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1. ECB concerned about SEPA for Cards

On October 26, Jean-Michel Godeffroy (Director General, Payment Systems and Market Infrastructure, European Central Bank) presented his views on the state of SEPA for Cards at the "Economics of Payment Systems" Conference in Paris. Right from the start, Godeffroy made it clear that he is very concerned about the current pace of the development. In his view, things are moving too slowly and he sees "SEPA for Cards" as "problematic point".

Godeffroy outlined the main requirements for a European scheme – adding clarity to some issues that were, so far, still open.

- four party architecture
- unbundled services
- debit scheme with credit as an option
- the scheme should be bank-owned
- there should be a "low" interchange fee
- the scheme should be profitable – thus, <u>prices should be higher than in BE or NL</u>

He pointed to two "delicate" issues:

- Limits to unbundling

Should there be an opt-out/opt-in with respect to the payment guarantee (as in Germany with ELV). Godeffroy seems sceptical but thinks that this is a point that merits debate.

- Interchange

Godeffroy appealed to the EU Commission to provide clear guidance on this point. He pointed out that DG Competition may not be able to provide just that because it can only decide whether or not a concrete rule is violating competition law or not (see also next topic). Therefore, he thinks it might be worthwhile to consider an EU regulation on interchange.

Of course, Godeffroy also discussed the different options to achieve the goal sketched out above. He repeated the reservations regarding a Visa/MC duopoly – acknowledging, however, that Visa Europe had moved a long way to fulfil the wishes of the EU Commission and the ECB. Repeating the ECB's favourable view of EAPS he pointed out however, that a "scheme of Schemes" is not enough. EAPS would have to become a full-fledged scheme of its own. The idea of some big European banks to build new scheme from scratch received little attention because Godeffroy does not expect such a solution to materialise. Finally, he came to the "missing initiative": a merger of national schemes. To achieve this goal, all schemes should unbundle their services, standardise business rules and technology and adopt a common interchange fee. He appealed to schemes and banks to give this idea serious consideration – acknowledging that such a merger might require a lead time beyond 2010.

Our comment:

Godeffroy presentation in Paris is remarkably frank. He openly voices frustration regarding the slow pace of SEPA for Cards and touches some sensitive issues. In particular, he is the first representative of either the Commission or the Eurosystem who tackles the delicate question where a European debit interchange should lie – at the low end of the range or closer to an average rate. He comes out with a clear statement that debit fees will have to be above the Dutch or Belgian level. Of course, that still leaves the question open, how a transition to higher fees can be achieved in these countries (given the level of merchant resistance).

The current strategy, observed in many countries, to rely on co-branding, EMV and modifications in rules and regulations is viewed with suspicion. Godeffroy fears that this may lead to a loss of momentum and that in the end MasterCard and Visa will offer the only true SEPA products. To get the SEPA train going, he wants a merger of schemes. But how realistic is such a scenario? Yves Randoux, CEO of Groupement des Cartes Bancaires, inserted a few question marks. He pointed out to the number of existing schemes (around 30) and stressed that important pre-conditions such as a European fraud database or a European merchant numbering system were still lacking.

2. MIF and the Role of DG Competition

Taking part in a panel session at the "Economics of Payment Systems" Conference in Paris, Lukas Repa (DG Competition, European Commission) took the opportunity to clarify an important issue regarding the current proceedings against MasterCard. Repa pointed out that DG Competition must not be confused with a regulatory body such as the FSA in the UK or the BaFin in Germany. DG Competition acts on official complaints. If there is a complaint, DG

Competition has to investigate the case and decide whether there is a violation of competition law or not. It cannot, however, introduce any regulations. In this respect, it is interesting to note that in the case against Visa, the introduction of cost-based interchange and stepwise reduction of rates to 0.7% was not a condition imposed by the EU Commission. It was a proposal by Visa. After the proposal was made by Visa, DG Competition could accept it or reject it. As is well known, it was decided to accept the proposal.
The decision in the MasterCard case will also be a decision regarding the particularities of MasterCard interchange and DG Competition plans to review interchange arrangement on a case-by-case basis – whenever there is a complaint.

Our comment:
Industry has been waiting for a long time for DG Competition to make a decision regarding the MasterCard MIF. While this decision will provide some clarity, the remarks by Lukas Repa show that a margin of insecurity will remain. Thus, the option proposed by Jean-Michel Godeffroy that the EU Commission should introduce a regulation on interchange fees may have some merits. Before pushing forward in this direction, however, the card industry should consider that such a regulation could also be formulated in a way that does not conform to the wishes of the card industry. Thus, a certain level of legal uncertainty may still be preferable over a well-defined but negative regulatory framework.

3. Gross or Net Settlement: Banks versus Retailers

One of the changes recently introduced for the German debit card system “ec cash” is a move away from gross settlement (the full payment of transaction amounts and monthly billing of fees) to net settlement (merchant are paid transaction amount minus fee). The Association of German Banks (ZKA) justifies this move with the necessity to introduce European SEPA norms. According to the German banks (organised in the ZKA) net settlement is a necessary ingredient in the migration to SEPA-compliant products. Merchants, however, are not convinced. They resist this move because it means extra interest costs and extra costs to adapt their back office systems.

Our comment:
We tried hard to understand why SEPA would make it necessary to switch from gross settlement to net settlement – but we failed. First, we asked ourselves whether Germany is

unique in Europe with a system of gross settlement. A quick survey provided us with three countries that also have gross settlement: Belgium (Bancontact), Finland (Pankkikortti) and Holland (PIN). Then we asked ourselves whether there are new regulations pointing in this direction. We consulted the PSD and found that gross settlement should be the norm with net settlement a permissible exception. In article 58 it is stated: "Amounts transferred and amounts received 1. Member States shall require the payment service provider of the payer, the payment service provider of the payee and any intermediaries of the payment service providers to transfer the full amount of the payment transaction and refrain from deducting charges from the amount transferred. 2. However, the payee and his payment service provider may agree that the payment service provider deducts its charges from the amount transferred before crediting it to the payee. In that case, the full amount of the payment transaction and charges shall be separated in the information given to the payee."

So, the PSD also does not provide an explanation. We also do not see how net settlement could help to streamline processes. So what remains – a hidden agenda? Do banks want to reduce the loss of interest due to delayed payment of fees? We calculated the approximate size of the effect. Based on a value of about 209 Mio. EUR in fees, a money market rate of 2.8% and an average delay of four weeks we calculate an increase in earnings of about 450.000 EUR (approx. 0.2% of total fees). Hard to believe that banks would start a fight with retailers for such a tiny sum. Thus, for us, it remains a riddle. Stay tuned!

Should you have any questions or comments please contact

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