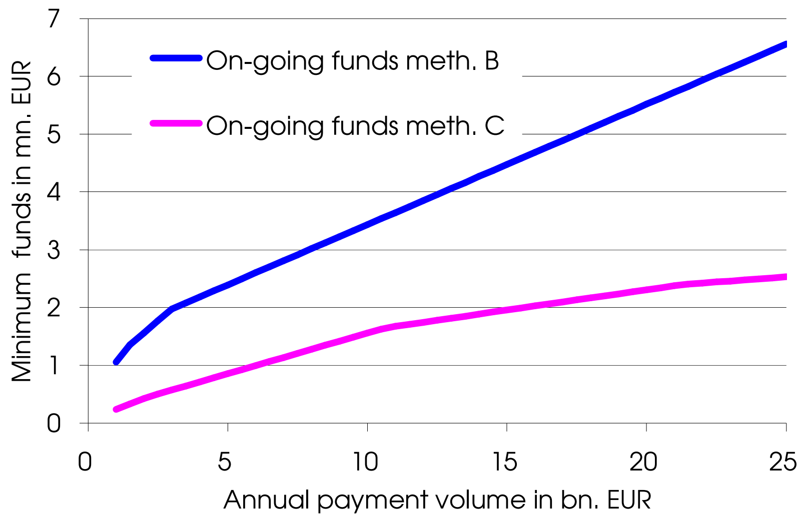
Capital requirements were one of the hot topics in the discussion of the PSD. The compromise which has been agreed in the council undermines the full harmonisation approach, as each country may implement its favourite method. A comparison between method B and method C (for the moment we are not able to evaluate method A) can be made with regard to two different questions:

1. What is the respective capital requirement when average acquiring metrics are applied?

2. Where is the "break even", i.e. for which relation between PV and the income indicator of method C do both methods result in the same capital requirements?

In order to answer the first question, we assume a payment volume of 30% credit cards and 70% debit cards with ATVs of 100 EUR and 50 EUR respectively. For credit cards, we assume a margin of 0.5% plus 0.05% interest income (in % of EUR-credit card volume) and 0.05 EUR fee income per debit card transaction. Accordingly, the C-indicator yields a value of 0.235% of annual PV.

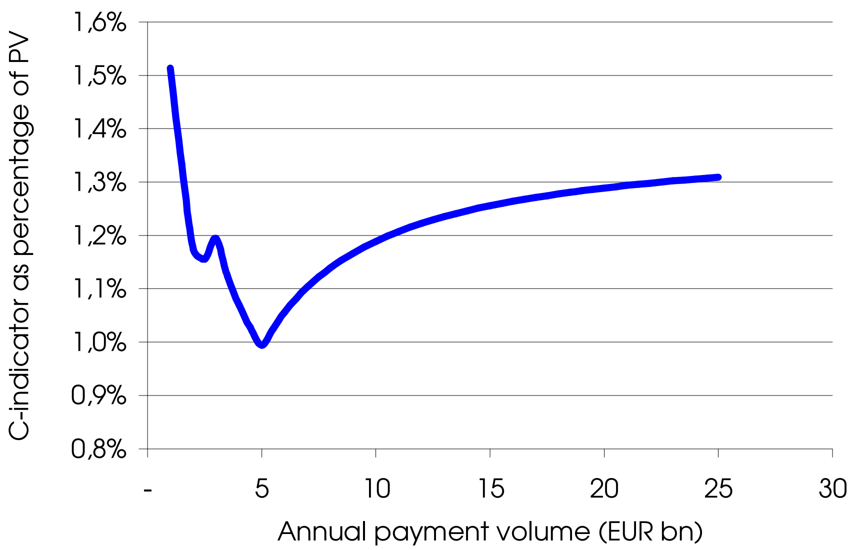
On-going capital: Comparison of method B and C



The resulting requirement on own funds according to method C are more than 60% lower then the corresponding capital requirements based on method B.

The above result depends on the assumptions we made. Varying the ratio between the income indicator and the volume of payments (PV) allows us to estimate the break-even point where both methods yield the same capital requirements. The break-even point depends on size. For large PV (above EUR 20 bn.) it is equal to 1.3%.

On-going capital: Break even between method B and C



One crucial assumption in this calculation is that interchange is not included in an acquirer's net income. This is, however, not entirely clear from the text which states: "Expenditures of the outsourcing of services rendered by third parties may reduce the relevant indicator..." If interchange were to be interpreted as income, method C would yield far higher capital requirements.

3. Maestro: Set-Back in Belgium

On March 31, 2007 the Belgian banks announced that the planned introduction of Maestro for national Belgium debit card transactions from January 2008 onwards would be cancelled[2]. Thus, the Belgian debit card system, Bancontact/MisterCash will continue operating after December 31, 2007. As prime reason for this move, the banks cited insufficient support within the parties concerned. In addition, the Belgian banks noted that a clear European reference framework for card payments is still missing. The press release gives no indications how Belgian banks want to implement SEPA compliance with respect to card payments. According to Belgian sources, all possibilities are once more scrutinized: national maestro interchange, parallel introduction of Maestro and V Pay, making Bancontact/MisterCash "SEPA-compliant" like the German ec cash scheme.

Our comment:

The recent decision of Belgian banks highlights one of the most explosive stepping stones on the road to SEPA: the possibility that payments fees may have to rise in some countries. For most experts it has been clear from the start that „convergence" would imply that fees will settle somewhere in the middle (maybe a little below) of the current fee spectrum. That means that in some countries fees would have to rise. This is exactly what merchants in Belgium feared when banks announced in 2006 that the national scheme would be migrated to Maestro. These fears were justified. When MasterCard published its SEPA interchange fees it was clear that Belgian merchants would have to pay more. The two merchant organisations Fedis and Unizo calculated that merchant fees would be rising by 100 mn. € and 65 mn. € respectively. Taking the tiered structure of MasterCard fees into account and

[2] See: www.febelfin.be

assuming a 50% market share of large merchants (>20 mn. transactions), PaySys Consultancy has derived the results presented below.

Comparison of Maestro and Bancontact/MisterCash

	Total	per Tx.	Small Merch.*	Large Merch.*
Maestro Interch.(EUR)	77.925.868	0,120	0,15	0,09
BC/MC Interch. (EUR)**	42.295.067	0,065	0,065	0,065
Increase (EUR)	35.630.801	0,055	0,085	0,025
Increase (%)	84%	84%	130%	38%

**: Assumed market share of large merchants: 50%.*
***: Bancontact/MisterCash interchange according to figures published by Unizo.*

Thus, for the sector as a whole, interchange fees will rise by about 36 mn. EUR or 84%. On a per transaction basis, fees are rising from 6.5 cents to 12 cents (average transaction volume 50 €). For smaller merchants the increase is even larger, from 6.5 cents to 15 cents (+130%), and for large merchants it is smaller, from 6.5 cents to 9 cents (+38%). On top of this, the acquirer fee (currently about 5 cents) could also be expected to rise after the move to Maestro.

Merchants were not willing to accept such a rise and prepared to file formal complaints with the Belgian competition authorities. Merchant resistance must be seen as the prime reason for cancelling the 2008 introduction of Maestro. The current development in Belgium is interesting for two reasons: First, it can be expected that similar difficulties will emerge in other countries. One just has to look north across the Belgian border. Second, one of the solutions that are discussed is the introduction of a domestic Maestro (or V Pay) interchange. Similar ideas seem to be floated in the Netherlands. In Germany Visa has just passed a domestic interchange for V PAY. This is hardly in line with SEPA.

Should you have any questions or comments please contact

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